UNIVERSITY OF SOUTHAMPTON

SUBROGATION IN THE LAW OF MARINE INSURANCE

by Sanming Chen

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ABSTRACT

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The law of subrogation is one of the most important and complex doctrines in the law of marine insurance. Controversy and complexity over this doctrine have long been discussed in courts and among academic scholars. Common law has created some rather unjust and harsh results towards this doctrine, such as *Yorkshire v. Nisbet* as to the surplus of recoveries as the result of currency fluctuation; *Napier v. Hunter* as to the 'top down' recovery rule; *Simpson v. Thomson* as to rights against vessel in the same ownership. The thesis which is primarily based on the English law is attempted to tackle the legal problems in application of the doctrine in the law of marine insurance. Comparative study of this doctrine has been carried out and proposals to reform this law were also submitted in the thesis.

The problems exist in the law of subrogation, *inter alia*, the basis of subrogation rights; the mechanics of taking over the rights and remedies of the person who has been paid; the distribution of recovery when the payment has not satisfied all the loss of the assured; the legal issue when the payment is not made under legal obligation by the insurer or by a third party; limitation, loss of rights and the defences available to the third party.

Chapter I is a brief introduction. Chapter II is the general consideration of doctrine of subrogation. In the third chapter, basis of subrogation was explored, which was debated for many years until the decision of the House of Lords in *Napier v. Hunter*. In Chapter IV, the exercise of subrogation rights was discussed, in particular, when does the insurer remain *dominus litis*? In Chapter V, a thorough analysis of the distribution of recoveries under various kinds of policies and proper allocation of subrogation recovery is proposed; Chapter VI is an attempt to solve the legal problem of voluntary payments which relate to the insurer's subrogation rights. In Chapter VII, extent of subrogation rights was examined, and limitation of the doctrine was fully discussed. In Chapter VIII, when subrogation rights are lost and defences available to the third party was discussed. In Chapter IX, a full study of the doctrine of subrogation and its relation to abandonment, assignment and contribution was examined. Chapter X is a comparative study of the doctrine under U.S. and Chinese Law, particularly, the legal problems under Chinese law in comparison to English law. In the final Chapter, the conclusion was summarised and the future of subrogation was also discussed.

Table of Cases

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Chapter I Introduction

An insurance contract is said to be a contract of indemnity.[1] If an insured loss has occurred, the insured has the entitlement of recovering the loss from two sources, i.e. from the insurer under the insurance contract and from the third party wrongdoer either in tort or in contract. Clearly, the assured in a risk may be overcompensated. This has been suggested to be unjust enrichment at the expense of the insurer.[2] To prevent the insured from "taking with both hands", common law rule confers upon the insurer the right to recoup from the insured any overcompensation.[3] "If he has a means of diminishing the loss, the result of the use of those means belongs to the underwriters and if he does diminish the loss, he must account for the diminution to the underwriters".[4] The right is commonly known as "subrogation". As the common law does not allow assignment of a bare chose in action,[5] the intervention of subrogation is thus "a convenient way of describing the transfer of rights from one person to another, without assignment or assent of the person from whom the rights are transferred"[6] and without against the doctrine of privity of contract. There has the dictum showing "it (subrogation) was derived by our English Courts from

[1] Except life and personal accident insurance as they are contracts upon payment on contingent events and not on indemnity. It has been argued that hospital and medical expenses have the indemnity features.

[2] Goff and Jones, *The Law of Restitution*, 4th ed. p12-16.

[3] Charles Mitchell suggested that " it is best understood as a restitutionary remedy: the cases in which subrogation has been awarded to date can all be explained in restitutionary terms, and the award of subrogation in the future should be guided by reference to the principle of unjust enrichment. (Mitchell, *The Law of Subrogation*, 1994 at p4.) However, Lord Diplock regarded it as "having its origin at common law in the implied terms of contract". (*Hobbs v. Marbwe*, [1978] AC 16, at 39).

[4] *Castellain v. Preston* , (1883) 11 QB 380 at 401, per Bowen L.J.

[5] Before Judicature Act 1873 which was re-enacted as Law of Property Act 1925, the chose of action was not assignable as contrary to the principle of maintenance and champerty.

[6] *Orakpo v. Manson*, [1978] AC 95, per Lord Diplock at 104.

Roman law".[7] The word literally means "substitution",[8] however, in the context of insurance law, the doctrine is far more than its original meanings and the complex and controversy over this doctrine has long been discussed either in courts or in the academic papers.

Common law position as to the doctrine of subrogation, as stated by Brett L.J. in *Caetellain v. Preston*,[9] is that, as between the insurer and the assured, "the underwriter is entitled to every advantage of the assured, whether such consists of contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has accrued...by exercise or acquiring of which right or condition the loss against which the assured can be, or has been diminished."[10] It seems that the insurer is entitled to every benefits of the assured whether in contract or in tort which comes into his hands in diminution of loss occurred. However, it was held that the insurer has no subrogation right for a gift which is paid to benefit the assured solely without any legal liability,[11] and yet, it is open to doubt that the insurer is entitled to recoup any advantage of the assured in case of anything coming into his hands which has no relevance to the loss of the subject-matter insured.[12] The dictum by Brett L.J in *Castellain v. Preston* somewhat widened the insurer's entitlement in subrogation and thus misleads, as it is apparent that exercising subrogation rights are subject to contractual limitations.[13] The insurer can have no better rights than those possessed by the assured. Thus, if the assured could not himself enforce the right against the third

[7] *John v. Motor*, [1922] 2 KB 249, per McCardie J. at 252.

[8] *Black's Law Dictionary,* 7th Ed. p1427.

[9] (1883) 11 QBD 380.

[10] Ibid. at 388. See also: *Burnand v. Rodocanachi* (1882) 7 App. Cas. 333 at 339, per Lord Blackburn; *Darrell v. Tibbitts* (1880) 5 QBD 560; *H. Cousins v. D & C Carriers,* [1971] 2 QB 230.

[11] *Burnand v. Rodocanachi* (1882) 7 App. Cas. 333.

[12] As the case in *Castellain v.Preston*, supra. Full arguments discussed in Chapter VII 2.

[13] See Chapter VII.

party wrongdoers, the insurer will not bring the subrogation actions against them either. Moreover, subrogation right may be waived by the insurer by an express or an implied term in the contract which may deprive the insurer of exercising the right.[14]

Argument over the basis of subrogation ended in the House of Lords in *Napier v. Hunter.*[15] Equitable doctrine thus regains its prominence. Based on this principle, subrogation is suggested to be "a mean to an end and not a right itself, it is either a piece of machinery which enables equity to make use of the common law to vindicate an equitable right or it is a concept (and no more), a fiction from the realm of 'as if ', which only serves to define the nature and extent of an equitable rights."[16] Under the common law, the insurer vests no cause of action against the third parties wrongdoers unless there is a valid legal assignment from the assured.[17] However, equity can be used to compel the insured to lend the "shoe" for the insurer to "stand in" if the assured refuses to do so.

The difficult issue has always arisen when the indemnity under the contract of insurance has not been able to fully compensate the assured's losses and it therefore gives rise to conflicting interests as between the insurer and the insured for the allocation of recoveries from the third party. Chapter V. will attempt to tackle this problem.

Also, it was well settled that the assured shall be fully indemnified before the insurer is entitled to be subrogated.[18] The question is whether he shall be fully indemnified under the policy terms or must be fully compensated of loss even

[14] See Chapter VIII.

[15] [1993] 1 ALL ER 385.

[16] James, *The Fallacies of Simpson v. Thomson,* Modern Law Rev. 1971 at p151.

[17] Under the Law of Property Act 1925 S.136.

[18] *John v. Motor*, [1922] 2 KB as per McCardie J at 255; *City v. Evans,* (1912) 91 L.J. KB 379 Scrutton L.J at 385; *Scottish v. Davis* [1970] 1 Lloyd's Rep. 1.

the shortfall remains in the deductible or excess. It is clear from the authority that the assured would remain *dominus litis* in the case of underinsurance.[19] However, as inferred from *Napier v. Hunter*, the courts would not regard the contract of insurance with an excess or deductible clause as underinsurance, and thus it would be probably sufficient for the courts to award a subrogation right as long as the assured has been fully indemnified under the policy and the insurer would meanwhile remain *dominus litis*. Any agreement compromising the third party's liability by the assured is undoubtedly binding on the insurer, in which case the assured may face liability either on an express clause or an implied term on the contract which prohibiting the infringement of the insurer's subrogation rights.[20] In case of partial indemnity, the assured may similarly prejudice the insurer's subrogation rights by compromising with the third party wrongdoers without *bona fide* considering the whole interests of both the insurer and the assured though the assured remains *dominus litis*.

Already, as far as the law of marine insurance is concerned, English law has codified the doctrine of subrogation in Section 79 of Marine Insurance Act 1906 which confers upon the insurer "all rights and remedies of the assured in and in respect of the subject-matter", very different from the doctrine of abandonment which confines the insurer to take "all the proprietary rights incidental thereto".[21] Legal subrogation, that is the subrogation arising by operation of law as a remedy awarded by the legislature and the courts, is what the thesis is primarily concerned. However, subrogation can also arise by an express term in contract of insurance or a subrogation agreement. This is known as conventional or contractual subrogation. Contractual subrogation may modify the effect of subrogation at common law.[22] The law of subrogation varies from country to

[19] *Commercial v. Lister*, (1874) L.R. 9 Ch. App. 483.

[20] See further Chapter VIII.

[21] A detailed discussion of the distinction between these two doctrines could be seen in Chapter IX.

[22] J. Birds, "*Contractual Subrogation in Insurance Law*", JBL, 1979.

country and a comparative study among other common law countries as well as China may serve to improve the understanding of the doctrine.[23]

Future subrogation has been debated among scholars and insurance industry. The insurers using the subrogation as cost saver have at the same time borne the subrogation liabilities, where almost all the third party liability has been insured. And thus some insurers have seemed reluctant to use the subrogation right as it would somewhat make the insurance even more expensive.[24] However, the subrogation is designed to prevent the insured from unjust enrichment, and if the law of subrogation had not existed, it would be a harsh result against negligent behaviour.[25]

[23] See Chapter X.

[24] Among UK motor insurers, there is a "knock for knock" agreement for not using the mutual subrogation rights.

[25] Full arguments in final Chapter.

Chapter II General Consideration of Subrogation

1. Meaning of subrogation

Subrogation means literally the substitution of one person in the place of another with reference to a lawful claim, demand or right, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities.[26] Subrogation or principles analogous to it have been applied in at least seven areas:[27] (1) vendor's lien, (b) payment out of prior securities, (c) indemnity insurance, (d) guarantee (e) executors and receivers carrying on *ultra vires* business, (f) unauthorised or unenforceable borrowings by married women, infants, partners and companies and (g) marshalling. The term is derived from two Latin words: *sub,* meaning "under", and *rogare*, meaning "to ask". Thus, subrogation means "asking (for a payment) under another name".[28] In the context of insurance law, where an insurer has made a payment to the assured under the policy terms, he is entitled to stand in the assured's shoes to the extent of acquiring all the rights and remedies, so far as the assured has been indemnified, which he may have possessed against the third parties wrongdoers.

It has been argued that the doctrine of subrogation was derived by English courts from the system of Roman law[29] and was intended as a restatement of the common law which did not draw any distinction between marine insurance and non-marine insurance policies.[30] Rights of subrogation may be also conferred by contract and it is also possible for two parties to form a contract to exclude or

[26] *Black's Law Dictionary*, 7th Edition p.1427.

[27] Meagher Gummow and Lehane, *Equity doctrines and Remedies,* 7th Ed., 1984.

[28] D Hansell, *Introduction to Insurance*, 1996, p.203.

[29] *John v. Motor,* [1922] 2 KB 249

[30] *Burnand v. Rodocanachi* at 339, per Lord Blackburn; *H. Cousins v. D & C. Carriers* at 244, per Davies L J.; *Pages v. Scottish* at 575, per Scutton L. J.; *Hobbs v. Marlowe* at 39, per Lord Diplock.

modify the application of subrogation arising by operation of law to their relation.[31]

2. Subrogation is a corollary of indemnity

It is well settled law that subrogation is a corollary of the principle of indemnity as it precludes the assured from recovering from two sources in respect of the same loss and is ancillary only to indemnity contract.[32] Comprehensive illustration could be seen in an earlier leading case of *Castellain v. Preston*[33] in which a vendor insured his house which was damaged by fire during negotiations for its sale. The fire occurred between the date of contract and completion of the sale. The vendor was paid by the insurer but subsequently received the full purchase price from the purchaser without any abatement for the fire damage. The insurer was held to be entitled to the purchase price. As stated by Bowen L.J. that:

"What is the principle which must be applied? It is a corollary of great law of indemnity, and is to the follow effect: That a person who wishes to recover for and is paid by the insurers as for a total loss, cannot take with both hands. If he has a means of diminishing the loss, the result of the use of those means belongs to the underwriters. If he does diminish the loss, he must account for the diminution to the underwriters."[34]

In the same case, Brett L.J. put very clearly the point that the contract of insurance is a contract of indemnity only, as he said :

[31] *Orakpo v. Manson* [1978] A.C. 95, at 112 per Lord Edmund-Davis; J. Birds, *"Contractual Subrogation in Insurance"* [1979] J.B.L. 124.

[32] *John v. Motor,* [1922] 2KB at 256 per McCardie L.J; *Burnand v. Rodocanachi,* (1882)7 App. Cas. at 339 per Blackburn L.J.

[33] (1883) 11 QB 380.

[34] Ibid. at 401.

"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".[35]

This proposition was also cited in an earlier case *Simpson v. Thomson,*[36] where Lord Cairns referred the right of insurer after payment as that:

"Where one person has agreed to indemnify another he will, on making good the indemnity, be entitled to succeed to all the ways and means by which the person indemnified might have protected himself against or reimbursed himself for the loss." [37]

Also in *Burnand v. Rodocanachi,*[38] Lord Blackburn explained the rights as an equity which entitles the insurer to recoup the money which he has paid.

"The general rule of law is, that where there is a contract of indemnity, and loss reduces or diminishes the amount which the indemnifier is bound to pay; and if the indemnifier has already paid it, then, if anything which diminishes the loss comes into the hands of the persons to whom he has paid it, it becomes an equity

[35] Ibid. at 386.

[36] (1877) 3 App. Cas. 279.

[37] Ibid, at 284.

[38] (1882) 7 App Cas 333.

that the person who has already paid the full indemnity is entitled to be recouped by having that amount back."[39]

The principle of indemnity entitles the insurer to take any advantage which may be received by or come to the hands of the assured in diminution of the loss, and it prevents the assured from recovering more than a full indemnity. However, the insurers can never retain more than they have paid.[40]

Subrogation does not apply to life insurance as it is not indemnity contract and arguably applies to personal accident insurance. Likewise, if there is a p.p.i policy, the insurer is not entitled to subrogation as such contract is not a contract of indemnity at all.[41]

3. Simple & Reviving subrogation

Charles Mitchell[42] suggested that subrogation could be analysed to fall into a distinctive fact-pattern, within which it is possible to distinguish one set of circumstances in which the award of "simple subrogation" may be appropriate, and another where the award of "reviving subrogation" may be called for. The strongest illustration of "simple subrogation" is to be found in insurance law. When an insurer ("S", it stands "Subrogee") pays its insured ("RH", it stands "Right holder") in respect of an insured loss under a contract of indemnity insurance, this payment does not extinguish the assured's right of action against a third-party tortfeasor ("PL", it stands "Person liable"). The courts have held that, under a contract of indemnity insurance, the assured should never be more than fully indemnified for his loss, which principle would be reached were the insured permitted to recover in respect of his loss from both his insurer and the third party.

[39] Ibid. at 339.

[40] *Yorkshire v. Nisbet*, [1962] 2 QB 330; *L. Lucas Ltd v. Export Credit* [1973] 1 WLR 914.

[41] *John v. Motor* [1922] 2 KB 249.

[42] *The Law of Subrogation,* LMCLQ 1994.

To prevent this, the insurer is entitled on indemnifying the insured to be subrogated to the assured's position *vis-à-vis* the third party tortfeasor. It should be noted that an insurer must bring any subrogated action in the name of the insured-- he can not purport to pursue the assured's right in his own name after he has taken them over by "simple subrogation". This denotes the fact that the assured's rights continue to vest in him even after he has received a payment from the insurer in respect of the insured loss, and that the insurer may pursue them only by dint of being substituted to the assured's position. By contrast, "reviving subrogation" arises in the following circumstances. As in the model for "simple subrogation" expounded above, a right-holder "RH" receives a payment which puts him in the position in which he would have been, had "PL", the party primarily liable towards "RH", performed his obligation. Unlike the situation giving rise to "simple subrogation", however, in this instance the payment which "RH" receives also actually discharges "PL"'s obligations towards "RH". Thus, "RH" both receives that to which he is entitled and lost his entitlement to sue for it. In this situation, "S" is the third party at whose expense "PL"'s obligation is discharged. "S" may have discharged "PL"'s obligation himself, by making a payment in respect of it directly to "RH". Alternatively, "S" may have advanced money to "PL". However, in some circumstances, the courts have thought it desirable to characterise "S"'s right of recovery from "PL" not as a direct right of "S"'s own, but rather as a right acquired by subrogating "S" to "RH"'s position *vis-à-vis* "PL". The problem that "RH"'s right has been extinguished, and that there is therefore nothing left for "S" to take over, is overcome by the courts' saying that "RH"'s right is fictional revived for "PL" to take advantage of it.

According to Mitchell's classification, the primary difference between simple and reviving subrogation lies on whether the payment from "S" discharges the rights of "RH" for suing the "PL". If so, then "S" could sue the "PL" in his own name, otherwise, the "RH"'s right against "PL" has not been extinguished even if "S" has made the payment to him under the simple subrogation and "S" is subrogated to "RH"'s position *vis-à-vis* the third party "PL". It should be noted that "S" cannot pursue "RH"'s right in his own name after he has taken them over

by simple subrogation as the rights against the "PL" still vests in the "RH". In term of law of insurance, it falls into pattern of simple subrogation in which the insurer's payment does not discharge the obligation of third party wrongdoer owed to the assured and the assured could be able to pursue third party even after he has been indemnified however hold all the remedies on trust for the insurer.

4. When the right of subrogation arises

It has been well established that the right of subrogation arises once the insured has been indemnified. In *Simpson v. Thomson*[43] Lord Blackburn, after reviewing the reasoning of *Manson v. Sainsbury* [44]and *Yates v. Whyte*,[45] pointed out[46] that "the right of the underwriters could not arise in those case by relation back to the passing of the property. It could only arise, and did only, from the fact that the underwriters had paid an indemnity, and so were subrogated for the person whom they had indemnified in his personal rights from the time of the payment of the indemnity." Further in *Darrell v. Tibbitts*[47] Brett J observed[48] that "the doctrine is well established that where some thing is insured against loss, either in a marine or fire policy, after the assured has been paid by the insurer for the loss, the insurers are put into the place of the assured with regard to every right given to him by the law respecting the subject-matter insured". The learned judge reiterated the proposition in *Castellain v. Preston*[49] and added that "he (the insurer) can not be subrogated into a right of action until he has paid the sum to the assured and made good the loss."

[43] *Simpson v. Thomas* (1877) 3 App. Cas. 279.

[44] 3 Douglas's Rep. 61.

[45] 4 Bing. N.C. 272.

[46] Ibid at 293.

[47] (1880) 5 QBD 560.

[48] Ibid, at 563.

[49] (1883) 11 QBD 380 at 389.

The best illustration of this proposition can be seen in *Page v. Scottish,*[50] where the defendant insurers of a car claimed to be subrogated to the rights of their assured against the plaintiff who had damaged the car by careless driving. A third party involved in the accident had a claim against the assured for damages for injury to her car and the defendants at first instance denied that they were liable to their assured to pay this claim under the policy. Meanwhile, they asked the plaintiff to repair the car and when he sued for the cost of the repair, the defendants instituted an action against him in the name of the assured for the loss arising from the accident. The actions were consolidated and the insurers claimed to set off the damages, to which their assured was entitled, against the plaintiff's claim. Since the insurers were still denying liability under their policy with the assured when they issued their writ against the plaintiff, the Court of Appear held that no rights of subrogation had arisen as they had not paid to the assured the losses and the writ had therefore been issued without the authority of the assured. In Scrutton L.J's words:[51]

"The underwriter has no right to subrogation unless and until he has fully indemnified the insured under the policy."

Further in *Scottish v. Davis*[52] the defendant assured's damaged car was handed to a garage for repair with the consent of the plaintiff insurers. After three attempts at repair by the garage, the insured was not satisfied with their work and took the car elsewhere. The garage nonetheless sent their bill to the insurers who paid it without getting a satisfaction note signed by the assured. Latter the assured then recovered compensation from the party originally responsible for the damage and used this money to have his car properly repaired. The insurers claimed the latter sum, but the court of Appeal had no difficulty in rejecting their claim. Russell L. J said that:

[50] (1929) 140 L.T. 571.

[51] Ibid. at 578.

[52] [1970] 1 Lloyd's Rep.1.

"You only have a right to subrogation in a case like this when you have indemnified the assured, and one thing that is quite plain is that the insurers have never done that." [53]

However, it is submitted that the right may exist as a contingent right when the contract of insurance is made and only after the insurer has indemnified the assured then can he exercise the subrogation right.[54] This proposition was based on the case in the Court of Appeal in *Boag v. Standard*[55] where cargo owners had insured their cargo with Standard Marine for £685. However, due to market fluctuations, the net value of the cargo increased to £900, and the owner insured this increase in value with Lloyd's underwriter. The cargo became total loss, and the assured received under both policies. They also received £532 as a general average contribution. The question to be decided was whether the increased value underwriters had an equity in it for an amount proportional to their share of the total insurance coverage. It was held that Standard Marine obtained a right of subrogation when its policy was effected, and that its rights could not be altered by any later policy entered into by the assured. Lord Wright described the right which an insurer obtains when the contract of indemnity is effected as a contingent right:

"The result is, that is an integral condition of this policy that the Standard Marine Co. has a contingent right of subrogation which attaches and vests in them at the moment when the policy is effected. It is contingent in the sense that the state of affairs postulated may never arise, but the contingent right is there, and here the contingency has arisen, and the right vested as a contingency has become an effective right." [56]

[53] Ibid. at 5.

[54] Derham, *Subrogation in the law of insurance,* 1986, p49-50.

[55] [1937] 2 KB 113.

[56] Ibid. at 122.

It may be argued that the case is concerned with layer insurance. It seems both insurers have the right of subrogation and general average contribution should be apportioned among them in proportion to their insured value. If the insurer has part of coverage of subject matter and the other insurer later insured the other part of coverage, can it be said that the latter one has no subrogation right? In writer's view, both insurers have the joint subrogation right. In fact, the rule of *Boag* has been modified by an increased value clause, for example, in the Institute Cargo Clause 1/1/82, which clause 14 provides that:

14.1 If any increased value insurance is effected by the assured on the cargo insured herein the agreed value of the cargo shall be deemed to be increased to the total amount insured under this insurance and all increased value insurance covering the loss, and liability under this insurance shall be in such proportion as the sum insured herein bears to such total amount insured.

In the event of claim the assured shall provide the underwriters with evidence of the amounts insured under all other insurance.

14.2 Where this insurance is on increased value the following clause shall apply: the agreed value of the cargo shall be deemed to be equal to the total amount insured under the primary insurance and all increased value insurance covering loss and effected on the cargo by the assured, and liability under this insurance shall be in such proportions the sum insured herein bears to such total amount insured.

In the event of claim the assured shall provide the underwriters with evidence of the amounts insured under all other insurance.

Nevertheless, it is purely academic to distinguish whether the right arise when the contract is effected or after payment as the right could not be exercised unless the insurer has paid the assured's loss and this has been embodied in the Marine Insurance Act in s.79 which clearly stipulates that "where the insurer pays for a

total loss, either of whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to ..". However, in the contract of insurance, an express clause of subrogation may modify the doctrine operated by law and give the insurer the subrogation right before the insured has been indemnified.[57]

5. The four categories of subrogation rights

It is been suggested that the rights conferred upon the insurer by virtue of the doctrine of subrogation may encompass four contexts, i.e. contract; tort; statutory rights and property.[58]

Subrogation rights extend to contract[59] if the contract in question imposes on a third person the obligation of making compensation to the assured in respect of the loss, the benefit of the obligation clearly passes to the insurers. Thus, where the goods insured are lost or destroyed in the hands of a bailee, e.g. a carrier, the insurers may sue the bailee on the contract of bailment. However, the doctrine of subrogation is not confined to contracts imposing the obligation of making good the loss, the insurer is entitled to be subrogated to any contract rights possessed by the assured which will diminish or extinguish the loss. "It extends to any contract relating to the subject-matter of insurance, which entitles the assured to be put by the other contracting party into as good a position as if the loss insured against had not happened".[60] "It is immaterial that the contract which is sought to be enforced is not a contract, either directly or indirectly, for the preservation of the property insured, and that the contract of insurance is a collateral contract wholly distinct from it, since the loss is, in fact, lessened by its fulfilment and affected by its

[57] See: John Birds, "*Contractual Subrogation in Insurance Law*" [1979] J.B.L p124.

[58] Ivamy, *General Principles of Insurance Law*, 6th ed. p.498.

[59] *Darrell v. Tibbitts* (1880) 5 QBD 560; *Fifth v. Travellers* (1893) 9 TLR 221.

[60] *Castellain v. Preston*, supra, per Brett LJ at 390,392.

nonfulfilment".[61] It is arguable that the insurer is entitled to be subrogated to such contractual rights as they may immaterial to the loss though in respect of the subject-matter insured. Whether or not a loss occurred does not affect the right of the assured to enjoy his contractual rights.[62] However, there may exist a benefit of insurance for the third party or a subrogation immunity clause in such contract, thus, the insurer's right to subrogation is not enforceable. It is, however, possible for the insurer to deny liability on the grounds of the duty of utmost good faith as the assured has not disclosed to the insurer those terms in the contract.[63]

Likewise, the insurer may be subrogated to the claims of assured against the third party tortfeasor if the third party tortfeasor is responsible for the loss.[64] In a case of collision between two vessels, the insurer of one vessel, after paying the assured the vessel's loss, may sue in tort against the other vessel if it is to blame.

In some circumstances, under statute, the assured may be able to recover the whole or part of his loss, the insurer is accordingly entitled to succeed such benefits after payment. For example, under the Riot (Damage) Act 1886, the local police authorities are responsible for peace and order within their jurisdiction. Where riot damage has been caused within the scope of the Act, an insurer who makes payment in respect of such damage has a right of subrogation against the police.

In the event of a total loss, the assured cannot claim both to receive from the insurers a full indemnity for his loss and to retain the remains of subject matter, since he would thus be more than fully indemnified. It is, therefore, for the assured on receiving the payment in full, to hand over to the insurers the

[61] *Castellain v. Preston*, supra, per Bowen LJ at 404.

[62] Full arguments discussed in Chapter VII 2.

[63] See Chapter VIII 3.

[64] *Lister v. Romford* [1957] AC 555; *Assicaraziono v. Empress* [1907] 2 KB 814.

salvage.[65] However, it is arguable that salvage rights are those by way of subrogation as the doctrine deals only with the rights possessed by the assured against the third parties and the salvage is not a right against the third party. Salvage is primarily a matter of salvage of physical things remaining after the assured has been paid for a total loss; subrogation, by contrast, is concerned primarily with the legal rights of the assured against third party.

6. Subrogation in the law of marine insurance

As far as marine insurance is concerned, s.79 of Marine Insurance Act 1906 provides:

(1) Where the insurer pays for a total loss, either of the whole, or in the case of goods any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss;

(2) Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to this Act, by such payment for the loss.

The Act draws a clear distinction between cases where an underwriter has paid for a total loss and cases where he has paid only for a partial loss. In the former, the underwriter on payment is subrogated to all the rights and remedies of the

[65] *Rankin v. Potter* (1873) LR 6 HL 83, as per Blackburn J, at 118: " There is no notice of abandonment in cases of fire insurance, but the salvage is transferred on the principle of equity expressed by Lord Hardwicke in *Randal v. Cockran* (1748) 1 Ven Sen 98 that the person who originally sustains the loss was the owner, but after satisfaction made to him the insurer."

assured in respect of the subject-matter insured, and is entitled to take over and obtain a proprietary or salvage right 'in whatever may remain of the subject-matter so paid for', while in cases of partial loss, the right extends only so far as the assured has been indemnified and do not includes salvage rights. However, though subrogation is closely related to the doctrine of abandonment and assignment,[66] it is still distinguishable from these doctrines. In case of abandonment and assignment, the insurer is entitled to retain all the remedies in respect of which the assured's right against the third party and may be more than they have paid. Subrogation is also closely related to the concept of salvage. Salvage is primarily a matter of salvage of physical things remaining after the assured has been paid for a total loss; subrogation, by contrast, is concerned primarily with the legal rights of the assured against third party.

[66] *Arnould's Law of Marine Insurance and Average*, 16th Ed. para.1300,1301. See also, s.63 of MIA. Further discussion see Chapter IV.

Chapter III Disputed basis of subrogation

The origin of subrogation has long been disputed in courts. There are two main authorities in this respect in the law of insurance. It is submitted by Goff and Jones[67] that subrogation is a remedy, rather than a right, which is designed to prevent the unjust enrichment of the insured at the expense of the insurer. Unjust enrichment is, simply, the name which is commonly given to the principle of justice which the law recognises and gives effect to in a wide variety of claims of this kind. This is said to be a rule of equity.[68] The notion of equitable doctrine was said to derive from Roman law.[69] The second school suggested that it is in fact a common law right derived from an implied term in the contract of insurance. Distinguishing the nature of subrogation is somewhat important, especially when the assured becomes insolvent, the issue is that whether the insurer has the priority over the other creditors. Further, if there is an express subrogation agreement, it would be difficult for the insurer to seek to assert a right of subrogation based on implied term. However, if subrogation is an equitable principle concerned with unjust enrichment, there would be less justification for excluding or modifying subrogation even given the presence of an express subrogation term.[70] In some circumstances, once the insurer has paid the assured, an attempt to enforce the assured's rights by way of subrogation is in theory open to challenge if the wrongdoer can demonstrate that the insurer was not legally liable to the assured and that its payment was gratuitous, intentionally or otherwise as for any implied term only giving the insurer the right to stand in the assured's shoes can only operate where the payment made by the insurer falls within the terms of the agreement.[71]

[67] Goff and Jones, *the Law of Restitution*, Fourth Ed., 1993.

[68] See also: Meagher, Gummow & Lehane, *Equity Doctrines and Remedies*, para.903.

[69] *John v. Motor*, supra.

[70] Robert M. Merkin, *Insurance Contract Law*, Issue 30, C4.3-05.

[71] However, this was solved in *King v. Victory*, where it has been inferred that subrogation is available where payment is made under avoidable policy or on a risk technically outside the

The earliest statement of equitable subrogation doctrine was cited in *Randal v. Cockran,*[72] a vessel was insured against loss and the insurance company paid the amount of insurance when the vessel was captured by Spaniards. The owner of the vessel became entitled to share in the prize money from the sale of captured Spanish vessels in accordance with a Royal Proclamation. The commission for the distribution of the prize money refused to entertain a claim from the insurer. Lord Hardwicke held that the insurer "the plainest equity that could be". In *Blaauwpot v. Da Costa*[73] a ship insured for £1636 was seized by Spaniards and the insurance company paid the sum insured. Subsequently prize money amounting to £2050 18s. 6d. was paid to the executors of one of the former owners of the vessel. The executors were ordered to pay the sum of £1636 7s. 3d. to the insurers in accordance with the following judgment of the Lord Keeper, Lord Northington:

"I am of opinion that upon the policy, and the peril happening, and the payment of the money by the underwriters, the whole rights of the assured vested in them. The assured had this right of restitution vested in them against the Spanish captors, which was afterwards prosecuted by the crown by reprisals. Satisfaction having been made in consequence of that capture, I think the plaintiffs are entitled to that benefit; and it was received by the executors...in trust for them." [74]

This proposition was further reaffirmed in subsequent cases. Bosanquet J. in *Yates v. Whyte*[75] held that the insured "has the legal right to the damages, and if the insurer have an equitable right they will establish in another court". In *White v. Dobinson,*[76] the ship *Diana* was insured against damage. After a collision the

insurance. MacGillivray and Parkington suggested that the subrogation would not be allowed only where the insurance agreement is void or illegal. See: *MacGillivray and Parkington on Insurance law*, 8th ed. at para. 1152. See further discussion in Chapter VI.

[72] (1748) 1 Ves. Sen.97.

[73] (1758) 1 Ed. 130

[74] Ibid. at 131.

[75] (1838) 4 Bing. 272.

[76] (1844) 14 Sim. 273.

insurers paid £205 in respect of the damage. The owner of the vessel, Hicks, was awarded damages of £800 against a defendant who was held liable for the collision. Sir Lancelot Shadwell V.- C. granted an injunction restraining the insured person Hicks from receiving and the wrongdoer Dobinson from paying the sum of £800 in respect of damages without first paying or providing for the sum of £205 in respect of which the insurers were entitled to be subrogated. On appeal, Lord Lyndhurst L.C. expressed the view that it would be contrary to equity if not to award the subrogation right:[77]

"What is an insurance but a contract of indemnity? Then Hicks having received a full satisfaction under the award, what right has he to retain money received from the insurance office as an indemnity for damage?... If Hicks had received an indemnity before the payment of the money by the company, it would clearly have been contrary to equity that he should retain that money. Park on Marine Insurance [8th ed. (1842)] says, that a contract to insure is one of indemnity only, and that the insured shall not receive double compensations for a loss; but in case the loss has been paid, and the insured afterwards recovers the amount of damages from another source, the insurer shall stand in his place to the extent the sum they have paid."

Hick then argued that the plaintiff had no remedy in equity and that his only course was an action in a court of law for money had and received. This argument was rejected by Lord chancellor:

"Here the company have paid for a loss, for which the insured afterwards obtains full satisfaction, and it is contrary to equity that he should retain the money. The underwriters have a claim upon the fund awarded, and are entitled in some shape or other to recover back the money they have paid."

[77] (1844) 116 L.T.O.S. 233.

While Lord Blackburn in *Burnand v. Rodocanachi*[78] stressed that an insurer who has indemnified its insured for his loss has "an equity" in anything subsequently received by the insured which diminishes that loss.

There are other authorities supporting the equitable doctrine. In *John v. Motor*,[79] McCardie J. referred the right which insurer is subrogated to the assured's claim against third party as "a matter of equity", similar opinion was expressed by Wynn Parry L.J. in *Re Miller*.[80]

However, Cotton L J. in *Darrell v. Tibbitts*[81] took a different view of basis of subrogation. He considered that the common law was able to apply equitable principles in this respect, by regarding the right of subrogation as an implied term of the contract. Lord Fitzgerald in *Burnand v. Rodocanachi* doubted that "the plaintiff's equity rests". Doubt about the equitable doctrine was further cited by Lord Wright M.R. in *Boag v. Standard*[82] where he commented that "the right of subrogation which attaches and vests in policy at the moment when it is effected is an integral condition of this policy". Likewise, in the same case, Scott L.J preferred the view that the insurer has a "contractual right" to any compensation coming into the hands of the insured from third parties.[83] It was not until the judgement of Diplock J. in *Yorkshire v. Nisbet*[84] that the contractual theory of subrogation gained its prominence. His Lordship explained what he considered to be the relationship of subrogation to both law and equity.

"The doctrine of subrogation is not restricted to the law of insurance. Although often referred to as an "equity" it is not an exclusively equitable doctrine. It was

[78] (1882) 7 App. Cas. 333 at 339.

[79] [1922] 2 K B. 249 at 253.

[80] [1957] 1 W.L.R 703 at 707.

[81] (1880) 5 QBD 560 at 565.

[82] [1937] 2 KB 113 at 122.

[83] Ibid at 128.

[84] [1962] 2 QB 330.

applied by the common law courts in insurance cases long before the fusion of law and equity, although the powers of the common law courts might in some cases require to be supplemented by those of a court of equity in order to give full effect to the doctrine; for example, by compelling an assured to allow his name to be used by the insurer for the purpose of enforcing the assured's remedies against third parties in respect of the subject-matter of the loss... "

His Lordship then went on to express what he considered to be the nature of subrogation right.

"The expression `subrogation' in relation to a contract of marine insurance is thus no more than a convenient way of referring to those terms which are to be implied in the contract between the assured and insurer to give business efficacy to an agreement whereby the assured in the case of a loss against which the policy has been made shall be fully indemnified, and never more than fully indemnified... In my view the doctrine of subrogation in insurance law requires one to imply in contracts of marine insurance only such terms as are necessary to ensure that, notwithstanding that the insurer has made a payment under the policy, the assured shall not be entitled to retain, as against the insurer, a greater sum than what is ultimately shown to be his actual loss... Thus , if after payment by the insurer of a loss that loss, as a result of an act of a third party, is reduced, the insurer can recover from the assured the amount of the reduction because that is the amount which he, the insurer, has overpaid under the contract of insurance, This sum he can recover at common law without recourse to equity, as money had and received... the duty of the assured to take proceedings to reduce his loss and the correlative right of the insurer to require him to do so was a contractual duty. The remedy for its breach, by compelling the assured to allow an action to be brought in his name, was an equitable remedy in aid of rights at common law, and was alternative to the common law remedy of recovering damages for the breach of the duty:..."[85]

[85] Ibid. at 339-340.

In *Hobbs v. Marlowe*[86] Lord Diplock reiterated the opinion as that:

"For my own part I prefer to regard the doctrine of subrogation in relation to contracts of insurance as having its origin at common law in the implied terms of the contract and calling for the aid of a court of equity only where its auxiliary jurisdiction was needed to compel the assured to lend his name to his insurer for the enforcement of rights and remedies to which his insurer was subrogated. But the practical effects of the doctrine of subrogation upon the rights and remedies of insurer and assured are similar in many respects to the effect of an equitable assignment of a chose in action..."[87]

Lord Diplock's contractual theory was accepted and approved by Widgery L. J. in *H. Cousins v. D & C. Carriers.*[88] Also, in *Morris v. Ford*[89] James L. J adopted Lord Diplock's dictum that the assured's right of subrogation is enforced by the courts as a contractual right.

Further in *Orakpo v. Manson,*[90] Lord Diplock insisted that the right of subrogation is an implied term in the contract, as he said:[91]

"There is no general doctrine of unjust enrichment recognised in English law...[subrogation] embraces more than a single concept in English law. It is a convenient way of describing a transfer of rights from one person to another, without assignment or assent by the person from whom the rights are transferred and which takes place by operation of law in a whole variety of widely different circumstances. Some rights by subrogation are contractual in their origin, as in

[86] [1978] AC 16.

[87] Ibid. at 39.

[88] [1971] 2 QB 230.

[89] [1973] QB 792.

[90] [1978] AC 95.

[91] Ibid. at 104.

the case of contracts of insurance. Others ... are in no way based on contract and appear to defeat classification except as an empirical remedy to prevent a particular kind of unjust enrichment."

This view was reiterated in his brief speech in *Hobbs v. Marlowe*[92] and was agreed to by Lord Elwyn Jones and Lord Salmon. From the House of Lords in *Hobbs v. Marlowe*, the authority is that subrogation in insurance law is a legal doctrine by origin. Equity later came to play a useful supporting role in the development of the doctrine. Equity's significant performance in that role has created the impression that subrogation was an entirely equitable doctrine, but equity should not be permitted to upstage the common law in that way.

However, the view of subrogation, which has become prominent only since it was espoused by Lord Diplock, is of doubtful origin in the common law. In *Morris v. Ford*[93] Lord Denning illustrated an equitable ground for compelling an uncooperative assured to lend his name to proceedings be taken against the third party.

"In my opinion, therefore, this case is to be tested according to the principles of equity. Before the Judicature Acts, the question would be: would a court of equity compel Fords(the assured) to allow their name to be used to sue their servant, Roberts? Since the Judicature Acts, the question is: is it just and equitable that Fords should be compelled to sue, or to lend their name to sue, their own servant, Roberts, for damages, so as to make him personally liable? My answer to that is emphatic. It is not just and equitable." [94]

He rejected the Lord Diplock's dicta in *Yorkshire v. Nisbet* that subrogation is an implied term in the contract.

[92] [1987] AC 16 at 39.

[93] [1973] QB 792.

[94] Ibid, at 801.

In a recent case *Napier v. Hunter,*[95] involved an action by Lloyd's names, members of the Outhwaite syndicate, against the syndicate's managing agents for negligence and breach of duty causing aggravated losses, for a dispute arising between the Outhwaite names and their stop loss insurers as to their respective rights to the settlement money. Lord Templeman, after reviewing the long history of the origin of subrogation, especially the proposition of Lord Diplock in *Yorkshire v. Nisbet*, came to the conclusion that:

"It may be that the common law invented and implied in contracts of insurance a promise by the insured person to take proceedings to reduce his loss, a promise by the insured person to account to the insurer for moneys recovered from a third party in respect of the insured loss and a promise by the assured person rights of action vested in the assured person against third parties for the recovery of the insured loss if the insured person refuses or neglects to enforce those rights of action. There must also be implied a promise by the assured person that in exercising his rights of action against third parties he will act in good faith for the benefit of the assured person so far as he has indemnified the assured person against the assured loss. My lord, contractual promises may create equitable interests. An express promise by a vendor to convey land on payment of the purchase price confers on the purchaser an equitable interest in land. In my opinion promises implied in a contract of insurance with regard to rights of action vested in the insured person for the recovery of an insured loss from a third party responsible for the loss confer on the insurer an equitable interest in those rights of action to the extent necessary to recoup the insurer who has indemnified the insured person against the insured loss." [96]

In the same case, Lord Goff rejected the defendant's arguments that equity simply came to the aid of common law by compelling an assured whose loss has been paid to allow the insurer to proceed in his name against a third party wrongdoer responsible for the loss, but that "a principle of subrogation was the

[95] [1993] AC 713.

[96] Ibid. at 736.

subject of separate development by courts of equity in a line of authority dating from *Randal v. Cockran*, which was decided before Lord Mansfield was appointed Chief Justice of the Court of King's Bench."[97]

Similarly, Lord Browne Wilkinson suggested that Lord Diplock's dicta that subrogation was purely a common law doctrine and equity only intervened for the purpose of enabling the insurer to sue in the name of the assured as established in *Yorkshire v. Nibset* was not well founded, he tended to the view that the insurer had an equitable proprietary right for the money received by the assured:

"In my judgement therefore an insurer who has paid over the insurance moneys does have a proprietary interest in moneys subsequently recovered by an assured from a third party wrongdoer. Although many of the authorities refer to that right as arising under a trust, in my judgement the imposition of a trust is neither necessary nor desirable: to impose fiduciary liabilities on the assured is commercially undesirable and unnecessary to protect the insurer's interests. In my judgement, the correct analysis is as follows. The contract of insurance contains an implied term that the assured will pay to the insurer out of the moneys received in reduction of the loss the amount to which the insurer is entitled by way of subrogation. That contractual obligation is specifically enforceable right gives rise to an immediate proprietary interest in the moneys recovered from the third party. In my judgement, this proprietary interest is adequately satisfied in the circumstances of subrogation under an insurance contract by granting the insurers a lien over the moneys recovered by the assured from the third party. This lien will be enforceable against the fund so long as it is traceable and has not been acquired by a bona fide purchaser for value without notice. In addition to the equitable lien, the insurer will have a personal right of action at law to recover the amount received by the assured as moneys had and received to the use of the insurer."[98]

[97] Ibid. at 741.

[98] Ibid. at 752.

In *Napier v. Hunter,*[99] the principal obstacle facing the insurers was the predilection of Lord Diplock for explaining the doctrine of subrogation in insurance law by implied contractual terms in *Yorkshire v. Nisbet*, which he explained that the expression "subrogation" in relation to a contract of marine insurance is thus no more than a convenient way of referring to those terms which are to be implied in the contract between the assured and the insurer, it is concerned solely with the mutual rights and liabilities of the parties to the contract of insurance. The only role which Lord Diplock assigned to equity was to come to the aid of the common law by compelling the assured to allow his name to be used in proceedings against the third party. This view of the right of the insurer was rejected by Lord Goff, which he said:[100]

"There is no reason why, subject to the one matter to which Lord Diplock refers, the principle of subrogation in the field of insurance should not have developed as a purely common law principle. But as a matter of history it did not do so."

The House of Lords in this case acknowledged the development of subrogation by courts of common law[101] but pointed equally to parallel authority in courts of equity.[102] Their Lordship held that on payment to the assureds under the policies the doctrine of subrogation had conferred on the stop loss insurers an equitable proprietary right in the form of a lien over the settlement moneys, rather than by saying that the money was impressed with a trust. Thus, if the insured who has received the money goes bankrupt or, if a company, goes into insolvency, the insurers can recover the money without regard to the claims of other creditors as inferred from the decision in *Napier v. Hunter.*[103] However, the dicta of equitable proprietary right in the decision of House of Lords has been subject to criticism by Charles Mitchell where he suggested that the insurer is only entitled to a personal

[99] [1993] AC 713.

[100] Ibid, at 740.

[101] *Manson v. Sainsbury*, Supra.

[102] *Randal v. Cockran*, Supra.

[103] Supra. See also *Re Miller, Gibb & Co.* [1957] 1 W.L.R. 703.

right of action when the insurer pays after the assured has been paid by a third party, the proprietary claim arise when he pays before the third party's payment to the assured:[104]

"As a matter of principle, there is one very good reason why an insurer should not be allowed to assert a proprietary claim over the moneys received by its insured in the circumstances described. That is that, if the insurer paid the assured after the assured's receipt of payment from the third party, the best action against the assured which it could then bring would be an action for money had and received to recover its overpayment-i.e., a personal claim. Why should the insurer suddenly be allowed a proprietary claim simply because it has happened that the insurer has paid its insured before the insured's receipt of payment from the third party? The effect of giving the insurer a proprietary claim in the latter, but not in the former, circumstances is to create an anomaly for which there is no justification. For this reason, it is the writer's view that, where an insured is paid in respect of his insured loss by a third party subsequent to his receipt of payment by the insurer, he should owe a personal duty to account to the insurer for this money, to the extent that he is more than fully indemnified for his loss, but that the insurer should be given no proprietary claim against him."

Also, Derham took a different view of Lord Diplock's authority in *Yorkshire v. Nisbet*. He commented that:

"It is misleading to suggest that the doctrine of subrogation was applied by the common law courts long before the fusion of law and equity. Cases such as Randal v. Cockran, Blaasuwpot v. Da Costa (1758) 1 Eden 130 and Brooks v. Macdonnell (1835) 1 Y. & C. EX. 500 show that the insurer's right of subrogation was enforced in equity, and for this reason it should be considered to be an equitable doctrine. It is true that in cases such as Mason v. Sainsbury the common law ensured that the right of subrogation remained a valuable one, by holding

[104] Charles Mitchell, *Subrogation and Insurance Law: Proprietary Claims and Excess Clauses*, LMCLQ 1994.

that the damages payable by a defendant should not be reduced to the extent of any payments received by the plaintiff under a policy of indemnity insurance. However it would be a mistake to conclude from these cases that the common law enforced the insurer's right of subrogation. The more likely interpretation is that the common law recognised that the insurer was entitled in equity to anything paid, or payable, by third parties to the insured in diminish of the loss, and determined that this right should not be emasculated by a damages rule that would prevent the insured receiving any such payments."[105]

Arnould pointed out[106] that "subrogation is closely related to that of abandonment which applies only to cases of total loss, and probably only to contracts of insurance, it is an equitable assignment incident to all contracts of indemnity and to all payments on account thereof", while Mustill and Gilman prefer the view[107] that the right of subrogation derives from implied terms in the policies (though now embodied in the Marine Insurance Act 1906). McGillivrary & Parkington similarly suggested[108] that subrogation is implied into the contract of insurance by operation of law.

The equitable subrogation based on Goff & Jones' restitutionary theory requires a party who is seeking to be subrogated, to demonstrate that some other party or parties have been unjustly enriched at his expense before the remedy should be made available to him, i.e. (1) at his expense, (2) some other party or parties have been enriched, and (3) their enrichment at his expense is unjust.[109] They describe

[105] *Subrogation in Insurance Law*, 1985, p20-21.

[106] *Arnould's Law of Marine Insurance and Average*, 16th Ed. 1981, para. 1298. See also: *MacGillivray & Parkington on Insurance*, 1988, 8ed. No.1171. "Although its subrogation historical origins are obscure, it is more probable that subrogation emerged as a development of the principle of abandonment, which itself was a doctrine of the old marine insurance law preserved in the Continental codes of insurance, and that it was received into the common law from that source."

[107] *Arnould's Law of Marine Insurance and Average*, 16th Ed. 1981, para. 1298 at Note 4.

[108] *MacGillivray & Parkington on Insurance Law*, 8th ed. para. 1201.

[109] Goff and Jones, *The Law of Restitution*, 4th Ed. p.12-16.

the right of subrogation as arising in a case where one has unofficiously conferred a benefit on another, and in order to prevent that one's unjust enrichment, the one should have the benefit of rights or assets whether that other's or a third party's, the rights or assets of a third party may become for the benefit of the one if the other has or had an obligation to the third party.[110]

Meagher Gummow and Lehane suggested[111] that subrogation is a creature of equity and does not depend upon principles of contract. They pointed out the implied theory developed by Lord Diplock in *Yorkshire v. Nisbet* must be rejected. They referred the authority in *Hobbs v. Marlowe*[112] and *Orakpo v. Mason*[113] that, the right of subrogation declared in House of Lords that whilst some rights of subrogation are contractual in origin, others defeat classification except as an empirical remedy to prevent unjust enrichment. They also quoted that parties may contract on terms that exclude or modify what would otherwise be their equitable rights of subrogation as the *dicta* in *L. Lucas v. ECGD.*[114]

As the view taken by Mustill and Gilman:[115] in the context of marine policy, the question whether the doctrine of subrogation in relation to contract of indemnity is based on implied terms of the contract or on general principle of equity is a somewhat controversial question, but wholly academic. Conversely, Derham took different points. He considered[116] that the distinction between them may be important if the assured has become bankrupt after being indemnified for a loss by his insurer, and subsequent to his bankruptcy the assured has received compensation from the third party responsible for the loss. If the assured is a trustee in equity of that fund for the insurer, the insurer may recover it *in toto* from

[110] Goff and Jones, *The Law of Restitution*, 4th Ed, p.591,601,602.

[111] *Equity Doctrines and Remedies*, 7th Ed., 1984, p.252-253, para. 903.

[112] [1978] AC 16 at 39.

[113] [1978] AC95 at 104.

[114] [1973] 2 ALL ER 984.

[115] *Arnould's Law of Marine Insurance and Average*, para.1298 note 4.

[116] Derham, *Subrogation in the Law of Insurance*, 1985, p.4.

the bankrupt estate. If on the other hand the insurer's only right to the fund is contractual, then it would be confined to a dividend in the bankruptcy. However, the latest decision in House of Lords in *Napier v. Hunter*[117] established that the principle of subrogation is rooted firmly in equity, rejecting the earlier view that subrogation rested exclusively on an implied term in the contract of insurance based on the fact that insurance was a contract of indemnity and that the role of equity was merely to supplement this implied term by forcing the assured to lend his name to proceedings brought by the insurer against the third party. The position is now reversed as inferred from the case of *Napier v. Hunter*: subrogation is an equitable doctrine arising out of the very nature of a contract of insurance but has been supplemented by a series of implied terms which adapt its operation to insurance, requiring the assured to : (1) take proceedings against the third party to diminish the loss; (2) account to the insurer for the proceeds of any action against the third party; (3) allow the insurer the use of the assured's name in proceedings against the third party should the assured fail to act; (4) act in good faith in conducting proceedings against the third party.[118]

The effect of the equitable lien on charge, recognised in *Napier v. Hunter*, is that when the wrongdoers is ordered or agrees to pay an amount which diminishes the insured loss, and has notice of the insurer's right of subrogation, he can either pay the damage into court or decline to pay them without the consent of both the insurers and the assured. If the damages are paid to the assured, or to his solicitors or other agents, the lien or charge can be enforced so long as the damages form an identifiable separated fund. Once notified, the solicitors or agents must keep the fund separate. The lien will be enforceable so long as the recoveries from the wrongdoer are traceable, and have not been acquired by a *bona fide* purchaser for value without notice. While the lien or charge subsists, the insurer will not be affected by the assured's becoming insolvent; his proprietary interest in the moneys will allow him to take them ahead of other creditors. Although some of the earliest cases used the language of trust, the House of Lords specifically held

[117] [1993] 1 ALL ER 384.

[118] *Colinvaux's Law of Insurance*, 7th Ed., 1997, p.174, para 8-11.

that the proprietary right arising under the doctrine of subrogation is not one of trust.[119] However, it is still left open whether the proprietary interest may confer on the insurer a cause of action against the third party as opposed to a lien or charge on an amount recovered.

[119] See: *Arnould's Law of Marine Insurance*, Vol.3, para.1299.

Chapter IV Exercise of subrogation rights

Common law confers no direct right of action upon the insurer against the third party wrongdoers after the insurer has fully satisfied the assured under the policy. All subrogation action must be brought in the name of assured unless they have obtained a valid legal assignment pursuant to the s.136 of Law of Property Act 1925. However, in America, the real party in interest rule[120] may modify this principle and would give the insurer a direct right for all the subrogation actions against the third parties wrongdoers who are liable for the loss. Common law does however confer upon the insurer the right to recoup from the assured the benefits of all the rights and remedies of the assured against the third party, which, if satisfied, will diminish or extinguish the ultimate loss sustained.[121] It is settled law that the insurer may not exercise his subrogation rights unless the assured has been fully indemnified and until then the assured remains *dominus litis.*[122] This Chapter attempts to examine all these issues.

1. In the name of assured

It is well settled law that the right of subrogation by the insurer should be exercised in the name of the assured for whatever rights the assured has to seek compensation for the loss from third parties.[123] The insurer's right to sue the third parties, however, in the name of the assured, has been recognised at least since the decision in *Mason v. Sainsbury*,[124] in which Lord Mansfied stated the right of

[120] This rule would be further discussed in Chapter X 1.

[121] *Castellain v. Preston*, supra.

[122] See detailed discussion in Chapter II 4.

[123] *London v. Sainsbury* (1783) 3 Dougl; *Simson v. Thomson*, (1877) 3 App. Cas. 279 at p. 284 as per Lord Carins, L.C.; *King v. Victoria* [1896] AC 250, at 256, per Lord Hobhouse; *John v. Motor* [1922] 2 KB 249 at 253-254, per J. McCardie.

[124] (1782) 3 Doug. 61.

insurer as that "every day the insurer is put in the place of the assured. In every abandonment it is so. The insurer used the name of the assured...".[125] If, following payment of the assured's loss, the assured refuses to allow the insurer to use his name as a plaintiff in the action against the third parties, the insurer may force them to do so in equity.[126] In *Simpson v. Thomson*,[127] Lord Cairns said:

"But this right of action for damages they must assert, not in their own name but in the name of the person insured."[128]

In *King v. Victoria*[129] Lord Hobhouse in delivering the advice of the Board stated:

"It is true that subrogation by act of law would not give the insurer a right to sue in court of law in his own name, but that difficulty is got over by force of the express assignment of the bank's claim, and of the Judicature Act..."[130]

Diplock L. J. in *Yorkshire v. Nisbet*[131] described the insurer's right against the third parties as that:[132]

"It vests in the insurer who has paid a loss no direct rights or remedies against anyone other than the assured. He can not sue such parties in his own name; he is bound by any release given by the assured to a third party. The insurer's right

[125] Ibid at 65. See also: *Esso v. Hall*, [1989] 1 ALL ER 37.

[126] *Wilson v. Raffalovich* [1881] 7 QBD 553; *King v. Victory*, [1896] AC 250 at 255-256; *John v. Motor*, [1922] 2KB 249; *Yorkshire v. Nisbet* [1962] 2 QB 330 at 341; *Esso v. Hall* [1989] 1 ALL ER 37.

[127] (1877) 3 App Cas. 279.

[128] Ibid. at 284.

[129] [1896] A.C. 250.

[130] Ibid. at 256.

[131] [1962] 2QB 330.

[132] Ibid. at 339.

against the assured cannot be affected by any subsequent contract, or dealings between the assured and a third party."

The common law confers no rights upon the insurer for suing in his own name and any action brought in the name of the insurer will fail. In *The Aiolos*[133] cargo insurers paid on a short delivery claim and brought an action against the carriers in their own name by way of subrogation. The proceedings were struck out on the grounds that the insurers had no right for claiming against the carriers in their own name. The insurer's subsequent action for leave to amend the writ and statement of the claim by joining the assured to the proceedings failed because at this stage the assured's claim against the carriers was time barred under the Hague Rules.

Similarly, in *Esso v. Hall,*[134] the vessel *Esso Bernicia* caused oil pollution due the fault of the tug, *Stanechakker*, the plaintiff, Esso Petroleum after paying the losses to crofters under the TOVALOP, sought the compensation from Hall Russell, who designed and built the tug. One of issues that arose was whether the doctrine of subrogation entitled plaintiff to sue Hall Russell in its own name. Lord Goff concluded that had the payment from Esso been made under a contract of indemnity between Esso and the crofters, and there could have been no doubt that Esso would upon payment be subrogated the crofter's claim against Hall Russell. This would enable Esso to proceed against Hall Russell in the names of crofters, but it would not enable Esso to proceed, without more, to enforce the crofters' claims by an action in its own name against Hall Russell. He based himself on the ground that Esso's payment to the crofters does not have the effect of discharging Hall Russell's liability to them.

"There can of course be no direct claim by Esso against Hall Russell in restitution, if only because Esso has not by its payment discharged the liability of Hall Russell, and so has not enriched Hall Russell; if anybody has been enriched,

[133] *Central Insurance Co., Ltd. v. Seacalf Shipping Corp. (The Aiolos)* [1983] 2 Lloyd's Rep. 25.

[134] [1989] 1 Lloyd's Rep. 8.

it is the crofters, to the extent that they have been indemnified by Esso and yet continue to have vested in them rights of action against Hall Russell in respect of the loss or damage which was the subject matter of Esso's payment to them."[135]

Under Mitchell's classification of subrogation, Esso's right of subrogation remains in pattern of simple subrogation as the payment made to the crafters did not discharge the liability of third party wrongdoers to the crofters. In other words, the third party Hall Russell has never been enriched at the Esso's expense.

However, the rule has created a number of difficulties. MacGillivrary & Parkington commented[136] that "English law is remarkably strict in its rigid separation between the assured and the insurer. In most of the cases mentioned no injustice will result to the insurer, but it is not difficult to imagine cases where an insurer might suffer from the inflexibility of the law. Thus, an assured might lend his name to the action as a plaintiff but, when the trial takes place, refuse to give evidence. In such a case the insurer should be able to ask for the court to issue a *subpoena*, but it is unlikely that a court would feel free to do so, since a plaintiff can hardly request an order for a *subpoena* to be served on himself. At present the insurer would be obliged to ask the court to adjourn the proceedings, and then, shedding the mantle of the assured and donning his own, to commence proceedings in his own name against the assured to obtain enforcement of the terms of the contract of insurance obliging the assured to give all assistance necessary to permit the insurer to enjoy his rights of subrogation."

Moreover, in the case where the insurer is not in the same country as the assured and the third party wrongdoers, once the insurer has indemnified the assured, it would cause hardship for the insurer to sue the wrongdoers in his own country, as they are not able to sue in his own name while both the assured and wrongdoers are located in the different country from the insurer. Furthermore, if two ships belong to the same owner and are insured by different insurers, then the

[135] Ibid. at 13.

[136] *MacGillvray & Parkington on Insurance Law,* 8ed. para1197.

indemnifying insurer would not be able to enforce his subrogation rights in the assured's name. However, he could be entitled to the benefit of the assured which received from the other insurer. If the assured refuses to take action against the other insurer, the indemnifying insurer has no right to compel the assured to do so. Likewise, if the assured has allowed the action to become time-barred, the limitation period may be pleaded against the insurer, although it is possible that the insurer might have some recourse to the assured in circumstances. It is arguable whether the duty of assured clause in the policy imposes on the assured the duty to protect the time limit.

Thirdly, if the assured is a company which has gone into liquidation and has been removed from the register of companies, it has ceased to exist and its name cannot be used in subrogation proceedings.[137] If the insurer reaches a settlement with the third party, such settlement must be in the name of the assured and not merely in the name of the insurer, as the insurer strictly speaking is not a party to the dispute giving rise to the settlement.

After the Justicature Act 1873, the insurer usually brings proceedings against the third parties in his own name and join the assured as a second defendant if the assured refuse to allow the insurer to use his name in the action and seek an Order that the second defendant lend his name to the action. The situation would be different if the insurer takes the legal assignment pursuant to s.136 of Law of Property Act from the assured the right of claims against the third party, then he would be entitled to use his own name in the proceedings.

2. *Dominus litis*

The right of insurer against third parties arises where the assured has been fully indemnified[138] and not until then. The insurer is entitled to bring proceedings in

[137] *Smith v. Mainwaring* [1986] BCLC 342.

[138] *Commercial v. Lister*, supra.

the name of the assured and take over the conduct of any existing proceedings as *dominus litis*. However, one point which has given rise to some difficulty is whether the assured must be fully indemnified before subrogation rights may be exercised, or whether all that is required is that the insurer has met in full its own obligations to the assured under the contract of insurance. The issue becomes of importance where the sum insured under the policy is not adequate to meet the assured's total loss. There may be an express policy provision which confers subrogation rights upon the insurer when it has met its full contractual obligation to the assured, irrespective of whether the assured has been indemnified overall, but in the absence of such a provision the matter is open to doubt. It would be inferred from the case of *Napier v. Hunter,*[139] that the courts will hold in future that insurers are entitled to be simply subrogated to their assured's rights of action from the moment that the assured is fully indemnified under the terms of the policy, even though they may not have been fully compensated for their loss. Even when full payment had been made by the insurer, the assured still has the right to pursue the third party. If, however, the insurer has the right to control the litigation, and may decline to exercise the right of subrogation (whether or not there may have an agreement with the third party's insurer), then the insured has the right to sue the wrongdoer even if he has received an insurance moneys but however holds them on trust for the insurer.

In the case of underinsurance or partial insurance, the assured is entitled to be *dominus litis* even if the insurer has made a full payment under the policy terms. In *Commercial v. Lister*,[140] underwriter brought an action against their assured who had himself commenced proceedings against a third party seeking to recover his uninsured loss. The underwriters sought a declaration that the assured be restrained from prosecuting his action against the third party unless he sought recovery of the whole amount of the damage including the losses paid by underwriters. The assured undertook to the Court to sue the third party for the whole amount of the loss and not just his uninsured losses, and upon that

[139] Supra.

[140](1874) LR 9 Ch. App. 483, CA.

undertaking the Court expressed the view that there was no ground to deprive the assured of his right to remain *dominus litis* and in control of the proceedings. The Court also found that the assured (a) was not entitled to compromise the action otherwise than bona fide and, (b) must not take any action inconsistent with his duty towards the underwriters. The Court also observed that it was (c) an indisputable proposition that the assured would hold any sums recovered from the third party in excess of the uninsured loss as trustee for the insurance company and it was held that the assured was entitled to control the proceedings since the sum insured, which he had been paid, was less than the full amount of his loss. However, the assured had to give an undertaking to include his insured loss in his claims against the third party and the underwriter can take effective steps to ensure that the proceedings are conducted with proper regard to his interests.

In the meantime, the assured can not be stopped by his insurer from claiming uninsured loss even after he has been indemnified for his insured loss under the policy. This often happens in respect of the motor insurer's voluntary agreement between the insurers themselves, as known as the "knock for knock" agreement.[141] In *Morley v. Moore,*[142] in which the plaintiff, whose motor-car had been damaged through the defendant's negligence, recovered a sum less than the whole amount of the damage sustained from his insurance company, who, in pursuance of a "knock for knock" agreement with defendant's insurance company, requested the plaintiff not to make any claim against the defendant. Nevertheless the plaintiff brought an action in tort and recovered from the defendant the full amount of the damage. It was held that the fact of the request of the plaintiff's insurers did not prevent the plaintiff from recovering, but that he would hold the amount to the extent of the sum received from his insurers as trustee for them, they being subrogated to his rights.

The assured's partial indemnity would not affect the assured's position of *dominus litis* in the claims for an entire losses against the third party even if the

[141] However, this agreement was finally abolished in 1993.

[142] [1926] 2 K B 359.

insurer has met his full liability under his policy. However, the insurer may sue the assured for damage if his compromise with the third party has not been made *bona fide*. Any surplus after satisfying his losses must be held by the assured subject to a charge in the insurer's favour.[143] However, practical problems may arise where an assured who is underinsured commences proceedings against the third party in his own name but only for the amount of his uninsured loss, for if the insurer fails to act in time and the assured obtains judgement for the uninsured sum, this may debar the insurer's further subrogation claims as contrary to the rule that a cause of action may not be litigated twice.[144] This is strictly prohibited as an abuse to the court process.

If, however, the insured value is paid in full or under a valued policy, this is conclusive between the parties[145] and it must therefore follow that the underwriter is entitled to control the proceedings even if the actual value of the insured property happens to be more. As always, underwriters' right to proceed as *dominus litis* is subject to their indemnifying the assured against costs.[146]

However, an express clause could provide for the insurer to be *dominus litis* and to control proceedings even before the insured has received a full indemnity, and indeed it may enable the insurer to exercise a right of subrogation before it has made payment under the policy.[147] A provision to this effect would merely constitute an agreement between the parties that an existing but unenforceable right of subrogation should be treated as an enforceable right. Nevertheless it may be that it is not possible to confer a right of subrogation in situations in which one otherwise does not exist, because of the danger that a clause purporting to do this could be said to be champertous.[148]

[143] As ruled by the House of Lords in *Napier v. Hunter.*

[144] Further discussion in Chapter VIII 4.

[145] *North v. Armstrong; Thames v. British; Goole v. Ocean; Yorkshire v. Nisbet, supra.*

[146] See: *Netherlands Insurance Co., V. Ljunberg & Co.* [1986] 2 Lloyd's Rep.19 at p.22.

[147] John Birds, "*Contractual Subrogation in Insurance Law*", 1979 J.B.L p124.

[148] Derham, *Subrogation in Insurance Law*, 1985, p145.

The policy may also provide that the insurer is entitled to an assignment of the assured's right of action against the third party. It was established long before the passing of the Judicature Act 1873 that equity would not allow or lend its assistance to the enforcement by an assignee of a bare cause of action, either in contract or in tort, and that that position had continued to obtain since the fusion of law and equity in 1873.[149] A valid assignment of the assured's right of action entitles the insurer to bring the proceedings in his own name, however, under the Law of Property Act 1925, a legal assignment can be made provided a notice of assignment is given to the third party. Thus, the insurer upon a valid legal assignment of the assured's chose in action may enforce the subrogation right in his own name and become *dominus litis*.[150] They can even gain more than they have been paid.

Subrogation vests no cause of action for the insurer and unless an express clause clearly provides so or the insurer takes a valid legal assignment of the assured's chose in action, he can only exercise his right against the third parties in the name of the assured. Thus, the real plaintiffs may always be the name of the assured in the proceedings. The insurer would take over the proceedings and to be *dominus litis* had the assured been fully compensated. However, one issue still left open as to whether the insurer would become *dominus litis* if there is a deductible under the policy term. It was settled in the decision of *Buckland v. Palmer*[151] that the assured may still control the proceedings even he has not been satisfied by the small sum of deductible. It may be argued that the insurer must be *dominus litis* although the assured has not been met by the insurer on ground of deductible which the assured agree to bear by their own under the policy. As inferred from the recent case of *Napier v. Hunter*[152] in the House of Lords, a full liability by the

[149] *Compania v. Pacific,* supra, p110 as per Roskil J.

[150] see: *King v. Victoria; Compania v. Pacific, supra.*

[151] [1984] 3 ALL ER 554.

[152] Supra.

insurer under the policy term even the deductible has not been met would be suffice to the insurer's *dominus litis*.

By contrast, in respect of under-insurance,[153] even after having fully paid by the insurer under the contract of insurance, the assured still retains the right to control the proceedings against the third party. In so litigating, the assured owes an equitable duty to the insurer to safeguard the insurer's subrogation rights. The assured must sue for the entire loss, not merely that part of the loss which remains outstanding after payment by the insurer. Moreover, although the insurer has no right to be consulted regarding the conduct or settlement of the action unless the policy otherwise provides, all steps taken, including the conclusion of any compromise, must be consistent with equitable obligation recognised by the law as owed by the assured to the insurer to act in good faith. The insurer may, however, take a valid assignment of the assured's cause of action by an express clause in the policy or any other agreement between them, in which case there is vested in the insurer a right to sue the third party as equitable assignee. A legal assignment permits the action to be brought in the insurer's name.[154] An equitable assignee must join the assignor in the proceedings, but this is purely procedural and leave may be obtained to amend pleadings even after expire of the limitation period. Thus, in *The Aiolos* although the insurer's subrogation argument failed because the assured's claim was time barred, leave was granted to amend the pleadings to join the assured so as to permit the insurer to claim against the third party as equitable assignee.

3. Subrogation rights

The doctrine of subrogation confers two distinct types of rights on the insurer after payment of a loss. The first is to receive the benefit of all rights and remedies of the assured against third parties which, if satisfied, will extinguish or diminish

[153] The assured is not deemed to be under-insurance in case of a deductible clause.

[154] *King v. Victoria; Compania v. Pacific*, supra.

the ultimate loss sustained; the second right has vested in the insurer by operation of doctrine of subrogation is to claim from the assured any benefit conferred on the assured by third parties with the aim of compensating the assured for the loss in respect of which the insurer has indemnified him[155]. However, in Enright's view,[156] besides these two rights, there is another right by way of subrogation is the right of insurer to defend any proceedings by a third party against the assured. This may be only analogous to subrogation. All the insurer's remedies developed by the courts to enforce the principle of subrogation arise in the three situations:

a. An assured suffers an insured loss. The insurer pays the assured for his loss. The assured has a subsisting right of action against a third party in respect of the insured loss. In these circumstances, provided that it has fully indemnified the assured for his loss, the insurer is entitled to take over the assured's right of action via simple subrogation; that is, the insurer can pursuit the assured's subsisting right of action against the third party in the assured's name for its own benefit. This lies in the right of pursuit.

b. An assured suffers an insured loss. Unknown to the insurer he then receives a payment in respect of that loss from a third party. The insurer then pays the assured for his loss. In these circumstances, the insurer is entitled to recover back from the assured so much of its payment as brought the total of the amounts received by the assured from the third party and the insurer above the amount of the insured loss, as money had and received, paid by mistake of fact. The insurer's mistake was to think that the assured had suffered a greater loss than was in fact the case, once the assured had received the third party's payment in respect of the loss.

c. An assured suffers an insured loss. The insurer pays him on the policy. The insured then received a payment in respect of the same loss from a third party, which brings the total of the amounts that the assured has received in respect of

[155] *MacGillivray & Parkington on Insurance Law,* 8th Ed. para1151.

[156] *Professional Indemnity Insurance Law,* W.I.B. Enright, London, 1996.

his loss above the amount of his loss. In these circumstances, the insurer is entitled to bring a claim against the assured for so much of the money paid by the third party to the assured as more than fully indemnifies the insured for his loss.

"b" and "c" foregoing give rise to a recoupment for the insurer by way of subrogation. Thus, insurer's right may be exercised by the followings:

a. Pursuit and defence

An insurer is entitled to be, on indemnifying the assured, subrogated to the claims possessed by the assured whether in contract or in tort in respect of the subject matter insured against the third party by bringing proceedings against the third parties wrongdoers in the name of assured, the third party wrongdoer cannot deny liability on the ground that the insured has a right to be or has been indemnified for that loss by the insurer, an insurer cannot deny liability to its assured because the insured has a right to claim for that loss against the third party wrongdoer.[157]

The assured may not compromise any right of action the insurer has against a third party by the exercise of which he can diminish his insured loss. Before the assured has received an indemnity from the insurer the right to control the action against the third party remains under the sole control of the assured,[158] so that any binding agreement with the third party reducing the subsequent liability will be binding on the insurer; on principle, given that subrogation rights are exercised only in the name of the assured, the same should follow even if agreement is

[157] *MacGillivray & Parkington on Insurance Law,* 8th Ed. para.1152. See also cases: *Darrell v. Tibbitts* (1880) 5 QBD. 560 at 561, 562; *Mason v. Sainsbury* (1782) 3 Doug K.B. 61; *Yates v. Whyte* (1838) 4 Bing N C. 272; H. *Cousins v. Carriers* [1971] 2 QB 230 at 240 243; *Hobbs v. Marlowe* [1978] A.C. 16 at 24, 37; *The Yasin* [1979] 2 Lloyd's Rep. 45 at 48-49; *Mark v. Berni* [1986] 1 QB 211; *NOW v. DOL* [1993] 2 Lloyd's Rep. 582.

[158] *Commercial v. Lister* (1874) 9 Ch. App. 483.

reached between the assured and third party after the assured has been fully indemnified and has thus lost the control of the action to the insurer. However, the insurer is entitled to be reimbursed in damage for loss of the subrogation rights against the third party,[159] if the settlement reached by the assured with the third party is a *bona fide* compromise, it may be difficult for the insurer to prove that he has suffered any damage. If the insurer has an equitable charge on the cause of action,[160] then the third party is bound by the insurer's equitable rights, at least where he knows of them and it may be arguable whether release by the assured after he has been indemnified is still binding the insurer.

However, the right of pursuit is subject to series of limitation by way of contract, equity and law. These will be discussed latter. If, however, the assured refused to lend his name in the proceedings, then the insurer may compel the assured to do so in equity or since the Judicature Act 1873, by bringing proceedings in its own name and joining the assured as a co-defendant. As the right of pursuit could only be enforced in the name of the assured and in favour of the assured, all the costs awarded against him should be borne by the insurer. If the insurer recovers more from the third party than it has paid the assured, then it holds the excess on trust for the assured.[161] The assured will also be entitled to any award of interest to which the assured was entitled, although as between the assured and the insurer, the former is entitled to the interest up to the date he is indemnified by the insurer, but may retain or recover the interest after that date. Right of pursuit may be modified by express clauses in policy and thus the insurer's right of pursuit may be enforced even before he has made a payment under the policy terms.

The right of defence is a corollary of the right of pursuit and, one of the forms of assured's right to indemnity is to compel the insurer to act to procure the third party to forebear in his action against the assured. Thus, it is not a requirement of the right to the defence that the insurer has indemnified the assured; it is the

[159] *Commercial v. Lister*, supra; *Boag v. Standard* [1937] 2 KB 113.

[160] A possibility left open by the House of Lords in *Napier v. Hunter*.

[161] *Lonrho Export v. ECGD*, [1996] 4 ALL ER 673.

obligation to indemnify. In this way the right to defend may be better described as a right analogous to a right by subrogation. On the basis of this right the insurer will be entitled with limits to defend or control the defence of, the third party's claim against the assured.

b. Right by recoupment

Castellain v. Preston[162] is the authority for the proposition that the right of subrogation will entitle the insurer to recoup from the assured any amounts that have been paid to the assured or received by the assured from any other party, that are in excess of the amount required to indemnify the assured. If the assured recovers any sums from a third party by way of diminution of his loss before the insurer has made any payment, all such sums should be deducted from the sums payable by the insurer.[163] Thus, if the insurer is sued he can claim a set-off in respect of any such sums received by the assured. However, in practice duty of assured clause may bar any action made by the assured for doing that unless it is a *bona fide* settlement which is taken into consideration the interest of the insurer; If the assured makes a recovery from a third party, after the insurer has made a payment under the policy, the assured can retain what he has recovered until he is fully indemnified, but holds the rest on trust for the insurer up to the value of the insurer's payment.[164]

Recoupment can be seen as an instance of equity. The House of Lords in *Napier v. Hunter*[165] held that the stop loss insurer had an equitable proprietary right in the form of a lien over the settlement moneys kept by the assured's solicitors. The insurers were, therefore, entitled to injunctions to restrain the payment or receipt

[162] (1883) 11 QBD 380. See also *Esso v. Hall, the Esso Beneficial* [1989] 1 A.C. 643.

[163] *West v. Isaacs* [1897] 1 QB 226.

[164] *White v. Dobinson* (1884) 14 Sim. 273; *Commercial v. Lister* (1874) L.R. 9 Ch. App. 483; *King v. Victoria* [1896] A C 250; *Darrel v. Tibbits* (1880)5 QBD 560.

[165] [1993] AC 713.

of the money until the amount due to them had been paid. Equity would intervene to protect the rights of one entitled to subrogation by not allowing damages to be paid over without satisfying the claims of the insurer. Otherwise, the insurer would suffer the delay and expense in recouping what the right of subrogation was designed to grant. If the recipient of damages became bankrupt before the insurer could recoup then "subrogation" right would be meaningless.[166]

[166] Ibid. at 737.

Chapter V Distribution of recoveries

Distribution of recoveries may give rise to difficulties especially when the assured's actual loss is greater than the value of his insurance. If the damages recovered from the third party in fact less than the amount of his actual loss, either the insurer will fail to recoup the full amount of its payment or the assured will fail to obtain a full indemnity or both. As a general rule, an insurer is not allowed to recover from the third party or the assured a greater amount than he himself has paid by way of subrogation. However, as discussed above, indemnity insurance confers upon the assured no more than a full indemnity. The issue may arise if an insurer has paid out under an insurance contract and the assured later receives from the third party a sum exceeding the original payment, who would be entitled to the windfalls? This chapter will examine in detail the problems arising out of allocation of recoveries under different types of policies, and, in the meantime, the writer will attempt to seek the proper rules for distribution of recoveries.

1. General rule

The general rule is that an assured, who has been paid on his policy and then proceeds to recover from a third party, is entitled to retain the recovery until he is fully indemnified. This rule is based on the principle of indemnity and as described by Brett L.J. in *Castellain v. Preston*[167] that:

"if ever a proposition is brought forward which...will prevent the assured from obtaining a full indemnity...that proposition must certainly be wrong."

[167] (1883) 11 QBD 380 at 386.

As discussed above, the assured remains *dominus litis* if the insurer meet his liability under the policy but not fully compensate the assured[168] even if the shortfall lies on the deductible.[169] Then the assured may deduct the shortfall from the recoveries up to full indemnity[170] and hold the surplus on trust for the insurer.

This general principle is also established in foreign case law. In an Irish case *Re Driscoll*[171] the assured was a tenant of premises which were damaged by fire. The indemnity being insufficient to enable the assured to meet his reinstatement obligations, the assured sued a sub-tenant for breach of the latter repair obligations. The insurer claimed to be entitled to the proceeds of this claim in priority over full indemnification to the assured, a claim emphatically rejected by the Irish High Court. O'Connor M.R described the insurers right of subrogation as that:

"A contract of insurance against fire is only a contract of indemnity, and I think that the foundation of the doctrine of subrogation is to be found in the principle that no man should be paid twice over in compensation for the same loss. The corollary to this is that a contract of indemnity against loss should not have the effect of preventing the assured from being paid in full. I do not think that this can be disputed."[172]

The Canadian court adopted the same approach. In *National v. Mclaren*[173] Chancellor Boyd made the remark[174] that:

[168] *Commercial v. Lister, supra.* See: Chapter IV.

[169] *Buckland v. Palmer, supra.*

[170] *Hobbs v. Marlowe,* [1978] AC 16.

[171] [1918] 1 I.R. 152

[172] Ibid at 159.

[173] (1886) 12 O.R. 682.

[174] Ibid.at 687.

"In case of insurance where a third party is liable to make good the loss, the right of subrogation depends on and is regulated by the broad underlying principle of securing full indemnity to the assured, 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...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."

Thus, the general principle has been accepted as being that the assured has the first claim on any compensation recovered from a third party to the extent required to achieve a full indemnity, this principle is no doubt correct in so far as it is applied to cases where the assured's interest was fully covered but not fully compensated,[175] in the case of particular types of contracts, such as underinsurance, partial insurance, valued policy and a policy with excess or deductible and or limitation clause, the principle may be modified and become more complex. This will be discussed further below.

2. Underinsurance and partial insurance

Where the subject matter of the insurance has not been insured to its full value, there may be an express policy provision which confers subrogation rights upon the insurer when it has met its full contractual obligation to the assured, irrespective of whether the assured has been indemnified overall, but in the absence of such a provision the matter is open to doubt. The essence of the question is whether , as a matter of construction, the assured has agreed to be his own insurer for the uninsured sum, for , if this is so, the amount insured is deemed to be the totality of the loss for which he may seek to be indemnified *vis-à-vis* the insurer, and any sums recovered from the wrongdoer must be divided between the

[175] *MacGillivray & Parkington on Insurance Law*, 8th Ed. para. 1220.

assured and insurer in proportions representing their respective liabilities. This was fully illustrated in the case of *The Commonwealth,*[176] where the owner of a steamship, which had run down a schooner, *The Welsh Girl*, paid into Court £1000 in respect of the loss the schooner. Underwriters who had paid the owner of schooner £1000, as being the amount of which she was insured , under a policy stating the value to be £1335. After paying the loss of the owner of schooner, the underwriter claimed the sum paid into the court by the owner of steamship, *The Commonwealth.* The Court of Appeal held that the owners of schooner were entitled to be treated as their own insurers for £350 and therefore, the £1000 must be divided between them and the underwriters in the proportion of their respective interests. The authority was further approved by Court of Appeal in *Kuwait v. Kuwait.*[177] The decision in the case of *The Commonwealth* similar to that of an American decision *the Livingstone.*[178] However, as far as the marine insurance law is concerned, the situation is now codified under Section 81 of Marine Insurance Act 1906 which provides that:

"Where the assured is insured for an amount less than the insurable value or , in the case of a valued policy, for an amount less than the policy valuation, he is deemed to be his own insurer in respect of the uninsured balance".

However, in cases of non-marine insurance there is no such presumption. The insured is not his own insurer unless there is an average clause in the policy.[179] Thus, the assured is entitled to claim the full amount insured and, if this is insufficient to compensate his actual loss, he can no doubt retain whatever he recovers from third party until he has been fully indemnified and need only hand over any surplus to the insurer. In practice, an average clause is always inserted in the policy whether in marine or non-marine insurance.

[176] [1907] P. 216.

[177] [1996] 1 Lloyd's Rep 664.

[178] 130 Federal Reporter 746.

[179] See: *MacGillivray & Parkington on Insurance Law*, 8th Ed. para. 1220.

There is a partial insurance when only one type of loss is insured and the assured, as a result received an unapportioned lump sum for settlement of the whole loss. Difficulty may arise as to how to distribute the recovery. In *Commercial v. Lister*, it was held that the assured was entitled to be *dominus litis* for the uninsured loss, however, he must act in good faith to consider his insurer's interests. In case of an unapportioned lump sum recovered from the third party wrongdoers, the assured was held to be the first claim of the recovery and to hold any surplus on trust for the insurers. It is clear from the authority that the assured is not deemed to be his own insurer under such circumstance and *The Commonwealth* authority does not apply. If the recover from the third party wrongdoers can be apportioned, no authorities could be cited in English law, however, it would be of justification for awarding the insurer for such sum which falls within the insured loss. In Canada the courts held the subrogation insurer for the insured part of loss could recoup a sum calculated by reference to the proportion which the value of the insured part bore to the total property value.[180] Conversely, in *Horse v. Petch,*[181] the assured had a claim against a third party for wrongful death under Lord Campbell's Act, and also a claim for property damage by his insured car. After being fully indemnified for his property damage by his insurer he entered into a settlement with the third party, as a result of which the assured received an unapportioned lump sum payment in return for releasing that third party from all claims against him. Rowlatt J. held that, since the assured had settled the property damage claim when he had no right to do so, the insurer was entitled to treat him as having settled for the full amount paid by it, which amount therefore was held by the assured on trust. The Australia approach may be seen as an equitable basis as the assured's settlement may infringe the insurer's subrogation right. However, if the assured is still *dominus litis* and the settled the whole loss with a *bona fide* consideration of the insurer's interests. Then it could not be awarded for the insurer the whole sum recovered by the assured. If the assured's insured part has been fully indemnified, then he has no right to enter into a settlement without the

[180] *Willumsen v. Royal*, (1975) 63 D.L.R. (3d) 112.

[181] (1916) 33 T.L.R. 131.

insurer's consent. The insurer may sue in damage for losses of his subrogation right.

3. Valued policy

So far as marine insurance is concerned, it is customary for the insured and the insurer to agree a fixed value subject matter insured in the policy. In such cases, it is well settled law that the agreed value in the policy is deemed to be conclusive between the assured and the insurer. That means the insurer is only liable to the agreed value in the event of a total loss no matter what there may be a subsequent change in the market value of subject-matter insured. In practice, the value as between the insured and the third party wrongdoers may be different from that as between the assured and his insurer. It may therefore be a question of considerable practical difficulties whether an insurer in paying a loss in accordance with the policy valuation is entitled to subrogation on the basis of the real value of the property insured in which case the real value is greater than the agreed value. The answer may depend upon the final recoveries from the third party wrongdoers. In the event of a recovery from the third party less than the insurer's actual payment, the insurer would be entitled to the first claims up to the extent of his payment. Conversely, it was arguably held that in any event the insurer is not entitled to recoup what he has paid out by way of subrogation.

In The *North of England v. Armstrong*[182] the *Hetton* was insured for the full amount of its valuation £6000 and was run down and sunk by the *Uhlenhorst*. The plaintiff underwriters paid the owners £6000 as for a total loss, which was less than its actual value £9000, subsequently brought an action against the *Uhlenhorst* which was held solely to blame for the collision. The judgment was given against them for £5700 which was limited pursuant to the Merchant Shipping Acts in force. The owner of the *Hetton* claimed that they were entitled to participate in

[182] (1870) L.R. 5 QB 244.

the £5700 inasmuch as the real value of the *Hetton* was not £6000 but £9000 while the underwriters claimed to be entitled to the whole of this sum. The Court held that as between the underwriter and the assured, the value of ship must be taken to be £6000 for all purposes; and that therefore the damages recovered, which were in the nature of salvage, belonged entirely to the underwriters. Cockburn L. J. reasoned that:

"Where the value of a thing insured is stated in the policy in a manner to be conclusive between the two parties, the insurer and the insured , as regards the value, then, in respect of all rights and obligations which arise upon the policy of insurance, the parties are estopped between one another from disputing the value of the thing insured as stated in the policy."[183]

He then concluded that:

"if a party chooses to have his vessel or his goods, as the case may be, taken at a fixed value, instead of leaving the contract, as in an ordinary policy, simply one of indemnity to the extent of the real value, and if thereby any benefit accrues to the underwriters, the underwriters must be entitled to it. I think, therefore, our judgment must be for the plaintiffs."[184]

It is clear from the judgment that if the owners of the *Hetton* had in the first instance sued the *Uhlenhorst* and recovered £5700, and afterwards sued their own underwriters for £6000, they would have been obliged to give credit for the £5700 obtained from the *Uhlenhorst.* Therefore, the underwriter would in any event have the first claims from the recoveries up to his payment in the case of valued policy and leaving the assured under compensated notwithstanding the fact that the underwriters may be enriched as a result of the difference between the agreed value and the real value. But the judgments go further and suggest that if the whole £9000 had been recovered from the *Uhlenhorst*, the underwriters on the

[183] Ibid. at p.248.

[184] Ibid, at 250.

Hetton, on the ground of their having paid for a total loss would have been entitled to retain the whole of this sum, although they would thus be making a profit of £3000. Arnould commented[185] the judgment that "it is clear that if the assured had sued the *Uhlenhorst* and recovered £9000 from her owners, without making any claim upon the underwriters, they would have been entitled to retain the whole of such sum. And it would be an inequitable result if the underwriters should be allowed to make a profit, and the assured to sustain loss, merely owing to the mistake of the latter in following, in a particular case, the usual business course of claiming upon their policy, instead of first proceeding against the party in default." Arnould further criticised that "it is apprehended that the mistake in the judgments arose from the failure to grasp the distinction to which we have already referred, and which appears to have been for the first time expressly pointed out by Lord Blackburn seven years later, between the principles and results of abandonment and subrogation. By the former, underwriters are entitled to the thing abandoned, and to all rights of ownership accruing after they become owners; by the latter they become entitled to all the collateral remedies and advantages of the assured, but only for the purpose of reducing the loss which they have themselves sustained by payment under their contract."

Notwithstanding the case was agreed to be contrary to the principle of subrogation, the sole subject of which is to prevent the assured from recovering more than a full indemnity from the insurers, it has now been enacted in the Marine Insurance Act 1906 in Section 27(3) which provides that "subject to the provisions of this Act, and in the absence of fraud, the value fixed by the policy is, as between the insurer and the assured, conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial." Thus, in the case of valued policy, the assured is estopped from asserting the distinction of agreed value from the real value.

[185] *Arnould's Marine Insurance law and Average*, 16th ed. para 1304.

The decision of *North of England v. Armstrong* was followed in *Thames & Mersey Marine Insurance Co. v. British and Chilean Steamship Co.*[186] In that case a ship insured for an agreed value of £45,000 was worth £65000, it was sunk by colliding with another ship and the insurer paid the full amount of the agreed value. In the later proceedings, both ships were held to be blame and the assured was entitled to recover from the owners of the other vessel a sum of £26,900 which being five-twelfths of the £65000, less certain charges and costs. After giving the assured credit for £19660 which was due to them from the insurers under the collision clause in the policy, there remained a balance of £7240 and the insurers claimed that under the principle of subrogation they were entitled to receive that sum from the shipowner. The latter contended that the insurers were not entitled by subrogation to more than five-twelfths of the amount of the valuation, i.e. of £45000, on which basis, after debiting the insurers with £19660 in respect of their liability under the collision clause, nothing remained due to them. At the first instance, Scrutton J. held, however, that as the amount recovered by the shipowners from the other vessel was less than the amount paid by the insurers, the latter were entitled to recover from the shipowners the sum of £7240, though it was based on a larger value than the insured value. The underwriter paid for the total loss of the ship and was held entitled to the whole sum recovered from the other ship. On appeal, the judgment was affirmed. As Swinfen-Eady L.J said that:[187]

"In my opinion, the Act embodies the law as laid down in North of England Iron Steamship Insurance Association v. Armstrong, and the judgment below was right on this point, and the plaintiffs are entitled to recover from the shipowners all the sums which the shipowners received in respect of the ship up to the £45000, the amount of the insurance."

[186] [1915] 2 KB 214.

[187] [1916] 21 Com. Cas. 150 at 153.

The agreed valuation is similarly conclusive in the event of a partial loss. In *Goole & Hull Steam Towing Co. Ltd v. Ocean Marine Insurance Co. Ltd.*[188] a vessel with an agreed value of £4,000 and insured for that sum sustained damage in a collision which cost £5,000 to repair. The assured recovered £2,500 from the owners of the other vessel on a both to blame basis and claimed £2,500 from the insurers. Mackinnon J. upheld the insurer's contention that the assured's recovery was limited to £1,500, being the difference between the sum recovered and their maximum exposure on the valued policy. He pointed out that, in the language of section 79 (2) of the Marine Insurance Act 1906, the insurer is subrogated to the rights and remedies of the assured, not in so far as the assured has been ideally or fully indemnified, but in so far as he has been indemnified "according to this Act"; that is say, in the case of a valued policy, according to the bargain made between the parties. The learned judge accordingly applied the principle of *North of England v. Armstrong* and *Thames v. British* to the case of partial loss. Had the insurers paid £4,000, they would have been entitled to all the damages recovered up to that payment.

However, all these cases refer to recovery of less than the payment by the insurer although the recovery was based on an actual value higher than the value agreed in the policy. In the event of recovery of more than the insurers payment, the general rule is that the insurer is not allowed to recover more than they have paid out. The rule had been approved by a series of classical cases. Cotton L. J. in the *Castellain v. Preston,*[189] referring to the principle in *Darrell v. Tibbitts,*[190] said that "the insurer was entitled to get back that which he had paid out". In *Burnand v. Rodocanachi*[191] Lord Blackburn stated the insurer is entitled to recoup "by having that amount back". Similarly, in *Glen Line v. A.-G* [192]Lord Atkin said that "subrogation would only give the insurer rights up to 20s. in the £ on what he had

[188] [1928] 1 KB 589.

[189] (1883) 11 QBD 380.

[190] (1880) 5 Q.B.D. 560.

[191] *Supra.*

[192] [1930] 37 LiL Rep. 55.

paid". In *King v. Victoria*[193] Lord Hobhouse expressed the opinion that an assured receiving damages from a third party is treated as trustee for the insurer "to the extent of the payment made". However, none of these cases were dealt with recovery based on an actual value that may more than the agreed value. There is little authority in English case. In the United States, in *The Livingstone*[194] where the a ship sunk by collision and abandoned to the insurer, being an actual total loss, was insured by a valued policy, and the stipulated sum was paid to the owner, who subsequently recovered her actual value, which exceeded her insurance value, as damages from the vessel responsible for the collision, the insurer was held to be only entitled to be reimbursed from such recovery to an amount it paid out, with interest, and the insured was entitled to the remainder in payment of his uncompensated loss. The Circuit Court of Appeal relying on the rule of equity said that:[195]

"We are fully convinced that equity and good sense do not require the court to go further and permit them[the insurance company] to realise an enormous profit from the transaction. No controlling authority compels such a decision; no principle of equity requires it. By limiting the recovery within the bounds of indemnity we are on safe and logical ground, where exact justice is done to both parties and where injustice to either is impossible."

In *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.*[196] where recovery was over the insurers' payment due currency devaluation. In this case, the assured had a valued policy for loss or damage to a ship for the sum of £72,000. The ship was damaged, had no salvage value and the underwriters paid £72,000. The assured later successfully claimed from the Canadian Government for the loss of the ship. The sum paid represented the value of the ship at the time of loss, namely £75,514. The dollar equivalent was $336,000. Sterling then devalued and

[193] *Supra.*

[194] 130 Fed. R. 746.

[195] Ibid, at 751.

[196] [1962] 2 QB 330.

when the dollars were converted £126,971 was paid to the assured. The insurance company claimed this amount whereas the insured offered to repay the £72,000. The court held that the insurance company was only entitled to the amount they had originally paid out under the policy, £72,000.

The decision of *Nisbet* case was doubted in the Court of Appear in *L. Lucas v. ECGD*[197] which was related to a surplus due to the devaluation of currency. The court held that the guarantors were entitled to the profit that arose from the new exchange rate, however, when the case further appealed to the House of Lords, their Lordships based their decision on the express provisions of the contract, and delivery a contrary decision.[198] The case did not concern an insurance contract but a guarantee which was treated by the courts as equivalent to an insurance policy. The Export Credit Guarantee Department as a section of the Board of Trade provided a guarantee covering the sale of goods by Lucas & Co. to the United Arab Republic. The purchase price was expressed in U. S dollars. One area of cover provided against non-payment or delay in payment of the purchase price due to circumstances beyond the buyer's control. In some circumstances the amount of the loss was to be calculated in sterling by converting the foreign currency into sterling at the buying rate of exchange in London foreign exchange market on the date when the goods were exported under the contract of sale. The ECGD were to cover 90 per cent of loss calculated in this way. Exchange control restrictions were imposed by the UAR. The merchants therefore made a claim against the ECGD. The value of the goods under the contract was $1,155,181 and at the rate of exchange of $2.8 to the £ this was equivalent to £413,412. A payment of £372,071, being 90 percent of the loss, was paid to the merchants. Subsequently the exchange control restrictions were lifted and by this time sterling had been devalued and the rate now stood at $2.4 to the £. When the purchase price, stated in dollars, was thus converted into sterling it amounted to $443,032. or an excess of approximately £26,000. The merchants argued that under the rules of subrogation they were bound to repay the amount paid to them

[197] [1973] 1 W.LR. 914.

[198] [1974] 1 W.L.R 909.

by the ECGD, namely £372,071. The ECGD contended that by a special clause in their agreement they were entitled to 90 per cent of whatever sum was recovered by the assured. They therefore claimed £398,739. The Court of Appeal held unambiguously for the guarantor. Leave to the House of Lords was granted. The House re-examined the express provisions and arrived at a contrary decision which reversed the decision of the Court of Appeal.

However, the decision of the *Nisbet* case has been subject to criticism. Birds argued that the decision in *the Nisbet* case was unfair because the insurer had indemnified its insured in 1945, but it was not until 1958 that the judgement fund was received. It was denied the use of money for thirteen years, whereas the insured had received an immediate indemnity.[199] Derham sought a solution for the injustice in this respect by adopting a proper definition of "profit".

"The principle could be applied that, in determining whether indeed a profit has resulted from a subrogation action, regard should be had to whether the insurer has been indemnified fully both for the effects of inflation and also for being deprived of the use of the money in the period following indemnity."[200]

In *Chalmers' Marine Insurance Act 1906* the discussion on section 79 admits that it was formerly suggested that the insurer might recover more than he had himself paid out but that it "has now been definitely decided that this is not so and that the insurer can not recover under the doctrine of subrogation more than he has paid.[201]

It may be noted that both *Nisbet* and *Lucas* case involved a profit due to the fluctuation of currency, it can not be said the insurer has been reimbursed more than he has paid if the profit due the fluctuation goes to his account, the payment he has made is not equivalent to currency money several years latter. The

[199] See: J Birds, "*Contractual Subrogation in Insurance*" [1979] JBL 124 at 131.

[200] Derham, *Subrogation in Insurance Law*, 1985, p.139.

[201] 7th ed. p.128.

recoupment by way of subrogation is a mechanism for preventing the assured for more than a full indemnity. If the doctrine of subrogation is based on unjust enrichment, then it may be seen that in *Nisbet* case the assured has been unjust enriched at the expense of the insurer. However, in the *Lucas* case in the Court of Appeal Megaw L. J. disregarded the value of pound and remarked that:[202]

"A pound is always a pound: so that whatever the exchange rate between the pound and any or all other currencies, and whatever may happen between one date and another to the internal purchasing power of the pound, in the eyes of the law a pound today is the same as it was yesterday or a year or ten years ago."

Megaw may confuse the currency value and the currency. The writer agrees that the pound is always a pound. However, the value of sterling is not always the same. After the assured has been indemnified, the sum received by the assured which hold on trust for the insurer is subject to condition of that it should be in diminution of the loss insured. The payment made by the insurer at the date of payment may reflect a higher currency value some years latter. It may be correct to say that the insurer could recoup an amount up to the same value as he paid at the date of actual payment, i.e. an amount reflects the payment he has made. Thus, the insurer could have more currency than he has paid, but in fact he could never be enriched.

The courts in several cases has awarded the insurers interest.[203] It seems that the courts has realised that the insurer would have suffered a loss had he been deprived the use of money. It seems odd why the court had not awarded the surplus being fluctuation of the currency to the insurer. It may be suggested that the dictum in *the Nisbet* case applies only to where there is a surplus by devaluation of currency. The decision followed by American court[204] and some

[202] [1973] 1 WLR 914, at 922.

[203] *Harbutt's v. Wayne* [1970] 1 QB 447; *H. Cousins v. D & C* [1970] 2 QB 230; *Lucas v. ECGD*, [1973] 1 WLR 914.

[204] *The Livingstone*, supra.

other countries. It is also supported by R. W. Hodgin.[205] However, in Australia, the Law Reform Commission has made a recommendation[206] for amending the decision of *the Nisbet* case and the recommendation has now been embodied in s.67 of Insurance Contracts Act 1984, which entitles the insurer to hold the surplus.

4. Policy with an excess or deductible clause

In case of an excess clause in the policy, the distribution of recoveries may become controversial. Few scholars have tackled this point except Derham who expressed the view [207] that if a policy has an excess clause, the insured should be entitled to recoup the amount of his excess before the insurer is subrogated to any recovery from a third party. Further, the insured is entitled to a full indemnity for his actual loss including the excess. It may be seen that the rule similarly applies to where there is a deductible clause in the policy. However, in practice, "recoveries against any claim which is subject to deductible shall be credited to the underwriters in full to the extent of the sum by which the aggregate of the claim unreduced by any recoveries exceeds the deductible." [208]

In *Napier v. Hunter*,[209] an reinsurance contract contained excess and limitation clauses. After the stop loss reinsurer paid the reinsured the losses to the extent of his limit, the reinsured successfully recovered a sum from the third party. The insured argued *inter alia* that they should be entitled to be indemnified in full before the insurers should be allowed to recover anything. The insurers pleaded that the insured should only be entitled to recover in respect of their uninsured losses above the maximum figure set down by the limit clause, before the insurers

[205] Hodgin, *Subrogation in Insurance Law*, 1975 J.B.L.

[206] See: A.L.R.C *Report on Insurance Contracts* Report No.20.

[207] Derham, *Subrogation in Insurance law*, 1985, p.134.

[208] ITC Clauses (Hulls) 1995 clause12.3.

[209][1973] AC 713.

could levy their claim in respect of the amounts which they had paid; only out of the money which then remained, if there are any, would the insurers finally be allowed to recoup themselves in respect of their uninsured losses below the minimum figure set out in the excess clause. In fact the loss suffered by the assured was £160,000. The limit of the insurer's liability was £125,000 and there was an excess of £25,000. The sum recovered from the third party responsible for the loss was £130,000. The insurers paid the assured £100,000, that is the sum insured less the excess. The question was whether the assured was entitled to £60,000 of the sum recovered which represents the loss suffered less the insurer's payment, so that he would recover the whole of his loss, and the insurer would therefore receive £70,000 back; or whether the insurer was entitled to a greater proportion of the £130,000, so that the assured would be under-compensated.

At first instance, Saville, J. held for the assured on this issue. He explained why he awarded for the reinsured:

"The question to be asked ... is whether the recovery together with the indemnity will more than compensate the assured for the loss. If it will, then if this arises before payment, the amount of the indemnity will be reduced so as to avoid over-compensation, while if it occurs after payment, the assured will have to repay the amount of over-compensation to his indemnifies...any approach which does not achieve this result but instead leaves the assured over-or under-compensated must be wrong..."[210]

It seems from the judgment of Saville J. that the assured has the first claim for the recoveries up to a full indemnity in spite of the excess clause, which is consistent with the proposition of Derham. However, when the case was further appealed to the House of Lords, their Lordships established the rule of 'top down' distribution of recovered amount. Thus, the reinsured may not be fully indemnified as the "top down" rule may leave them nothing for the loss below the

[210] [1993] 1 Lloyd's Rep.10 at p.17.

excess. It was held that where an insurance contract contains an excess clause, it is incorrect to say that under the principle of indemnity the insured should be entitled to recover a full (though not more than a full) indemnity for his total loss from his insurer and from third party sources: by agreeing to the excess clause, the insured agrees rather that he is entitled only to a full indemnity in respect of that part of his total loss which is not covered by the excess clause. Therefore, the assured was only entitled to £35,000 of the sum recoveries, that is his uninsured loss of £60,000 less the amount of the excess and the insurers were entitled to the balance of £95,000.

Lord Jauncy reasoned that:

"When an insured loss is diminished by a recovery from a third party, whether before or after any indemnification has been made, the ultimate loss is simply the initial loss minus the recovery and it is that sum to which the provisions of the policy of assurance apply including any provision as to an excess." [211]

Thus, the ultimate loss was £30,000, namely the initial loss of £160,000 less the recovery £130,000 and the excess of £25,000 applied to the £30,000 so that the assured recovered from the insurer only £5,000.

The reasoning that critical to the judgement is that of Lord Templeman. He considered that there were in fact three layers of insurance, the first for the first £25,000 of any loss; the second for the next £100,000 and the third for any payment in excess of £125,000. On loss of £160,000, the assured would recover £25,000, £100,000 and £35,000 from the respective insurers and he accepted that "recoveries automatically reduce a loss from the top and therefore the subrogation must follow the same rule".[212] Thus, on the recoveries of £130,000, £35,000 would first go back the third insurers and the remaining £95,000 would go to the second insurers and left the first insurer nothing to recover.

[211] [1973] AC 713 at 748.

[212] Ibid, at 727.

It may be argued that the "top down" rule established by the House of Lords in *Napier v. Hunter* applies only to unlimited liability insurance with different layer of insurance and is not applicable to property insurance.[213] In case of property insurance with different layer, the dictum in *Boag* case[214] would apply. It is still doubtful whether the rule adopted by Derham would apply to marine property insurance with an excess clause. If so, the assured has the first claim up to a full indemnity. If the assured is deemed to be his own insurer in case of an excess, then the dicta in *The Commonwealth* would apply, which is enacted into s81 of MIA. The situation in *The commonwealth* is one of under-insurance. However, it is inferred from the *Napier* case in the House of Lords that the assured is not deemed to be his own insurer in a fully insured policy with excess or deductible clause, thus, any recovery should account first to the underwriter to the extent of his payment and the rule adopted by the Derham does not apply, at least in the context of marine insurance. In practice, an express provision in Clause 12.3 of Institute Time Clauses (1995) (Hulls) and Clause 10.3 of Institute Voyage Clauses (Hulls) clearly stipulates that the insurer has the priority for the recovery in case of deductible. Clause 12.3 ITC (Hulls) 1995 which provides that:

Excluding any interest compromised therein, recoveries against any claim which is subject to the above deductible shall be credited to the Underwriters in full to the extent of the sum by which the aggregate of the claim unreduced by any recoveries exceeds the above deductible.

The general rule is that the assured would be fully indemnified before he could account any balance to his insurer.[215] In case of under-insurance, there are

[213] The editors of *Arnould's Law of Marine Insurance and Average*, 16th ed. v.3 para 1299 suggested that "top down" rule applies to marine policies where the insurance is on slice, layer or stratum of liability but it has no application to partial insurance on ship cargo or freight, similar to that in *The Commonwealth.*

[214] [1937] 2 KB 113.

[215] See: *Castellain v. Preston*,(1883) 11 QBD 380 at 386.

distinction between non marine and marine insurance. In non marine insurance, the assured is entitled to recovery until his loss over the policy limit is reimbursed unless there is an average clause in the policy. In a marine policy, s.81 of MIA applies and the effect is the same as the non marine policy with an average clause. In contrast, in a fully insured policy with excess clause, the rule inferred from *the Napier* case in the House of Lords is that the insurer has the first claim up to his payment. However, there was authority that the assured has the first claim for the recoveries even the shortfall within the deductible.[216] In writer's view, it would be unjust to deprive the assured of the shortfall of deductible. If the purpose of subrogation is to prevent unjust enrichment, and the assured can hardly be said to be unjustly enriched until he receives a full compensation for his loss, which includes the excess or deductible. At least, the assured shall be entitled to share proportionately the recovery. In fact, English law has not treated the assured as his own insurer in the event of excess or deductible clause has been criticised by United Nations Conference on Trade and Development:[217]

"It is suggested that the English practice is inequitable to the assured. Whenever hull damage has occurred it is quite clear that both parties have suffered losses--- the insurer is paying the claim and the assured is bearing the deductible. Just as the insurer desires to diminish his losses by offsetting recoveries from third parties, it seems inequitable to deny the assured the same opportunity. It would seem in this respect that the insurer who is in the business of running the risk of loss, does not merit preferential treatment over the assured, who has attempted to eliminate the risk of such losses by buying the insurance in the first place."

Furthermore, in writer's view, the "top down" recoveries approved by the House of Lords seem unfair to the assured as well. Their Lordships' grounds for the rule in *the Napier* case was seen not as one of unjust enrichment but as construction of

[216] *Buckland v. Palmer*, [1984] 3 ALL ER 554.

[217] UNCTAD Report on Marine Insurance, *Legal and Documentary Aspects of the Marine Insurance Contract,* p57, 20th Nov. 1978, TD/B/C.4/ISL/27.

contract and the assumption of risk.[218] As a matter of contract, the insurer has promised indemnity only in respect of loss greater than the excess. The excess is stipulated by the insurer to reduce the transaction costs and to encourage the assured to be risk averse, does it follow that, if compensation is available from the third party wrongdoer, the assured intends it to go top down to the insurer first? The case of *the Boag* was not cited in *the Napier* case in the House of Lords, and the "top down" rule would also apply when there are more than two different layer of liability reinsurance, if *the Boag* case was rightly decided, then it may be arguable the "top down" rule established in *the Napier* case was correct. In writer's view, the policy in this case may be deemed to be under insurance and *the Commonwealth* authority would apply. Thus, the assured would be able to retain on a basis of proportion of his uninsured loss and excess in the total losses. Thus, in the case of the excess, the proper distribution of recoveries may be formulated as followings:

$$\text{i. the assured} = \frac{\text{uninsured's loss + excess}}{\text{total losses}} \times \text{recoveries}$$

$$\text{ii. the insurer} = \frac{\text{limit - excess}}{\text{total losses}} \times \text{recoveries}$$

This is based on the underinsurance principle and it seems more just and fair for the allocation of recoveries when there is an excess clause or deductible clause in the policy. In my view, neither *the Napier* nor *the Boag* case had been rightly decided and the conflict between them has been cited in a completely different way of allocation of subrogation recoveries. It is better to say that *the Boag* case is involving the layer insurance and *the Napier* case, on the other hand, is a case of

[218] See: Malcolm A. Clarke, *The Law of Insurance Contracts*, 3rd ed. 1997, 31-3 B1, p.855.

underinsurance and where *the commonwealth* authority applies. The rational is that:

Firstly, as discussed above, the assured retains the right to be *dominus litis* even if the insurer has met his liability under the policy terms[219] and to deduct the shortfall from the recoveries up to a full indemnity. *The Napier* case refers not to the assured's total loss but rather to that part of the assured's loss which is acknowledged by the policy that the assured should bear the part of his own loss by way of excess or deductible. That means that the assured would not be entitled to be *dominus litis* for the whole claims even if he has not been fully indemnified.

Secondly, the "top down" recovery rule deprives the assured of recoveries of excess or deductible. This is contrary to the purpose of subrogation which is to prevent the assured from double indemnity. Thus, it may be the situation that the insurer has not been a chance for the distribution of recoveries if the recoveries sum is less than the uninsured loss. On the other hand, it would not encourage the assured to endeavour to pursue against the third party wrongdoer as he may prejudice his insurer by entering into the settlement for an inadequate amount, when he actually has a strong case.

Thirdly, the *Napier* case contrary to the *Boag* case, which proceeds on the basis that, where insurance is arranged in layers, the first layer insurer obtains a contingent right of subrogation which can not be affected by the subsequent layers. Thus, the distribution lies on the "bottom up" rule. The case has not been cited in the House of Lords.

5. Proper Allocation

[219] *Commercial v. Lister,* (1874) LR 9Ch App 483; *Buckland v. Palmer* [1984] 3 ALL ER 554.

In conclusion, the writer would attempt to summarise the proper distribution of recoveries in the context of marine insurance:

(1) The general rule is where the assured is fully insured and fully indemnified under the policy, the insurer remains *dominus litis* and has the first claim of recovery up to his payment. In the case of partially paid by the insurer, the assured remains *dominus litis* has the first claim up to a full indemnity and hold any surplus as trustee of the insurer.[220] However, the insurer is safeguarded by the possibility of the assured becoming liable to him in damages if he conducts proceedings without due regard to the insurer's interests either after or before he has been paid.

(2) Where the assured is fully insured under an agreed value policy, the agreed value is conclusive and the insurer would be entitled to have the first claim of recoveries up to his payment even in the case of partial loss. The assured is estopped from asserting the difference between the real value and the agreed value even if the real value happens to be greater than the agreed value. The rule has now embodied in Section 27 of Marine Insurance Act notwithstanding that the rule is suggested to be contrary to the principle of indemnity which deprives the assured of a full indemnity and which enriches the insurer as the result of benefits accrues from the basis of greater real value. If, however, the recoveries happens to be more than the agreed value or the insured amount though it is rare nowadays, the assured could retain the surplus. However, it is arguable that the insurer would entitled to retain the surplus if the surplus arise out of the currency devaluation.[221] Indeed, in *L. Lucas v. ECGD*[222] the Court of Appeal has held that the Exports Credits Guarantee Department who paid the 90 percent of losses under the guarantee was entitled to 90 percent of the excess as a result of sterling had risen as against the US dollar. Unfortunately, the decision was reversed by the House of

[220] *MacGillvray & Parkington on Insurance law*, 8th ed. para. 1220.

[221] *Yorkshire v. Nisbet*, [1962] 2 QB 330.

[222] [1973]1 WLR 914.

Lords. It was well settled that if the surplus arising from the interests, the insurer is entitled to recoup more than he has paid.

(3) Where under the (1) situation, the policy has also subject to an excess or deductible clause. It was ruled that the insurer has the first claims of the recoveries up to his full payment under the policy.[223] But it was also held that the assured is entitled to sue the losses of excess from the third party wrongdoer.[224] Whichever is rightly decided is immaterial in practice in the context of marine insurance as the marine policy always provides that the insurer has the first claim.[225] In America, the situation is totally different as the court would allow the assured to share the recoveries in case of an excess clause in the policy.[226] The writer also noted the criticism which the English Law and practice in respect of hull insurance rule are inequitable to the assured.[227] Thus, in writer's view, in the absence of contrary stipulations in the contract, the assured should not be deprived of the shortfall of deductible, at least, they are entitled to the contribution of recoveries in proportion to their respective interests. Neither the insurer nor the assured should have the first claim of the recoveries and a "pro rata rule" would seem more just for dealing with this respect no matter whether in marine or non-marine insurance.

(4) Where the assured is under insured for his losses where the assured is deemed to be his own insurer, the insurer cannot prevent the assured from pursuing the claim against the third party for the whole loss. It is settled that the insurer is entitled to a proportionate share of recovery in proportion to his insured amount bears to the total value. *The Commonwealth* applies. However, there is no such presumption in non-marine insurance. Under an agreed value policy, the agreed

[223] *Hobbs v. Marlowe*, [1978] AC 16. And also inferred from *the Napier* case.

[224] *Buckland v. Palmer* [1984] 3 ALL ER 554.

[225] See ITC Hull Clause(1995), C.12.3.

[226] English law does not treat the assured as co-insurer in case of deductible and in English marine insurance conditions also deny the assured a co-insurer status as to the deductible

[227] UNTACD Report on marine insurance, Nov. 20th, 1978, TD/B/C.4/ISL/27 at p57.

value is conclusive between the insurer and the assured and not the actual value. In the event that the recoveries is more than the agreed value, the insurer is not entitled to retain the surplus.

(5) Under the situation of (4) and subject to an excess clause and/or limit clause where it is commonly recognised as layer insurance. That the case happens in *the Napier* case as discussed above. Then the "top down" rule is applies. However, contrary allocation was also established in the *Boag* case as "bottom up" rule.[228] It has been suggested that the "top down" rule only applies to layer insurance and does not apply to partial insurance and under-insurance.[229] The writer would suggest a "*pra rata*" rule as set up in *The Commonwealth* under such circumstances.

(6) Under the partial insurance where only one type of loss is insured, the insured remains *dominus litis* of the action in respect of uninsured loss but must take *bona fide* consideration of his insurer's interests as against the split of cause of action.[230] That means that the assured must sue for the whole loss including the insured loss against the third party wrongdoers. In the event of an unapportioned recoveries, the assured has the first claims up to a full indemnity, if the recoveries is able to be apportioned, the insurer has the respective interests in respect of insured loss. However, it has been argued that the cause of action is separate in the case of partial insurance and the insurer is entitled to use the assured's name to sue the third party wrongdoers in a separate action without abusing the court process. The insurer is entitled to sue the assured in damage for infringing the insurer's subrogation rights if the assured releases the whole loss with the third party wrongdoers without due regards to the insurer's loss.

[228] However, an increased value clause in Institute Cargo Clause has modified the effect of *Boag* case and the increased value insurer has been entitled to a rateable share of the recoveries in proportion to the increased value.

[229] *Arnould's Marine Insurance and Average*, 16th Ed. V.3 para.1299.

[230] As the case in *Commercial v. Lister*, supra.

Chapter VI Voluntary payment

1. Gift or not?

Payment made by third party who is under no legal obligation may present difficulties as to whether the insurer is entitled to such a gift. The intention for gift given is an issue. If, however, there is an clear intention to benefit the assured solely, then it can not be suggested that the insurer has any entitlement to recover the gift from the assured. It is a pure gift paid to the assured as a goodwill gesture or a pure grace without any legal obligation to do so. This is consistent with the decision of House of Lords in *Burnand v. Rodocannachi*,[231] in which the assured effected with underwriters valued policies of insurance on a cargo, which was afterwards destroyed by a Confederate cruiser, and the underwriters paid to the assured as on an actual total loss the agreed value, which was less than the real value. The Government of United States under the Act of Congress, in the meantime, paid a sum to the assured for the difference between their real total loss and the sum received from the underwriters. The payment was not intended to reduce the loss, but to compensate the assured for any loss from being under-insured. Accordingly, the award was against the insurer and no subrogation right thereby arose.

Likewise, in *Merrett v. Capitol*,[232] the reinsured, liability insurers at Lloyd's, suffered a reinsured loss, which was partly "funded" by payment to them of a smaller sum by their brokers. The brokers were not obliged to pay the money but did so for their own commercial purposes, namely, to save themselves work and to keep the goodwill of the insurers. It was intended not as a loan but as an outright gift. On a subsequent claim by the reinsured, arbitrators deducted from their award against the reinsurer an amount equivalent to the gift. On appeal from

[231] (1882) 7 App. Cas. 333.

[232] [1991] 1 Lloyd's Rep. 169.

the arbitrators, Steyn J found that the award disclosed an error of law and remitted the award for reconsideration by the arbitrators. Steyn J applied the established principle:

"*The payment by the brokers was a gift, albeit a gift made for commercial rather than purely disinterested purposes. The contracts of reinsurance are contracts of indemnity. The question is, therefore, whether the payment diminishes the loss. Not every gift to an assured by a broker diminished his loss. It is a question of fact in each case whether a gift has or has not been paid in diminution of the loss, and if it is established that the payment was intended solely for the benefit of the assured, it has not been paid in diminution of the loss. In that event it must be disregarded in assessing the assured's recoverable loss.*"[233]

By contrast, if the payment is not clear enough to be intended to benefit the assured himself or in the absence of any intention for the gift, then the insurer is not deprived of the right to recoup it back from the assured. In two earlier cases of *Randal v. Corckran*[234] and *Blaauwpot v. Da Costa*[235] in which the distribution of prizes by the government which arose from the seizures of goods, by way of reprisal, taken from the Spain, was intended to whom had actually suffered rather than the shipowners personally. The judgement was awarded for the insurer accordingly. Likewise, in *Stearns v. Village*[236] the defendant company, a gold mine owner in South Africa had insured its gold under an all risks Lloyd's policy. After the gold was commandeered by the South Africa government the underwriter paid over its value to the assured. However, as a result of representations being made to the government, a sum of money was received as compensation on the understanding that the defendant would continue to work on the mine and would hand over 50 percent of the gold won to the government. The underwriter claimed the sum received by the assured. The Court of Appeal held

[233] Ibid, at 171.

[234] (1748) 1 Ves. Sen. 98.

[235] (1758) 1 Eden 130.

[236] (1905) 10 Com. Cas. 89.

the insurer to be entitled to do so. The issue in this case was whether the compensation from the South Africa government was a result of bargain with government, where the assured agreed to continue to work on the mine in return for the government returning some of gold seized in the form of cash payment, in order to prevent the mine being shut down because of a lack of funds. The Lordship, after examining the earlier cases of *Roandal v. Cockran*[237] and *Burnand v. Rodocanachi*[238], came to the conclusion that the sum paid to the assured in the absence of any intention to benefit the assured personally was intended to diminish the loss which had been incurred by the company in respect of that gold.[239] Stirling L J rejected the argument that the payment to the assured was the result of bargain. He said:

"I do not think that the Government in so doing were acting under the idea that they were entering into any bargain with the defendants(the assured), but, at the most, upon an expectation which proved to be well founded, that under the stress of circumstances created by the war and in their own interests the defendants would continue, to work the mines."[240]

A gift is a voluntary act. However it does not mean that all the voluntary payment must go to the assured's own account. If the gift is intended to benefit the sufferers who had satisfied the losses of the assured, then it would be the insurer who is entitled to the gift. However, if the payment made by the third party is not in a voluntary or *ex gratia* way but with legal obligation to do so by merely compromising in respect of loss with the third party, it is apparent that the payment is intended to be in diminution of the losses so long as the insurer has fully indemnified the losses of the assured. Therefore, the insurer has the absolute right against the compromise payment which the assured must hold on trust for the insurer. Meanwhile, it would be more likely that the assured would be held

[237] *Supra.*

[238] *Supra.*

[239] Ibid., per Romer L J, p95.

[240] Ibid., at p 97.

liable in damage for the insurer for infringing their subrogation rights. There are plenty of authorities in respect of this proposition and will be further discussed in Chapter VIII. As the compromise settlement are the results of those rights possessed by the assured against the third party whom may have a disputed claims with the assured and it is not a gift in any event, the insurer could recoup those payment by way of subrogation up to what he has indemnified. In a recent peculiar case *The Wind Star*,[241] the assured received a payment for compromise of a claim and assigned the insurance to the tortfeasor. The insurer obtained a declaration that the payment was not a gift and should be taken into account between insurer and assignee. The court awarded the insurer the entitlement to the payment on the ground that the payment was not voluntary in this sense.

In general speaking, a voluntary payment is the same as a gift and it should be irrelevant to the loss of the subject matter insured. However, the authority is that "the question is not whether the money was voluntarily paid or not voluntarily paid, but whether de facto the money which was paid did reduce the loss",[242] in *Merrett v. Capitol*[243] Steyn J. used a similar yardstick that "the question is, therefore, whether the payment diminishes the loss".[244]

Above authority is largely based upon the fundamental principle of indemnity which can be seen in a number of classic cases. In *Simpson v. Thomson,*[245] Lord Cairns, L.C. said:

"I know of no foundation of the right of underwriters, except the well known principle of law, that where one person has agreed to indemnify another, he will, on making good the indemnity, be entitled to succeed to all the ways and means by

[241] [1995] 1 Lloyd's Rep. 570; affirmed, [1997] 1 Lloyd's Rep. 261.

[242] *Burnand v. Rodocanachi* (1882) 7 App. Cas. 333 at 341, per Lord Blackburn.

[243] *Supra.*

[244] Ibid. at p171.

[245] (1877) 3 App. Cas. 279

which the person indemnified might have protected himself against or reimbursed himself for the loss."[246]

Also, Lord Blackburn in *Burnand v. Rodocannachi*[247] pointed out that:

"The general rule of law is that where there is a contract of indemnity and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay; and if the indemnifier has already paid it, then if anything which diminish the losses comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back".[248]

Likewise, in *Castellain v. Preston*[249] Brett L.J emphasised the insurer's right of "the advantage of every right of the assured... which the loss can be or has been diminished"[250]; Bowen L.J. made the similar remarks at the same case that "if he (the assured) has a means of diminishing the loss, the result of the use of those means belongs to the underwriters".[251]

It is arguable that the insurer's right to the gift is based upon whether the gift made by the third party is intended to diminish the loss or not. First, if the insurer, after satisfying a loss, is merely succeeded to the rights and remedies of the assured in respect of the losses and as the gift is made under no legal obligation but goodwill or pure grace, it would be odd to confine the gift to be the "rights and remedies of the assured". The authority in *Simpson v. Thomson*[252] established the

[246] Ibid. at 284.

[247] (1882) 7 App. Cas. 333.

[248] Ibid. at p339.

[249] (1883) 11 QBD 380.

[250] Ibid. at 388.

[251] Ibid. at 402.

[252] supra.

rule that an insurer is only subrogated to those rights which may be enforced against the third party as pointed out by Lord Cairns that "on payment the insurers are entitled to enforce all the remedies, whether in contract or in tort, which the insured has against third parties, whereby the insured can compel such third parties to make good the loss insured against"[253]. It is apparent that there is no right for the assured to the gift as it is without any legal liability but mere voluntary. Likewise, Brett J in *Castellain*[254] case cited the judgement in the *Burnand* case and said that "what was paid by the United States Government could not be considered as salvage, but must be deemed to have been only a gift. It was only a gift to which the assured had no right at any time until it was placed in their hands"[255]. The notion was also cited in *City v. Evans*[256] where Scrutton L. J had the view that "when he (the insurer) has paid, and not till then, he is subrogated to any legal rights the assured had which might reduce the loss, but not to any charitable contributions or sources of profit not depending on legal right".[257] It is clear from those dictum that the insurer's subrogation rights are those rights and remedies which the assured possess against the third party in respect of losses. Therefore, the better illustration of subrogation right is those rights and remedies the assured possesses against the third party which would be in diminution of the losses occurred in respect of the subject matter insured. The broad definition in *Castellain v. Preston*[258] may be conflicting: the underwriters is entitled to the advantages of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has accrued, and whether such right could or could not be enforced by the insurer in the name

[253] (1877) 3 App. Cas. 279 at 284.

[254] supra.

[255] Ibid. at 389.

[256] (1921) 38 L.T. 230.

[257] Ibid., at 233.

[258] (1883) 11 QBD 330

of the assured by the exercise or acquiring of which right or condition the loss against which the assured is insured, can be, or has been diminished.[259]

Meanwhile, it is also irrelevant to the diminution of the loss to consider who would succeed to the gift. The test for the gift, from the writer's point of view, must be based on whom the gift is intended to benefit rather than whether the gift is intended to diminish the loss. In *the Burnand* case "it is perfectly obvious from the statements made by the parties, upon which they agreed, that the compensation (from the government of the United States) was awarded to the respondents(the assureds) upon the second of these grounds, namely, in respect of that the insurance which they effected fell short of protection against the whole loss which they sustained". In *Merrett v. Capitol*, that the brokers made a goodwill payment for sake of the commercial advantage is nothing to do with the loss and it is a mere gift to the assured, while in *Randal v. Cockran* and *Blaauwpot v. Da Costa* the prize distributed by the British government was intended for the parties who actually suffered which included the insurer. In *Stearns v. Village*, the intention was not apparent but it is by no means to be assumed that no clear intention suggests an intention to diminish the loss. It is much more likely that the gift was the result of the bargain with the government for continuation of work on the gold mine which was commandeered by the South African government rather than the diminution of loss. The insurer, after paying the total loss to the assured had no right to the salvage by way of subrogation as the salvage belonged to the South African government. The transaction was a business arrangement after the seizure, which resulted in a loss to the assured and the salvage of gold mine, it is nothing to do with the insurer. Unfortunately, it was not decided on that ground. Conversely, *The Wind Star* case was not an issue of gift, as the payment comprised the assured's claims and assignments of the insurance. That is a deal rather than pure voluntary payment, therefore, it is not a gift.

[259] Ibid., per Brett L.J. at 339.

Moreover, it is more accurate to say that a gift from a third party is nothing to do with the subrogation rights, but is more relevant to whom the gift is intended to benefit and the beneficiary has the absolute right to that gift. Every gift made has its intention and whom the gift is intended to benefit is a question of fact. If there have not a clear intention for the gift, can it suggest that it intends to diminish the loss? As discussed above, the gift is not a right of the assured until it comes to the assured's hands. The gift is rather intended to benefit someone else than to diminish the loss and is distinguishable from a compromise payment of disputed claim or any other transaction of the assured's claims against third party in respect of the loss where those compromise or transaction are not the voluntary payment in nature.

Lastly, as inferred from *the Burnand* case, the assured, after having been fully indemnified under the policy, has not been overcompensated in addition to the payment of gift as the value agreed is conclusive to both parties and the gift paid is nothing to do with the loss and therefore it is irrelevant to the right of subrogation taken by the insurer.

However, it is unclear whether the assured may share the gift under a underinsurance policy if the gift paid to them in the absence of any intention for benefiting the assured personally. The assured is deemed as own insurer for his uninsured loss under s.81 of Marine Insurance Act 1906, it seems from the authorities of foregoing discussion the assured is entitled to share the gift in proportion of the value insured and uninsured value. However, in the writer's opinion, the gift is not a right or remedies of the asssured which the insurer could be subrogated as the reasoning of the Law Lords in *Simpson v. Thomson*[260] that an insurer is only subrogated to those rights which may be enforced against third person in respect of the loss. The test for gift under such circumstance is based upon the intention for such payment which has the exact same yardstick under

[260] (1877) 3 App. Cas. 279.

fully coverage. Either the assured or the insurer could succeed the gift depending on whom the gift is intended to benefit.

2. *Ex gratia* payment to the assured from the insurer

To entitle the assured to receive payment under a policy, the insurers must be legally liable to make it, but it is the practice of insurers, in proper case, to make an *ex gratia* payment in respect of losses which is not strictly covered by the policy. A compromise settlement under a disputed claims by the assured would clearly be sufficient to entitle the insurer's subrogation rights. The difficulty may arise if the payment made by the insurer to the assured which the insurer is not legally bound to make under the terms of the policy, but make voluntarily, then would the insurer similarly be entitled to be subrogated to the assured's right? This may arise in a number of contexts: the policy may be avoidable for breach of the assured's duty of utmost good faith; the assured may have been in breach of a warranty or condition; the insurer might accept inadequate proofs of loss; or the perils causing the loss might fall outside the scope of cover.

In *King v. Victoria,*[261] the Bank of Australia took out an insurance with the plaintiff insurer upon wool on board the vessel the *Dorunda* at and from Townsville to London via Torres Strait. The risks was stated to attached from the loading of the goods on board the vessel. Some of the wool was on arrival at Townsville put on board a lighter belonging to a firm of wharfingers for the purpose of being conveyed to the vessel. While the lighter was moored to the wharf, a storm arose which drove away from their anchorage certain punts belonging to the government which had not been properly secured. The punts fell foul of the lighter, broke her away from her moorings, capsized her, carried her down stream, and so destroyed the wool. The bank claimed against the plaintiffs whom paid for the losses under the policy and took a formal assignment from the

[261] (1896) AC 250.

bank of all their rights and causes of action against the government. By way of defence, the government argued that payment made by the insurer was not covered by the policy as the loss occurred before loading and therefore the plaintiff stood in the position of a mere volunteer for making the payment to the bank which would not entitle them for the title to sue by way of subrogation.

However, when the case appealed to the Privy Council, their Lordships had no doubt that if, after receiving payment from the plaintiffs, the bank had got damages from the government, they must hold them as trustees for the insurers to the extent of the payment, and that if it had been necessary to use the name of the bank, the bank is compelled to permit it on the usual terms. It was established that the claim was not one which the insured might not honestly make, or to which the insurers might not honestly and reasonably accede and the payment was honestly made by insurers in consequence of a policy and in satisfaction of a claim by the assured, it was claim made under the policy, which entitled the insurers to the remedies available to the assured. As Lord Hobhouse pointed out[262] that, if the third party's contention were good law, "the consequence would be that insurers could never admit a claim on which dispute might be raised except at the risk of finding themselves involved in the very dispute they have tried to avoid, by persons who have no interests in that dispute." It is clearly seen from the authority that a payment honestly made by the insurer, which does not fall with the terms of the policy, will not deprive the insurer of subrogation rights.

Also, in *Assicurazioni Generali di Trieste v. Empress Assurance Co., Ltd*[263] the defendants had insured certain vessels and then reinsured them with the plaintiffs. The defendants paid for a loss, for which they supposed themselves to be liable, only as a result of a fraudulent misrepresentation on part of the assured. After they had recovered from the plaintiffs under the policy of reinsurance, they discovered the truth and obtained damages for fraud from the assured. The facts that the plaintiffs had honestly made under the reinsurance contract notwithstanding there

[262] Ibid. at p255.

[263] [1907] 2KB 814.

is a fraud under the assured's claim would be sufficient to be entitled to the rights of the defendants against the assured and were entitled to be reimbursed the sums they had paid out.

The proposition could be further supported by the judgement in *Austin v. Zurich*[264] in which the liability insurer had satisfied a claim brought by its insured, but did so without prejudice to its contention that it was not liable to do so. It was suggested that the insurer had "honestly" satisfied a claim under the policy, and that therefore it was entitled to be subrogated to its insured's right of action against a third party. The fact that the insurer did not admit its liability to the insured did not deprive it of this right, although the judgement was held against the plaintiff on other grounds . However, in the Court of Appeal[265] it was held that the case was one of double insurance and involving contribution rather than subrogation.

However, there is contrary authority in English law although it arises from areas outside insurance. In *Re Cleadon Trust Ltd*[266] Creichton was one of the two directors of a company, Cleadon Trust Ltd, which had guaranteed the debts of two subsidiary companies. The subsidiaries were unable to pay their debts nor could the Cleadon company which became liable. The subsidiaries' creditors was subsequently paid by the Creichton alone with the approval of his fellow company director. It was agreed that the company should pay him interest on the money together with his payment. Cleadon Trust Ltd and its subsidiaries later went into liquidation. However, the subsidiaries' assets were insufficient to discharge the amounts owing on the debentures which they had issued, with the result that any claim which Creichton might have had against them was worthless. However, Cleadon Trust Ltd had sufficient remaining assets to make it worthwhile for Creichton to prove in its liquidation for the money he had paid the subsidiaries' creditors, either in his own right or via subrogation to the claims of the creditors

[264][1944] 2 ALL ER 243.

[265] [1945] 1 K.B. 250.

[266] [1939] Ch 286.

who would have come against the company on the guarantee, had he not paid them on the company's behalf. The majority of the Court of Appeal, Scott and Clauson L J, set aside his claims since his payment had been made voluntarily and he was not entitled to recover the money back from the company either via a direct action for the money paid or via subrogation to the rights of the subsidiaries' creditors. In Scott L J's words:[267]

"Both of the appellant's grounds of claim ... are affected by two fundamental conclusions of fact to be drawn from the evidence:(1) that the company as a juridical persona took no action whatsoever; it could take none and was therefore wholly impassive; and (2) that the appellant's advances so far as the company was concerned were purely voluntary and gratuitous."

Charles Mitchell[268] commenting on the case suggested that "the case should rather have been decided on the basis that Creichton's payments did not discharge the company's liability under the guarantee. The court should therefore have held that Creichton could not recover from the company directly, both because he was a volunteer and because he had conferred no benefit on the company, and that he could not recover from the company via simple subrogation because he was a volunteer". In his theory, "where a volunteer S pays RH in respect of the obligations owed to RH by PL, PL's obligations are not automatically discharged by S's payment. In other words, RH's rights are not extinguished unless PL subsequently ratifies S's payment."

Contrary authority was also cited in *Owen v. Tate,*[269] the Tates' debt to a bank was secured by a mortgage on property owned by Lightfoot. Without the Tates' knowledge, and in order to benefit Lightfoot, Owen agreed with the bank that if it would release Lightfoot from the mortgage, he himself would guarantee the Tates' debt and give the bank a new security to support his secondary liability. Tates

[267] Ibid. at 311-12.

[268] *The law of Subrogation*, 1994 at p164.

[269] [1976] QB 402.

heard of the proposal and protested but the bank, as it was free to do, completed the arrangement. Subsequently, Tates defaulted on the debt and forced the bank to seek the payment from the Owen's security. Owen paid the debt and then brought an action against the Tates. The Court of Appeal held that Owen could not recover from the Tates, on the grounds that he had acted as a volunteer. Because he had voluntarily assumed his position as the Tates' surety, the court thought that his payment of the debt should be treated as a voluntary payment, even though he was legally obliged to pay under the guarantee. In Scarman LJ's words:[270]

"If without an antecedent request a person assumes an obligation or makes a payment for the benefit of another, the law will, as a general rule refuse him a right of indemnity. But if he can show that the particular circumstances of the case there was some necessity for the obligation to be assumed, then the law will grant him a right of reimbursement if in all the circumstances it is just and reasonable to do so. In the present case the evidence is that the plaintiff acted not only behind the backs of the defendants initially, but in the interests of another, and despite their protest. When the moment came for him to honour the obligation thus assumed, the defendants are not to be criticised, in my judgement, for having accepted the benefit of a transaction which they neither wanted not sought."

A more recent case which dealt with the same issue was *Esso Petroleum Co., Ltd v. Hall Russell & Co Ltd*, the case involving an oil tanker, the *Esso Bernicia*, owned by Esso while it was being berthed at a jetty at an oil terminal in Shetland Islands, one of the three tugs in attendance caught fire and the tow line from the tug to the tanker was cast off. The tanker, being no longer under the full control of the remaining tugs, crashed into the jetty causing damage to her hull and to the jetty and also causing bunker oil to escape in large quantities which polluted the foreshore causing loss to the local crofters. The fire on tug was caused by a coupling blowing out of a hydraulic pipe and the escaping

[270] Ibid. at 405.

hydraulic fluid coming into contact with an engine exhaust. The shipowners after paying the crofters and the operator of terminals under the TOVALOP agreement claimed against the tug builders asserting that the accident to the tanker was caused by the negligence of the tug's builders in designing and building the tug. The shipowners paid the crofters because it was a party to TOVALOP, the parties to which had agreed between themselves that in the event of oil pollution from one of their tankers, the owner of the tanker would pay anyone damaged by the resulting pollution for his loss, regardless of whether the tanker owner was legally liable for the pollution or not. The essential issue that arose was whether the shipowner might be entitled to assert the crofter's rights against Hall Russell via simple subrogation. It was held that the payment was gratuitous. Lord Jauncey said:[271]

"TOVALOP is and remains a gratuitous contract of indemnity notwithstanding that the event which gave rise to the payments thereunder was damage to the Bernicia. Esso cannot pray in aid the latter event in order to convey their claim to repayment of sums paid under that indemnity into a claim for economic loss resulting directly from the damage."

Also, it was held that the voluntary payments were not recoverable from the tugbuilders as economic loss directly resulting from the damage to their tanker, notwithstanding that the event which gave rise to the payments was the physical damage to their tanker. It was well established from the judgment that an indemnifier could not sue for reparation by reason of his contractual liability to the person indemnified for damage to his property. It could be seen from the judgment that a voluntary payment has in no way entitled the insurer a right of simple subrogation. Charles Mitchell who based on the *Burrows* and *Goff and Jones's* restitution remedy theory commented that:[272]

[271] Ibid. 678.

[272] *The law of subrogation*, 1994, p165.

"The significant feature of the case is that Esso's claim to be simply subrogated to the crofters' rights should arguably have failed anyway, for the more fundamental reason that it could not show that an unjust factor underlay its payments sufficient to entitle it to a restitutionary remedy."

Furthermore, the shipowner's claims failed on procedural grounds: he could not succeed in its claim to be subrogated to the crofters' rights for the reason that it should have brought its subrogated action in the name of the crofters, but had in fact sued Hall Russell in its own name. The shipowners' subrogation rights if any, according to Charles Mitchell,[273] is a simple subrogation where the payment of shipowner did not discharge the obligation of Hall Russell to the Crofters and the proceedings could only be initiated in the name of the Crofters. The proposition was approved by Lord Goff:[274]

"There can of course be no direct claim by Esso against Hall Russell in restitution if only because Esso has not by its payment discharged the liability of Hall Russell and so has not enriched Hall Russell; if anybody has been enriched, it is the crofters, to the extent that they have been indemnified by Esso and yet continue to have vested in them rights of action against Hall Russell in respect of the loss or damage which was the subject matter of Esso's payment to them."

However, if the case was rightly decided then it is open to doubt whether the insurer should have a subrogation right in the case where he is under no legal liability to reimburse the assured for the reason that the policy is avoidable at the insurer's option as was the case in *King v. Victoria*. In writer's view, the *King v. Victoria* was rightly decided. First of all, subrogation is regarded as a matter of equity,[275] principle would indicate that subrogation should be permitted in all these cases, for subrogation is simply the right of an indemnifier to take over the

[273] See Chapter II for further discussion.

[274] Ibid. 663.

[275] *Napier v. Hunter* [1993] 1 ALL ER 37.

rights of the party indemnified. Further, the decision of *King v. Victoria* can be supported on the grounds, first, that it is in the public interest against unnecessary litigation and, second, that it is not open to a third party to raise a defence, which is based on a contract to which he is not a party, a defence which the parties to the contract have chosen not to raise and which, certainly, they did not intend to ensure for his benefit. Even if the subrogation is regarded as an implied term in a contract of insurance, the insurer waives its right to set the policy aside or to reject the claim, the policy continues in force and the claim may be said to be made in accordance with the policy, so that the implied right of subrogation continues in force.

The distinction between these two sorts of contrary authority could be clarified as to whether the *ex gratia* payment has been deemed to be in satisfaction of a debt or claim under the contract or as a mere outsider, in Scarman LJ's words, "whether there are some necessity for the obligation to be assumed".[276] In *Re Cleadon Trust Ltd* case, Creichton was a mere stranger to the guarantee contract which the company guaranteed the debts of their two subsidiary companies, his voluntary payment could not be said to in satisfaction of the guarantee contract unless ratified by the company, he is an outsider of the guarantee and it is the similar case in *Owen v. Tate* where Owen's payment to bank has not any relevant to the Lightfoot's debt to the bank but in the interests of another. Though in the *Esso Bernicia,* Esso's payment was under the TOVALOP agreement. It is true that under the agreement Esso was obliged to the other members of the agreement to pay no matter whether he was liable or not. However, as for the crofters and Hall Russell were concerned, it was an independent voluntary indemnity agreement rather than under legal compulsion. Therefore, the payment was gratuitous. It may be arguably because of this which distinct from insurance contract and therefore simple subrogation was not considered. Conversely, in *King v. Victoria*, the payment though was made voluntarily was deemed to be in satisfaction of the loss under the policy notwithstanding that the insurer could

[276] Ibid. at 407.

avoid the contract at his option. As inferred from the authority in *Owen v. Tate*, the insurer's voluntary payment may be have "some necessity for the obligation to be assumed", while, in the *Esso Bernicia* the payment was entirely voluntary under an independent agreement. Meanwhile, it would be inequitable not to award the insurer the subrogation right at least in the law of insurance as the assured may be unjustly enriched at the expense of the insurer. It was clear from the authority that the insurer would be entitled to the subrogation rights so long as the payment made by the insurer in the absence of fraud. In practice, this issue may be governed by contract terms, ensuring that the insurer has rights of subrogation as soon as he has paid.[277]

Voluntary payment similarly presents difficulty in America. Some early cases held in America that when an insurer made a payment without an obligation to do so, a wrongdoer could avoid liability by raising the defence that the insurer acted as a volunteer and did not become subrogated to the rights of the assured.[278] On the other hand, it has been held that an insurer which made a payment, despite an existence of a policy defence, may be entitled to pursue subrogation against a wrongdoer.[279]

In the case that there is a void contract, then the payment made by the insurer could hardly be said to be a payment made under the policy. The payment would not give rise to a right of subrogation for the insurer either under equity or the implied terms theories. Where, however, the policy is illegal it is undoubtedly against public policy to permit the insurer to recoup its payment from the third party, as its own payment to the assured is frowned upon by the law. This is fully illustrated by the decision of McCardie J. in *John v. Motor.*[280] In that case, a hull

[277] See Birds, *Contractual Subrogation in the Insurance Law*, JBL [1979, at p.124.

[278] *Chase v. Hammond Lumber Co.*, 79 F 2d 716 (9th Cir. 1935); *Old Colony Ins. Co. v. Kansas Public Service Co.*, 154 Kan. 642, 121 P.2d 193 (1942).

[279] *Transamerica Insurance Company v. Barnes*, 29 Utah 2d. 101, 505 P.2d 783 (1972); per Callister, C. J., with one justice concurring and one justice concurring in the result.

[280] [1922] 2 K.B. 249. See also S.4 (2) (b) of MIA.

policy contained a "policy proof of interest" clause which is deemed to be a contract by way of gaming or wagering under the Marine Insurance Act 1906[281] and is void. The vessel collided with another vessel. The insurer made a payment under the policy. The assured received a payment from the owner of the other vessel. The insurer claimed to be entitled to the payment by way of subrogation. It was held that, since the presence of the p.p.i clause made the policy void, the insurer did not have a right of subrogation.[282] However, the insurer's remedies if may would be to seek to recover under the law of quasi-contract the money paid by it to the insured.

[281] Section 4(2) (b).

[282] Under United States decisions, p.p.i policy is not void insofar as the assured has an insurable interests and the insurer is accordingly entitled to be subrogated to the assured's claim in so indemnifying the assured's loss. See: *Frank B. Hall & Co v. Jefferson Insurance Co,* 279 F. 892 (1921).

Chapter VII The Extent of Subrogation

The Common law has somewhat widened the extent of the right of subrogation in a number of cases. It was established that the insurers were entitled to succeed to all the ways and means which come into the hands of the assured in diminution of the loss. It has been suggested[283] that subrogation is an equitable doctrine for preventing the assured from unjust enrichment. The insurer's right to enforce subrogation rights should be no better than that of the assured. Therefore, the insurer is not entitled to sue the assured himself or co-assured. If a gift comes into the hands of the assured, which is not intended to be in diminution of loss, the assured has no entitlements to the gift. This situation has been discussed in Chapter VI. Subrogation only confers upon the insurer "all rights and remedies of the assured in and in respect of the subject matter", very different from the doctrine of abandonment which allows the insurer to take "all the proprietary rights incidental thereto". Likewise, the insurer is not entitled to be subrogated to the remedies and rights of the assured which arise outside the subject matter insured or from an independent contract irrelevant to the loss of subject matter insured. Such remedies of the assured could not be said to be intended to diminish the loss. In any event, the prerequisite for exercising subrogation right is that the insurer must actually pay to the assured under the policy before stepping into the position of the assured. This Chapter will attempt to examine in which cases subrogation rights may be restricted.

1. The assured shall be indemnified

As discussed in Chapter II, the right of subrogation arises once the insurer has indemnified the loss of the assured. However, "it is important to distinguish between when the right of subrogation may be exercised and when it actually

[283] See Chapter III.

comes into existence, because it has been said that, while payment is a prerequisite to the exercise of the right, that right itself comes into existence when a contract of indemnity insurance is entered into."[284] The proposition derived from *Boag v. Standard*[285] which confers a contingent right of subrogation upon the insurer when the contract of insurance is initiated, with the consequence that the assured may face liability to the insurer for failing to take reasonable steps to preserve the insurer's rights, for example, by the issue of a writ within the relevant limitation period or to secure assets or evidence by means of a Mareva injunction or Anton Piller order. However, it is submitted that the contractual duty of the assured could not impose upon the assured an obligation to preserve the time limit and that in practice, notice of loss would be sufficient for the insurer to take prompt action. Even though the case of *Boag v. Standard* was rightly decided, it may be seen that the right of subrogation is not enforceable until the insurer has made the actual payment under the policy term unless he takes a valid assignment. In *John v. Motor,*[286] McCardie J pointed out[287] that the right of subrogation springs not from payment only but from actual payment conjointly with the fact that it is made pursuant to the basic and original contract of indemnity. There are several other cases supporting this proposition.[288] The question is whether it is enough for the insurer to indemnify the assured under the terms of the policy, or whether the assured must be fully compensated for his loss before the insurer can be subrogated. In some case, the shortfall may fall within the deductible or excess expressly stipulated in the contract. In *Page v. Scottish,*[289] Scrutton L.J expressly reserved the question whether full compensation is necessary. There is a Canadian case *Globe v. Trudell*[290] which held that the assured must be fully compensated. However, the

[284] Derham, *Subrogation in Insurance Law*, 1985.

[285] *Supra.*

[286] [1922] 2 KB 249.

[287] Ibid. at 255.

[288] *City v. Evans,* (1912) 91 L.J. KB 379, Per Scrutton L.J. at 385; *Scottish v. Davis* [1970] 1 Lloyd's Rep. 1.

[289] (1929) 140 L.T. 571.

[290] [1927] 2 DLR 659.

position is far from clear under English law. It could be inferred from *Napier v. Hunter*[291] that the courts would in future hold that full indemnity under the terms of the policy is sufficient notwithstanding that there may remain a shortfall by way of deductible or excess. In practice, the question may be academic as the position is frequently modified by an express agreement vesting subrogation rights in the insurer upon indemnification under the policy either in the contract of insurance or in a subrogation receipt. If the assured is underinsured, the insurer does not, however, acquire the right to control any action which the assured might bring against the third party.[292] Nevertheless, it would seem that underinsurance in this context does not include any excess or deductible which the assured must bear under the policy, as it was held in *Napier v. Hunter* that the assured who agrees to bear the first part of excess or deductible can not be said to be underinsured.

2. The insurer is only subrogated to rights and remedies of the assured against the third parties in respect of the loss of subject matter insured

The authority of *Castellain v. Preston*[293] confers upon the insurer the rights and remedies of the assured which, if satisfied, will extinguish or diminish the ultimate loss sustained, as described by Brett LJ:

"In order to apply the doctrine of subrogation, it seems to me that the full and absolute meaning of the word must be used, that is to say, the insurer must be placed in the position of the assured. Now it seems to me that in order to carry out the fundamental rule of insurance law, this doctrine of subrogation must be carried to the extent which I am now about to endeavor to express, namely, that as between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract,

[291] [1993] AC 713.

[292] *Commercial v. Lister, supra*, as discussed above.

[293] (1883) 11 QBD 380.

fulfilled or unfulfilled, on in remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has accrued, and whether such right could or could not be enforced by the insurer in the name of the assured, can be, or has been diminished. That seems to me to put this doctrine of subrogation in the largest possible form, and if in that form, large as it is, it is short of fulfilling that which is the fundamental condition, I must have omitted to state something which ought to have been stated".[294]

It seems that the authority has conferred upon the insurer the right to entitle all ways and means that come into the hands of the assured which would diminish the loss, no matter whether the assured possesses legal rights and remedies against third parties, or whether it is relevant to the loss of the subjected matter insured. As has been discussed in Chapter VI, the insurer might not have a right over a gift which is invariably made by the third parties as a goodwill gesture or a pure act of grace. In the *Castellain* case, the fact that the purchaser of house paid to the assured the sale price regardless of the damage to the house does not deprive the insurer of the right to recover the insurance money back. The case concerned a vendor who contracted with a purchaser for the sale of a house which had been insured by the vendor with the plaintiffs, an insurance company, against fire. The contract of sale contained no reference to the insurance. After the date of the contract, but before the date fixed for completion, the house was damaged by fire, and the vendor received the insurance money from the insurer who was ignorant of the existence of the contract for sale. The purchase was afterwards completed and the purchase money agreed upon, without any abatement on account of the damage by fire, was paid to the vendor.

At first instance, Chitty J held that the insurer was not entitled to the right of subrogation. In Chitty J's words:[295]

[294] Ibid. at 388.

[295] (1882) 8 QBD 613 at 617.

"On payment the insurers are entitled to enforce all the remedies whether in contract or in tort, which the insured has against third parties, whereby the insured can compel such third parties to make good the loss insured against."

It is clear that the insurers' right is described by the phrase that "the insured can compel such third parties to make good the loss insured against". The contract of sale was not conferred upon the assured a right to compel the purchaser to make good the loss. The right of the assured to the purchase price had nothing to do with the loss of the house. However, when the case was appealed to the Court of Appeal, it was held that the payment under contract of sale was intended to be in diminution of the insured loss which entitled the insurers to recover the insurance money back. It is arguable that such contractual right of the assured is able to be subrgoated after the payment by the insurer. If the purchaser had defaulted on payment of the sale price, would the insurer have the right against the purchaser in the name of the assured?

The vendor had the insurable interest in the house before the completion of the purchase and if the vendor had the liability to reinstate the house in the event of damage, he would be obliged to do so and that might leave the insurer with no claims. The fact was that the purchaser's action against the vendor failed and the full purchase price was paid to the assured without abatement. It was argued that the assured had been double compensated and unjustly enriched. If, however, the assured was so enriched, he was not enriched at the expense of the insurer as his contractual right to the purchase price had no relevance to the loss but at the expense of the purchaser. Whether or not there was damage to the house, the price had to be paid to the assured.

If the house was let and the vendor had the benefit of a covenant by the tenant to repair, the insurer on payment would succeed to the right of the vendor against the tenant. That is the case of *Darrell V. Tibbitts*[296] in the Court of

[296] (1882) 5 QBD 560.

Appeal. In that case the landlord insured, and had a covenant with his lessee under which the lessee was bound to rebuild or reinstate in the event of damage by fire. The house was damaged by explosion as a result of an escape of gas in a pipe which occurred when the corporation of Brighton repaired the streets. The insurer paid the landlord the insurance. The lessee were bound by the lease to make good injuries done by an explosion of gas. The lessee afterwards received compensation from the Corporation of Brighton for the damage done to the house by the explosion, and with the sum received reinstated the house. The question was whether the insurers were entitled to recover the amount they had paid. Their lordship referred to the principle of *North British v. London* [297] and pointed out that if the lessee had not repaired the house, the insurers would undoubtedly on payment have been entitled to bring an action on the lessee's covenant by way of subrogation, which related to the subject matter of the insurance and its preservation; if the landlord had sued the lessee before he received payment from the insurer, he must have recovered from them, for it would have been no answer by the lessee that the landlord has insured; if the landlord had recovered damages from the lessee to repair, he could not afterwards claim against the insurer. The fact that the landlord was paid by the insurers, as they were bound by their contract to pay, and afterwards the Corporation of Brighton, by whose negligence the mischief happened, paid the amount of damage to the defendant's house, and this amount was expended in making good the damage, the case stands in the same position as if the lessee had executed the repairs with their own moneys.

The difficulties of foregoing case are that the landlord had, by reason of the reinstatement of the building, actually received for the loss the benefit of the covenant to repair, and consequently no right of action on the covenant remained. It was held that "the assured shall hold for the benefit of the insurer or pay to them the amount that he subsequently receives under any contract relating to the loss, which they would have been entitled to require him to put

[297] (1877) 5 Ch. D. 569.

in force for their benefit at the time when they as insurers paid to him the amount of his loss". In Cotton LJ's words:[298]

"In principle there can be no difference between a right which the assured has as against a wrongdoer, and a right which has under a contract entered into by him ... I do not think that technically the company have a right to recover back the money which they have paid, but they have a right to the benefit of what the assured has received in respect of a contract referring to the loss, by which he was entitled to receive compensation in damages, and which they might have called upon him to enforce their benefit: when he has received that benefit, they can treat him as being under an obligation to use it as they may direct."

Likewise, Thesiger LJ based his opinion on the grounds:[299]

"The assured having been indemnified against the loss sustained by him through the payment by the insurance company, the latter have a right to be subrogated into the place of the assured; one of those rights was either to compel the tenants to repair the house demised to them, or to pay damages equivalent to the cost of the repair; and as the assured has received from other sources compensation for his loss, he ought to put the company in the same position which they would have held, if the house had been repaired before they were called upon to pay the amount of the damage."

It is clear from the judgment that the insurer is only entitled to receive those benefits which relate to the loss of the subject matter of insurance as described by Brett LJ:[300]

[298] Ibid. at p564-565.

[299] Ibid. at p568.

[300] Ibid. at p563.

"The doctrine is well established that where some thing is insured against loss either in a marine or a fire policy, after the assured has been paid by the insurers for the loss, the insurers are put into the place of the assured with regard to every right given to him by the law respecting the subject matter insured, and with regard to every contract which touches the subject matter insured, and which contract is affected by the loss or the safety of the subject matter insured by reason of the peril insured against."

However, in the *Castellain* case, the purchase price under the contract sale is irrelevant to the loss of subject matter insured, whether or not there was a fire in the house, the lessee was obliged to pay the agreed sale price. How could the sale price come to diminish the loss to the house? The contract of sale is an independent contract irrelevant to the loss and it is arguable that the insurer, by way of subrogation, to be entitled to recoup back a sum equivalent to the insurance money. In fact at the first instance of the case, their lordship seemed to accept that subrogation right is confined to those rights and remedies of the assured "which contract is affected by the loss or the safety of the subject matter insured by reason of the peril insured against", and as illustration taken by Chitty J:[301]

"Take the case of a landlord insuring, and the tenant under no obligation to repair, a case which I have before me the other day, where, under an informal agreement evidently drawn by the parties themselves, the large rent of £700 was reserved, and the tenant notwithstanding the fire was bound to pay the rent. I stay here to say that a lease, as has been often held, is but a sale pro tanto. Now assume that the building in such a case was ruinous, and would lost the length of the term only. Could the insurer recover a proportionate part of each payment of the rent as it was made, or could they wait until the end of the term, and say in effect you have been paid for the whole value of the building, and therefore we can recover against you? Or to vary the case somewhat again,

[301] Ibid. at 621.

suppose the building at the end of the term was only half the value, could the insurers then recover half of the sum they had paid? I think not; I think all these questions must be answered in the negative."

However, the case was overruled by the Court of Appeal on the grounds that the advantage received by the assured was intended to diminish the loss and therefore entitle the insurers to recover even the advantage the assured received was no relevance to the loss of the subject matter insured but it is sufficient so far as it did come to diminish the loss. In writer's view, Chitty J's judgment was right. The test of diminution loss held by the Court of Appeal is subject to a prerequisite, that is that the rights and remedies the assured received must be related to the loss of the subject matter insured. " The insurers are put into the place of the assured with regard to every right given to him by the law respecting the subject matter insured, and with regard to every contract which touches the subject matter insured, and which contract is affected by the loss or safety of the subject matter insured by the reason of the peril insured against". So, how a contract of sale was affected by the damage to the fire? *Castellain v. Preston* must be largely based on a principle of equity which prevent the assured from obtaining double compensation. However, was the assured enriched at the expense of the insurer? It is still open to doubt that every advantage which come into the assured's hands in diminution of loss must go to the insurers. Criticisms over the case have also been observed by Charles Lewis:[302]

"An insured who had contracted to sell premises quite properly recovered under a fire insurance policy when those premises were damaged before sale. But he then found that his purchaser nevertheless paid him the agreed price. Could he keep the windfall? He argued that the money had been properly paid over by the insurers and that what he later sold the property for was irrelevant, and that, even if it was not irrelevant, it did not affect his right to claim and

[302] *A Fundamental Principle of Insurance Law*, LMCLQ 1979 May.

keep the insurance moneys representing the damage to the property. With our developed sense of equity we might have regarded his contention as unarguable, but the court, in rejecting, was not prepared simply to say that he must repay the insurance moneys: it felt obliged, somewhat legalistically and, as a matter of legal logic, somewhat doubtfully, to put it that he held the purchase moneys on trust for the insurers to account to them for the relevant benefit received. The insurance moneys had been paid to indemnify the insured, but, as it turned out, they were not in fact necessary for the purposes of indemnification."

As far as marine insurance is concerned, "the insurer is thereby subrogated to all rights and remedies of the assured in and in respect of that subject matter". Thus, a hull insurer is usually not entitled to be subrogated to the rights of assured for the loss of profit or freight under a charter party as those rights are not related to the subject-matter insured. In *Young v. Merchants*[303] the appeal from the reinsurer on hull seeking for the recoupment of the wrongdoing vessel's collision liability calculated in accordance with single liability was dismissed by the Court of Appeal. In this case the defendants underwrote a policy of marine insurance on *the Whimbrel* against total loss, and also by a running down clause, against three-fourths of collision liability on the principle of cross liabilities. The defendants reinsured their liability for total loss only with the plaintiff. During the currency of the policy *the Whimbrel* was sunk as the result of a collision with *the Marloch* and became a total loss. In proceedings in the Admiralty Court both vessels were held equally to blame, and, as *the Marloch's* half damage exceeded *the Whimbrel's* half damages, *the Whimbrel* had to pay the balance under the Admiralty rule of single liability. The defendants paid the owners of *the Whimbrel* for a total loss, and also a further sum under the running down clause, that sum being ascertained by bringing into account a payment treated as having been received in respect of *the Marloch's* liability for the damage done by her to *the Whimbrel*, and the

[303] [1932] 2 KB 705.

payment of a larger sum in respect of the damage done by *the Whimbrel* to *the Marloch*. The plaintiff claimed that he was entitled to the benefit of the credit in respect of *the Marloch's* liability. MacKinnon J. held that the plaintiff, not being a reinsurer of the liability under the running down clause, was not entitled to the benefit of the credit. The crucial issue is that whether the shipowner has received any sum in diminution of his total loss, and as stated by MacKinnon J. in his judgment:

"The truth is that the shipowner has not received any sum in diminution of his total loss, and therefore the liability of the defendants to the shipowner to pay him a full total loss has not in any way been diminished, and as the liability of the defendants to pay the shipowner in full his claim for a total loss has not in any way been diminished, so in my judgment the liability of the plaintiff to pay the defendants in full has not been diminished in any way."[304]

The fact in the case is that *the Marloch's* damage is greater than *the Whimbrel's*, if, however, the damage of shipowner of *the Whimbrel* is greater than *the Marloch's*, the sum received may be in diminution of his total loss and then entitles the reinsurer to recoup the sum by subrogation. Accordingly, the court may reach the contrary decision which may not base on grounds of which the reinsurer is not being the reinsurance of collision liability as his subject matter insured is total loss only.

Similarly, where a vessel is damaged by collision, and her owners recover from those by whose negligence the collision was caused damages in respect of matters which are not covered by a policy on ship, the underwriters cannot, by paying for a total loss, recover from their assured sums paid to them by the wrongdoer, but not paid as part of the value of the ship insured. In *Sea v. Hadden*[305] the defendant's ship, which was voyage-chartered, came into collision with the other ship and became a constructive total loss. The other ship

[304] Ibid. at 714.

[305] (1884) 13 QBD 706.

was held to be wholly to blame and later the defendants successfully pursued a claim for loss of ship and freight from the other ship. The plaintiff being the hull insurer paid the total loss of the ship sought the whole of the sum received by the defendants. The defendants contended that the portion of the damages attributable to freight had been properly paid over by them to their underwriters on freight and was not payable to the plaintiffs. The plaintiffs were held not entitled to any part of the damages recovered from the owners of the vessel in fault on account of the loss of freight intended to be earned by the defendants' ship. Brett M.R. in his judgment endeavored to illustrate the freight earned is independent of ownership. He said that:

"That seems to me to be strong authority for saying that those two things, the freight to be earned by the contract of carriage, and the ship herself, are not so attached together, that one can be said to be, within the meaning of the rules laid down, an incident of the other: a contract of affreightment is not an incident to the ownership of the ship: it is an independent contract which the owner of the ship may or may not enter into."[306]

However, as long as the insurer made an actual payment for a total loss, if the contract of affreightment is considered "salvage" that would be in diminution of the losses and the insurer would be entitled to the benefit of that contract. If that is so, he will be entitled to sue upon that contract although not by way of subrogation but by abandonment. Similarly, the freight may be incidental to the ship if the ship is abandoned as a constructive total loss but still completes the voyage and thereby earns freight, then the hull insurer may be entitled to the freight by the doctrine of abandonment. In that case, the subject matter insured is the ship and the freight is an independent contract of which the ship is not the subject matter. Thus, the insurer is not entitled to be subrogated to the right of the freight earned.

[306] Ibid. at 714, 715.

Likewise, confusion also arises in respect of the loss of profit. In *Attorney-General v. Glen*[307] a dispute arose as to whether a claim by the Crown, as reinsuring underwriters, to be entitled a sum paid by the German Government, as compensation to shipowners. The underwriters had paid a total loss in respect of a vessel seized by the German Government at the outbreak of war and abandoned to them by the owners. At the conclusion of the war the vessel was returned to her former owners, and, being the property of the underwriters, was sold for their account, realising a sum greatly in excess of the amount paid by the underwriters under the policies insuring the ship. Subsequently the former owners succeeded in recovering from the German Government a large sum as compensation for the loss of the use of the vessel, and it was claimed on behalf the Crown that the right to recover that sum was a proprietary right incidental to the ownership of the vessel, to which the underwriters were entitled by subrogation. It was held, however, that the sum recovered by the former owners was not paid to them in respect of the loss of their ship, but in respect of profits they might reasonably have expected to make by the use of their ship, and it was not therefore a sum to which the underwriters were entitled by reason of their payment of a total loss under policies insuring the ship itself.

In an American case *Mason v. Marine*[308] the Sixth Circuit of Circuit Court of Appeals held that the insurers on ship, in a case of constructive total loss, happening through the fault of another vessel, were entitled to the damages recovered from the vessel in fault for the prospective earnings of the insured ship, which was under charter at the time of the loss. However, the remedies of the hull underwriters in this case was held to be by way of abandonment rather than subrogation. A right to recover damages for loss of profits is no less an incident of the property in the ship than is a property damage claim for loss of the ship itself. The hull underwriter's entitlement in this latter case is based on subrogation rather than abandonment.[309] It may be seen that an insurer becomes

[307] (1930) 37 Lloyd's Rep. 55.

[308] (1901) 110 Fed. R. 452.

[309] *Simpson v. Thomson* (1877) 3 App. Cas. 279 at 292.

entitled upon an abandonment to the wreck of the vessel, and to any proprietary rights incidental thereto, but if the insurer has the right to damages for loss of profit, however, damages for such loss of profits may be as a consequence of subrogation as they are calculated by reference to the vessel before the casualty and not by reference to the wreck itself. In a Canadian case *Hochelaga v. R.*[310] the Supreme Count assumed that subrogation does vest the right to loss of profit, as against the assured, in the hull underwriter, though in fact it is difficult to distinguish damages for loss of profits from damages for loss of freight, to which the hull underwriters are not subrogated. However, it has been submitted that the hull underwriter only insures the vessel, and not the profits which may be earned by that vessel. These damages do not diminish the loss insured against. The better view is that neither abandonment nor subrogation confers upon hull underwriters a right to receive the benefit of an award of damages for loss of profits.[311] The loss of profit is not concerned with the wreck after a total loss as it happens prior to the happening of total loss for the loss of use of the vessel and no abandonment or subrogation may entitle the insurer for the rights of loss of profit if any as the right to profit is an independent right of the assured irrelevant to hull insurance which could not be deprived of as a result of payment from the insurer in respect of hull insurance.

In most cases the hull insurers are not awarded to the loss of profit and loss of freight as they are not connected to the subject-matter insured in respect of hull insurance, it is better to say that they are not related to the loss of hull as no matter whether there is a loss of hull, the right for the freight and the profit would still vest in the assured. Such rights are not subrogated as a result of indemnification of hull loss. By comparing the case of *Castellain* and the cases in respect of loss of freight and profit, it seems that all those contractual rights of the assured are not related to the loss of subject-matter insured. Can it be said that the loss of freight or profit is intended to diminish the loss of the hull? In writer's view, the test for diminution of loss is too ambiguous and it negates the

[310] [1944] S.C.R. 138.

[311] Derham, *Subrogation in Insurance Law*, 1985, p.36.

connection of those rights of the assured with the loss of subject-matter insured. The insurer is only subrogated to those rights and remedies of the assured against third party wrongdoers who are responsible for the loss of the subject-matter insured. Not every benefit coming into the assured's hands either in contract or in tort is subject to the subrogation rights. Still, there remains a controversy whether every benefit to the assured would diminish the loss or not. If someone intends to profit the assured either in contract or in term of gift, it could not be said that those benefits are intended to diminish the loss. If in *Castellain*, the assured had the obligation to repair the house, the issue would never happen, however, the fact that the assured took the advantage of the contract of sale and obtained the whole purchase price even there was a fire damage to the house. If the assured was enriched, he was not enriched at the expense of the insurance moneys but by taking the advantages from the sale of the house.

3. Not more than the insurer has paid?

The general rule is said to be that the assured should make no profit from his insurance, the insurance being an indemnity and no more, as stated by Brett LJ in *Castellain v. Preston*[312] that "which either will prevent the assured from obtaining a full indemnity, or which will give the assured more than a full indemnity, that proposition must certainly wrong."

The above *dictum* was concerned with preventing the assured from making a profit at the expense of the insurer. It was also well established that the insurer should not recover more than they paid out. Lord Blackburn in the *Burnand* pointed out that "it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back".[313] In the

[312] (1883) 11 QB 380 at 388.

[313] (1882) 7 App. Cas. 333 at 339.

Castellain, Cotton L.J, relying on the judgment in *Darrell v. Tibbitts*[314] and concluded that "...if the purchase money has been made in full, the insurance office will get back that which they have paid..." Again, in *Thames v. British*[315] Scrutton J took the view[316] that "the underwriters here are entitled to recover, to the extent to which they have paid in respect of the subject matter insured..." In *Boag v. Standard*[317] Lord Wright M.R, after examining Section 79 of Marine Insurance Act of 1906 and the judgment of *North of England v. Armstrong*[318] commented that "the plaintiff are entitled to recover from the shipowner all the sums which the shipowner received in respect of the ship up to the £45,000, the amount of the insurance."[319] The *dictum* was also cited in the *Re Miller*[320] by Wynn Parry J, quoting from *Randal v. Rockran,*[321] that " the assured stands as a trustee for the insurer, in proportion for what he has paid."

Thus, the difficulty is that where the insurer has paid out under an insurance contract and the insured later receives from another party a sum exceeding the original payment, or the insurer is put into the place of the assured and claim against the third parties a sum more than they has paid, is the insurer entitled to keep the surplus?[322]

The issue first arose in *Yorkshire v. Nisbet,*[323] which involved in a surplus as the result of fluctuation of currency. It was held that the insurer was only entitled to an amount they had originally paid out under the policy.

[314] (1880) 5 QBD 560.

[315] [1915] 2 KB 214.

[316] Ibid. at p221.

[317] [1937] 2 KB.113

[318] (1870) L.R. 5 QB 244.

[319] *Ibid. at 122.*

[320] [1957] 1 WLR 703.

[321] (1784) 1 Ves. Sen. 98.

[322] See furthe in Chapter V. 3.

[323] [1962] 2 QB 330.

The authority was further reiterated in *L. Luscas v. ECGDt*[324] where it happened to be that the excess recovered was due to the devaluation of currency and it was held that the insurer was not entitled to hold the excess. It is apparent from these two authorities that the insurers are never entitled to recoup more than they have paid out. However, it is arguable where the subrogation recovery may arise some years later and the currency paid has gone through devaluation. Although the situation is very rare, it did happen in *Yorkshire v. Nisbet* and *L. Lucas v. Export* as discussed above and under such circumstances, the insurer was held not to be able to retain the surplus due the currency depreciation. It seems unjust as the insurer was out of pocket several years later and as a result the currency has depreciated, the insurer would have never been enriched had they retained the surplus. If the subrogation is preventing the assured from more than he has suffered the actual loss, then he may be enriched by retaining the surplus arising from the devaluation.[325]

However, this authority of *Nisbet* case is subject to exceptions, in particular, the award of interest. The interest awarded in a subrogation claims may be apportioned between the assured and the insurer based on the amount of subrogation recoveries payable to each and on the date at which the insurer paid to the assured.[326] The interest awarded has been codified in Supreme Court Act 1981, s.35A.[327] And the insurer is able to retain the interest representing the period from his payment to judgment or actual payment by the third party. That may be the possibility that the insurer may recover more than he has paid to the assured. In practice, the effect is expressly stipulated in the contract, for instance, Clause 12.4 of Institute Time Clauses (Hulls 1995) provides:

[324] [1973] 1 WLR 914.

[325] Full argument has been discussed in Chapter V.

[326] *H. Cousins v. D& C Carriers Ltd,* [1971] 2 QB 230.

[327] The interest is awardable in a subrogation action in a usual way, i.e. from the date at which the cause of action arose until the date of payment or judgment; See also: *Metal Box v. Curry's* [1988] 1 WLR 175.

"Interest comprised in recoveries should be apportioned between the assured and the underwriters, taking into account the sums paid by the underwriters and the dates when such payments were made, notwithstanding that by the addition of interest the underwriters may receive a larger sum than they have paid."

Moreover, the over recoupment may sometimes occur in an underinsurance policy with agreed value. In which the actual value happens to be higher than the agreed value. In the case the agreed value is conclusive between the assured and the insurer, and it was held that the assured is not entitled to satisfy his shortfall based on the higher actual value insured before meeting the insurer's recoupment. Conversely, if it happens to be that the insurer's subrogation recoveries are more than he has paid to the assured, it is settled law that the assured would retain the surplus. However, the insurer may retain more than he has paid when there is an abandonment, it confers the insurer upon the entitlement to take over the proprietary remains.

The *Nisbet* case was subject of strong criticism. However, it is the writer's view that the insurer was entitled to hold the surplus in the event of currency devaluation and the interests of his payment, but it would be inequitable for the insurer to hold the surplus as a result that the actual value is greater than the agreed value as it would deprive the assured of a full indemnity unless the surplus accrues from the insurer's taking over the subject-matter by way of abandonment. Therefore, the dictum that the insurer is not entitled to recoup more than they have paid is subject to two exceptions, i.e. in the case of currency devaluation and award of interests. In Australia, the Law Reform Commission had made a recommendation[328] for the reversal of the decision in the *Nisbet* case and the recommendation has now been embodied in s.67 of Insurance Contracts Act 1984 which entitles the insurer to hold the surplus in such circumstance. But the position under English law remains unchanged.

[328] See: ALRC Report on Insurance Contracts, Report No. 20.

4. No rights against the assured himself

Common Law principle is clear that the insurer is only entitled to the benefit of such remedies, rights, or other advantages, as the assured would himself be able to enjoy.[329] If, apart from agreement or compromise, the assured has no right of action which he could not take, then the insurer can be in no better position. The best illustration of this principle was found in *Simpson v. Thomson*[330] in the House of Lords, where the respondents were underwriters who had paid Mr. Burrell in respect of the loss of his ship *Dunluce Castle* upon her abandonment as a total loss. She had been run down and sunk by the ship *Fitzmaurice* off Lowestoft while *en route* from London to Leith. The collision was due to the negligence of the master of the *Fitzmaurice.* The situation was, however, peculiar in that Mr. Burrell owned both vessels. Mr. Burrell paid into the court a fund equivalent to the Sunk ship's tonnage limitation under the Merchant Shipping Acts for the purpose of restricting his liability to all the claims raised from the appellant cargo owners who had suffered loss by collision. However, the respondent underwriters claimed for a share of the funds but were resisted by the appellant cargo owners. The crucial issue in the case is that whether the respondent underwriters had a right against Mr. Burrell. The Court of Session decided in favour of the underwriters on the principles that upon abandonment for total loss all rights of property incident to the vessel should be deemed to pass by operation of law to underwriters. On appeal, the House of Lords reversed the decision that the underwriters had no such right under such circumstance of the case.

[329] See: *Castellain v. Preston,* (1883) 11 QBD 380 at 388, per Brett L. J, where he said that the doctrine of subrogation must be carried to the extent ...as between the insurer and the assured, that the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for capable of being insisted on or already insisted on....

[330] (1877) 3 App. Cas. 279.

The first reason given concerned the nature of subrogation: the right of action for damages must be asserted, that is that the proceedings should be brought in the name of the assured. Lord Cairns said that:[331]

"I know of no foundation for the right of underwriters, except the well known principle of law that where one person has agreed to indemnify another, he will, on making good the indemnity, be entitled to succeed to all ways and means by which the person indemnified might have protected himself against or reimbursed himself for the loss. It is on this principle that the underwriters of a ship that has been lost are entitled to the ship in specie if they can find and recover it; and it is on the same principle that they can assert any right which the owner of the ship might have asserted against a wrongdoer for damage for the act which has caused the loss. But this right of action for damages they must assert, not in their own name but in the name of the person insured, and if the person insured be the person who has caused the damage, I am unable to see how the right can be asserted at all."

He also cited the earlier cases of *Yates v. Whyte;*[332] *Manson v. Sainsbury;*[333] *Randal v. Cockran*[334] and concluded:[335]

"My Lords, these authorities seem to me to be conclusive that the right of the underwriter is merely to make such claim for damages as the insured himself could have made, and it is for this reason that(according to the English mode of procedure) they would have to make it in his name; and if this is so, it cannot of course be made against the insured himself".

[331] Ibid. at 284.

[332] 4 Bing. N. C. 272.

[333] 3 Douglas' Rep. 61.

[334] 1 Ves. Sen. 97

[335] Ibid. at 286.

The second reason concerns the nature and scope of the cover. This was again illustrated by Lord Cairn:[336]

"Either the policy by which the underwriters are bound is an insurance against perils of seas arising from the negligent navigation of any other vessel, even although that vessel belong to the person insured, or it is not. If it is not an insurance against such a peril of the sea, the underwriters should defend themselves accordingly, and decline to pay for the loss. If, on the other hand, the insurance is a contract to indemnity against the consequences of the negligent navigation of any other ship of the insured, it would be little short of an absurdity that the underwriters should in the first place indemnity the insured for the consequences of that negligent navigation according to their contract, and immediately afterwards recover the amount back from the insured as damages occasioned by the negligent navigation."

The third reason is to preserve the fiduciary relationship between insurer and insured from the deleterious effects of conflicting interests. Otherwise, for example, the insurer would be able to secure information, while representing the insured, for later use in a subrogation action against him.[337]

The decision of *the Simpson* case has been subject to doubt by Philip S. James.[338] He suggested that *the Simpson* case is not a subrogation issue but "in fact a claim in equity against Mr. Burrell which was maintainable against him without recourse to subrogation". He further commented that:[339]

"Subrogation is a means to an end, and not a right in itself: it is either a piece of machinery which enables equity to make use of the common law to vindicate

[336] Ibid. at 286.

[337] See: Clarke, *the Law of Insurance Contracts*, 3rd ed. 1997. 31-5C.

[338] Philip S. James, *The Fallacies of Simpson v. Thomson*, the Modern Law Review, Volume 34, 1971.

[339] *Supra*, p.151.

an equitable right or it is a concept(and not more), a fiction from the realm of "as if", which only serves to define the nature and extent of an equitable right..... Subrogation presupposes three parties, one entitled, another liable and a third 'first liable' against whom the one entitled may claim because he has an equity to that end. The equity, however, being a thing of its own does not depend upon the accident of the presence of some third party against whom one has to borrow 'shoes' to 'stand in'; it may also arise where no more than two people are involved. In such a case subrogation becomes not merely a superfluous fiction--a piece of 'as if' -- something simply irrelevant".

He suggested that the decision of *the Simpson* case will certainly cause confusion and injustice.[340] As to the confusion, *Castellain v. Preston* was referred to and compared. In the *Castellain case*, it was clear that the insurer was entitled to recoup in equity from the assured in respect of the insurance moneys paid. Likewise, the *Simpson* case produced an unjust result upon the ground that Mr. Burrell, being at fault, was the party first liable; and that payment of the insurance moneys raised an equity in favour of the underwriters so as to deprive him of the advantage of going free for his wrong.

James's analysis does not seem pointless. Indeed, the reasoning of House of Lords in *Simpson case* that the insurer is not able to sue the assured himself is at least arguable. If that is the case, it would be inequitable if the insurer after paying the loss of one ship is not able to claim against the wrongdoer who caused the loss. There would be no problem in *Simpson's case* in awarding the insurer subrogation rights if the collision did not happen between vessels in the same ownership. If, however, two ships in the same ownership were insured by different insurers, the obstacle would be the same as in *the Simpson* case. What is the difference between a collision with the assured's own ship and a collision with a third party's ship? If the decision of *Simpson case* is rightly decided, then the insurer of *Fitzmaurice* if different may be unjustly enriched at the expense

[340] *Supra*, p.153.

of the *Dunluce Castle's* insurer. The writer would prefer James's suggestion that *the Simpson* case is a case based on equity rather on the subrogation. In practice, sistership vessels are treated as vessels of different ownership for the purposes of the colliding liability clause. This is now embodied in Institute Clauses as the Sistership Clause[341] which provides that " should the vessel hereby insured come into collision with or receive salvage services from another vessel belonging wholly or in part to the same owners or under the same management, the assured shall have the same rights under this insurance as they would have were the other vessel entirely the property of owners not interested in the vessel hereby insured, but in such cases the liability for the collision or the amount payable for the services rendered shall be referred to a sole arbitrator to be agreed upon between the underwriters and the assured." Moreover, under American law, the real party interest rule[342] may enable the insurer to sue in his own name in the proceedings, then, it would be possible to 'see how the right can be asserted'.

5. **Against the co-assured**

Where two or more persons are insured in a single policy, the policy may be joint or composite. The distinction appears to be based on the nature of the interests of the assureds. If the assureds share a common interest in the insured subject matter, for example where they are joint owners of property, the policy is joint. By contrast, if the parties have different interests, as in the case of a landlord and tenant or a mortgagor and mortgagee or contractor and sub-contractor, the policy is composite. The parties insured under the joint or composite policy are the co-assureds. The principle that subrogation cannot be obtained against the insured himself is found in *Simpson v. Thomson* as discussed above. However, difficulties have also arisen as to whether the

[341] Clause 9 of ITC Hulls 95.

[342] This rule would be further examined below.

insurer could be subrogated to a claim by one co-assured against the others. Particularly, in the case of composite policy.

a. Subrogation rights under joint policy

In a case of a joint policy, the insurable interests of the joint assureds are identical, and extend to the entire subject matter insured. If a claim occurs, the co-assureds have an identical claim to indemnity as they have undivided interests in the subject matter. Likewise, if the insurer is under a strict liability to indemnify one of the co-assureds under the policy even if the loss was caused by negligence of a co-assured, he is not entitled to claim against the other by way of subrogation.[343] This rule may follow the principle of subrogation rights against the assured himself as discussed above. However, the breach of duty by one of the co-assureds may lead to the entire policy being avoidable.[344] By contrast, the wilful misconduct of one co-assured will prevent the other co-assured from recovering under the policy. This is based on the general principle of insurance law that an assured wilful misconduct caused or contributed to his loss may render the policy avoidable. This is not by application of subrogation principles but simply because misconduct of one joint assured has extinguished

[343] However, little authority has been cited for this contention. It is submitted that there is an implied term in the joint policy that the insurer is not entitled to claim the jointly co-assured.

[344] As inferred from the judgment of *Woolcott v. Sun Alliance* [1978] 1 Lloyd's Rep. 629. that had the parties been joint owners of the insured premises and one of them had failed to disclose a material fact(even if known only to him), the insurer would have been at liberty to avoid the entire policy. See also *Advance (NSW) Insurance v. Matthews* (1989) 166 CLR 606. There is an obiter in a Canadian case in *Commonwealth v. Imperial* (1976) 69 D. L.R. (3d) 558, De Grandpre J. after citing the case of *Simpson v. Thompson* (1877) 3 App. Cas. 279 said that: "In the case of true joint insurance, there is, of course, no problem; the interests of the joint insured are so inseparably connected that several insureds are to be considered as one with the obvious result that subrogation is impossible. In the case of several insurance, if the different interests are pervasive and if each relates to the entire property, albeit from different angles, again there is no question that the several insureds must be regards as one and that no subrogation is possible".

all rights under the policy. Under the MIA 1906, s.55(2) has the similar effect that "the insurer is not liable for any loss attributable to the wilful misconduct of the assured". "It may well be that, when two persons are jointly insured and their interests are inseparably connected so that a loss or gain necessarily affects them both, the misconduct of one is sufficient to contaminate the whole insurance".[345] However, a peculiar issue is less clear as to whether one co-assured commits a wrongful act contrary to wishes of the other.[346] This could happen in joint ownership of property insurance, for example, where an estranged husband deliberately sets fire to jointly owned property. It is arguable that the husband's wrongful act of arson is operative to divide the joint tenancy and to give the parties equal but divided rights in the subject matter under an equitable or legal tenancy in common, so that for insurance purposes the policy becomes composite rather than joint.[347] In New Zealand, the problem has been overcome by the court construing the policy as composite rather than joint despite the parties' joint ownership of the insured subject matter.[348] The subrogation rights under the composite policy will be discussed below.

b. Under composite policy

It has been less clear whether the insurer, after paying for the loss, can be subrogated to claims against the co-assured whose fault or wilful misconduct has caused the loss in the name of the other co-assured under a composite policy. The question was first addressed by Lloyd J in *The Yasin,*[349] in that case the charter party provided that the defendant shipowner should take out

[345] *Phillips' Law of Insurance*, Vol. I, s.235. As seen in *Samuel v. Dumas* (1924) 18 Li. L. Rep 211 H.L.). per Viscount Cave at p214.

[346] As far as the marine insurance is concerned, no authority could be cited in this respect. It seems the issue has never brought to the decision of the court.

[347] This situation is discussed in detail in Gray, *Elements of Land Law,* .p317.

[348] *Maulder v. National Insurance Co of New Zealand* [1993] 2 NZLR 351.

[349] [1979] 2 Lloyd's Rep 45.

insurance for the cargo receiver and paid the premium as well. After paying the loss of cargo to the cargo receiver, the insurer plaintiff sought recovery against the negligent defendant shipowner. The defendant pleaded, *inter alia*, that the shiopowner and the cargo receiver were co-assureds under the policy and that the insurer could not exercise a right of subrogation in the name of one assured against a co-assured under the same policy. The learned judge rejected the argument that there was any general principle which prevented an insurer from exercising subrogation rights against a co-assured. In his judgment, "the reason why an insurer cannot normally exercise right of subrogation against a co-assured rests not on any fundamental principle relating to insurance, but on ordinary rules about circuity. In the present case, a claim in the name of the plaintiffs might well have been defeated by circuitry if the insurance had purported to protect the defendants against third party liability".[350] He drew a distinction between a policy under which parties have insured their respective interests in property, and a policy in which one party has insured property and the other party has insured against liability for damage to property and it was the latter case that he rejected the subrogation claims. However, in present case the fact that the defendant shipowner took out the policy was held to establish him as the mere agent of the cargo owner and not as a co-assured in a composite policy although he has a separate insurable interest on cargo as a bailee. The court found that the defendant shipowner had not established any sufficient intention to insure any interest of his own in the goods as bailees.

The principle of circuitry was further extended in case of separate interests of co-assureds under property policy. In *Petrofina v. Magnaload,*[351] contract works were insured by the head contractor in his own name and in the name of the employer and of all sub-contractors. Property on the site was damaged by a sub-contractor, and the insurer having paid the owners claimed subrogation rights against the sub-contractor. The sub-contractor contended that the insurers had no right of subrogation because they were themselves fully insured under the

[350] Ibid. at p55.

[351] [1983] 2 Lloyd's Rep 91.

policy. In this case, Lloyd J. abandoned his distinction between these two types of policy in *the Yasin* and extended the circuity rule equally applicable where parties had both insured their respective interests under a property policy:[352]

"Thus where a bailee is insured against liability to the bailor, and the bailor is insured under the same insurance, it is obvious that the insurer could not exercise a right of subrogation against the bailee; circuitry would be a complete answer. But in the Yasin I went on to contrast the position where the bailee had insured, not his liability to the bailor, but the goods themselves...Whatever be the reason why an insurer cannot sue one co-assured in the name of another (I am still inclined to think that the reason is circuitry) it seems to me now that it must apply equally in every case of bailment, whether it is the goods which the bailee has insured, or his liability in respect of the goods. The same would also apply in the case of contractors and sub-contractors engaged on a common enterprise under a building or engineering contract".

However, the rule of circuity was extended by Colman J. as breach of an implied term in the contract in *Stone v. Appledore.*[353] In the case, the shipbuilders insured a ship under construction, and made sub-contractors co-assureds in respect of the entire subject matter. The sub-contractors supplied a propeller, but it was alleged by the shipowners that the propeller was defective. The sub-contractors brought an action for the price, but were met by a counterclaim by the shipbuilders in respect of losses due to delays resulting from the defective propeller. These losses had been paid by the insurers, and so the question became whether the insurers could exercise subrogation rights against the sub-contractors as their own assured. Colman J. rejected the insurer's claims on the grounds[354] that "there had to be implied into the contract of insurance a term that the insurer would not in such circumstances use rights

[352] Ibid. at 98.

[353] [1991] 2 Lloyd's Rep 288.

[354] The decision of Colman J was reversed by the Court of Appeal on other grounds. See: [1992] 2 Lloyd's Rep. 578.

of subrogation in order to recoup from the co-assured the indemnity which he had paid to the assured". He explained the reason of subrogation immunity as that:[355]

"Where a policy is effected on a vessel to be constructed and it is expressed to be for the benefit of sub-contractors as co-assured, if a particular sub-contractor negligently causes loss of or damage to the whole or part of the vessel which has been insured under the policy and the sub-contractor has an insurable interest in the vessel, it was not open to underwriters who had settled the insured shipbuilders' claim to exercise rights of subrogation in respect of the same loss and damage against the co-assured sub-contractor; to do so would be completely inconsistent with the insurers' obligation to the co-assured under the policy; The insurer would in effect be causing the insured with whom he had settled to pursue proceedings which if successful would at once cause the co-assured to sustain the loss arising from the loss or damage to the very subject matter of the insurance in which that co-assured has an insurable interest and a right of indemnity under the policy. In my judgment so inconsistent with the insurer's obligation to the co-assured would be the exercise of rights of subrogation in such a case that there must be implied into the contract of insurance a term to give it business efficacy that an insurer will not in such circumstances use the rights of subrogation in order to recoup from the co-assured the indemnity which he has paid to the assured. To exercise such rights would be in breach of such a term. In such a case the law recognizes the rights of the co-assured by enabling him to rely on his rights under the policy by way of defense in the proceedings which the insurers have caused to be commenced in breach of their implied obligation under the policy. This is an effective means of enforcing the co-assured's rights and makes it unnecessary for him to join the insurers as third parties in the action".

[355] Ibid. at 302.

The rule of circuitry was further argued in *NOW v. DOL,*[356] in which works under construction were insured by the contractor and sub-contractors under a joint names policy. The facts were that plaintiffs NOW(as sub-contractor) had agreed to supply to the defendants DOL a subsea well head completion system to be used as part of a floating oil production facility which DOL were constructing for use on the Emerald Field in the North Sea, and it had caused losses to the DOL. The insurers after settling these losses with DOL asserted their rights of subrogation under the builders all risks policy in respect of DOL's claim against NOW. The issue raised as to whether the insurers is precluded from pursuing a subrogated claim against the co-assured.

Colman J. insisted that an insurer pursuing such a claim against a co-assured would be in breach of an implied term in the policy:[357]

"For these reasons I am firmly of the view that the conclusion arrived at by Mr. Justice Lloyd in Petrofina was right: an insurer cannot exercise rights of subrogation against a co-assured under an insurance on property in which the co-assured has the benefit of cover which protects him against the very loss or damage to the insured property which forms the basis of the claim which underwriters seek to pursue by way of subrogation. The reason why the insurer cannot pursue such a claim is that to do so would be in breach of an implied tern in the policy and to that extent the principle of circuitry of action operate to exclude the claim".

The crucial issue of subrogation immunity in the case of composite policy is whether all the parties insured are intended to be insured in the same policy and whether all of them have the respective insurable interests in the subject mattered insured. The essence of circuity requires all the co-assureds to be covered in a single policy. If the policy is not intended to cover one of the co-assured or the co-assured ceases to be an assured under the policy, the

[356] [1993] 2 Lloyd's Rep. 582.

[357] Ibid. at 614.

subrogation rights will not be deprived. The intention to be covered by the policy is a matter of construction of contract of insurance.

In an earlier case *Boston v. British*[358] the appellants chartered a vessel from the owners who had taken out insurance on the vessel. That insurance contained a collision clause. As the result of collision with another vessel, the appellants had had to pay damages to the owners of that other vessel and they then sought to recover from the owner insurers. The appellants was held not to be entitled to recover under the policy as the shipower had not intended to insure on behalf of the appellants. This is a case involving a claim against the insurers and not insurer's subrogation claims against the co-assured. Likewise, in *Stone v. Appledore,*[359] at the first instance, the High Court denied the insurers recovery on the grounds that the sub-contractors possessed an insurable interest in the entire contract works and not just in the propeller. On Appeal, the Court of Appeal concluded that on the proper construction of the documents no intention was established to insure those particular sub-contractors on the part of the principal assured. Because no such intention was proved and because there was no express or implied actual authority to contract it was held that privity of contract between the sub-contractor defendants and the insurers could not be established.

In *The Yasin*, the shipowner was held to act as only an agent and there was nothing to indicate that it was anybody's intention to insure the owners' separate interest as bailees and all indication in fact were that the owners were simply fulfilling their obligation to insure the receivers' interest as owners of the cargo. In *The Petrofina* the sub-contractors co-assureds were themselves fully insured under the policy. Similarly, in *NOW v. DOL*, since DOL only intended to insure NOW against losses occurring before delivery of the goods to DOL, NOW did not enjoy cover under the policy in respect of post-delivery losses and was not therefore a co-assured under the policy so far as it gave cover

[358] [1906] A.C. 336.

[359] [1992] 2 Lloyd's Rep 578.

for post-delivery losses. Not being a co-assured, it was not entitled to the benefit of the implied term which prohibits an insurer from bringing a subrogated claim against a co-assured.

The intention of covering all the parties in an identical policy depends on the true construction of the policy and the agreement between the parties insured. The mere fact that a person is named on the policy or is a member of a class defined in the policy does not, of itself, make him a party to the contract of insurance. This was formulated by Coleman J in *NOW v. DOL* in three situations:[360]

"(i) Where at the time when the contract of insurance was made the principal assured or other contracting party had express or implied actual authority to enter into that contract so as to bind some other party as co-assured and intended so to bind that party, the latter may sue on the policy as the undisclosed principal and co-assured regardless of whether the policy described a class of co-assured of which he was or become a member.

(ii) Where at the time when the contract of insurance was made the principal assured or other contracting party had no actual authority to bind the other party to the contract of insurance, but the policy is expressed to insure not only the principal assured but also a class of others who are not identified in that policy, a party who at the time when the policy was effected could have been ascertained to qualify as a member of that class can ratify and sue on the policy as co-assured if at that time it was intended by the principal assured or other contracting party to create privity of contract with the insurers on behalf of that particular party.

(iii) Evidence as to whether in any particular case the principal assured or other contracting party did have the requisite intention may be provided by the

[360] [1993] 2 Lloyd's Rep 582 at 596.

terms of the policy itself, by the terms of any contract between the principal assured or other contracting party and alleged co-assured or by any other admissible material showing what was subjectively intended by the principal assured".

However, the principle of subrogation immunity conferred on the co-assured subject to two exceptions i.e. whether the co-assured has the insurable interest in the entire subject matter and whether subrogation claim has been caused by the co-assured's wilful misconduct.

The essence of the *Petrofina*[361] case was that each of parties had insurable interest in the entire contract works. In that case the court took the reference to a decision of the Supreme Court of Canada in *Commonwealth v. Imperial,*[362] where it was settled that at least on construction policy, all the parties in the construction works have a exhaustive insurable interest. The decision of *Petrofina* was followed by Colman J. in *Stone v. Appledore.*[363] The position was further illustrated in *NOW v. DOL,*[364] in which works under construction were insured by the contractor and sub-contractors under a joint names policy. All of the parties had an insurable interest in the entire works, so that each could potentially have insured the entire works. However, in that case, the subcontract between the contractor and the sub-contractor obliged the contractor to insure only in respect of losses occurring before goods had been delivered to the contractor by the sub-contractor. Post-delivery losses occurred as the result of the sub-contractor's default was held not to immune from a subrogation action.

Moreover, where the policy is composite, the wilful misconduct of one party precluded recovery by him but will not preclude recovery by other co-assureds.

[361] [1983] 2 Lloyd's Rep. 91.

[362] 69 D.L.R. 3rd 558(1977).

[363] [1991] 2 Lloyd's Rep 280.

[364] [1993] 2 Lloyd's Rep 528.

In *Samuel v. Dumas*[365] where a ship was scuttled by the master and crew with the connivance of the owner, the insurer who was subrogated to an innocent mortgagee was held entitled to recover against the guilty shipowner who had wilfully scuttled the vessel.

[365] (1924) 18 Li.L. Rep. 211.

Chapter VIII Loss of Subrogation

As discussed above, an insurer is merely subrogated to those rights the assured possesses in respect of loss of the subject-matter insured.[366] All pleas open to the third party against the assured are also available against the insurers. More frequently it happens that the right of subrogation vests in the insurers, but cannot be exercised in proceedings against a particular third party since the assured is himself not entitled to enjoy it, either because there is a benefit of insurance clause between the assured and the third party or an implied term precluding the assured from exercising such action. Similarly, compromise by the assured would ultimately bind the insurer's subsequent subrogation action either before or after the insurer pays the asssured under terms of the policy, although the insurer may be safeguarded by suing the assured for damages for infringing subrogation rights. Also, a right of subrogation can be lost under a void policy or restricted as to its exercise as being against the public policy or as an inequitable result notwithstanding that the insurer might still pay under the policy. This chapter will explore this potential defence available the third party in which the subrogation rights could be lost.

1. Benefit of insurance

A contract which expressly or implied confers upon the third party the benefit of insurance under a prior agreement between the assured and the third party or by reason of a trade usage incorporated into a contract between them would inevitably bar the insurer's subsequent subrogation rights. Benefit of insurance clauses have their origin in contracts of carriage. In United States, the carrier and the insurers have for many years engaged in a "battle of forms" in respect of the insurer's subrogation action against the carriers after the insurers have

[366] See Chapter VII 2.

paid out under the cargo insurance. The struggle was first triggered by the carriers inserting a clause in the bill of lading which gave them the benefit of insurance effected by the shipper. In *Phoenix Insurance Co. of Brooklyn v. Erie and Western Transportation Co,*[367] the bill of lading issued by the carrier to the shipper stipulated that "the carrier so liable shall have the full benefit of any insurance that may have been effected upon or on account of said goods". The goods were damaged due to the negligence of the carrier. The shipper's insurer indemnified the shipper for its loss and then brought the subrogation action against the carrier. It was held that a stipulation in a bill of lading giving the carrier the benefit of insurance was effective to prevent the insurer from enforcing subrogation rights. As the Court pointed out:

"As the carrier might lawfully himself obtain insurance against the loss of the goods by usual perils, although occasioned by his own negligence, he may lawfully stipulate with the owner to be allowed the benefit of insurance voluntarily obtained by the latter. This stipulation does not, in terms or in effect, prevent the owner from being reimbursed the full value of the goods; but being valid as between the owner and the carrier, it does prevent either the owner himself or the insurer, who can only sue in his right, from maintaining an action against the carrier upon any terms inconsistent with this stipulation."[368]

Although the carrier won the victory in the first instance, the insurers responded with a policy clause providing for "nonliability of the insurer upon shipment under a bill of lading giving the carrier the benefit of insurance".[369] A typical clause to this effect was found in *Inman v. The South Carolina Rly Co.,*[370] as that:

[367] (1886) 117 U.S.312, 6 Sup. Ct. 750, 29 L.Ed. 873.

[368] Ibid, at 325.

[369] *Fayerweather v. Phenix Ins. Co*, 118 N.Y, 324, 23 N. E. 192 (1890); *Hartford Fire Ins. Co. v. Payne,* 199 Iowa 1008, 203 N.W. 4, 39 A.L.R.1109 (1925)

[370] (1889) 120 U.S 128.

"In case of any agreement or act, past or future, by the insured, whereby any right of recovery of the insured against any persons or corporations is released or lost, which would, on acceptance of abandonment or payment of loss by this company, belong to his company but for such agreement or act, or, in case this insurance is made for the benefit of any carrier or bailee of the property insured other than the person named as insured, the company shall not be bound to pay any loss, but its right to retain or recover the premium shall be affected...."

Since the carriers then had nothing to gain and the shippers had much to lose by retention of the clause previously used in bills of lading, the carriers modified the clause to give the carrier the benefit of any insurance effected on the goods "so far as this did not defeat the insurer's liability".[371] However, this would still leave the insurer with problems. If the insurer paid a shipper, then the carrier still has the benefit of insurance unless the insurer acts as a mere volunteer, if the insurer did not pay a shipper, how could it maintain good business relations with an assured who wanted prompt payment from the insurer? To meet this problem, the insurers invented the loan receipt approach and the result is that the insurer pays the shipper an amount equal to the promised insurance benefits, but the transaction was cast as a loan repayable out of the prospective recovery from the carrier. This enables the insurer to win the victory. However, the "benefit of insurance" clause was subsequently held invalid as against the public policy.[372]

Benefit of insurance clause were also seen in English jurisdiction. In *the Auditor*,[373] the bill of lading containing a benefit of insurance clause was held to be binding upon the cargo insurers who were subrogated to the cargowner's claims after paying out under the cargo insurance.

[371] *Admas v. Hartford Fire Ins. Co.*, 193 Iowa 1027, 188 N.W. 823 (1922), 24 A.L.R. 182 (1923); *Richard D. Brew & Co. v. Auclair Transp., Inc.*, 106 N.H. 370, 211 A. 2d 897 (1965), 27 A.L.R. 3d 978 (1969).

[372] *Salon Serv., Inc. v. Pacific & Atl. Shippers*, 24 N.Y. 2d 700 (1969).

[373] (1924) 18 Li.L. Rep. 464.

However, if the policy provides that the insurer can avoid its obligation in the event of the benefit of the insurance passing to the carrier, the benefit of insurance clause does not operate. In *Canadian Transport Co. Ltd v. Court Line Ltd*[374] the owner by charterparty agreed to give the charterer "the benefit of their protection and indemnity club insurance so far as club rules allow". The club rules provided that "no assignment or subrogation by a member of his cover with this Association to charterers or any other person shall be deemed to bind this Association to any extent whatever". Damage was caused to cargo due to improper stowage and the liability of the shipwner was settled by the club. The club then brought the action against the time charterer in the name of the shipowners. It was awarded before an arbitrator that the shipowner was not entitled to the full amount of claim but only the excess. The award was upheld by Lewis J. at first instance. The shipowner appealed to the Court of Appeal and then it was held by majority that the shipowners were entitled to a full amount of claims from the charterer. In Scotts L. J.'s words:

"Owners will give to time charterers the benefit of insurance in case of shortage or damage to cargo if the rules of the club permit that to be done; but if the rules of the club do not permit that to be done, then this undertaking to give the time-charterers the benefit of the insurance will have no application. The promise to give it is conditional upon the club rules allowing it, and if there is a condition in the club rules which forbids it, then ex hypothesis, it cannot be done."[375]

However, in order to overcome this ruling, charterers often insert in the charterparty a clause that "the owners undertake to indemnify the charterers to the same extent that the owners would be covered by their P & I clubs". In such circumstances, the shipowners will eventually have to absorb the claim of the cargo owner.

[374] [1940] A.C. 934.

[375] (1939) 64 Li.L.Rep. 57 at 63.

The charterer then further appealed to the House of Lords. The decision was affirmed by the House of Lords as their Lordships interpreted these rules to mean that the Association did not allow shipowners to give charterers the benefit of their insurance. Consequently the benefit of insurance was ineffective and the charter was liable to the shipowner for its loss resulting from the improper stowage of the cargo.

Besides the policy restricting the assignment of the benefit of insurance to the third party, the insurer may avoid the policy by availing himself of the pleas of non-disclosure if the non-disclosure of the benefit of insurance clause by the shipper constitutes a fact "which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk or not".[376] In *Tate & Sons v. Hyslop,*[377] the assured had contracted with a lighterman to carry his goods on the basis that the lighterman's liability would be confined to damage to the goods resulting from his own negligent or wilful acts. As a result of public statements made by lightermen that henceforth they would only contract on this basis. Underwriters, to the knowledge of the insured, had set two rates of premiums, the higher one to be operative in the event that the lightermen assumed the liabilities of a common carrier, and the lower one to be used if the lighterman's liability was confined to negligence and wilful conduct. The insured took out a policy of insurance at the lower rate. The Court of Appeal unanimously held that the failure by the insured to disclose the fact that the lighterman's liability was limited to negligence and wilful conduct allowed the insurer to avoid the policy.

In the United States, failure to disclose the existence of a benefit of insurance clause does not allow the insurer to avoid the policy for non-disclosure,[378] though it has been held that, if the policy is issued prior to the bill of lading, and

[376] Section 18.2 of MIA.

[377] (1885) 15 QBD 368.

[378] *Phoenix Insurance Co. of Brooklyn v. Eire and Western Transport Co.*, supra.

the policy expressly provides that the insurer is to be subrogated to the assured's right of action against the carrier, then a benefit of insurance clause in the contract of carriage will allow the insurer to avoid policy.[379] In Australia, the assured is not under a duty to disclose to the insurer the existence of an agreement with the third party for the effect of limiting the subsequent subrogation right.[380]

Difficulties sometimes arise when the benefit of insurance is not clearly stipulated in the contract between the assured and the third party. In such circumstance, the court must construe the contract to ascertain the true intention of the parties. In *Coupar Transport v. Smith*[381] the parties agreed that the assured alone would insure against particular risks and that third party was not to do so; this arrangement was held by the court to exempt the third party for losses they would have been liable for. Similarly, in *Mark Rowlands Ltd v. Berni Inns Ltd,*[382] the plaintiff was the landlord of a building, the basement of which was leased to the defendant restaurateur. The defendants covenanted to repair the basement and to pay the landlord an insurance rent related to the premium to be paid by the landlord for insurance of the whole building. The lease contained a common provision that, in the event of fire, the tenant was to be relieved of the duty to repair and that the landlord was to use the insurance money to repair the building. The landlord insured the whole building, which was later destroyed by the fire. The insurer paid the landlord and brought action in his name against the tenant who admitted his negligence for causing the fire. The Court of Appeal found that the insurance was taken for the joint benefit of landlord and the tenant as the construction of the lease and the effect was to substitute the fire insurance for exempting tenant from liability of negligence, it followed the insurer could not be entitled to be subrogated the landlord's claim against the tenant.

[379] *Carstairs v. Mechanic's and Trader's Insurance Co. of New York* (1883) 18 F. 473.

[380] Section 68 of Insurance Contracts Act 1984.

[381] [1959] 1 Lloyd's Rep. 369.

[382] [1986] 1 QB 211 (CA).

In this case, the court relied on decisions of the Canadian Supreme Court in construing the lease for the benefit of the tenant. In *Ross Southward Tire Ltd v. Pyrotech Products*[383] leased premises were destroyed by a fire caused by the negligence of a tenant. The fact that the tenant paid the premium of the insurance which taken out by the landlord was held to be intended that the landlord would only seek the compensation for its loss from the insurance. Likewise, in *Eaton Co., Ltd v. Smith*[384] leased premises were destroyed by a fire which resulted from the negligence of employees of the tenant. The lease contained the usual covenant on the part of the tenant, "wear and tear and damage by fire, lightning and tempest only excepted". This phrase does not include fire damage negligently caused by the tenant or its employees. It was held that the tenant had the benefit of the insurance and loss to the premises was to be borne by the insurer. In *Agnew-Surpass Shoe Stores Ltd. v. Cummer-Younge Investment Ltd*[385] the lease which required the lessee to take good and proper care of the leased premises, "except for reasonable wear and tear...and damage to the building caused by perils against which lessor is obliged to insure thereunder" was construed to preclude a claim by the leasor or its subrogated insurer against the lessee for fire damage to the building caused by the negligence of the lessee's employees.

Similarly, in a Scottish case *Barras v. Hamilton*[386] the landlord covenanted to insure the basement of a building and the tenant agreed to pay the cost of the premiums to the landlord. There was no reinstatement obligation imposed on the landlord. It was held that the landlord had no cause of action against the tenant following the allegedly negligent destruction of the basement by the tenant.

[383] (1975) 57 D.L.R. (3d) 248.

[384] (1977) 92 D.L.R. (3d) 425.

[385] [1976]2 S.C.R. 221.

[386] (1994) *The Times*, 10th June. Cited from Merkin, Insurance Contract Law, issue 25. C4.3-67.

In above cases the courts construed the lease to be intended to benefit the tenant of the insurance though not straightforward but it is true that the court has taken great care to limit such litigation by curtailing normal subrogation rights. However, if there is no express provisions in the lease between the landlord and the tenant, does the court give the same effect? Charles Huband questioned the decisions as he pointed out:[387]

"One might well ask: when are subrogation rights left intact? When there is a covenant on the part of the lessee to pay the insurance costs, subrogation rights vanish. When there is a covenant on the part of the lessor to insure, subrogation disappear. It would seem that subrogation rights will survive only if there is no written lease, or if the written lease does not contain a covenant imposing the obligation to insure on the landlord or the obligation of paying for insurance upon the tenant."

Similar decisions can be found in the United States, where courts have emphasised that it would "be undue hardship to require a tenant to insure against his own negligence, when he is paying, through his rent, for the fire insurance which covers the premises".[388] From the benefit of third party of the insurance it may be further inferred that the third party is co-insured under the policy and thus debar the insurer for subrogation against co-assured as discussed above. However, if the beneficiary third party is not intended to be insured in respect of the loss in question, then he can not rely in the benefit of insurance even if he is a co-assured in the contract.[389]

2. Waived by the insurer

[387] Charles R. Huband, *The Gruda (and Illogical) Demise of Subrogation Rights(1979)* 9 Manitoba Law Journal 147 at 155

[388] *Community Credit Union v. Homelvig*, 487 NW 2d 602; *Dix Mutual Ins Co v. LaFramboise*, 597 NE 2d 622.

[389] *NOW v. DOL*, [1993] 2 Lloyd's Rep. 582.

Insurers may sometimes voluntarily agree not to exercise subrogation rights either in a term of the policy as a waiver clause, or in an agreement of settlement with the third party. Alternatively, the insurers may simply waive the subrogation rights in general term among the insurers themselves, such as "gentleman agreement"[390] and "knock for knock" agreement.[391]

The waiver clause can be seen in *Thomas v. Brown*,[392] where the policy contained a "without recourse to lightermen" clause. The subrogation cargo owner was held not to be able to pursue any action against the lightermen as the effect of the waiver clause implies that the lightermen would not be liable for any loss that could be insured against.

In *Tenneco Oil Co., v. Tug Tony and Coastal Towing Corp*[393] the plaintiff cargo owners entered into a charter-party with the defendant carrier, for the carriage of cargo from the Brownsville to Chalmette. The plaintiffs took out the policy which provides, *inter alia,* that :

"Privilege is granted the assured hereunder to waive subrogation prior to a loss against parties with whom the assured has a working agreement."

Meanwhile, the charterparty also provided an insurance clause:

[390] This was the effect of the decision of *Lister v. Romford* [1957] AC 555. The agreement is that the British Insurance Association and Lloyd's , as the liabilities insurers, agreed not to pursue claims in an employer's name against a negligent employee to recoup money paid out to indemnify the employer against a third party claim by a fellow employee based on the negligence of the employee. In Australia, the effect of *Lister v. Ramford* has been reversed by the Australia Insurance Contract Act at s.67.

[391] However, the agreement has been finally suspended as the decision of *Hobbs v. Marlowe* [1977] 2 ALL E R. 241.

[392] (1889) 4 Com. Cas. 186.

[393] [1972] 1 Lloyd's Rep. 514.

"Hull and P & I coverage shall be carried with first class underwriters by Owners for Owner's account. Cargo insurance shall be procured by the charterer for the account of and at the expense of the charterer and owner of the cargo, and all rights of subrogation shall be waived by the cargo insurance against all equipment and Owners and Operators thereof."

The plaintiffs' cargo was loaded by the plaintiffs into unmanned barges and taken in tow by the carriers' tug Tony. In the course of the tow, due to the negligence of the carrier, one of the barges was involved in a collision resulting in loss of part of the cargo. The plaintiffs contended that the total value of the lost cargo was $11,453. The plaintiffs made a claim against the underwriters and were paid $6845 of the total alleged loss. The cargo owners sought to recover the balance from the carriers. It was held that the cargo owner had been reimbursed for loss by the insurers and the subrogation waiver clause would prevent him or the subrogated insurer from recovering against the carrier.

Likewise, In *The Surf City,*[394] a cargo of naphtha was insured by KPC, the policy providing that no right of subrogation was to be exercised by the insurers against any vessel on which the insured cargo was being carried, provided that the carrier was a subsidiary or affiliated company. The cargo was sold to E on CIF terms, which meant that E also became the assignee of the policy. The cargo was lost due to the alleged negligence of the carrier C which was in the same group of companies as KPC. The case turned on the proper construction of the subrogation waiver clause. The carrier argued that the clause applies to affiliated companies of the original assured KPC, whereas the insurers argued that the clause applied only to affiliated companies of the person actually indemnified by the insurers. Clark J. held that the assignment of the policy did not necessarily deprive KPC of the benefits of it, and therefore the carriers was an intended beneficiary of the subrogation waiver clause. The waiver clause

[394] [1995] Lloyd's Rep. 242.

precluded the insurers from enforcing the subrogation rights against the carrier notwithstanding that the carrier is not a party to the insurance contract.

A subrogated insurer may also be deprived of subrogation rights by entering into an agreement with the third party wrongdoer limiting the subsequent liability to a specific amount. In *Kitchen Design v. Lea Valley*[395] a water main owned by LV burst and flooded KD's premises. KD was insured with QBE against property damage and business interruption, and received from QBE some £18,500 in settlement of KD's claim for property damage. QBE then entered into a settlement with LV not to pursue any subrogation against LV in connection with LV's liability due to the burst of water main. Subsequently, KD presented a further claim for £17,224 against QBE, in respect of consequential loss. QBE, having paid KD, sought to exercise subrogation rights against LV. It was held that the settlement agreement with LV prima facie precluded an action by QBE as it was clearly intended to extend to all claims arising out of the burst, including future claims which had not been put forward at the time of the settlement. The issue raised as to whether QBE was authorised to settle this claim with LV and the Court was no difficulty in finding that the relevant provision in the policy was sufficient to confer upon QBE the power to bind KD.

3. Released by the assured

It has been held that the assured who is partly indemnified by his insurer would remain *dominus litis* but must act *bona fide* to consider the insurer's interests. The insurer can not prevent the assured from entering a binding agreement with the third party for compromising the loss. In case the assured has been fully indemnified under the policy, he may still have the right to claim against the third party if he so chooses but hold on trust for the insurer. However, the

[395] [1989] 2 Lloyd's Rep. 221.

assured is subject to "one aspect of the general principle that, once rights of subrogation exist or potentially exist for the benefit of the insurers, the insured must not do anything which might prejudice those rights on pain of his being liable to repay to the insurers as damages the amount which the insurers have paid or, where appropriate, of the insurers being able to avoid liabilities".[396] The insured is thus under a duty not to prejudice or compromise the insurer's right of subrogation. If the assured does so act, the insurer would be entitled to remedy in restitution against the assured for prejudice of the subrogation rights. A compromise entered into between the insured and the third party wrongdoer will normally bind the insurers. Such compromise whether agreed before or after indemnity by the insurers, may amount to a breach of duty of the assured.

a. Before indemnity by the insurer

It is settled that the insured cannot exercise subrogation rights until the assured has been fully indemnified. Before the insurer's payment, the assured remains *dominus litis*. It has also been held that the insurer has a contingent right as soon as the policy is entered into,[397] but such right cannot be exercised until the insurer indemnified the assured's loss. Therefore, the insurer does possess limited rights prior to his making full payment under the policy. Section 79 of Marine Insurance Act provides that the insurer is subrogated to all rights and remedies of the assured in and in respect of that subject matter as "from the time of the casualty causing the loss". This clearly confers upon the insurer a contingent rights of subrogation after the loss. Thus, after a loss has occurred but before the insurer has made payment, any release or settlement made by the assured with the third party wrongdoer to the prejudice of the insurer will entitle the insurer to set up, in answer to the assured's claim, a counterclaim for damages in the amount of the loss thereby suffered by the insurer. The insurer may avoid the contract if the contract prohibit form so doing. However, the

[396] J. Birds, *Modern Insurance Law*, 4ed. 1997. p.297-298.

[397] *Boag v. Standard* [1937] 2 KB 113.

assured is not precluded from setting a doubtful claim in good faith for the benefit of himself and his insurers, and such a settlement is not a defence to his claim on the policy in the absence of an express term forbidding such conduct.

If after the inception of the policy before any loss has occurred, the assured entered into an agreement with the third party wrongdoer which has the effect of exempting the insurer from any subrogation rights, it is possible that the assured might face liability in damages to the insurer for entering a pre-loss agreement of this nature. As inferred from the *Boag v. Standard*[398] that the insurer's subrogation rights come into existence as soon as the policy is entered into, this implies an obligation on the assured prior to payment to take all reasonable steps to preserve the efficacy of his remedy against the third party. However, English law is far from clear as to whether in the absence of an express clause, there is any obligation on the assured to take active steps to prosecute a claim against a third party, so as to stop it becoming time barred. In practice, an express clause in the policy would impose an obligation on the assured to take any active steps to prosecute claims or to preserve time limit prior the payment. For example, Clause 16 of Institute Cargo Clause which provides that:

16. It is the duty of the assured and their servants and agents in respect of loss recoverable hereunder

16.1 to take such measures as may be reasonable for the purpose of averting or minimising such loss, and

16.2 to ensure that all rights against carriers, bailees or other third parties are properly preserved and exercised

[398] [1937] 2 KB 113.

and the underwriters will, in addition to any loss recoverable hereunder, reimburse the assured for any charges properly and reasonably incurred in pursuance of these duties.

It is submitted that the effect of this clause is to give the underwriters a cross-claim for damages, which in appropriate circumstances may amount to a full defence to a claim under the policy, in any case where the assured has failed to preserve a time limit against the third party, or has committed some other breach of the obligations imposed by the clause.[399] It is however, arguable that the effect of the Reasonable Despatch Clause in the Institute Cargo Clauses has the similar effect. The editors in the *Arnould's law of marine insurance* suggested[400] that "the reasonable Despatch Clause does not have such a far reaching effect, since it is not possible to equate the need to issue a protective writ within a fixed period with the need to act with reasonable dispatch, but as the clause has yet to be judicially construed, the point remains uncertain."

b. After indemnity by the insurer

If the assured makes a release or settlement with the third party wrongdoer after he has been fully indemnified by the insurer, then he loses the right to control the proceedings brought in his name against the third party wrongdoer. He thus has no longer the right as against the insurer to reach any settlement with the third party wrongdoer, even he is acting in *bona fide*, but in that case the insurer would find it difficult to prove that he has suffered any loss. In case of partial indemnity, the assured still controls the proceedings and would be entitled to settle with the third party and any settlement would discharge the insurer's subsequent subrogation rights if any, however, the assured must act *bona fide* considering the insurer's interests for avoiding the prejudice of the insurer's

[399] *Arnould's Law of Marine Insurance,* 16th ed. v.1.para1320.

[400] *Arnould's Law of Marine Insurance,* 16th ed. v.1 para1320.

rights. There are *obiter dicta* that the assured owes an equitable duty to the insurer to safeguard his subrogation rights.[401]

As the insurer acquires no cause of action against the third party wrongdoer after payment[402] and a release by the assured, even when he has obtained a full indemnity, will similarly preclude the insurer's subsequent subrogation actions. In case of a release by the assured, he will be liable to compensate the insurer for the amount by which the insurer's right of subrogation were diminished. The insurer may recover from the assured under either of two possible theories: (1) in equity under the theory that the assured becomes a trustee of the fund paid by the tortfeasor for the insurer; and (2) at law under the theory that the law creates on the part of the insured an implied promise to repay an amount paid as indemnity for damages suffered when the party who caused the damages has also made them good to the injured party.[403] In *West of England Fire Insurance Co. v. Isaacs*[404] a landlord covenanted to insure the demised premises against fire and spent any money received under the insurance on reinstatement of fire damage. A fire occurred as a result of which the tenant had the choice of calling upon either the landlord under the covenant or upon his own insurer. Having chosen the latter course of action and the insurer having paid, the tenant then renounced his rights as against the landlord, thus discharging the insurer's subrogation rights. It was held that the insurer was entitled to restitution from the assured of the indemnity paid.

[401] James L. J. in *Commercial v. Lister* (1874) L.R. 9 Ch App. 483 at 486 -487 considered that an insured settling his action without due regard for the interest of the insurer would be in breach of an equitable duty. See also: Bennett, Howard, *The law of Marine Insurance*, 1996, para 19.3. Derham, *Subrogation in Insurance Law*, Chapter 11, the duty of the assured.

[402] In U.S. A, it was held that by subrogation the insurer is vested absolutely with a proportionate share of the claim, and a discharge given by the insured does not effect the insurer's right. See: *Sisson v. Hassett*, 155 Misc. 667, 280 N.Y. Supp. 148 (Sup. Ct. 1935).

[403] Cecil G. King, *Subrogation under Contracts Insuring Property*, Texas Law Review , Vol.30, 1951, p.88.

[404] [1896] 2 QB 377 affd. [1897] 1 QB 226.

However, it was held that a third party who is aware or constructively aware of the insurer subrogation rights may not be able to plead the settlement in defence to a subrogation action by the insurer.[405] It is further submitted that a release by the assured, with the knowledge of third party that the assured have received payment from the insurer, will be deemed to be in fraud of the insurer's rights and consequently void.[406]

Conversely, on similar principles, the insurers must not, by the manner in which the exercise a right of subrogation, act in such a way as to prejudice the assured; thus if the insurers were to settle a claim against a third party on unfavourable terms, in a case where the third party was liable for an amount greater than the measure of indemnity under the policy, the assured would, it is submitted, have a claim for damages against the insurers. In *Groom v. Crocker*[407] it was accepted by Sir Wilfrid Greene M.R that a liability insurer controlling the defence of an action brought against its insured must consider not only its own interests, but also those of its insured. It is submitted that the insurer similarly owe an equitable duty to consider *bona fide* the insured's interests, in particular, in the event of under-valuation in a valued policy.

4. Split of cause of action

[405] *Haigh v. Lawford* (1964) 114 NLJ 208. In American cases: *City of N.Y. Ins. Co. v. Tice*, 159 Kan. 176, 152 p.2d 836 (1944); *Wolverine Ins. Co. v. Klomparents*, 273 Mich. 493, 263 N.W. 724 (1935); *General Exchange Ins. Corp. v. Young*, 357 Mo. 1099, 212 S.W.2d 396 (1948); *Pacific Fire Ins. Co. v. Smith*, 219 S.W. 2d 710(Tex. Civ. App. 1949).

[406] *Arnould's Law of Marine Insurance,* 16th ed. v.1.para1320. Meanwhile, the editors submitted that there is no reason in principle why a settlement reached in advance of the payment by the underwriters, if made by the third party with knowledge that its effect is to prejudice their rights, should not also be treated as void. It may also open to the underwriters, in a appropriate case, to claim damages in their own right against the third party for tortious interference with their rights under the contract of insurance.

[407] [1939] 1 KB 194.

A practical problem arises where an assured who is underinsured or only insured for one type of risk. The assured would remains *dominus litis* even after he has been indemnified under the policy. Thus, if the assured proceeds only for his uninsured loss and obtains a judgment , it follows that the insurer may be unable to take advantage of a cause of action against a wrongdoer again, if that cause of action has already been prosecuted to judgment. The principle that damages resulting from one and the same cause action must be assessed and recovered once for all. *Nemo pro eadem causa debt vexari.*

In *Buckland v. Palmer*[408] the plaintiff assured's car was insured under a policy provided for a £50 excess. The car was damaged in a collision caused by the defendant's negligence, and the plaintiff, having been informed by his insurer that they would meet the claim in full subject to the excess, brought the action for the excess. The defendant paid the sum into the court and the action was stayed. The insurer subsequently commenced the action against the defendants for the insured loss and it was held the latter action was in fact an abuse of the process of court and should be struck out as the first action had not proceeded to judgment. It remained open to the insurers to apply for the revival of the original action and its extension to cover both uninsured and insured loss. However, the court retains a discretion to set aside the original judgment in exceptional case if justice so requires. This was considered by the Court of Appeal in *Hayler v. Chapman*[409] In that case H's car was written off in a collision with C's car. H was paid the write-off value of his car by his insurers, but was not sufficient to give him a full indemnity, as part of the value was uninsured. Consequently, and without informing his insurers, H commenced county court proceedings against C for the uninsured balance; this was referred to arbitration by the registrar, judgment was ultimately awarded to H, and this was satisfied by C's liability insurers. Subsequently, H's insures commenced subrogation proceedings against C in H's name. The Court of Appeal struck out

[408] [1984] 3 ALL ER 554.

[409] (1988) *The Times*, 11th November. Cited from Merkin, The Insurance Contract Law, Issue 4.

the subrogation action held that a second action should be permitted only where it would be unjust and equitable for the first action to stand. The court observed that no injustice had been caused to H's insurers.

If however the assured reaches a settlement with the third party for uninsured loss, the insurer will not be bound by the settlement. In *Taylor v. O'Wray & Co Ltd,*[410] the plaintiff was responsible under his motor cover for excess of £10 and was not insured at all against personal injury or consequential loss. Following a collision with a lorry, which was at fault, his claim against the owner of the lorry, which included items for the excess and for consequential loss, was settled. In a subsequent action in respect of the insured loss, the owner of lorry defended, saying that the right of action in respect of that loss had been lost when the previous claim had been settled. It was held that the subsequent subrogation claim for the insured loss was not extinguished by an agreement relating to the uninsured loss only.

It has been argued that the cause of action could be split. For instance, in motor insurance, the car damage and personal injury are essentially separable, therefore, the action for uninsured loss would not prevent the further subrogation action by the insurer. In United States, the majority rule appears to be that a single act or omission which causes injury to the assured and to the property of the assured constitutes a single cause of action with separate items of damage; hence, separate actions may not be maintained by the assured by the assured for personal injury and by a subrogated insurer for property damage. A recovery of a judgment for either item of damage is held to bar an action to recover the other item.[411] However, a minority of jurisdictions hold that damage to person and to property are infringements of different rights giving rise to different causes of action; settlement or judgment in one of the causes of

[410] [1971] 1 lloyd's Rep. 497.

[411] *Dearden v. Hey,* 304 Mass, 659, 24 N.E. 2d 644 (1939); *Booth v. Frankenstein*, 209 Wis. 362, 245 N.W. 191 (1932).

action is not considered a bar to the other.[412] When a wrongdoer has notice of an insurer's claim or subrogation right, he is either estopped from asserting or is deemed to have waived his right to invoke the rule against splitting causes of action as a defence.[413]

5. Inequitable

The rights of subrogation may be denied as it would not be just and equitable for allowing subrogation action. In *Morris v. Ford*[414] Cameron contracted to clean at Ford's works. A term of this contract provided that Cameron would indemnify Ford in respect of any liability attaching to Ford for negligence of the employees of either of them. Morris, an employee of Cameron, was injured by an employee of Ford for whom Ford may have been liable. Ford claimed an indemnity from Cameron under the term and Cameron in return claimed to be subrogated to Ford's right to sue its employee for failing to take reasonable care and skill. Lord Denning M.R stated that it was not just and equitable for Ford to be compelled against their will to sue their own servants and that since doctrine of subrogation was a creature of equity, it could not be used for inequitable purposes, while James L.J preferred to rest his decision on the view hat there was an implied term in the contract of indemnity that the cleaners should not have any rights of subrogation.

This case was directly contrary to the decision of *Lister v. Romford*[415] where the father and son were both employed in the same company. The son negligently injured the father while driving a vehicle on company business and the father recovered damages from the company. The company then sued the

[412] *Hoosier Casualty Co. v. Davis,* 172 Ohio St. 5, 173 N.E. 2d 349 (1961); *Wilson v. City of Portland,* 153 Or. 679, 58 P.2d 257 (1936).

[413] *Donegal Mutual Insurance Co. v. Silverblatt,* 36 Pa. D & C 2d 394 (1964).

[414] [1973] QB 792.

[415] [1957] AC 555.

son as a joint tortfeasor and for breach of his contract of services. It was held by House of Lords that the company was entitled to recover. However, this decision was subject of criticism and it would be clearly that the court in *Morris v. Ford*[416] was aware of the criticism. The effect of *Lister* decision has now been negatived by the "gentleman agreement" among the employers' liability insurers, where it provides:

"Employers' liability Insurers agree that they will not institute a claim against the employee of an insured employer in respect of the death of or injury to a fellow-employee unless the weight of evidence clearly indicates (I) collusion, or (ii) wilful misconduct on the part of the employee against whom a claim is made."

6. Void Policy

If the contract of insurance is void or illegal or a nullity, it is unlikely that a court will hold that an insurer is subrogated to the rights of an insured who has been indemnified and it has been held that an insurer is not entitled to be subrogated to any rights arising out of a p.p.i policy, even though he has made a payment under it, since such a policy is avoided *in toto* by the virtue of Section 4 of Marine Insurance Act 1906.[417]

[416] [1973] QB 792.

[417] *John v. Motor* [1922] 2 KB 249.

Chapter IX Subrogation Compared to Abandonment, Assignment and Contribution

1. Subrogation and abandonment

Subrogation and abandonment are very closely related. "Abandonment is a corollary of the doctrine of subrogation which is a necessary incident of every contract of indemnity";[418] while Arnould pointed out[419] that "the doctrine of subrogation is closely related to that of abandonment". Likewise, Merkin had the view[420] that the doctrine of abandonment is "in its origins linked to the doctrine of subrogation, and shares with subrogation the objective of preventing the assured from obtaining more than an indemnity; it is frequently regarded as a sub-rule of the general principle of subrogation". Confusion of these two doctrines has been found both in the Act and in the court decisions. Much has been discussed above in respect of the doctrine of subrogation, and before a comparative study of these two doctrines, the doctrine of abandonment will be first examined.

a. Doctrine of abandonment

The word "abandon" has no definition under the Marine Insurance Act 1906. "The word 'abandon' is one in ordinary and common use, and in its natural sense well understood; but there is not a word in the English language used in a more highly artificial and technical sense than the word 'abandon'; in reference to constructive total loss, it is defined to be a cession or transfer of the ship from

[418] *Chalmers on Marine Insurance*, 9th Ed., at p 95. See also, *Simpson v. Thomson* (1877) 3 App. Cas. at 292, 293 per Lord Blackburn; cf *Rankin v. Potter* (1873) LR 6 HL at 118; *Kaltenbach v. Mackenzie*, (1878) 3 CPD at 471, per Lord Esher.

[419] *Arnould's Law of Marine Insurance and Average*, 16ed. at para. 1298.

[420] R. Merkin, *Insurance Contract Law*, Issue 2, C4.2-01.

the owner to the underwriter, and of all his property and interests in it, with all the claims that may arise from its ownership, and all profits that may arise from it.'[421]

Scott L. J in *the Lavington Court*[422] clarified three different senses of the word "abandonment" under the Marine Insurance Act 1906, as he said:[423]

"It (the word of 'abandonment') is used three different senses in the very group of sections which deal with constructive total loss. Indeed, it is used in two different senses in Sect. 60(1). When the ship is spoken of as abandoned because of 'actual ...loss appearing unavoidable,' the word is used in nearly the same sense as when, according to the law of salvage, the ship is left by master and crew in such a way as to make it a derelict, which condition confers on salvors a certain, but not complete, exclusiveness of Possession, and a higher measure of compensation for salvage services."

He went on further in Section 61 and 63:

"In Sect. 61 the word 'abandonment' seems to import an act on the part of the assured, but in truth it amounts usually to nothing more than his making up his mind to give a notice of abandonment to insurer under sect. 62(1), at the peril of losing his right of election under sect.61. The legal consequences of a notice of abandonment if accepted by, or established as valid against the insurer is to pass the property to the underwriter to the underwriter as an abandonment to him under sect.61. A valid 'abandonment' in sect. 63 necessarily means an abandonment by the assured to the insurer to the insurer and passes the property to him. It cannot be the same act as is contemplated by sect. 60(1) where the act is done in consequence of an actual total loss appearing unavoidable."

[421] *Rankin v. Potter*, (1873) L.R. 6 HL 83, at p 144 per Baron Martin MR.

[422] [1945] 2 ALL ER 357.

[423] Ibid at 362. See also: *Bradley v. Newsom (H.) Sons & Co.*, [1919] A.C. 16.

As far as marine insurance is concerned, the effect of a valid abandonment has been clearly defined by section 63(1) of Marine Insurance Act 1906 which provides:

"Where there is a valid abandonment the insurer is entitled to take over the interests of the assured in whatever may remain of the subject matter insured, and all proprietary rights incidental thereto."

Meanwhile, Section 79 of the Act is also contemplated that the insurer is entitled to take over the remains of the subject matter so paid for whether is a actual total loss or a constructive total loss. It seems that the assured is obliged to abandon the subject matter as soon as the insurer pays a total loss under the section. Thus, abandonment in this sense denotes the cession or transfer, which takes place, by operation of law, of whatever remains of the subject matter insured when the insurer pays a total loss. It is a corollary of the subrogation right, however, not a right by virtue of subrogation.

It is only in case of constructive total loss that the abandonment seems to be significant. 'Where there is a constructive total loss the assured may either treat the loss as a partial loss, or abandon the subject matter insured to the insurer and treat the loss as if it were an actual loss.'[424] The law thus imposes the obligation upon the assured to give notice of abandonment to the insurer.[425] "If he fails to do so the loss can only be treated as a partial loss".[426] It is suggested that the notice of abandonment is peculiar to the constructive total loss in the law of marine insurance.[427] 'In the case of an actual total loss, no notice of

[424] Section 61 of *Marine Insurance Act 1906.*

[425] It is suggested that equity does not allow the insured to retain the benefit of the remain of the subject matter while he is in the meantime fully indemnified for a total loss. See: *Rankin v. Potter*, (1873) L.R. 6HL 83 at 118, per Lord Blackburn.

[426] Section 62(1) of *Marine Insurance Act 1906.*

[427] *The Lavington Court, supra,* per Stable J. at 366.

abandonment need be given.'[428] Similarly, notice of abandonment is not necessary in case 'there would be no possibility of benefit to the insurer if the notice were given to him'.[429] 'Where an insurer has re-insured his risk, no notice of abandonment need be given by him.'[430]

It is somewhat confusing whether the abandonment is peculiar to constructive total loss in the marine insurance. Lord Ellenborough held in an earlier case in *Mellish v. Andrews*[431] that 'Abandonment is only necessary to make a constructive total loss'. However, many of scholars and decisions has been supporting that abandonment is not confined to marine insurance. Meanwhile, Arnould pointed out[432] that "abandonment is applicable to the claims whether it be for an actual loss or for a constructive loss".

As explained by Derham:[433]

"Since abandonment is not confined to marine insurance, but in fact is an incident of every contract of indemnity insurance, it should follow that, in any situation in which the subject matter of a contract of indemnity is itself a contract, an insurer paying for a total loss should have a common law right to the benefits obtainable under the contract."

Similarly, in *Kaltenbach v. Mackenzie,*[434] Brett L. J delivered the view that:

"...abandonment is not peculiar to policies of marine insurance, abandonment is part of every contract of indemnity wherever, therefore, there is a contract of

[428] Section 57(20) of *Marine Insurance Act 1906.*

[429] Section 62(7) of *Marine Insurance Act 1906.*

[430] Section 62(8) of *Marine Insurance Act 1906.*

[431] (1812) 15 East 13, at p.16. Cited from *Anrould'sLaw of Marine Insurance and Aveage*, 16ed. para 1259 at note 5.

[432] *Arnould's Law of Marine Insurance and Average*, 16ed. at para 1259.

[433] Derham, *Subrogation in Law of Insurance*, 1985, p.38.

[434] (1878) 3 CPD 467.

indemnity and a claim under it for an absolute indemnity, there must be an abandonment on the part of the person claiming indemnity of all his rights in respect of that for which he receives indemnity."[435]

It is obvious that where there is a total loss whether marine or non-marine insurance, there would be an abandonment by the assured to the insurer for any benefit of the remain of subject matter. In case of actual total loss, the insurer is entitled to take over the salvage as it is a matter of equity for the assured to abandon the salvage to the insurer. However, the notice of abandonment is not needed in the circumstance, it is, therefore, confusing as if abandonment does not happen at all. In case of constructive total loss, abandonment would not be negated as it is the condition precedent for the assured to give a written abandonment notice to the insurer and treat the loss as a total loss, if failing, he can only claim for a partial loss. Constructive total loss is suggested to be a hypothetical total loss. It is a hybrid, an intermediate stage between an actual total loss and a partial, and notice of abandonment play an important role there. To give a notice of abandonment is peculiar to marine insurance. It appears from Lord Mansfield's judgment in *Goss v. Withers*.[436] For a notice of abandonment to be given, a constructive total loss must be established. In writer's view, abandonment is not peculiar to constructive total loss, it is suggested that constructive total loss is peculiar to marine insurance and do not apply to non-marine policies.[437] Abandonment differs from the notice of abandonment. Notice of abandonment confers upon the insurer the option to take over the remain of subject matter if there is any salvage in the subject matter, it is a condition precedent to a constructive total loss. Whereas, abandonment is the process whereby an assured, having suffered a total loss, divests himself of the insured subject matter.

[435] Ibid, at 470-471.

[436] (1758) 2 Burr 683.

[437] *Moore v. Evans*, [1918] AC 185, at 194.

It is very clear from the Act that the abandonment automatically happens at the moment the payment is made and there is no need to give a notice of abandonment to the insurer in case of actual total loss. However, it is at the insurer's option to take over the remains of the subject matter when it is abandoned to him. The problem may arise if the insurer has been keeping silence for a long time as to whether or not to take over the remain of the subject matter after paying a total loss, has the insurer still had the rights to take over the subject matter? The question was addressed by the United States Court in *The Central America.*[438] The case involved a claim by the salvors for the ownership of gold recovered from *The Central America* which was sunk in 1857, 130 years before the sunk vessel was located and recovered. *The Central American* was bound for New York from Panama and was hit by the hurricane and sank. It must be the richest ship ever reported lost in the history. Some insurance companies who had paid the shippers' losses of gold also asserted to be entitled to possession of the gold. It was an issue whether the law of salvage or the law of finds should be applicable to this matter. Norfolk District Court held at the first instance that the salvors could be entitled to the whole of the gold recovered. However, the decision was reversed by the U. S Court of Appeal which the salvor was only entitled to a salvage reward and did not become the owner of the property. This case demonstrates that the insurer's entitlement to take over the remains of the subject matter after paying a total loss has no time limit unless he formally abandon the proprietary right of it.

There have been confused by some authorities in common law as to whether the abandonment by the assured automatically vests the insurer ownership of the subject matter remained? Before the Marine Insurance Act 1906 was passed, Blackburn in *Simpson v. Thomson*[439] expressed the view that:

"I do not doubt at all that where the owners of an insured ship have claimed or been paid as for a total loss, the property in what remains of the ship, and all

[438] [1990] AMC 2409.

[439] (1877) 3 App. Cas. 279.

rights incident to the property, are transferred to the underwriters as from the time of the disaster in respect of which the total loss is claimed for and paid."

In section 63(1) of Marine Insurance Act, the insurer is "entitled to take over" the interests of the assured in whatever may remains of the subject-matter insured, and all proprietary rights incidental thereto. It is clear from the Act that the insurer, upon abandonment, has the option to take over the interests of the assured as well as the option not to do so. It is interesting to note that Marine Insurance bill was at this committee stage in the House of Commons, the draft was altered from 'entitled to the interests' to 'entitled to take over the interests'. This implies that the insurer is not obliged to exercise their rights.

Thus, in *Allgemeine v. Administrator of German Property*[440] Scrutton CJ stated that:

"What is the effect of abandonment under English law..? When the total loss of a thing insured is not actual but constructive that is, where thing insured is in specie, but the cost of preserving and repairing it would be more than its value when preserved or repaired...the assured must give notice of abandonment. This in itself does not pass any property or rights in the thing insured to the underwriters. If the underwriter then pays the assured a total loss, it used to be thought that the payment passed the property and rights incidental to it to the underwriter, as benefit of salvage...Before the Marine Insurance Act was passed in 1906, circumstances arose which rendered it necessary to consider whether an underwriter, merely by paying, necessarily become the 'owner' of the thing insured...For it might be a damnosa hereditas, whose ownership only imposed liabilities which the underwriter did not want. The owner of a ship wrecked in a harbour might be liable to the harbour authority for costs of buoying and removing the wreck."[441]

[440] [1931] 1 KB 672.

[441] Ibid, at 686.

However, the difficulty was confronted in *Arrow Shipping Co. v. Tyne Improvement Comrs,*[442] where the question was raised whether the insurer who had paid a total loss, was not as owner liable for the expense of raising the wreck. Lord Herschell declined to decide the question.

In *Boston Corporation v. France Fenwick & Co, Ltd*[443] Bailhache J. regarded the remains of subject matter as a *res nullius* as he said:

"On principle it must be borne in mind that in the case of a constructive total loss an owner can only abandon to his underwriters. Having done this, he divests himself of his property in the thing abandoned and ceases to be its owner... I have refrained from expressing any opinion whether a valid notice of abandonment, unaccepted by underwriters, while it divests the owner of his property in the wreck at the same time automatically transfers the property to the underwriters. I will only say that there is a good deal to be said against this view in favour of the wreck becoming in such circumstances a res nullius. The point does not call for decision... ."[444]

In this case, it was accordingly held that the shipowner was not responsible for the removal of the wreck. Similarly, in *The Crystal*[445] the defendant shipowners were held not liable for the removal expenses on the ground that they were not the owners at the material time.

The proposition of *res nullius* has been doubted in *Vandervell v. IRC.*[446] Plowman J. pointed out that "a man can not abandon his own property simply by saying 'I don't want'". Likewise, in *Ocean Steam Navigation Company Ltd*

[442] [1894] AC 508.

[443] (1923) 39 TLR 441.

[444] Ibid, at 443, 444.

[445] [1894] AC 508, HL.

[446] [1966] Ch. 261.

v. Evans[447] Greer LJ refused to deem the subject matter as a *res nullius*, as he said:

"It does not follow that, because notice of abandonment is given to an insurer, therefore the vessel, which may have some value, is abandoned to all the world so that it has no owner at all, and becomes what lawyers prefer to describe using the Latin language, a res nullius."[448]

Abandonment happens whenever there is a total loss, likewise, it applies to a total loss in the event of underinsurance where the insured is not fully indemnified and he is deemed to be his own insurer by virtue of section 81 of Marine Insurance Act 1906, the insurer, therefore, is entitled to insist upon an abandonment by the assured, however, in proportion to his insured amount. It must be distinguished between valued policy and unvalued policy.

In case of valued policy, the agreed value is conclusive and the assured is estopped from denying that the agreed value is not the actual value. If the actual value happens to be more than the agreed value, the insurer is entitled to the remain of subject matter insured in proportion to his insured amount bears to the agreed value. If the assured is fully insured of his agreed value, then the insurer, after paying the total loss, is entitled to the whole of the remain of subject matter insured.

In case of unvalued policy, if the actual value happens to be more than the insured amount, by the virtue of section 81 of Marine Insurance Act 1906, the assured and the insurer is deeded to be the co-owners of remain of subject matter insured in proportion to their respective amounts insured.

The difficulties may arise in event of underinsurance under non-marine policy as there is no concept of the assured undertaking to be his own insurer in

[447] (1934) XL Com. cas. 108. CA.

[448] Ibid, at 111.

respect of the uninsured balance. The courts have yet to consider the question of whether a non-marine indemnity insurer is entitled to the remains of the subject matter insured after paying the assured the whole insured amount required by the policy when the amount paid may not actually fully indemnified the assured's loss. Merkin[449] addressed four possible solution of this difficulty in the absence of average clause in the policy:

(a) the insurer's right of salvage is ousted completely by the fact that the assured has not received a full indemnity; or

(b) the insurer is entitled to the subject matter insured by way of salvage by virtue of having paid the maximum amount due under the policy; or

(c) the assured is entitled to retain ownership of the subject matter subject to an equity in the insurer's favour for the amount by which the proceeds of the subject matter insured exceed the amount necessary to indemnify the assured; or

(d) the insurer is entitled to the insured subject matter but subject to a duty to account to (or to hold in trust for) the assured the amount of the uninsured loss.

Merkin suggested the proper choice with (a) and (d). However, in writer's view, the best solution is that the assured and the insurer is the co-ownership of the remain of the subject matter insured as the same as in the case of marine insurance even in the absence of average clause in the policy. The solution is based on the principle of indemnity as it would be more just and equitable for both parties share the remain of the subject matter insured in their respective interests.

b. Confusion between subrogation and abandonment

[449] *Insurance Contract Law*, Issue 1, C.4.2-09.

Rights of subrogation in case of total loss has often been confused in English law, even by learned judges and by drafters of statutes, with the rights vested in the underwriter in case of abandonment. Section 79 of Marine Insurance Act is intended to deal with the rights of subrogation, where, in the first limb of the sub-section, it confers the right of insurer to take over the remain of the subject matter in case of total loss which it is supposed to be more closely to the right of abandonment. This limb seems to be identical to the section 63 (1) as to the effect of the abandonment. It tends to be regarded the rights of subrogation in this section confer upon the insurer the rights to take over the remain of the subject matter in case of total loss. Arnould[450] clarified that section 63 (1) is relating only to constructive total loss, the case of actual total loss being dealt with in sub-section (1) of section 79, the provisions of which appear, however, to be applicable to constructive total loss as well. It is submitted that the difference which is set out in English law between subrogation and abandonment was not therefore fully taken into account by the draftsmen of the Marine Insurance Act 1906 whom had confused these two principles as well.

Meanwhile, the confusion of subrogation with abandonment was also found in *North of England Insurance Assurance v. Armstrong.*[451] The facts of the case has been elaborated in Chapter V(3). This is a dispute of a valued policy and the sum insured is £6000. The insurer paid agreed value of £6000 for the total loss of the ship and claimed for the whole of recoveries in a sum of £5700 which is based upon the real value of the ship at £9000. It was held that the insurer's claim was justified and that the damages recovered should entirely belong to the insurer. The confusion arises from the judgment of Cockburn J, where he said:[452]

[450] *Arnould's Law of Marine Insurance and Average*, 16ed. para1182, note 3.

[451] (1870) L.R. 5 Q.B 244.

[452] Ibid, at 248.

"Now, I take it to be clearly established in the case of a total loss, that whatever remains of the vessel in the shape of salvage, or whatever rights accrue to the owner of the thing insured and lost, they pass to the underwriter the moment he is called upon to satisfy the exigency of the policy, and he does satisfy it. It is admitted that if this ship had been recovered from the bottom of the sea by any of the contrivances of modern skill and science available for that purpose, the body of the vessel would have passed to the underwriters. If, moreover, her value had proved to be more than the estimated value in the policy, the underwriters would still have been entitled to the vessel so recovered...I think it is clear also, where we have, instead of the ship, the supposed value of the ship, or so much of it as the delinquent vessel could be called upon to contribute for the loss, that what is recovered must be taken to represent the lost ship; and then, just as the underwriters would be entitled to the ship if it could have been bodily got back, so they are entitled to that which is the representation of the ship, in the shape of damages to be paid by the owners of the vessel which caused the collision."

He added:

"Where the policy is an open policy, and simply a policy of indemnity as to the actual value of the vessel, no difficulty would arise in such a case as this. It is only because it is a valued policy that these difficulties present themselves. I think we must still apply the old rules, and not make new ones; and if a party chooses to have his vessel or his goods, as the case may be, taken at a fixed value, instead of leaving the contract, as in an ordinary policy, simply one of indemnity to the extent of the real value, and if thereby any benefit accrues to the underwriter, the underwriter must be entitled to it."

Likewise, Lush, J. supported the learned Chief Justice's judgment as he said:

"If the underwriters had got the wreck up, and if they had procured the wrongdoer to repair the vessel, the vessel so repaired would still belong to the

underwriters. What difference can it make whether the wrongdoer repairs the thing in specie, or pay in money the amount it would take to repair?"[453]

The above parts of judgments were rightly considered as *obiter dicta*, Cockburn J. draws a distinction between unvalued policies, which are described as ordinary policies, to which the indemnity rule should be applied, and valued policies through which the subrogated underwriter is allowed a benefit. It is correct to say that if the benefit which accrues from the remains of subject matter happens to be more than the insurer has paid, then he is entitled to the profit as illustrated by Cockburn J. that 'if this ship had been recovered from the bottom of the sea by any of the contrivances of modern skill and science available for that purpose, the body of the vessel would have passed to the underwriter, if, moreover, her value had proved to be more than the estimated value in the policy, the underwriters would still have been entitled to the vessel so recovered...'.

However, the judgment went further and supposed that 'what is recovered must be taken to represent the lost ship, and then just as the underwriters would be entitled to the ship if it could have been bodily got back, so they are entitled to that which is the representation of the ship, in the shape of damages to be paid by the owners of the vessel which caused the collision'. It was this part of judgment which confused subrogation and abandonment. As discussed above, subrogation is the right and remedies of the assured against the third party who is responsible for the loss. The assured's right against the third party does not accrue from the ownership of the remain of the subject matter. It could not be said to represent the "lost ship".

Arnould illustrated[454] the difficulties of this part of judgment as he suggested that if the £9000 had been recovered from the owners of the other ship, the underwriter would have been able to retain the £9000 as a whole, on the ground

[453] Ibid, at 251.

[454] *Arnould's Law of Marine Insurance and Average*, 16ed. para1303.

that they indemnified the assured for a total loss. Their recoupment would have then exceeded the loss they had sustained and they would have made a profit of £9000 less £6000 namely £3000 out of the contract of insurance. He further clarified the judgment that[455] if the assured had sue the other ship and recovered £9000 from her owners, without making any claim upon the underwriters, they would have been entitled to retain the whole of such sum. And it would be an inequitable result if the underwriter should be allowed to make a profit, and the assured to sustain loss, merely owing to the mistake of the latter in following, in a particular case, the usual business course of claiming upon their policy, instead of first proceeding against the party in default.

The decision of *the Armstong* case was followed by *Thames and Mersey Marine Insurance Co. v. British and Chilean Steamship Co.*[456] However, the *obiter dictum* was also criticised.

"Some expression in the judgment suggest that the underwriters, who had only paid £6000, might have recovered the whole £9000 if paid. They have been the subject of much criticism and may be contrary to the principle that subrogation is to give an indemnity only, as expressed in Castellain v. Preston; they may result from failure to distinguish between abandonment and subrogation. But they were not necessary to the decision. The decision itself is to the effect that an underwriter who has paid for a total loss is not prevented from recovering up to the extent of his payment sums received by the shipowner in respect of the subject matter insured by the fact that those sums are based upon, or part of, a larger sum fixed by reference to a value other than the insured value, where no part of that insured value is at the risk of the shipowner....."[457]

The confusing dictum in *the Armstrong* where it was suggested that the subrogated insurer could recover from the third responsible party more than the

[455] *Arnould's Law of Marine Insurance and Average*, 16ed. para1304.

[456] [1915] 2KB 214.

[457] Ibid, at 220-22, as per Scrutton J.

amount he had paid has been universally subject of criticism and was finally rejected in *Yorkshire Insurance Co. Ltd v. Nisbet Shipping Co. Ltd.*[458]

c. Distinction between subrogation and abandonment

The rights of the insurer which arise from subrogation and those resulting from abandonment are not identical but complementary. The distinction could be seen at least as follows:

(1) Subrogation rights arise whether there is a total loss or partial loss, whereas abandonment only accrues in case of total loss. It is been disputed whether abandonment arises merely in case of constructive total loss. Merkin suggested[459] that "abandonment is recognised formally only on the context of marine insurance. This is so because salvage is normally likely to be significant only where the assured has suffered a constructive total loss as opposed to an actual total loss, for in the latter case there will rarely be anything in existence to be abandoned; non-marine insurance does not of course recognise the concept of a constructive total loss. However, abandonment does operate to a limited extent in non-marine insurance, for example, where subject matter thought to be lost or destroyed turns up safe and well after the insurer has paid out in respect of it." In writer's view, abandonment also exists in the case of actual total loss where the abandonment automatically happens the moment the insurer pay a total loss. Therefore, it applies to non-marine insurance as well. It is more correct to say that the notice of abandonment is only confined to constructive total loss. It must be distinguished the abandonment from the notice of abandonment which have been discussed above.

(2) Subrogation confers upon the insurer rights to pursue the assured's claims against the third parties for the loss of the subject matter, whereas abandonment

[458] [1961] 2 ALL E.R. 487. In this case, the insurer was held not to be entitled to the surplus.

[459] *Insurance Contract law* (issue 2) C.4.2-01.

merely confers upon the insurer rights over remains of the subject matter and the proprietary right incidental thereto. Thus, "upon the abandonment of a ship, the insurer thereof is entitled to any freight in course of being earned, and which is earned by her subsequent to casualty; and, where the ship is carrying the owner's goods, the insurer is entitled to a reasonable remuneration for the carriage of them subsequent to the casualty causing the loss."[460] However, there may be the case that neither subrogation nor abandonment confers upon the insurer for the right for freight or profit. In *Sea Insurance Co. v. Hadden*[461] where a ship was under charter to load a cargo at a subsequent port, which she was disabled by collision from reaching, and her owners recovered damages from the ship in fault in respect not only of the loss of their ship itself, but also in respect of the loss of freight which they expected to earn on the subsequent voyage, it was held that the damages awarded under the latter head were recoverable by the shipowner, or by the underwriters on freight, and not by the abandoned ship. As discussed above, the freight in dispute was not the subject matter insured by the hull insurer and therefore the hull insurer was not entitled to the freight by virtue of subrogation. Similarly, in *Glen Line v. Attorney-General*,[462] the House of Lords held that the compensation being seizure and in respect of what were then prospective profits was not a proprietary right incidental to the ownership of the vessel and did not pass to the insurers on abandonment and the insurer on hull is not subrogated to any profit lost accrued from the seizure.

(3) Subrogation does not permit the insurer to bring an action in its own name, whereas once an insurer has accepted the abandonment, it becomes the owner of the remains of subject matter insured in those goods.

(4) Any profits earned by abandoned property accrue to the insurer, whereas the subrgoated insurer is not allowed to retain more than he has paid.

[460] Section 63(2) of *Marine Insurance Act* 1906.

[461] (1884) 13 QBD 706.

[462] (1930) 36 Com.Cas. 1.

(5) Subrogation operates automatically, by operation of law as the result of the principle of indemnity, to confer rights of action upon the insurer, whereas abandonment does not automatically divest the ownership of the assured to the insurer. The insurer has the option to take over the remain of the subject matter after paying a total loss.

2. Subrogation and assignment

As has been discussed above, an insurer who pays its assured in respect of an insured loss is entitled by operation of law to be simply subrogated to its assured's rights of action against the third party in respect of the insured loss. It is also established that the parties under the insurance contract are entitled to insert into a term in the contract of insurance to exclude or modify the application of legal subrogation.[463] Thus, "a party who has acquired rights of action via contractual subrogation may differ sharply from that of a party who has acquired rights of action via legal subrogation, since the latter is entitled to recover no more than his loss following his payment in respect of another obligation."[464] Contractual subrogation as to its effect is somewhat similar to assignment of a chose in action. However, it differs from the assignment in the important aspect that the chose of action under contractual subrogation still vests in the assured although by contractual subrogation the insurer may be entitled to the subrogation right before indemnifying the assured.

[463] *Tate & Son v. Hyslop*, (1885) 15 QBD 368; *Thomas & Co. v. Brown*, (1894) 4 Com. Cas. 186; L. *Luscas Ltd. v. Export Credit*, [1973] 1 WLR 914 at 922, per Megaw LJ; *Morris v. Ford*, [1973] QB 792, at 815 per James LJ; *Re T.H Kuitwear Ltd* [1987] 1 WLR 371, at 376, per Nicholas Browne-Wilkinson v-c. However, a clause in the policy to the simple effect of subrogation rights is unnecessary in the context of indemnity insurance as the rights arise automatically by operation of law. See, J. Birds, "*Contractual Subrogation in Insurance Law*" (1979) JBL 124.

[464] J. Birds, "*Contractual Subrogation in Insurance Law*" (1979) JBL 124, at 131.

Assignment of choses in action may arise by way of express contractual term in the policy or alternative arrangement by way of statutory requirements. At Common law, choses in action were not assignable, but they were in equity. Equitable assignment must join the assured and the third party as joint defendants. The statutes did nothing to take away the efficacy of equitable assignment. In practice, equitable assignment may be seen in the subrogation receipt which provides that the assured transfer to the insurer all the rights and remedies against the third parties. This statement of assignment in the subrogation receipt does not itself effect a legal assignment.[465] Statutory assignment was introduced by the Supreme Court of Judicature Act 1873, Section 25(6) and was now replaced by the Law of Property Act. Section 136 of the Act provides that:

Legal assignments of things in action

(1) Any absolute assignment by writing under the hand of the assignor (not purporting to by way of charge only) of any debt or other legal thing in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to claim such debt or thing in action, is effectual in law (subject to equities have priority over the right of the assignee) to pass and transfer from the date of such notice--

(a) the legal right to such debt or thing in action;

(b) all legal and other remedies for the same; and

(c) the power to give a good discharge for the same without the concurrence of the assignor;

[465] Catriona Simpson, *Cargo Insurer's Choice between Subrogation, Equitable Assignment and Legal Assignment in Proceedings in HongKong*, LMCLQ 1997, p153.

Provided that, if the debtor, trustee or other person liable in respect of such debt or thing in action has notice--

(a) that the assignment is disputed by the assignor or any person claiming under him;

or

(b) of any other opposing or conflicting claims to such debt or thing in action;

he may, if he thinks fit, either call upon the persons making claim thereto to tnterplead concerning the same, or pay the debt or other thing in action into court under the provisions of the Trustee Act 1925. ...

The essentials of a valid legal assignment under Law of Property Act Section 136 is that (a) the assignment must be in writing under the hand of the assignor; (b) express notice in writing must be given to the debtor, i.e., to the insurers in the case of an insurance policy, but it does not matter if it is not given to them until after the death of the assured. However, no special form is required to constitute a valid equitable assignment.

Under the valid legal assignment, the insurer is entitled to sue in his own name without the need to join the assured as co-defendant, if the assured company goes into liquidation and ceases to exist, the insurer's right of action is not lost, whereas a subrogated insurer must sue in the assured's name; The insurer is limited under a subrogation recovery to the amount of its own payment to the assured, by contrast, where the insurer has taken an assignment of the assured's rights, any surplus accrues to the insurer. Moreover, a valid legal assignment under section 136 of Law of Property Act even permits the insurer to sue before the assured has been indemnified, whereas the subrogation rights are, subject to contract, enforceable only where the insurer has made a full payment under the policy, and even if the insurer has satisfied its obligation under the policy it may not be able to control the action until the assured has received a full indemnity. However, in United States, the "rule of real party in interest" may entitle the

insurer to sue in his own name without a necessary legal assignment between the assured and the insurer.[466]

It is because of above the insurer might wish to take a legal assignment rather than to rely upon subrogation rights.[467] However, the use of assignment does, have some disadvantages.[468]

Firstly, the fact that the insurer must use in its own name may result in unwelcome publicity.[469] This would appear to be the overriding consideration militating against the widespread use of assignment as an alternative to subrogation.

Secondly, subrogation operates automatically on payment by the insurer, whereas the insurer may have to take positive steps to obtain an assignment; in practice this problem does not necessarily arise, as policies which provide for assignment may stipulate that assignment is to occur automatically on payment.

Thirdly, there is some doubt as to whether the insurer can take an assignment of the assured's rights once the assured has commenced arbitration proceedings against the third party.

3. Subrogation and contribution

The general rule is that any persons may take out as many policies as he wishes against the same risk in respect of the same subject matter and he is free to

[466] This rule would be further discussed in Chapter X.

[467] Full discussion see Catriona Simpson, *Cargo Insurer's Choice between Subrogation, Equitable Assignment and Legal Assignment in Proceedings in HongKong*, LMCLQ 1997.

[468] Merkin, *Insurance Contract Law*, issue 19, C.4.3-11-12.

[469] Charles Mitchel expressed the view that the insurers wish to pursue litigation against third parties in the name of the assured because they think this will improve the chances of recovery. See: Mitchell, *Law of Subrogation*, at p.173.

claim payment from his insurers in such order as he thinks fit. Where he does so, he is said to have taken out double insurance. In case of over insurance by double insurance, the common law principle of indemnity provides that an assured can merely recover an amount representing his actual loss or, in case of valued policies, his agreed loss, in the absence of average clause in the policy, one of the insurers may bear the whole or most part of the loss, while leave the other insurers unjustly enriched. Thus, the doctrine of contribution was evolved, apparently by Lord Mansfield in *Godin v. London Assurance Co*[470] as he said that[471] "if the insured is to receive but one satisfaction, natural justice says that the several insurers shall all of them contribute pro rata to satisfy that loss against which they have insured".

As far as marine insurance is concerned, the doctrine was codified in Section 80 of Marine Insurance Act 1906 which provides:

80. Right of contribution. (I) Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract.

(2) If any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution against the other insurers, and is entitled to the like remedies as a surety who has paid more than his proportion of the debt.

The doctrine of contribution is based on the principle of equity.[472] It confers upon the insurers a cause of action among them for contributing the loss rateably. This equitable doctrine of contribution is also seen as an historical link

[470] (1758) 1 Burr. 489.

[471] Ibid, at 492.

[472] *Godin v. London Ass. Co.* (1758) 1 Burr, per Lord Mansfield a p.492; *American Surety Co of New York v. Wrightson* (1910) 16 Com. Cas 37, per Hamilton J., at p.49.

to the emerge of subrogation.[473] The subrogation is, therefore, arguably derived from the basis of equity.[474] The basis of these two doctrine seems very similar as a principle of equity. Subrogation ensures that the assured shall receive not more than an indemnity; contribution ensures that the insurers shall not indirectly suffer injustice *inter se* as a result of double insurance. However, there remains distinction between these doctrines and few has ever contrasted these two doctrines except Colinvalux.[475]

Firstly, an subrogated insurer can merely sue in the name of the assured, whereas the right of contribution confers upon the insurer to sue in his own name.

Secondly, the right of subrogation derived from one policy, whereas the right of contribution is a result of double insurance.

Thirdly, the insurer, after paying the loss of the assured, is subrogated to all the rights and remedies of the assured against the responsible third party, whereas by virtue of doctrine of contribution, one of insurers is entitled to call upon the other co-insurers to contribute the loss of the assured rateably in which they are liable.

Moreover, a voluntary payment by the insurer does not deprive the insurer of subrogation rights insofar as the payment is made honestly by the insurer.[476] However, a voluntary payment by the insurer could not confer the right of contribution from the other co-insurers. In *Legal & General Assurance Society Ltd. v. Drake Insurance Co., Ltd*,[477] the assured injured a third party in a road accident while covered under two policies. The third party commenced

[473] M.L. Marasinghe, *An Historical Introduction to the Doctrine of Subrogation: the Early History of the Doctrine,* Valparaiso University Law Review, v. 10, 1976, at p.48.

[474] See Chapter II.

[475] *Colinvalux's Law of Insurance*, 7th Ed. Para. 8-36.

[476] *King v. Victoria*, [1896] A C 250.

[477] [1992] QB 887.

proceedings against the assured which were settled by the first insurer. After paying the whole loss of the assured, the first insurer then sought the contribution from the second insurer. The Court of Appeal held that the first insurer's payment in excess of his rateable proportion was voluntary and irrecoverable.

The decision was submitted to be contrary to the principle of unjust enrichment as the basis of equity.[478] "Where an assured has the right to seek satisfaction of a loss from either of two insurers and obtains full satisfaction from I1, I2 is undeniably enriched by I1's payment. As both insurers are subject to a common demand, I2's enrichment is unjust and I1 is justified in seeking restitution from I2 of a rateable proportion of the sum paid to the assured. Contribution is the label attached to the mechanism for the reversal of unjust enrichment in this particular context." Therefore, it is still arguable in *Drake*'s decision in the Court of Appeal which held in effect that I2's enrichment was 'just' because I1's overpayment was voluntary. If the I2's contract is avoidable as the result of breach of one of conditions in the insurance contract, such as, warranty, *Uberrimae Fidei*, or the risks falling into the exception clauses, is the insurer who has made the full satisfaction of the assured's loss entitled to insert the contribution from the other co-insurers? The answer may be negative based on *the Drake's* authority though it would be odd that one insurer claims the contribution from the other co-insurer who, meanwhile, pleads to avoid the contract on the ground of non-disclosure of the assured. The cause of action for contribution is not based on the contract but as a matter of equity. In writer's view, where there is an unjust enrichment of one insurer at the expense of the other insurer, then there must be a contribution. In the case of breach of notification clause, the fact that the assured could claim against one insurer for a full indemnity does not necessarily give a notice to the other co-insurer. The other co-insurer has not been prejudiced by not giving the notice of accident. Therefore, the other co-insurer may unjustly enriched if the contribution is not

[478] Howard Bennett, *The Law of Marine Insurance*, 1996, at p. 432.

allowed on the ground of breach of notification clause. On the other hand, in breach of warranty, non-disclosure and or the risks within the exception clause, it would be unjust for the other co-insurer to share the loss by way of contribution if he may avoid the contract at the first instance when the assured claim against him directly. Thus, his pleading for non-contribution does nothing to be unjust enrichment at the insurer's payment.

Both principles are sometimes applicable in the same case. Thus, if the owner of premises insures them with two insurers, both of whom pay him in respect of a loss, they will be entitled to contribution between each other with regard to any subrogation rights against a tenant in respect of repairs. One insurer can not proceed against the tenant in the assured's name and retain the whole of the proceeds. Contribution, in fact, applies not only to the liabilities but also to the benefits which an insurer is entitled under a policy.

Chapter X Comparative Study of Subrogation

1. Under US law

US law is originally derived from English common law system. English decisions in the field of marine insurance are contemplated in a great weight in the U. S. courts. Unlike English law, there is no uniform federal statutory law governing the law of marine insurance. Substituted for the single body of federal law is the present system of co-existence of federal law with the separate legal regimes of the 50 states. English law has occupied a dominate position in US law. Though the Marine Insurance Act 1906 is not applicable in the United States, however, the Act itself is the codification of the common law of marine insurance. "Consequently, those decisions upon which each section of the Act is predicated *a fortiori* are, and certainty should be, highly persuasive authority in the courts of the United States."[479] Nevertheless, of course, the ultimate source of the law remains in the U. S. Before the *Wilburn Boat v. Fireman's Fund,*[480] marine insurance disputes were governed by the federal admiralty rule comprised of common law rules, however, since the decision of *Wilburn Boat* in the Supreme Court, it was established as authority that the state law can operate, at least in the case of warranty, unless there is a well established federal admiralty rule in respect of corresponding disputes. The case has been suggested to change the law of United States insofar as the law of marine insurance is concerned. Despite the difficulty in this formulation, many subsequent decisions in both federal and state courts have used it to apply local state law to marine insurance disputes. The decision has been subject much criticism, but before we turn to examine the doctrine of subrogation under US law, it is desirable to look into the *Wilburn boat* case in more details. Further

[479] Alex Parks, *The Law of Tug, Tow, and Pilotage*, (1982) Cornell Maritime Presss, 2nd ed., p508.

[480] 348 U.S. 310, 1955 A.M.C. 467.

discussion in the section lies in the basis of subrogation; "real party in interest" rule and conflicting interests between the insurer and the assured under partial subrogation.

a. *The Wilburn Boat* case

The case involved a small houseboat operated on Lake Texoma, a man-made inland lake between Texas and Oklahoma. The boat had originally been purchased in Greenville, Mississippi, by three brothers and had been insured under a policy of full marine risk for the voyage from Greenville, requiring the navigation of the waters of five states, to. and its use in , Lake Texoma. The policy contained the normal express warranties that the boat would be used "solely for private for pleasure purposes...and shall not be hired or chartered unless permission is granted by endorsement hereon...". It was also agreed expressly in the policy that the insurance "shall be void in case this policy or the interest insured thereby shall be sold, assigned, transferred or pledged without previous consent in writing of the insurers." Despite these express warranties, the Wilburn brothers formed an Oklahoma corporation and sold, assigned or otherwise transferred the insured vessel to it, pledged the vessel successively to a leading institution and themselves, and then, as was always their intention, proceeded to charter the boat for hire in commercial carriage of passengers within the lake between the two states. During the winter of 1949, while the boat was moored near the Oklahoma shore and vessel caught fire from unknown causes and was destroyed. The subsequent claim was denied by the insurers as the result of breach of express warranties.

Suit was first brought in the state court of Texas and removed to United States District Court. The District Court found that federal maritime law applied, rather than state law, and accordingly it was held that the assured was not entitled to recovery as a result of "literal performance rule" in respect of express warranties. The decision was affirmed by the Fifth Circuit. When appealed to

the Supreme Court, the decision of Fifth Circuit was reversed and the majority held that "it is clear that at least until 1944 this court has always treated marine insurance contracts, like all others, as subject to state control."[481] In Mr. Justice Black's judgement,

"Whatever the origin of the 'literal performance' rule may be, we think it plain that it has not been judicially established as part of the body of federal admiralty law in the country. Therefore, the scope and validity of the policy provisions here involved and the consequences of breaching them can only be determined by state law unless we are now prepared to fashion controlling federal rules."[482]

The fundamental difference between the federal rule and state law in this regard is that the state law provides that the breach of the private use warranty was no defence to the action unless it could be shown that the breach contributed to the loss, whereas the federal maritime rule, like the common law rule in England, was much strict in term of breach of express warranty. Breach of it would give rise to the contract void automatically from the date of the breach regardless of whether the breach amounts to the loss.

However, Mr. Justice Reed, joined by Mr. Justice Buton disagreed with Mr. Justice Black's reasoning. They favoured that it was well established rule of "literal performance" in respect of the breach of warranty.

"Our admiralty laws, like our common law, came from England. As a matter of American judicial policy, we tend to keep our marine insurance laws in harmony with those of England. Queen Ins, Co, v. Globe Ins. Co., 263 US 487, 493, 1924 A. M.C 107; Calmar Steamship Corp. v. Scott, 345 U.S. 427, 442-443, 1953 A. M.C 952. Before our Revolution, the rule of strict compliance with maritime insurance warranties had been established as the law of England.

[481] Ibid., at 316.

[482] Ibid., at 371.

That rule persists. While no case of this Court has been cited or found that says specifically that the rule of strict compliance is to be applied in admiralty and maritime cases, that presupposition has been consistently adopted as the basis of reasoning from our earliest days. Other courts have been more specific. No case holds to the contrary."[483]

Unfortunately, their opinions were not favoured and the decision cast doubt as to future litigation in the field of marine insurance. The federal maritime rule thus lacked development from then on and the marine insurance disputes are left to be governed by the substantive state law in the absence of well-established federal rule.

b. The nature of subrogation

Subrogation under U. S. law has been submitted to be a creature of an equity which will "compel the ultimate payment of the debt by one who in justice and good conscience ought to pay it".[484] Thus, the subrogation was defined as " a legal fiction through which a person who, not as a volunteer or in his own wrong, and in the absence of outstanding and superior equities, pays debt of another, is substituted to all rights and remedies of the other, and the debt is treated in equity as still existing for his benefit, and the doctrine is broad enough to include every instance in which one party pays the debt for which another is primarily answerable, and which in equity and good conscience shall have been discharged by such other".[485] In the context of insurance law, subrogation has been defined as the right of the insurer to be put in the position of the insured in order to pursue recovery from third parties legally responsible to the assured for a loss paid by the insurer. This definition is very similar to section 79 of Marine

[483] Ibid., at 325.

[484] *United States Fidelity & Guaranty Co., v. First International Bank of Lincoln*, 224 Ala. 375, 380. 140 So 755, 760 (1932).

[485] *Homeowner's Loan Corp. v. Sears Roebuck and Compan*, 123 Conn. 232, 193A, 769.

Insurance Act 1906. It seems no controversy over the origin of the subrogation. Most of the courts accepted that subrogation rights accrue from the very nature of equity. The purpose of subrogation is to prevent the assured from recovering twice for one loss, as would be the case if he could recover from both the insurer and from a third person who caused the loss, and to reimburse the surety for the payment which he has made, that confers the restitution right upon the insurer.

Generally, the right of subrogation arises when the insurer has paid the assured's loss.[486] However, in *Welded Tube v. Hartford*[487] it was held that a cargo underwriter could plead an ocean carrier in an action brought by its assured even though it had not technically acquired any subrogation rights by making payment to the assured. Further, in *Blasser v. Northern Pan-Am*[488] it was held that although a cargo insurer generally has no right to sue the ocean carrier until it has become subrogated by payment of its assured's loss, such subrogation can occur where the assured has sued both the insurer and the carrier in the same action and both are found liable. The insurer was permitted to recover on its cross-claim against the carrier for cargo damage found to have been covered by its policies. The insurer's subrogation right is restricted to his payment and he is not entitled to any surplus other than his payment and interests. This was the finding of the Supreme Court in *The Livingtone*.[489] The position in this respect is the same as the decision of *Yorkshire v. Nisbet* as discussed above.

c. Real party in interest rule

[486] *West Aleta*, 12 F.2d 855, 1926 AMC 855 (9th Cir.); *Frank J. Fobert*, 129 F.2d 319, 1942 AMC 1052 (2d Cir.).

[487] 1973 AMC 555 (E.D., pa.)

[488] 628 F.2d 376, 1982 AMC 84 (5th Cir.).

[489] 130 Fed. Rep. 746.

The federal rules of civil procedure and the codes of civil procedure in most other jurisdictions require an action be brought by, or in the name of, the real party in interest. Federal Rule of Civil Procedure Article 17(a) which reads:

Every action shall be prosecuted in the name of the real party in interest; but an executor, administrator, guardian, trustee of an express trust, a party with whom or in whose name a contract has been made for the benefit of another or a party authorised by statue may sue in his own name without joining with him the party for whose benefit the action is brought...

By operation of this rule, the insurer must bring the subrogation suit in his own name if he has fully indemnified the assured for his loss. The difficulties may arise when the assured is only partially compensated by the insurer. "It is generally held that if the insurance paid by the insurer covers only a portion of the loss, the insurer is not the real party in interest, but rather, the right of action against the wrongdoer who caused the loss remains with the assured for the entire loss, and the action must be brought by him in his own name."[490] Indeed, many state courts allow the assured to sue alone in cases of partial payment. In allowing the assured to sue for the whole loss, however, the allocation of the recoveries tend to be uncertain as to who should have the first claim. Furthermore, it is less clear whether the assured is liable to the insurer in damage if he does not bona fide consider the insurer's interests. In *North River Insurance Co, v. Mckenzie*,[491] the assured suffered property damage and received $2,537. This payment constituted the limit payable under the policy. The assured then started an action against the tortfeasor, alleging total property damage of $7,500. Without notice to the insurer, the assured subsequently settled their claim against the tortfeasor for $5,982.15. The insurer subsequently commenced an action against the assured for repayment of insurance proceeds. The court held for the insurer that the when an assured accepts from the insurer the amount of the policy damage to his property and thereafter settles his claim

[490] 29 A American Jurisprudence, Insurance Sec, 1746 (1960).

[491] 74 So. 2d 599 (Ala. 1954).

against the tortfeasor to the prejudice of the insurer, the insurer is entitled to recover from the assured the amount paid on the policy without necessarily demonstrating that the settlement exceeded the actual loss less the amount paid on the policy.

The real party in interest rule was designed to avoid splitting the cause of action and making the tortfeasor defend two suits for the same wrong. The federal courts maintain that the insurer remain the real party in interest and should prosecute the action in its own name jointly with the assured. It is true that after a partial payment both the assured and the insurer have substantive rights, both of them are the real party in interests, certainly they could sue in the same action as joint plaintiffs, thereby preventing splitting of the cause of action.

In most of subrogation actions, the insurers are reluctant to appear in the court file as the jury may prejudiced against the insurance company. The device of loan receipt was used to get around the difficulty. The key to the loan receipt device is that the payment made by the insurer is only a "loan" since technically the insurer has not paid the loss it has not yet become subrogated to the assured's right to recovery, hence the assured retains his rights and remedies against the wrongdoer and can bring action in his own name. The loan to the assured is, of course, interest free and is repayable only to the extent of whatever there is any recovery from the wrongdoer. The device originally arose to offset the "benefit of insurance" clause. The validity of the loan receipt has been subject to different interpretation in courts.

d. Allocation of recovery

When the assured is not fully reimbursed for the loss, there is a split of authority among the jurisdictions as to whether the insurer or the assured has a superior interest in amounts recovered from third party wrongdoers. Robert

Keeton submitted[492] that the assured is to be reimbursed first, for the loss not covered by insurance, and the insurer is entitled to any remaining balance, up to a sum sufficient to reimburse the insurer fully, the insured being entitled to anything beyond that amount. This rule represents majority of jurisdictions.[493] The decision most frequently cited in support of this rule is *Garrity v. Rural Mutual Insurance Co.*,[494] in the Wisconsin Supreme Court. In *Garrity,* the assured suffered a loss of $110,000 was paid $67,227.12 under the insurance contract as a result of policy limit. The assured succeeded in recovering part of the losses from the third party tortfeasor. The insurer sought to participate in the recoveries and was rejected by the court. It was held that the assured was entitled to be made whole before any moneys were paid to the insurer pursuant to its right of subrogation. The assured-whole rule, insofar as the non-marine insurance is concerned, seems to be identical to that under English law. However, there are a minority of jurisdictions which have held that the insurer is entitled to be made whole first as a general rule and the remaining balance accrues to the assured. The insurer is not entitled to make a profit. This was the case in *Peterson v. Ohio Farmers Insurance Co.*[495] In the case, a partial payment under a fire insurance policy was insufficient to meet the actual loss of the assured. The insurer joined with the assured obtained a judgement from tortfeasor. It was held that the insurer was entitled to be indemnified first out of the proceeds of any recovery against the tortfeasor. The jurisdictions adopting this rule include California, Idaho, Nebraska, Ohio, Virginia, and Wyoming.[496] In the context of marine insurance law, the US law is far from clear. The

[492] Robert Keeton, *Basic Text on Insurance Law*, at 160, 1971.

[493] See Elaine M. Rinaldi, *Apportionment of Recovery between Insured and Insurer in a Subrogation case,* Tort & Insurance law Journal, p. 807, Volume XXIX, Number 14, Summer 1994.

[494] 253 N. W. 2d 512 (Wis. 1977).

[495] 191 N.E. 2d 157 (Ohio 1963).

[496] See Elaine M. Rinaldi, *Apportionment of Recovery between Insured and Insurer in a Subrogation Case,* Tort & Insurance law Journal, p. 811, Volume XXIX, Number 14, Summer 1994.

position under common law was the illustrative of *The Commonwealth.*[497] English law has drawn a distinct authority between the marine insurance and non-marine insurance in respect of allocation of recoveries.[498] U. S. law tend to be less distinguishable between marine and non-marine insurance.

However, the application of subrogation under agreed value policy is entirely different. Under the U. S. law, the agreed value is not conclusive between the parties. In *Aetna Ins. Co, v. United Fruit Co.*[499] the Supreme Court held that the assured was not estopped from the agreed value under the policy and the insurer was only entitled to subrogation after the assured has been appropriately indemnified according to the actual value. The decision was further affirmed in *Nils Risdal, et al, v. Universal Ins. Co.*[500] In this case, a vessel was insured for $30,000 although the actual value was $60,000. The court held that the owners were co-insurers to the extent of the uninsured $30,000. The court referred the decision of *Aetna Ins. Co. v. United Fruit Co,*[501] in which the Supreme Court had said to of a valued policy:

" The valuation clause in its usual form does not operate as an estopel or by agreement to foreclose proof that actual value exceeds agreed value when the question is of the insurer's right to subrogation...beyond its controlling effect in determining the insurance liability, the clause does not operate to exclude proof of actual value when relevant."

The court concluded that since the risk retained by the owners was in the same amount as that assumed by the insurers, they were entitled to an equal share of the recovery. There was nothing that entitled the insurer to be made whole at the expense of the assured. It would be inequitable to make him the beneficiary of

[497] [1907] P. 216. The rule of "*pro rata*" recovery.

[498] See Chapter V.

[499] 1938 AMC 710.

[500] 1964 AMC 1894.

[501] 1938 AMC 710.

that portion of the amount recovered which was attributable to the uninsured loss.

A similar position exists insofar as cargo insurance are concerned. In the case of *Standard Oil of New Jersey v. Universal Ins. Co*[502] it was held that an assured was co-insured in respect of the excess of the actual value of cargo over the insured value and was, therefore, entitled to share rateably with the underwriters in a recovery obtained from a colliding ship.

However, under English practice, the insurer is entitled to the full amount of any recovery from third parties if it does not exceed the amount he has paid. Even in case there is a deductible clause under the policy, the insurer is similarly entitled to the full amount of recovery although the assured may not be fully indemnified.[503] Indeed, clause 12.3 of the Institute Time Clauses 1995 (Hulls) provides that recoveries against any claim which is subject to the applicable deductible average shall credited to underwriters in full to the extent of the sum by which the claim, unreduced by any recoveries, exceeds the deductible. Under U. S law, it is more likely that the deductible clause would confer the assured as co-insurer in the later recoveries. However, the assured must in the same time equally share the legal costs. The difficulties may arise when the claim are not successfully recovered.

Any policies written on "policy proof of interest" and "full interest admitted" terms are usually agreed to be "without benefit of salvage". This occurs in case of increased value or disbursements policies. Under the English law, even it is not in such a case of p.p.i policy, the insurer is not entitled to participate in any recoveries from the third party as the decision in *the Boag*[504] case. However,

[502] 1933 AMC 675.

[503] See Chapter V.

[504] [1937] 2KB 113.

under US law, the insurer's subrogation right is not infringed under the p.p.i policy as long as the assured can prove the insurable interest.[505]

2. Under Chinese law

Prior to the discussion of the law of subrogation under Chinese law, Chinese legal framework must be examined for the better understanding of the background of the Chinese law. China now is experiencing the transition from centrally-planned economy to market economy. Much new legislation has been passed in line with the development of the market economy. Before the opening to the outside world in 1978, the economy of China operated almost exclusively by way of administrative orders and directions, or in accordance with customary practices and there were only a few pieces of laws governing the law of contract. Since the decision of China to focus on economic growth and development by the third plenary Sessions of the 11th Central Committee of the Communist Party in 1978, China has been steadily building up the law governing the contractual relationship when dealing the economic activity in China.

One of the first significant piece of legislation was the Economic Contract Law of People's Republic of China ("the Economic Contract law") in 1981[506] which governed the contractual relations of economic activity, including the formation and the performance of the contract, its amendment and termination, the liability of breach of an economic contract and the disputes resolution. Another major piece of legislation of interest to foreigners is the Foreign Economic Contract Law of People's Republic of China ("the Foreign Economic Contact law") in 1985. The General Principles of Civil Law of People's Republic of China ("the Civil Law") which was passed in 1986 deals with the private law relationship

[505] *Hull v. Jefferson Ins. Co.*, 279 Fed. 892 (S.D. N. Y. 1921)

[506] It was further amended in 1993.

between individuals and legal persons, including such matters as tort, right to bring suit, and certain contract-like principles not dealt with elsewhere.

The law relating to marine insurance is specifically set out in the Chapter XII of the Maritime Code of People's Republic of China ("the Maritime Code") which was adopted at the 28th Meeting of the Standing Committee of the Seventh National People's Congress of the People's Republic of China on 7 November 1992 and is effective from 1 July of 1993. The Maritime Code has a total of 278 articles covering general principles, vessels, crew, contract for the carriage of goods by sea, contracts for the carriage of passengers by sea, charter parties, maritime towage contracts, collision of vessels, salvage, general average, limitation of liability, marine insurance contracts, statutory limitation and the application of the law to foreign-related matters. Articles 216-256 deal specifically with marine insurance contracts. They cover general provisions, formation, termination and assignment of contracts, obligation of the assured, liabilities of the insurer, abandonment and payment of indemnities.

Another codification of law of insurance is the Insurance Law of the People's Republic of China ("the Insurance Law") which was adopted at the Fourteenth Session of the Standing Committee of the Eighth National People's Congress on 30 June of 1995 and is effective from 1 October 1995. The Insurance Law has a total of 152 articles covering general provisions, property insurance contracts, personal insurance contracts, establishment of insurance company in China, insurance business rules, supervision and administration of the insurance industry, insurance agents and brokers, the legal liability. It does not apply to marine insurance unless the Maritime Code has no corresponding codification. Nor does it apply to agriculture insurance which will be separately regulated in due course. The Insurance Law applies to all the activity in China when dealing with the insurance contracts.

The Contract Law of People's Republic of China ("the Contract Law") which has combined and replaced the Economic Contract Law , Foreign Economic

Contract Law and Technological Contract Law of People's Republic of China has just been passed by the National People's Congress and will be of effect from October 1 of 1999. The Contract Law will also govern the insurance contract including those marine insurance where there are no corresponding stipulations in the Maritime Code or the Insurance Law. The Contract Law takes a more western approach such as the principle of *contra proferentum*; the principle of offer and acceptance when negotiating a contract. The Contract Law has a total of 428 articles including the formation of contract, its legal effects and performance of contract, rights and obligations of the both parties in a contract and their liabilities of breach. The law is divides into two parts, the general principle of contract law and detailed contracts. The insurance contract has not been among those detailed contracts. It is suggested that the insurance contract is govern by the Insurance Law and as far as the marine insurance is concerned, the Maritime Code. However, the insurance contract will inevitably abide by those general principles in the Contract Law.

Besides the enacted legislation by the National People's Congress, many other organisations have law-making power in China. Provincial and local councils also have the power to make regulations for the region provided that they are not inconsistent with those of the National People's Congress. The Supreme People's Court has an interpretative function to fill in the gaps of the codified legislation. The interpretation made by the Supreme People's Court has the prevailing power in interpreting Chinese laws. The Supreme People's Court has the sole direction to promulgate regulations or directions in specific areas, such as, Regulations on Arrest of Ship Before Proceedings; Regulations on Enforce of Sale of Arrested Ship for Reimbursing the Debt by the Maritime Courts. A host of government department are also empowered to legislate in their particular area, such as State Economy and Trade Commission. However, most of governmental regulations are promulgated by State Council. As far as the law of insurance is concerned, the most significant regulation promulgated by State Council is The Regulations Concerning Property Insurance of People's Republic of China in 1983 ("the Regulations"). The Regulations was made on

the basis the Economic Contract Law and has the dominated guideline for the law of marine insurance before the codification of the Maritime Code and the Insurance Law. The Regulations cover similar stipulations as those in the Maritime Code, including the establishment, amendment, assignment and termination of an insurance contract, the duty of the assured and the obligation of the insurer and so on. The Regulations is still applies to property and marine insurance, it also applies to foreign-related property insurance contracts entered into by Chinese individuals. Some regulations promulgated by Ministry of Communication, such as the liability of oil pollution, wreck removal and tonnage liability etc.

As to the application of law relates to foreign elements matters, the international treaty ratified and acceded to by People's Republic of China will prevail to apply unless the provisions are those on which the People's Republic of China has announced reservations. International practice may be applied to matters for which neither the relevant laws of the People's Republic of China nor any international treaty ratified and acceded to by the People's Republic of China have the similar stipulations.[507]

However, the real power lies in the hands of Chinese Communist party. The party is the guiding force both in practical and constitutional terms.[508] The National People's Congress will not pass any significant laws or make any important policy decisions unless it has met with approval by the party. Important positions in all of the main organisations of the state and legislature are filled by communist party members since it is dominated by only one-party in China's political system.

There is no system of case precedent in China. Case decisions have no binding authority under Chinese law, therefore cases are rarely reported. However, the usefulness of studying Chinese cases as a source of guidance has recently

[507] Article 142 of The Civil Law; Article 268 of The Maritime Code.

[508] Art. 3 of Constitution of PRC (as amended in 1993).

gained prominence in both Chinese and foreign commentaries. This has led to growth in both the number and quality of the cases reported. Opinions of the Supreme People's Court from particular disputes have the most prevailing power in China and it applies to all subsequent similar disputes. This seems to be sort of Chinese precedent. All the opinions or directives promulgated by the Supreme People's Court are empowered as judicial interpretation and have the prevailing power under Chinese law.

a. Concept of subrogation under Chinese law

English law has some conflict of authority as to whether subrogation is a doctrine stemming from the operation of equity or whether it rests upon an implied term in every contract of insurance permitting the insurer to exercise the assured's right.[509] Equity is not part of Chinese law, therefore it is not able to trace how the right of the subrogation originally based. As far as the law of marine insurance is concerned, the law of subrogation is now codified both in the Maritime Code and the Insurance Law. Before the codification in the statues, it is customarily used as an international practice or by way of contractual subrogation in a device of subrogation receipt or as an expressed term in the contract. It may be much more correct to say that the subrogation right is rest upon an implied term in the contract of insurance under Chinese law.

The insurer's subrogation right under Chinese law somewhat tends to be confused as statutory assignment of the assured's right against the third party to the insurer. Before the enactment of the Maritime Code and the Insurance Law, the right of subrogation was first codified in the Economic Contract Law, which contemplates that the right of the assured against the third party must assign to the insurer after the indemnity from the insurer.[510] Similar codification could be

[509] See Chapter III.

[510] Article 25 of the Economic Contract Law.

seen in the Regulations which was promulgated based upon the Economic Contract Law.[511] The confusion similarly remains in the Maritime Code. Article 252 of the Code states:

"Where the loss of or damage to the subject matter insured within the insurance coverage is caused by a third person, the right of the insured to demand compensation from the third person shall be subrogated to the insurer from the indemnity is paid...".

The word of "subrogation" is used in the English translation version, however the true meaning under the Code which it was written in Chinese should be defined as "transfer" in stead of "subrogate".

It seems less confusing under the Insurance Law, the definition seems more closely to English counterparts which was enacted in the Marine Insurance Act of 1906.

"*When the occurrence of the insured event results from the loss or damage to the Subject matter of the insurance caused by a third party, the insurer may be subrogated into the insured's right of indemnity against the third party up to the amount of indemnity from the date when the amount of indemnity is made...*".[512]

The legal right of the insurer after payment contemplated by the Insurance Law is distinguishable from that of the Maritime Code. Under the Insurance Law, it is much more like the concept of subrogation. However, under the Maritime Code, the right tends to be statutory right of assignment. Chinese law is originally derived from the civil law system and many of the statutes have been influenced by the Roman civil law system. Under the Roman law, the word of subrogation does not approach the meaning of that word in English law. In Roman law, the term subrogation was a well-known term of constitutional law,

[511] Section 19 of the Regulations.

[512] Article 44 of the Insurance Law.

denoting the replacement of one official by another, or replacing one official's action with another action. There is no subrogation by law under Roman law unless the actions are actually transferred.[513] Thus, the right of subrogation tends to operate as an implied assignment under the civil law system. This is suggested that the Chinese legislators have been so influenced by the Roman civil system and therefore confused the subrogation right as right of legal assignment. In the contrary, the Insurance Law is more approaching to that of common law counterparts at least in respect of the law of subrogation.

It is submitted that the law of subrogation under Chinese law is not a statutory assignment or an implied assignment. Assignment and subrogation are two distinct legal doctrines.[514] By virtue of a valid legal assignment, the insurer is entitled to sue in his own name and to acquire all the proceeds of recoveries even though it exceeds his payment, where the subrogation right only confers upon the insurer an amount no more than his payment. Under English law, the right against the third party tortfeasors always vests in the assured whether there is a full indemnity or not and the insurer can only step into the assured's shoes for exercising the subrogation right. However, under Chinese law, the insurer is conferred upon a direct right against the third party for what he has paid, while "the right of indemnity by subrogation exercised by the insurer shall in no way affect the assured's right of indemnity against the third party for the unindemnified amount".[515] To construe the subrogation right as statutory assignment will inevitably deprive the assured of the right against the third party for his uninsured loss and will be contrary to the codification in the Insurance Law.

[513] W.W. Buckland, Equity in Roman Law, 47-54 (1911), cited from M. L Marasinghe, *An Historical Instruction to the Doctrine of Subrogation: The Early History of The Doctrine I*, Valparaiso University Law Review v.10, 1976.

[514] See detailed discussion in Chapter X. 2.

[515] Article 44 of the Insurance Law.

Further, the wordings under the Maritime Code and the Insurance Law tend to be ambiguous. By virtue of both the Maritime Code and the Insurance Law, the insurer is entitled to be subrogated into the assured's right against those who cause the loss to the subject matter insured, other than rights and remedies of the assured which may come into his hands to diminish the losses occurred. It seems the insurer is only subrogated to those rights and remedies of the assured which losses are caused by third party by tort or breach of contract but not including those contractual rights and statutory rights of the assured, this would be discussed below. In the meantime, the insurer shall not be entitled to those gifts which come into the assured's hands no matter whether it is to diminish the loss or not. As far as marine insurance is concerned, it will encompass those payment under TOVALOP. Therefore, under Chinese law, in the event of cases like *Castellain v. Preston*[516]; *Sterns v. Village,*[517] the insurer shall be no right of subrogation after the indemnity whatever there is a contractual right of the assured or any voluntary payment from a third party.

Moreover, it seems clear that the right of subrogation under Chinese law arises from the indemnity of the insurer. Thus, before making any payment to the assured under the policy, the insurer has no right to take any action to protect their potential rights which they may acquire after the payment. Under English law, it has been subject of much debate whether the right of subrogation arises from the time of the inception of contract. There is *dictum obita* that the insurer has a contingent right of subrogation when the policy was initiated.[518]

b. Direct right of action by the insurer

The law of subrogation in China has been codified as one of substantive law and there has long been controversial in whose name the right of subrogation is

[516] (1883) 11 QBD 380.

[517] (1950) 10 Com. Cas. 89.

[518] See *Boag v. Standard* [1937] 2KB 113.

to be exercised in the proceedings. In practice, the courts and practitioners tend to favour the direct right of action by the insurer. The rationale has never been well interpreted by courts or any legislative institutions. As has been discussed, before the codification of law of subrogation, the courts would regard the right of subrogation as kind of international practice, a subrogation form is necessary in a subrogation action by the insurer and therefore the right of subrogation has long been recognised in courts. In the meantime, the lawyers have rarely argued about the procedural matter of subrogation action in court. It tends to be contemplated that right of insurer after full indemnity to be a device of transferring the chose in action from the assured to the insurer under civil law and thus inevitably confers upon the insurer a direct right of action. The direct right of action can also been seen in most the civil law system.[519] It is therefore submitted that Chinese approach of exercising the subrogation right has somewhat been influenced by the civil law system. Moreover, the direct right of action is suggested to be in compliance with the civil procedure law in which Article 108 of the Civil Procedure Law of People's Republic of China states, among others, that all the lawsuit must be brought in the name of the party whom has a direct interest in the claim. In the meantime, the intention of the legislators also favoured a direct right of action by the insurer. This could be inferred from the Insurance Law in which it states, *inter alia*, that the assured ceases to have the right to claim against the third party after he has obtained a full indemnity.[520]

Contrary to the approach under Chinese law, direct right of action was rejected from English law unless there is a valid legal assignment.[521] Under English law, the doctrine of privity prevent the insurer to use his own name in the subrogation action, the insurer is only allowed to "stand in the shoes" of the assured and therefore has no right of his own against the wrongdoer. This was

[519] Under Japanese law and French law.

[520] Article 45 of the Insurance Law.

[521] Detailed discussion see Chapter IV. I.

made clear in the House of Lords, in *Simpson v. Thomson*[522] where Lord Cairns said: "*But this right of action for damages they must assert, not in their own name but in the name of the person insured.*"[523] It is submitted that insurer's indemnity under the policy does not discharge the third party's obligation to the assured and the right still vests in the assured. The insurer's subrogation is suggested to be a simple subrogation right.[524] Under the doctrine of privity of contract, the insurer is not supposed to be a party of contract between the assured and the third party wrongdoer. Therefore, the insurer could not avail himself of the assured's right against the third party in his own name. The English approach is completely different to the Chinese counterparts. Chinese courts recognise the direct right of action by the insurer as the effect of the reasons discussed above, however, it does not deprive the assured's right for uninsured loss. "*The right of indemnity by subrogation exercised by the insurer...shall be in no way affect the insured's right of indemnity against the third party for the unindemnified amount.*"[525] The law of subrogation is thus itself confusing under Chinese law, while, on one hand, it contemplates the subrogation right as a statutory assignment of chose of action, on the other hand, the insurer's subrogation right does not extinguish the assured's right for his uninsured loss. It is suggested that the right of subrogation under Chinese law is not a statutory assignment device. In the case of partial payment of the assured's loss, the insurer has no right of suit for the uninsured loss unless he has obtained a valid legal assignment of the assured's claim. The principle of direct right of action by the insurer is more closely related to the Civil Procedure Law of People's Republic of China where requires that any lawsuit must be brought in the name of party whom has the direct interest in the case. This looks similar to the "rule of real party in interest" under the US law. However, no courts have ever interpreted the "rule of real party in interest" pursuant to the Civil Procedure Law of People's Republic of China.

[522] (1877) 3 App. Cas. 279.

[523] Ibid, at. p. 284.

[524] Charles Mitchell, *The Law of Subrogation*, LMCLQ 1994, p487.

[525] Article 44 of the Insurance Law.

The direct right of action by the insurer has caused some consequence of procedure difficulties, in particular, in the case of arrest of ship in China. While the arresting party is usually the assured, after indemnified from the insurer, the insurer faces the difficulty to be replaced in the proceedings which has begun. It is still far from clear whether the insurer could replace the assured in the proceedings. If the answer is negative, then the insurer shall proceeds to court in a separate action and the vessel will be released unconditionally as the assured has ceased to be a lawful claimant in the case when the insurer has fully indemnified him. The difficulty has yet to interpret in courts. However, in writer's opinion, the insurer could join in the proceedings raised by the assured as the insurer is entitled to subrogated into the assured's right against the third party wrongdoers including all the preservative steps the assured has taken.

c. The extent of subrogation right

Unlike the common law position where the insurer is entitled to all those rights and remedies of the assured which come into his hands in diminution of the loss,[526] the extent of subrogation right seems very narrow under Chinese law. Under Article 252 of the Maritime Code, the insurer's subrogation rights are those that the right of the insured to demand compensation from the third party where the loss of or damage to the subject matter insured within the insurance coverage is caused by that third party.

Similarly, by virtue of article 44 of the Insurance Law, the insurer may be subrogated into the assured's right of indemnity against the third party when the occurrence of the insured event results from the loss or damage to the subject matter of the insurance caused by that third party. Both laws emphasis on the

[526] See further in Chapter VII.

subrogation rights of those which the assured possesses against the third party whom cause the loss or damage to the subject matter insured.

Therefore, it seems that under Chinese law, the insurer's subrogation right are merely related to torts and breach of the contract by the third party. First of all, the extent of the subrogation right are those in respect of the "loss or damage" of the assured. Gifts paid to the assured have nothing to do with the loss or damage of the assured which caused by the third party and therefore the insurer is not entitled to any gift whether it comes into the assured's hands for the diminution of the loss or not. The position under common law is that the insurer has the subrogation right insofar as the gift is intended to diminish the loss of the assured.[527] Secondly, the loss or damage should be "caused by" the third party. It does not include those contingent contract right of the assured and those statutory right of the assured. In the case of the *Castellain v. Preston*,[528] the insurer has no rights to recoup those sale price the assured possesses where in the meantime he has obtained the indemnity from the insurer after the house was burn down. Furthermore, it is not clear what the "third party" consists of. In the context of marine insurance, the third party may not include those co-assureds and sister ships. Thus, if two sistership vessels collides each other, the insurer of one vessel would be no subrogation right after paying the loss. However, the sistership clauses in the ITC clauses hulls[529] would confer on the insurer the same right against the other sistership as if the ship belongs to the other shipowner.

Chinese law has limited the right of subrogation against the family member and employees of the assured in the absence of fraud. *"The insurer has no right of indemnity by subrogation against any family member or staff member of the insured unless the occurrence of the insured event ...has resulted from the wilful*

[527] See further in Chapter VI (1).

[528] (1883) 11 QB 380.

[529] Clause 9 of ITC hull 1995.

misconduct of such a third party."[530] However, limit against the co-assureds has not been explicitly codified. If one of co-assured is not within the definition of the "third party", then the insurer's right of pursuing the assured or sistership will inevitably be barred in the absence of fraud whatever under the joint or composite policy. In practice, the subrogation action against the co-assured rarely arises. Chinese courts tend to restrict the insurer right of pursuing the co-assured and sistership.[531] The courts stresses that the subrogation rights can only be enforced against the third party wrongdoers.[532] Similarly, under a void policy, it would be clear that the insurer is not entitled to the subrogation right.

The prerequisite for acquiring a subrogation right under Chinese law is the actual payment of the insured loss. This is clearly stipulated in Article 252 of the Maritime Code which states, among the others, "*...from the time the indemnity is paid*" and in Article 44 of the Insurance Law, "*...from the date when the amount of indemnity is made*". However, it seems less clear under English law whether the right of subrogation arises from the payment of the loss or from the inception of the policy in which the authority of *The Boag*[533] case confers upon a contingent right at the time when the insurance contract is initiated. Under Chinese Law, there is no confusion in respect of when the subrogation right arises. The vagueness remains whether the insured must be fully indemnified under the policy or a full indemnity of the actual loss even though the shortfall is the deductible, in particular, where there is a partial payment from the insurer which does not meet the actual loss of the assured. The difficulties similarly give rise to controversy under English Law.[534]

[530] Article 46 of the Insurance Law.

[531] It is submitted that the co-assured is not within the definition of the third party.

[532] *Annotation of the Insurance Law of PRC*, ed. Yiao Wu Bian, Law Publishing Limited, 1996 at p. 99.

[533] [1937] 2KB 113.

[534] See Chapter II (4) and Chapter V.

Chinese Law confers upon the insurer the partial right over the subject-matter insured in the case of under-insurance but fully indemnify under the policy *"...in the case of under-insurance, the insurer shall acquire the right to the subject-matter insured in the proportion that the insured amount bears to the insured value"*.[535] It could be inferred that the insurer shall be entitled to be partially subrogated to the assured's rights and remedies against the third party wrongdoers in the case of partial payment of the assured's loss especially in the case of under-insurance. In that case, the insurer has the subrogation rights against the third party up to their actual payment to the insured, and the insured meanwhile remains the cause of action over the uninsured losses. Indeed, the Insurance law has the similar codification of not to deprive of the right for the uninsured loss. "*The right of indemnity by subrogation exercised by the insurer in accordance with the first paragraph shall in no way affect the insured's right of indemnity against the third party for the unindemnified amount.*"[536] The effect of partial subrogation right will give rise to difficulties as to the split of cause of action. Chinese law confers upon a direct right of action for the insurer, in the meanwhile, the insured will remain part of cause of action for the uninsured loss against the third party. It may probably lead to two different judgement in a single cause of action. Some scholars in China have suggested to consolidate both actions or by way of joiner in the existing proceedings. In writer's opinion, either ways of these will protect the insurer and the assured's rights and pursuant to the principle of indemnity. Either the insurer or the insured remains the cause of action against the third party wrongdoers and there may be a joiner if one action has been proceed to court or consolidation of both actions. Thus, the insurer and the insured have the rateable right over the recoveries proceeds in proportion to their respective loss and similarly bears rateably the legal costs in the proceedings.

Likewise, there remains unclear as to whether the assured still has the cause of action against the third party over the shortfall of deductible. Under English

[535] Article 256 of the Maritime Code.

[536] Article 44 of the Insurance Law.

law, it seems that a fully indemnity under the policy where there is a deductible clause confers upon the insurer the *dominus litis* over the subrogation action. The insurer shall have the first claims of the recoveries up to his payment and the remaining would hold on trust for the insured.[537] Under Chinese law, the case never reach the courts. In writer's view, the insured will have the similar right as if he is his own insurer for the deductible or excess and therefore, he is entitled to recover against the third party for the deductible in the way of joiner or consolidation of the insurer's subrogation action.

In any event, the insurer can only be "subrogated into the assured's right of indemnity against the third party up to the amount to indemnity", therefore, *"...where the compensation obtained by the insurer from the third person exceeds the amount of indemnity paid by the insurer, the part in excess shall be returned to the insured."* [538] In practice, the insurer only assert an amount of his payment and will not give rise to a recovery exceeding his payment. Therefore, in view of writer, in the case of *The Yorkshire* [539] where there is a windfall due the currency fluctuation, the insurer shall have the windfall for the ground that the insurer has a direct right of action for what they have paid under the policy and the payment reflects the amount the insurer asserts and no more. If the payment from third party exceeds what the insurer assert in the subrogation action, then the insurer should return that part in excess to the insured.

Where there is an *ex gratia* payment from the insurer, it is not clear whether the insurer shall be likely to have a subrogation right. The common law position has been clear that the insurer shall have a subrogation right as long as the payment is honestly made by the insurer.[540] Likewise, under Chinese law, it may be likely for awarding a subrogation right unless the loss is clearly within the exclusion clauses. The approach will be in line with the Article 252 of the

[537] See Chapter V (4).

[538] Article 254 of the Maritime Code.

[539] [1962] 2QB 330.

[540] See Chapter VI (2).

Maritime Code which confer upon the insurer right of subrogation against the third party "where the loss of or damage to the subject matter insured *within the insurance coverage* is caused by a third person." By contrast, if the insurer has paid to the insured by mistake, then he can recourse against the insured as a matter of mistake.

d. Duty of the assured to preserve the subrogation rights

Given that the right of claims against the third party vests in the assured whether there is an indemnity or not, thus, the insurer's rights to be subrogated into the assured right against the third party wrongdoer may be prejudiced by the assured either before the indemnity or after the indemnity. Under Chinese law, both the Maritime Code and the Insurance Law have the codification for restricting prejudice of the subrogation right.

The legal effect of prejudice of subrogation rights may be clarified by the intention of the assured under Article 253 of the Maritime Code:

"Where the insured waives his right of claim against the third person without the consent of the insurer or the insurer is unable to exercise the right of recourse due to the fault of the insured, the insurer may make a corresponding reduction from the amount of indemnity."

By the virtue of the this Article, it seems that the Code simply defines the legal effect of waiving subrogation right by the assured before the indemnity from the insurer. It is unclear as to the legal effect for prejudicing the insurer's subrogation right after the indemnity. Similarly, the vagueness in the Article remains in whether a clause exempting the subrogation right made before the indemnity but after the inception of the policy will bind the insurer. The defect has partly remedied by the Insurance Law.

"If the insured waives the right of indemnity against the third party after the occurrence of the insured event and before the insurer making the indemnity, the insurer shall bear no obligation for indemnity. If the insured, without the insurer's consent, waives the right of indemnity against the third party after indemnity is made by the insurer, the waiver of the insured shall be regarded as invalid. The insurer may deduct a corresponding sum from the amount of indemnity if it is not able to exercise the right of indemnity by subrogation due to the fault of the insured."[541]

In the case that subrogation right is waived by the assured, it is conflicting effect between the Maritime Code and the Insurance Law. Before the indemnity from the insurer, the waiver of the subrogation right by the insured gives rise to a corresponding reduction from the amount of the indemnity under the Maritime Code, while under the Insurance Law the insurer bears no liability for indemnity after the occurrence of the loss but before the indemnity from the insurer. By contrast, after the indemnity from the insurer, the waiver of subrogation right by the insured shall be regarded as invalid under the Insurance Law. But the Maritime Code remains silent under such circumstance. It is still ambiguous whether waiver of subrogation right by the assured extends to any compromise agreement made between the assured and the third party.[542] Chinese law tend to restrict the assured to make any claim against the third party after he has obtained a full indemnity from the insurer. Therefore, under Chinese law, any release by the assured after a full indemnity may be held invalid. The codification in the Insurance Law should not be interpreted to include any compromise by the assured for uninsured loss with the third party in the case that the insurer only partially indemnify the assured's actual loss. If otherwise, it will inevitably deprive the assured of claims for the uninsured loss. It remains unclear whether any compromise by the assured for the whole losses including the insured loss will be held invalid under this Article. Under English law, any release by the assured will ultimately bind the insurer, however, the assured will

[541] Article 45 of the Insurance Law.

[542] In writer's view, it should be included in all the compromise agreement made by the assured.

be liable for damage for the insurer unless it is honestly made by the assured. Whether Chinese courts will accept that the compromise will bind the insurer as the authority in *Commercial v. Lister* [543] is far from clear. It is the opinion of the writer that, in the case the assured has been fully indemnified, any agreements between the assured and the third party will not bind the insurer under Chinese law, while in case of partial indemnity, compromise by the assured for the whole loss including the insured loss and the uninsured loss will certainly bind the insurer no matter whether it is honestly made or not unless the third party acknowledges the existing subrogation right before the compromise is made. If otherwise, it will impose a huge duty upon the third party to check whether the assured has been indemnified by the insurer and the third party will thus be possibly claimed by the insurer for the same loss after the third party has already paid the whole loss to the assured. This seems unjust to the third party. However, the insurer is entitled to sue for damage against the assured for prejudicing his subrogation right if it is not made in good faith. If the compromise is only made by the assured for the uninsured loss, then it will not bind the insurer in any event.

If the loss of subrogation right is due to the fault of the assured, both the Maritime Code and the Insurance Law have the similar effects of conferring upon the insurer the right to a corresponding reduction from the amount of the indemnity. However, it is unclear whether the duty of the assured for not prejudicing the subrogation right will include the duty for protecting the time limit and arrest of vessel. In practice, there is a clause in the policy to impose the assured to preserve the rights against the carriers, bailees or other third parties.[544] It will suffice to be held to be breach of the duty under this clause if the time limit against the carrier has not been well preserved. But the clause will not impose upon the assured a duty to arrest the vessel as far as marine insurance is concerned.

[543] (1874) L.R. 9 Ch App. 483.

[544] ICC (A) 1/1/82, cl.16.2.

Article 45 of the Insurance Law is construed as the duty of the assured after the occurrence of a peril insured. However, the Article remains silent as to whether any act depriving the subrogation right by the insured before the occurrence of a peril insured will be binding on the insurer. It is similarly unclear under the Maritime Code. The insurer may be held to be entitled to a corresponding reduction from the amount of the indemnity under such circumstance, however, it may not affect the validity of any release by the assured before the occurrence of loss. Therefore, under Chinese law, a benefit of insurance clause in the bill of lading will probably be held effective. However, the insurer may deny the liability by pleading the duty of non-disclosure of the assured if there is a non-disclosure when the insurance is initiated, alternatively, he can make a corresponding reduction from the amount of indemnity. Similarly, it may be held valid if any agreement by the assured excluding the subrogation right is concluded after the policy is initiated but before the occurrence of a peril insured.

Furthermore, silence under Chinese law meanwhile remains in which the insurer has the right of recoupment against the assured if the assured further obtains an indemnity from the third party after he has fully indemnified by the insurer. The right of subrogation under Chinese law seems to be those of the assured's claims against the third person. Unlike the common law position, the insurer will avail himself of the equity to recoup from the assured for any surplus he has retained from the third party. The purpose of the subrogation right is to prevent the assured from double compensation, therefore, if the assured has been overcompensated more than his losses, all the surplus may be held on trust for the insurer and the insurer has the cause of action to recoup from the assured for any surplus. Likewise, under Chinese law, the insurer is entitled to recoup any surplus from the assured if he is over-compensated for his loss on the ground of unjust enrichment. However, complex will arise in the case of partial payment and the assured is not fully indemnified by the insurer. Even if the assured further obtains the indemnity from the third party, he will not be fully indemnified, will the insurer has a right of recoupment from the

assured in proportion to his payment? In writer's view, the insurance is said to be an indemnity contract and until the assured has been fully indemnified, it will be contrary to the indemnity to allow the insurer to participate in any proportionate share of recoveries. However, as far as marine insurance law is concerned, it could be inferred from article 256 of Maritime Code that, in the case of under-insurance, the insurer is entitled to be partially subrogated into the assured's right against the third party wrongdoers in proportion to his payment bears to the total losses as if the assured is his own insurer for his uninsured loss. Thus, it may be possible for the insurer to recoup from the assured in proportion to his payment if the assured has compromised the whole loss with the third party.

Chapter XI Conclusion

Subrogation in marine insurance is complex in nature and international in scope. The writer has primarily examined the doctrine based on English law where the historic reason has given its reputation in the field of marine insurance law and in effect has in large or less extent affected the other legal regimes in the world. However, the legal problems remain in the application of the doctrine and criticism of the doctrine being rigid and inequitable to the assured has been generated not only among the academic scholars[545] but also by the UNCTAD secretariat.[546]

In particular, in respect of the agreed value in the subrogation recovery. As criticised by the UNCTAD secretariat, "the rule making the agreed value in the policy binding the determination of the right of the parities to any recoveries from third parties should be altered in view of the resulting in equitable preference given to the insurers in cases where the actual value of the insured subject is greater than the agreed value".[547] Similarly, English practice which deprive the assured of participating in the recovery in respect of the deductible has also been suggested to be inequitable to the assured. The UNCTAD secretariat suggested that " the clause in standard hull policies denying the shipowner a co-insurer status to the extent of his deductible, thereby denying him proportional rights to participate in recoveries from third parties and instead giving the insurer preference in such recoveries, is inequitable to the shipowner and should be amended".[548] Much of the defects in the English law have been analysed in the thesis and although the criticism of the application of the doctrine has carried a great weight, the defects remain unsettled. Fortunately,

[545] Reuben Hasson, *Subrogation in Insurance Law---a Critical Evaluation.* Oxford Journal of Legal Studies Vol. 5, No.3, 1985.

[546] UNCTAD report on legal and documentary aspects of the marine insurance contract, 1982.

[547] Supra, p.36.

[548] Supra, p.36.

some hardships have been overcome by inter-regulations among the insurers.[549] In Australia, most of the defects have been altered in the Insurance Contract Acts.

Likewise, the Chinese law is also problematic in this area. It is vague, ambiguous and in the meantime very conflicting. The lack of judicial decisions and interpretation of the application of the doctrine give rise to hardship for the better understanding of the exact legal effect of the doctrine. It is suggested that a comprehensive interpretation by the Supreme People's Court is necessary to fill the gap and the courts are not to encourage to impose a harsh result towards the doctrine.

Few has addressed the future subrogation except Clarke and Birds in their great works of insurance contract law. Subrogation is submitted necessary to preclude double recovery by the assured or any unjust enrichment which the assured is able to claim from the insurer and the tortfeasors causing the loss or damage. However, it is equally unjust to preclude the insurer from suffering a loss, which it had expressly agreed to assume as a risk in return for the payment of the premiums. Thus, it has been argued that subrogation recovery is a windfall to the insurer. It has been further argued that the subrogation is a waste of legal costs and make the insurance even more expensive as most of the subrogation actions are between two insurers, therefore, it must be abolished. It would be difficult to cite them as justification for abandoning the doctrine of subrogation. Insofar as marine insurance is concerned, the recoveries seem relatively weight in the underwriting perception, especially in heavy marine disaster which occur invariably as the effect of negligence of third party other than the assured. The potential net recoveries would mean to the insurer to reduce the loss paid and therefore affects the rating. In the meantime, subrogation remains a useful device to curb a negligent third party while the assured can get the indemnity quickly without recourse to the court. Although

[549] See: *Insurance Law Reform*, A Report by the National Consumer Council, May 1997.

the "knock for knock" agreements allow substantial saving in the expenses involved in the recovery. Fortunately, the agreement does not seem to be widespread although they do exist among a few companies and for the nature of marine insurance, it would seem rather difficult to curb the exercise of subrogation rights for the reason of its international characteristics.

In writer's opinion, subrogation should continue to exist as an important doctrine in the law of marine insurance, what need to be altered are those defects remain in the application of the doctrine. Most of defects remain in the English law have not been followed by other jurisdictions, in particular, in the USA and Australia. Under Chinese law, many issues have not been reached the courts and it is hoped that Chinese courts will take into account those defects discussed and make judgements more impartial.

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