UNIVERSITY OF SOUTHAMPTON

THE LAW OF CO-INSURANCE POLICIES

BY

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For my mother, and her grandchildren

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ABSTRACT

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Co-insurance policies have increasingly become a common feature in the insurance market, and their use has raised numerous questions in the courts as to both their interpretation and implementation. The focus of this thesis shall be to resolve some of these issues and also to determine the relevance of such policies to parties relying upon them.

In achieving the above aims, emphasis shall be placed on the extent of which co-insurance policies provide and protect parties with the twin benefits available to a party under an insurance policy, i.e. rights of enforcement against the insurer and subrogation immunity. A comparison shall also be made with alternate ways, other than co-insurance, through which a third party can attain the above benefits. It is hoped that through this exercise, the relevance of co-insurance policies can be further highlighted.

As mentioned above, an essential part of this thesis shall also be to critically examine the approach of the English courts in resolving major issues in relation to the interpretation of such policies. It is hoped that such an exercise would provide an insight into the present law relating to such policies and, where necessary, offer solutions which would facilitate in the development of a coherent body of rules necessary for the implementation of such policies.

Overall, it is hoped that through the above analyses, the laws relating to such policies, can be better understood and developed in order to satisfy the legitimate expectations of parties relying upon them.

TABLE OF CONTENTS

TABLE OF CASES	**i**
TABLE OF STATUTES AND STATUTORY INSTRUMENTS	**ix**
ACKNOWLEDGEMENTS	**xi**
PREFACE	**xii**

CHAPTER I

THE NATURE OF CO-INSURANCE POLICIES

1. The joint-composite policy distinction	**1**
1.1 Introduction	1
1.2 Case laws	1
1.3 The justification for the rule of construction	4
1.4 An alternative approach	5
1.5 Composite policies: A distinction within?	6
1.6 Contingent policies	9
2. The insurable interest requirement	**11**
2.1 Introduction	11
2.2 The pervasive interest doctrine	12
2.3 The extent of the doctrine	18
2.4 Pervasive interests: joint or composite policy?	20
2.5 Conclusion	21

CHAPTER II

CREATION OF CO-INSURANCE POLICIES: ENFORCEMENT RIGHTS OF EACH CO-INSURED

1. Introduction	**22**
2. Co-insurance and agency	**23**
2.1 Proposition One: X is authorized to insure on Y's behalf	24
2.1.1 Authority	24
2.1.2 Intention	25
2.1.3 The Undisclosed principal doctrine	27
2.1.4 Are the agency principles applicable to insurance contracts?	30
2.2 Proposition Two: X has no authority to insure on Y's behalf	32
2.2.1 Lack of authority	32
2.2.2 Intention	32

2.2.3 The policy is expressed to insure the principal insured and others. 33

2.2.4 Y must be legally competent to enter into the contract and must be capable of being ascertained as a co-insured, at the time the contract was effected 33
2.2.5 Ratification 39
2.3 The scope of the agency principles 40

3. Conclusion **44**

CHAPTER III

WILFUL MISCONDUCT AND THE RIGHT OF TERMINATION

1. Introduction **46**

2. Wilful misconduct by a co-insured **46**
2.1 The application of the rule of construction to joint policies 49
2.2 The modern approach 51
2.3 The application of the modern approach 51
2.4 The Canadian jurisdiction 52
2.5 The New Zealand jurisdiction 57

3. Can the English courts apply the modern approach? **59**
3.1 Conceptual difficulties 59
3.2 The English Courts' ruling on the modern approach 62
3.3 Conclusion 63

4. The co-insured's right of termination **65**
4.1 The right to terminate the whole policy 65
4.2 Can a co-insured unilaterally terminate his cover? 67
4.3 *Federation Insurance Ltd. v. Wasson and others* 68
4.4 Conclusion 71

CHAPTER IV

CO-INUSREDS AND THE DUTY OF UTMOST GOOD FAITH

1. Introduction **72**
1.1 The pre-contractual duty 73
1.2 The post-contractual duty 75

2. The application of the duty to co-insurance contracts **76**
2.1 Scenario 1: All the co-insureds negotiate directly with the insurer 77
2.2 Scenario 2: One co-insured negotiates and contracts with the insurer for the benefit of all 77

2.3 Scenario 3: The insurance contract identifies the co-insureds, but at the time the contract is effected, the actual identity of each co-insured is not known 78
2.4 Scenario 4: Insurance under Block policies 81
2.4.1 The block policy as a contract of insurance 83
2.4.2 The block policy as a contract for insurance 83
2.5 Conclusion 85

3. The obligation of the co-insured **85**
3.1 The pre-contractual duty 86
3.2 The approach of the Common law 88
3.3 The case laws 88
3.4 The principle in *Samuel v. Dumas* 93
3.5 Variations, renewals and the application of held-covered clause provisions 99
3.6 Conclusion on the pre-contractual duty 100
3.7 The obligation imposed by the post-contractual duty 103

4. Conclusion **104**

CHAPTER V

THE WARRANTY OBLIGATION

1. Introduction **105**
1.1 Warranties in insurance law 105

2. Warranties in co-insurance contracts **108**
2.1 The joint-composite distinction 108
2.2 The 'separate contracts' analysis 110

3. Situations in which the warranty imposes separate obligations **112**
3.1 The contract of insurance expresses a contrary intention 112
3.2 Multi-risk policies 113
3.3 Policy of insurance in which each co-insured has a distinct and independent subject matter of insurance 114
3.3.1 Warranty obligation not joint, but severable 115
3.3.2 The 'separate contracts' argument 117

4. 'Basis of contract' clauses **118**

5. Conclusion **120**

CHAPTER VI

SUBROGATION IMMUNITY

1. Introduction **121**

2. Subrogation immunity in co-insurance policies **121**
2.1 Joint policies 121
2.2 Composite policies 123
2.2.1 Conceptual analysis 123
2.3 The approach adopted by the English Courts 124
2.4 The pervasive interest doctrine and subrogation immunity 125
2.5 The circuity of action defence 126
2.6 The nature of the rule against circuity 127
2.7 Implied term in the contract of insurance 130

3. The *Taylor Young* Case **131**

4. Co-insureds lacking underlying contractual relationships **134**

5. The extent of the immunity **137**
5.1 When the loss suffered has been caused by the wilful misconduct of a co-insured. 137
5.2 The co-insured responsible for the loss was, at the time of the loss, not covered under the policy 137

6. Conclusion **138**

CHAPTER VII

THE CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

1. Introduction **139**

2. The right of enforcement under the 1999 Act **139**
2.1 Section 1(1)(a) of the Act 140
2.2 Section 1(1)(b) of the Act 141

3. The insurable interest requirement **142**

4. The effect of the Contracts Act 1999 on the *National Oilwell* Principles **145**
4.1 Conceptual differences 146
4.2 Consequential differences 146
4.2.1 The extent of the co-insured's right 146
4.2.2 Variation and rescission of the right 148
4.2.3 Composite policies: The 'separate contracts' analysis 151
4.3 Procedural differences 153
4.4 Does the 1999 Act make the agency rules redundant? 154

4.5 The insurer's defence under the 1999 Act 155

5. Subrogation waiver clauses **158**
5.1 The position at common law 158
5.2 The Approach of the Province of Western Australia: *Woodside Petroleum Development Ltd v. H & R-E & W PTY & ORS* 163
5.3 The effect of the 1999 Act 164

6. Conclusion **167**

CHAPTER VIII

ALTERNATIVE MEANS AVAILABLE TO THIRD PARTIES

1. Introduction **169**

2. Policies enuring to the benefit of third parties **169**

3. The bailment cases **170**
3.1 When does the principle apply? 172
3.2 The right of the third party 174
3.3 The right of the third party prior to the 1999 Contracts Act 175
3.4 The right of the third party against the insured 176
3.5 The bailor's proprietary interest in the policy proceeds 178
3.6 The effect of the Contracts Act 1999 179

4. The insurance of real property **181**
4.1 The Life Assurance Act 1774 181
4.2 Landlord and tenant cases 183
4.3 The right of the third party 185
4.4 The third party's right under s.83 of the Fires Prevention (Metropolis) Act 1774 186
4.5 The right to the policy proceeds when reinstatement is impossible 187
4.6 The effect of the Contracts Act 1999 190

5. Subrogation immunity **191**
5.1 Bailment cases 191
5.2 Subrogation immunity in Landlord and tenant cases 193
5.3 The nature of the immunity 195
5.4 The possible extension of the rule in *Mark Rowlands* beyond landlord and tenant cases 197
5.5 The limit of the immunity 199
5.6 Conclusion 200

6. The third party as a trust beneficiary **201**
6.1 Declaration of a trust 202
6.2 The search for an intention: The insurance policy or beyond? 202
6.3 The intention to create a trust 203

6.4 Must the third party have an insurable interest in the subject matter of the insurance? 204
6.5 The right of the third party beneficiary 205
6.6 Subrogation immunity 205
6.7 The effect of the Contracts Act 1999 206
6.8 Conclusion 207

7. Noting **207**
7.1 A right to the insurance proceeds? 208
7.2 Noting and the Contracts Act 1999 209
7.3 Subrogation immunity 210
7.4 Conclusion 211

CHAPTER IX

CONCLUSION

1. General overview **212**

2. The nature of co-insurance policies **213**

3. Co-insureds and rights of enforcement **214**

4. Co-insureds and subrogation immunity **217**

5. The Contracts Act 1999 as an alternative to co-insurance policies **218**

6. Policies enuring to the benefit of third parties and other alternative means **219**

7. The continuing relevance of co-insurance policies **221**

BIBLIOGRAPHY **223**

TABLE OF CASES

Agnew-Surpass Shoe Stores Ltd. v. Cummer-Younge Investments Ltd. (1975) 55 D. L. R. (3d) 676 194

Advance Insurance Agencies v. Matthews (1988)12 N.S.W.L.R. 263..89

Agapitos and Others v. Agnew. [2002] 2 Lloyd's Rep. 42 ....47, 93

Albazero, The. [1977] A.C. 745 ....42, 43, 178

Arab Bank v. Zurich. [1999] 1 Lloyd's Rep. 262 ....8, 34, 70, 79 ....80, 91, 93, 96, 97, 98, 119, 215

Bank of Nova Scotia v. Hellenic Mutual Risk Association (Bermuda) Ltd. The Good Luck . [1991] 3 All E.R. 1 ....106, 107, 109

Banque Keyser Ullman SA v. Skandia (UK) Insurance Co. Ltd. [1990] 1 Q.B. 665 ....74, 75

Barras v. Hamilton. [1994] S.L.T. 949 ....199, 200, 220

Beresford v. Royal Insurance Co. [1938] A.C. 586 ....46, 166

Beacon Carpets Ltd. v. Kirby. [1985] Q.B. 755 ....188, 189, 190

Beswick v. Beswick. [1968] A.C. 58 141

Brewer v. Westminster Bank Ltd. [1952] 2 All E.R. 650 ....2, 66

Caisse Populaire v. Societe d'Assurances (1984) 19 D.L.R. (4th) 411 ....102, 208

Canadian Imperial Bank of Commerce v. Dominion of Canada General Insurance Co. (1988) 46 D.L.R. (4th) 77 ....102, 208

Canadian Pacific Ltd. v. Base Fort Security Services Ltd (1991) 77 D.L.R. (4th) 178 26

Carlill v. Carbolic Smoke Ball. [1893] 1 Q.B. 256 37

Carter v. Boehm. (1776) 3 Burr. 1,905 ....72, 74, 86

Castellain v. Preston. (1883) 11 Q.B.D. 380 ....169, 173, 183

Cochrane v. Leckie's Trustee (1906) 8 F. (Ct. of Sess.) 975 ....174, 178

Colonial Mutual General Insurance v. ANZ Banking Group Ltd [1995] 1 W.L.R. 1,140 209

Commonwealth Construction Co. Ltd. v. Imperial Oil Ltd
(1997) 69 D.L.R. (3rd) 558..............................12, 13, 14, 15, 122, 123, 125

Constitution Insurance Co. of Canada v. Kosmopoulos
(1987) 34 D.L.R. (4th) 208 14

Co-operative Retail Services v. Taylor Young
[2001] 1 Lloyd's Rep. I.R. 122 (CA); [2002] 1 All E.R. (Comm.)
918 (HL) 127, 129, 131, 133, 134, 136, 138, 198, 199, 213, 217

Crippen, Re. [1911] P. 108 166

C.T.N. Cash and Carry Ltd. v. General Accident Fire
and Life Assurance Corporations Plc. [1989] 1 Lloyd's Rep.
299..107

D.G. Finance Ltd. v. Andrew Scott and Eagle Star Insurance Ltd
[1999] Lloyd's Rep. I.R. 387 ....26, 36, 39, 40, 41, 42, 43
....44, 175, 176, 178, 179, 202, 203, 204, 205

Davjoyda Estates Ltd. v. National Insurance Co. of New Zealand.
(1969) 69 S.R. (N.S.W.)
381..183

Dawsons v. Bonnin [1922] 2 A.C. 413 118

De Hahn v. Hartley (1786) 1 T.R. 343 105

Deepak Fertilisers & Petrochemical Corporation v. ICI Chemicals
& Polymers Ltd. [1999] 1 Lloyd's Rep.387......................18, 19, 21, 131, 137

Direct Line Insurance v. Khan. [2002] Lloyds Rep. I.R. 364 ....48, 49, 51
....62, 63, 67, 99

DSG Retail Ltd v. QBE International Insurance Ltd
[1999] Lloyd's Rep. I.R. 283 ....9, 10, 11

Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge & Co. Ltd.
[1915] A.C. 849 ....22, 159

E. Dibbens & Sons Ltd. (in Liquidation), Re. [1990] B.C.L.C. 577
....42, 177, 178, 180

Economides v. Commerical Union Assurance Co. Plc.
[1999] 3 All E.R. 636 74

Enimont Supply SA v. Chesapeake Shipping Inc.,
The Surf City. [1995] 2 Lloyd's Rep. 242 ....161, 162, 164

Federal Insurance Ltd. v. Wasson and others. (1987) C.L.R. 303 68
....69, 70, 71

First National Commercial Bank Ltd. v. Barnet Devanney
[1999] C.L.C. 11 (High Ct.); [1999] 2 All E.R. (Comm.) 233 (C.A)
....90, 94, 95, 102, 208

Forsakringsiktieselskapet Vesta v. Butcher. [1989] 1 All E.R. 402 106

Fraser River Pile & Dredge Ltd v. Can-Dive Services Ltd
[2000] 1 Lloyd's Rep. 199 ....35, 149, 150

GD Construction (St. Albans) Ltd. v. Scottish & Newcastle Plc.
[2003] EWCA Civ. 16
....133, 134

Galloway v. Guardian Royal Exchange (U.K.) Ltd.
[1999] Lloyd's Rep. I.R. 209 ....46, 47

Gate v. Sun Alliance. (1995) 8 A.N.Z. Insurance Cases 61-251, 75,806
....5, 6, 58

General Accident Fire and Life Assurance Corporation Ltd v.
Midland Bank and Others. [1940] 2 K.B. 388 ....1, 2, 3, 4, 5
....6, 7, 89

General Accident Fire and Life Assurance Coporation v. Tanter,

The Zephyr. [1985] 2 Lloyd's Rep. 529 34

Glengate-KG Properties Ltd. v. Norwich Union Fire Insurance Society
[1996] 1 Lloyd's Rep. 614 ....16, 17, 18, 19

Glicksman v. Lanchashire Assurance [1927] A.C. 139 119

Goorberg v. The Western Assurance Coy. 150 Cal. 510 117

Great American Insurance Co. v. Curl. (1961) 181 N.E. 2d 916 135

Grover & Grover Ltd. v. Mathews. [1910] 2 K.B. 405 ....39, 40

HIH Casualty v. Chase Manhattan Bank. [2001] 1 Lloyd's Rep. 30 84

Hampshire Land Co., Re [1896] 2 Ch. 743 98

Harmer v. Armstrong. [1934] Ch. 65 205

Hedtcke v. Sentry Insurance Company. (1982) 109 Wis. 2d 461
....50, 54

Hepburn v. A. Tomlinson (Hauliers) Ltd. [1965] 2 W.L.R.634 (C.A.);
[1966] A.C. 451(HL) 12, 42, 43, 171, 172
....173, 175, 176, 181, 185, 206

Home Insurance Company v. Pinski Brothers. 160 Mont. 219 135

Higgins v. Orion Insurance Co. [1985] 17 D.L.R. (4th) 90 ....51, 52
....53, 54

Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd
[1962] 2 Q.B. 26 104

Hopewell Project Management Ltd. v. Ewbank Preece Ltd
[1998] 1 Lloyd's Rep. 448 ....26, 33

Hoyt v New Hampshire Ins. Co. (1942) 29 A. 2d 121 (N.H.)
....54

Hussain v. Brown. [1996] 1 Lloyd's Rep. 627 107

Jones v. Yates. (1829) 9 B. & C. 532 ....2, 66

K/S Merc-Scandia XXXXII v. Certain Lloyd's Underwriters,
The Mercandian Continent. [2001] 2 Lloyd's Rep. 563 ....72, 75
....76, 80, 85, 99, 103, 104

Keightly v. Watson (1849) 3 Ex. 716 3

Keightly, Maxstead & Co. v. Durant. [1901] A.C. 240 27

Kelner v. Baxter. (1866) L.R. 2 C.P. 174 33

King Decd., Re [1963] Ch. 459 ....42, 175, 176, 181, 187
....188, 189, 190

Kler Knitwear Ltd. v. Lombard General Insurance Co. Ltd.
[2000] Lloyd's Rep. I.R. 47 107

Koenigsblatt v. Sweet. [1923] 2 Ch. 314 39

Lambert v. Keymood Ltd. [1999] Lloyd's Rep. I.R. 80 195
....196, 197

Lonsdale & Thompson Ltd. v. Black Arrow Group Plc. [1993] Ch. 361
....183, 184

Lucena v. Craufurd. (1806) 2 Bos. & P.N.R. 269 ....14, 17

Luxor (Eastbourne) Ltd. v. Cooper. [1941] A.C. 108 81

Macaura v. Northern Assurance Co. Ltd [1925] A.C. 619 14

Mackay v. London General Insurance Co. ltd. (1935) 51 Ll.L.R. 201 119

Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co., The Star Sea
[2001] 1 Lloyd's Rep. 389..46, 75, 76, 103, 114

Mark Rowlands Ltd. v. Berni Inns Ltd [1986] Q.B. 211 ....17, 132, 166
....169, 182, 185, 193, 194, 195, 196, 197
....198, 199, 200, 219

Maulder v. National Insurance Co. of New Zealand Ltd.
[1993] N.Z.L.R. 351..5, 6, 51, 57, 58, 59, 67

Morgan Grenfell & Co. Ltd v. Welwyn Hatfield District Council
[1995] 1 All E.R. 1 143

Mumford Hotel v. Wheeler. [1964] Ch. 117 ....183, 185

Napier and Ettrick v. Kershaw. [1993] 1 Lloyd's Rep. 197 135

Natal Land Co. v. Pauline Syndicate [1904] A.C. 120 33

National Oilwell Ltd v. Davy Offshore Ltd. [1993] 2 Lloyd's Rep. 582
....15, 23, 24, 25, 26, 29, 32, 34, 39, 40, 44, 110, 123
..............................129, 130, 137, 140, 145, 146, 147, 148, 153, 159, 160
....161, 165, 198, 214

Newbury International v. Reliance National Insurance Co. (UK)
and Tyser Special Risks. [1994] 1 Lloyd's Rep. 83 143

New Hampshire Insurance Co. v. M.G.N. Ltd [1996] C.L.C. 1,693 ....4, 5, 6
..........................7, 8, 70, 90, 91, 92, 95, 96, 97, 98, 100, 103, 114, 117, 215

New Zealand Shipping Co. Ltd. v. A.M. Satterthwaite,
The Eurymedon. [1975] A.C. 154...38

North British and Mercantile Insurance Co. v. Moffatt. (1871) L.R. C.P. 25
....174

Orakpo v. Barclays Insurance Services Ltd. [1995] L.R.L.R. 443 46

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Pan Atlantic v. Pine Top [1994] 3 All E.R. 581 72

Pennsylvania General Insurance Company v. Austin Powder Company
510 N.Y.S. 2d 67...135

Peters v. Fireman's Fund Insurance Co. of Canada

(1992) 93 D. L. R. (4th) 637 ....55, 56

Petrofina Ltd v. Magnaload Ltd. [1983] 2 Lloyd's Rep. 91 ....13, 14, 17
..........122, 172

Printpak v. AGF Insurance Ltd. [1999] 1 All E.R. (Comm.) 466 105
..........107, 112, 113, 127

Prudential Union Staff v. Hall [1947] 1 K.B. 685 143

Reynolds v. Phoenix Assurance Co. Ltd. [1978] 2 Lloyd's Rep. 440 186

Ross Southward Tire Ltd. v Pyrotech Products Ltd
(1975) 57 D. L. R. (3d) 248 ....194, 197

Samuel v. Dumas. [1924] A.C. 431 ....2, 47, 51, 91, 92
..........93, 94, 95, 97, 98, 137

Saunders v. Vautier. (1841) 4 Beav. 115 206

Scott v. Wawanesa. [1989] 4 W.W.R. 728 ....50, 52, 54, 55, 56, 63

Sharp v. Sphere Drake Insurance, The Moonacre. [1992] 2 Lloyd's Rep. 501
..........16

Sheffield Nickel v. Unwin. (1877) 2 Q.B.D. 214 89

Sidaways v. Todd. (1818) 2 Stark. 400 176

Simpson v. Scottish Union Insurance Company. (1863) 1 Hem. & M. 618
..........186

Simpson v. Thomson (1877) 3 App. Cas. 279 121

Siu Yin Kwan v. Eastern Insurance Co. Ltd,
The Osprey [1994] 1 All E.R. 213 ....27, 28, 29, 30, 31, 183

Sorsbie v. Park (1843) 12 M. & W..........3

State of Netherlands v. Yuoell [1997] 2 Lloyd's Rep. 44..........3, 20

Stone Vickers Ltd v. Appledore Ferguson Shipbuilders Ltd
[1991] 2 Lloyd's Rep. 288 (High Ct.); [1992] 2 Lloyd's Rep 578 (C.A.)
..........14, 15

Surrey Heath Borough Council v. Lovell Construction Ltd

(1990) 48 B.L. R. 108 198

T. Eaton Co. Ltd. v Smith. (1977) 92 D. L. R. (3d) 425 ....194, 196

Teheran-Europe Co. Ltd. v. S.T. Belton (Tractors) Ltd. [1968] 2 Q.B. 545 27

The London and North Western Railway Co. v Glyn (1859) E. & E. 652 ....171, 177, 180

Thomas and Co. v. Brown. (1891) 4 Com. Cas. 186 ....158, 159, 162, 164

Thomas v. National Farmers' Union Mutual Insurance Society [1961] 1 W.L.R. 386 143

Thomson v. Weems (1884) 9 App. Cas. 671 109

Thorpe v. Facey. [1949] Ch. 649 89

Trident General Insurance Co. Ltd. v. McNiece Bros. Pty Ltd (1988) 165 C.L.R. 107 36

Turner v. Davis 2 Wms. Saund. 150 127

Tweedle v. Atkinson. (1861) 1 B.& S. 393 ....22, 159

Vandepitte Appellant v. Preferred Accident Insurance Corporation of New York. [1933] A.C. 70 ....35, 201, 202, 203, 205, 206, 207

Vantage Navigation Corp. v. Suhail and Saud Bahwan Building Materials, The Alev. [1989] 1 Lloyd's Rep. 138 38

Walsh v. Canadian General Insurance Co. (1989) 60 D.L.R. (4th) 358 56

Walters v. Morgan. (1861) 3 De G.F. & J. 718 72

Walmesley v. Cooper. (1839) 11 Ad. & E. 216 ....127, 128, 129

Waters & Steel v. Monarch Fire and Life Assurance Co

(1865) 5 E. & B. 870 ....12, 170, 171, 173, 177, 181

Welsh Development Agency v. Export Finance Ltd [1992] B.C.L.C. 148 26

West v. National Motor & Accident Insurance Union Ltd [1955] 1 Lloyd's Rep. 207 106

Williams v. North China Insurance Co. (1876) L.R. 1 C.P.D. 757............39, 40

Woodside Petroleum Development Ltd. & ORS v. H & R-E & W Pty Ltd. & ORS. (1999) 20 W.A.R. 380 ....159, 163, 164

Woolcott v. Sun Alliance and London Insurance Ltd [1978] 1 Lloyd's Rep. 629 ....82, 83, 84 ....88, 90, 108

Yasin, The. [1979] 2 Lloyd's Rep. 45 ....126, 198

TABLE OF STATUTES AND STATUTORY INSTRUMENTS

UNITED KINGDOM

Contracts (Rights of Third Parties) Act 1999

s.1 .... 141, 155
(1)(a) 140, 141, 164, 179, 193, 209
(1)(b) 141, 142, 146, 151, 164, 179, 180, 193, 206, 209, 210, 211
(2) 141, 142, 147, 164, 179, 190, 206
(3) 141, 190, 193, 207, 211
(4) 147, 165
(5) 142
s.2 148
(1) 148, 165
(a) 150
(3) 148, 180
s.3 155
(2) 155, 156, 157
(3) 157
(5) 157
s.5 191
s.6 154
s.7(1) 154

Criminal Damage Act 1971

s.1(1) 166

Fire Prevention (Metropolis) Act 1774 (s.83) 184, 186, 219

Marine Insurance Act 1906

s.4(1) 133, 143
s.4(2)(a) 11, 133, 143
s.17 .... 72, 74
s.18 .... 72, 73, 88, 100
(1) 74, 77, 86
s.19 .... 72, 73, 78
(a) 78
(b) 78
s.20 .... 72, 88
(1) 74, 77
s.33(2) 119
s.33(3) 105, 106, 112, 113, 116
s.50(2) 10
s.55(2)(a) 46, 95

The Gaming Act 1845
s.18..........143

The Life Assurance Act 1774
s.1..........143
s.2..........181, 182
s.3..........182
s.4..........182

Third Parties (Rights against insurers) Act 1930..........28, 96, 156
s.1(1)..........41

Unfair Contracts Terms Act 1977..........166

Unfair Terms in Consumer Contracts Regulations 1999
..........166

AUSTRALIA

Insurance Contracts Act 1984
s.9(1)(d)..........101
s.28(2)..........101

Marine Insurance Act 1909..........101

Hong Kong

Hong Kong Third Parties (Rights against insurers) Ordinance..........29

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PREFACE

AIMS AND GENERAL OVERVIEW OF THE THESIS

A co-insurance policy is essentially a policy which protects the interests of two or more parties against loss or damage to the subject matter of insurance. Such policies are widely used in the insurance market, both in respect of commercial and domestic risks and are therefore a vital means of providing protection to interested parties. In a contract of insurance, an insured has available to him, two main benefits. The first is a right of enforcement for an indemnity against the insurer in the event of a loss to the subject matter caused by an insured risk. The second benefit is that, by virtue of being an insured, the latter is protected against any subrogated actions of the insurer.[1] The purpose of this thesis is to examine the present law of co-insurance policies in relation to its ability to provide and protect the above benefits to a party insured under a co-insurance contract (each party is referred to as a co-insured), with the aim of determining the relevance of such policies in the insurance market.

In achieving the above aim, the structure of this thesis shall be divided into two main parts. The first part shall focus on the nature of co-insurance contracts and the extent of which the co-insureds can enforce the benefits of rights of indemnity and subrogation immunity. A major theme of this part of the thesis will be to discuss various problems that have been faced by the courts which have the potential of affecting the availability of the above benefits to a co-insured. In addition to discussing these issues an attempt shall be made to offer solutions to them, based on established legal principles and which reflect the reasonable expectations of the parties relying on such policies. It is believed that such an exercise would provide a clearer understanding of co-insurance contracts and a platform on which to evaluate the efficacy of such contracts in being able to provide its co-insureds with the above twin benefits. It should also be pointed out, at the outset that this thesis does not set out to discuss and resolve all the issues relating to co-insurance policies, but to focus on those issues which have been the subject of litigation in the courts and which it is felt that their

[1] The reasons why an insured is protected against a subrogated action is discussed in Chapter VI, pg.121.

resolution would provide a better understanding of the implementation of such contracts.

The second part of the thesis shall focus on the alternative means by which a third party can exercise rights against the insurer and subrogation immunity in insurance policies effected for another party. To this end, four main areas shall be discussed. First, the possible use of the Contracts (Rights of third parties) Act 1999 (hereafter referred to as the Contracts Act 1999) by third parties to enforce terms in an insurance contract shall be explored. Second, an examination of policies enuring to the benefit of third parties shall be made with the aim of determining the extent of the benefits which it provides a third party. Third, a discussion of the possibility of the third party being a trust beneficiary of the policy shall be made and fourth, an inquiry into the effect of noting, and whether it provides the third party with any rights or subrogation immunity against the insurer. These four alternative options have been chosen because each option provides a third party with some right or protection against the insurer and it is necessary to discuss the extent of these in order to determine if they amount to providing the third party with the same protection afforded under a co-insurance contract. In the final analysis, a comparison would be made between the availability of the twin benefits to a third party through the above arrangments and the availability of the same benefits to a co-insured under a co-insurance contract in order to determine the importance of the latter contracts.

THE STRUCTURE OF THE THESIS

In discussing the main issues described above, the thesis has been divided into nine chapters, with chapters I - VI covering the first part of the thesis. The second part is discussed in chapters VII and VIII, whilst chapter IX shall be the concluding chapter. A brief account of the aims of each chapter shall now be given.

Chapter I shall focus on the nature of co-insurance policies, and in particular on the joint-composite policy distinction. The aim of this chapter shall be to determine, from the case law, how co-insurance policies are interpreted by the courts and the aim behind composite and joint policies. These policies shall

also be distinguished from contingent policies, and the nature of insurable interests required by co-insureds shall be explored, particularly the pervasive interest doctrine which has developed in relation to such policies.

Chapter II focuses on how co-insurance contracts are often effected in the commercial market. In a majority of cases, a co-insured often concludes the contract for the benefit of the other co-insureds, and the latter can only have rights against the insurer unless they can prove that they are privy to the contract. Prior to the enactment of the Contracts Act 1999, such third parties could only have a right by relying on agency principles, and it is the application of these principles that shall be the main focus of this chapter. This issue is very important because where the third party co-insured cannot prove that it is a party to the insurance contract, he cannot enforce the benefits he is entitled to under the insurance contract. The possible use of the 1999 Act by the third party to enforce the contractual terms shall be discussed in Chapter VII, where a comparison between both exceptions to the privity doctrine shall be made.

Since co-insurance involves the protection of the interests of multiple insureds under the same policy, the insurer finds itself contracting with more than one party, and the question arises as to the legal relationship between the co-insureds in relation to the performance of their contractual obligations. Should the co-insureds, in relation to their contract be treated as one, or should they be treated as separate entities? This issue shall be discussed in chapters III – V by an examination of specific obligations of a co-insured, and an enquiry whether a breach by one would affect the rights of the others. These obligations are the duty of utmost good faith, the rule against wilful misconduct, and the breach of a contractual warranty. In addition, the ability of a co-insured to terminate the whole policy shall also be discussed. It is argued that an examination of these issues are important as it provides one with an assessment of the protection available to a co-insured in relation to its benefits under a co-insurance policy.

Chapter VI deals with the question of subrogation immunity in co-insurance contracts. In cases, where a co-insured has been responsible for the loss of the insured subject matter by an insured risk, the courts have held that, upon indemnifying the co-insureds who have suffered a loss, the insurer cannot bring a subrogated action against the responsible co-insured. The justification

for this immunity has however been controversial and the aim in this chapter is to discuss the various justifications that have been employed by the courts, and to determine the approach which is the most consistent with both the nature of co-insurance policies and established legal principles. In particular, the pervasive interest doctrine, discussed in chapter I, shall be referred to and it shall be determined whether or not the doctrine should continue to act as a justification of a co-insured's immunity.

Chapter VII focuses on the Contracts Act 1999. The aim of this chapter is to discuss how the Act can be used by a third party to enforce terms in an insurance contract intended for its benefit. In discussing this issue, the chapter covers not only the use of the Act by a third party who has no relationship to the insurance contract, but also the use of the Act by a third party co-insured to enforce terms in a co-insurance contract which was effected for its benefit. The latter issue therefore discusses the possibility of the Act being used as an alternative to the agency principles to be discussed in chapter II. A comparison between both approaches shall also be made to determine which approach would be more beneficial to the third party co-insured. In relation to subrogation immunity, the ability of a third party to rely on a subrogation waiver clause shall be discussed, first by giving a detailed account of the approach of the common law and secondly, by discussing how the Contracts Act 1999 can now be used by such parties to rely on the waiver clause. It is hoped that by a discussion of all these issues, it can be determined whether the Act can provide third parties with the similar rights and protection available under a co-insurance contract.

Chapter VIII looks at three other alternatives means by which a third party can protect its interest, and discusses whether or not such protection provides the third party with the twin benefits available to a co-insured. The chapter shall also attempt, where applicable, to determine the principles underlying these alternatives, and their limitations, if any, when compared to co-insurance contracts. Finally, in chapter IX, the issues discussed and the conclusions reached shall be recapitulated in order to determine the relevance of co-insurance contracts.

METHODOLOGY

The methodology employed in this thesis has been mainly case analysis. The aim has been to articulate the English law on co-insurance contracts, and to this extent the cases discussed have been mainly English cases, with the few exceptions where it was necessary to discuss cases from other foreign common law jurisdictions. Since there is hardly any case law on the Contracts Act 1999, the method of analysis with this Act has been entirely statutory interpretation with extensive reliance on the Law Commission Report which preceded the enactment of the Act. [2]

[2] "Privity of Contract: Contracts for the benefit of third parties" Law Commission Report No. 242.

CHAPTER I

THE NATURE OF CO-INSURANCE POLICIES

1. THE JOINT-COMPOSITE POLICY DISTINCTION

1.1 Introduction

A major recurring theme in co-insurance policies is the distinction between joint and composite policies. This distinction has proved to be a major factor in English law in terms of determining the rights and obligations of co-insureds. The purpose of this chapter will therefore be to determine the distinction between these two forms of co-insurance policy. It has been said that the distinction in English law, is based on the nature of the interests of the co-insureds.[1] If the co-insureds have a joint interest in the subject matter of insurance, the policy is joint. Where each co-insured has a separate interest in the subject matter, the policy is composite. An example of parties under a joint policy would be joint owners of property, while examples under composite policies would include mortgagee and mortgagor, landlord and tenant, owner of goods and hirer under a hire-purchase agreement. The reasoning behind this distinction is however not self-evident. It is therefore necessary to examine the relevant case laws in order to determine this.

1.2 Case Laws

The leading case on the distinction between joint and composite policies is the Court of Appeal's judgment in *General Accident Fire and Life Assurance Corporation Ltd v Midland Bank and Others.*[2] A policy was issued covering the interests of a tenant, landlord and a mortgagee bank in respect of a building and plant. A fire occurred which resulted in loss only to the tenant and a claim was made. The insurer however made the payment, by cheque to each of the three parties. The landlord and the mortgagee having suffered no loss endorsed the cheque to the tenant. It was

[1] See *Colinvaux & Merkin's Insurance Contract Law* (Sweet & Maxwell, 2002) Ed. Robert Merkin, para. A-0600, pg. 10,575.
[2] [1940] 2 K.B. 388.

subsequently discovered that the tenant's claim had been fraudulent and the insurer sought to recover the cheques made to the landlord and mortgagee. No action was sought against the tenant presumably because it had subsequently gone into liquidation and therefore there was no prospect of recovering the money paid to it. The main argument of the insurers was that the policy of insurance was joint and it was therefore entitled to make the payment to all three. It was further argued that the consequence of this was that in an action to recover the money, the insurer could sue the other two co-insureds.

The insurer's argument therefore depended on the policy being classified as joint. Sir Wilfrid Greene MR, giving the leading judgment of the court held that the policy was not joint but composite, because by including in its definition of the insured, the phrase, 'for their respective rights and interests', the parties intended that each co-insured would be protected by the insurer in respect of its seperate interest. Sir Wilfrid Greene also discussed at length the difference between joint and composite policies. In his view, a joint policy was a policy in which the interests of the co-insureds were joint and there was an undertaking to indemnify the co-insureds jointly.[3] Thus policies satisfying the above two requirements would always be joint whereas, where the co-insureds have different interests, 'the covenant of indemnity which the policy gives must...operate as a covenant to indemnify in respect of each individual different loss which the various persons named may suffer.'[4] The above shows that the difference between joint and composite policy is essentially one focusing on the co-insured's right of indemnity. Where the policy is joint the co-insureds have a joint right of indemnity and the insurer's obligation to them is joint. The consequence of this is that all co-insureds must be able to sue for the right to be exercised and where one party is prevented from suing, the right cannot be exercised.[5] Where the policy is composite, each co-insured has a separate right relating to his interest in the subject matter of insurance and the inability of one co-insured to sue would not affect the right of the others.

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[3] Ibid. at 404-5.
[4] at 405.
[5] An application of this rule can be found in the case of *Samuel v Dumas* [1924] A.C. 431, discussed in Chapter III, pg. 47. Also see, *Jones v Yates* (1829) 9 B. & C. 532, per Lord Tenterden CJ, at 539 and *Brewer v Westminster Bank Ltd* [1952] 2 All E.R. 650, 654.

The focus on the interests of the co-insureds is however only a rule of construction in determining the nature of their right of indemnity. This rule was first developed in relation to covenants. The rule in its simplest form states that where a covenant is made with several persons and the covenant is ambiguous as to whether it is owed jointly or severally, the covenant is joint if the interests of the covenantees are joint, or several if their interests are several.[6] The rule is also applicable with contracts made with two or more parties. Thus where a contract is made with a number of persons and the contract is ambiguous as to whether it is joint or several, it iss joint if the interest of the parties are joint, and several if their interests are several.[7]

In *General Accident*, this rule of construction was not applied as the court held that the parties had clearly expressed the nature of the right by the inclusion of the phrase, 'for their respective rights and interests' in the policy. Sir Wilfrid Greene's decision in *General Accident* was applied in *State of Netherlands v Yuoell*[8]. Two submarines under construction were insured under builders risk policies. The co-insureds under the policies were the owners and the builders. The submarines had paint work defects and the owners brought made a claim to the insurers to be indemnified for this. The insurer rejected the claim on the basis that the defect was as a result of the wilful misconduct of the builders and that as the policy was a joint policy, the act of the owners was a defence against the claim. Rix J, at first instance, held that as the owners and the builder had separate interests and the policy was expressed to cover 'the interests and liabilities of each of them ', the policy should be construed as covering each co-insured in respect of their separate interest and was therefore composite.

[6] See *Sorsbie v Park* (1843) 12 M. & W. 146, per Lord Abinger CB at 158 and *Keightly v Watson* (1849) 3 Ex. 716, per Pollock CB, at 721.
[7] See G.H. Treitel, *The Law of Contract* (10th edn) (Sweet and Maxwell, 1999) at 533-534.
[8] [1997] 2 Lloyd's Rep. 440

1.3 The justification for the rule of construction

If the distinction between joint and composite policies is really on the nature of the right of indemnity of the co-insureds, this raises the important question whether the focus on the interests of the co-insureds in determining this, is justifiable. The question of the nature of the contractual right of indemnity is essentially a question of the intentions of the parties and would be better determined by focusing on the contractual terms. This is exactly the approach taken by Lord Greene MR in *General Accident*. However, in most cases, the policy terms are incapable of providing any assistance, thus shifting focus to the interests of the co-insureds. A major justification for this rule of construction can be argued to be that a co-insured effecting an insurance contract would expect to have rights in the contract similar to the rights he has over the subject matter of insurance. In *General Accident*, Lord Greene was of the view that construing the relevant policy as joint would lead to a 'curious result.' This is because when a party with a separate interest effects an insurance policy against loss to that interest, he has an independent right of indemnity. Since such right is more advantageous than a joint right, it is quite unlikely, in the absence of clear words to the contrary, that the party upon effecting a co-insurance policy would intend to have the latter right. This is surely what the Court of Appeal meant by a curious result because if the policy were to be construed as being joint, a co-insured with a separate interest would be in a disadvantageous position in respect of his right of indemnity than he would have been had the policy been only for his benefit. The same reasoning would also apply in respect of a joint interest holder. Since the insured has a joint interest, the intention must also be that his right to policy proceeds would be joint.

It should however be emphasized that this rule of construction is subject to the terms of the contract. Where the policy terms indicate the intention of the parties, the courts ought to give effect to it even if it runs contrary to the rule. The intention must however be clear. In *New Hampshire Insurance Co. v MGN*[9], Potter J and the Court of Appeal held that a policy insuring against liability to distinct co-insureds was composite irrespective of the fact that the policies contained a clause

[9] [1996] C.L.C. 1693, discussed in chapter IV, pg. 90.

titled 'Joint Insured.' The Court of Appeal held that the clause did not 'go as far as to say that all those insured have joint interests or are joint contractors'[10], and therefore the policy could not have been construed as being joint. The above clearly shows that for the policy to be treated as a joint one, it is sufficient for the clause to state that the co-insureds for the purposes of the policy have 'joint interests' or are 'jointly insured', especially in the case of commercial policies where the parties would be expected to know the meaning and consequence of such phrases.[11]

1.4 An Alternative approach

A major criticism of the present rule of construction is that by assuming that the parties would want to have rights in the policy similar to the nature of their interests, the rule in some cases, can never be a true indication of the intentions of the parties. For example, it could be argued that just because the parties are joint interest holders is not a sufficient reason to construe their intention as being to have joint rights, especially since construing the policy as being composite would be to their advantage. To this extent, an alternative approach has developed in other jurisdictions in which the distinction between composite and joint policies is determined by the policy terms. The approach has developed in relation to the rights of a co-insured in light of the wilful misconduct of another co-insured and it shall be discussed in more detail in a subsequent chapter dealing with this issue.

It is however sufficient for the present purposes to state that the approach is based on a presumption that the rights of co-insureds are severable and where the contract is silent as to the nature of the rights of the parties, the court would construe their right as being separate, irrespective of the nature of their interests. The rule would therefore only affect the rights of joint interest holders. For example, in the New Zealand case of *Maulder v National Insurance Co. of New Zealand Ltd*[12], the Wellington High Court construed a domestic policy as being composite despite the fact that the co-insured spouses had joint interests in some of the subject matters of

[10] Ibid. at 1,737.
[11] In *MGN*, Potter J, at 1,715, did not dissent from the insurer's suggestion that there was nothing in the *General Accident* case to suggest that 'if the parties agree that separate insureds shall be treated as a single entity/joint assured for purposes of an insurance contract, that cannot be achieved.'
[12] [1993] 2 N.Z.L.R. 351.

the insurance. Eichelbaum CJ, was of the view that Sir Wilfred Greene in *General Accident* did not intend his view of joint policies 'to be limited to cases where the interest of the insured in the property was joint in the strict sense, down to the point that the respective interests in the property must be as joint tenants.'[13] He felt that as a result of the changes in societal attitudes, the rule of construction no longer accords 'with reality, practicality and expectations.' In line with societal expectations, he construed the policy as being composite. In *Gate v Sun Alliance*[14], the New Zealand Court of Appeal although not disagreeing with the decision in *Maulder*, left open the question whether the same approach should be taken in construing commercial policies.[15]

Both cases however suggest a movement away from the interests of the co-insureds in determining whether the policy is joint or composite, to an approach which relies more on the interpretation of the policy terms with the aim of reaching a result which is both realistic and consistent with the expectations of the co-insureds. The merits of this approach and whether it ought to apply in English law shall be discussed in Chapter III. To conclude, although the main distinction between composite and joint policies is primarily one of the nature of the right of indemnity of the co-insureds, the approach taken by the English courts in determining this right is to focus on the nature of their interests in the subject matter of the insurance. The nature of the interests of the co-insureds is therefore an important factor in respect of the joint-composite policy distinction.

1.5 Composite Policies: A distinction within?

In *General Accident*[16], Sir Wilfrid Greene MR, described a composite policy as 'combining in one insurance a number of persons having different interests in the subject matter of the insurance.' A literal interpretation of the above suggests that in composite policies, the co-insureds have separate interests in the same subject matter of insurance. Thus for example, a mortgagee and mortgagor have different interests

[13] Ibid, at 355.
[14] (1995) 8 A.N.Z. Insurance Cases 61-251, 75,806
[15] Ibid, at 75,817.
[16] *Supra, fn.*2 at 405.

in the same house which is the property that is subject to the risk insured against. Sir Wilfrid Greene refers to the insureds' connection with the subject matter as making it 'natural and reasonable' and for 'reasons of obvious convenience' that the whole matter should be dealt with in one policy.[17] Does this mean that for a policy to be composite, the diverse interests of the co-insureds must be in the same property? For example, In the *MGN* case[18], the insured companies insured against their potential liabilities as a result of employee fraud under a fidelity policy. In such a case, each company employs different employees[19], thus their interests in the insurance are distinct and does not form part of a discernable whole. Is such a policy a composite policy?

The reader's initial reaction might be that such a question is irrelevant, but this author is of the view that an answer to the above would provide a clearer understanding of the nature of composite policies. It could be argued that a policy where the co-insureds are protecting risks to different subject matters of insurance is no different from a policy, which contains a group of contracts for each insured. This is because in both policies, the insurer is dealing with separate risks[20] to each subject matter and would therefore have to assess each risk separately. In most cases, damage or loss to one subject matter would not lead to loss to the other subject matters. For example, in the case of the fidelity policies in *MGN*, the fact that an employee of Company X has committed fraud against it which results to a loss to that company, would ordinarily not result to any loss to the other companies, unless a similar fraud was committed against them by their own employees. Since there is therefore no common subject matter shared by the insureds, could it be said that such policies are more akin to groups of separate contracts and are therefore not

[17] *Ibid.*
[18] *Supra, fn.9.*
[19] In *MGN*, the companies made up the Maxwell Group. Therefore, there might be some cases of an employee of one of the companies, being also employed by another company. This however does not take away the point, that the potential liability of each company was distinct and not part of a discernable whole.
[20] The term 'separate' is used here to denote the independent application of the risk to each subject matter. The type of risk insured is however the same in relation to all the subject matters covered by the policy.

composite policies? In *MGN*, Potter J at first instance was of the view that such policies were still composite. Relying on *General Accident*, he said:[21]

While the circumstances in the *General Accident* case was very different, the parties having different interests in respect of buildings insured against loss or damage by fire, the words quoted seem to me equally applicable in this case, where the reasons of dealing with the various parties' insurance within a single policy stemmed not so much from the subject matter of the insurance as the commercial and administrative convenience of the parties.

The Court of Appeal in *MGN*, did not refer to this point, so it is arguable that Potter J's view still stands. It must therefore follow that composite policies are not restricted to arrangements in which the co-insureds have a shared interest in the same subject matter, but also extends to situations where the co-insureds have interests in distinct subject matters and have decided to insure under one policy because of the commercial convenience of such policies. This view is also supported by the editors of *MacGillivray*.[22]

Even if such contracts are held to be composite policies, there is a strong case to argue that they are really a group of separate contracts. This would however depend on the construction of the policy by the courts. A factor, which should be taken into consideration, is the market practice and whether such policies are drawn up by insurers on the basis that they create separate contracts with each insured. At present, there is a growing trend to treat all composite policies as being prima facie 'bundle of separate contracts.'[23] The reason for this is because such an interpretation allows the courts to resolve the various conflicts, which arise as a result of the application of the various obligations faced by the co-insureds.[24] This view, whether all composite policies are prima facie bundles of separate contracts, shall be explored in a subsequent chapter, but it could be said that even if they were

[21] *Ibid.* at 1715.
[22] *MacGillivray on Insurance Law* (10th edn.) (Sweet and Maxwell, 2002) General Editor: Nicholas Legh-Jones QC) (hereinafter referred to as *MacGillivray)* Para 1-194, pg. 7.
[23] Per Rix J in *Arab Bank v Zurich* [1999] 1 Lloyd's Rep. 262, at 276. This construction is discussed in more detail in Chapter IV, pg. 96.
[24] See, in particular the breach of the duty of disclosure, discussed in Chapter IV, pg. 88.

not, a strong case could be made for composite policies in which each insured was insuring against loss to a separate subject matter.

1.6 Contingent policies

A final distinction needs to be made between composite policies and contingent policies. A contingent policy is a policy which gives protection to an insured against loss or damage and also gives to another party a right to recover under the policy when the initial insured is unable to claim under the policy for a specified reason. An example of such a policy can be found in the case of *DSG Retail Ltd v QBE International Insurance Ltd.*[25] The case involved a sales promotion scheme offered by Dixons to its retail customers. The purpose of the scheme was to offer free flights to its purchasers. The scheme was partnered by JSI, a Travel agency, which was responsible for the administration of the scheme through payments from Dixons and by the commission earned by providing extra services to the customers such as accommodation and car hire. It was agreed that Dixons were to pay for over-redemption insurance, the purpose of which was to provide indemnification against any losses made under the promotions. JSI were contractually obliged to indemnify Dixons against any losses caused by JSI's failure to comply with the conditions of the insurance including those caused by the infidelity or dishonesty of JSI's directors or employees. Both Dixons and JSI signed separate proposal forms, but no formal policy was ever issued. A slip was issued which listed both parties as insureds, with an additional clause providing that Dixon 'may only take over the insureds' rights under the policy should JSI be unable to continue to run the promotion.'

The promotion was unsuccessful and the JSI subsequently became insolvent. Dixons therefore sought to recover under the insurance. The insurers however denied liability on the grounds that there had been a misrepresentation and non-disclosure by JSI. Dixons argued that even if there had been a breach of the above duties, this would not affect their right to recover under the insurance, as the contract was essentially a composite policy and protected their interest in the venture.

[25] [1999] Lloyd's Rep. I.R. 283.

Tuckey J, rejected this argument on the basis that there was only one interest insured, which was the 'net ascertained loss' and Dixons did not have a separate right, as in the case of a composite policy, but could only recover under the policy, unless JSI could no longer run the promotions. Therefore, Dixons would be exercising the rights of JSI, and thus the former assumed no better rights than the latter.

The crucial distinctions between composite and contingent policies can be categorised into three. First, with contingent policies, there is only one interest being protected against and therefore there is only one insurable interest insured by the policy. In *DSG*, the interest insured was the 'net ascertained loss' of the promotion, and this interest was the same irrespective of which of the parties was claiming under the policy. This is in contrast to composite policies in which protection is given to more than one interest and with each interest relating to a particular insured, e.g. the interests of a mortgagee and mortgagor. Secondly, the fact that only one interest is protected would mean that there is only one right of indemnity under the policy. This is unlike composite policies in which each insured has a separate right of indemnity. This would no doubt be the case where the policy states that the parties had insured for their respective rights and interests. In *DSG*, Tuckey J was right in pointing out the absence of such a clause and the presence of the contrary clause, which stated that Dixon, would 'take over the insured's rights under the policy should JSI be unable to continue to run the promotion.' The above clause clearly expresses the intention of the parties that Dixon would not have a separate and independent right of indemnity, but could exercise JSI's right, once the latter was unable to continue to run the promotion.

This leads to the last distinction between both policies which is the fact that with contingent policies, there is really only one insured while the other party only becomes one, once the latter withdraws from the venture. The fact that the slip included Dixon as an insured was not enough to entitle it to rights independent of JSI's. At the most, the inclusion as an insured on the slip could be interpreted to mean that it was only Dixons that could exercise the rights of an insured, once JSI could no longer operate the scheme. Thus, it is submitted that the phrase

'contingent' is slightly misleading to the extent that it implies that the other party has rights which are dormant and only become effective once the active insured withdraws from the venture. What actually occurs is that with the withdrawal of the insured, the third party now comes into the picture and exercises the rights of the insured.[26] The phrase should be interpreted, in this context, to mean that Dixon's right to become an insured, and thus his ability to exercise rights under the policy, is contingent on JSI withdrawing from the management of the promotional scheme. Thus, a contingent policy is quite distinct from composite policies as it only protects one interest and thus one insured, but allows a third party to be able to stand in the shoes of the insured, where the latter has withdrawn.

2. THE INSURABLE INTEREST REQUIREMENT

2.1 Introduction

The focus of this section is to examine how the requirement of insurable interest is satisfied in respect of co-insurance contracts. Under any form of insurance, an insured must have an insurable interest in the subject matter of the insurance for the contract to be valid.[27] The same requirement would apply in respect of co-insurance policies. The identification of an insurable interest in most cases of co-insurance is without difficulty. For example, with a joint policy the insurable interests of each insured would be their joint interests in the whole subject matter and in the event of a loss either party could recover the full amount insured. With composite policies, the logical view would be that as each insured has a separate interest in the subject matter, his insurable interest would be limited to this and in the event of a loss he would only be entitled to recover up to the full value of that interest. This view has however not been followed in relation to certain composite policies, in which the

[26] The closest analogy that comes to mind is the assignment of a marine policy to a third party which, once effected, entitles the assignee to sue in his own name: s. 50(2) of the Marine Insurance Act 1906 (hereinafter referred to as MIA 1906.)

[27] See for example, s. 4(2)(a) of the MIA 1906 in relation to marine insurance contracts. This requirement can at times be waived in relation to the insurance of goods. See, for example, *Prudential Staff Union v. Hall* [1947] K.B. 685.

courts have recognized, in each co-insured, a pervasive or full insurable interest in the whole subject matter, despite the fact that each co-insured only had a limited proprietary or contractual right in the subject matter. This concept of pervasive interest will now be discussed to determine, amongst other things, its basis and the extent to which it applies.

2.2 The Pervasive Interest Doctrine.

The pervasive insurable interest doctrine was first applied by the Canadian Supreme Court in *Commonwealth Construction Co Ltd v Imperial Oil Ltd.*[28] The case involved a composite policy which provided all risks protection to a construction venture. Imperial decided to construct a fertilizer plant and entered into a contract with Wellman-Lord for the latter to carry out the construction. Wellman-Lord sub-contracted part of the construction to Commonwealth. In the process of performing its sub-contract, Commonwealth started a fire which resulted in damage to the works. The damage was covered by a multi-peril policy against damage to property and which included all the above parties as co-insureds. The insurer indemnified Imperial for its loss, and then brought a subrogated action against Commonwealth to recoup its payment. The issue faced by the court was whether the insurer could bring a subrogated action against one of the co-insureds. De Grandpré J, who gave the judgment of the court, held that in cases of composite policies:[29]

> ...if the different interests are pervasive and if each relates to the entire property, albeit from different angles,...there is no question that the several insureds must be regarded as one and that no subrogation is possible.

He further held, relying on cases on bailment[30] in which it had previously been decided that a bailee has an interest in the goods on bail and can therefore insure his interest for the full amount of the goods, that the co-insured sub-contractor under the

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[28] (1977) 69 D.L.R. (3rd) 558.

[29] At 561.

[30] *Waters & Steel v Monarch Fire and Life Assurance Co.* (1865) 5 E. & B. 870; *Hepburn v Tomlinson (Hauliers) Ltd* [1966] 1 All E.R. 418. These cases are discussed in Chapter VIII, pg. 170, in relation to policies enuring to the benefit of third parties.

policy had a pervasive interest in the whole contract works. Although conceding that unlike a bailee, the co-insured did not have a possessory or proprietary right in the whole contract works, De Grandpré J felt nonetheless that the co-insured should be said to possess a pervasive insurable interest for the following reason:

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

These passages indicate that the policy objective underlying the court's finding that co-insureds under a construction policy possess a pervasive insurable interest in the contract works is to prevent parties involved in a common goal from suing one another in the event of damage to their joint effort. Presumably, the reason for this is to ensure that the communal goal of the parties, which in this case is the construction of the plant, is not disrupted. There is obvious commercial sense in preventing such parties from suing one another in the event that one of them causes damage to the works. The true basis of the doctrine is therefore commercial convenience.

The doctrine was first applied by the English courts in *Petrofina v Magnaload.*[31] The facts of this case are similar to those of *Commonwealth,* in that it arose as a result of damage to a construction site, allegedly caused by a sub-contractor. An all-risks policy had been taken out in the names of the employer, contractor and all sub-contractors involved in the project. Having indemnified the contractor in respect of the loss, the insurer brought a subrogated action against the sub-contractor. Lloyd J held that the policy was on property and not liability, and he went to hold that each co-insured had an insurable interest in the entire works and

[31] [1983] 2 Lloyd's Rep. 91.

was insured against loss to the works under the policy. In reaching this decision, Lloyd J relied heavily on the *Commonwealth* decision and the cases on bailment.

A major criticism of the application of the pervasive interest doctrine under English law is that it goes beyond the orthodox English definition of insurable interest in property. The view has always been that an insured only has an interest in property if it has either a proprietary (either legal or equitable) or contractual right in the property. In the seminal case of *Lucena v Craufurd*[32], Lord Eldon held that insurable interest in property was:

> ...a right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the property.

The courts have, in the past, consistently applied this rule as the orthodox definition of insurable interest in property.[33] For example, the House of Lords[34] have held that a sole shareholder of a limited company could not insure in his own name the assets of the company because he did not have any right to the company's assets because the latter was a separate entity to him. The pervasive interest doctrine does not fall within the scope of this definition as it recognises that a contractor may have an insurable interest in the whole construction works, even though it does not possess a legal or equitable right in the whole works. The doctrine is therefore inconsistent with the leading case on insurable interest under English law.

However, in two first instance decisions, Colman J held that an insurable interest in property was not only rooted in a right in the property, but could be based on a party's potential liability in the event of loss or damage to the property. In *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd*[35], Anthony Colman QC, as he then was, held that a supplier of a propeller for the construction of a research vessel, who was a co-insured under the marine policy taken out by the main

[32] (1806) 2 Bos. & P.N.R. 269, at 321.
[33] *Cf.* the case of *Constitution Insurance Co. of Canada v Kosmopoulos* (1987) 34 D.L.R. (4th) 208, in which the Canadian Supreme Court declined to follow this definition and decided to adopt a wider definition.
[34] *Macaura v Northern Assurance Co. Ltd* [1925] A.C. 619.
[35] [1991] 2 Lloyd's Rep. 288.

shipbuilder, had a pervasive interest in the whole vessel. Relying on both *Petrofina* and *Commonwealth*, the judge held that a supplier to a construction project had an insurable interest in the whole works, even though it did not undertake actual construction on the vessel. In addition to relying on the commercial convenience rationale mentioned in the previous cases, he also considered that the approach taken in these cases was to ask whether the party would be adversely affected by loss or damage to the works. In his view, a supplier of parts to be used in the construction of a vessel would be adversely affected because if he supplied a defective part to the construction, he might be liable for the damage arising from the defective part.[36]

A few comments are necessary with regard to this decision. First, the case involved a supplier of parts, and not a party involved in the actual building of the ship. If the basis underlying the pervasive interest doctrine is to prevent parties to a construction contract from 'fighting' amongst one another, to the detriment of the project, such concerns might be irrelevant in the case of a supplier who is not an ongoing participant in the project. Arguably, therefore, the policy of commercial convenience which underpins the doctrine should not have led to the conclusion that the supplier needed the protection that it was afforded by holding that it had a pervasive interest in the works. Moreover the deputy judge's view that the supplier would be affected where it was responsible for loss caused by a defective part amounted to recognising an insurable interest in property that was based not on any ownership interest but on the potential liability of the co-insured. The obvious difficulty with this is that a reasoning of this kind is better adapted to the situation where several parties are co-insured under a liability policy than it is to the situation where they are co-insured under a property policy.

In *National Oilwell Ltd v Davy Offshore Ltd*[37], Colman J, as he had by then become, was again able to elaborate on the nature of the interest. The case also involved a construction case arose out a contractual relationship in which National Oilwell (NOW) was under an obligation to provide parts for a floating production facility which Davy Offshore (DOL) was building. Both parties were insured under

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[36] Colman J's decision was reversed by the Court of Appeal on other grounds, See [1992] 2 Lloyd's Rep. 578.
[37] [1993] 2 Lloyd's Rep. 582.

a marine policy, and one of the issues that had to be determined was the extent of NOW's interest in the construction given that it was only a supplier of parts for the construction. One of the arguments made against the supplier having an insurable interest in the whole construction works, was that it did not have any possessory or proprietary interest in the whole works. Colman J rejected this view and held that an insurable interest in property does not have to be based on such interests. To support this view, he relied on his previous decision in *The Moonacre*[38], in which he had held that a claimant, who did not have a proprietary right in a yacht, but only a power of attorney from the registered owner, had an insurable interest in the yacht. With respect, however, Colman J's reliance on this case was misplaced, because the claimant in that case had actual possession of the yacht, and by virtue of his power of attorney, had a right derivable out of a contract relating to the property.

Professor Merkin[39] has argued that the basis of the insurable interest in *National Oilwell* was that if the works had been destroyed, the sub-contractor's contract would have been brought to an end. However, while it is not disputed that this might be a valid basis of an insurable interest in property, it is argued that a reading of the judgment in *National Oilwell* suggests that Colman J's focus was on the co-insured's potential liability in the event of damage to the works, and not on a potential loss of contract and remuneration. The decision therefore could not justify the doctrine from a legal point of view. Its true basis seems to be commercial convenience.

The next case in which the doctrine was considered was the Court of Appeal's decision in *Glengate-KG Properties Ltd v Norwich Union Fire Insurance Society.*[40] Here, a fire occurred in a building under refurbishment. The fire destroyed plans that were being used by the architects responsible for the work. The loss of the plans led to some delay to the refurbishment. The claimant insured, which owned the building, had taken out two policies. One was a material damage policy while the other was a business interruption policy. The latter policy contained a proviso which stated that liability under the policy only arose if there

[38] *Sharp v Sphere Drake Insurance, The Moonacre* [1992] 2 Lloyd's Rep. 501.
[39] *Colinvaux & Merkin*,para. A-0397, pg. 10,364-5.
[40] [1996] 1 Lloyd's Rep. 614.

was a material insurance covering 'the interest of the insured in the property.' The plans could not have been insured under the material damage policy as the policy expressly excluded documents. The insured therefore sought to recover under the interruption policy and one of the issues the Court of Appeal had to consider was whether the insured had an interest in the plans which was sufficient for the purposes of the proviso.

Two of the three judges held that the reference to 'interest' in the policy referred to property owned by the assured, and that since the assured did not have a proprietary interest in the plans, the proviso was not satisfied. In reaching this conclusion, Neill LJ expressed the view that insurable interest in property could be seen in two different ways. A narrow insurable interest which is based on an insured's proprietary right in the property and a wide insurable interest which is not limited by proprietary interests, but which is recognised where a loss of the property would be to the detriment of the insured. This wide insurable interest is based on the definition of insurable interest given by Lawrence J in *Lucena v Craufurd*: [41]

> A man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it;...and whom it importeth that its condition as to safety or other quality should continue... To be interested in the preservation of a thing is to be so cirumstanced with respect to it as to have benefit from its existence, prejudices from its destruction.

Neill LJ referred to the interest in *Petrofina* as an example of a wide insurable interest. Thus, it could be said that the legal basis of the doctrine can be found in the above definition. The obvious difficulty with this is that Lawrence J's definition has not always been accepted as the true basis of an insurable interest in property. The classic definition has always been that of Lord Eldon which focused on a legal or equitable right in the property. However the wider test has been invoked in a few recent cases[42], and it has been suggested by Professor Merkin that

[41] (1806) 2 Bos. & P.N.R. 269, 302.

[42] See in particular, Kerr LJ in *Mark Rowlands Ltd v Berni Inns Ltd* [1986] Q.B. 211, 228. In *Glengate*, Auld LJ was of the view that Kerr LJ's reliance on the broad proposition of Lawrence J was 'unnecessary on the facts of the case.'

it is consistent with current commercial practices.[43] The existence of the wider test should however not detract from the fact that the basis of the pervasive doctrine is commercial convenience, as explained above. Thus in *Glengate,* Auld LJ was of the view that the wide test was an extension of the narrow rule, which made 'commercial sense' but should be closely defined. This at the very least suggests that he considered commercial motivations to lie behind the wider test of insurable interest in property.

2.3 The extent of the doctrine

The case of *Deepak Fertilisers & Petrochemical Corporation v ICI Chemicals & Polymers Ltd*[44] seems to have cast some doubt as to the extent and nature of the doctrine. The case arose out of an explosion at a construction plant in India. A firm of consulting engineers had been involved in providing technological and processing know-how in the construction and the commissioning of the plant. As a result of the explosion, Deepak, the owner of the plant, was indemnified for its loss, and the insurers brought a subrogated action against Davy alleging negligence on the latter's part. One of the arguments raised by Davy was that it was a co-insured under the all-risk insurance taken out by Deepak to insure the plant and thus had a pervasive interest in the whole construction project. In the Court of Appeal it was held that Davy only had an insurable interest in the plant while it was being constructed, because they might lose the opportunity to do the work and be remunerated for it if the property was damaged. The court further held that after the completion of the project, any damage to the project would not affect Davy unless it was responsible for it. The court felt that in order to protect itself against this risk Davy would have to take out a liability policy, and could not rely on the property policy. Since the explosion occurred after the commissioning of the plant, Davy could therefore not have an interest in the plant at that time.

The case obviously raises the question as to the true nature of a pervasive interest because the facts of the case suggest that the doctrine ought to apply. This

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[43] *Colinvaux & Merkin*, para. A-0397, pg.10,364.
[44][1999] 1 Lloyd's Rep. 387. Noted by John Lowry, in "The Temporal limits of contractors' Insurable Interest" [2001] 12 K.C.L.J. 236-239.

was in fact the position taken by Rix J at first instance. However, Stuart-Smith LJ, who gave the judgment of the Court of Appeal, felt obliged to recognise the more limited interest based on the co-insured's potential loss of profits in the event of the destruction of the plant. This has prompted some commentators to suggest that the basis of the doctrine is no longer sufficient to establish a valid insurable interest and that the focus should now revert to identifying a legal or equitable right in the subject matter of the insurance.[45] Whilst this might be one interpretation of the case, another might be that a co-insured's pervasive interest will only exist until the construction is completed. This is because once the project has been completed the commercial convenience basis behind the doctrine no longer exists. Thus, the pervasive interest of the parties expires upon completion of the project. That this analysis might be the true interpretation of *Deepak* is suggested by a number of factors.

First, Stuart-Smith LJ did not expressly reject the pervasive interest doctrine. In fact he actually refers to it and the cases that have applied it, when he quotes a passage from *Macgillivray on Insurance Law*[46]. Secondly, when he refers to these cases, he suggests that the insurable interest only subsisted during the construction and commissioning of the project. This at best indicates that the doctrine should only apply when the loss occurs during construction. However, the problem with this interpretation is that Stuart-Smith LJ does not rely on it in reaching his decision, but rather on the insurable interest based on the co-insured's loss of remuneration. The effect of *Deepak* on the doctrine is therefore far from certain. Drawing on *Glengate*, however, it might be argued that the proper interpretation of *Deepak* is that a pervasive interest only subsists for as long as the communal effort is ongoing.

[45] See *MacGillivray*, para. 1-159, pg.57, and Birds and Hird, *Birds' Modern Insurance Law*, (5th edn) (hereafter referred to as Birds and Hird) (Sweet & Maxwell, 2001), pg. 61.
[46] *Macgillivray on Insurance Law* (9th ed.) (Sweet & Maxwell, 1997), para. 1-150-1, pg.63-4.

2.4 Pervasive Interests: Joint or Composite policy?

Where co-insureds have a pervasive interest in the subject matter of the insurance, does this mean that by virtue of this interest, the co-assureds are insured under a joint policy? This issue was considered in *State of Netherlands v Yuoell.*[47] As mentioned earlier[48], one of the issues considered by Rix J, was whether the policy was joint or composite. One of the arguments of the insurers was that since the builders were co-insureds and had a pervasive interest in the whole properties, both co-insureds had the same interest in the properties and therefore the policy was joint. Rix J, held that the fact that the co-insureds had a pervasive interest in the property did not alter the fact that policy was still composite because each co-insured had a separate proprietary interest in the subject matter of insurance. Thus, the question whether a policy is composite or joint is determined by the nature of the insureds' proprietary interests and not his insurable interest. In most cases both would be identical e.g. a mortgagees's proprietary interest in a building also qualifies as its insurable interest in it. However where the insured has a pervasive interest in the subject matter, the relevant interest in determining whether the policy is joint or composite is its proprietary interest. This surely must be right if one takes into consideration the purpose behind the pervasive interest doctrine, which is to protect co-insureds working together from the potential liability that might occur from their communal effort.

It therefore should not be relevant in determining the entitlement of each insured in the event of loss or damage to the subject matter. This is re-enforced by the fact that the cases applying the pervasive interests doctrine, have held that in the event of loss to the subject matter of insurance, the co-insured sub-contractor can recover for the whole amount insured, but is only entitled to retain an amount equivalent to its proprietary interest, holding the excess on trust for the others. This clearly indicates that co-insureds with pervasive interests are nonetheless insured under a composite policy, because each has a separate proprietary interest in the subject matter of insurance.

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[47] [1997] 2 Lloyds Rep. 440.

[48] At pg. 3.

2.4 Conclusion

From the foregoing, it is quite clear that the pervasive interest doctrine as it presently stands is unclear. In particular, the significance of *Deepak* is a matter of dispute and raises doubts as to the true nature of the doctrine. There is also the uncertainty as to the extent of the doctrine. Does it only apply to the insurance of building and construction projects, or could it extend to other categories of co-insurance? Given that the rationale behind the doctrine is to prevent the parties from suing one another, in the event of a loss to the subject matter (a possibility in most co-insurance contracts) there seems no justifiable reason to restrict its application to the above categories.

A stronger criticism of the doctrine is the fact that it is an inappropriate way of resolving the disputes faced by the parties. The recognition of the doctrine, serves the purpose of providing subrogation immunity to each co-insured and it could be argued that stretching the insurable interest principle in order to achieve this is unnecessary and that the issue should be dealt solely as a question of the insurer's subrogation right.[49] This point shall be explored in a chapter on the insurer's subrogation rights and it is argued that the solution advanced there would be a more appropriate way of achieving the aim behind the pervasive interest doctrine.

[49] Chapter VI, in particular pg.125-134.

CHAPTER II

CREATION OF CO-INSURANCE POLICIES: ENFORCEMENT RIGHTS OF EACH CO-INSURED.

1. Introduction

The focus of this chapter is to determine how co-insureds become parties to the contract of co-insurance. This is obviously of importance, because of the doctrine of privity which states that only parties to a contract can sue and be sued on the contract.[1] The effect of this rule has been drastically reduced by the Contracts (Rights of Third Parties) Act 1999[2], which allows, in certain circumstances, third parties to enforce contractual terms. The Act is however an exception to the privity doctrine and therefore the latter is still much a rule of English law. In respect of co-insurance policies, it is submitted that a co-insured can only rely on the policy terms if either the co-insured is a party to the contract of co-insurance, or is able to rely on the Contracts Act 1999. This chapter shall focus on the former issue. The question whether an individual is a party to the co-insurance contract is very important because where it is a party to the contract, it has a right to enforce the terms of the policy, which would include a right of indemnity, and subrogation immunity. The focus shall be on the principles developed and applied by the courts in determining whether a co-insured is a party to the contract of co-insurance, and therefore entitled to sue upon the contract. These principles relate to the law of agency and it is the intention in this chapter to determine not only the efficacy of these principles, but also whether they are appropriate to co-insurance contracts. The application of the Contracts Act 1999 to co-insurance contracts shall be discussed in a separate chapter focusing on the Act and discussing amongst other things, how it can be used by third party co-insureds to become parties to the co-insurance policy.

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[1] *Tweddle v Atkinson* (1861) 1 B. & S. 393, *Dunlop Pneumatic Tyre Company Ltd v Selfridge* [1915] A.C. 849.

[2] Hereafter referred to as the Contracts Act 1999.

2. Co-insurance and Agency

Suppose X and Y decide to protect their interests under a co-insurance contract. Where both parties complete a proposal form for their respective or joint interests, each is a party to the contract and each can sue upon the co-insurance contract. This is however not the way in which most co-insurance contracts are entered into. In a number of cases, especially in relation to commercial insurance, one party insures on behalf of himself and the other co-insureds. In such cases, the question faced by the courts is whether the other co-insureds, are parties to the contract of co-insurance. The applicable principle relied upon by these parties is agency, and it is to these principles that we shall now turn to.

In *National Oilwell (UK) Ltd v Davy Offshore Ltd*[3], Colman J relying on previous authorities expressed the following propositions applicable to co-insurance contracts[4]:

(1) 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 described as the undisclosed principal and co-assured regardless of whether the policy described a class of co-assured of which he was or became a member.

(2) 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.

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[3] [1993] 2 Lloyd's Rep. 582.

[4] Ibid., 596-597. A useful discussion of these principles in co-insurance contracts can be found in J. Birds, "Agency and insurance" [1994] J.B.L. 386.

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

In light of the above propositions, it is necessary to determine their efficacy and suitability to co-insurance contracts.

2.1 Proposition One: X is authorized to insure on Y's behalf

2.1.1 Authority

A finding of authority can be express or implied. In most cases however, X's authority to insure on Y's behalf is never expressed and the courts have to imply it from the facts of the case. For example, in the *National Oilwell* case, the claimant, National Oilwell (NO) were sub-contractors for Davy Offshore (DOL) who were under contract to construct a floating oil production facility. NO were to supply DOL with a subsea wellhead completion system to be used for the main construction. The contract between both parties imposed an obligation on DOL to effect 'All Risks' insurance 'for the Work and materials in the course of manufacture until the time of delivery in the amount of the Contract Price.'[5] Colman J held that as a matter of construction, 'there must be a strong inference that DOL's authority to insure was co-extensive with its obligation to do so.'[6] Thus DOL's authority was implied from its obligation to NO. This construction makes good commercial sense because such a finding of authority is necessary in order for DOL to be able to fulfil its obligation to NO. Since an obligation to insure can be interpreted, as a source of authority, the consequence of this shall be that the extent

[5] Cl. 14.2 of the main contract, referred to by Colman J at 592.
[6] At 597.

of the implied authority cannot exceed beyond the performance of that obligation. Thus, in *National Oilwell*, the obligation imposed on DOL was to insure the materials until the time of delivery. NO delivered the equipment, which turned out to be defective. DOL clamed to have suffered losses as a result of the defective equipment, and were indemnified by their insurers. The insurers thereafter sought to exercise subrogation rights against NO. NO argued that it was a co-assured under the policy of co-insurance taken out by DOL, and it was insured against loss to the equipment supplied through out the duration of the policy. Colman J rejected this argument and held that since DOL's obligation under the contract was to procure insurance for NO, for works and materials until the time of delivery, DOL's authority to insure on behalf of NO, was restricted to the time of delivery. Again, this interpretation should be welcomed as it ensures that any implication of authority is tailored according to the objective intentions of the parties.

2.1.2 Intention

In order for Y to able to sue on the policy, X must have intended when contracting with the insurer, to insure on Y's behalf. It might be thought anomalous that the subjective and undisclosed intention of one party to the contract is made relevant for the purpose of interpreting the contractual obligation of the other party, as this goes against the objective approach of interpreting contracts. This argument was put to Colman J in *National Oilwell*, whose response was that the purpose of ascertaining the intention of A was not to interpret the policy itself, but to identify the parties entitled to rely on it.[7] This point needs to be elaborated on, for it to be fully understood. The relevance of X's intention is to determine whether or not he acted on Y's behalf in contracting with the insurer. At the most, the co-insurance policy might stipulate that it covers the interest of a class of individuals, of which Y belongs to, but this in no way informs us that X has insured for the benefit of Y. All it tells us is that Y could be insured under the policy. Thus, X's intention in taking out the policy is necessary in order to determine whether Y is a party to it.

[7] At 600.

Arguments to the effect that this approach goes against general principles of interpretation are misconceived because X's intention is in no way determinative of the obligations defined by the contractual terms.[8]

In determining whether X has the necessary intention, the courts can refer to the policy itself or other contractual documents. It is however argued that where X has the authority to insure on Y's behalf, his intention to take out insurance on Y's behalf would be established easily. This is because it would be assumed that X intends to act in accordance with his authority.[9] Thus, in *National Oilwell*, it was assumed that DOL, only intended to procure insurance for NO's materials until the time of delivery. This does not however mean that such assumption shall be made where there is evidence to suggest otherwise. Thus for example, where X is contractually under an obligation to insure on Y's behalf and the policy in question restricts cover to sub-contractors, if Y is not a sub-contractor or is deemed as not falling within this category[10], then the courts would construe from the policy terms that X did not intend to insure on Y's behalf in respect of that policy. It should however be pointed out that if X is under an obligation to insure for Y, the fact that he does not do this would amount to a breach of contract, entitling Y to damages.[11] Also where the contract of insurance is taken out by X prior to his being under a contractual obligation to insure on Y's behalf, it cannot be said that he intended to effect the insurance on behalf of the latter.[12]

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[8] See F. Reynolds, "Some agency problems in insurance law", Chap. 4, *Consensus Ad Idem*, by F.D. Rose (ed.) (London, 1996), pg. 79, at 81, and C. Mitchell, "Subrogation, co-insurance and benefit of insurance clauses" [1998] 6 Int.I.L.R. 263, at 267.
[9] *Colinvaux & Merkin,* para. A-0607, 10,581-2.
[10] In *Hopewell Project Management Ltd v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep. 448, Recorder Jackson QC, held, at 456, that the in respect of construction works, the term 'sub-contractors' referred to parties whose work formed an integral and necessary part of the construction process and thus did not include engineering consultants. Also refer to the Canadian case of *Canadian Pacific Ltd v Base Fort Security Services Ltd* (1991) 77 D.L.R. (4th) 178.
[11] *Colinvaux & Merkin,* para. A-0607, pg. 10,582.
[12] *D. G. Finance v Scott* [1999] Lloyd's Rep. I.R. 387.

2.1.3 The undisclosed principal doctrine

The proposition suggests that where X has authority to insure on Y's behalf and does in fact intend to do so when contracting with the insurer, the latter may sue as an undisclosed principal and co-insured. The use of the undisclosed principal doctrine in this proposition is quite misleading as it tends to suggest that the doctrine can be used to change an insurance covering the interest of one insured into a co-insurance contract covering the interests of numerous co-insureds. In the light of this confusion, it shall be necessary to analyse the doctrine, in order to determine whether it is an appropriate concept to co-insurance contracts.

The undisclosed principal doctrine allows a person who has the authority to act for another to contract on behalf of that person without indicating to the other party to the contract that he is acting for a principal. [13] Thus, although it appears to the third party that the agent is contracting for himself, the undisclosed principal can nevertheless intervene and sue on the contract. The doctrine therefore allows a party who is really a third party to the contract to exercise rights under it.[14] The doctrine has been expressed as being 'one of commercial convenience and its justice is disputable.'[15] The courts have relied on a principle of 'beneficial assumption' to facilitate the application of the doctrine. In the Privy Council decision of *Siu Yin Kwan v Eastern Insurance Co. Ltd (The Osprey)*[16], Lord Lloyd[17] made reference to this assumption which was stated in *Teheran-Europe Co. Ltd v S. T. Belton (Tractors) Ltd.*[18] In the latter case, Diplock LJ[19] expressed the principle as:

[13] Where the agent does not have authority or exceeds his authority, the doctrine is not applicable, *Keightly, Maxstead & Co. v Durant* [1901] A.C. 240

[14] This was the opinion of the Court of Appeal in *Welsh Development Agency v Export Finance Ltd* [1992] B.C.L.C. 148 at 173, 182.

[15] *Bowstead and Reynolds on Agency* (17th ed.) by FMB Reynolds (Sweet and Maxwell, 2001), pg. 343, para. 8-071.

[16] [1994] 1 All E.R. 213, discussed by J. Birds, "When the undisclosed principal cannot intervene" [1994] J.B.L. 260, and S. Kneel, "Claims by undisclosed principals: *Siu Yin Kwan and another v. Eastern Insurance Co. Ltd.*" [1994] 2 Int.I.L.R. 278.

[17] at 221.

[18] [1968] 2 Q.B. 545.

[19] at 555.

> Where an agent has...actual authority and enters into a contract with another party, intending to do so on behalf of his principal, it matters not whether he discloses to the other party the identity of his principal, or even that he is contracting on behalf of a principal at all, if the other party is willing or leads the agent to believe that he is willing to treat as a party to the contract anyone on whose behalf the agent may have been authorised to contract. In the case of an ordinary commercial contract such willingness of the other party may be assumed by the agent unless either the other party manifests his unwillingness or there are other circumstances which should lead the agent to realise that the other party was not so willing.

It has been argued[20] that although the case for a beneficial assumption can be made in the case of the sale of goods, where from all indications, the vendor is not really concerned about the identity of the true purchaser, in the context of insurance in which the duty of utmost good faith is applicable, and the identity of the insured might be relevant to the 'moral hazard' of the insurance, there is less justification for such an assumption. In fact, the presence of the duty of utmost good faith in insurance contracts suggests that the doctrine of undisclosed principal should not be applicable to insurance contracts. This view was however rejected by the Privy Council in *The Osprey*[21]. The courts reasoning for rejecting the argument shall be discussed later, but what is relevant for the present purpose is the application of the doctrine in insurance contracts.

In *The Osprey*, Hong Kong shipping agents effected employers' liability insurance on behalf of a ship-owning company, the latter having authorised the agents to take out insurance on its behalf. The policy effected did not however indicate that the agents were insuring on behalf of another party. Some members of a vessel owned by the ship-owner were killed in circumstances entitling them to compensation from the latter. The company had however been wound up and the representatives of the deceased brought a claim against the insurer under the Hong Kong Third Parties (Rights Against Insurers) Ordinance.[22] The insurer resisted the claim relying on two major arguments. Relevant to our discussion is the argument

[20] Reynolds, *supra. fn.*8, at 80.
[21] *Supra, fn.*16.
[22] This is the Hong Kong equivalent of the Third Parties (Rights against Insurers) Act 1930.

that the agents had acted as undisclosed agents for the ship-owners and that the doctrine of undisclosed principal was inapplicable to insurance contracts. The Privy Council rejected this argument and held that the doctrine was applicable to insurance contracts. The case however did not involve a co-insurance contract, and this is very important for the following reason. In *The Osprey*, the effect of the application of the doctrine, was that the ship-owners (had they not been wound up), could intervene in the contract, and sue on the policy.[23] The doctrine did not create a new right for the ship-owner, but rather allowed it to exercise the right, which on the face of the contract was for the benefit of the contracting agent. Thus if the effect of the doctrine is to allow an undisclosed party to intervene into a contract which he has not directly negotiated, there seems no reason why the doctrine should not have the same effect in respect of co-insurance contracts. However Colman J's proposition in *National Oilwell* interpreted literally seems to suggest otherwise. His dicta suggests that as long as the contracting agent had the authority and intention to insure on behalf of the undisclosed principal, the latter is a party to the contract, by virtue of the doctrine, as a separate co-insured. This is surely a misapplication of the doctrine, because it transforms what would otherwise be a contract for the protection of one party, into a contract for the protection of two parties. It is also a good example of where the undisclosed intention of one party to a contract is being used to construe the contractual obligation of the other, and should therefore be resisted.[24]

If the above argument is right, does this mean that Colman J's first proposition is wrong? The view taken by this author is that the proposition would only be right if the policy, which X enters into, is a co-insurance policy, i.e. it already contemplates the insurance of interests of parties other than X. Thus, X

[23] This was the argument of the representatives of the deceased who, through the Hong Kong Third Parties (Rights against Insurers) Ordinance, were suing the insurers.

[24] It is further argued that the beneficial assumption principle cannot be apply here. The principle assumes that the identity of the contracting party is irrelevant to the other party. Its application however has no effect on the nature of the obligation of the other party. What it affects is the latter's belief as to whom his obligation is owed to. Thus, where X enters into a contract with Y, for the benefit of Z, the effect of the principle is that Z becomes the party to the contract even though Y was unaware that X was contracting for Z's benefit. The effect of the Colman J's dicta however goes further than this. The inclusion of the undisclosed principal as a co-insured would add to the obligation of the insurer. In the event of the occurrence of the insured risk, the insurer is not liable to one party but two, i.e. Y is obligated to both X and Z as separate parties.

could insure on Y's behalf under the policy, without the insurer being aware of Y's identity. The only difficulty with this reasoning is that if Y were to become a party, he would not do so as an undisclosed principal, but as an unnamed principal, since the insurer, by virtue of the scope of the policy, would be aware of the inclusion of other co-insureds, but not as to their identities. Thus, it is submitted that the undisclosed principal doctrine cannot have any application to co-insurance contracts in this respect. Y, if he can, only becomes an insured under the first proposition as an unnamed principal.[25]

2.1.4 Are the Agency doctrines applicable to insurance contracts?

In *The Osprey*, the House of Lords held that the doctrine of undisclosed principal was applicable to insurance contracts, despite the fact that such contracts were subject to the duty of utmost good faith. In light of this ruling, it could be said that a decision disallowing the unnamed principal doctrine to insurance contracts, would seem illogical taking into consideration the fact that the latter doctrine is more consistent with the privity rule than the former.[26] It is however necessary to determine how these doctrines would be applied in the light of the duty of utmost good faith imposed on parties to the contract.

In *The Osprey*, the argument was made that insurance contracts were contracts of personal liability and therefore the insurer was always entitled to know of the existence and identity of the insured. Lord Lloyd, while accepting that there were some contracts which were of a personal nature and therefore could not be

[25] See the comments of Mitchell, *Supra. fn.*8, at 266, where the author states that: "It should be evident in most cases from the terms of the insurance policy itself that the insured intends to insure for others as well as himself—and if it is not, so that the third party is obliged to contend that he was an undisclosed rather than an unnamed principal, the insurer may be entitled to repudiate the policy on the ground that the insured's intention to insure for a third party as well as himself was a material fact which he should have disclosed.'

[26] With the unnamed principal, the other party to the contract essentially knows that the contract is being effected on behalf of another, but is unaware of the identity of the true principal. The contract is therefore really between the true principal and the other party to the contract. With the undisclosed principal, the other party does not know that the agent is contracting on behalf of another party, and therefore the intervention of the undisclosed principal conflicts with the privity rule.

performed vicariously[27], held that contracts of insurance were not of such category. In his opinion, a vendor could take out insurance on behalf of a purchaser, 'provided that the information given to the insurers relate to the purchaser, and not the vendor.'[28] Professor Birds[29] has argued that the rejection by the House of Lords, of the personal nature of insurance contracts is open to challenge, specifically because it does not consider the obligation of the duty of utmost good faith on both parties. It could however be argued that the direction given by Lord Lloyd in no way compromises the application of the duty. This is because he suggests that insurance can be taken out on behalf of another, as long as the information disclosed relates to the principal.[30] This surely means that the doctrine would only be applicable to insurance contracts, where the identity of the insured is immaterial and the agent has disclosed all the material facts to the insurer.[31] Thus, in a case where X insures on behalf of Y and the former fails to disclose a material fact known to him, then the insurer could avoid the policy as against Y, because any defense the insurer has against it will also be available against Y.[32] It should also follow that where the material information is not known to X, but is known to Y, the insurer should still be able to avoid the policy because there has not been disclosure of all the material facts. A final point is that it has been suggested by the editor of *Colinvaux & Merkin*[33], that the undisclosed doctrine principal has no application where the policy is expressly restricted to a particular insured or to insured's falling within a specified class. This is surely right because where the policy is restricted to insureds falling within a particular class, the co-insureds are unnamed principals and the former doctrine has no relevance. The effect of this is that only parties falling within that

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[27] An example of such personal contract given by his Lordship was a contract to paint a portrait.
[28] *Supra, fn.*16, at 223.
[29] J. Birds, "Insurable Interests", Chap. 4, *Interests in Goods*, N. Palmer and E. McKendrick (eds) (2nd edn.) (LLP, 1998), p.91, at 100.
[30] Lord Lloyd's exact words, at 223, were: "But there is nothing in the *Peters'* case which decides that a vendor cannot take out insurance on behalf of a purchaser...provided always, of course, that the information given to the insurer relates to the purchaser, and not the vendor." It is curious that in describing the undisclosed principal and his agent, he refers to them as vendor and purchaser. If the agent is a vendor, and the insurer knows this, then the latter must know that the vendor is insuring on behalf of another. Thus the principal would be an unnamed principal and not undisclosed.
[31] *Colinvaux & Merkin,* para. A-0608, pg. 10,582.
[32] See the comments of Lord Lloyd in *The Osprey* at 220.
[33] Para. A-0609, pg. 10,582-3.

class can become parties to the contract. Where the policy is expressly restricted to a particular insured, the intention of the parties must be to cover only the interest of that party. It would therefore be a case where the 'beneficial assumption' principle is overridden by the terms of the contract.

In respect of unnamed principals, how would the duty of disclosure be applied? Unlike the undisclosed principal doctrine, the policy contemplates that the agent is insuring for the benefit of another party, but not the identity of that party. Thus, as long as information relating to that party is disclosed, the duty has not been breached. The application of the duty would therefore be no different from its application in respect of the undisclosed principal. It therefore follows that the application of the unnamed principal doctrine would be applicable to co-insurance contracts.

2.2 Proposition Two: X has no authority to insure on Y's behalf

2.2.1 Lack of authority

Where X has no authority to insure on Y's behalf, Y could still be a party to the contract through ratification. The parties must however satisfy the following conditions.

2.2.2 Intention

Like the first proposition, X must have intended to insure on Y's behalf. The obvious difficulty with this requirement is that since X is not authorised to insure on Y's behalf, a finding of intention might be difficult to prove. It would also be more difficult to prove X's intention where he has authority to insure on Y's behalf, but his authority falls short of the alleged intention.[34] Intention could however be inferred from X's contractual obligation to a third party. For example, where X is a

[34] Refer to the discussion of *National Oilwell*, at pg. 24-25.

contractor, and enters into a contract with Z to construct a building. The contract might impose an obligation on X to take out an 'all risks' insurance for all parties involved in the construction, including sub-contractors. Where Y is a sub-contractor, and in the event that the sub-contract between X and Y is silent as to insurance, and X does takes out insurance in accordance with his contractual obligation to Z, the courts should infer from that obligation that X must have intended to insure on Y's behalf.

2.2.3 The Policy is expressed to insure the principal insured and others

Where the policy is expressed to be for the benefit of X and a class of others, the terms of the contract therefore implies that X is also insuring for the benefit of other parties as co-insureds. The contract is therefore a co-insurance contract and Y would only be able to sue as an unnamed principal. Where Y is expressly named in the contract, as a co-insured, other parties cannot rely on the contract. Where the policy is expressed to insure a class of individuals, Y can only become a party to the contract if he falls within that class.[35]

2.2.4 Y must be legally competent to enter into a contract and must be capable of being ascertained as a co-insured, at the time the contract was effected.

Y can only ratify the contract if at the time it was effected, he was legally competent. This rule would be relevant where Y is a company, as it has been held that a company cannot ratify a contract made on its behalf before the company was formed.[36] More important is the issue whether a co-insured must have been capable of identification at the time the policy was effected. It is not uncommon for policies to seek to protect future co-insureds who cannot be identified until after the policy has been effected. This raises the question whether such parties can ratify and

[35] *Hopewell Project Management Ltd v Ewbank Preece Ltd* [1998] 1 Lloyd's Rep. 448.
[36] *Kelner v Baxter* (1866) L.R. 2 C.P. 174, *Natal Land Co. v Pauline Syndicate* [1904] A.C. 120, especially at 126.

become parties to the contract. In *National Oilwell*, Colman J[37] left this issue open. Professor Reynolds has argued that such insureds cannot be parties to the contract through the law of agency because, 'the basis of agency reasoning is that a person is doing something through another. For this to be so, that person must exist and be competent at the time.'[38] This argument is surely right, and one is therefore faced with the question whether such co-insureds can become parties to the contract.

It is submitted that the approach to take in answering this question is to first consider whether there is any need for such future co-insureds to become parties to the contract. The presence of such a need can be seen from the practice in the insurance market. For example, in terms of director and employee liability, it is not uncommon for such policies to include as its insureds, future directors and employees.[39] Secondly, a practice has developed in the London insurance market in which brokers who are instructed to obtain insurance against a particular risk, would first of all approach re-insurers and obtain from them a binding promise to provide re-insurance for underwriters who would provide insurance for the risk. The effect of this practice is that the broker, as agent of the insuring underwriters enters into the re-insurance contracts, before the latter underwriters enter into the insurance contracts. The practice arose presumably because it would be easier for brokers to provide the necessary insurance, if they are able to offer the underwriters re-insurance at the same time. That this practice is present in the market, was noted by the Court of Appeal in *General Accident Fire and Life Assurance Corporation v Tanter, (The Zephyr)*[40], and in the same case it was also assumed, without any explanation, that the insuring underwriters were parties to the contract.[41] The fact that various types of insurance contracts are entered into with the aim of protecting parties that are not identifiable at the time the contracts are concluded, suggests that

[37] At 597.
[38] Supra.*fn*.8, at 83.
[39] An example of such policy can be found in the case of *Arab Bank v Zurich* [1999] 1 Lloyd's Rep. 262. The policy in question was a professional and indemnity policy taken out by a firm of professional and estate agents and valuers. The insureds were defined as including 'partner, director, sole proprietor and any person who may at any time become partner or director of the firm(s).' This case is subsequently discussed in Chapter IV, pg. 96.
[40] [1985] 2 Lloyd's Rep. 529.
[41] *Ibid.*

the expectations of the parties is to make such 'future insureds' parties to the contract. Although it is conceded that agency is not the appropriate doctrine to apply, it is nonetheless necessary for the law to provide an explanation of how such insureds can become parties to the contract. With the enactment of the 1999 Contracts Act, it could be said that such parties could now rely on policy terms without having to worry about the privity rule. However this problem had existed long before the enactment of the above Act, and it is therefore necessary to analyse the various ways through which such insureds could be regarded as parties to the contract.

i.) The establishment of a trust

A reasoning which could be applied by the courts is that the effect of the contract of insurance was to create a trust with X being the trustee who holds the benefit of the trust, which in this case is the chose in action of the insurer's promise to indemnify each co-insured in respect of insured losses, for the benefit of both X and Y. Since a trust can generally be created for the benefit of unborn persons, the same would therefore be applied in respect of future co-insureds. The effect of a finding of a trust in this circumstance would mean that in the event of a loss, Y would be able to compel X to sue on his behalf, and where X declines to do so, Y can sue joining X as a co-defendant.

It should however be remembered that the trust reasoning is only being used in this case, in order to avoid the privity rule and therefore the courts should not easily rule that a trust exists where the evidence does not suggest this. In *Vandepitte Appellant v Preferred Accident Insurance Corporation of New York*[42], Lord Wright held that for a trust to be construed from the contract of insurance, an intention to constitute a trust 'must be affirmatively proved', and 'the intention cannot

[42] [1933] A.C. 70. In Canada, the Privy Council's strict application of the privity rule in this case has been overruled by the Supreme Court of Canada in *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd* [2000] 1 Lloyd's Rep. 199. This decision, apart from being of persuasive authority, does not have any effect on the court's pronouncement on the trust reasoning.

necessarily be inferred from the mere general words of the policy.'[43] Hobhouse LJ in *DG Finance Ltd v Andrew Scott and Eagle Star Insurance Ltd*[44] relying on *Vandepitte,* held that a policy insuring specified risks to a trailer with the defendant haulier being named as the insured, without more, was insufficient to find an intention to create a trust for the benefit of the claimant financiers, who had purchased and hired the truck to the defendants. This cautious and admittedly strict approach taken by English courts can be compared with a more liberal approach in construing a trust from the terms of the contract. In *Trident General Insurance Co. Ltd v McNiece Bros. Pty Ltd*[45], The High Court of Australia were faced with a liability policy for construction work which defined the assureds under the policy as including the main contractor and 'all its subsidiary, associated and related companies, all contractors and sub-contractors and/or suppliers.'[46] The issue faced by the court was whether a sub-contractor not appointed when the policy was taken out was allowed to sue on the policy. The High Court, by a majority, allowed the sub-contractor's claim, but Deane J in a dissenting judgment held that the policy created a trust. His approach to identifying an intention to create a trust is expressed below:[47]

> It is difficult to envisage a class of contracts in which the creation of such a trust would be more discernible than the type of contract which is involved in the present case, namely, a policy of liability insurance indemnifying both a party to the contract and others who are designated either by specific identification or by their membership of an identified group. In the case of such a policy, the terms of the contract itself will, in the context of the nature of insurance, ordinarily manifest an intention to the effect that...the promisee should hold the chose in action constituted by the right to enforce that promise upon trust for the relevant non-party assured.

Deane J's dicta therefore suggests that where the policy includes future co-insureds, and it is the intention that such co-insureds should have enforceable rights under the

[43] *Ibid.* at 80.
[44] [1999] Lloyd's Rep. I.R. 387.
[45] (1988) 165 C.L.R. 107.
[46] *Ibid.,* at 111.
[47] At 148-149.

contract, then an intention to create a trust should be inferred from the terms of the contract. It seems unlikely that the English courts would accept this approach, for the singular reason that an intention that the co-insureds should have enforceable rights, is not in anyway synonymous with an intention to create a trust. Deane J's approach is only justifiable to the extent that it gives effect to the intention of the parties, i.e. by the establishment of a trust, the co-insureds are able, through their trustee, to enforce rights under the contract. Thus the approach could be criticised on the basis that a finding of a trust might not in all cases be the true intentions of the parties. It could also be argued that in the light of the Contracts Act 1999 which, as it shall be shown later, gives such future insureds the right to enforce the terms of the contract and thus gives effect to the intention of the parties, the English courts would now be more reluctant to infer a trust, unless the terms truly and unequivocally indicate an intention to create a trust.

ii.) Contractual reasoning

An alternative way of making such future co-insureds as parties to the contract is through contractual analysis. The basic premise of this analysis is to interpret the obligation of the insurer to indemnify the future co-insureds, at the time the contract was effected, not as a binding contract, but as an offer of a uni-lateral contract from the insurer to the future co-insureds.[48] Thus, the insurer makes an offer to insure to anyone who essentially becomes a co-insured, and all the latter has to do in other to bind the insurer is to become a co-insured. To become a co-insured however means that the party must fall within the definition of co-insured, as expressed within the policy. Thus, in respect of policies protecting directors and employee liability, the policy might define the insureds, as 'directors and employees' and in relation to 'All risks' policies for construction ventures, the insureds might be defined as 'contractors and sub-contractors.' In both cases, a party can only accept and thus contractually bind the insurer if he satisfies the necessary requirement of being an insured.

[48] For an example of a unilateral contract, see the case of *Carlill v Carbolic Smoke Ball* [1893] 1 Q.B. 256.

Thus, the obligation of the insurer in relation to the future insureds does not exist at the time the contract is effected but only arises as soon as such parties become co-insureds.[49] Thus if one were to analyse the market practice of obtaining re-insurance before obtaining the primary insurance for a particular venture, the position would be that the re-insurers by accepting to provide re-insurance, are making an offer to anyone who eventually accepts to provide the primary cover. Once an underwriter provides the primary cover, he has accepted, by conduct, the offer of the insurer and a re-insurance contract is at that point in time created. The issue of consideration provided by the future co-insured to the insurer is not problematic, as the Privy Council has held that the same consideration could support two separate transactions.[50] Thus the very act of becoming a co-insured would constitute consideration.[51]

It is submitted that, as regards future co-insureds, the contractual reasoning as opposed to the trust reasoning should be adopted in establishing their status as parties to the contract. The contractual reasoning has to its advantage the fact that it provides a more realistic explanation of the position of such parties, while a finding of trust might in some cases not be a true reflection of the intentions of the parties.

[49] It could however be argued that by agreeing to insure future insureds, the insurer has created an expectation, that it would do so, and the loss of that expectation should result in damages. The party to whom the expectation is owed cannot however be the future co-insureds. It shall most likely be the contracting insured, and the claim would most probably not succeed where this party has not provided consideration for the promise and if he cannot show a loss arising from the failure of that expectation. In the absence of the latter, the contracting party would only be entitled to nominal damages.

[50] See the judgment of the Privy Council in *New Zealand Shipping Co. Ltd v A.M. Satterthwaite, The Eurymedon* [1975] A.C. 154.

[51] This finding of consideration might be criticised, but apart from having the support of the above decision, this approach could be seen as an example of the changing nature of the courts approach in identifying consideration which seems to focus more on whether the parties have voluntarily entered into an agreement. Where the evidence suggests the latter, the courts would be more inclined to find that the promisee has provided the necessary consideration. This approach was endorsed by Hobhouse J in *Vantage Navigation Corp v Suhail and Saud Bahwan Building Materials, The Alev* [1989] 1 Lloyd's Rep.138, at 147 in which he states that: '...now that there is a properly developed doctrine of the avoidance of contracts on the grounds of economic duress, there is no warrant for the Court to fail to recognise the existence of some consideration even though it may be insignificant and even though there may have been no mutual bargain in any realistic use of that phrase.'

2.2.5 Ratification

Where X contracts with an insurer on behalf of Y and without the latter's consent, the contract of insurance can only be enforced by Y where he has ratified X's act. The effect of ratification is to make X's act valid and effective, as if it had been made with Y's authority. The act of ratification has been said to be 'equivalent to antecedent authority.'[52] The main issue with ratification is whether the principal can ratify the contract of insurance after a loss has occurred. In relation to marine insurance, s.86 of the MIA expressly allows ratification after loss. However, this rule has been held as not being applicable to non-marine insurance contracts. In *Williams v North China Insurance Co.*[53], the Court of Appeal was of the view that the marine insurance rule, was an exception to the general principle that 'one who ratifies a contract must have power to make such a contract himself at the time of ratification.'[54] The latter principle was said not to apply to marine insurance because it was an exception to the rule, which had been long established and, in the opinion of one of the judges, 'justified by convenience.'[55] In *Grover & Grover Ltd v Mathews*[56], a case involving the possible ratification of a non-marine insurance contract after loss to the subject matter, Hamilton J relying on *Williams*, held that the principal could not ratify. In *National Oilwell*, Colman J held obiter, that the distinction made between marine and non-marine insurance contracts was undesirable and that the rule applicable to marine insurance should apply to non-marine contracts. It is argued that Colman J's view is right as it is hard to see why the fact that the insurance is marine or non-marine should be relevant to the issue of ratification. In *Williams*, Cockburn CJ, seemed to justify the more liberal approach to marine insurance on the basis that: [57]

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[52] Per Lord Sterndale in *Koenigsblatt v Sweet* [1923] 2 Ch. 314, at 325.
[53] (1876) L.R. 1 C.P.D. 757.
[54] Per Jessel MR, at 766.
[55] *Ibid.*
[56] [1910] 2 K.B. 405.
[57] At 764-765.

Where an agent effects an insurance subject to ratification, the loss insured against is very likely to happen before ratification, and it must be taken that the insurance so effected involves that possibility as the basis of the contract.

This same consideration can also be argued as applying to non-marine insurance, i.e. the loss insured against is also very likely to happen before ratification of the contract.[58] Thus, it is argued that if the above is the basis of the more liberal approach in respect of marine insurance, there seems no justifiable reason to prevent its application to non-marine insurance contracts. Professor Merkin makes the point more clearly when he states that the marine insurance position makes 'perfect sense when it is remembered that the insurer agrees to insure from the date of the policy and not from the date of its ratification.'[59] This is surely right when the effect of ratification is properly understood. It provides the contract with the necessary authority and thus legitimacy, not from the time of the ratification but retroactively from the time the contract was effected. Thus it should be wholly irrelevant whether ratification was made before or after the loss.

2.3 The scope of the agency principles

The dispute in *National Oilwell*, arose from a construction situation, and it might be thought that while the agency principles might resolve the issues in this field, it might not be applicable outside this context. Professor Birds[60] relying on the dicta of Hobhouse LJ *in D.G Finance Ltd v Scott*[61], questions whether the agency principles would be applicable in cases of bailment. In *D.G. Finance*, the first defendant purchased a trailer, under a hire purchase agreement with the claimant

[58] In *Grover*, counsel for the defendants raised the argument, at 403, that a contract 'in a policy of marine insurance is a contract to pay whether the subject matter of the insurance is lost or not lost, and therefore even after loss there can be a ratification of the contract.' If this argument is based on Cockburn CJ's reasoning in *Williams*, it is argued that it is a misinterpretation of the latter's remarks. His remarks properly interpreted suggests that since there is a possibility that the loss insured against might happen before ratification of the contract, in order to give effect to the intention of the parties the contract must be construed as covering that very possibility.
[59] *Colinvaux & Merkin,* para. A-408, 10,374-5.
[60] *Supra. fn*.29, pg. 107 at *fn*.24.
[61] [1999] Lloyd's Rep. I.R. 387

finance company. The effect of the agreement was that the claimants would retain legal ownership of the trailer until the defendant paid up the amount it owed to them. The agreement imposed on the defendant an obligation to provide comprehensive cover for the full replacement value of the trailer. The defendant did insure the vehicle, but the insurance procured was limited to the market value of the vehicle at the time of loss. The trailer was subsequently stolen and the defendant stopped paying the hire towards the agreement.

The defendant became bankrupt and the claimant brought a claim against the insurers, the second defendant. This claim could not be brought about through the Third Parties (Rights against Insurers) Act 1930, because the Act only applies to claims relating to third party risks.[62] Although the policy in question covered third party liability, the loss of the vehicle did not fall within this risk. Thus the only way the claimant could recover under the policy was by proving that the defendant had entered into the contract as their agent. The claimant was however not arguing that it was insured as a co-insured nor could it have been one because, in the opinion of Hobhouse LJ, there was nothing in the policy to suggest that the claimants had any contractual rights against the insurer. The policy however gave the insurer, in the event of an insured risk occurring, an option to make payments to the claimants. It has been argued[63] that this term might entitle the claimants to qualify as co-insureds. This view is, with respect, wrong as it attaches too much weight to the option. If the intention of the parties was to make the claimant a co-insured, then this intention must be stated clearly. The option was only exercisable where the loss to the insured is 'not made good by repair, re-instatement or replacement' suggesting that the purpose of the option is to prevent the insured from claiming where he has no intention of using the money recovered on the damaged vehicle.[64] This clause surely cannot be construed as entitling the claimants to qualify as co-insureds.

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[62] See s.1(1) and the preamble to the Act.

[63] Lisa Martine Bowyer, "Contracts (Rights of third parties) Bill and Insurance" [1997] J.B.L. 230 at 233.

[64] If this is the true purpose of the clause, it seems strange that the insurer should have an option to pay the money to the claimant, who it is not contractually liable to, and would have suffered no loss, as he is receiving his periodical payments from the defendant under the hire-purchase agreement. It

Hobhouse LJ further held that on the evidence before him, the only insured under the policy was the first defendant, and there was no evidence to suggest that he was acting as the agent of a disclosed or undisclosed principal. The claimants nonetheless argued, relying on a dictum by Diplock LJ in *Re King*[65] that the first defendant had insured on their behalf. The passage relied upon related to the insurance of goods held by a bailee. Diplock LJ[66], was of the opinion that where a bailee insured goods under his possession, for their full value, the consequence of this must be that the bailee is also insuring the bailor's interest as his agent. In *D.G. Finance*, Hobhouse LJ was of the view that the above was now open to question in light of the decision in the House of Lords in *Tomlinson v Hepburn*[67] in which the Court confrimed that a bailee has an insurable interest in the full property within his possession and could therefore insure such property for their full value.[68] In the event of a loss to the property, the bailee could then recover the full value of the goods, even though he has suffered no loss at all, and is under an obligation to pay the money recovered to the owner of the goods. The effect of this decision is that in the case of bailment and similar cases where the insured has an insurable interest in the whole property[69], the latter by virtue of its interest can recover for loss to the whole property holding any excess beyond its personal loss on trust[70] for the other parties. Thus in such cases, a bailor need not become a party to the insurance contract in order to recover for loss to the property. In *Re King*, Diplock LJ only resorts to an inference that it was the parties' intentions that the bailee contracts as the agent of the bailor, because it was not yet settled law that the party had a full insurable interest and such interpretation was required in order to avoid the policy

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could however be said that the option would be beneficial to the claimant where the assured stopped making his periodical payment after a loss had occurred to the trailer.

[65] [1963] Ch. 459.

[66] At 499.

[67] [1966] A.C. 451. This case is discussed in more detail in Chapter VIII.

[68] In particular, Lord Reid at 467- 468 and Lord Pearce at 480.

[69] Refer to Chapter VIII for examples of similar cases.

[70] The use of the phrase trust has been held by the courts not to imply the existence of a trust in the legal sense, but rather to explain that the assured is under a fiduciary obligation to pay the excess amount to parties having an interest in the property and who have suffered a loss, and this obligation only arises when the assured has recovered money from the insurer in excess of his own personal loss. Refer to *The Albazero* [1977] A.C. 774, at 845, and *Re E.Dibbens & Sons Ltd. (in Liquidation)* [1990] B.C.L.C. 577, at 583.

being a wagering policy, and thus unenforceable. Since the subsequent decision of the House of Lords in *Tomlinson* has however ruled that a bailee has an insurable interest in the whole property, it must therefore follow that there is no longer any need to resort to such inference because the policy would no longer be a wagering policy. Thus, it is submitted that Hobhouse LJ's dictum in *D.G Finance* is right.[71]

Does this however mean that in cases of bailment the agency principles are not applicable as the bailee can insure against loss to the whole value of the property? It is argued that the fact that the bailee has an insurable interest in the whole property should not preclude him from contracting on the agent's behalf. Two reasons shall be given to support this view. First, the case law does not suggest this. In *Tomlinson*, Lord Reid expressly made the point[72] that the parties in that case were not arguing that the bailee was acting as the agent of the bailor in contracting with the insurer. The bailee was relying solely on its own insurable interest, so the issue was never raised. In *D.G. Finance*, Hobhouse LJ held that there was no evidence that the first defendant, when insuring the trailer was doing so as the agent of the claimant. Thus, both cases suggest that had there been evidence that agency was involved, it would have been considered.

The second reason looks at the difference between when a bailor is a party to the contract of insurance, and when the bailee is accountable to pay to him, any proceeds relating to his interest. In respect of the former situation, the bailor as a party to the contract can rely on the policy terms and claim directly from the insurer in the event of a loss. Where he is not insured under the policy, he cannot enforce any rights against the insurer. The bailee however is under a duty to account to him, any proceeds relating to his interest, but this duty seems to only arise when the bailee recovers such proceeds from the insurer. Thus, in *The Albazero*[73], Lord Diplock in explaining the right of such party in a similar position as the bailor said:[74]

[71] Martine Bowyer, *supra. fn*.63 at 233, however suggests otherwise.
[72] At 467.
[73] [1977] A.C. 774.
[74] At 845.

Whatever rights they have spring up when the consignor has recovered judgment and their remedy before the merger of law and equity would appear to have been an action at common law in *indebitatus assumpsit* for money had and received by the consignor to their use.

If the bailor's right only arises after the bailee has recovered the proceeds from the insurer, it could also be argued that in the event that the bailee decides not to claim under the policy for the loss to the property, the bailor cannot compel him to do so.[75] It is therefore quite clear that a bailor in such a position is different from a bailor who is a party to the contract, and there seems no logical reason why the bailee having an insurable interest in the whole property should be precluded, if he decides to, from contracting as agent of the bailee, either as a co-insured or as a sole insured. Hobhouse LJ's dictum in *D.G. Finance,* does not support the contrary view. His dictum when properly interpreted suggests that in the light of *Tomlinson*, the fact that the bailee insures against loss to the whole property is no longer sufficient as evidence that he is insuring as agent of the bailor. It is submitted that it is only by applying the agency principles expressed by Colman J in *National Oilwell* that the requisite evidence can be provided.

3. Conclusion

Where the co-insurance contract is concluded by one co-insured for the benefit of all, the application of the agency principles expressed in *National Oilwell* stands as the sole common law principle, through which the remaining co-insureds can become parties to the contract. An examination of these principles has provided an insight as to how they should be applied in respect of co-insurance contracts. It is argued that if the above analyses are followed, the application of the principles would provide a coherent and consistent interpretation of such contracts. There is no reason why these principles should not be applicable to all types of co-insurance

[75] This issue is discussed in Chapter VIII, at pg. 176.

contracts and as long as the respective requirements are satisfied, third party co-insureds should be allowed to sue as parties to the insurance contract.

CHAPTER III

WILFUL MISCONDUCT AND THE RIGHT OF TERMINATION.

1. Introduction

The aim of this chapter is to discuss two possible limitations to a co-insured's right of indemnity under the policy. These limitations are wilful misconduct by one co-insured, and the rights of termination under the policy. With respect to the first limitation, it is a general rule that an insured cannot recover for a loss arising from his wilful loss and the focus shall be on how this rule is applied in the context of co-insurance. In relation to the right of termination, it shall be determined whether the nature of the right to terminate such policies should be determined by the nature of their interests, or whether different considerations should apply.

2. Wilful misconduct by a co-insured

Insurance contracts, especially indemnity policies, are contracts insuring against risks and therefore do not cover losses arising from the insured's deliberate act. This is a principle of insurance law and has been confirmed by both the courts and Parliament.[1] Where the insured however tries to bring a claim for this loss on the pretence that the loss was not deliberate, such action would amount to a fraudulent claim, the consequence of which entitles the insurer to reject the claim and forfeit all the benefits under the policy.[2] Thus an insured who decides to bring a claim, which

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[1] See *Beresford v Royal Insurance Co.* [1938] A.C. 586, especially Lord Atkin at 595 and, s.55(2)(a) of the MIA 1906.

[2] The exact remedy available to the insurer was until recent, far from clear. While the appropriate remedy would seem to be that the insurer has a right to reject the claim and terminate the policy from the date of such claim, some judgments have expressed the liability as amounting to a breach of utmost good faith, and thus implying a possible remedy of avoidance *ab initio*. In particular, see the comments of Sir Roger Parker in *Orakpo v Barclays Insurance Services Ltd* [1995] L.R.L.R. 443, at 452, and Millet LJ, in *Galloway v Guardian Royal Exchange (U.K.) Ltd* [1999] Lloyd's Rep. I.R. 209, at 214. In *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. (The "Star Sea")* [2001] 1 Lloyd's Rep. 389, Lord Hobhouse, at 403-5, was however of the view that the above cases could not be treated as being authoritative on the point. For the moment, the issue seems to have been settled

is in itself irrecoverable, risks the likelihood of losing his whole cover.[3] The same rule would also apply in the context of co-insurance. Thus, where a co-insured wilfully causes loss to the subject matter of the insurance, he cannot recover. There is however the additional issue, as to whether the other co-insureds who do not take part or consent to the act can recover.

The position of the English courts in respect of this issue is to focus on the joint-composite distinction. Where the policy is composite, each co-insured has a separate right of indemnity and the wilful misconduct of one would generally not affect the right of the other. Where the policy is joint, the right of indemnity is joint and therefore the wilful misconduct of one would affect the right of all. An example of an application of this approach can be found in the House of Lords decision in *Samuel v Dumas.*[4] The case involved the steamship *Grigorios,* which was insured against marine risks, for a specified sum. The policy was a composite policy covering the interests of the owner of the ship and the interest of the mortgagee bank, Samuel & Co. The vessel was lost on a voyage and a claim was made for the loss. The trial judge held that the master and crew with the connivance of the owner, Mr. Angelatos, had scuttled the ship and therefore the owner could not recover. The mortgagee was however allowed to recover for its loss, as it had not been privy to the act. The insurer appealed against this part of the decision. The insurer's defence consisted of a number of arguments, one of which was that in a joint policy, the interests of the assureds 'are so inseparably connected that that the misconduct of one of the assured enures for all' and that allowing the mortgagee to recover would be to allow the owner 'to profit by his own wrong, for his debt will be reduced.'[5] This argument by the insurer is in fact two separate and independent arguments. The first maintains that in a joint policy, the misconduct of one insured is the misconduct

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by the Court of Appeal, in *Agapitos and Others v Agnew* [2002] 2 Lloyd's Rep. 42. Mance LJ (at pg. 53) held 'tentatively' that the rule governing fraudulent claims should be treated as falling outside the duty of utmost good faith, thus precluding any question of the remedy of avoidance *ab initio* arising. For a discussion of the above decision, see B. Soyer, "Fraudulent claims under marine policies" [2001] 8 Int.M.L. 258.

[3] The defence would only apply if the claim is substantially fraudulent. See the case of *Galloway, ibid.*

[4] [1924] A.C. 431.

[5] *Ibid.*, 434.

of all. The insurer is in effect saying that the insureds have a joint right of indemnity. The second argument relates to the principle that a wrongdoer is not allowed to profit from his wrong. The argument of the insurer in this respect was that if the mortgagee was allowed to recover, the owner's debt to it would be discharged and thus the latter would have benefited from his wrong. In reply to these arguments, Viscount Cave made the following comments: [6]

> It may well be that, when two persons are jointly insured and their interests are inseparably connected so that a loss of gain necessarily affects them both, the misconduct of one is sufficient to contaminate the whole insurance...But in this case, there is no difficulty in separating the interest of the mortgagee from that of the owner: and if the mortgagee should recover on the policy, the owner will not be advantaged, as the insurers will be subrogated as against him to the rights of the mortgagee.

Thus the fact that the policy was composite prevented the wilful misconduct of the owner from affecting the separate right of the mortgagee. Therefore, a co-insured under a composite policy is immune from the wilful misconduct of other co-insureds. This rule is however not applicable where the alleged innocent co-insured is tainted with the misconduct, either through the law of agency or by active participation in the misconduct. An example of this exception can be seen in the case of *Direct Line v Khan.*[7] Mr. and Mrs. Khan took out a policy of insurance on their domestic home. Under the policy, the couple was listed as being joint policy holders for 'their respective rights and interests.' A fire occurred at the property and the couple lost certain property and had to move out for a period of time. Mr. Khan made a claim under the policy for rent alleged to be payable for alternative accommodation during the duration when the couple were not residing in their domestic home. Direct Line subsequently made a payment in respect of the rent. The claim was in fact fraudulent, as the property was actually owned by Mr. Khan and thus no rent was payable. Upon discovering the true facts, Direct Line sought to recover all monies paid in respect of the fire, including the cost of reinstating the Khans' domestic home.

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[6] *Ibid.*, 445-6.

[7] [2002] Lloyd's Rep. I.R. 364.

Jackson J, at first instance held that the fraudulent claim was a substantial fraud which tainted all other claims, and the insurers were therefore entitled to recover all monies paid. In the appeal against this decision, Arden LJ further held that from the facts, Mr. Khan had made the fraudulent claim for his own behalf and as agent of Mrs. Khan and therefore his actions would taint any potential right she had. Although the policy in the case was, at first instance, construed to be a joint policy, this exception could nonetheless apply in respect of composite policies, if a co-insured brings a fraudulent claim on his and another's behalf. It might be argued that this might be unfair to the innocent co-insured where it is unaware of the fraud of the other party. However this argument ignores the fact that such co-insured, by virtue of its separate right of indemnity can bring its own claim and where he chooses to allow another party to exercise this right on his behalf, the risk of fraud by that party should rightly fall on him rather than on the insurer. It is also suggested that where the co-insured participates in the fraudulent claim of the latter, he should be prevented from recovering under the policy even if his own separate claim is valid. For example, where co-insureds under a home contents insurance bring separate claims for recovery of their respective losses, and co-insured X deliberately supports a fraudulent claim of co-insured Y in respect of goods which never existed. In such a case, Y's cover would be forfeited as a result of his fraud, and it is argued that X' cover should also follow the same fate, because he knowingly took part in the fraud. X should not be made to think that he has nothing to lose by assisting Y in his fraud, and the risk of losing his cover should act as a deterrent to assisting Y.

2.1 The application of the rule of construction to joint policies

The main criticism of the present rule of construction is that its application is usually to the detriment of innocent joint co-insureds. An often cited example involves a married couple X and Y who own their family home as joint tenants. A joint policy is taken by both, insuring the house against loss by fire. A disagreement occurs between both parties, and X the husband, as an act of revenge deliberately sets the house on fire. X cannot recover for this loss because it was caused by his deliberate

act and Y can also not recover because she has a joint interest in the property and thus a joint right of indemnity which is tainted by X's act. As the Supreme Court of Wisconsin recognised[8], this approach is contrary to 'basic notions of fair play and justice', because it punishes the innocent victim. 'Having lost the property, the innocent insured is victimized once again by the denial of the proceeds forthcoming under the fire insurance policy.'[9] This view also has the support of the Insurance Ombudsman who has suggested that in such a case, the 'just and reasonable' outcome is that the innocent joint policyholder should be paid half the claim.[10]

It has also been argued that the rule of construction, with respect to joint policies, does not provide a real indication of the intentions of the parties. In essence, by focusing on the interests of the co-insureds, one is not really construing the contract.[11] As a minority of the Canadian Supreme Court has argued, 'reasonable persons would expect that they would lose the right to recover for their wilful destruction. But the same persons would find it an anomalous result if informed that they stood to lose it all if their spouse burned down their house.'[12] As a result of this criticism, there has been an emergence, in other jurisdictions, of an alternative rule of construction which rather than focusing on the proprietary interests of the co-insureds, construes the terms of the insurance contract in order to determine the right of each co-insured. This approach has been referred to as the modern approach as opposed to the present rule of construction, which is often referred to as the traditional approach. It is necessary to discuss the modern approach to determine how it would apply to prevent the injustice of the traditional approach.

[8] In *Hedtcke v Sentry Insurance Company* (1982) 109 Wis. 2d 461.
[9] *Ibid.*, 488.
[10] *Insurance Ombudsman Annual Report 1989,* para. 2.36-7.
[11] See L. Cunningham, "The right of an innocent co-insured spouse to recover under a "joint" insurance policy" [1994] 8 Otago Law Review 169, 177.
[12] *Scott v Wawanesa* [1989] 4 W.W.R. 728, at 736, discussed in more detail at pg. 55.

2.2 The Modern Approach.

The modern approach was developed as a response to the shortcomings of the traditional approach. Leane Cerven has identified three different approaches being applied by the various states in America.[13] The first approach, termed an 'all or nothing presumption' presumed that insureds under a co-insurance policy had a joint right of indemnity, irrespective of the nature of their interests.[14] This approach does not seem to have been applied in any jurisdiction other than the American states.[15] The obvious injustice of this approach saw the emergence of the second approach, which Cerven termed the 'rebuttable presumption' theory. This approach is really the traditional approach, as we know it in the English jurisdiction as it allows recovery where the innocent co-insured's interest in the property is separate.[16] As discussed earlier, this approach has its weakness, and Creven argues that it was the need to avoid this weakness that led to the development of the modern approach.

2.3 The Application of the Modern Approach

Unlike the traditional approach, the modern approach focuses on the contract of insurance in order to determine the right of the co-insureds. In applying the modern approach, the courts have approached the issue from the perspective of the insured's obligations. Thus, the question asked is not whether the co-insureds have joint or several rights, but whether their obligations are joint or several.[17] In *Maulder v National Insurance*[18], the High Court of Wellington, at one point, phrased the question from the insurer's perspective asking 'whether the obligation to indemnify was regarded as joint or several.'[19] It is argued that these differences are only one of form as they are all inquiring whether or not the innocent party has a right to be

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[13] Leane English Cerven, "The problem of the innocent co-insured spouse: Three theories on recovery" [1983] 17 Valparaiso University Law Review 849.
[14] Ibid. at 857.
[15] However, it was the approach being argued by the insurers in *Samuel v Dumas.*
[16] Cunningham, *Supra fn.*11, at 178, sees this second approach as being transitional, in the sense that the approach is moving towards the modern approach, but does not rely solely on the contract terms in determining the rights of the parties. However, it can be said that in the light of the Court of Appeal's decision in *Direct Line Insurance v Kahn,* discussed at pg. 62, the traditional approach as applied in English law cannot be seen as transitional.
[17] See the Canadian judgment of *Higgins v Orion Insurance Co.* (1985) 17 D.L.R. (4th) 90, 104.
[18] [1993] 2 N.Z.L.R. 351.
[19] *Ibid*, 357.

indemnified. The courts focus on the insured's obligation could be argued as being an attempt to emphasize the concept of individual responsibility for wrongdoing.[20]

In construing the contract, a presumption has developed that the rights of the co-insureds are severable.[21] This presumption seems to be based on an objective view of the intention of the co-insureds. That is, the average co-insured entering into such a contract would not expect that the wilful act of another co-insured would affect his own right, and would therefore view 'the obligations of the insurer as several as to each of the parties involved.'[22] Therefore when the contract is silent as to the effect of a wilful act by a co-insured, the courts would construe the contract as vesting each with separate rights. On the other hand, where there is a clause which states that the wilful act of the insured will prevent recovery, but the term is not clear as to the effect of such an act where the insureds are many, the courts would, applying the contra proferentem rule, construe the term against the party seeking to rely on it i.e. the insurer, and construe it in favour of the co-insureds. Thus, such a clause would be interpreted as only applying to the responsible co-insured and not to the others.[23] The modern approach has gained some popularity in Canada and New Zealand, but its application and degree of acceptance, seems to vary in respect of each jurisdiction. It would be instructive to determine its position and application in both jurisdictions.

2.4 The Canadian Jurisdiction

In discussing the application of the modern approach by the Canadian Courts, two highly relevant cases shall be looked at. The first is the case of *Higgins v Orion Insurance Co. Ltd*[24], which was presided over by the Ontario Court of Appeal. The background facts of the case were as follows. Mr. Higgins and Mr. Wood were partners in a retail business called Tom Wood Marine & Sport. The partnership was owned 51% by Higgins and 49% by Wood. The business was carried out in a

[20] See *Scott, supra fn.*12, at 735, discussed, and Cunnningham, *supra fn.*11, at 186.
[21] Cunningham, at 174.
[22] *Scott,* at 735.
[23] This was in fact the approach adopted by the dissenting judgment in *Scott* at 739, discussed at pg. 55.
[24] (1985) 17 D.L.R. (4th) 90.

building in Peterborough. The building and the stock of the business were insured against loss by fire under a policy of insurance. The policy named "Edmond K. Higgins and/or Thomas Wood o/a Tom Wood Marine & Sport" as "the insured." In relation to the insurance of the stock, there was an insurance clause, which excluded, inter alia, "loss or destruction by the assured or other party of interest." This clause was however not applicable to the insurance on the building. Subsequently, a fire set by an employee of the partnership destroyed the building and its contents. This employee was convicted of arson and it was discovered that his act was at the instigation of Wood. Higgins sought to recover under the policy of insurance for the loss of the building.[25] The insurers rejected the claim on the ground that Woods and Higgins had 'undivided and inseparably connected' interests in the partnership property so that a loss or gain necessarily affected them both. In effect the insurers were relying on the application of the traditional approach in resolving the issue.

Robin JA, who gave the leading judgment of the Ontario Court of Appeal, in his analysis of the traditional approach, felt that the approach focused on the nature of the property ownership as a means of 'finding the contract interests to be joint.'[26] By 'contract interests', he must have meant the rights of the parties under the contract, for he goes on to say that: [27]

> Where the property ownership can be regarded as joint, the *contract is then presupposed to be joint* because the insured's insurable interests, like their property interests are said to be indivisible with the consequence that the arsonist's guilt is imputed to the innocent assured.

Robin JA then moves on to an analysis of the modern approach. He recognized that the modern approach developed in response to the 'harsh and inequitable' results of the traditional approach. The Court in its discussion relied heavily on American

[25] In actual fact, he also sought recovery for loss of the stock, but this claim was not successful as the trial judge held that Wood was "a party of interest" under the policy, and therefore the loss was excluded by the exclusion clause.
[26] *Ibid* at 102.
[27] *Ibid.*

cases, where the modern approach has been adopted in some states.[28] Relying on these cases, the Court of Appeal in *Higgins* held that the modern approach was the rule to be applied because:

> The dispute is essentially a contract dispute between an insurance company and a policy-holder and should be governed by contract law and not property law. What may be a sound approach when dealing with titles to land may produce unjust results when applied in another context.

However, although the court endorsed the modern approach, it is argued that the approach was not applied to the facts of the case. The Court of Appeal acknowledged that a partner's individual interest in the partnership property was insurable and recognized for insurance purposes as separable and divisible.[29] The court then construed the policy, based on the definition of 'the insured' in the contract, as covering both the joint and separate interests of the partnership. As a result of this ruling, the court held that Higgins could recover for loss to his separate interest in the building.

It follows that what was relevant to the court in reaching its decision was the nature of the interests insured under the policy. The fact that the court focused on interpreting the definition of 'the insured' does not mean that the modern approach was applied. This was only done to determine the nature of the interests that were insured. After determining that Higgins' separate partnership interest was insured, the court then held that he had a separate right to recover. Had the modern approach been applied, the relevant question would not have been what the nature of the interests were, but what, based on the terms of the contract, were the nature of the rights of the co-insureds. All *Higgins* tells us is that when co-insureds insure both their joint and separate interests, an insured has a separate right of indemnity in respect of his separate interest.

A case, which in fact endorsed the modern approach, although only by a minority of the court, is the Canadian Supreme Court's decision in *Scott v*

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[28] Among the cases cited were *Hoyt v New Hampshire Ins. Co.* (1942) 29 A. 2d 121 (N.H.); *Hedtcke v Sentry Ins. Co.* (1982) 109 Wis. 2d 461. For further references, see the Court of Appeals judgment at p.103.

[29] Ibid. at 106.

Wawanesa.[30] Mr. and Mrs. Scott took out a fire insurance policy on their house with the respondent insurer. The definition section in the policy provided for the word 'insured' to include 'relatives and any other resident of the household under 21.' There was also a section, which excluded certain losses from the policy. In particular, subsection 'D' excluded:

> loss or damage caused by a criminal or wilful act or omission of the insured or any person whose property is insured hereunder.

The house was damaged by a fire, which was deliberately started by Charles Scott, the appellants' son, who was living with them. The Supreme Court, with three of its members dissenting, decided in favour of the insurer. The majority, in a judgment delivered by L'heureux-Dube J held that Charles Scott was an insured under the policy as he was under 21 and living in the house. It further held that the exception clause was perfectly clear and unambiguous and did not cover the type of risk, which had caused the loss. The majority in effect interpreted the word 'insured' in the exclusion clause to mean 'any insured.' The majority although not deciding the case by applying the traditional approach, relied on Viscount Cave's dicta on joint policies, in rejecting one of the arguments made by counsel representing the Scotts.[31] It is argued that this, at the very least indicates some support for the traditional approach.[32]

The dissenting judgment given by La Forest J held that the exclusion clause was far from clear and unambiguous. This was based on the conflicting case law on the interpretation of the exclusion clause.[33] The courts therefore had to decide whether the deliberate act of one insured prevented the others from claiming. The

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[30] [1989] 4 W.W.R. 728.
[31] Ibid. at 746.
[32] In *Peters v Fireman's Fund Insurance Co. of Canada* (1992) 93 D.L.R. (4th) 637, the Northwest Territories Court of Appeal, at 639, was of the view that the majority in Scott supported the traditional approach.
[33] Ibid., at 733-734. Also, see Hanson's critique of the decision in *Scott,* in "The Supreme Court in Flames: Fire Insurance Decisions after *Kosmopoulos*" [1995] 33 Osgoode Hall L.J. 678. In particular, pg. 687, where he says: 'The Court of Appeal's finding that the exclusionary clause is unambiguous is startling in view of the fact that both Canadian court and American Courts are evenly divided on it interpretation.'

minority faced with a choice between the two approaches, favoured the modern approach as it 'seemed to be entirely consonant with this courts approach to the interpretation of insurance contracts' whereas, the old approach 'was principally undergirded by public policy considerations extraneous to the contract.'[34] In interpreting the policy, the minority presumed that the rights of the insured were separate as it was of the view that reasonable persons purchasing insurance would expect to lose their rights only in respect of their own wilful destruction.[35] Although the insureds' rights could have been joint, such a view could only be successful if it had been clearly stated in the contract. However, the minority judges were of the view that the exclusion clause was ambiguous and applying the contra proferentem rule, it was interpreted against the insurer. The minority therefore held that the Scotts could recover.

Scott represents the closest the Canadian jurisdiction has come to endorsing the modern approach. Two points need to be made in relation to this case. The first has to do with the fact that the application was a dissenting judgment and it is therefore too early to say that the traditional approach no longer applies in this jurisdiction. In *Walsh v Canadian General Insurance Co.*[36], the Newfoundland Court of Appeal was of the view that although *Higgins* and the decision of the minority in *Scott* 'may indeed spell the beginning of the end of the old rule', the latter was still the law and had not yet been overruled.[37] The second point has to do with the fact that the minority judgment did not really provide a comprehensive application of the modern approach. This is necessary where the policy in question is joint.[38] Where the co-insureds are held to have separate rights of indemnity, what is the innocent insured entitled to? Is the co-insured entitled to the whole of the policy proceeds or is recovery restricted to half of the proceeds? Secondly, since the co-insureds have the same interest in the subject matter, how does one allow the

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[34] *Ibid.* at 735.
[35] *Ibid*, at 736.
[36] (1989) 60 D.L.R. (4th) 358.
[37] *Ibid.* at 388 and *Peters v Fireman's Fund Insurance Co. of Canada, Supra.*
[38] The policy in *Scott*, must have been composite as it insured the personal property of their son. This was the view taken by the minority of the court, at 742. The majority, at 746, was however of the view that the interests of the parents and child were 'inseparably connected.' This view is, with respect, rather doubtful given the fact that the purpose behind including the child as a co-insured was to protect his personal property. See Hanson, *Supra fn.* 33, at 684.

innocent co-insured to recover, without benefiting the wrongdoer? An attempt shall be made to answer these questions later on in this chapter.

2.5 The New Zealand Jurisdiction

In New Zealand, the modern approach was applied in *Maulder v National Insurance Co. of New Zealand Ltd.*[39] Mr. and Mrs. Maulder purchased a house and the property was registered in their names as joint tenants. The couple took out two fire insurance policies. One was insured against loss to the house while the other insured the contents of the house. Included in both policies were identical obligation clauses which stated to the insured that:

> You must...not cause or facilitate loss to the house or incur liability by any reckless or wilful act.

Mr. Maulder deliberately started a fire, which destroyed the house and its contents. The issue faced by the High Court of Wellington was whether Mrs. Maulder could recover under both policies. Eichelbaum CJ, giving the judgment of the court, decided first to determine the nature of the insureds' interests in the insured properties. The court held that the insureds had a joint interest in the house, while in relation to the contents of the house, it was held that some were solely owned while others were jointly owned by both. He then proceeded to determine if the policies were joint or composite and to achieve this, discussed both the traditional and modern approach. He concluded that the modern approach was to be favoured because it concentrated on the interpretation of the contract, rather than the traditional approach which, in his opinion, by focusing on the interests of the assureds 'has little to commend it in logic.'[40] Based on this, he held that the policies should be construed as composite policies, 'severally insuring the respective interests of the insured in the insured property.'[41] The court interpreted the obligations clause as 'simply recording the common law position for the insured's

[39] [1993] 2 N.Z.L.R. 351.
[40] *Ibid* at 358.
[41] *Ibid* at 359.

benefit, and adding nothing to it. Anything more is an ambiguity to be read against the insurer.'[42]

A few points are necessary in light of this decision. First, the court held that the policies were composite even though, the insureds had a joint interest in the house. Thus an inevitable consequence of the adoption of the modern approach is that the traditional distinction between joint and composite policies would no longer apply. Thus, a joint policy would no longer be associated with co-insureds with joint interests, rather the emphasis would be on the nature of their contractual rights as construed from the terms of the policy. It would therefore be possible for joint interest holders to insure their interest under a composite policy. It could however be argued that, although expressing support for the modern approach, the Chief Justice's decision to classify the policy as composite and reject the traditional approach was highly influenced by the perceived changes of women's property rights in modern times. As a result of this, the court felt that the 'manner in which legal title is held masks the rights arising on separation. Insurers must be taken to know that the ostensible categorization of property as joint is meaningless.'[43] Given that such reasoning would only be relevant to spousal relationships[44], it could be argued that the decision is only relevant to insurance of such interests and does not support a general adoption of the modern approach to co-insurance policies. However this ignores the general endorsement of the modern approach by Eichelbaum CJ, which points to a general adoption of the approach. It is suggested that the preferred interpretation is that the decision represents a general endorsement of the modern approach over the traditional approach in the interpretation of co-insurance policies.

In *Gate v Sun Alliance*[45], the New Zealand Court of Appeal dismissed, on a technicality, the argument by a co-insured with a joint interest that the modern approach should apply in determining its right of indemnity. It however referred to

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[42] *Ibid.*
[43] *Ibid.*
[44] It is suggested that the word 'spouse' should not be interpreted literally so as to extend the rule to unmarried couples.
[45] (1995) 8 A.N.Z. Insurance Cases 61-251, 75,806.

the decision in *Maulder,* but declined to comment on it. The court however left open the question whether a distinction should be drawn on 'social policy grounds between domestic and business assets.' The courts are yet to decide on this issue, but the problem with this distinction is that it assumes that the injustice of the traditional approach only affects domestic policies. It is however argued that the same consequence could also occur in relation to commercial policies insuring joint interests, and the root of the problem lies not in the application of the traditional approach to domestic policies, but in the rule of construction itself. It is therefore argued that the approach in *Maulder* is to be preferred over a limited application to domestic policies. It however remains to be seen whether this limited application shall be endorsed by the New Zealand courts.

3. Can the English Courts apply the modern approach?

3.1 Conceptual difficulties

The modern approach offers an alternative way of giving effect to the intentions of co-insureds, but its application in relation to policies insuring joint interests leaves a few questions unanswered. It is necessary to remind ourselves of these issues. If the application of the modern approach to a joint policy results in the courts construing the co-insureds as having separate rights of indemnity, and where one co-insured is guilty of wilful misconduct, should the innocent co-insured be entitled to the full policy proceeds? In *Maulder,* Eichelbaum CJ held that Mrs. Maulder was only entitled to half the proceeds, but does not explain how this was arrived at. A possible explanation might be the argument suggested by Professor Merkin[46] that the husband's act operates to sever the joint tenancy and to give the parties equal but divided rights in the subject matter under a tenancy in common.

[46] *Colinvaux & Merkin,* para. A-0618, pg. 10,592

The problem with this argument is that it seems unlikely that an act of arson would be capable of severing the joint tenancy. Under property law, a unilateral act of a joint tenant is only capable of severing the tenancy where it destroys any of the four unities of interest, possession, title and time which are the foundations of a joint tenancy.[47] It is suggested that the act of destroying the house in no way affects any of the above unities and that the argument should be rejected as a way of determining the entitlement of the innocent co-insured. Leane Cerven however offers an alternative solution. She makes a distinction between the property insured and the proceeds recoverable under the policy, arguing that the latter is not a substitute for the former. She argues that the proceeds are actually the 'product of the contractual relationship between the insurer and the insured, and as such, are severable as voluntarily acquired personal property.'[48] Thus the argument could be made that where insureds have separate rights and in the absence of a clause regulating the sharing of the proceeds, each insured should be entitled to an equal share of the proceeds.

Although this explanation and its conclusion could be said to be just and reasonable, it could be argued that by suggesting that the proceeds are not a substitute for the interest protected against, Leane Cerven ignores the fact that where the insurance is a contract of indemnity, its purpose is to protect an insured against loss or damage to its interest. Thus, the aim of the parties under such contracts must be to treat the proceeds of such policies as a substitute for the property. Applying this to co-insureds with joint interests, since each has an interest in the whole property, the innocent co-insured should therefore be entitled to the total policy proceeds. Although this approach does not have any support from the case law, it is argued that it is consistent with the reasonable expectations of the co-insured with a joint interest. Just as such a party would not expect to lose his right to claim where his co-insured wilfully destroys the property, it would also expect that in the event that the latter is prevented from claiming, he would be able to claim for the loss of his interest which would be the total policy proceeds. The consequence of such

[47] See Gray & Gray, *Elements of Land Law,* (3rd edn.) (Butterworths, 2001), at 856-864.
[48] *Supra, fn.*13 at 874.

wilful conduct would be similar to the doctrine of survivorship which is applicable to joint tenancies. Since the wilful co-insured is barred from claiming, the innocent co-insured as the only survivor to the proceeds claims ownership of the whole.

A final point relates to the argument that there might however be some cases in which recovery to the innocent co-insured would benefit the wilful co-insured, which is contrary to the public policy that a wrongdoer should not be allowed to benefit from his wrong. An illustration is needed to explain this point. A married couple insures their jointly owned house against loss by fire. The husband sets the house on fire and destroys it. The wife seeks to recovery under the policy and the courts applying the modern approach allow her to recover the full value of the house. Where the parties are separated, recovery by the wife would not benefit the husband. However, where the parties are still together the husband would most likely benefit from the recovery, at the very least through the intermingling of their funds. Thus the courts are faced with, on the one hand trying to ensure that the wife is compensated for her loss and, on the other hand that the husband does not benefit from this. Kevin Nicholson refers to this as an insoluble conundrum.[49] It could be argued that since the insurer would have a right of subrogation against the husband this would ensure that the husband would not benefit from the recovery. The reality of such action might however be that since the parties are still together, the insurer might be paid with the exact funds which it paid out to the wife. Thus although the insurer has recovered its loss, the husband would still have benefited from his wrong.

An alternative argument is that where the parties are still together, this might raise the suspicion of the wife's complicity in the act and therefore consideration should be given to reversing the burden of proof in favour of the insurer i.e., 'once fraud against one co-owner is established by the insurer, then the onus shifts to the other to prove that she or he was not implicated.' [50] The problem with this approach is that it is similar to the idea of treating the co-insureds as one entity which is no different from the traditional rule of construction which has so far been criticized.

[49] Kevin Nicholson, "Conundrums for Co-insureds" [1990] 3 Ins. L.J. 218, 249.
[50] Nicholson, *Ibid.*

Secondly, reversing the burden of proof would amount to imposing an onerous obligation on the innocent co-insured as it would be very difficult for the party to prove his or her innocence.[51] It is therefore argued that the burden of proof should not reversed and that the insurer should be left to rely on his subrogated action, however inadequate this might be at times, in preventing the wilful co-insured from benefiting from his wrong.

3.2 The English Courts' ruling on the modern approach.

As mentioned earlier, the perceived injustice of the traditional rule of construction towards joint policyholders resulted in the emergence of the modern approach in other jurisdictions. This emergence has however not extended to the English Jurisdiction. This was probably due to the facts that the courts were rarely faced with this issue and therefore the suitability of the approach was never raised. However the possible application of the approach was raised in the Court of Appeal's decision in *Direct Line v Khan.*[52] As discussed earlier[53], Mr. and Mrs. Khan had taken out a policy of insurance on their domestic home with both named as joint policyholders. A subsequent fire damaged the property and the couple had to move out for a certain period whilst the property was being reinstated. Mr. Khan on behalf of himself and his wife brought claims under the policy amongst which was a claim for rent payable for alternate accommodation. This claim was in fact fraudulent and upon discovery the insurers sought to recover all payments made in respect of the fire.

[51] See Nicholson, *Ibid.* The point being made here is that it is often difficult to prove a negative, as the insured would have to do there, if the burden of proof were to be reversed. The significance of which party should bear the burden of proof cannot be understated, as can be seen in the law of barratry in marine insurance, in which there is a controversy as to which party (the insured or the underwriter) bears the burden of proving or disproving the insured's complicity in the alleged act. For contrasting views on this issue, see Dr. Steven J. Hazelwood, "Marine perils and the burden of proof" and Dr. Mandraka-Sheppard, "Hull time and voyage clauses: marine perils in perspective", respectively in chs. 2 and 4 of *The Modern Law of Marine Insurance (Vol. 1)* (LLP, 1996) Editor D. Rhidian Thomas

[52] [2002] Lloyd's Rep. I.R. 364.

[53] At pg. 48.

The first instance judgment in favour of the insurer was appealed against by Mrs Khan and one of her arguments in the Court of Appeal was that in accordance with the modern approach, she had a separate right of indemnity in the insurance policy which was not affected by her husband's fraudulent claim. Surprisingly, the judges were willing to construe the policy as being a composite one, but counsel acting for Mrs. Khan argued that this was irrelevant if the modern approach applied and relied on the minority decision in *Scott v Wawanesa.* The appeal was dismissed on the basis that Mr. Khan in bringing the claim was also acting as the agent of his wife. This seems to be the *ratio* of the case as evidenced from the judgment of all the judges. Thus, the application of the modern approach would have been irrelevant to the outcome of the decision and would therefore not have assisted Mrs. Khan. This seems to be the point being made by Arden LJ, who was of the view that the minority opinion of the Canadian Supreme Court could not be relied upon.[54] The other judges did not discuss the point as it was not relevant to the facts. It is therefore suggested that although the judgment of Arden LJ could at first glance be interpreted as a rejection of the modern approach, this is highly unlikely as the case was decided on another ground, which made the issue irrelevant. It is therefore suggested that despite the decision in *Khan,* the issue as to whether the modern approach would apply in the English courts is still an open question to be determined by a court faced with an appropriate case demanding the application of the approach.

3.3 Conclusion

Under English law, the nature of a co-insured's right of indemnity is determined by the nature of his proprietary right in the subject matter of insurance. This approach is to the disadvantage of joint interest holders, as any misconduct of one co-insured would affect the right of the others. An alternative approach, which ignores the interests of the co-insureds and focuses on their reasonable expectations, has developed in other jurisdictions. The adoption of this approach would involve a change in the interpretation of insurance contracts. This is because the approach

[54] At 370.

proceeds on the basis that in the absence of clear clauses to the contrary, each insured has a separate right of indemnity irrespective of the nature of their proprietary interests in the subject matter of insurance. The English courts might view this presumption as extreme and unjustifiable, but it is argued that this presumption reflects the reasonable expectations of parties seeking insurance for their interests. The adoption of the approach would also have the effect of disrupting the present distinction between composite and joint policies. The distinction would no longer focus on the nature of the interest of the co-insureds but more appropriately on the right of each party, as construed from the contract of insurance. The consequence of this would be that the categories would only distinguish between the types of interests insured under each policy, but would not determine the nature of the rights of indemnity, which would now be construed from the terms of the contract, i.e co-insurance policies which protect the joint interest of parties would be referred to as joint policies, but the nature of their rights of indemnity under the policy could be either joint or separate depending on the terms of the contract. This however does not mean that the law on co-insurance policies would radically change. The adoption of this rule of construction would only affect the right of indemnity of joint co-insureds, since the nature of the rights of indemnity of composite co-insureds would still remain the same. However, insurers wishing to provide joint rights of indemnity in either form of co-insurance can easily do this by including a clause to this effect, and thus provide the co-insureds with the opportunity to accept or reject such cover.

4. The Co-insured's right of termination

An insured's cover can come to an end through various ways. It could come to an end naturally, when the duration of cover that the parties contracted for has elapsed. The cover could also be avoided by a breach of the duty of disclosure or misrepresentation.[55] The cover can also be brought to an end when the insured terminates the policy either through the exercise of a termination clause or, in the absence of this, the parties can agree to terminate the policy at the request of the insured. For example, a policy, which is automatically renewed annually, can be terminated by the insured informing the insurer of his intention not to renew the cover at the end of the current year. Thus, in an insurance contract covering only one insured, the insured can request or, in certain cases unilaterally terminate his cover. In a co-insurance context, since there is more than one insured covered under the policy, it would be necessary to determine whether one co-insured can terminate the whole policy. The issue is therefore whether the right to terminate the policy is a joint right, which can only be exercised with the consent of all the insureds, or a right exercisable by any insured. Secondly, it shall also be considered whether a co-insured has the right to terminate the insurance in respect of his interest but without affecting the insurance of the other co-insureds.

4.1 The Right to terminate the whole policy

The issue whether the consent of all the co-insureds is necessary in order to terminate the policy, has yet to be considered by the English courts. It is argued that whether a co-insured can terminate the policy is dependent on the terms of the contract. Where the policy contains an express term which unambiguously gives a co-insured such a right, the courts would have to give effect to it as it is evidence of the intention of the parties. Where such a clause does not exist, the courts are left to construe the contract in a way which best gives effect to the intention of the parties. Since the co-insureds are insured under the same policy with the purpose of

[55] Strictly speaking, the remedy of avoidance is different from termination, because when a contract has been avoided, it is set aside and its prior existence is of no legal effect. Whereas with termination, the contract is legally valid, but has now been brought to an end as from the time of the termination.

protecting their interests (whether joint or separate) against the insured risk(s), a construction that the right to terminate is joint would facilitate the purpose of the policy. On the other hand, a construction that each insured can terminate the policy would be a hindrance to the objective behind the joint insurance, as it would mean that a co-insured would be able to terminate the policy to the detriment of the other co-insureds. The fact that such a construction could be to the disadvantage of the others, should be a major factor, which ought to influence the courts only to allow such a construction when it has been expressed in the policy.

Thus the right of termination in a co-insurance contract, in the absence of contrary wording, should be construed as being joint, irrespective of whether the policy is joint or composite. However, Professor Merkin seems to be of the view that in the case of joint policies, a co-insured can terminate the whole policy without the consent of the others.[56] He comes to this conclusion on the basis that in joint policies, the parties have an undivided interest in the subject matter and therefore 'the rights of the co-assureds stand or fall together.'[57] The fact that he arrives at such a conclusion is curious, because assuming the nature of the insureds' interests is determinative of the nature of their rights, co-insureds having undivided interests ought to have a joint right of termination. His reliance on the principle that rights of joint insureds stand or fall together is also questionable, because the principle simply means that where parties have a joint right all must take part in exercising that right and where one insured is absent or withholds consent, the right cannot be exercised.[58] The principle therefore states the requirement necessary in exercising a joint right. The only way in which a co-insured could terminate the policy is if there is evidence that in seeking to terminate he was acting for himself and on behalf of the other co-insureds. Such conclusion should however only be reached where there is proof of agency and not assumed from the relationship in question. For example, the temptation to interpret acts by a husband as also being made on behalf of his co-insured wife should be resisted where the only basis is the fact that both parties are a couple. To give in to such temptation is to accept the traditional role attributed to

[56]*Colinvaux & Merkin, para.* A-0623, pg. 10,595.
[57] *Ibid.*
[58] See *Jones v Yates* (1829) 9 B. & C. 532 and *Brewer v Westminster Bank Ltd.* [1952] 2 All ER 650.

wives, which was rejected in the New Zealand case of *Maulder.* The better approach is to recognize an act of agency where there is actual evidence of this, for example from previous dealings with the insurer.[59]

Professor Merkin further states that with composite policies, 'the divisibility of interests under a composite policy clearly points towards the conclusion that...one co-assured cannot terminate the cover as regards other interests.'[60] Although the conclusion reached is not disputed, it is argued that the fact that the interests are divisible is not the determinative factor. What ought to be determinative is the fact that the purpose of entering into such contracts is best protected by construing the contract as providing the parties with a joint right of termination. It is therefore more of a question of the construction of the contract, rather than inferring from the nature of the interest of the co-insureds. Professor Merkin although suggesting that with a composite policy, a co-insured cannot terminate the whole policy, does not however conclude that the consent of all insureds is necessary. This is because he entertains the possibility that a co-insured, while not being able to terminate the whole policy, might be able to terminate his own cover under the policy. Whether or not a co-insured ought to have this right shall now be explored.

4.2 Can a co-insured unilaterally terminate his cover?

Before embarking on any analysis, it is necessary to point out that this question will only be relevant to composite policies. This is because co-insureds under a joint policy have an undivided interest in the subject matter of insurance and therefore, the insurer is dealing with only one insurance cover, although protecting more than one person. Thus with a joint policy, the indivisibility of the interest of the co-insureds, would make it impossible for one insured to be able to terminate its own cover, because technically the cover is for him and other insureds jointly. Even where, as argued earlier, the joint insureds have separate rights of indemnity, this in

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[59] In *Direct Line v. Kahn* [2002] Lloyd's Rep.I.R. 364, The Court of Appeal held that Mr. Khan in bringing the fraudulent claim was also acting for the benefit of his wife, presumably because the claim included losses which Mrs. Kahn had an interest in.
[60] *Colinvaux & Merkin,* A-0623, pg. 10,596.

no way alters the joint nature of their proprietary interests. Thus with respect to joint insureds, there is no question of each insured having a separate cover capable of being terminated.

Whereas with composite policies, since each co-insured has a separate interest, a co-insured could argue that while he or she cannot terminate the whole policy without the consent of the others, he should be able to terminate his own cover under the policy. The English courts have not been faced with this question but the Australian High Court has been confronted with it. While the decision of this court is not binding on English courts, it is of enormous persuasive authority and it is therefore necessary to discuss it.

4.3 *Federation Insurance Limited v Wasson and others*[61]

In *Federation*, four members of the Wasson family entered into a lease-rent agreement with a lessor in respect of a motor vehicle. In accordance with the lease agreement, the Wassons were required to insure the vehicle, covering their interest and the interest of the lessor. Under the insurance agreement, the Wassons were responsible for the payment of all premiums and included in the policy was a clause, which stated that the policy might be terminated at any time, 'at the request of the insured.' The Wassons sought to cancel the policy but without the consent or the knowledge of the lessor.[62] Shortly afterwards, the car became a total loss and the Wassons brought an action on the policy arguing that the cancellation had been ineffective because the lessor had not consented to it. The insurance company resisted the claim on the basis that the Wassons effectively terminated the insurance of their interest in the vehicle before the accident occurred. The High Court of Australia was therefore faced with the question whether a composite co-assured could terminate cover to his interest.

[61] (1987) 163 C.L.R. 303.

[62] The actual facts were that Mr. Wasson sought to cancel the policy. Since the interest of the Wassons were joint, it must therefore follow that Mr. Wasson in asking for a termination was acting as an agent on behalf of the other Wasson family members who were joint owners. This is because, as argued in the preceding section, all joint insureds must give consent to a termination for it to be effective.

The High Court decided the question by construing the contract in order to determine the intention of the parties. Emphasis was placed on the termination clause which the court held was clear and entitled the insureds to terminate the whole policy and 'not of the insurance of the respective rights and interests of the parties.'[63] The court construed this term to indicate that the intention of the parties must have been that if there was to be a termination, all the insureds must participate in that request. The court also mentioned the fact that the amount of premium to be refunded was not susceptible of calculation if one co-insured was allowed to terminate his cover as further evidence that the parties never intended this. Thus, it was held that the Wassons had not terminated the insurance of their interest. It is the view of this author that the approach taken by the courts and the decision reached in *Wasson* represents the appropriate way in dealing with the issue. The issue is essentially one of what the parties intended and this should be resolved by focusing on the contractual terms in the policy. Granted, the Court in *Wasson* was helped by the presence of a termination clause in the policy. It is however argued that even in the absence of such a clause, and in the absence of any term giving a co-insured the right to terminate his cover, the courts ought to construe the contract as only allowing termination by all. This is essentially because parties who enter into such contracts clearly intended to have a co-existent legal relationship with one another and it ought to be assumed that the parties intended this relationship to be permanent unless a contrary intention has been expressed. The High Court in *Wasson*, expressed a similar view saying:[64]

> The "reasons of obvious convenience", to adopt the phrase used by the Master of the Rolls in *General Accident*, which makes it appropriate to combine two insurances in a composite policy would be frustrated if it were possible for one only of the insured, acting unilaterally, to bring part of that policy to an end.

[63] Per Mason CJ, Wilson, Dawson and Toohey JJ, at 315 and Gaudron J at 319.
[64] At 316.

Another point, also made in *Wasson*[65], is that allowing a co-insured to exercise the right to terminate only his interest, would alter the insurance and subject the insurer to covering risks which he might not have been prepared to accept had it been proposed in the first place. If this were the case, it would be unjust to subject the insurer to this in the absence of clear words in the policy expressing this intention. The fact that the co-insureds' interests are divisible does not justify, nor is it any indication of the intention of the parties. In the absence of express terms, one has to look at the policy as a whole, in order to determine the intention of the parties. It is submitted that the very fact that the insureds decided to insure under a composite policy, is a strong indication that the parties did not intend that a co-insured could unilaterally terminate the insurance of his cover.

A co-insured should however be able to terminate his cover where the policy is in fact a bundle of separate contracts with each insured. Thus what the insured will be doing in this case is exercising his right to terminate his contract with the insurer and this, in no way affects the insurer's contracts with the other insureds. There is growing trend in the English jurisdiction to interpret composite policies as being bundles of separate contracts[66], and if this view prevails it would follow that a co-insured under such policy would have the right to terminate his cover. This interpretation however does not seem to have the support of the Court of Appeal[67], and until there is a decision on this issue, it cannot be said to be conclusive. As argued earlier[68], there is however a strong case to be made for construing composite policies insuring each co-insured against loss to a separate subject matter, as bundles of separate contracts. If such a view were accepted, a co-insured under such a policy would therefore have a right to terminate his contract without the consent of the other co-insureds.

[65] *Ibid.*
[66] See in particular, the High Court judgments of *Arab Bank v Zurich* [1999] 1 Lloyd's Rep. 262 at 277, discussed in Chapter IV, pg. 96.
[67] *New Hampshire Insurance Company v MGN* [1996] C.L.C. 1693. The Court of Appeal's position on this issue is discussed in Chapter IV, pg. 92.
[68] Chapter I, pg.6-8

4.4 Conclusion

In deciding whether a co-insured has an independent right to terminate, either the whole policy or just his interest, the focus should be on the policy and its terms in order to determine the intention of the parties. Where the parties have included a termination clause, such clauses should be construed taking into consideration the type of contract the parties have entered into, as shown in *Wasson*. The fact that the insureds have joint or divisible interests is insufficient as evidence that the parties intended that each co-insured should have a right to terminate the policy or cover. In most cases the co-insureds should have a joint right, as this is consistent with the co-existent legal relationship of the insureds. Co-insureds can only have independent rights where the policy contains separate contracts, with each contract insuring the interest of an insured. The insured, by exercising his right to terminate would not only be terminating his cover but also his contract with the insurer.

CHAPTER IV

CO-INSUREDS AND THE DUTY OF UTMOST GOOD FAITH.

1. Introduction

The focus of this chapter will be to examine the application of the duty of utmost good faith in co-insurance policies and whether or not a breach of the duty by one co-insured would affect the rights of the other co-insureds. Insurance contracts are contracts of utmost good faith and, in this respect, differ from other commercial contracts.[1] The law relating to the duty of good faith in all forms of insurance contracts is accepted as being codified in s.17-20 of the Marine Insurance Act 1906 (hereinafter referred to as MIA 1906.)[2] The duty consists of two separate obligations, namely, the pre-contractual duty, which further consists of the duty of disclosure[3] and the duty against misrepresentations[4], and the post contractual duty[5]. The remedy available when these duties have been breached was always thought to be avoidance of the contract of insurance.[6] Whilst this is still the case with the pre-contractual duty, the position with respect of the post-contractual duty is less clear cut. The present position adopted by the courts is that the remedy of avoidance is not available to all breaches of the post-contractual duty.[7] Despite this limited role in relation to the latter duty, the remedy of avoidance plays a vital role in the whole duty and the focus of this chapter shall be on how it is applied to co-insurance policies. I shall deal separately with the pre-contractual and post-contractual duties as the application of both duties are different. In my discussion of the pre-

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[1] In *Walters v Morgan* (1861) 3 De G.F & J 718, Lord Campbell expressed the view that there was no duty to disclose in a contract of sale.
[2] *Pan Atlantic v Pine Top* [1994] 3 All E.R. 581, per Lord Mustill at 588 and Lord Lloyd at 623.
[3] S.18 and 19 of the MIA 1906.
[4] S.20 of the MIA 1906.
[5] S.17 of the MIA 1906 is the source of this duty.
[6] *Ibid.*
[7] See *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563. For a useful discussion of the cases and the problems in this area, see H. Bennett, "Mapping the doctrine of utmost good faith in insurance contract law" [1999] L.M.C.L.Q. 165; B. Soyer, "Post-contractual duty of utmost good faith in marine insurance contracts: A new perspective for the new millennium" [2001] 6 Int.M.L. 191; A. Mandaraka-Sheppard, "The overarching duty of good faith in insurance contracts: Where does the buck stop?" [2001] 10 Int.M.L. 327.

contractual duty, I shall also determine whether in co-insurance contracts, all the co-insureds are under a pre-contractual duty. In determining this, I shall look at various ways in which co-insurance contracts are entered into. The main focus of this chapter shall however be whether the duty of utmost good faith imposes a joint or several obligations on the co-insureds. In other words, does the breach of the duty by one co-insured affect the cover of the other co-insureds? In answering this question, I shall discuss the relevant case laws, which express the position of the English courts. I shall also question if this position is consistent with the reasoning behind the duty.

1.1 The Pre-contractual duty

The pre-contractual duty consists of the duty of disclosure and the duty against misrepresentation. Section 18 of the MIA 1906, deals with the obligation of the insured to disclose material facts to the insurer prior to the contract of insurance being effected, whilst section 19 imposes a similar duty on the agent of the insured. Section 20, imposes a duty against misrepresentation against both the insured and his agent. The duty arises due to the particular nature of the contract of insurance, i.e. the applicant wishing to insure a risk has more knowledge than the underwriter(s) about the subject matter of insurance. So, in assessing the risk(s) being presented to it, the underwriter has to rely on the information given to him by the applicant.[8] Therefore, in order to give effect to the duty of utmost good faith, the applicant is under a duty to disclose and not to misrepresent to the underwriter(s) any information within his knowledge, which is necessary for the assessment of the risk to be covered. This reasoning is supported by the judgment of Lord Mansfield in *Carter v Boehm.*[9] Although the duty not to misrepresent is independent and separate from the duty of disclosure, the extent and width of the latter often subsumes the former. This has made the duty against misrepresentation less

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[8] Given the resources available to, and the expertise of the modern insurer, it could be argued that this rationale is no longer a true reflection of the insurer's position. There would however still be some information which, by their very nature, would be beyond the knowledge of the insurer e.g. information relating to the moral hazard of the insured, see Birds and Hird, at p.114-9.

[9] (1776) 3 Burr. 1905, at 1909-1911.

important in terms of utmost good faith.[10] This is however of no consequence, as most cases of a misrepresentation would also amount to a non-disclosure.[11]

The pre-contractual duty serves the purpose of ensuring that the insurer has the necessary information on which to decide whether or not to accept the risk and on what terms. It therefore serves a risk management function and its importance to the insurer cannot be over-emphasized. The obligations also apply to the insurer. This is evident from s.17 of the MIA 1906, which imposes a duty of utmost good faith on both parties. Thus, the underwriter is under a duty to disclose and not to misrepresent to the insured, facts which are relevant to the nature of the risk sought to be covered, or facts relevant to the recoverability of a claim which a prudent insured would take into account in deciding whether or not to place the risk with the insurer.[12] These obligations are said to be pre-contractual because they only apply during the negotiation process before the contract of insurance is concluded. Thus once a contract has been effected, based on the material information known to the insured at that time, any other subsequent information which become known after the contract has been concluded need not be disclosed, because the reason for the rule, i.e. to allow the insurer to assess the risk presented, is no longer present.

When a party breaches the duty of disclosure, the effect of such a breach is to make the contract of insurance voidable at the election of the aggrieved party. If such avoidance is elected, the contract is avoided *ab initio*.[13] This remedy of avoidance is the only remedy open to an aggrieved party, as he is not entitled to sue

[10] See Birds and Hird, at p.97.

[11] Where I misrepresent a material fact (either deliberately or negligently) and the true facts are known to me, the fact that I failed to disclose the true facts would also amount to a non-disclosure. This is probably why in most instances when the insurer is relying on the pre-contractual duty as a defence, both the breach of the duty of disclosure and the duty against misrepresentation are alleged. However it seems the defence of non-disclosure would not be successful where the insured has made an innocent misrepresentation. See *Economides v. Commercial Union Assurance Co. plc.* [1999] 3 All ER 636. Birds and Hird, have however argued that both doctrines should be treated separately and that insurers defending an action should not plead both indiscriminately, "Misrepresentation and Non-disclosure in Insurance Law – Identical Twins or Separate Issues? (1996) 59 M.L.R. 285, 285-6. See also, Hasson, "Misrepresentation and Non-disclosure in Life insurance – Some Steps Forward" (1975) 38 M.L.R. 89.

[12] *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co. Ltd* [1990] 1 Q.B. 665, 772.

[13] See s. 18(1) and 20(1) of the MIA 1906. This is in contrast to Lord Mansfield's view in *Carter v Boehm, Ibid*, at 1909, in which he felt that the breach of the duty resulted in the policy being void.

for damages.[14] The fact that avoidance is the only remedy seems to play an important factor in the courts application of the duty to co-insurance situations. This will be dealt with in detail in our discussion of the obligation imposed by the duty on co-insureds. To conclude, the pre-contractual duty applies to both parties to the contract of insurance. However it can be said to play a vital role to the insurer's management and decision making process. The duty enables the insurer to be able to have the necessary information on which to decide whether or not to accept a risk and on what terms. The importance of the duty to the insurer can also be seen in s.18-20 of the MIA 1906, which expressly deal with the duty of the insured to disclose and not to misrepresent material facts while the insurer's duty is implied from s.17. In our enquiries, the focus will be on the insureds' obligation(s) in relation to the duty, as the nature of the insurer's obligation is not problematic.

1.2 The Post-contractual duty

It can no longer be doubted that parties to a contract of insurance are subject to the duty of utmost good faith after the contract has been concluded.[15] What is not clear are the circumstances in which the duty is applicable. In the *Star Sea*, Lord Hobhouse[16] was of the view that the post-contractual duty was not as extensive as its pre-contractual counterpart and that it was not in every circumstance that such a duty was present. He did however accept that when the terms of the contract of insurance are being varied or renegotiated, there is a duty to disclose material facts that are related to the variation.[17]

In *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*[18], the Court of Appeal dealt with the scope of the post-contractual duty. Longmore LJ, giving the judgment of the court held that the post-

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[14] *Banque Keyser Ullman SA v Skandia (UK) Insurance Co. Ltd. Ibid* at 781.

[15] See the Judgment of Lord Clyde in *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2001] 1 Lloyd's Rep. 389, at 392. For a useful discussion of the case, see B. Soyer "The Star Sea - a lode star?" [2001]L.M.C.L.Q. 428.

[16] *Ibid* at 401.

[17] *Ibid*

[18] [2001] 2 Lloyd's Rep. 563.

contractual duty was not limited to specific categories, but continued throughout the contractual relationship between the insurer and the insured.[19] He also traced the development of the law of the post-contractual duty, which showed that it was 'by no means in every case of non-observance of good faith by the insured that the insurer can avoid the contract.'[20] It was therefore necessary to find a principle by which it was possible to decide the circumstances in which a breach of the post-contractual duty would result in the avoidance of the contract. The Court of Appeal held that it would only be appropriate to invoke the remedy of avoidance in situations in which the breach also entitled the insurer to terminate the contract. For example, where the conduct alleged to have been a breach of the duty is fraudulent, the fraud 'must have be material in the sense that the fraud would have an effect on the underwriter's ultimate liability' and 'the gravity of the fraud or its consequences must be such as would enable the underwriters, if they wished to do so, to terminate for breach of contract.'[21] This decision is no doubt important as it limits the scope of the duty in terms of the remedy of avoidance. Of importance to our inquiry is how this would be applied in respect of co-insurance policies. This shall be explored subsequently.

2. The Application of the duty to co-insurance contracts

The purpose of this section is to determine how the duty of utmost good faith applies to co-insurance policies. In particular, whether all co-insureds under a co-insurance policy are under a pre-contractual duty, i.e. are all co-insureds always under duties to disclose and not to misrepresent material facts? Since such duties only arise before the contract is entered into, the focus will be at the formation stage of the contract of insurance. The method of analysis will be to look at the different scenarios relating to co-insureds at the formation stage. However where the policy contemplates the inclusion of other co-insureds after the contract has been

[19] The duty is however superseded, once the parties become engaged in litigation, by the rules of court in the Civil Procedure Rules. See *The Star Sea*, *supra*, at 406.
[20] *Supra*, *fn.*18, at 572.
[21] At 576.

concluded, it shall be considered whether such parties are subject to a post-contractual duty.

2.1 Scenario 1: *All the co-insureds negotiate directly with the insurer*

The application of the duty in this case is unproblematic. Where all the co-insureds deal directly with the insurer, each co-insured is under a duty to disclose all material facts to the insurer. This is as a result of the rationale behind the rule. Since the information relating to the risk to be placed lies mostly in the hands of the co-insureds, each is under a duty to disclose, in order to provide the underwriter with all the relevant information it needs to decide whether or not to accept the risks presented by the them and if so, on what terms. Situations, which would fall under this scenario, include when limited or co-owners of property directly negotiate with an underwriter to insure the loss to their property against certain risks.

2.2 Scenario 2: *One co-insured negotiates and contracts with the insurer for the benefit of all*

Where only one co-insured negotiates and contracts for the benefit of all, are the other co-insureds under a pre-contractual duty? If they are, how is this obligation discharged? In respect of the first question, it could be argued that since the risk being presented relates to all, it must naturally follow that all the insureds are under a duty, irrespective of the fact that the contract was negotiated on their behalf. The duty against misrepresentation would not be applicable to such co-insureds as they would not be dealing directly with the insurer. However the agent co-insured would be under a duty not to make any misrepresentations in his dealings with the insurer.[22] In relation to the duty of disclosure, it could be said that section 18(1) of the MIA 1906, supports the view that the co-insureds are still subject to a duty of disclosure even when they do not deal directly with the insurer:

[22] S. 20(1) of the MIA 1906.

...The assured must disclose to the insurer before the contract is concluded, every material circumstance which is known to the assured...

A literal interpretation of this section seems to suggest that as long as one is an insured before the contract is concluded, he or she is under a duty to disclose. If this is indeed the case and each insured is under a duty to disclose, how does section 19 of the MIA 1906, which pertains to the duty of disclosure of an agent fit into this analysis? Section 19 deals with an agent effecting insurance on behalf of the principal and imposes a duty of disclosure on him. The agent that owes such a duty is the agent that actually negotiates and deals directly with the underwriters, referred to as the 'agent to insure' and does not include any intermediary agent, whose function it is to gather the necessary information.[23] In respect of commercial insurance, the broker acting for the co-insureds would be the 'agent to insure', and in accordance with section 19 (b), he is under a duty to 'disclose every material circumstance which the assured is bound to disclose, unless it comes too late to communicate it to the agent.' Therefore, when there has been a breach of duty, the insurer can, in most cases[24], claim that either the agent or the insured has breached his duty.

2.3 Scenario 3: *The insurance contract identifies the co-insureds, but at the time the contract is effected, the actual identity of each co-insured is not known*

Where the contract of insurance is expressed for the benefit of insureds, some of whom are not known or identifiable at the time the contract is effected, are the unidentifiable co-insureds under a duty of disclosure when they are subsequently identifiable? Examples of such contracts are contracts for the benefit of the employees of a company, or for persons occupying defined positions in a firm. For

[23] *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep. 241, per Saville LJ at 259.
[24] I use the phrase, 'in most cases', because the duty under s.19 is not restricted to what the assured ought to disclose, but can also include material information which the assured does not know of, but which the agent is aware of, in his capacity as agent. See, s.19(a) of the MIA 1906.

example, in *Arab bank v Zurich*[25], a professional indemnity policy was taken out by a firm of professional estate agents and valuers. A clause in the policy defined the insureds under the policy as including 'partner, director, sole proprietor and any person who may at any time become partner or director of the firm(s).'[26] In the case of the above policy, are the future partners and directors under a duty of disclosure? It must be remembered that the duty only applies to information available prior to the time the contract is effected, in order to allow the insurer to assess the risk being presented. Thus, where the future insureds are unknown at the time the contract concluded, the agent to insure has no information to disclose in relation to them. The agent is only obliged to disclose what he and his principals know or are deemed to know, and where either party has no such knowledge, the agent is not under a duty to disclose.

Professor Malcolm Clarke[27] is of the view that in some cases, there is a waiver of the duty of disclosure because of the nature of the insurance being sought. The insurer does not waive all material information, but only information, which is not readily available when the contract is made. This surely explains our scenario. This is because, at the time the contract is made, information relating to the identity of any future directors or partners are not known by the company and therefore any information relating to there future officials cannot be material in assessing the risk. However, rather than concluding that the insurer has waived such information, it is suggested that it would it be more appropriate to argue that in such cases, the agent to insure does not owe any obligation to disclose such information because such information is not known at the time of contract. There is only a duty to disclose information, which is material and known to either the assured or his agent. It must therefore follow that where the identity of the future assureds are unknown, the insurer does not waive any material information in respect of the latter, because his right to disclosure is limited to what is known to the present insureds and the agent to insure.

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[25] [1999] 1 Lloyds Rep. 262.
[26] Ibid. at 268.
[27] *The Law of Insurance Contracts* (LLP, 2002) (4th edn.) by Dr. Malcolm Clarke (hereafter referred to as Clarke) para. 23-12C, pg. 744.

Could it however be argued that such future partners are under a duty to disclose once they become insureds, such duty being a part of the post-contractual duty of utmost good faith? Although the duty of utmost good faith continues throughout the existence of the contract of insurance, it does not follow that every conduct of the insured is subject to this obligation. In *K/S Merc-Scandia*, Longmore LJ listed instances in which the courts held that the post-contractual duty applied.[28] Of importance to our scenario, are the instances where the risk insured is varied, and where the insurer asks for information during the duration of the policy.[29] Longmore LJ was of the view that instances where the risk was varied, were rather examples of pre-contract lack of good faith because they arise before the variation and the remedy of avoidance is only applicable to the variation and not the whole contract.[30] In respect of cases where the insurer asks for information, there will only be a duty where the insurer has a right to such information by virtue of an express or implied term. Thus, applying this to our co-insurance example, future co-insureds would be under a duty to disclose, if their inclusion into the contract amounts to a variation of the risk or if the insurer has a contractual right to ask for information relating to them. However, the fact that the definition clause includes future directors and officials as co-insureds, implies that their inclusion has already been contemplated by the insurer and therefore their eventual inclusion does not amount to a variation of the risk.

It is not certain whether the policy in *Arab Bank*, included a term, giving the insurer the right to ask for information relating to future insureds. If such a term is present, the co-insureds are bound to answer such information asked for. It does not however mean that they are bound to disclose every material information known to them, because the clause by giving the insurer the right to ask information only obliges the co-insureds to answer when asked. Thus, it could be said that in such an instance the post-contractual duty has been limited, by contract, to disclosing only

[28] *Supra fn.*18, at 571
[29] The other instances were:(1) the fraudulent claims jurisdiction, which he said might not be based on the duty of utmost good faith, but a separate principle of law, (2) Renewal of the contract (3) 'Held covered' cases.
[30]At 574. He also says the same of renewal of the contract and the application of the 'held-covered' provision.

what the insurer asks for.[31] If however, there is no such term, should it be implied into the contract? The courts normally imply terms into the contracts in order to give effect to the intention of the parties[32], thus it would be necessary to determine whether such a right was intended by the parties. This would depend on the construction of the contract by the courts. It is however argued that the fact that the parties included future insureds in the definition clause is indicative of the insurer's intention to take a risk of providing cover to such parties without requiring any safeguards to ensure that the latter should disclose any material information. Such argument might seem harsh, but since it would have been quite easy for the insurer to have included a clause requiring disclosure from future co-insureds, the absence of such a term ought to be construed as evidence that the parties did not intend the insurer to have this right.

2.4 Scenario 4: *Insurance under Block Policies*

Block policies are a form of co-insurance in which the insurer covers the interests of a group of people with distinct, but similar subject matters. A typical example is when a bank takes out a policy of insurance, which covers its interests as mortgagee, and the interests of the mortgagors of the homes of its customers. Two observations are necessary here. Firstly, the policy covers more than one subject matter of insurance. It covers not one house, but as many houses as the bank decides to finance.[33] The corollary of this is that the risk to each co-insured will be different and not related to one another, thus damage to a mortgagor's property will not affect the property of another mortgagor. Secondly, the block policy is for the benefit of not only existing mortgagors of the bank but can also be used by future mortgagors who are financed during the duration of the policy. This again raises the question that if the duty of disclosure arises only before the contract is concluded, is the contracting party bound to disclose material information relating to such future

[31] A breach of such a duty does not give the insurer the right to avoid the contract. See Longmore LJ at 571.
[32] *Luxor (Eastbourne) Ltd v Cooper* [1941] A.C. 108.
[33] However, it is not disputed that the insurer can contractually limit the number of houses that can be insured under the policy.

mortgagors, once they have become known? The answer to this question, supported by case law, is that there is a duty to disclose such information. In *Woolcott v Sun Alliance and London Insurance Ltd*[34], the defendant insurance company issued a block policy to the Bristol & West Building Society. The building society agreed to finance the claimant's purchase of a house and both parties' interests in the property were covered under the block policy. The claimant failed to disclose to the building society that he had a criminal conviction. The house was destroyed by fire, and the defendants, although indemnifying the Building Society for its loss, refused to indemnify the claimant based on the non-disclosure of his conviction. One of the questions Caulfield J had to consider was whether the claimant's conviction ought to have been disclosed. His conclusion to this was: [35]

> The plaintiff knew that the society would be effecting a policy of insurance on their own behalf and on his behalf, and accordingly, in my judgment, there was a duty upon the plaintiff to disclose such facts as a reasonable or prudent insurer might have treated as material.

In Caulfield J's view, the claimant's conviction ought to have been disclosed because he was, through the bank, entering into a contract of insurance. This obviously raises the question that if the contract of insurance is entered into when the claimant accepts to be covered, then what is the nature of the block policy. There are two possible answers to this question. The first maintains that the block policy is a contract of insurance. Therefore the duty of disclosure will only arise prior to the contract being concluded. However, it could be argued that material information relating to a subsequent mortgagor ought to be disclosed under a post-contractual duty of disclosure. The alternative answer argues that the block policy is not a contract of insurance but a contract for insurance, in other words, an agreement between the insurer and the bank that the latter has the authority to accept risks presented to it for insurance on behalf of the insurer. The consequence of this is that, a contract of insurance is entered into, each time the bank accepts to provide cover

[34] [1978] 1 Lloyd's Rep. 629.
[35] *Ibid,* at 633.

to the mortgage property on behalf of the insurer. In such a situation, information relating to each mortgagor must therefore be disclosed. Both views will now be considered

2.4.1 The Block policy as a contract of insurance

If the block policy is a contract of insurance, it must follow that as soon as the contract has been concluded, the pre-contractual duty of disclosure comes to an end. Thus any mortgagor who is subsequently covered by the policy is not subject to the pre-contractual duty. Subsequent mortgagors might however be subject to a post-contractual duty of disclosure. This would be the case where the inclusion of the subsequent mortgagor amounts to a variation of the risk. Whether or not these inclusions amount to a variation of the risk can only be determined by the terms of the policy. The decision in *Woolcott*, however does not point to this conclusion. Caulfield J's decision does not suggest that the insurance of the claimant amounted to a variation of the policy. In fact his judgment suggests that the insurers effected a separate insurance for the benefit of both the claimant and the mortgagee in respect of the former's house.[36] It therefore seems that the block policy in this case was not a contract of insurance.

2.4.2 The block policy as a contract for insurance.

The basis of this argument is that the block policy, rather than being a contract of insurance, is really evidence of an agreement between the bank and the insurer that the latter undertakes to accept risks presented to it by the bank. The effect of such an agreement is that the bank has the authority to bind the insurer in relation to risks it accepts.[37] Therefore each time a risk is accepted, the insurer enters into a contract of insurance with the bank and the particular mortgagor as co-insureds. The pre-contractual duty of disclosure would therefore apply to any material information

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[36] See, in particular the findings of the judge at 631-2 and his application of the duty of disclosure, at 633 (see *fn.*40 of this thesis.)
[37] See *Woolcott,* at 631.

within the knowledge of both the bank and the mortgagor. The block policy would therefore only contain the framework for the insurance contracts to be effected if the insurer decides to accept any risk and since it is not a contract of insurance, no duty of utmost good faith should attach to it.[38] The duty would only attach to the individual insurances made under the facility. The attraction with this approach is that it gives a more realistic account of block policies. For example, the fact that each risk covers different, albeit similar, subject matters owned by different insureds, is a strong indication that the insurer effects separate insurance contracts with the co-insureds.

Secondly, if the insurer enters into separate contracts, it must follow that each would pay different premiums, and not an aggregate sum. In *Woolcott*, the mortgagor had to pay a separate premium to the insurer, which seemed to have been calculated, based on the value of the mortgaged property.[39] Thirdly, Caulfield J was of the view that the contract of insurance between the insurer and the co-insureds (i.e. the mortgagor and the bank), was effected subsequent to the block policy.[40] It follows that in *Woolcott*, each time the insurer accepted a risk, a contract of insurance was concluded for the benefit of the bank and a mortgagor and therefore, the mortgagor in filling the proposal form was under a duty to disclose any material information.

To conclude, it is argued that although the second approach seems to correspond with the reasoning in *Woolcott,* this does not mean that all block policies would be interpreted this way, to the exclusion of the first approach. It surely depends on the block policy itself and the interpretation given to its terms by the courts. If the policy is construed as a contract of insurance, then once the policy is

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[38] In *HIH Casualty v Chase Manhattan Bank* [2001] 1 Lloyd's Rep. 30, Aikens J, at 47, held that a contract for insurance was not a contract of utmost good faith, therefore precluding any duty of disclosure attaching to such contracts. If it is therefore accepted that the block policy is a contract for insurance, the same conclusion should also apply.

[39] At 630.

[40] Caulfield J says, at pg. 633: 'The duty, in my judgment, rested on the plaintiff, when he completed his application form for a loan, to disclose his criminal record, for by that application, he was *accepting that the society would effect the insurance* of his property and on his behalf as well as their own behalf...The plaintiff knew the society *would be effecting a policy of insurance* on their own behalf and on his behalf...'

effected, the pre-contractual duty of disclosure comes to an end. A subsequent duty of disclosure would only be present where the inclusion of additional insureds would amount to a variation or modification of the terms of the contract.

2.5 Conclusion

The conclusion to be drawn from the above analysis is that in most cases of co-insurance, all co-insureds would be under a duty of disclosure. Where the insured is not identifiable at the time the contract is concluded, the insured will still be under a duty if his subsequent inclusion amounts to a modification or variation of the contract. The fact that the insureds will in most cases be subject to the duty further emphasizes the importance of the duty to the insurer, in respect of its decision making process.

3. The Obligation of the Co-Insured

The next enquiry is to determine the obligation imposed by the duty of utmost good faith on each co-insured. This discussion shall be divided into two parts, with the first enquiry focusing on the obligation imposed by the pre-contractual duties. The discussion shall focus mainly on the remedy of avoidance available to the insurer when a co-insured has breached any of the pre-contractual duties. Since the remedy of avoidance applies to both the duty of disclosure and the duty against misrepresentation, and since the rationale behind both duties are the same, separate discussions on their application to co-insurance will be unnecessary. The second enquiry shall deal with the obligation of the post-contractual duty of utmost good faith in co-insurance policies and the effect of the Court of Appeal's decision in *K/S Merc-Scandia* on such policies.

3.1 The pre-contractual duty

In a contract of insurance for the benefit of only one insured, a breach of the pre-contractual duty by the insured, gives the insurer the right to avoid the contract of insurance.[41] With co-insurance contracts, since there is more than one insured covered under the policy, the question to be asked is whether the breach of the duty by one insured avoids the cover of the other insureds? In terms of obligations, the question therefore is whether the duty imposes a joint or several obligations on the co-insureds? If the obligation is joint a breach by one insured avoids the whole policy, while if the obligation is several a breach by one does not affect the rights of the other co-insureds. Before embarking on an analysis of the approach taken by the English courts, it is necessary to attempt to identify the type of obligation implied by the duty.

As mentioned earlier, the purpose of the duty from the insurer's point of view is to provide him with the necessary information in order to make an informed decision on whether or not to accept the risk presented and on what terms or even whether to take out re-insurance on the risk. Where the insured fails to disclose, or misrepresents the material information, the insurer is denied the opportunity to make an informed decision and is therefore entitled to avoid the contract. The duty is therefore present to prevent or remedy the absence of an informed decision. Once there has been an absence of an informed decision on the part of the insurer, he is entitled to avoid the contract. This is why the liability of the insured can be said to be strict. This is because the non-disclosure or misrepresentation by the insured could have been innocent or negligent and still the insurer can avoid the policy because the breach prevented him from making an informed decision.[42] If the focus of the duty is therefore to facilitate informed decisions, it must follow that similar considerations should apply in a co-insurance context. Where a co-insured has failed to disclose a material fact, the insurer has been denied material information to make an informed decision and should therefore be entitled to avoid the policy. It should

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[41] S.18(1) of the MIA 1906.

[42] In *Carter v Boehm*, *supra. fn*.9, at 1909, Lord Mansfield said: 'Although the suppression should happen through mistake, without any fraudulent intention; yet the underwriter is deceived, and the policy is void...'

not matter that only one co-insured out of many failed to disclose, because his act is sufficient to create the undesired outcome, i.e. an uninformed decision by the insurer. Once this outcome has been created, the insurer should have the right, to avoid the whole contract. It therefore does not matter if one or all the co-insureds caused the breach, because in either case, the insurer has not been able to make an informed decision.

The duty therefore implies a joint obligation on the co-insureds. The effect of this would mean that the breach by one would be the breach of all. However the decisions of the English courts suggest otherwise. The approach taken by the English courts is to focus on the joint-composite policy distinction. Where the policy is joint, non-disclosure or misrepresentation by a co-insured, entitles the insurer to avoid the whole policy. Therefore, in the context of joint policies, the co-insureds are under a joint obligation. Where the policy is composite, the cases have held that non-disclosure or misrepresentation by one co-insured does not affect the cover of the other co-insureds. A fundamental flaw with this approach is to assume that the proprietary interests of the co-insureds are determinative of all their obligations under the contract of insurance. Whilst it is arguable that the co-insured's interest could be determinative of his right of indemnity, the same considerations do not apply in relation to the duty of disclosure essentially because of the rationale behind the duty. In determining the nature of the obligation to be imposed by the duty, it is suggested that the logical approach would be to focus on the duty itself and its rationale. The English courts have however not taken this approach and it is instructive to consider the case laws in this area in order to determine whether the approach embarked upon is satisfactory in relation to other areas of the law and consistent with the rationale underlying the doctrine.

3.2 The approach of the Common law

As mentioned in the previous paragraph, the approach taken by the English courts is to focus on the nature of the interest of the co-insureds. The question that is asked is whether the policy is joint or composite. Where the policy is joint, the obligation of the co-insureds are joint, while with a composite policy, the case law seems to suggest that each insured is under a separate obligation. Virtually all the cases on this topic, involve composite policies. It seems that the position as regards joint policies has been accepted by all and is not controversial. The position regarding composite policies, on the other hand, has proved controversial and, as will be shown in the following cases, the reasoning behind this approach is not entirely clear.

3.3 The Case Laws

In their analysis of the pre-contractual duty, the courts have mostly focused on the duty of disclosure and not the duty against misrepresentation. This really makes no difference as the laws in respect of both duties are similar and trigger the same remedy in the event of a breach of either duty.[43] Thus, in our discussion, our focus shall be on the duty of disclosure, bearing in mind that the analysis also applies to duty against misrepresentation. A good starting point is the case of *Woolcott v Sun Alliance and London Insurance Ltd.*[44] The facts of this case have already been stated in our discussion of block policies.[45] It will be remembered that the co-insureds were the claimant mortgagor and the mortgagee bank and the insured property was a dwelling house. A subsequent fire destroyed the house, and the insurer indemnified the Bank for its loss but refused to indemnify the claimant for his loss on the ground that the claimant failed to disclose his criminal conviction at the time the contract of insurance was concluded. The claimant brought an action against the insurer claiming that he was entitled to be indemnified under the policy.

[43] See s.18 and 20 of the MIA 1906.
[44] [1978] 1 Lloyd's Rep. 629.
[45] At pg. 82.

The claimant's argument was that the policy was a joint one and if the insurer indemnified their loss to the bank, they were obligated to indemnify him for his loss.

Caulfield J held, following the judgment of Sir Wilfrid Greene MR in *General Accident Fire and Life Assurance Corporation Ltd v Midland Bank Ltd*[46], that the policy was an insurance of two persons for their respective rights and was therefore not joint, but a composite policy. He further held that the mortgagee's non-disclosure was a material one, which ought to have been disclosed and on this basis, the insurer could avoid the policy 'in so far as that policy affects the plaintiff's separate interest.'[47] The consequence of the above dicta is that when the policy is composite, breach by one co-insured only affects the insurance of the latter. Caulfield J does not however explain how this is possible, given the fact that breach entitles the insurer to avoid the whole contract and not just a part of it. This decision has been criticised by Samuel JA in *Advance Ins. Agencies v Matthews,*[48] as being wrongly decided. His view was based on the fact it is established law that 'if a contract cannot be rescinded *in toto*, it cannot be rescinded at all.'[49] This rule also applies to English law.[50] Samuel JA, is right in this respect, because the remedy of avoidance applies to the whole contract and the insurer cannot partly avoid and affirm the contract.

Macgillivray[51] argues that a breach by one co-insured would not affect the other co-insureds, where the policy is evidence of separate contracts between the insurer and each co-insured. Thus each insured would have a separate contract and breach by one would only affect his contract. This has led Professor Clarke to argue that the above rule although applying in English law, has no application to

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[46] (1940) 2 K.B. 388. Discussed in chapter I, pg.1.
[47] *Supra, fn*.34 at 633.
[48] (1988) 12 NSWLR 263, at 261-262. Although, Samuel JA's decision was a dissenting judgment, his dictum on composite policies is regarded as being accurate in respect of Australian law. See Clarke, para. 27-2C6, pg. 907.
[49] Ibid., at 261. Samuel JA relied on two English cases in support of this view. *Sheffield Nickel v Unwin* (1877) 2 Q.B.D. 214, 223 and *Thorpe v Facey* [1949] Ch. 649, 664. Both cases deal with the general rule that the right to rescission was barred where *restitutio integrum* was impossible. The courts did however mention the ancillary point that once rescission was barred, it was as to the whole contract or agreement, hence the above dictum.
[50] *Ibid*. Also refer to Clarke, *supra. fn*.48.
[51] *Macgillivray* para.17-33, pg.423.

composite policies because under English law, a composite policy in fact contains several contracts and not one.[52] This view, if true would allow the co-insured who has not failed to disclose any material circumstance, to remain on cover without undermining the purpose of the duty to the insurer. Caulfield J in *Woolcott*, however did not construe the policy as containing two separate contracts for the bank and the claimant respectively, nor did he explain how the insurer could avoid his obligation to the mortgagee whilst at the same time indemnifying the mortgagor bank. Presumably, this was because the claimant's only argument was that the policy was a joint policy and since the insurer indemnified the bank, it had to also indemnify his loss. Since the courts held that the policy was composite and not joint, the mortgagee's argument failed.[53] Thus, the case was really argued on the nature of the policy and not on whether with a composite policy, a breach of the duty of disclosure by one insured, gave the insurer the right to avoid the whole policy.[54]

The next case of importance and which deals directly with this issue is *New Hampshire v MGN Ltd.*[55] The case involved fidelity insurance policies which were taken out for member companies of the Maxwell group. Following the death of Robert Maxwell, various companies within the group made claims in respect of losses alleged to have been suffered by them as a result of dishonest and fraudulent acts on the part of Mr. Maxwell and several of his associates. The insurers rejected the claims on numerous grounds including the fact that there had been a breach of

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[52] Clarke, para. 27-2C6, pg. 908.

[53] The editors of *Macgillivray*, in its 9th edition (Sweet & Maxwell, 1997) expressed the view, at 17-28 pg. 401, that the claimant, who appeared in person, 'might well have succeeded upon an argument that the right to avoid had been waived by the insurer's decision to pay the claim of the mortgagee.' However, Clarke, at para. 27-2C6, pg. 907, *fn*. 20, seems to be of the view that such an argument by the insurer might have been futile, because the policy was a block policy taken out by the insurer. From the analysis of block policies (at pg. 53), it has been argued that the policy in *Woolcott*, was no more than an agreement between the bank and the insurer on the insurance of future risks. Thus, the breach of the claimant's duty would only affect the contract, which insured the claimant's and the bank's interests in the house and not the block policy itself, which evidences contracts with other mortgagors. It is therefore submitted that Professor Clarke is wrong on this point.

[54] In *FNCB Ltd v Barnet Devanney* [1999] 2 All E.R. (Comm) 233, Morrit LJ, at 238, said that, in *Woolcott*, 'there was no issue whether the mortgagee was entitled to recover because it had already been paid' and at pg.243 he said: '*Woolcott v Sun Alliance* was not a decision concerning the rights of the mortgagee at all.'

[55] [1996] C.L.C. 1692.

the duty of disclosure. One of the issues the court had to decide was whether a non-disclosure by one co-insured company affected the entitled the underwriters to avoid that policy against all the companies.

Potter J, at first instance, held that the policies were composite policies and that the insured under the policies was not the Maxwell Group, but the various companies under the group and each company was insured separately. In relation to the question whether breach of the duty of non-disclosure by one co-insured affected the other co-insureds, the claimant companies argued, relying on the decision of the House of Lords in *Samuel v Dumas*[56], that the principle to be applied was that 'where an independent interest is separately insured, there can be no question of avoiding the policy for non-disclosure quoad that interest unless the person so insured was privy to the non-disclosure.' [57] Potter J agreeing with the claimants held that:[58]

> The claimants are correct in their statement of the principle prima facie applicable in the case of composite policy of insurance. While it is common to speak in terms of avoiding a policy of insurance, the right to avoid for non-disclosure relates to the contract of insurance made with the individual assured, of which there were a number in this case.

Ignoring for the moment any discussion of *Samuel v Dumas,* the above quote from Potter J is capable of two different interpretations. The claimant's argument, which states the view that breach by one would not affect the other does not attempt to explain how this principle can be reconciled with the rule that if a contract cannot be rescinded *in toto*, it cannot be rescinded at all. Potter J's dicta, provides the answer, but it is unclear just how this answer is arrived at. Is he saying, like Professor Clarke that with a composite policy, the insurer is entering into a separate contract with each insured[59], or is he saying that non-disclosure would affect only the particular insured where the composite policy evidences separate contracts? The

[56] [1924] A.C. 431.
[57] *Ibid,* at 1,716.
[58] *Ibid*
[59] This is the interpretation adopted by Rix J in *Arab Bank v Zurich* [1999] 1 Lloyd's Rep. 262.

two interpretations, although purporting to say the same thing, are by no means similar. The first, assumes without proof that a composite policy is really evidence of separate contracts. Thus, the separate contract view would be the prima facie position of composite policies, and insurers would have to disprove this in order to successfully defend a claim by the other co-insureds. The alternative interpretation shifts the burden of proof in favour of the insurer. With this interpretation, it is accepted that the policy could evidence separate contracts, but that this is not the prima facie position of composite policies. In order to recover from the insurer, the insured has to prove that the policy was evidence of more than one contract. It is highly likely that Potter J expressed the former view but this interpretation was not adopted by the Court of Appeal.

In the Court of Appeal, Staughton LJ, giving the leading judgment held, on the question whether a breach by one insured would affect the cover of the others:[60]

> Technically one ought to enquire whether for each layer in each year, there was one contract, or as many contracts as there were companies insured. And if the former, can a contract be avoided for non-disclosure as against one or some of the insured, but not against others? We feel that we are relieved from the need to answer those questions by the authority of the House of Lords in the passage already quoted from *P Samuel & Co. Ltd v Dumas*. That, it is true, was not a case of non-disclosure but of wilful misconduct by one of two persons insured. But in our opinion the principle that the innocent party can still recover if it is a separate insurance must equally apply.

Two important points can be taken from this quote. First, the Court of Appeal held that an insurer could avoid the policy only against the insured who failed to disclose. Its reason was not based on a 'separate contracts' theory of composite policy but on the decision of the House of Lords in *Samuel v Dumas*[61]. Secondly, the quote seems to suggest that had *Samuel v Dumas* not been followed, the court would have inquired whether the policy contained one or many contracts. The latter therefore suggests that the Court of Appeal was not of the view that composite policies are

[60] At pg. 1,737.
[61] [1924] A.C. 431.

prima facie separate contracts and this decision could be argued as going against the view advanced by both Professor Clarke and Potter J.

3.4 The Principle in *Samuel v Dumas*

Although the Court of Appeal did not endorse the 'separate contracts' theory, it nonetheless held that it was bound by the principle in *Samuel v Dumas*. Therefore, the following questions are immediately pertinent. First, what principle was expressed in *Samuel v Dumas?* Second, does this principle have any relevance to a co-insured's obligation to disclose? Third, if the principle applies, how is this reconciled with the general rule that if a contract cannot be rescinded *in toto*, it cannot be rescinded at all? The case of *Samuel v Dumas*, has been discussed extensively in our earlier analysis of the co-insured's right of indemnity.[62] The House of Lords in that case, held that the deliberate destruction of the subject matter of insurance by one co-insured did not prevent the remaining co-insured from recovering from the insurer, as long as the innocent co-insured had a separate interest in the subject matter. On the other hand, where the interests of the co-insureds are joint, the misconduct of one would affect the right of the other. The principle in that case was therefore on the consequence of one co-insured's willful misconduct on another's right of indemnity. None of the judges, in their respective judgments, referred to the principle of utmost good faith in reaching their decisions and it is surprising that the Court of Appeal felt bound by this decision.[63]

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[62]Chapter III, pg. 44.

[63] It might be argued that whilst an insured's wilful act would not be a breach of utmost good faith, an attempt by the insured to bring a claim for this loss would amount to such a breach. However, this argument is contrary to the dicta of Mance LJ in *Agapitos and Others v. Agnew* [2002] 2 Lloyds Rep. 42, who was of the view that a fraudulent claim should be treated as falling outside the scope of the duty of utmost good faith. See Chapter III of this thesis, at pg.46, *fn*.2. In any event, the facts of *Samuel v. Dumas,* did not actually involve a fraudulent claim, because it was the innocent co-insured (P.Samuel & Co.) who brought the claim against the insurer. The owner, who was responsible for the scuttling of the ship, did not actually bring a claim. This is supported by Viscount Cave's account of the facts, at pg.439. Thus the claim by P. Samuel & Co. could not have been fraudulent. However, Rix J in *Arab Bank v Zurich* [1999] 1 Lloyd's Rep. 262, in his discussion of the case, at 277, seemed to think that the owner had in fact made a fraudulent claim. The same assumption was made by Professor John Birds in, "Fraud and Composite Insurance" [1999] J.B.L. 151, at 154-5.

This leads to the second question, whether the principle has any relevance to a co-insured's obligation to disclose. It is argued that the principle has no such relevance. The principle essentially arises because the aim of insurance contracts is to protect the insured against fortuitous losses only, and not when he causes the loss himself. On the other hand, the duty of disclosure is imposed on both the insured and insurer to ensure that both parties have the necessary information needed to make an informed decision. There is also an additional difference relating to the time when the misconduct occurs. With wilful misconduct, the act occurs after the contract has been effected and the insurer is not liable for losses attributable to it. Beyond this, the insurance contract is still valid and continues to protect the interest of the insured. However, the obligation to disclose arises prior to the contract being effected and when breached taints the whole contract thus entitling the insurer to avoid *ab initio*. This at the very least indicates that both rules are very different and should not be treated alike. Thus, the principle in *Samuel v. Dumas* ought not to have any relevance in determining the obligation imposed by the duty of disclosure. In light of the above arguments, it is therefore suggested that the Court of Appeal in *MGN* were not bound by the decision in *Samuel v. Dumas* and their decision is, with respect, open to question.

A case which might be said to indicate some support for the above view is *First National Commercial Bank plc v Barnet Devanney (Harrow) Ltd*[64], in which Morritt LJ giving the leading judgment of the court, said the following in relation to the *MGN* case[65]

> I accept that that is the law for the decision of this court in *New Hampshire Insurance Co. v MGN Ltd...* so decided and that decision is as binding on us as it was on the judge. But it was by no means clear in 1989 that that was so or that the court would so decide. There was no authority to that effect. *Samuel v Dumas* established that a mortgagee was unaffected by the wilful act of the owner, but the principle that a man should not profit from his own wrong had no obvious application to the innocent mortgagee.

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[64] [1999] 2 All E.R. (Comm) 233.
[65] *Ibid*, 243.

Could the above, be interpreted as expressing Morritt LJ's disagreement with the decision in *MGN*? It is impossible to tell his exact meaning but it is quite clear that prior to *MGN*, *Samuel v Dumas* would not have been thought as being relevant to the issue of a breach of the duty of disclosure.

Even if the court in *MGN* is right and it was bound by the decision in *Samuel v Dumas*, is this principle consistent with the rule that if a contract cannot be rescinded *in toto*, it cannot be rescinded at all? In *Samuel v Dumas*, Viscount Cave held that where the policy is composite, the innocent co-insured could recover under the policy, with the insurer having subrogated rights as against the responsible co-insured. Thus, the policy was not avoided, but only resulted in the latter co-insured being denied his right of indemnity.[66] The principle therefore did not involve the avoidance of the contract of insurance, and applying it to a case involving a breach of the duty of disclosure would still not resolve the problem with the general rule. The Court of Appeal failed to explain how the principle in *Samuel v Dumas* would be applied, given that the remedy for breach is avoidance of the contract of insurance. Since the courts did not hold that composite policies evidence separate contracts, does this mean that the rule that if a contract cannot be rescinded in toto, it cannot be rescinded at all, has no application in respect of composite policies, and if this is the case, why should it not apply? To the extent that these questions remain unanswered, it is argued that the reasoning in *MGN* remains problematic. This however does not mean that the decision in *MGN* was wrong. In the case, both the High Court and the Court of Appeal held that the co-insureds under the policy were the respective companies under the Maxwell Group and not the Maxwell Group itself. As mentioned in an earlier chapter[67], this would mean that the co-insureds do not have interests in the same subject matter but different and distinct subject matters. The policy is therefore more likely to be a group of separate contracts. Therefore it could be said that the decision in *MGN* was right because the policy in

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[66] In *Samuel v Dumas,* Viscount Cave, at pg. 446, construed s.55(2)(a) of the MIA 1906 which provides that 'the insurer is not liable for any loss attributable to the wilful misconduct of the assured' as applying only to the particular assured that caused the loss.

[67] Chapter I, pg. 6.

that case was really a group of separate contracts.[68] This in turn would mean that breach by one insured avoided only his contract and the problem with the rule relating to avoidance would not occur.

The separate contracts analysis has however been further endorsed by Rix J in *Arab Bank v Zurich.*[69] In that case, the defendant insurers had provided professional indemnity insurance to an estate agency and valuation company (JDW.) The claimant companies had recovered judgment against JDW for negligent valuations and, with JDW having gone into liquidation, they sought to enforce the judgment against the insurers under the Third Parties (Rights against Insurers) Act 1930. The insurers resisted the claims on the assumed fact that the valuations were fraudulently made by the JDW's managing director (B), and should have been disclosed to them at the time the policy was being effected. By the terms of the policy, the insured was defined as including not only 'the firm' but also partners, and directors of the firm. The clause was also subject to a proviso which stated that 'such definition of the term "Insured" shall not be construed to mean that the company shall indemnify any person knowingly committing, making or condoning any dishonest, fraudulent or malicious act or omission.' Rix J construed the policy as being a composite policy and the question he was faced with was whether the fraudulent non-disclosure by B affected the rights of JDW. The argument of the insurer was to distinguish between a composite policy which was in reality a bundle of separate contracts between the insurer and each insured and one in which the policy only contained one contract in which the insurer undertook distinct obligations to the various insureds. The insurer's contention was that the policy was of the latter category, in which case the fraudulent non-disclosure by B entitled them to avoid the whole policy as against all the insureds. Rix J however held that, from a construction of the policy terms, the policy contained separate contracts. It is

[68] This view is also expressed in *Macgillivray, First supplement to the 9th edition,* Sweet & Maxwell, 1999, pg.42 para 17-28B, in which the editors commenting on the judgment in *MGN* said, "the reference to 'separate insurance' by Staughton LJ should be taken as an acknowledgment that the composite policies in that case contained separate contracts between the insurers and each assured company."

[69] [1999] 1 Lloyd's Rep. 262, discussed by J. Birds, "Fraud and Composite Insurance" in [1999] J.B.L. 151-7.

suggested that the inclusion of the proviso to the definition clause contemplates that the insurance would still provide cover to other co-insureds, in the event of a fraudulent act by another.[70] It is further suggested that in order to give effect to this intention, the courts when interpreting ambiguous terms of the policy should adopt interpretations consistent with this intention. This seems to be why Rix J interpreted the fraud clause as imposing separate obligations on each co-insured.[71] It is however argued that whilst the terms might indicate that the contractual obligations on each co-insured are separate, this by no means supports an interpretation that the policy consists of separate contracts.[72] A more accurate interpretation would be that since the parties intended that each co-insured should have separate obligations, the consequence of this must be that the application of the duty of disclosure has been limited by the terms of the contract. It is argued that the above is a more accurate construction of the policy, and avoids the artificial reasoning inherent in the separate contracts interpretation. In addition, Rix J held that the decision in *MGN* adopted the view that composite policies were *prima facie* bundles of separate contracts and thus, the case was further support for his interpretation of the insurance policy. It has already been argued that the Court of Appeal in *MGN* did not adopt this interpretation and therefore, Rix J's view is open to question.[73] However, Rix J was clearly bound by the Court of Appeal's decision and was, as a matter of precedent, right to follow its decision. The reasoning behind that decision is still far from clear and to this extent, so is the decision in *Arab Bank.*

[70] Also see the proviso to Section 2, Sub section B of the insurance policy, at 268, which was relied upon by Rix J, at 272.

[71] The exact wording of the clause was: 'If any claim under this certificate of insurance shall be in any respect fraudulent or if any fraudulent means or devices are used by the insured to obtain any benefit under this certificate of insurance all benefit thereunder shall be forfeited.' It could be suggested that this term is not ambiguous and clearly suggests that any fraud by any insured would forfeit all benefits under the contract. This view is supported by the first few phrases 'if any claim under this certificate...' which is not qualified or restricted to a particular insured and thus implies that the obligation imposed by the section is joint. However given the presence of the provisos (see above text and *fn.*70) and the fact that the section itself subsequently refers to 'any fraudulent means or devised...by the insured' and not 'any insured', there exists an ambiguity in the section. However, consider the contrary view of Professor John Birds in "Fraud and Composite Insurance" [1999] J.B.L. 151, at 153-4.

[72] See the comments of Professor John Birds, *Ibid*, at 153-4.

[73] It seems Rix J was aware of this because he goes on to suggest, at 277, that 'whether the attempt of mine to bridge the difference is correct or not, it seems to me...that the matter had already been concluded by *Samuel v. Dumas.'*

The merits of the separate contracts analysis cannot be doubted. By construing the policy as containing separate contracts, the insureds have separate obligations towards the insurers and a breach of the duty of disclosure by one, will not affect the insurance of the rest. This interpretation was however not adopted by the Court of Appeal in *MGN*, and it could be further suggested that given the terms of the policy, Rix J could have resolved the dispute solely on the construction of the contractual terms. From the terms of the policy, it was clear that the remedy of avoidance of the whole policy was not available to the insurer where one of the insured's had committed a fraudulent non-disclosure. It could therefore be said that Rix J's view of the *prima facie* interpretation of composite policies was unnecessary. Whether or not a composite policy consists of separate contracts is surely a question of fact which should be determined from a construction of that particular policy. This is the position that would have been adopted by Staugthon LJ in the *MGN* case, but for the courts reliance on *Samuel v Dumas*. The separate contracts analysis should therefore be rejected as the *prima facie* interpretation of composite policies.

The separate contracts analysis however does not guarantee protection to an insured in every circumstance. In some cases, the knowledge of the fraudulent insured could be imputed to the other insureds, the consequence of which would entitle the insurers to avoid their separate policies. Rix J discussed this possibility in the *Arab Bank* case. The argument of the insurers was that since B acted for the JDW in effecting the policy, his non-disclosure should be imputed to the latter. The learned judge held that since the aim of the policy was to treat the company and its directors as separate insureds, it was inappropriate to treat the knowledge of B as that of JDW. He also relied on the principle expressed in *Re Hampshire Land Co.*[74] which prevents the attribution of an agents knowledge to his principal when such knowledge related to the fraud of the former on the latter. *Arab Bank* was however not a case in which B, the agent was fraudulent towards his principal (JDW.) The fraud was in fact directed towards JDW's clients, the claimants. Rix J nevertheless felt that the principle should apply because B's fault 'is such a breach of duty to

[74] [1896] 2 Ch. 743.

JDW as in justice and common sense must entail that it is impossible to infer that his knowledge of his own dishonesty was transferred to JDW.'[75] This decision can be compared with the decision of the Court of Appeal in *Direct Line v Khan*[76], where the court held that Mrs. Khan, a co-insured under a co-insurance policy, could not recover for loss to her interest in the house, because her co-insured husband had made a fraudulent claim on her behalf. The Court was of the view that 'Mr. Khan carried out partly on his own behalf and partly as agent for Mrs. Khan within the scope of Mr. Khan's actual or apparent authority from Mrs. Khan'[77] and therefore the latter was bound by the consequences of her husbands actions even though she did not know about his fraud. However, this does not mean that the cases are inconsistent. This is because in *Direct Line,* the fact that Mr. Khan brought a claim for all the losses meant that he was also acting for the benefit of his wife, so there was no question as to the possible attribution of his act to his wife. Whereas in *Arab Bank,* the question as to whether B's fraudulent act could be said to be the act of JDW could only be determined by attribution, hence the application of the rules.

3.5 Variations, Renewals and the application of held-covered clause provisions

In *K/S Merc-Scandia,* Longmore LJ was of the view that instances of renewals, variations and the application of the held-covered clause provisions were really examples of pre-contractual lack of good faith. His view was based on the fact that such disclosures were necessary for the negotiations which would lead to the eventually presentation of the new risk. Whether or not, the above are examples of the pre-contractual duty, it is clear that the remedy available to the insurer in the likelihood of breach is the avoidance of the variation, renewal or the application of the held covered provision and not the existing contract. This is because the information required by the insured was necessary to make an informed decision in respect of the variation, renewal or clause. Thus, a breach of the duty should only entitle the insurer to avoid the decision made in respect of such disclosure. It should

[75] At pg. 283.
[76] [2002] Lloyd's Rep. I.R. 364, discussed in Chapter III, pg. 48.
[77] *Ibid.* at 371.

therefore follow that in a co-insurance context, the breach by one co-insured in respect of the changes to the policy would also avoid all such changes, but not the prior contract, and it is irrelevant that the other co-insureds did not fail to disclose or make any misrepresentation. The duty, like in the pre-contractual scenario, ought to impose a joint obligation on the co-insureds. However, the decision in *MGN* suggests otherwise. The approach of the courts would be to focus on the interests of the co-insureds in the subject matter of insurance and therefore impose a joint obligation where the policy is joint and separate obligations in the case of composite policies.

3.6 Conclusion on the pre-contractual duty

The English approach in relation to the obligation imposed on co-insureds by the pre-contractual duty is to focus on the nature of the interests of the insureds. This approach is defective in two fundamental ways. First, it ignores the rationale and purpose behind the duty in determining the obligation to be imposed. The effect of this will be to undermine the duty itself and at times, stifle the attainment of the objective it sets out to achieve. Thus, when a co-insured has failed to disclose a material fact, the insurer has been deprived of the opportunity to make an informed decision on whether or not to accept the risk and on the terms to apply to the contract. The rationale behind the duty has therefore not been achieved as the insurer is denied the appropriate remedy in the event of a breach of the duty. It really does not matter if the other co-insureds did not fail to disclose any material information on their part and it is a misnomer to regard such insureds as innocent. The issue is not whether one party is innocent or not, but whether the insurer has been able to make an informed decision. It is only where the policy is in fact evidence of separate contracts that a breach of the duty by one insured would not affect the right of the others. This will be because, the breach by one insured, would amount to an absence of an informed decision on the part of the insurer in relation to the contract of that particular insured and not the contracts of the others.

Secondly, the application of the approach ignores the general rule in relation to the avoidance of contracts. Where the parties are insured under a composite policy and there has been a breach of the duty by one insured, the approach allows the other co-insureds to be able to recover, even though the remedy for breach is avoidance of the contract. Viewed from this perspective, it can be argued that the approach amounts to ignoring the statutory provision of section 18 of the MIA 1906, which states the law for both marine and general insurance. These are the essential problems with the present approach, and it is argued that were the courts to focus on the nature of the duty in determining the obligation of the insureds, a more coherent approach could be developed. An understanding of the purpose behind the duty would indicate the imposition of a joint obligation on the insureds irrespective of whether the policy is joint or composite.

The consequence of such an obligation might be perceived as being to the detriment of co-insureds, but it is argued that since the nature of the obligation is implied from the duty itself, the problem is not with the application of the duty, but with the nature of the duty itself, in particular the remedy of avoidance. Therefore, whatever reforms are to be made should be directed at the duty and not by adopting an artificial interpretation of composite policies. For example in the Australian jurisdiction, although parties to the insurance contract are under a duty of disclosure, the remedy of avoidance is only applicable to fraudulent non-disclosures.[78] The English Law Commission, in its report on the law of non-disclosure and breach of warranty, also recommended that the insurer should only be entitled to avoid the contract, where the insured has conducted himself dishonestly or unreasonably.[79]

If such reforms were undertaken, this would go some way in reducing the circumstances in which the co-insured would be seen to be at a disadvantage. If reform is however not undertaken, this does not mean that insureds would always be at a disadvantage. In commercial situations, insureds can negotiate to include terms the effect of which would be to sever their obligations under the duty. Such clauses

[78] S. 28(2) Insurance Contracts Act 1984. The Act however does not apply to Marine Insurance contracts, which are governed by the Marine Insurance Act 1909 (s.9(1) (d) of the 1984 Act.)

[79] "Insurance Law: Non-disclosure and breach of warranty" Law Commission Report no. 104, para. 4.43-4.53.

will be similar to mortgagee's interest clause. An example of such a clause is the standard mortgagee clause approved by the Insurance Bureau of Canada, which provides that: [80]

> This insurance...-AS TO THE INTEREST OF THE MORTGAGEE ONLY THEREIN-is and shall be in force notwithstanding any act, neglect, omission or misrepresentation attributable to the mortgagor owner or occupant of the property insured including transfer of interest.

Such clauses have been interpreted by the Canadian courts as creating a separate contract between the insurer and the mortgagee, preventing a breach of disclosure by the mortgagor from affecting the right of indemnity of the mortgagee.[81] In *First National Bank Plc v Barnet Devanney (Harrow) Ltd*[82], Gage J at first instance held that the use of such clauses was only in relation to policies issued to the borrower alone and were therefore not relevant to composite policies.[83] This could be said to be as a result of the fact that with the present approach, co-insureds under a composite policy do not need the use of such a clause. However, if it were accepted that the insureds are under a joint obligation, it would be necessary to extend the use of such clauses to composite policies. However, parties would have to take care in phrasing such clauses, in order that their intentions are given effect to. An appropriate clause could state that:

> Where an insured fails to disclose or misrepresents a material fact, the only remedy available to the insurer, if he decides to avail himself of such a remedy, is to avoid any rights, privileges or benefits available under the contract of insurance, to that insured. The effect of such avoidance, apart from terminating any future rights of the particular insured, would also entitle the insurer to recover any payments or benefits which have been made to that insured in accordance with the terms of the policy.

[80] See *Macgillivray, Supplement to the 9th edn.*, pg. 40, para.17-28A.
[81] *Canadian Imperial Bank of Commerce v Dominion of Canada General Insurance Co.* (1988) 46. D.L.R. (4th) 77; *Caisse Populaire v Societe d'Assurances* (1984) 19 D.L.R. (4th) 411.
[82] [1999] C.L.C. 11.
[83] *Ibid,* at 20.

Such a clause would have the effect of avoiding the insured's cover without avoiding the whole contract and thus not depriving cover to the other co-insureds, without going against the rule as to total avoidance. The acceptance and frequent use of such clauses would reduce the perceived harshness of the obligation imposed in co-insurance contracts. This approach, it is submitted, should be adopted rather than the present approach in *MGN*, which leaves questions unanswered.

3.7 The obligation imposed by the post-contractual duty

In determining the obligation imposed by the post-contractual duty, the distinction between the duty and its pre-contractual counterpart should not be ignored. The pre-contractual duty is imposed before the contract is concluded and therefore, the remedy of avoidance of the contract is justifiable where there is a breach. The post-contractual duty however occurs after the contract has been concluded and it is very hard to see the justification for a remedy of avoidance, which unravels even settled acts that occurred before the breach. This consequence prompted Lord Hobhouse to refer to the remedy in the post-contractual setting as being 'wholly one-sided', in favour of the insurer.[84] In *K/S Merc-Scandia,* Longmore LJ in his review of the development of the post-contractual duty was able to show that it was not in every instance of breach that the insurer was entitled to avoid the contract. As mentioned earlier, the Court of Appeal held that in order for the remedy of avoidance to be applicable to post-contractual breaches, the conduct alleged to constitute the breach must also be capable of amounting to a repudiation of the contract. The court felt that this was the only way that the operation of the post-contractual duty would have 'appropriate symmetry' to the operation of the pre-contractual duty.

Thus, if the Court of Appeal is right, a breach of the post-contractual duty would only entitle the insurer to avoid the contract, if such a breach would also entitle the latter to terminate the contract. Thus where the breach deprives the insurer of substantially the whole benefit of which he was intended to obtain from

[84] *The Star Sea* [2001] 1 Lloyd's Rep. 389, at 401.

the contract[85], the insurer would be able to avoid the contract. It is argued that in a co-insurance policy, the fact that the insureds are several would mean that a breach of the duty by one would rarely amount to the insurer being deprived of substantially the whole benefit of which he entered into the contract. This is because the other co-insureds have not breached the duty and as long as they continue to abide by the terms of the policy, are still providing some benefit to the insurer. If this argument is accepted, it would mean that, unlike the pre-contractual duty, an insurer would rarely be able to avoid a co-insurance contract where one insured has breached the post-contractual duty.

4. Conclusion

This chapter represents an attempt to identify the application of the duty of utmost good faith to co-insurance contracts. What is quite clear is that the operation of the pre-contractual duty differs from the post-contractual duty. The rationale behind the former is to ensure that the parties make informed decisions in relation to agreeing on a contract of insurance. Thus any breach of the duty by any co-insured ought to entitle the insurer to avoid the whole contract. The post-contractual duty on the other hand does not pre-date the existence of the contract and does not deal with matters relating to entry into the contract. The remedy of avoidance, therefore, ought not to be applicable in every circumstance of breach. This argument is even stronger in co-insurance policies, where the policy is for the benefit of more than one insured. The decision of the Court of Appeal in *K/S Merc-Scandia* therefore represents a welcome development to the law and if applied to co-insurance contracts, would impose separate obligations on each co-insured in respect of the post-contractual duty.

[85] *Hong Kong Fir Shipping Co. Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 Q.B. 26

CHAPTER V

THE WARRANTY OBLIGATION

1. Introduction

This chapter attempts to look at the application of warranties in co-insurance contracts, in order to determine the type of obligation it imposes on the co-insureds. The first step will be to provide a brief summary on warranties, identifying its purpose in insurance contracts. Secondly, an examination shall be made on how warranties should apply in co-insurance contracts, focusing on the obligation it imposes on the co-insureds.

1.1 Warranties in insurance law

A warranty is a term of the contract of insurance, by which the insured promises the existence of a state of affairs or undertakes to do or not to do something, the fulfilment of which, the right of the insured to recover under the policy is dependent on.[1] Warranties can be as to the present state of affairs e.g., a warranty that the insured is of good health, or has not been convicted of any crime. Warranties can also be as to a continuing state of affairs e.g. a warranty under a fire policy that the insured shall maintain a fully operational fire alarm system in the insured building. This latter form of warranty is known as a continuing warranty as it continues throughout the duration of the policy. The reason why warranties are regarded as being important is because the insured's right to recover for any loss is dependent on strict compliance with the warranty.[2] To the extent that the liability of the insurer under the contract is dependent on compliance with the warranty, the latter serves as an important tool for the insurer. It allows the insurer to control and limit the circumstances in which it is liable to the insured. Thus, what the insurer is saying is that, 'I shall protect you against fire to your building, provided that that it is installed with an operational fire system.' Where the insured fails to provide the required

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[1] S.33(3) of the MIA 1906 gives a more accurate definition of a warranty. This statutory definition is accepted for non-marine insurance cases. See, the judgment of Hirst LJ in *Printpak v AGF Insurance* [1999] 1 All ER (Comm) 466, at 470.

[2] see s.33(3) of the MIA 1906 and the case of *De Hahn v Hartley* (1786) 1 T.R. 343.

system and a fire destroys the building, the insurer's obligation is discharged, from the moment of the breach, even though the fire would still have destroyed the premises had a fire alarm been installed. Thus, It is not a requirement to show a causal link between the breach of warranty and any subsequent damage or loss to the insured property.[3]

Where there has been a breach of a warranty, the liability of the insurer is automatically discharged as from the time of the breach.[4] This was the interpretation given to s.33(3) of the MIA 1906, by the House of Lords in *The Good Luck.*[5] Lord Goff, giving the only judgment of the court held that this was the case, 'for the simple reason that fulfilment of the warranty is a condition precedent to the liability or further liability of the insurer.'[6] *The Good Luck* was a marine insurance case, and this has raised doubts as to whether its ruling applies to non-marine cases. The source of this doubt stems from the fact that prior to the decision in the *Good Luck*, the prevalent view was that the breach of a warranty in insurance was no different from a breach of a contractual condition, i.e. the insurer was entitled to elect to terminate the contract.[7] There was also judicial support in the Court of Appeal prior to the *Good Luck,* which adopts this view.[8] However, the language used by Lord Goff in the *Good Luck*, suggests that the remedy is the same for both types of insurance:[9]

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[3] A good illustration of this point is the case of *Forsakringsiktieselskapet Vesta v Butcher* [1989] 1 All E.R. 402, in which the House of Lords held that the insured's breach of warranty to provide a twenty four hour watch, entitled the insurer to discharge its obligations to the former, although the fulfilment of the warranty could not have prevented or minimised that particular loss. However such causal requirement is necessary for a breach of a condition precedent. See generally *Birds' Modern Insurance Law,* at pgs. 93-4 & 141-2, for the distinction between both types of terms.

[4] If the warranty is as to a past or present fact, the breach would automatically discharge the insurer as from the time of breach which in this case would be as soon as the contract commences. Thus, the insurer's liability is discharged *ab initio.* See Birds and Hird, at pg. 138.

[5] *Bank of Nova Scotia v Hellenic Mutual War Risk Association (Bermuda) Ltd (The Good Luck)* [1991] 3 All E.R. 1.

[6] Ibid. at 16.

[7] See *MacGillivray and Parkington on Insurance Law* (8th edn), Sweet & Maxwell, 1988, para. 790, pg. 326, and Clarke, *Insurance Contract Law* (1st edn), LLP, 1989, para. 20-6C, pg. 402.

[8] In particular, the Court of Appeal's decision in *West v National Motor & Accident Insurance Union Ltd* [1955] 1 Lloyd's Rep. 207.

[9] *Ibid.* at 16.

...the rationale of warranties in *insurance law* is that the insurer only accepts the risk provided that the warranty is fulfilled. This is entirely understandable; and it follows that the immediate effect of a breach of a promissory warranty is to discharge the insurer from liability as from the date of the breach.

Secondly, some non-marine cases decided post-*Good Luck*, have adopted Lord Goff's ruling. In *Hussain v Brown*[10], Saville LJ, stated that a breach of a continuing warranty 'produces an *automatic cancellation* of the cover.'[11] In *Printpak v AGF Insurance Ltd*[12], Saville LJ's dicta was cited by Hirst LJ[13], and the case was decided on the basis that a breach of a warranty resulted in an automatic discharge of the insurer's liability. It is submitted that until the House of Lords rules otherwise, the ruling in the *Good Luck* should be applied to all insurance cases.[14] As a result of the remedy available in the event of breach, the courts have adopted a strict approach in interpreting clauses as warranties. Unless the intention is made clear, the courts might classify such clauses as being suspensive conditions, breach of which suspends cover for the duration of the breach.[15] The attraction with this interpretation is that it avoids the harsh consequence of a breach of warranty, while at the same time denying cover to the insured during the period of breach. While the benefit of this approach cannot be denied, it makes the law relating to warranties uncertain by making it difficult to distinguish between warranties and suspensive conditions.

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[10] [1996] 1 Lloyd's Rep. 627.
[11] *Ibid.* at 630. In the *Good Luck*, Lord Goff held that a breach of a warranty did not terminate the contract, but only automatically discharged the insurer's obligation with the contract still subsisting. If therefore, in holding that the 'cover is terminated', Saville LJ was referring to the contract, his view is contrary to the decision in *The Good Luck.*
[12] [1999] 1 All E.R. (Comm) 466.
[13] *Ibid.* at 470.
[14] *Colinvaux & Merkin*, para. B-0165, pg. 20,133-4 para. 6-28, Clarke, para. 20-6C pg. 654, and *MacGillivray*, para. 10-90, pg. 261. Also see Dr. B. Soyer, *Warranties in Marine Insurance* (Cavendish Publishing, 2001) at 180-181.
[15] This was the interpretation adopted by MacPherson J in respect of a clause in *CTN Cash and Carry Ltd v General Accident Fire and Life Assurance Corporation Plc.* [1989] 1 Lloyd's Rep. 299 . Also see *Kler Knitwear Ltd v. Lombard General Insurace Co. Ltd* [2000] Lloyd's Rep. I.R. 47.

2. Warranties in Co-insurance policies

Since the remedy for a breach of warranty is discharge of the insurer's liability, our enquiry shall focus on how this remedy is applied in a co-insurance context. Where a co-insured has breached a warranty, is the insurer discharged as to his liabilities to all insureds under the contract, or just his liability to the co-insured responsible for the breach? Like the previous chapter, the question being asked is whether warranties impose a joint, or several obligations on the insureds. The instinctive reaction might be to resolve the nature of the warranty obligation according to the joint-composite distinction. The argument would be that where the policy is joint the warranty imposes a joint obligation, while with a composite policy the warranty imposes several obligations on each insured.[16] As argued in the previous chapter, this approach is flawed as it solely focuses on the relationship between the insureds in determining the obligation between the latter and the insurer, rather than focusing on the warranty itself and taking into consideration its purpose in the contract of insurance. The first step will therefore be to show the irrelevance of the joint-composite distinction in determining the obligation imposed by the warranty.

2.1 The joint-composite distinction

An approach, which focuses on the joint-composite distinction would totally ignore the purpose of the warranty and thus result at times in not giving effect to the intention of the parties. The following illustration highlights this point. Suppose joint tenants of a house, X and Y, take out a fire policy to protect their interests in the dwelling. The policy contains a term, which states that 'a fire alarm system would be installed in the house.' The fire alarm is in fact not installed and subsequently a fire occurs which destroys the house. Assuming that the courts construe the term as a warranty, can Y claim that since the breach was caused by X, he ought to recover? It is without a doubt that the reason the insurer included the

[16] It seems, but one is not quite certain, that this is what Professor Merkin is suggesting in *Colinvaux & Merkin*, para. A-0616, pg. 10,589, when discussing the case of *Woolcott v Sun Alliance* [1978] 1 Lloyd's Rep. 629 in which the court held that where a policy was composite, a breach of the duty of disclosure by the mortgagor did not affect the right of the mortgagee. Professor Merkin is of the opinion that 'the same would doubtless have been reached had the mortgagor been in breach of a warranty.'

above warranty was to limit his risk of liability by limiting the circumstances under which it was liable. The insurer is effectively saying that, 'I shall only provide cover if you've installed a fire alarm system.' Presumably, the premium charged was also calculated on the basis that the risk of loss by fire was reduced by the installation of an alarm system. Thus it could be argued that the insurer contracted to be liable provided the warranty was fulfilled.[17] It should therefore follow that once the warranty has been breached, the insurer is not liable to any insured. Y is therefore unable to recover, not because he has a joint interest with X, but because the fulfilment of the warranty is a pre-condition to the insurer being liable under the contract.[18]

Applying this reasoning to composite policies, does the warranty impose a joint or several obligation? Let us assume that the insureds in our previous example were not joint tenants, but a mortgagor and a mortgagee. Suppose, like in our previous example, the mortgagor failed to install a fire alarm system and a fire occurs and destroys the property. In the absence of a mortgagee interest clause, which seeks to protect the interest of the mortgagee, in the event of breaches committed by the mortgagor, the insurer should be able to resist any claims from the mortgagee solely on the same basis that fulfilment of the warranty was a pre-condition to recovery under the policy. The fact that the insureds have separate interests in the property does not justify a contrary view. The co-insureds can only be under separate obligations if such an intention can be construed from the contract term. Construing the warranty as imposing separate obligations without any evidence would amount to restricting the purpose and effectiveness of the warranty. The consequences of this would be to ignore the intention of the parties as evidenced by the policy terms. It would also mean that the mortgagee is allowed to recover, because he was not responsible for the breach of the warranty. This introduces an element of fault into the law relating to warranties, which would only obscure our understanding of the concept. It is argued that warranties are not concerned with 'who' or 'what' caused the breach, but whether or not the warranted state of affairs

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[17] Lord Goff expresses a similar view in *The Good Luck, Supra fn.*5, at 16.

[18] In *Thomson v Weems* (1884) 9 App Cas 671, Lord Blackburn, at 684, said that a warranty 'is a condition precedent to the attaching of the risk.'

exists. Where it does not exist, a breach has occurred and the insurer's liability comes to an end.

2.2 The 'separate contracts' analysis

Although it has been argued that the interests of the insureds are irrelevant in determining the obligation imposed by warranties, could it be argued that with composite policies, the obligations are several because composite policies are in fact a bundle of separate contracts? The argument would be that a breach of a warranty by one co-insured only affects his contract, but not the contracts of the other co-insureds. As the point has already been made that it is debatable whether all composite policies are in fact a bundle of separate contracts[19], it shall not be repeated here. It shall however be shown that the fact that a policy is in fact a bundle of separate contracts does not necessarily follow that a breach by one co-insured would not affect the others. Take for instance, the above example involving a mortgagor and a mortgagee. Assuming the policy is indeed a bundle of separate contracts, then both insureds have entered into separate contracts with the insurer, in respect of their interests in the house. In respect of the mortgagor's contract, the warranty to install fire alarms is a term of his contract, and since it has been breached the insurer's obligation to him is discharged. In order to determine whether the mortgagee can recover under his contract, we have to identify the terms of his contract with the insurer, in particular, we have to determine if the warranty is one of such terms applicable to him. We cannot just conclude that the warranty is not applicable to his contract, without any proof of this. We have to infer from the policy itself if the term is applicable to his contract, as this is our only tool in giving effect to the intention of the parties.

In *National Oilwell v Davy Offshore Ltd*[20], Colman J held that a co-insured could be covered by an insurance policy on terms different from his co-insureds, where the policy evidences such an intention.[21] Thus, for the warranty not to be applicable to the mortgagee, the parties must have expressed or implied it in the

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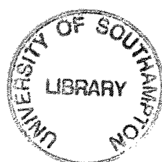
[19] See Chapter IV, in particular pg. 92-98.
[20] [1993] 2 Lloyd's Rep. 582.
[21] *Ibid.* at 610.

policy. Thus, if the policy includes a term stating that, 'a breach of the above warranty shall not affect the rights of the mortgagee' or 'the responsibility of the warranty only applies to the mortgagee', then such terms evidence an intention that the warranty has no application to the mortgagor and is therefore not a term of his contract with the insurer. If no such intention is expressed in the policy, it should follow that the warranty must also be a term of the contract between the mortgagee and the bank. If this is the case, the next question is whether a breach of the warranty in one contract, would also amount to a breach of the warranty in the other contract.

It is argued that where the co-insureds have interests in the same property and the warranties in each contract specify a similar condition in relation to that property, breach by one assured of his warranty would also breach the warranty of the others. Thus in our scenario, the co-insureds have separate interests in the house, and the warranty in each contract specifies that a fire alarm must be installed in the house. Once the fire alarm has not been installed, the warranties in both contracts have been breached. Thus, although the co-insureds are subject to separate warranties, their compliance are so inter-related that a breach of one, would constitute a breach of the other. This consequence is as a result of the co-insureds having their interests in the same subject matter and the fact that the warranties are similar and relate to the subject matter. The latter is a very important factor, and should not be ignored, because where it is absent, breach of one warranty would not necessarily breach the other warranty. For example, in our mortgagee/mortgagor illustration, the warranty rather than relating to the subject matter, might have related to the moral character of each co-insured. Thus, each insured could have warranted that (s)he had never been charged or convicted of a criminal offence. Where an insured breaches this warranty, it would not affect the other insured's contract, because the warranty relates to the individual insured. The other insured would only have breached his warranty if he had also been charged or convicted of a criminal offence.

The above analysis clearly shows that the joint-composite distinction in no way helps in determining the obligation imposed by warranties on co-insureds.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What is necessary is a consideration of the purpose of the warranty in the co-insurance contract. Where the co-insurance contract involves a subject matter, which each insured has an interest in (whether separate or joint) and the warranty relates to a state of affairs pertaining to that subject matter, the obligation imposed by the warranty should be joint, unless the policy states otherwise. Any attempt to avoid this by relying on the joint and composite distinction, as shown above, will seriously undermine the purpose and effectiveness of the warranty. This however does not mean that all warranties in co-insurance contracts impose joint obligations. There can be situations where the insureds are under separate obligations or, although having joint obligations, the consequence of a breach would not be to discharge all the insurer's liabilities under the contract. The following are an attempt to recognize such situations.

3. Situations in which the warranty imposes separate obligations

3.1 The contract of insurance expresses a contrary intention

Section 33(3) of the MIA 1906, states that if a warranty 'is not complied with, then, *subject to any express provision in the policy*, the insurer is discharged from liability...' It follows that where the parties have expressly provided in the policy that breach of the warranty by one insured would not affect the other co-insureds, the obligations are separate. The effect of this would make the warranty obligation fault based. It is further argued that section 33(3) would also be applicable in non-marine insurance cases. Support for this can be found in the case of *Printpak v AGF Insurance*[22], a non-marine case, in which the Court of Appeal held that s.33(3) laid down a general principle which was subject to a contrary express provision in the policy.

[22] [1999] 1 All E.R. (Comm.) 466.

3.2 Multi-risk policies

A policy, which insures the insureds against, more than one type of risk could contain warranties, which pertain only to a specific risk. Where one of these warranties has been breached, the consequence is not to discharge all the insurer's liabilities, but to discharge the liability relating to the risk, which the warranty applies to. The decision in *Printpak v AGF Insurance Ltd*[23] illustrates this point. In *Printpak*, the Claimant Company owned a factory in which it carried out a print finishing business. The claimant was insured by the defendant under a 'commercial inclusive' policy, which consisted of a number of sections, each providing insurance against different risks. The assured had to decide the risks he wanted to be insured against by selecting from the sections. The claimant's choice included section A and B, which respectively covered fire damage and loss by theft. The selective nature of the policy meant that certain terms and conditions were contained within each section. Section B, which related to loss by theft, contained a term that the insured warranted that all burglar alarms would be fully operational when the assured's premises were closed for business. A fire occurred in the premises causing loss and damage to the claimant's stock. The claimant made a claim under section A, the fire risk section, but the insurer refused on the ground that at the time of the fire, the claimant was in breach of the warranty to have all burglar alarms fully operational, and therefore such a breach discharged it from all liability since the policy formed a single contract.

The Court of Appeal affirming the decision of the High Court held that although the policy was a single policy, albeit covering several risks, it did not follow that it should be treated 'as a seamless contractual instrument.'[24] Hirst LJ held that the warranty in question was only related to section B and was not related to other sections. He also held that in keeping with the wording of s.33(3) of the MIA 1906, that there was a provision in the policy which stated that the warranties were to be effective 'only as stated in the policy schedules' which was effectively an

[23] *Ibid.*
[24] Ibid. at 471.

express contrary provision to the general principle. The effect of this interpretation was that the breach of the warranty only discharged the insurer's obligation as to that risk but had no effect on the insurance against other risks, which were covered by other sections.

Applying this case to a co-insurance contract of a similar nature, the effect of the breach of warranty would be to discharge the obligations of the insurer in respect of the risk the warranty applies to, while cover would remain in relation to the other risks. Thus, it is not so much that the warranties impose separate obligations on each insured. In fact, the obligation would be joint, but breach of a warranty would, according to the wording of the policy, only discharge the insurer's obligation as to a particular risk and not to all risks. Thus, it would be more accurate to say that such warranties, although imposing a joint obligation on the insureds, have a limited effect, as the breach does not discharge all the insurers' liability under the contract.

3.3 Insurance policy of which each co-insured has a distinct and independent subject matter of insurance.

Policies, which fall under this category, include insurance of a fleet of ships, which are each owned by 'one-ship' companies.[25] Another example is liability insurance for a group of companies, each of which are independent but have a common owner or majority shareholder.[26] Each company is a co-insured under the contract, insuring against risk to the company's interest. The reason why such companies are insured together is really because each company is owned, or beneficially owned by a common person or group and the creation of separate entities for each company has been done for commercial reasons. Where there is a warranty in such a policy, which relates to each subject matter, should the effect of its breach be to discharge the insurer from all his liabilities? The following example is provided. Four ships all beneficially owned by one company or individual, are legally owned by separate 'one-ship' companies. The ships are insured against marine risks under a policy of

[25] See, for example, the case of *Manifest Shipping Company Ltd v Uni-Polaris Shipping Company Ltd and others (The Star Sea)* [2001] 1 Lloyd's Rep 389.
[26] The case of *New Hampshire Insurance v MGN Ltd* [1996] C.L.C. 1692 is a good example.

insurance and the respective insureds are the one-ship companies. There is a term in the policy that warrants that the ships would not sail to a certain port or zone. It is further assumed that in this case, there is no 'held covered' clause, which the insured could rely on, when the term has been breached. Supposing ship A, which is owned by company X, sails into the prohibited zone/port, are the insurer's liabilities discharged in relation to the remaining three ships?

In deciding this case, the courts would have to determine if the term is a warranty. This is obviously crucial, because if the term is a warranty, it must follow that breach of it must result in the discharge of all of the insurer's liability under the contract. The fact that the consequence of this would be the loss of cover to the other three ships seems unduly harsh and might influence the courts not to classify the term as a warranty. The courts could classify the term as a suspensive condition, which when breached suspends cover to ship A only during the period of breach. The courts however need not take this option as the term could still be classified as a warranty without the insureds being subject to a joint obligation. The courts could interpret the warranty as imposing separate obligations on the insureds through two different approaches. The first approach argues that the warranty imposes separate obligations because of the nature of the contract and the requirement of the warranty. The second approach is an attempt to argue that the policy contains separate contracts. These approaches will now be looked at with a view to determining which is more suitable.

3.3.1 Warranty obligation not joint, but severable

The focus with this approach would be on the warranty itself with a view of identifying its purpose. It is this author's view that once this can be identified, the nature of the obligation of the warranty would also be known. However, in identifying the purpose of the warranty, one is not relying on the insurer's intention but on the intention as expressed in the policy of insurance. So in the co-insurance example, each insured warrants that his ship would not go to a particular zone or port. The purpose of the warranty is to limit and control the risk of loss to the ships.

Thus, where a ship goes into the prohibited area, the risk contracted by the parties has been altered, and therefore a breach has occurred. But since a separate company wholly owns each ship, the insurer is faced with not a single risk but multiple risks. Each risk would however be different in degree depending on a range of factors like the worth of each ship, its life span etc. If one views the contract this way, it would follow that the warranty regulates not one risk but multiple risks. It should therefore follow that when an insured breaches the warranty, its effect only ought to apply to his cover and not to the cover of the other insureds, because the breach in no way affects the risk to the other ships which are owned by the other companies. In effect, the obligation imposed by the warranty ought to be severable due to the separate and distinct nature of the insured properties. Thus, a breach by insured X would amount to the insurer's liability to X being discharged, while its obligations to the other co-insureds still remain. This interpretation would, in no way, undermine the purpose of the warranty, which is to limit and control the risk of loss to each ship. This is because a breach by one ship only alters the risk to that ship and not to the other ships.

The only problem with this approach is that it conflicts with section 33(3) of the MIA 1906. The section clearly states that where a breach has occurred the insurer's liability is discharged unless an express provision is made in the policy. Thus, unless the parties express a contrary intention in the policy, a breach of warranty would discharge all liabilities of the insurer under the contract. It could however be argued that since the warranty attaches to the separate risks, the courts could construe s.33(3) as applying only to the insurance of the risk which the breach of the warranty arises from. Such a construction does not run contrary to the provisions of the section and would be consistent with the aim behind the warranty. The alternative way to argue that the insureds are under separate obligations is to construe the policy as a bundle of separate contracts.

3.3.2 The 'separate contracts' argument

It has been said earlier that not all composite polices are in fact a group of separate contracts. However there are some that are really a bundle of separate contracts. The obvious difficulty is how to identify such contracts and at the present, the courts have not provided much guidance on this. It is however argued that in a co-insurance policy in which each insured's subject matter of insurance is separate and independent from one another, the policy could be viewed as consisting of separate contracts. This is because the policy is effectively insuring multiple risks with each risk being different from the others.[27] This is different from a co-insurance contract in which all co-insureds have separate interests in the same property and therefore the policy is insuring against only one risk. Thus, if the policy is insuring against risk to several properties owned by different insureds, it could be viewed as separate contracts insuring insureds against loss to their respective properties. Whether or not, such a view will be accepted will depend on the facts of the case at hand. For instance, where each insured has to pay a separate premium, it is more likely that the courts would find that the policy was in fact a group of separate contracts. Where the premium is an aggregate sum, but the terms of the policy provide for additional premium to be calculated pro rata, in the event of subsequent inclusion of other insureds, the courts could also construe such policy as providing separate contracts to each insured.[28] Where the premium is an aggregate sum, it should not necessarily follow that the policy should be viewed as an entire contract, because the premium could be an aggregate amount.[29]

If the policy were construed as a group of separate contracts, it would mean that each insured is insured under identical terms unless the policy indicates to the

[27] The difference is one of degree and not of the type of risk.
[28] See the case of *New Hampshire Insurance v MGN Ltd* [1996] C.L.C. 1,692, at 1,717 where Potter J drew attention to a similar clause to support his view that the policy in question was in fact a group of separate contracts.
[29] In some American jurisdictions, the fact that the premium is single is conclusive evidence that the contract is entire, while some do not treat the single nature of the premium as being conclusive. See, the case of *Goorberg v The Western Assurance Coy* 150 Cal. 510, at 513-515, in which the Californian Supreme Court discusses these approaches.

contrary. However since the interest of the insureds are not related to one subject matter but distinct subject matters, it would follow that where ship A breaches the warranty, the breach would not breach the warranties in the other contracts. Such warranties would only be breached when the ship of that particular contract sails into the prohibited zone or port. Thus each insured would be subject to separate and distinct warranties.

From the above, it can be seen that where the co-insureds are insuring separate subject matters, and the warranty relates to each subject matter, the obligation of the warranty can be construed as being severable, only if the courts are willing to construe the policy as being a group of contracts, providing cover to each insured. The attraction with this approach is that it interprets the policy without compromising the function and role of the warranty. It is obviously a question of fact whether or not a policy is in fact a group of contracts, but it is argued that a policy in which the insureds have separate subject matters, and therefore the insurer is covering varying degrees of risks, is no different from a situation in which the insureds have entered into separate contracts. Such policies, rather than all composite policies, should be viewed as bundles of separate contracts. If this view were accepted, it would follow that each insured is subject to a separate warranty. Rejecting it on the other hand would mean that the courts would have to rely more on the classification of such terms as suspensive conditions in order to avoid the harsh consequence that would follow if the term were classified as a warranty.

4. 'Basis of the contract' clauses

A brief mention should be made about basis of contract clauses and how they would operate in co-insurance contracts. These clauses are usually in the form of a declaration in the proposal forms, which state that the answers to the questions asked in the form are to be the basis of the contract. This declaration has the effect of

giving the insureds' answers the force of warranties.[30] Thus where the insured has given a false answer to one of the questions asked, the insurer's obligation under the policy is discharged. This clause is not applicable to marine insurance contracts because, by virtue of s.33(2) of the MIA 1906, warranties in marine insurance have to be included in or written upon the policy or contained in a document incorporated by reference into the policy, in order to be enforceable. The use of such clauses has been criticised by the judiciary[31] and the Law Commission[32] as being unjust and harsh towards insureds. Insurers have accordingly volunteered not to use such clauses in consumer policies through their Statements of Insurance Practice.[33] The Statements are not legally binding and therefore a refusal to follow the statement cannot be legally challenged. The Statements do not apply to commercial contracts and therefore insurers can rely on such clauses in respect of commercial risks. Whether or not such clauses impose a joint obligation on co-insureds depends on the wording of the clause.

In *Arab Bank v Zurich*[34], Rix J discussed the effect of such clauses in a co-insurance contract. In the case, the managing director (B) of a company (JDW) had signed a basis of contract clause in the proposal form for a professional indemnity policy. The policy covered JDW, B and the other directors as separate insureds and was effected by B for the benefit of all. The proposal form was subject to a basis of contract clause which stated that the answers given were 'to the best of my/our knowledge true and complete' and 'shall be the basis of the contract between me/us and the insurer.'[35] One of the questions asked by the insurer was whether B was aware of any circumstance which might give rise to a claim, which B did not answer truthfully. This amounted to a breach of the basis of contract clause and one of the issues Rix J had to consider was whether this breach affected the right of JDW. In

[30] See *Dawsons v Bonnin* [1922] 2 A.C. 413.
[31] See *Glicksman v Lanchashire Assurance* [1927] A.C. 139 at 144 and *Mackay v London General Insurance Co. Ltd* (1935) 51 Ll.L.R. 201 at 202, amongst others.
[32] "Insurance Law: Non-disclosure and breach of warranty" Law Commission Report no. 104, Pt VII, para. 7.2-7.4, pg.90-92.
[33] See para 1(b) of the Statement of General Insurance Practice 1995 and Paragraph (b) of the Statement of Long-Term Insurance Practice 1986.
[34] [1999] 1 Lloyd's Rep. 262, at 283.
[35] *Ibid.*

essence, whether the basis of contract clause imposed a joint obligation on all the co-insureds. The learned judge held that the warranty was not simply as to the statements' truth but was qualified by the expression 'to the best of my/our knowledge.' The effect of such phrase was that each insured seperately warrants that the information provided by B was truthful to the best of his personal knowledge and since the majority of the directors, other than B and an additional director, were unaware of the alleged fraud which gave rise to the false answer, JDW as an insured had not breached the warranty. The warranty therefore imposed severable obligations on each insured. Rix J however held, *obiter,* that the obligation would have been joint, if the qualification in the clause was absent. For example, if the term had stated that 'the answers given in this proposal shall be the basis of the contract between me/us and the insurer.' In such a case, a breach by the insured signing the form would affect the whole policy and would preclude any attempt by another co-insured to avoid the consequences by arguing that he has a separate contract from the insured responsible for the breach.

5. Conclusion

The question as to the type of obligation imposed by a warranty on co-insureds should depend on the obligation implied by the particular warranty and not whether the policy is joint or composite. Although the issue is yet to be decided by the courts, the present trend of construing the obligations of the insureds according to the nature of their interests suggests that the courts would also adopt this approach in determining the obligation imposed by the warranty. It is suggested that this approach ignores the purpose behind the warranty and fails to give effect to the intention of the parties as construed from the warranty clause. The conclusion reached from the analysis suggests that generally, where the warranty is as to a state of affairs, the obligation on the co-insureds is joint, unless the policy states a contrary intention.

CHAPTER VI

SUBROGATION IMMUNITY

1. Introduction

When an insurable risk is caused by a third party, the insurer upon indemnifying the insured, has the right to bring a subrogated action in the name of the insured against that third party. The aim behind this chapter is to determine how this rule would be applied to a co-insurance context in which a co-insured is responsible for the loss or damage in question. Can the insurer bring a subrogated right, in the name of the indemnified insured against the responsible insured, or is the latter protected against any subrogated action, by virtue of being a co-insured under the policy?

The starting point is to recognize that in an insurance contract (as opposed to a co-insurance contract) an insurer cannot bring a subrogated action against the insured for losses the latter has negligently caused, where the cause is an insured risk. There are essentially two reasons why this is so. First, under English law, the subrogated action is in the name of the insured and it is therefore impossible for the insured to bring an action against himself.[1] Second, the insured is protected against the very risk that has occurred and it would amount to a breach of the insurer's obligation if it were allowed to recover the very loss that it agreed to indemnify. The former reason is usually cited as the main reason why an insured is immune from a subrogated action, but the latter reason is equally as important and, as it shall be shown, is more relevant in the co-insurance context.

2. Subrogation immunity in co-insurance policies

2.1 Joint policies

The issue of a joint co-insured's immunity from a subrogated action of its insurer has never been the subject of judicial litigation in English law. One reason for this is that it is rightly assumed that the co-insured is immune from such action. The exact reason for this immunity is however not clear and it is therefore necessary to

[1] *Simpson v Thomson* (1877) 3 App. Cas. 279.

discuss this. Whilst the English courts have not been faced with the issue, the Supreme Court of Canada was able to give a reason in the case of *Commonwealth Construction v Imperial Oil.*[2] The case involved a composite policy which provided all risks protection to the parties to a construction venture. In the performance of its obligation, the sub-contractor, Commonwealth, negligently started a fire which resulted in damage to the construction. The insurer, upon indemnifying the benefactor of the construction, Imperial Oil, sought to bring a subrogated action against Commonwealth. The issue was therefore whether Commonwealth, as a co-insured had an immunity against the subrogated action. De Grandpre J, giving the only judgment of the court, held that Commonwealth was immune from the insurer's subrogated action. In addition to this, De Grandpre J also held, *obiter,* that if the interests of the co-insureds were joint each co-insured would have immunity against such actions because:[3]

'...the interests of the joint insured are so inseperably connected that the several insureds are to be considered as one with the obvious result that subrogation is impossible.'

The above quote was cited with approval by Lloyd J in *Petrofina v Magnaload*[4] and it is very likely that this reasoning would be adopted by the English courts. Whilst the conclusion reached by De Grandpre J cannot be faulted, it is the view of this author that the reasoning applied can be. This is because the learned judge does not explain why joint co-insureds should be treated as one entity solely on the basis of their joint interests. It might be argued that the reasoning stems from the rule of construction that co-insureds under a joint policy have joint rights but, as argued in an earlier chapter, this rule only determines the nature of the right of indemnity of the co-insureds. It does not mean that the several insureds should be treated as one.[5]

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[2] (1977) 69 D.L.R. (3rd) 558, discussed in Chapter I.
[3] *Ibid* 561.
[4] [1983] 2 Lloyd's Rep. 91, at 98.
[5] The analysis of the co-insureds as one entity has also been criticised by S. Derham, *Subrogation in Insurance law* (Sydney, 1985), pg. 80 and The Hon. Mr. Justice Brownie, "Co-insurance and Subrogation" [1990] 3 Ins. L.J. 48, at 57.

The reason why joint co-insureds have subrogation immunity can however be explained without adopting the above reasoning. Since each co-insured has an interest in the whole subject matter of insurance, it must follow that when joint co-insureds are insured under a co-insurance policy, the insurer cannot bring a subrogated action against an insured, for its negligent loss, because the latter is insured against that very loss. It would therefore be an implied term of the contract that the insurer cannot exercise rights of subrogation against any co-insured.[6] For example, suppose X and Y joint owners of a house, take out a joint policy to protect the house against loss or damage by fire. Where X negligently causes fire damage to the property the insurer is bound to indemnify the loss to the house and cannot bring a subrogated action in Y's name against X because the latter is also insured against the same loss to the property. As discussed earlier, this reason is also relevant in providing X with immunity when he is the only insured under the policy. Thus, to refer back to the *Commonwealth* case, it is because the policy protects the co-insureds against loss to the same subject matter, that each has subrogation immunity. The fiction of the co-insureds as one entity is therefore unnecessary.

2.2 Composite policies

2.2.1 Conceptual analysis

With composite policies, since each co-insured has a separate interest in the subject matter of the insurance, it could be argued that the insurer's promise to each co-insured is to indemnify the latter for any loss or damage that arises to his particular interest. Thus, where X and Y insure their separate subject matters under the same policy, and X causes damage to Y's property, it could be argued that upon indemnifying Y, the insurer could bring a subrogated action against X to recover this loss. Since the parties have separate interests, the insurer could argue that the aim of the policy was to protect each insured against loss to its respective interests, and

[6] A similar term was implied by Colman J in the *National Oilwell* case, which shall be discussed subsequently.

since X has no interest in Y's property, it cannot have any subrogation immunity in respect of this loss.

A criticism of the above analysis is that it ignores the particular nature of composite policies. Parties insured under such policies have a common aim or purpose, be it as a result of having separate interests in the same subject matter or working on the same project and thus being exposed to the same risks, which would be best protected under the same policy. Given that the aim of the policy is to protect this common or joint purpose against specified risks, it could be argued that its scope ought to include protection to a co-insured against its own losses. This would certainly have been the intention of the co-insureds, as it would be absurd if in seeking to protect one another against specified losses, they failed to protect themselves against losses caused by any of them. It is therefore argued that as a result of the nature of such policies, co-insureds ought to be immune from subrogated actions.

2.3 The approach adopted by the English courts

A study of the relevant cases suggests that the courts support the recognition of subrogation immunity for each co-insured. However the analysis used to reach this conclusion is, at the very least, questionable as it involves the use of the pervasive interest doctrine which, as discussed in chapter one, involves the 'stretching' of the insurable interest concept. The approach for the rest of this chapter shall therefore be to discuss the present approach and secondly to advance an alternative approach which would provide the required immunity without conflicting with any established legal principles.

2.4 The pervasive interest doctrine and subrogation immunity

The cases which deal with the issue of a composite co-insured's subrogation immunity have all centered on construction disputes in which the courts have held that the respective co-insureds have a pervasive interest in the whole construction works. The nature of this interest has been discussed extensively in chapter one and it is therefore unnecessary to discuss this again. At the end of the chapter, it was however argued that the whole rationale behind the emergence of the pervasive interest doctrine was to provide the insureds with immunity from a subrogated action. It is therefore necessary to determine how this immunity is justified.

Our enquiry shall start with the Canadian case of *Commonwealth Construction v Imperial Oil*, of which the pervasive interest doctrine was first recognised. As mentioned earlier, the Supreme Court of Canada had to decide an insurer of a composite policy could bring a subrogated action against one of its co-insured, who had been responsible for an insured loss. The court held that the co-insureds had a pervasive interest in the whole construction works and therefore all the co-insureds should be treated as one, with the consequence that subrogation against any would be impossible. The fiction of the insureds as one has already been argued against in relation to joint policies and it is suggested that it would even be less credible as an argument in relation to composite policies. Despite recognizing the pervasive interest doctrine, the English courts have however not adopted the fiction of one insured as the reason for denying subrogation immunity. The courts have used the pervasive interest doctrine to deny immunity on two other grounds.

2.5 The circuity of action defence.

This defence was first raised by Lloyd J in *The Yasin.*[7] In that case, the claimants were owners of cargo which was carried aboard the ship *Al Riaz.*[8] In the course of its journey, *Al Riaz* became a total loss allegedly by reason of the fault of its owners, the defendants had taken out insurance against loss to the cargo for the benefit of the claimants. The claimants were subsequently indemnified by the insurer, which now brought a subrogated action against the cargo owners. One of the arguments raised by the defendants was that the insurance was taken out for the benefit of both parties and since the claimant had been indemnified by the insurer, the action would be defeated by the principle that one co-insured could not sue another co-insured. Lloyd J held that the intention of the parties was that the cargo was to be insured for the benefit of the claimants only, therefore there was no issue of co-insurance. Lloyd J however had the following to say about subrogation immunity in co-insurance contracts:[9]

> It is said to be a fundamental rule in the case of joint insurance, that the insurer cannot exercise a right of subrogation against one of the co-assured in the name of the other. I am not satisfied that there is any such fundamental rule. In my judgment, the reason why an insurer cannot normally exercise a 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 circuity if the insurance had purported to protect the defendants against third party liability.

Thus, the rule against circuity of action essentially prevents a party from claiming from another, where the latter would also have a similar right against him. In *The Yasin,* Lloyd J felt that the defence would only have been applicable if the policy had also covered the defendant ship owners against third party liability, because the insurer would therefore have insured the defendant for the very loss which was the

[7] [1979] 2 Lloyd's Rep. 45.

[8] The owners of the *Al Riaz* also owned *The Yasin.* The latter ship was however not involved in the present litigation.

[9] At pg. 54-5.

subject of the subrogated action. In *Petrofina v Magnaload*[10], Lloyd J was again faced with the question of a co-insured's immunity, and was of the view that the rule against circuity of action would prevent the insurer from bringing a subrogated action where the co-insureds have pervasive interests in the whole of the subject matter of insurance: [11]

> 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. Now that the matter has been argued again, I have come to the conclusion that the contrast I was seeking to draw is fallacious. Whatever be the reason why an insurer cannot sue one co-insured in the name of another (and I am still inclined to think that the reason is circuity) it seems to me that it must apply equally in every case of bailment....

Both the House of Lords and Court of Appeal have recently held that the rule against circuity is an inappropriate defence against the insurer.[12] Before discussing their reasoning, it is necessary to discuss the nature of the rule itself.

2.6 The nature of the rule against circuity of action.

The rule against circuity has been described as an arcane defence which was used at a time when the pleading of cross-claims and counter-claims could not have been brought.[13] The rule can be traced as far back as 350 years ago[14], but a detailed account of its application can be found in the nineteenth century case of *Walmesley v Cooper.*[15] In the case, Walmesley, one of the claimants released, by deed, the defendant from a debt which was owed jointly to both Walmesley and Nelstrop. The deed did not specify an exact amount but within it, Walmesley promised not to sue D for any debt due from him. Subsequently, an action was brought by both creditors to recover the debt. The argument faced by the court was whether the promise by Walmesley constituted a release from the debt by virtue of the rule

[10] [1983] 2 Lloyd's Rep. 91, discussed in Chapter I.
[11] Ibid., at 98.
[12] In the respective judgments of both Courts in *Co-operative Retail services v Taylor Young*, [2001] 1 Lloyd's Rep. I.R. 122(CA); [2002] 1 All E.R. (Comm.) 918 (HL.)
[13] See the Judgment of Brooke LJ in *Taylor Young,* ibid. para. 72, pg. 137, and Brownie, *supra*. fn.5, at 53.
[14] Justice Brownie refers, at p.53, to the case of *Turner v Davies* 2 Wms Saund 150, in which Kelynge CJ said, "The law abhors circuity of action."
[15] (1839) 11 Ad & E 216; 113 E.R. 398.

against circuity, i.e. if the creditors were held to recover, the defendant could sue Walmesley for the breach of his promise and would therefore be entitled to the same amount from him. Lord Denman CJ, however held that the defendant was not released from the debt, because the principle of avoiding circuity of action was not applicable to the case. He said that the principle against circuity existed to prevent:[16]

> ...the scandal and absurdity of allowing A to recover against B in one action, the identical sum which B has a right to recover in another action against A. The law when it detects the possibility of such a waste of the suitor's money and its own process as well as of the public time will interpose to prevent its happening.

Justice Brownie[17] has suggested that from the above, one can extract two factors necessary for the defence to be applicable. First, there must be a complete identity between the parties having the competing claims and secondly there must also be a complete identity between the amounts recoverable by the respective parties. In *Walmsely*, the first factor was absent because both claimants had a joint right against the defendant, whereas the defendant, by virtue of the deed, only had a right against Walmesley. It was on this basis, that Lord Denman CJ held that the defence was not applicable.

Applying the two factors to a co-insurance scenario, it can be seen that the first factor is also not satisfied. For example, take the situation where X and Y, have diverse but pervasive interests in the insured subject matter. Where X causes damage to the subject matter, and the loss amounts to an insurable risk, the insurer is liable to indemnify Y for the damage to its property. In the event that the insurer brings a subrogated action, such action would be in the name of Y, and not in the name of the insurer, therefore the parties to the subrogated action would be X and Y. In the event that the action is successful and supposing that X could bring a subsequent action against the insurer, the parties to the second action would be X and the insurer. Thus there would be no identity between the parties having the

[16] Respectively at 221-2 &399-400.
[17] *Supra fn.*5 at pg. 54.

competing claims. Lloyd J's reliance on the circuity defence therefore seems to have been based on the error that under a subrogated action, the insurer is a direct party to the claim, when in fact it is not.[18] The absence of this factor, as held in *Walmesley*, is enough to defeat the application of the defence, and thus makes it an inappropriate justification for a co-insured's immunity.

However, there is a more important reason why the defence would have no application in a co-insurance context. Implicit in the circuity of action defence is that where the insurer sues X for a loss, X can also sue the insurer for that same loss. So where X has no right against the insurer, the defence cannot apply. The courts have held that this requirement is not satisfied in a co-insurance context. The point was first brought up in the *National Oilwell* case, but has now been elaborated upon by both the Court of Appeal and the House of Lords in the *Taylor Young* case. In the Court of Appeal, Brooke LJ was of the view that the defence against circuity of action, was an inappropriate justification for a co-insured's subrogation immunity because: [19]

> ...if the insurer has provided a full indemnity to one co-assured because it will have discharged its liability under the policy in respect of the losses in question and a second co-assured cannot look to it to pay him those losses a second time.

What the above suggests is that once the insurer has indemnified one co-insured, it has discharged its liability in respect of that loss. Where it recovers, in the form of a subrogated action, the loss from the negligent co-insured the latter cannot re-claim that loss from it because the insurer is no longer liable in respect of that loss. The circuity of action defence is therefore an inappropriate justification for the co-insured's subrogation immunity.

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[18] This error was also pointed out by Brooke LJ in *Taylor Young*, at para. 72, pg. 137.
[19] At para. 72, pg. 137. This view was also endorsed by Lord Hope in the House of Lords, at para. 65, pg. 937.

2.7 Implied term in the contract of insurance

In *National Oilwell Ltd v Davy Offshore Ltd*[20], Colman J was of the view that the reason why co-insureds with pervasive interests had subrogation immunity was as a result of an implied term in the contract of insurance. His view was based on the following analysis:[21]

> The explanation for the insurers' inability to cause one co-assured to sue another is that in as much as the policy on goods covers all the assureds on an all risks basis for loss and damage, even if caused by their own negligence, any attempt by an insurer after paying the claim of one assured to exercise rights of subrogation against another would in effect involve the insurer seeking to reimburse a loss caused by a peril...against which he had insured for the benefit of the very party against whom he now sought to exercise rights of subrogation...For the insurers who had paid the principal assured to assert that they are now free to exercise rights of subrogation and thereby sue the party at fault would be to subject the co-assured to a liability for loss and damage caused by a peril insured for his benefit...it is necessary to imply a term into the policy of insurance to avoid this unsatisfactory possibility. The implication of such a term is needed to give effect to what must have been the mutual intention (on this hypothesis) of the principal assured and the insurers, as to the risks covered by the policy.

What Colman J suggests from the above is that to allow the insurer to recover from the negligent co-insured contradicts the aim behind the pervasive interest doctrine, and in order to avoid this, one has to imply a term into the contract of insurance preventing the insurer from exercising this right against any co-insured. The true nature of this implied term is however far from clear. In chapter one, it was pointed out that the recognition of a pervasive interest by the courts was to prevent the respective co-insureds from suing one another in the event of a loss. This, from the insurer's perspective, would amount to providing the insureds with subrogation immunity, since the insurer can have no better rights than its co-insureds. If, as Colman J suggests, the reason why a term is implied is because the insureds have a pervasive insurable interest, then by extension the true reason for implying the term is to prevent the parties from suing one another. Such a term is therefore not based

[20] [1993] 2 Lloyd's Rep. 501.
[21] At 613.

on the mutual unexpressed intentions of the parties, as indicated by Colman J, but on the need to give effect to the policy reason underlying the doctrine.[22]

Since the term is only implied where the insureds have pervasive interests, it would follow that where the co-insured has no pervasive interest, it would have no immunity against the insurer's subrogated action. However, the scope of the pervasive interest doctrine is at present unclear. It has only been recognised in the insurance of construction and building projects, and it is uncertain if it would be recognised in other forms of composite insurance. Given the fact that the aim behind the doctrine is to prevent parties from suing one another, in the event of loss or damage to the subject matter by any of them, the doctrine ought to be recognised in other categories of composite insurance. There is also the fact that the decision by the Court of Appeal in the *Deepak* case[23] raises doubts as to the true nature and extent of the doctrine. Faced with these issues, it is suggested that the pervasive interest doctrine does not provide an adequate and comprehensive justification for a composite co-insured's subrogation immunity. However, both the Court of Appeal and House of Lords in the recent case of *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd*[24] have provided an alternative and less problematic means of justifying the immunity of the co-insured.

3. The *Taylor Young* case

The case arose in the course of a construction project. CRS, the claimants, decided to build a new office headquarters and contracted with Wimpey as the main contractor. The contract between CRS and Wimpey was a JCT 80 building contract with amendments. Clause 22 of the contract stipulated that Wimpey should effect a joint names policy covering the work and site materials, with CRS, the contractor and sub-contractor as co-insureds. In the event of an insured peril occurring, cl.22A stated that Wimpey was to restore the work and replace or repair any damages.

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[22] Such at term would be a term implied in law, as opposed to one implied in fact. See G. Treitel, *The Law of Contract,* 10th edn. (Sweet & Maxwell, 1999), 184-190.
[23] Discussed in Chapter I, pg. 18-19.
[24] [2001] 1 Lloyd's Rep. I.R. 122(C.A.); [2002] 1 All E.R. (Comm.) 918 (HL).

Wimpey was also under an obligation to authorize the insurers to pay the proceeds recoverable as a result of the loss, to CRS who would then pay them over to Wimpey. Wimpey entered into a sub-contract with Hall, in respect of the electrical works of the building generator systems, on terms identical to the main contract. CRS also employed TYP and HLP as professional advisers for the construction. In compliance with Cl.22, Wimpey effected an 'all risks' policy covering the interests of itself, CRS and Hall as co-insureds. The advisers were however not covered under the policy.

During construction, a fire broke out which resulted in damage and loss to property. The insurers indemnified CRS in respect of the costs of reinstating the building and associated professional fees and thereafter brought a subrogated action against TYP and HLP. The latter brought third party proceedings against Hall and Wimpey on the basis that they were also liable for the loss and thus liable to make contribution under the Civil Liability (Contribution) Act 1978. The issue in the case therefore focused on whether Hall and Wimpey were liable to make contribution. In the Court of Appeal, Brooke LJ, giving the judgment of the court, interpreted the above terms in the contracts as showing an intention between the parties that in the event of an insured peril occurring, the insurer alone would bear the risk of such loss. The consequence of this was that the co-insureds (i.e. Wimpey and Hall) were not liable for the loss and were therefore not liable to make any contributions to the professional advisers.

In reaching his decision, Brooke LJ relied on the previous decision of the Court of Appeal in *Mark Rowlands Ltd v Berni Inns Ltd*[25], in which the court held that, based on the terms of a tenancy, a policy of insurance taken out by the landlord was also for the benefit of the tenant and therefore the insurer could not bring a subrogated action against the latter. He further held that in cases involving the issue of subrogation immunity, the proper question to ask is, 'what does the contract provide?'[26] In the House of Lords, Lord Hope of Craighead[27] also adopted this approach and agreed that the answer to the question whether a defendant should be

[25] [1986] Q.B. 211.
[26] At para. 72, pg. 137.
[27] At para. 65, pg. 937.

entitled to subrogation immunity 'is to be found in the contract between the parties.' It is suggested that the reference to 'contract' in both judgments was to the construction contract (and sub-contracts) between the various parties and not to the co-insurance contract.

Professor John Birds[28] has argued out that the Court of Appeal's decision focusing on the contract between the parties as a reason for denying subrogation amounts to a separate basis for subrogation immunity, distinct from the pervasive interest analysis. He has also argued that in some cases, possibly including *Taylor Young*, either the pervasive interest analysis or the contractual analysis might be sufficient to give a co-insured immunity. This is certainly a possible interpretation of the case. However, another interpretation might be that the courts' findings in *Taylor Young* marked a shift of judicial approach to the question whether a co-insured should have subrogation immunity.

It might be argued that in this case the courts abandoned the strategy of stretching the concept of insurable interest in property entirely, in favour of the different strategy of looking at the contracts between the co-insureds to determine whether the parties intended to pass on the risk of loss to the insurer and thereby protect themselves against subrogated proceedings. On this understanding of the case, the courts' approach was in tune with the reality of the commercial arrangement between the parties and absolved them from the need to distort the insurable interest concept. It could however be said that this analysis might not be open to a court where the terms of the contract are not sufficiently extensive for the courts to infer an intention by the parties to provide immunity amongst themselves. However, it could be argued that even in such cases and taking into account the nature of composite policies, it must have been the intention of the co-insureds that losses by any of them would be at the risk of the insurer. Support for this interpretation can be found in the recent Court of Appeal judgment in *GD Construction (St Albans) Ltd. v Scottish & Newcastle Plc*[29], in which Aikens J[30],

[28] J. Birds, "Denying subrogation in co-insurance and similar situations", [2001] L.M.C.L.Q. 193, 196.
[29] [2003] EWCA Civ 16
[30] *Ibid.*, para. 50.

giving the leading judgment, interpreted Lord Hope's judgment as recognizing the above analysis as a separate justification for a co-insured's immunity. The argument could therefore be made that even where the terms are not conclusive of such an intention, the courts could still imply a term in the contract between the parties, on the basis that by agreeing to protect their interests under the policy, such parties must have intended not to sue one another in the event of a loss. The implication of such a term would require no greater stretch than the implication of a term to give effect to the pervasive interest doctrine, and it would have the advantage that it obviated the need to distort the insurable interest concept.

4. Co-insureds lacking underlying contractual relationships

The approach adopted in *Taylor Young,* would only apply where the co-insureds are in a contractual relationship with one another. This raises the question of how the issue of subrogation immunity would be resolved in a situation where the co-insureds are not in a contractual relationship with one another. A common example would be the situation where a home-sharing couple insures their separate interests in their home against specified risks. Despite the absence of a contract between the couples, it is argued that given the nature of their relationship, it would be absurd to expect the co-insureds to have intended the insurer to have subrogated rights against either of them in the event of a loss or damage. This is because the aim of the couple in taking out a co-insurance policy must have been to pass the risk of all possible losses recoverable under the policy to the insurer. Such parties would therefore find it surprising if, upon indemnifying their claim for a loss, the insurer thereafter brought a subrogated claim against the negligent partner. In such a case, the proper analysis should be that the co-insureds are immune from a subrogated action by virtue of an implied term to this effect in the contract of insurance. The issue of subrogation immunity in such cases has yet to be discussed by the English courts. Support for this analysis can however be found in the American jurisdiction. The American courts recognize a general anti-subrogation rule in respect of co-insureds. The leading case relied upon by most commentators is the decision of the Supreme

Court of Montana in *Home Insurance Company v Pinski Brothers*[31] The case itself did not involve a co-insurance contract, rather the court was faced with the issue as to whether an insurer could bring a subrogated action against a third party which it had also insured against, under a separate liability policy, the very loss it was seeking to recover from it. The Supreme Court of Montana rejected the insurer's claim on the basis that subrogation was an equitable right and therefore, the insurer in seeking equity must do equity. The court was of the view that the insurer's claim against its own insured was inequitably and against public policy and should therefore be dismissed. This decision has been relied upon by subsequent courts to provide co-insureds with subrogation immunity. For example, in *Pennsylvania General Insurance Company v Austin Powder Company*[32], the Court of Appeal of New York, relying on *Home Insurance,* held that co-insureds of a basic automobile policy were immune from the insurer's subrogated action.[33]

Macgilivray suggests that the American decisions should be treated with some caution since, 'they proceed upon principles which do not form part of English law'[34] The above reluctance is as a result of the American view that subrogation is an equitable remedy, a view which is far from clear in the English jurisdiction. The highest authority on the issue is the House of Lords decision in *Napier and Ettrick v Kershaw*[35], a case dealing with the issue whether an insurer could exercise equitable proprietary rights over proceeds paid to an assured by a wrongdoing third party, in reduction of the loss it had suffered but which he had recovered from the insurer. In reaching its decision, the House of Lords held that prior to the Judicature Act, both Courts of Equity and Common Law applied the doctrine of subrogation and therefore the insurer could have an equitable remedy. This decision at the very least

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[31] 160 Mont. 219.
[32] 510 N.Y.S. 2d 67.
[33] Other notable cases include *Great American Insurance Co. v Curl* (1961) 181 N.E. 2d 916, discussed by Derham, *supra, fn.*5, 79-80. In that case, the Court of Appeals of Ohio held that a homeowner's insurance policy covering damage to the building which included the primary insured's mother-in-law as an additional insured protected her against any subrogated action even though she did not have an insurable interest in the home.
[34] Para. 22-102, pg. 611.
[35] [1993] 1 Lloyd's Rep. 197.

suggests that, under English law, subrogation is not exclusively an equitable doctrine.[36]

It is suggested that where the co-insureds have not contracted with one another, the English courts could, drawing from the American approach, deny subrogation against the co-insureds, on the basis of an implied term to this effect. The difference between both approaches would however be that whilst the American approach is based on notions of equity, the English approach would focus on the unexpressed intentions of the parties influenced by the particular nature of composite policies.

A final point remains to be made. If, as suggested, the courts are willing to imply a term into the contract insurance, the question would arise as to the relationship between that approach and the approach in *Taylor Young,* i.e. if the courts can imply a term into the co-insurance contract, why not imply it to all co-insurance contracts, even where there is an underlying contract between the co-insureds? This argument is very persuasive as its consequence would be to establish a general rule of subrogation immunity in all forms of co-insurance.[37] Whilst this might be the case, it is suggested that the approach in *Taylor Young* should still be maintained. This is because, where there is an underlying contract between the co-insureds in which there is an obligation to take out insurance for the benefit of all, the reasonable expectations of the parties implicit from this obligation is that the insurer cannot bring a subrogated action against any of them, and it therefore makes more sense to recognize this term in the contract between the parties. It is only where there is no contract between the parties that the courts should then consider the insurance contract. It is however submitted that cases in which the co-insureds have no underlying contractual relationship would be very rare in commercial arrangements. It would however be a common occurrence in domestic or consumer insurances and given the nature of the relationships in such cases, it is reasonable to infer that the co-insureds contract in the expectation that the insurer would have no subrogation rights against any of them.

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[36] See *Macgilivray,* para. 22-20, pg. 576 and 22-102, pg. 612.

[37] Such an approach is endorsed by Birds and Hird, at pg. 309.

5. The extent of the immunity.

Despite the above reasonings, the immunity granted to a co-insured might not apply in every case. There are two main limitations which should always be taken into consideration:

5.1 When the loss has been caused by the wilful misconduct of a co-insured.

Where co-insured X wilfully causes damage or loss to the subject matter of the policy, X's cover under the policy is brought to an end, and in the event that the insurer brings a subrogated action against it, it has no immunity as it no longer has the protection of the policy. The case which supports this view is the decision of the House of Lords in *Samuel v Dumas*[38], in which it was held that a deliberate scuttling of a ship by a ship owner, did not prevent the mortgagee co-assured from recovering its loss from the marine underwriters. It was however held that the latter could bring a subrogated action against the ship owner.[39]

5.2 The co-insured responsible for the loss was, at the time of the loss, not covered under the policy

The above situation could exist in two ways:

i.)The first is where the protection granted to each co-insured is for different durations. Thus in *National Oilwell*, NOW was only covered in respect of pre-delivery losses while DOL was covered through out the duration of the project. Thus when a loss arose in relation to a part that had already been delivered, NOW was no longer covered in respect of this loss and therefore did not have any immunity against a subrogated action.

ii.) The second situation would be where the co-insured responsible for the loss has no valid insurable interest at the time of such loss. This situation is based on the decision of the Court of Appeal in *Deepak v Davy McKee*. Despite the uncertainty

[38] [1924] A.C. 431, discussed in chapter III, pg. 47.
[39] In particular, pg. 445-5, per Viscount Cave.

surrounding this decision, it seems to be clear that the pervasive interest of a co-insured in a construction project only subsists till the project has been completed. Thus, after such completion the co-insured no longer has an interest in the whole property. If co-insured were to cause a loss after his pervasive interest comes to an end, the latter would have no subrogation immunity as it is no longer covered by the policy.

6. Conclusion

The joint nature of co-insurance contracts suggests that co-insureds ought to have subrogation immunity. That this is the view of the English courts cannot be doubted in light of the numerous cases in which the courts have confirmed the presence of this immunity. However, the approach of the courts, particularly with the pervasive interest doctrine, is ill-conceived and raises more questions than it seeks to answer. It is suggested that the way forward is to reject the pervasive interest doctrine, and rely on the reasoning employed in *Taylor Young* to reach the same result by implying a term into the contract between the co-insureds. Such an approach is a more realistic interpretation of the agreement between the co-insureds and it has the additional benefit of not distorting the established definition of insurable interests.

CHAPTER VII

The Contracts (Rights of Third Parties) Act 1999.

1. Introduction.

The purpose of this chapter is to examine the Contracts (Rights of Third Parties) Act 1999 (hereafter referred to as Contracts Act 1999) with the aim of determining how it can provide particular individuals or groups who are not privy to a contract of insurance, with the twin benefits of rights of enforcement against the insurer and subrogation immunity. The aim to be achieved by this discussion is to determine the extent of which the Act can be used by parties as an alternative to co-insurance contracts in terms of the above benefits. Since the 1999 Contracts Act, creates a statutory exception to the doctrine of privity, it shall also be discussed how third party co-insureds can rely on the Act in order to enforce co-insurance contracts effected on their behalf. To a third party co-insured, the 1999 Contracts Act is therefore an alternative to the agency principles discussed in chapter two, and a comparative analysis between both approaches shall be undertaken.

2. The Right of Enforcement under the 1999 Act.

The Contracts Act 1999 provides third parties, which meet the requirements of the Act, with the right to enforce terms of contracts between other parties. Thus a contract between X and Y could be enforced by Z, if the requirements of the Act are met. The Act essentially creates a statutory exception to the doctrine of privity. In applying the Act, the focus shall be on two distinct insurance scenarios. The first involves a co-insurance policy in which X enters into a contract of insurance for the benefit of himself and Y. Y is not a party to the contract and therefore cannot sue the insurer directly, unless the agency principles discussed in chapter 2 are satisfied.[1] The Contracts Act 1999, would however allow him to directly enforce the terms of the contract, if the requirements of the Act are satisfied. This scenario shall be

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[1]At pg. 23.

called the co-insurance scenario as the policy intends to protect both X and Y against loss. The second scenario is where X insures against a risk to himself but the terms of the policy states that in the event of loss, Y shall have a right or recovery against the insurer. This scenario shall be called the insurance scenario because the policy only covers risk to one party. Y is not a party to the insurance contract and in the event of loss to X, Y would be unable to sue or demand recovery of the proceeds directly from the insurer as a result of the doctrine of privity. However, as a result of the 1999 Act, both third parties can now recover directly from the insurer without satisfying the privity doctrine. The requirement of the Act can be satisfied through two distinct ways.

2.1 Section 1(1) (a)

The above section states that where the contract expressly provides that a third party may enforce a term of the contract, that third party would be able to enforce the particular term. Thus where the co-insurance contract contains such an express term, the co-insured would be able to rely on it. It is however unlikely that this section would be satisfied in a co-insurance scenario. This is because such policies do not contain an express term that Y may enforce the contract, but only include terms that state that Y is a co-insured and its interests are covered under the policy. In as much as the implication of such terms is that Y should have a right to sue the insurer in the event of loss or damage to its interest, it is not expressly stated in the policy and therefore does not satisfy s.1(1)(a) of the Act.[2] In relation to an insurance scenario, much would also depend on the terms of the policy. Where the policy

[2] In *Privity of Contract* (LLP, 2000) (Gen. Editor, R. Merkin), Professor Rob Merkin, at pg 101, applied the Act to the facts of the *National Oilwell* case. The sub-contractor in that case was a co-insured under the policy and he argued that the case would fall under s.(1)(a), because the effect of making the sub-contractor a beneficiary of the policy 'is to give him a right to sue under it as party to it.' With respect, this interpretation can be criticised on the basis that the subsection requires an express statement and a term which lists the third party as a co-insured, only implies that the insured should have a right of enforcement. Professor Merkin has subsequently adopted this latter interpretation, in *Colinvaux & Merkin*, at A-0612, pg. 10,585, as he now suggests that 'it is apparent that the mere fact that a third party is named as beneficiary does not bring him within C(RTP)A 1999, s.1(1)(a), as that provision is satisfied only by an express statement that the third party has a right to enforce a term.'

states that 'in the event of loss or damage, the insurer should pay the proceeds to Y', it is also unlikely that the requirement of the sub section would have been satisfied. In the Law Commission Report which formed the basis for the enactment of the 1999 Act[3], the Commision was of the view that s.1(1)(a) was self-explanatory. It was also of the view that terms like, " C shall have the right to enforce the contract" and "C shall have the right to sue" would satisfy the requirement of the sub section. This clearly suggests that the term must expressly state that the third party has a right in the contract, and terms which only state that the third party has a benefit under the contract are insufficient.[4]

Section 1 of the Contracts Act 1999 is also subject to s.1(3) which states that the third parties relying on the Act must be identified in the contract. This requirement is easily met in respect of both scenarios because in most insurance policies, Y is usually identified either by name or as a member of a particular class. S.1(3) also states that although the third party must be identified in the contract, the party need not have been in existence at the time the contract was concluded. The Act therefore applies to 'future co-insureds' in a co-insurance scenario whom, as discussed earlier[5], could not rely on the agency principles. Such parties would now be able to rely on the Act.

2.2 Section 1(1)(b)

The above section states that where a term purports to confer a benefit on the third party, the latter may enforce the term in his own right. The subsection is however subject to s.1(2), which states that the above subsection would not apply where 'on a proper construction of the contract, it appears that the parties did not intend the term to be enforceable by the third party.' Thus, in order to fall within this section, two requirements have to be met. First, the term must confer a benefit on the third party and second, the parties, from a construction of the contract, must have intended that

[3] 'Privity of Contract: Contracts for the Benefit of Third Parties' (Law Com. No.242) at para. 7.10.
[4] This view is reinforced by the fact that the Commission was of the view that the case of *Beswick v Beswick* [1968] A.C. 58, in which a third party was conferred a benefit under a contract, would not be covered by the subsection.
[5] Chapter II, pg. 34.

the third party should have a contractual right of enforcement. It however does not mean that the onus is on the third party to prove both. In reference to our hypothetical scenarios, third party Y would easily satisfy s.1(1)(b), because by being expressed either as a co-insured or as a beneficiary of the policy, the policy intends to confer him with a benefit. In relation to s.1(2), the onus of proving that the parties did not intend the term to be enforceable by the third party, is on the promisor, which in this case is the insurer. This is based on the view of the Law Commission[6], in which it stated that the effect of s.1(1)(b), is to establish a rebuttable presumption in favour of a third party right. This presumption could however be rebutted where on a proper construction of the contract, the parties did not intend to confer such right to the third party. It follows that all the third party would have to prove is that a term of the contract conferred a benefit on him. The third party would therefore be able to sue under s.(1)(b), as long as there is no term in the contract[7], which indicates to the contrary.

Apart from being able to enforce the contractual term, a third party falling within the Act also has, by virtue of s1(5) of the Act, the right to any remedy that would have been available to him had he been a party to the contract. The Act therefore puts the third party on the same footing as a party to the contract.

3. The Insurable Interest requirement

A major uncertainty regarding the application of the Contracts Act 1999 to insurance policies is whether, third parties seeking to rely on it can do so, without having any insurable interest in the subject matter of insurance. For example, in a situation where X insures his property against loss or damage, and the policy states that in the event of such loss or damage, Y has a right of indmenity, can Y recover under the policy even though it has no insurable interest in the property? The requirement of

[6] *Supra, fn.3*, para. 7.17.

[7] s.1(2), restricts the scope of the construction, to the terms of the contract, so the insurer cannot rely on terms other than those within the policy as evidence of the parties' intentions.

insurable interest is an important doctrine in Insurance law. With indemnity insurance, an insured must have an insurable interest in the subject matter of the insurance because the purpose of such policies is to indemnify an insured a loss it has suffered. Therefore, where the insured does not have an insurable interest in the subject matter of the insurance at the time of the loss or damage, it cannot recover for this.[8] The requirement also applies to non-indemnity policies, for example, s.1 of the Life Assurance Act 1774 requires that an insurance 'on the life or lives of any person or persons, or any other event or events whatsoever', is void unless the person 'for whose use, benefit or on whose account' the policy is made has an interest in the insurance. In addition, s.18 of the Gaming Act 1845 states that any contract by way of gaming or wagering is void. An insurance contract in which the insured has no insurable interest could in appropriate circumnstances be deemed as a wagering contract and is thus invalidated by the above statute.[9] The question therefore is whether the enactment of The Contracts Act 1999 abolishes the requirement of insurable interest in respect of third parties relying on the Act.

An immediate response to the above is that since the 1999 Act does not expressly state this, it would be a misconstruction of the Act, given the importance of the principle in insurance law, to suggest that it implicitly excludes the requirement. In the words of Christopher Henley: [10]

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[8] For example in relation to marine insurance, s. 4(2)(a) of the MIA 1906 states that when an assured has no insurable interest, the policy is deemed to be a 'gaming or wagering contract', rendering such policy void (s.4(1).) However, with the insurance of goods against non-maritime risks, the insurable interest requirement can be waived, provided that the insurance does not amount to a wagering or gaming contract. See, *Prudential Staff Union v. Hall* [1947] K.B. 685.

[9] An example of a case in which an insurance contract has been held to be a wagering contract because of the absence of an insurable interest is *Newbury International v Reliance National Insurance Co (UK) and Tyser Special Risks* [1994] 1 Lloyd's Rep. 83 in which Hobhouse J held, at 92-3, that the assured of the prize indemnity policies did not have any insurable interest and thus both policies were wagering contracts. However Christopher Henley in, *Privity of Contract, Supra.*, ch.9, at 223 suggests, relying on the decision in *Morgan Grenfell & Co Ltd v Welwyn Hatfield District Council* [1995] 1 All E.R. 1, that the absence of an insurable interest does not necessarily mean that the contract is a wagering or gaming one. He further suggests (at 226) that in the absence of any intention to wager, the courts would give effect to such policies provided 'that there is some inherent commercial purpose.' Also, see *Prudential Staff Union v. Hall, Ibid.,* and *Thomas v. National Farmers' Union Mutual Insurance Society* [1961] 1 W.L.R. 386.

[10] Ibid. at 226.

It would have been remiss of a parliamentary draftsman not to have identified the potential conflict between the "insurable interest" legislation and the provisions in the Contracts (Rights of Third Parties) Bill, and doubly remiss not to have proposed a solution, such as ensuring that the new Act would take precedence.

It is therefore suggested that the 1999 Act does not abolish the insurable interest requirement. A second reason can be found in the diffference between the privity rule and the insurable interest doctrine. The purpose of the 1999 Act is to create a statutory exception to the privity doctrine. It therefore allows third parties who would normally not have a right to sue, to enforce rights against a contractual party. This aim is however different from the rationale behind the insurable interest which is based in part on the need to prevent wagering and to ensure that the principle of indemnity is satisfied. It is therefore suggested that there is no reason why the rationale behind the insurable interest doctrine should not be relevant in the case of a third party relying on the 1999 Act. However, it does not follow that all third parties must satisfy the insurable interest requirement in order to rely on the 1999 Act. It is necessary to refer to our two distinct scenarios, to fully explore this issue.

In the insurance scenario in which X is the only insured under the policy, the fact that Y has no insurable interest can be argued as being irrelevant for the following reasons. Firstly, as X is the insured and it is his potential loss that is being insured against, it is X that needs to satisfy the insurable interest requirement, and not Y who is not even a party to the contract of insurance. Secondly, the policy against gaming or wagering is not being infringed in this case, because X has an interest in the subject matter. The only difference is that Y has the right of indemnity. However this difference should not matter because the right has been conferred on Y by the parties to the policy. Thirdly, if the rule were that Y would need to have an insurable interest in the subject matter, it would severely restrict the situations in which the 1999 Act would apply in an insurance scenario. The Act would therefore only apply to situations in which both X and Y have an interest in the same subject matter. Such a consequence would limit the ability of parties to make commercial arrangements, according to their intentions. It is therefore argued

that the better approach is that, in the light of the fact that X the insured has an insurable interest, there is no need for Y to have one in order to enforce the right of indemnity.

A situation in which the third party would however need to have an inusrable interest is the co-insurance scenario. Thus, where X takes out a policy of insurance for himself and Y, Y would need to have an insurable interest in the property because the policy protects him against any loss to the subject matter. This is different from the earlier scenario in which the policy did not protect Y from any potential loss. The policy was to insure risks to X, and as long as he had an insurable interest, the policy would be valid. In this case the policy intends to protect both X and Y against specified risks, and therefore Y would have to identify an insurable interest in order for its cover to be valid. Parties insured under a co-insurance policy usually have an insurable interest in the subject matter, and it is therefore very unlikely that the requirement of insurable interest would be a controversial issue in relation to such policies. It however remains to be seen the position of the courts in relation to an insurance scenario. It is suggested that the preferred position is that as long as the insured has an insurable interest, there seems no reason why the third party should be required to have an additional interest in the same subject matter.

4. The Effect of the Contracts Act 1999 on the National Oilwell Principles

In relation to co-insurance policies, the 1999 Act represents a valid means by which a third party co-insured can enforce rights against the insurer without being a party to the contract. It is therefore an alternative to the agency principles discussed in the *National Oilwell* case.[11] In light of this, it is therefore necessary to compare both rules in order to highlight their differences, with the aim being to determine which approach is better suited for a third party co-insured.

[11] At pg. 23.

4.1 Conceptual differences

Where the agency principles are applied, the co-insured becomes a party to the contract of co-insurance. The Contracts Act 1999, however does not make a third party co-insured, a party to the contract. The consequence of satisfying the requirements of the Act is that the third pary is allowed to enforce the terms of the contract, which was intended by the parties to the contract that he should be able to enforce. Thus, on one level it could be said that a difference is that with the 1999 Act, the third party is still not a party to the contract. This difference is however one without much substance. This is because, by giving the third party the right to enforce a contractual term, the Act gives the latter essentially the same rights he would have, had he been a party to the contract i.e. the right to be indemnified in the event of loss or damage to the subject matter of insurance. It is therefore suggested that the fact that the co-insured is still not a party to the contract is without any significance.

4.2 Consequential differences

4.2.1 The extent of the co-insured's right

The inquiry here is to determine whether the application of the Act to a third party co-insured would produce a different result from an application of the agency rules to the same scenario. The case of *National Oilwell*, can be used as an example. It will be remembered that, as a result of applying the agency principles, Colman J held that the contractor was not authorised to insure on behalf of the sub-contractor beyond the date of delivery, nor did it have such an intention when effecting the insurance. Would the same decision have been reached through the 1999 Act? The sub-contractor, would rely on s.1(1)(b) of the Act, as he is identified as a co-insured under the contract and the policy confers a benefit upon it. This therefore creates a rebuttable presumption, which the insurer in this case would not be able to disprove, as it does not appear from a construction of the contract that it was not intended that the sub-contractor should not be able to directly enforce his rights against the insurer in the event of a loss. Professor Merkin has argued that the effect of this application

would be that the co-insured would be covered for all losses 'whether pre- or post delivery.'[12] This obviously goes against the decision by Colman J, in which the latter took account of the contract between both parties, which restricts the contractor's obligation to insure for the benefit of the other to the time of delivery of the goods, in reaching the decision that the contractor's intention and authority was restricted by this obligation. S.1(2) of the 1999 Act, in determining whether the parties intended the term to be enforceable by the third parties, however restricts its scope to the contract terms and therefore prevents any inquiry into other contracts which might restrict the scope of the third party's right. Professor Merkin argues that in the light of this, and in order to give effect to the intentions of the parties, the proper construction of the Act is to allow a term for the benefit of the third party to be divided 'into its constituent, including its temporal, parts according to its construction.' Thus the sub-contractor, relying on the 1999 Act, would only be made 'a party to the insurance...to the extent of the contractors' obligation to insure on the sub-contractor's behalf.'[13]

With respect, it is argued that in relation to the *National Oilwell* case, the above construction is unnecessary. This is because, the policy taken out by the contractor, apart from defining the co-insured, contained the following clause: [14]

> The interests of the "other Assurred(s)" shall be covered throughout the entire policy period...unless specific contract provisions to the contrary, in which event, insurance hereunder for such specific contracts only, shall be limited accordingly.

The above clause was interpreted by Colman J as restricting the cover of the sub-contractors to the cover expressed under the contract between the two parties.[15] It is argued that this clause would also be taken into consideration, in an application of the 1999 Act, by virtue of s.1(4) , which states that: 'This section does not confer a

[12] *Colinvaux & Merkin*, at A-0612, pg. 10,586 and *Privity of Contract,* at 101-2.
[13] In *Privity of Contract*, pg. 101, para. 5.30.
[14] [1993] 2 Lloyd's Rep. 582, at 588.
[15] Ibid., at 602.

right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.' The sub-contractor's right to sue the insurer would therefore be subject to the above clause, which restricts the latter's cover to pre-delivery losses. Professor Merkin's construction is therefore unnecessary to give effect to the true intentions of the parties.[16]

4.2.2 Variation and rescission of the contract

A possible consequence of the application of the 1999 Act is that since the co-insured is not a party to the contract, the parties to the contract could vary the former's rights in the contract without its consent. The ability of the parties to vary the rights of the third party is however subject to s.2 of the 1999 Act. This section allows the parties to the contract, by an express term, to vary or rescind the contract without the consent of the third party.[17] Therefore, in the insurance scenario in which Y is entitled to enforce the right of indemnity in X's insurance policy, the parties can vary or rescind this right without Y's consent if there is a term in the contract to this effect. It should however be noted that the conclusion might not be the same, were the facts to be slightly different. For example, if X was insuring for the benefit of Y, with the latter having a right of indemnity, any variation of the contract which transferred the right of indmenity to X might fall foul of the rules against insurable interest and thus make the contract void.

Where the policy does not contain an express term as to variations, the default rules apply. [18] These rules state that the consent of the third party is needed for any variation where the third party falls in any of the three scenarios:

(a) the third party has communicated his assent to the terms of the promisor

[16] In *Colinvaux & Merkin*, at A-0612, pg. 10,586, Professor Merkin rightly suggests that the application of Act to the facts of *National Oilwell*, would only be problematic, where there is no policy term which restricts such cover to pre-delivery losses. It therefore seems strange that he makes no reference to the above clause in his discussion.

[17] S.2(3) of the Act.
[18] S. 2(1) of the Act.

(b) the promisor is aware that the third party has relied on the term, or

(c) the promisor can reasonably be expected to have forseen that the third party would rely on the term and the third party has in fact relied upon it.

Applying the above rules to the insurance scenario, if Y communicates his assent to the insurer the parties cannot vary this right without his consent. The third party's right is also protected where he has relied upon the term and either the promisor is aware of this, or he would have been reasonbly expected to have forseen this. An example of such reliance could be found in the co-insurance scenario, in which X takes out a policy covering himself and Y. It could be argued that Y has relied on the term, because he does not take out any alternative policy to cover the risk insured, and the insurer can reasonably be expected to have forseen this. It can therefore be said that although third parties in principle might have a disadvantage in respect of variations to the contracts which might affect their rights, the default rules in the 1999 Act go some way in limiting the freedom of the parties to alter these rights.

The default rules in the 1999 Act can be compared with the decision of the Supreme Court of Canada in *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*[19] in which the Court developed a principled exception to the doctrine of privity and allowed a charterer of a dredging vessel not party to the contract, to rely on a subrogation waiver clause in which it was named as a beneficiary. The court held that the charterer could rely on the clause even though, subsequent to the resultant loss, the owner of the vessel and its insurer had agreed to cancel this waiver in relation to the charterer. The Supreme Court was of the view that the parties could not revoke this right once it had developed into an actual benefit for the charterers. Compared with the 1999 Act, the case suggests that a third party cannot protect its right under the contract by assenting to it. In the words of the Supreme Court, the third party is protected against any variation, only when its 'incohate rights' have crystallized into an actual benefit. The fact that the third party's right only crystallizes into a benefit once it has caused the loss suggests that on a general level a third party is protected as soon as an event occurs which necessitates that party to

[19] [2000] 1 Lloyd's Rep. 199.

exercise the right in the contract. Applying this to our insurance scenario, it would mean that prior to a loss occurring under the policy, the parties can vary the terms of the policy without the consent of Y, even where the latter has relied on the term. The default rules in the 1999 Act are therefore more protective of the third party's interests than the Canadian approach.[20]

An ambiguity in the Canadian approach relates to the extent of the crystallization of the third party's rights. Is such crystallization of a permanent effect that would protect the third party in relation to subsequent events? For example, assuming the vessel in *Fraser River Pile* had not been destroyed and the charterers were still contracted to use it for a subsequent period, could the parties have varied the application of the clause for this remaining period? The emphasis of the Court on the principle of freedom of contract, suggests that the crystallization only relates to the particular loss and subsequent to this, the parties ought to be able to vary the terms for the remaining period of cover. It is however unlikely that the 1999 Act would be construed this way. This is because the default rules implicitly suggest that the right is crystallized permanently and not for a particular period. For example, s.2(1)(a) of the Act states that the third party assents to the term as a whole and not for a particular length of time, or in relation to a cause of action. The same can be said regarding reliance. The Law Commission defined reliance as 'conduct induced by the belief (or expectation) that the promise will be performed'[21], suggesting that reliance is in relation to the promise of the right as a whole. Thus, in the co-insurance scenario, Y rightly assumes that his right in the co-insurance policy taken out by X on his behalf lasts until the expiration of the policy, and it is on this basis that he is not taking out an alternative policy.

[20] For a detailed analysis of the differences in both approaches, see M.H. Ogilvie, "Privity of Contract in the Supreme Court of Canada: Fare thee well or welcome back", [2002] J.B.L. 163, 174.
[21] *Supra, fn.*3, para. 9.14.

4.2.3 Composite Policies: The 'separate contracts' analysis

A possible confusion might arise in the application of the 1999 Act to composite policies. It has already been mentioned in an earlier chapter that the prevailing view is to interpret such policies as containing separate contracts. If this view is accepted and in cases in which the policy can actually be construed as such, the question arises as to how the 1999 Contracts Act would apply given that it only applies to a single contract which provides a benefit to a third party. Suppose X decides to take out a composite policy on behalf of himself and Y. The subject matter of the insurance are two houses, X1 and Y1. X owns the former while Y owns the latter. The policy lists both X and Y as co-insureds and states that in the event of damage or loss, X or Y should be indmenified depending on which party has suffered loss. If the courts construe the policy as embodying two separate contracts, it could be said that, applying agency principles, in the first contract X contracts with the insurer for the protection of X1, while in the second contract X again contracts with the insurer, but as agent of Y, for the protection of Y1. As long as the agency principles are satisfied, Y would become a party to the second contract. How then would this scenario be interpreted if the 1999 Act is applied?

In respect of the first contract, X would be the party to the contract insuring for the protection of X1. With the second contract, X is the party to the contract, insuring against loss or damage to Y1, but Y has the right of indemnity in the event of loss to the property. This right would be implied from the policy term which states that Y shall be indemnified where there is a loss or damage to YI.[22] Thus Y would have to rely on the s.1(1)(b) of the 1999 Act in enforcing the second contract against the insurer.[23] An illustration of the above example is given below:

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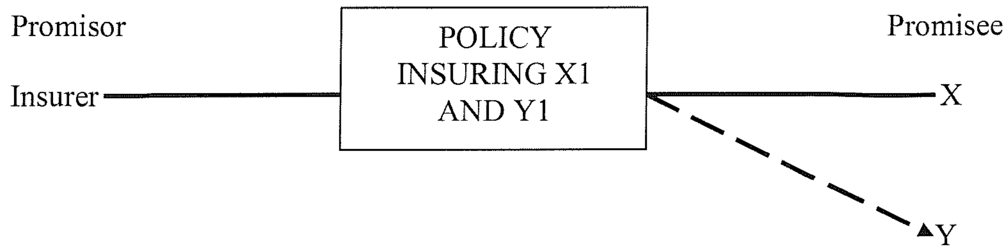
[22] Where the policy does not state this, the right could still be implied from the fact that Y is a co-insured under the policy and has an interest in Y1

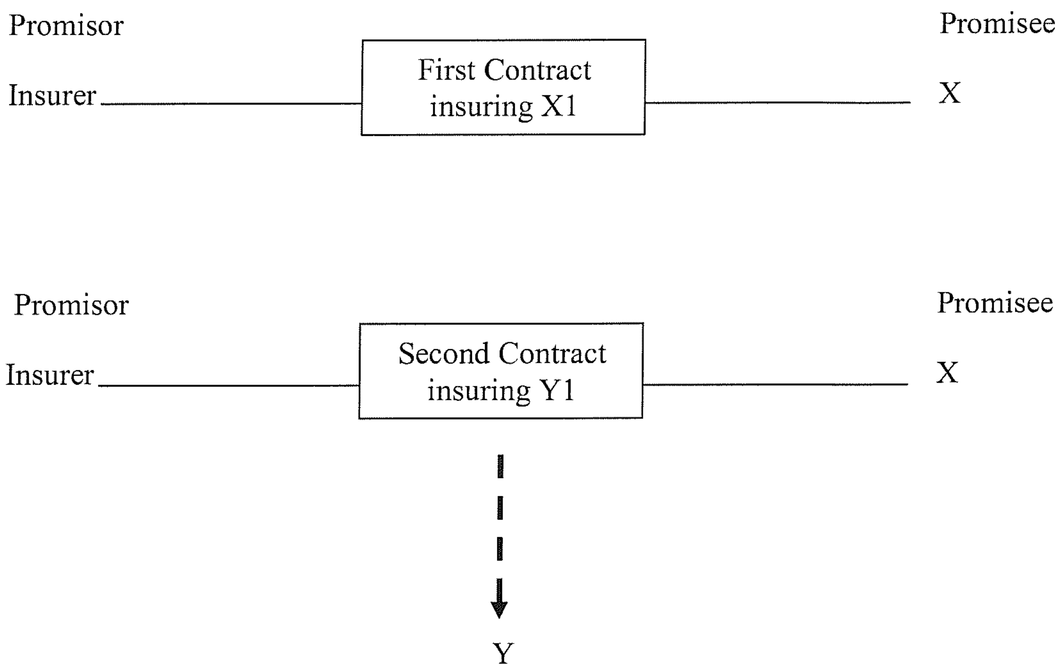
[23] This is because, as discussed in pg. 140-1, the policy does not expressly state that Y may enforce a term of the contract.

Agency Scenario



Y is made a Party to the contract, through X's agency.

Construction of policy as embodying separate contracts



- - - - - -▶ = Right of indemnity

4.3 Procedural differences

The major difference between the Act and the agency principles, is the requirements necessary for each. With the agency principles, the aim is to determine whether or not the agent intended to insure on behalf of the purported principal, and to this extent the enquiry focuses on the subjective intentions of the agent. With the 1999 Act, the focus is on whether the parties intended the third party to enforce rights under the contract, and the emphasis is therefore on the terms of the contract and nothing else.[24] One could therefore argue that the 1999 Act is more in line with contractual prinicples as it focuses on the objective intentions of the parties as expressed in the contract. This however does not mean that the agency principles are wrong. The rationale behind an enquiry into the subjective intentions of the agent has already been discussed, and has been endorsed by the judiciary.[25] The consistency of the Act with contractual reasoning, however makes it more acceptable than the agency option.

It could also be said that the third party co-insured has to satisfy more requirements under the agency principles, than he has to prove in regards to the 1999 Act. With the latter, as long as the policy expresses that the third party has a right enforceable against the insurer, or the contract confers a benefit on him, he should be able to enforce the contract against the insurer. With the agency principles, the third party not only has to prove that the agent insured intended to insure on his behalf, but in certain cases he might also have to prove that the agent has the necessary authority to take out the required insurance. Although these principles are in most cases easily satisfied, it is nonetheless more convenient and easier for the co-insured to satisfy the requirements of the Act, than it would be to satisfy the agency principles.

[24] Extrinsic evidence can only be referred to where, like in the *National Oilwell* case, the contractual terms refer to this.

[25] See the judgment of Colman J in *National Oilwell*, at pg. 599, and the discussion of the case in Chapter II.

4.4 Does the 1999 Act make the agency rules redundant?

In light of the fact that the requirments of the Act are more easily satisfied than the agency principles, there is much to be said for the above question. It however needs to be emphasised that the Act does not abolish the agency principles. S.7(1) of the 1999 Act states that:

Section 1 does not affect any right or remedy of a third party that exists or is available apart from this Act.

This section therefore preserves the common law rules which were relied upon by third parties prior to the Act. The agency principles are therefore still very much in force and can be relied upon by third parties. It however seems more likely that such parties would now rely on the Act, given the fact that its requirements can be easily established. The 1999 Act, also applies to most contracts, apart from the few exceptions listed in s.6.[26]

However it seems that the parties to the contract can, with the aid of an exclusion clause, exclude the application of the Act.[27] Thus, where the terms of the policy exclude the application of the 1999 Act, the agency principles would therefore be the only by way which a third party can directly enforce rights under the policy. The agency principle is therefore still very relevant as it would play a subsidiary role in the event that the 1999 Act is unavailable to a third party.

[26] Some of the excluded contracts already have their own statutory regimes which govern third party rights, e.g. bills of lading, promissory notes, bills of exchange. Others like contracts of employment were excluded by the government. See *Privity of Contract, supra*, para 5.109, pg. 133.

[27] The authors of *Birds' Modern Insurance Law*, at pg. 64, suggest that 'parties to a contract can exclude the operation of the Act, and it may well be the case that insurers insert an appropriate exclusion clause in a wide range of insurance contracts.'

4.5 The Insurer's defence under the 1999 Act

Section 3 of the 1999 Act deals with the defences available to a promisor where a third party enforces a term of the contract in reliance of s.1 of the Act. S. 3(2), provides that where the third party brings a claim, the promisor can rely on any defence or set-off, which would have been available to him had the action been brought by the promisee, arising from or in connection with the contract and is relevant to the term which the third party is relying on. The provision therefore ensures that the third party has no better rights than the promisee. Applying this section to the insurance scenario, a breach of the duty of disclosure or the duty against misrepresentation by insured X would affect the right of enforcement of third party Y, because the breach relates to the whole contract and is therefore relevant to Y's enforcement right. There is also the ancillary point that the remedy of avoidance applies to the whole contract and if it is exercised, it would affect Y's right. The same would also apply in relation to a breach of warranty by the insured. That is, a breach of a warranty by X would automatically discharge the insurer from liability as from the date of breach, thus preventing Y from exercising its right of enforcement as from that date.

In respect of co-insurance policies, much would depend on the nature of the policy in question. Where the co-insurance policy is a single contract, then any breach of disclosure or misrepresentation by one co-insured ought to invalidate the whole policy. Where the policy is construed as containing separate contracts with each co-insureds, then a breach of the duty of disclosure by one co-insured would not affect the other. In such a situation the insurer cannot rely on s.3(2) to deny the other co-insureds, because the breach of the former is not related to the right of the latter.

Professor Merkin[28], raises the additional point that s.3(2) could in some cases have a detrimental effect to the third party. His point relates to the fact that the sub-section ensures that the third party can have no better right than the promisee so that even in situations where the promisor has a personal defence against the promisee, for example where the promisee is prevented from pursuing the claim by

[28] *Privity of Contract,* Supra. para. 5.100-101, at p.127-8.

reason of laches, the former can rely on this defence against a claim by the third party. Professor Merkin concedes that this point is not clear from the Act, but argues that like the Third Parties (Rights against Insurers) Act 1930, s.3(2) should be construed as not allowing the promisor to rely on personal defences it has against the promisee. This is also the view of the Law Commission which was against the view that 'all restrictions on the promisees's remedies...should carry across to bar or restrict automatically the third party's remedy.'[29] Professor Merkin also makes the additional argument that in applying s.3(2), one has to make a distinction between rights and remedies, and that the promisor only has a defence against the third party where the promisee's right is restricted: [30]

> ...If the promisee cannot claim equitable relief, the right of the third party is unaffected, but if the promisee's right to claim is barred-even though the bar stems from some personal matter affecting the promise...the third party himself is barred.

This argument is persuasive but the issue remains unclear until an interpretation from the courts. It could however be argued that if it is accepted that the purpose behind the sub section is to ensure that the third party has no better rights than a a party to the contract, then breaches which are personal to the promisee and which would not affect the third party if it were a party to the contract, should have no relevance to its claim. The obvious difficulty with this argument is that the sub section expressly refers to defences available if the 'proceedings had been brought by the promisee', suggesting that all defences against the promisee pertaining to the enforcement of the term also applies to the third party. However it could be argued that this could not have been the intention of Parliament as evidenced from the comments of the Law Commission quoted above. It is suggested that the inclusion of the promisee in the sub section should be interpreted to mean 'the promisee in the third party's shoes.' The outcome of this would be that the third party in effect would have no better rights than a party to the contract. The consequence of such

[29] *Supra,* para. 10.2
[30] *Privity of Contract,* supra, para. 5.101, at 128.

an interpretation could be viewed by some as judicial law making, but it is argued that such exercise is necessary in the light of the true purpose behind the sub section.

In accordance with s.3(3), the insurer can also rely on a defence not pertaining to the particular term enforced by the third party, but relating to a breach by the promisee, where there is an express term to this effect. Professor Merkin rightly suggests[31] that this sub section allows 'purely personal defences against the promisor' which, as argued above, might not apply under s.3(2) as binding on a third party. This sub section could also be useful in a co-insurance context. For example, where the composite policy is in fact separate contracts, an express term stating that all the co-insureds are subject to any defence which the insurer may have against each one, would have the effect that a breach of the duty of disclosure or warranty by one would affect all the others because the above term would be incorporated into their respective contracts. Although the consequence of such a term is far reaching, it is not within the exclusive capabilities of the 1999 Act. Even without relying on the 1999 Act, it is quite possible for the parties to the insurance policy to include such a term, which would be binding on all co-insureds. Section 3(2) therefore promotes the concept of freedom of contract as it allows the parties to the contract to determine the limit of the third party's right. The same idea can be found in s.3(5) which allows the parties to the contract to exclude, by an express term, defences that would have been available to the promisor against the third party. Thus in an insurance context, an express term of the policy stating that a breach of the duty of disclosure or warranty by X cannot be relied upon by the insurer in an action by Y would fall under this sub-section and enable the latter to recover in the event of a breach by X of any of the above duties.

[31] *Ibid.* para. 5.102, at 129.

5. SUBROGATION WAIVER CLAUSES

The second part of this chapter discusses the extent of which a third party can rely on a subrogation waiver clause in a contract of insurance. Such clauses in insurance contracts are express undertakings by the insurer that it would not bring a subrogated action against named groups or individuals. The important question however is how third parties to the insurance contract can rely on the clause, given the applicability of the privity rule. The enquiry shall be two-fold. First, the position of the common law prior to the enactment of the 1999 Act shall be discussed. Second, the effect of the 1999 Act shall be considered with the aim of determining how the Act can be relied upon to provide subrogation immunity to the third parties.

5.1 The position at common law

Prior to the enactment of the 1999 Act, the position of the common law was uncertain as a few cases, without reference to the privity doctrine, suggested that a third party could rely on a waiver clause. One of such cases is *Thomas and Co. v Brown.*[32] The case arose as a result of a verbal contract between the claimants and the defendant lightermen, which required the latter to transport goods to a steamship on the River Thames. The claimants were insured against any risk to the goods under a policy, which included a term that the policy was "without recourse to lightermen." Whilst being transported to the steamship, the goods were damaged and the underwriter indemnified the claimant in respect of its loss. It then brought subrogated proceedings against the defendant. Mathew J held that it was common practice for lightermen on the Thames to contract on terms that they shall not be liable for any insurable risks, and held that such term was implied into the contract between the claimant and the defendant. The underwriter having no better rights than the insured claimant could therefore not bring a subrogated action against the defendants. This was obviously sufficient to decide the case, but in his concluding paragraph, Mathew J states a second reason against the underwriters: [33]

[32] (1891) 4 Com. Cas. 186.
[33] At 192.

There is a further difficulty in the way of the underwriters. They are endeavouring to get out of the contract contained in their policy, they have agreed to surrender the right of proceeding against the lightermen, and I cannot understand how they can now come forward and that that right which they have relinquished has been subrogated to them.

It could be argued that the case was decided on the basis of an implied term and that the above forms no part of its *ratio.* The case has however been relied upon as supporting the view that an insurer cannot exercise rights of subrogation against a third party, where its rights against the latter have been excluded by a subrogation waiver clause.[34] This is obviously true where it is the insured that is relying on the clause. The dictum however seems to also suggest that a third party intended to benefit from the clause could also rely on it, and this view has been endorsed outside the English jurisdiction.[35] Charles Mitchell[36] however argues that this would not be right in principle as it would be contrary to the rules of privity. From an English common law point of view, this must surely be right because a third party can generally not rely on a contractual term even where such a term is intended for his or her benefit.[37]

A case which has been argued as applying the privity rule is the judgment of Colman J in the *National Oilwell* case. The case, which has been discussed various times in this thesis, involved a sub-contractor (NOW) who had been hired to provide certain parts for the construction of a floating facility. In the sub-contract the contractor (DOL) was under an obligation to provide insurance for NOW, in respect of each supply up to the date of delivery. The policy taken out by the DOL, contained a subrogation waiver clause, which stated that:

Underwriters agree to waive rights of subrogation against any Assured and any person, company or corporation whose interests are covered by this policy...

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[34] See *Macgillivray,* at para. 22-33, pg. 582 and *The Law of Insurance Contracts,* at para. 31-5, pg. 862.
[35] *Woodside Petroleum Development Pty Ltd v H&R-E & W LTD,* discussed *infra.*
[36] C. Mitchell, "Defences to an Insurer's Subrogated Action" [1996] L.M.C.L.Q. 343, at 351.
[37] *Tweedle v Atkinson* (1861) 1 B & S 393; *Dunlop Pneumatic Tyre Co. ltd v Selfridge & Co. Ltd* [1915] A.C. 847.

Thereafter, DOL incurred losses as a result of defective parts supplied by NOW. The insurer indemnified DOL and sought to bring a subrogated action against NOW, in respect of this loss. One of the arguments made by NOW, was that the subrogated waiver clause protected it against such an action. Colman J held that the subrogation clause could only be relied upon by a party to the policy and, from the construction of the policy, NOW could only rely on it to the extent of its cover i.e. the clause was only effective in relation to pre-delivery losses. It has been argued by some commentators that Colman J's decision was based on an application of the privity rule, i.e. since NOW was only a party to the contract of insurance in respect of pre-delivery losses, it could not rely on the clause in relation to post-delivery losses. This is surely right if what is meant is that Colman J inferred, based on the limited cover provided to NOW, that the parties intended that the waiver clause would only apply to NOW's insured losses. Professor Merkin has however argued that the decision has in effect deprived the clause of all legal effect because: [38]

> If the beneficiary was insured in respect of the loss in question then he was in any event immune from subrogation proceedings, whereas if the beneficiary was not insured in respect of the loss in question then he could not rely upon the subrogation waiver clause even though he was a party to the contract in which it was contained.

The above argument can be faulted on the basis that it assumes that had NOW been insured in respect of post-delivery losses, it would be immune from any subrogation action in respect of such loss, without having to rely on the waiver clause. This is based on a misconception of the pervasive interest doctrine which, has been explained in a previous chapter, assumes that the presence of the interest alone provides the co-insured with subrogation immunity. The presence of the pervasive doctrine is itself not enough to prevent a subrogated action by the insurer because once it has indemnified the co-insured who has suffered the loss, there is nothing to stop it from bringing a subrogated action against the negligent co-insured. It is therefore necessary to imply a term into the contract to give effect to the aim of the doctrine, which includes preventing the insurer from exercising a subrogated right

[38] *Colinvaux & Merkin,* at C-0599, pg. 30,560.

against a co-insured. However, where the parties have already expressed in the policy that the insurer cannot bring a subrogated action against a co-insured, there is no need to imply the above term into the contract, because the express term serves exactly the same function. This is the point made by Colman J, when he states that:[39]

> Given that, if the parties had not inserted an express waiver of subrogation, such a term would have been implied and such a term would have had the effect of a waiver of subrogation only in respect of losses insured for the benefit of the sub-contractor, it is in my view, entirely unsurprising that the parties should have inserted a waiver clause in their policy and that its proper construction should give it an effect exactly equivalent to the term which business efficacy would otherwise require to be implied.

In the light of the above, it therefore seems difficult to accept Professor Merkin's view because where the policy contains a waiver clause, there is no need to imply a term as it is the waiver clause that is relied upon to provide subrogation immunity to the co-insureds.

The privity rule was however not applied by Clarke J in *Enimont Supply SA v Chesapeake Shipping Inc, The Surf City.*[40] The case involved sellers who had insured a cargo that was being shipped on a vessel owned by one of its subsidiaries, to a purchaser. The policy included a subrogation clause which stated that:

> It is agreed that no right of subrogation except through general average, shall lie against any vessel...on which cargo hereby insured is being carried...belonging in part or whole to a subsidiary and/or affiliated company.

The seller assigned the policy to the purchaser, but the cargo was lost as a result of the negligence of the shipowner. The insurer indemnified the purchaser for its loss, and sought to bring a subrogated action against the seller. The issue Clarke J had to decide was whether the clause referred to the purchaser's subsidiary or the seller's. It was conceded by both parties that if the clause was for the benefit of the seller, 'it

[39] At 604.
[40] [1995] 2 Lloyd's Rep. 242.

would not be equitable to allow the subrogated claim to proceed.' Clarke J, held that the clause was intended to protect the seller, and that this protection did not come to an end when the policy was assigned to the purchaser. The effect of *The Surf City* suggests that a waiver could be relied upon by a third party where an action by the insurer would be inequitable. Professor Merkin[41] states that one possible interpretation of *The Surf City* is that the insurers were not prepared to enforce their subrogation rights against the ship-owner, if it was decided that the subrogation waiver clause was for the latter's benefit. He however suggests that there might be an alternative interpretation which is based on a possible underlying assumption in the case that the insurers were 'as a matter of law or equity' precluded from exercising subrogation rights against the ship-owner, on the basis that the latter was an intended beneficiary of the subrogation waiver clause. What Professor Merkin seems to suggest with this interpretation is that in *The Surf City,* subrogation was denied on equitable grounds. The problem with this interpretation is that it does not provide any understanding as to when such equitable grounds would apply, and to this extent it seems arbitrary. Charles Mitchell[42] on the other hand, resolves the case on 'straightforward contractual principles', with the suggestion that it was the insured seller, which was enforcing the waiver clause to protect its wholly owned subsidiary. The facts of the case however suggests otherwise, as it was the seller's wholly owned subsidiary and not the seller that was the defendant to the claim. It is however argued that, in light of the privity doctrine, the better view as to the decision in *The Surf City,* is to adopt Professor Merkin's initial interpretation i.e. that the insurers were not prepared to enforce their rights against the shipowners, if the clause applied to them. The decision should therefore be restricted to the special circumstances of its facts.

Clarke J's decision and Hamilton J's dicta in *Thomas & Co.* have however found support in other jurisdictions. It is necessary to discuss one of such cases, if only to consider the possible options that might have been open to the English courts, had the 1999 Act not been passed.

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[41] *Colinvaux & Merkin,* at C-0600, pg. 30,561.
[42] *Supra., fn.* 36, at 351 in particular *fn.* 43.

5.2 The Approach of the Province of Western Australia: *Woodside Petroleum Development Ltd & ORS v H& R-E & W PTY LTD & ORS*[43]

In the above case, Woodside decided to construct a drilling platform and on this basis entered into contracts with various parties, including HREW for design services for the sub-structure of the platform and DNV for the design verification services for the project. Woodside was insured in relation to the project by an all risks policy, which identified the "principal assured" as Woodside and defined "other assureds" as "contractors and any other Company, Firm...with whom the principal assureds...have, or in the past had, entered into agreement(s) in connection with the subject matter of Insurance..." The policy also contained a subrogation waiver clause which stated that:

> Underwriters agree to waive rights of subrogation against any Assured and any person...whose interests are covered by this Policy...The foregoing shall not apply in respect of operations not connected with the project.

During the construction, certain parts of the installation were damaged, resulting in a remedial cost of over $280 million. The insurers indemnified Woodside up to this amount, and brought a subrogated action against the defendants, which included HREW and DNV. One of the issues that had to be considered was whether the defendants could rely on the waiver clause even though they were not parties to the insurance policy. The argument of the underwriter was that the waiver clause was a benefit under the policy which could only pass to the defendants by a contract between the latter and Woodside. The Supreme Court of Australia rejected this argument and held that the waiver clause did not exclude the insurer's rights that would otherwise exist, but affected the right 'as it were, at their birth.' Ipp J, who gave the only judgment of the court, held that the waiver clause was not a benefit of the insurance policy but 'merely a convenient way of defining and qualifying the rights of subrogation to which, by the policy, the underwriters became entitled.'[44]

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[43] (1999) 20 W.A.R. 380.
[44] at 390.

Thus as long as the defendants were within the categories listed in the clause, they could rely on it.

In reaching the above view, Ipp J relied on a number of authorities, one of which was *Thomas & Co. v Brown.* From a commercial point of view, the decision in *Woodside* has much to offer as it allows insureds to extend their immunity to third parties, who might have a sufficient relationship with the subject matter of insurance. The reasoning employed by Ipp J would however not be successful in the English courts, as it ignores the privity doctrine which is an important principle of English law. From an English point of view, even if the waiver clause defines the subrogation rights of the insurer, the third party can only prove this by relying on the clause itself, which it cannot do as it is not a party to the contract. There is also the additional point made by Charles Mitchell[45] that as the promise of the waiver clause was made by the underwriter to the insured, an insurer can challenge a third party's reliance on the waiver clause on the basis that the insured's consent to the insurer's use of his name in the subrogated action overrides the operation of the waiver clause. The analysis in *Woodside,* could therefore not have been accepted by the English courts.

5.3 The effect of the 1999 Act

The enactment of the 1999 Act has now made it possible for third parties to rely on subrogation waiver clauses. The ability to do so is however subject to the requirements of the Act. In order to rely on such terms, the third party must satisfy either s.1(1) (a), or s.1(1) (b) and s.1(2) of the Act. In accordance with s.1(3) of the Act, the third party must also be expressly identified by name as a member of a class or description. Most third parties relying on a waiver clause would fall under s.1(1) (b) and s.1(2) of the Act, as the clause would be providing a benefit to them and as long as the other terms of the policy do not preclude direct reliance on the waiver clause, such parties would have satisfied the relevant requirements. For example, the ship owners in *The Surf City* would have been able to rely on the 1999 Act, as Clarke J construed the clause as being intended for their benefit. The outcome of the

[45] *Supra. fn.*35, at 352.

case would thus have been no different had the Act been applicable. The same would also apply in the *National Oilwell* case. NOW would be able to rely on the 1999 Act, in relation to the waiver clause, but only in respect of pre-delivery losses. This is contrary to Professor Merkin's view that since the waiver clause and policy itself do not limit NOW's cover, the 1999 Act would operate to allow NOW to have an immunity in respect of post-delivery losses. This statement would be true if the policy itself does not refer to a limited cover for NOW but, as observed in an earlier paragraph[46], the policy did contain a proviso clause the effect of which restricted NOW's cover to pre-delivery losses. In seeking to limit the waiver clause to pre-delivery losses, the insurers would rely on s.1(4) of the 1999 Act which states that the third party's right is subject to and can only be exercised in accordance to other relevant terms of the contract, which in this case would bring the proviso clause into operation. The presence of the proviso clause in the policy therefore raises doubt as to the accuracy of Professor Merkin's view. The third party is also protected from any variation or revocation of the waiver clause, where the requirements of s.2(1) of the Act have been satisfied. This section has already been discussed in relation to a third party's right of enforcement, and it is submitted that the same issues and consequences would apply in this case.

The presence of a subrogation waiver clause intended for the benefit of a third party is one clear way by which the 1999 Act can provide subrogation immunity to such parties. A further question that needs asking is, whether the Act can provide immunity to third parties in situations where the policy does not contain a subrogation waiver clause. Suppose X insures his property against certain risks, and the policy states that in the event of loss or damage to the property, Y a third party should be paid the required amount to compensate for the loss. In the event of such loss, Y should able to rely on the 1999 Act to enforce the term. However, suppose Y negligently causes damage to the insured property, should it be allowed to enforce this right? If he is, can the insurer bring a subrogated action against him to recover this payment?

[46] Pg.146-8 of this thesis.

In relation to the first question, it is argued that there is no reason preventing Y from enforcing his rights even if he is responsible for the loss. This is because the policy covers specified risks to the subject matter and once these risks have occurred, it should not matter that it was caused by Y. This is obviously subject to one exception, which is when Y deliberately causes the loss. If Y were allowed to enforce the term in such a situation, it would be benefiting from its own wrong, and the courts should prevent it from enforcing the term based on this policy reasoning.[47]

In relation to the second question, it is argued that the way to resolve this issue is by construction of the insurance contract. If it is accepted that third parties can recover for their negligent losses and that this is, from the construction of the contract, the intentions of the parties, then the possibility of a subrogated action by the insurer against such third parties would contradict this intention. Thus, in the absence of an express contrary term, it would be reasonable to infer that the parties also intended that the insurer would not be able to bring a subrogated action against the third party. The insured might also have entered into a separate contract with the third party, which might contain a clause excluding liability to the latter in the event of his causing loss or damage to the property.[48] Such a term would also affect the right of the insurer.[49] In the absence of such an arrangement, the intention of the parties must have been that the insurer cannot bring an action against the third party, and in order to give effect to this intention, a term to this effect should be implied into the insurance contract based on the unexpressed intentions of the parties.

The conclusion might however be different if the facts were varied. Suppose X insures not his property but Y's property for the latter's benefit, and the terms of the contract state that Y has a right of indemnity in the event of a loss. In such

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[47] The deliberate act by Y would constitute criminal damage (see s.1 (1) of the Criminal Damage Act 1971), and the courts would prevent Y from profiting from this crime. See, *Re Crippen* [1911] P. 108, and the House of Lords decision in *Beresford v Royal Insurance Company Ltd* [1938] A.C. 586, in which the public policy doctrine is discussed.

[48] Such an exclusion clause might, depending on the exact facts, be subject to the requirements of the Unfair Contracts Terms Act 1977, and possibly the Unfair Terms in Consumer Contracts Regulations 1999, if the contract is between a seller and a consumer.

[49] See, for example, *Mark Rowlands Ltd v Berni Inns Ltd* [1986] Q.B. 211, discussed in the next chapter, at pg. 193. However, the tenancy agreement in that case did not contain an express exclusion clause.

circumstance, if X were responsible for the loss, can the insurer bring a subrogated action against it? Unlike the first example, X has no relationship to the subject matter or to Y, other than in his capacity as agent. The policy therefore does not provide any benefit to it and on this basis it seems unlikely that the courts would imply a term into the contract that the insurer cannot exercise a subrogated right against it. The only way X can have immunity is if X and Y have entered into a separate contract the effect of which excludes Y's right against X, where the latter has been responsible for the loss. However where the nature of the insurance is one in which there is clear intention that the policy should also benefit X, the latter should have immunity. For example, where X is a company, which takes out a policy of insurance to cover medical expenses of its employees arising out of injury in the work place, the intention of such a policy must be, not only to provide financial assistance to its employees, but also to protect X from incurring medical expenses when it is responsible for the injuries. It is therefore a clear example of where, from the construction of the policy as a whole, it must have been intended that in the event of such expenses arising X shall look to the insurer to compensate the employees. It would therefore be necessary for the courts to imply a term into the contract to give effect to this intention.

6. Conclusion

The Contracts Act 1999 by creating a statutory exception to the doctrine of privity, allows third parties to directly enforce benefits under an insurance contract. The benefits in this case are the right of indemnity and subrogation immunity. The ability of the 1999 Act to extend these benefits to third parties, would no doubt improve the flexibility of commercial practice in responding to the demands of interested parties to an insurance contract. It might be assumed that since the Act allows third parties to enforce contractual terms, the role of co-insurance policies would be diminished. This is however unlikely for the singular reason that co-insurance contracts cater for the insurance of multiple parties, which cannot be catered for in any other way. Thus, where X and Y have separate interests in the

same subject matter, the only kind of policy that will cover both their interests is a co-insurance policy. The Act would nonetheless have a role to play in relation to such contracts. This is because it allows co-insured third parties to enforce contractual terms of the policy without having to satisfy the privity doctrine. This is a major benefit to such co-insureds as it avoids the agency principles which would normally have to be proved. In practical terms, the influence of the 1999 Act would be most evident in relation to subrogation immunity. Such immunity, through subrogation waiver clauses, would no longer be the preserve of co-insureds, and can now be extended to interested third parties.

Chapter VIII

ALTERNATIVE MEANS AVAILABLE TO THIRD PARTIES.

1. Introduction

This chapter discusses alternative means, in the absence of being a co-insured or relying on the 1999 Contracts Act, by which a third party could be provided with the twin benefits under an insurance policy. Three different means shall be discussed, with a view to determining the extent of which each is able to provide the third party with the twin benefits of indemnity and subrogation immunity. The first shall be policies which have been effected for the benefit of the insured but which also enure to the benefit of third parties. The second shall discuss the possibility of the third party as a trust beneficiary of the insurance policy. Finally, the practice of 'noting' the interests of third parties in the policy shall be discussed with a view to determining whether this act provides the party with a right to the insurance proceeds, or more importantly subrogation immunity.

2. Policies enuring to the benefit of third parties

It has generally been accepted that insureds with a limited interest in the subject matter can take out an insurance policy protecting against loss to their interest and the interests of other parties.[1] It is on such policies that this section shall focus on. In particular the focus shall be on two types of relationships in which parties have limited interests in the same subject matter. These are: (1.) Cases on bailment; and (2.) Landlord and tenant relationships.

[1] See *MacGillivray*, at para. 1-160-1-188, pg. 75-87; *Castellain v Preston* (1883) 11 Q.B.D. 380, per Bowen LJ, 398; *Mark Rowlands Ltd v Berni Inns Ltd.* [1986] Q.B. 211, per Kerr LJ at 226.

3. The bailment cases

When a party has been entrusted with goods belonging to another, the position of the law has been that such party can take out property insurance, protecting its interest in the goods, and that of the owner. In the case of *Waters v The Monarch Life Assurance Co.,*[2] the claimant wharfingers, took out two policies of insurance which both covered damage by fire to, amongst other things, goods in their warehouses and also "goods in trust or on commission therein." A fire occurred in one of the warehouses which destroyed goods belonging to the claimants and those belonging to other parties. The claimants sought to recover from the underwriters losses to its property and those belonging to its customers. The underwriters argued that the claimants could recover the full value of the goods belonging to them, because they are had an insurable interest up to this value. In respect of the goods belonging to its customers, the insurers argued that the insurable interest of the claimants was only to the extent of a lien on the goods for charges incurred in warehousing the goods, and they could not recover beyond this amount as they would be over-indemnified. All three judges of the court held in favour of the claimant. Lord Campbell CJ, in particular, held that the phrase, 'goods in trust' were appropriate to cover goods belonging to the customers, and that the policy wordings indicated an intention not only to cover the claimant's personal interest in the goods, but also those of the owners. He further held that the claimants could insure against loss to the owners' interests, on the basis that 'it would be most inconvenient in business if a wharfinger could not, at his own cost, keep up a floating policy for the benefit of all who might become his customers.'[3] Upon recovery of the monies, the claimant, after deducting an amount in respect of its personal interest, was to hold the remaining on trust for the owners. This was necessary not only because the remainder represented the interests of the owners, but also because any retention of the remainder by the claimant would offend the principle of indemnity which the contract was subject to.

An important issue from the above case is the distinction between the claimant's personal interest and its insurable interest in the subject matter of

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[2] (1856) 5 E. & B. 870.
[3] *Ibid.,* at 881.

insurance. A bailee's personal interest in the property is its unpaid charges for its services which constitute a lien over the property, while its insurable interest, extends beyond this to the whole property because of the commercial convenience of having the bailee insure for the benefit of all with a proprietary interest in the property. This commercial convenience was explained by Wightman J in the subsequent case of *The London and North Western Railway Co. v Glyn.*[4] The facts of the case were similar to *Waters*, as the claimants were common carriers who had taken out insurance for their goods and those held 'in trust or on commission', both of which were held in a warehouse. A fire destroyed the warehouse and the goods in it, and the claimants sought to recover loss to the goods in the warehouse. Relying on *Waters*, the Court of Common Pleas held that as long as the goods not belonging to the claimants were insured, and the policy was against damage to property, the claimants could recover for the benefit of its customers. Wightman J elaborated on the commercial convenience of recognising a full insurable interest in the claimant on the basis that[5]:

> If a different construction was put on such a policy as this, it would be necessary, as my brother Crompton has observed, that several policies should be effected on the same goods, and thus insurance companies would obtain several premiums instead of one in respect of what, to them, is the same risk.

The rationale for recognising such an interest is therefore the need to prevent the multiplicity of insurance in relation to the same risk. The rationale however relates to the same risk in the same property, therefore the insured can only have an interest in the whole property, only when it also has a limited interest in it.[6] Thus, in the Court of Appeal decision of *Tomlinson v Hepburn*[7], Pearson LJ[8], in explaining the reasoning in the cases, states that 'there were two persons, bailor and bailee, having

[4] (1859) 1 E. & E. 652.
[5] At 661.
[6] The above cases were used to support the pervasive interest doctrine in the *Commonwealth* case, discussed in chapter II pg. 12, even though the insured in that case, did not have a limited legal or equitable interest in the whole subject matter of the insurance.
[7] *A. Tomlinson v Hepburn Ltd* [1965] 2 W.L.R. 634.
[8] At 650.

concurrent interests *in the same goods,* so that it would be reasonable and economical for one of them to insure for the benefit of both.'[9]

3.1 When does the principle apply?

Since the insured has a limited interest in the property, there is the difficulty of determining when the policy is only protecting its limited interest and when it protects that and the interest of the bailor. The sole determining factor is the intentions of the parties as construed from the terms of the contract. This was the approach taken by the House of Lords in *Tomlinson v Hepburn.*[10] In that case, the claimants were road hauliers who contracted to transport goods belonging to third parties. Under the contract, the claimants were under an obligation to take out insurance against loss to the property, which they did. During the period of cover, the goods were stolen in circumstances in which the claimants were not liable to the third party owners. The claimants sought to recover under the insurance policy for the benefit of the third party, and the insurers resisted this arguing that the policy was not on goods and, even if it was, the insured could only recover to the extent of its personal loss which in this case it did not have. The House of Lords held that whether or not the policy was one to protect property or liability depended on the terms of the policy. The policy in question was a Lloyd's J policy and the fact that it was titled "Goods in Transit" policy was said to be neutral and consistent with either a goods or liability policy.[11] What was however decisive were the typewritten conditions in the policy which were held to be more appropriate for property insurance. On this basis the courts interpreted the policy as insuring not just the limited interest of the hauliers, but also the interests of the owners. The reason for this construction in favour of protecting the third party seems to be based on the fact that if the parties really intended to cover only the limited interests of the insured,

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[9] Emphasis added. In the appeal to the House of Lords, [1966] AC 451, Lord Pearce (at 480) also refers to the limited interest of the assured, when he states that 'Both those who have the legal title and those who have a right to possession have an insurable interest in the real or personal property in question.'' Also see *Macgillivray,* at 1-173, pg. 82. However, in *Petrofina v Magnaload* (discussed in chapter II and VI of this thesis) Lloyd J extended the principle to insureds in construction projects not having a limited interest in the whole of the subject matter insured.
[10] [1966] A.C. 451.
[11] Per Lord Reid, at 468.

the insurer could easily have expressed it in the terms of the policy.[12] The Court also laid to rest the view that the insured must also show evidence of its subjective intention to cover interests other than its own. The Court was of the view that this was contrary to 'the fundamental principle that the construction of a contract cannot be governed by the intention or belief of one of the parties not communicated to the other.'[13] This requirement seemed to have originated from a dictum of Bowen LJ in *Castellain v Preston*[14], in which the latter stated that two requirements were necessary for an insured with a limited interest to insure on behalf of other parties with an interest in the subject matter. The first was that the policy must have intended this, while the second was that the insured must have intended, at the time, to insure the whole value of the subject matter. What is curious about these requirements is that the fulfillment of the first renders the second superfluous, i.e. if the terms of the policy indicate that the parties intended to insure the full value of the property, why would it be necessary to prove that the insured intended to?

In *Tomlinson*, the House of Lords, interpreted Bowen LJ's dicta as not overruling the primacy of the policy terms in determining the intentions of the parties, but rather as suggesting that if the insurer could prove that the insured did not intend to insure on behalf of the third party, the policy in relation to the interest of the third party would be a wagering contract and therefore unenforceable.[15] It is the view of this author that this interpretation is right. The terms of the policy must determine whether or not the insured is insuring to protect the interest of third parties with limited interests and his unilateral intention can only be relevant if the insurer can prove that the insured never had the intention to benefit the third party.

The exact wording that would extend protection to the whole subject matter of the insurance varies. In cases like *Waters,* the fact that the policy covered 'goods in trust or on commission' was held to be sufficiently clear to cover the interests of the owners. *Tomlinson*, however suggests that if the policy wording is able to cover the whole subject matter, in the interest of the commercial advantage of such

[12] Per Lord Pearce, at 475.
[13] Per Lord Reid, at 469, Lord Hodson at 473 and Lord Pearce at 481-2.
[14] (1883) 11 Q.B.D. 380, 398.
[15] See in particular, Lord Hodson at 472 and 478, Lord Pearce at 481, and to a lesser extent Lord Reid at 469.

construction, the policy would be construed as covering the full proprietary interest of the goods. This construction is however subject to the terms of the contract. In *North British and Mercantile Insurance Co. v Moffat*[16], The defendant wholesale tea merchants, purchased certain chests of tea, which they stored in a warehouse. The chests were insured against loss under policies of insurance which covered 'merchandise...the assured's own, in trust or on commission for which they are responsible for or on all or any of the warehouses...' A fire occurred in the warehouse, destroying some of the chests of tea and the insurers paid out an amount equal to the value of the chests to the defendant. However, the insurers discovered that prior to the fire, the defendant had sold the goods to a third party, and brought an action to recover the money on the basis that the policy did not cover them at the time of the loss. The Court of Common Pleas held that the phrase in the policy, 'for which they are responsible for..' restricted the goods covered under the policy to those which the defendants were responsible for at the time of the loss, and once the chests were sold to the third party, the risk to the chests had passed on the third party, thus making the defendant no longer responsible for the goods. More importantly the court held that the above phrase indicated that the parties intended to cover only the limited interests of the defendants, and that the policy did not extend to the interests of other parties in the goods.[17]

3.2 The Right of the third party.

An important inquiry is to determine whether a third party in the above scenario has a right to enforce a policy which the insured has entered into partly for his benefit. The enquiry shall focus on two time periods. First, the right of the third party prior to the enactment of the 1999 Contracts (Rights of third parties) Act 1999 shall be determined. Secondly the effect of the Act on such right shall be analysed.

[16] (1871) L.R. 7 C.P. 25.

[17] The above case can be compared with the Scottish case of *Cochrane v Leckie's Trustee* (1906) 8 F. (Ct. of Sess.) 975 in which Lord Kyllachy, at 981 was of the opinion that a policy which covered 'stock in trade held by him in trust for which he is responsible' could be construed as an insurance covering the risk of both the insured and other parties with an interest in the goods.

3.3 The right of the third party prior to the 1999 Contracts Act

The common law position has always been that the third party cannot bring a direct claim against the insurer because he is not privy to the contract of insurance, even though the policy has been effected to partly protect its interest. This issue was touched upon by Hobhouse LJ in *D.G. Finance Ltd v Scott*[18]. This case involved a hire purchase agreement in which the claimants had purchased and hired a new trailer to the first defendants for a period of five years. Under the hire purchase agreement, the first defendant was under an obligation to take out comprehensive insurance for the vehicle in addition to other obligations relating to the insurance. The defendant in fact effected a cover which was inconsistent with his obligations under the agreement. The vehicle was subsequently stolen and the defendant was declared bankrupt. The claimants therefore sought to bring a direct claim against the insurers. One of the issues discussed by the Court of Appeal was the nature of the claimant's relationship to the insurance contract. Hobhouse LJ giving the judgment of the court, and relying on the case of *Tomlinson*, held that the policy was a policy on goods and that upon loss Mr. Scott was entitled to be paid the full insured value of the trailer. However, upon receiving the payment and deducting an amount equivalent to his interest, Mr. Scott was under an obligation to account the balance to the claimants. He further held that the liability of the insurance company was to Mr. Scott alone and that the principle did not give the claimants any direct rights against the insurance company. The claimants' right was only against Mr. Scott in respect of his recovery from the insurance company.

The above decision clearly suggests that the third party cannot have a direct right of action against the insurer. Attempts to avoid this problem have resulted in some judges interpreting such policies as one in which the insured enters into the policy to protect his interest and also as an agent for an unnamed principal. For example, in *Re King*[19], Diplock LJ was of the view that in such policies:[20]

[18] [1999] Lloyd's Rep. I. R. 387.
[19] [1963] Ch. 459.
[20] At 499.

...the bailee insures the bailor's proprietary interest in the goods as agent for the bailor as his unnamed principal, and even if he is under no contractual liability to his bailor to do so, the contract can be ratified by the bailor though he was unaware of it at the time at which it was entered into.

The advantage with this analysis is that the third party is effectively a party to the insurance contract and therefore has a direct right of action against the insurer. This interpretation was however not followed by the House of Lords in *Hepburn v Tomlinson*, in which their Lordships chose to recognise in the insured, a full insurable interest in the goods insured. This very much suggests that the interpretation in *Re King* is no longer valid.[21]

3.4 The right of the third party against the insured

It is clear that the bailor has a right of action against the insured once the latter has received the policy proceeds. In *Sidaways v Todd*[22], the claimant, in an action for money had and received, recovered from the defendant wharfingers, policy proceeds which were paid to the latter as a result of the loss of goods belonging to the claimant, which the defendant as bailees had insured against loss. It is however not clear whether the bailee has a right to compel the insured to recover from the insurer in the event that the latter decides not to. The fact that the policy is intended to protect the interests of the bailor, is a strong argument to suggest that the bailor should be able to compel the bailee to recover on its behalf but this argument alone, without any valid legal principle, would be unable to provide the bailor with such right. One such legal principle that would have provided this right is by recognising the existence of a trust relationship between the bailee and the bailor. Thus, the bailee in entering into the insurance contract would be insuring to protect its interest and also as a trustee of the bailor to protect the latter's interest. The consequence of this analysis would be that the bailor as beneficiary of the trust could sue the insurer, joining the bailee as a defendant to the action. The trust analysis also seems to be consistent with some of the dicta in earlier cases. For example, in *London and*

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[21] This is also the view of Hobhouse LJ in *D.G. Finance,* at 392. However see the comments of Lisa Martine Bowyer in 'Contracts (Rights of third parties) Bill and Insurance', [1997] J.B.L., 230 at 233.
[22] (1818) 2 Stark. 400.

North Western Railway Co., Wightman J[23] refers to the insurance as 'in the nature of a voluntary trust undertaken by the plaintiffs without the knowledge of the cestuis que trust, the owners of the goods.' This analysis was however not followed by Harman J in *Re E Dibbens.*[24]

The case arose as a result of the voluntary winding up of E. Dibbens & Sons, which prior to the liquidation was in the business of storing furniture for third parties in various warehouses. Some of the parties specifically requested that the company take out an insurance policy to protect their property, whilst others did not. The company took out a policy protecting all the furniture against specified risks. One of the company's warehouses was destroyed by fire resulting in the company going into liquidation. The insurance company paid out money in respect of the furniture destroyed by fire and the liquidator sought the determination of the court on the manner in which it was to distribute the money paid. The issue faced by the court was essentially whether the owners of the lost furniture had a proprietary claim over the money.

Harman J in determining the relationship between the bailee and bailor was of the view that the old cases using the trust language were far from conclusive in suggesting that the parties had created a trust in the technical sense of the word. In particular he refers to a passage in *Waters*, in which Lord Campbell CJ states that the phrase, 'goods in trust' in the policy did not mean that the goods were trust property, in the technical sense, but meant 'goods with which the assured were entrusted.'[25] Harman J was also of the view that imposing a trust relationship on the parties would create the inevitable difficulties of establishing the three certainties necessary for the establishment of a trust. There was also the additional point that the bailee by virtue of being a trustee would be required to perform onerous duties which would be inappropriate to the reality of the relationship between the parties. This latter point is very persuasive, because the bailee in taking out insurance to protect the interest of the bailor, intends to do no more than that, and he or she would find it surprising if upon concluding such insurance, they were now treated as

[23] (1859) E. & E. 652, at 661. Also see the comments of Crompton J, at 663.
[24] [1990] B.C.L.C. 577.
[25] At 579.

a trustee with the onerous responsibilities of that position. In light of the above, it is suggested that the bailee cannot be a trustee of the bailor, and the better view would seem to be that the latter's rights against the bailee only arises when the bailee has recovered the money. Prior to this, the bailor has no right to compel the bailee to recover the proceeds from the insurer.[26] If however the bailee has contracted with the bailee to take out insurance for the latter's benefit, a refusal to recover the insurance monies would amount to a breach of contract, resulting in damages to protect the expectation interest of the bailor.

3.5 The bailor's proprietary interest in the policy proceeds.

In *Re E Dibbens*, Harman J was of the view that rather than imposing a trust relationship on the parties, the better view was to recognise a fiduciary relationship, where it was relevant. In his view, the customers who had requested and paid for insurance of their furniture were owed a fiduciary obligation by the bailee to take out insurance on their behalf and this in turned entitled them to a proprietary interest in the policy proceeds. Where the customers had not requested for insurance, they had only contracted for their furniture to be stored and in the event of such loss, no fiduciary obligation could arise to give them priority to the policy proceeds over the other creditors. They were in effect unsecured creditors.[27]

In *Re Dibbens*, the recognition of a fiduciary duty seems to be restricted to situations in which the bailor has requested and paid an additional amount in respect of the insurance. Does this mean that in situations in which the bailee is contractually obliged to take out insurance and the bailor is not charged a separate amount in respect of the insurance, the latter is not owed a fiduciary obligation? If an affirmative answer is given, it would be an unnecessary narrow interpretation of the case. A fiduciary obligation ought to exist as long as the bailee is contractually

[26] Hobhouse LJ in *D.G. Finance*, at 392, quoting Lord Diplock in *The Albazero* [1977] A.C. 774, 845

[27] Compare the above with the Scottish case of *Cochran v Leckie's Trustee*(1906) 8 F. (Ct. of Sess.) 975, in which the bailor had priority over the general creditors to the policy proceeds. In the case, the Court upheld the decision of the Sheriff that the bailee had undertaken to the bailor to take out insurance for its benefit. This, consistent with *Re Dibbens*, is sufficient to establish a proprietary interest in the proceeds, but this was not the basis of the Court's decision. Lord Kyllachy , at 981, focused on the fact that the insurer paid out the money on the understanding that the proceeds was to be paid to the insurer. In *Re Dibbens*, Harman J distinguished the case on the basis that the laws of trusts in both jurisdictions were different.

obliged to protect the interest of the bailor, and there seems no reason why it must be necessary that the bailor has to agree to pay a separate amount for insurance.

In light of the above cases, the bailor's right to the policy proceeds is restricted to an action against the bailee once the latter has recovered from the insurer, and the bailor would only have a proprietary interest in such proceeds where it has paid for the insurance or at the very least, the bailee has contractually agreed to take out insurance for his benefit. In the absence of such circumstances, the bailor only has a personal right of action against the bailee.

3.6 The effect of the Contracts Act 1999

With the enactment of the 1999 Act, a bailor might now be able to bring a direct right of action against the insurer, as long as the requirements of the Act are satisfied. It is therefore necessary to consider these requirements. Section 1(1) (a) of the Act would only be applicable if the policy expressly states that the bailor can bring a direct right of action against the insurer. Thus the section would rarely apply to such policies as the bailor is never expressed as having a right to enforce the term. However given that the 1999 Act now allows it, it is no longer inconceivable to expect such terms in policies entered into by the bailee. In the absence of an express term, the bailor can only have a right if it satisfies the requirement of s.1(1)(b) and s.1(2). The former section would easily be satisfied, because by insuring beyond the limited interest of the bailee, the parties must have intended to confer a benefit upon the bailor. As mentioned in a prior chapter on the 1999 Act, once the third party satisfies s.1(1)(b), there is a presumption in favour of his right, which can be rebutted if it can be shown from the terms of the contract that it was not the intention of the parties that the third party would have this right. An example of such an intention can be found in the policy in *D.G. Finance,* which included a term to the effect that:

> If to the knowledge of the Company [Eagle Star] the insured vehicle is the subject of a hire purchase or leasing agreement, any payment for damage to or loss of the insured vehicle which is not made good by repair, re-instatement or replacement may at the discretion of the Company be made to the owner whose receipt shall be a full discharge of the Company's liability.

The fact that the insurer had the discretion as to whether to pay the bailor in that case clearly indicates that the parties did not intend that the policy should be enforceable by the bailor.[28] In the absence of terms indicating such an intention, the requirements of s.1(1) (b) would be satisfied.

A potential obstacle to the bailor enforcing the policy is s.1(3) of the Act which requires the third party to be expressly identified in the contract. Thus, where the policy makes no mention of the bailor, the latter cannot rely on the Act. This point is very important because in some cases in which the bailee insures on behalf of the bailor, the latter is not mentioned in the policy. For example, in *London and North Western Railway Company*, the relevant condition of the policy stated that 'Goods held in trust, or in commission, are to be insured as such otherwise the policy will not extend to cover such property.' This term on its own would not satisfy s.1(3), even though it is quite clear from the term that the bailee is also insuring for the benefit of the bailor. Had the clause stated that 'goods held in trust, or in commission, for the benefit of customers/clients/merchants, are to be insured as such...', then the section would be satisfied and the bailor would have a right as long as it could be classified as any of the groups specified in the clause.

A bailor who can rely on the 1999 Act has a direct right of action against the insurer in the event of loss or damage to the goods on bail. In contrast to a bailor who has no such right, the former is in a more favourable position. He is not dependent on the bailee recovering first from the insurer, as he can recover directly from the insurer once a loss has arisen. Secondly, and in the light of *Re Dibbens*, such a bailor can avoid being an unsecured creditor of the bailee, by recovering directly from the insurer before the total proceeds is paid to the liquidator.

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[28] As suggested by Lisa Martine Bowyer, *Supra fn.*21, at 237.

4. The insurance of real property

The rule in *Waters* is also applicable to other relationships in which a party has a limited interest in the subject matter of the insurance. In *Tomlinson,* Lord Pearce held that , 'a bailee or mortgagee, therefore (or others in analogous positions) has by virtue of his position and his interest in the property, a right to insure for the whole of its value, holding in trust for the owner or mortgagor the amount attributable to their interest.'[29] The extension of the principle to such cases must surely be right by virtue of the reason behind the principle. For example, by allowing the mortgagee to take out insurance for the benefit of the mortgagor, multiple insurances on the same risk would be avoided. In such a situation the rights of the mortgagor would be the same as those of the bailor, discussed in the previous section. In light of the above, it could also be suggested that the principle ought to apply in landlord and tenant cases. Although the case law allows one party to insure the premises for the benefit of himself and the other, it is unclear whether this is based on the principle in the bailment cases. It is therefore necessary to consider the relevant cases on this relationship. Before proceeding on this analysis, it is necessary to briefly discuss the possible relevance of the Life Assurance Act 1774 to the insurance of real property.

4.1 The Life Assurance Act 1774

A major obstacle to the insurance of real property enuring to the benefit of a third party is the Life Assurance Act 1774. Section 2 of the Act requires that it shall be unlawful to make any policy 'on the life of lives of any person or persons, or other event or events, without inserting in such policy or policies the person or persons name or names inserted therein, or for whose use, benefit, or on whose account such policy is so made or underwrote.' Despite the fact that the short title of the Act, suggests that the Act applies only to life insurance[30], it is uncertain whether its application extends to the insurance of real property. In *Re King*[31], Lord Denning MR, in a dissenting judgment, was of the view that the reference in the section to the

[29] At 481.
[30] In *Birds Modern Insurance Law*, the authors, at pg. 49, however raise the point that the short title of the Act was only added a century after the Act was passed, thus the title might not be indicative of the extent of the application of the Act.
[31] [1963] Ch. 459, at 485.

insurance of 'other events' other than life, extended to the insurance of real property. This interpretation is given greater weight in the light of the fact that s.4 of the Act specifically excludes the insurance on 'ships, goods and merchandises.' The express exclusion of the above insurances implicitly suggests that the Act extends to non-life policies other than those excluded, the consequence of which would include the insurance of real property within the purview of the Act. The practical effect of this would be that a named insured with an interest in the property would be prohibited from effecting a policy enuring to the benefit of another party also having an interest in the property, where that party was not named in the policy. Additionally, in the event of loss or damage to the property, s.3 of the Act prevents an insured from recovering an indemnity beyond the value of his interest. The insured would therefore be prevented from recovering an indemnity for the benefit of another party.

The above interpretation of the Act was however rejected in the case of *Mark Rowlands v Berni Inns Ltd.*[32] The case involved the landlords of a freehold taking out an insurance policy protecting the property against loss of damage by fire. The lease imposed an obligation on the tenant to pay an insurance rent equivalent to the premium charged for the insurance. The tenant negligently caused the property to be damaged by fire and upon indemnifying the landlord the insurer brought a subrogated action against the tenant. The tenant's argued that although it was not named in the policy, the landlord had also taken out the policy for its benefit and therefore a subrogated action against it was not possible. One of the points raised by the insurers to contest this defence was that such policy benefiting both the landlord and tenant was in conflict with s.2 of the 1774 Act, since the tenant was not referred to in the policy. The Court of Appeal held that the Act did not apply to indemnity policies. This decision was not supported by any analysis nor did it try to address the meaning of 'the insurance of other events' which the Act refers to. In this respect, the decision could be seen as a policy motivated one, with the aim being to

[32] [1986] Q.B. 211

avoid the practical consequences of the Act applying to real property.[33] The decision has however been approved by the Privy Council in *Siu Yiu Kwan v Eastern Insurance Co. Ltd*[34]. In light of these decisions, it seems that the position of the courts is that the Act does not apply to insurance on real property, where such insurance is one of indemnity.[35]

4.2 Landlord and tenant cases

A landlord has an insurable interest in the premises by virtue of its right of reversion. The very fact that the premises reverts to him after a tenancy, gives the landlord an insurable interest up to the full value of the property. He might also have an insurable interest by virtue of its obligation under the lease. For example where, in the event of damages to the property, he is under an obligation to reinstate the landlord has an insurable up to the full reinstatement cost.[36] The insurable interest of the tenant is the amount sufficient to compensate him for the loss of his legal estate. This interest is however not restricted to the market value of his legal estate, because in the event of loss to its interest, the tenant loses more than the pecuniary value of his interest, but also 'the beneficial enjoyment' which he derives from living in the house.[37] It has therefore been suggested that the tenant can insure the premises for its full value by virtue of his possession of the property. A tenant may also have an insurable interest by reason of its liability under the lease. Thus, where the tenant is under an obligation to insure or repair the premises, it has an insurable interest up to that amount required.

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[33] In some cases, the possible application of the Act to the insurance of real property has been ignored. In particular, *Mumford Hotel v Wheeler* [1964] Ch. 117 and *Lonsdale & Thompson Ltd v Black Arrow Group plc* [1993] Ch. 361.

[34] [1994] 1 All E.R. 213.

[35] An alternative interpretation of the Act has been suggested in the Australian case of *Davjoyda Estates Ltd v National Insurance Co. of New Zealand* (1967) 69 S.R. (N.S.W.) 381. Manning J, at 426-8, was of the view that s.2 of the Act was intended as a supplementary provision to the preceding section. Since s. 1 was intended to strike down gaming and wagering contracts, by requiring the assured to have an insurable interest at the time the contract was concluded, Manning J interpreted s.2 as only applying to situations in which the person effecting the insurance had no insurable interest in the property and was only contracting on behalf of another party. Thus if the insured had an interest, satisfying the requirement of s.1, there was no need to satisfy the requirements of s.2 by naming other parties interested in the policy.

[36] *Londsdale Ltd v Black Arrow Plc.* [1993] Ch. 361, at 368.

[37] *Castellain v Preston* (1883) 11 Q.B.D. 380, per Bowen LJ, at 400.

The fact that a tenant or landlord can normally insure the premises for its full value makes it unnecessary to apply the commercial reasoning applicable in the bailee cases. Therefore, rather than focus on whether the insured can insure for the full value of the property, the cases focus on whether, in insuring for the full value, the insured intended to benefit the third party. The focus is therefore, as to the obligations of the insured to the third party and in order to determine this, the terms of the leasehold between the parties have to be construed to ascertain the aim of the insured in effecting the insurance policy. In *Lonsdale Ltd v Black Arrow Plc*[38], landlords leased a warehouse to the claimants for 25years. In the lease, the landlord covenanted to insure the premises for a sum not less than the reinstatement value of the premises. The claimants were to pay an additional amount corresponding to the premium and where the premises were damaged by an insurable risk, the moneys paid by the insurer were to be used in rebuilding the premises. During the tenure of the lease, the landlord contracted to sell his freehold subject to the lease in favour of the claimants. However, prior to the completion of the contract, the warehouse was damaged by fire, which was an insured risk under the policy of insurance. The sale was eventually concluded and the landlord was paid the full value of the freehold without regard to the fire damage. The tenant thereafter served a notice, in accordance with s.83 of the Fire Prevention (Metropolis) Act 1774, to the insurers requesting the latter to lay out the policy proceeds for the reinstatement of the damaged property. The insurers refused to do this on the basis that the landlords were already indemnified for their loss by the sale of the freehold for its full value and therefore the insurers were not liable.

Jonathan Sumption QC held that by virtue of its obligation to insure, the landlord had an insurable interest in the property up to its reinstatement value, and that this did not offend the principle of indemnity because the landlord was under an obligation to use the proceeds for the reinstatement of the property. The policy of insurance, by virtue of the landlord's obligation was therefore for the benefit of both the landlord and its tenant and although the landlord had sold its freehold, the insurers were still liable to lay the proceeds for the reinstatement of the property for

[38] [1993] Ch. 361.

the benefit of the tenant. The intention to benefit the tenant might also be construed from the tenant's obligation to pay the premium for the insurance. For example, in *Mark Rowlands v Berni Inns*, the Court of Appeal held that from the terms of the lease, which included, inter alia, an obligation on the tenant to pay a yearly insurance rent, the intention of the parties was that the insurance would also benefit the tenant.[39]

The fact that in the landlord and tenant cases, the courts focus on the terms of the lease and not the policy in determining whether the policy benefits the tenant, in no way conflicts with the rule of construction enforced in *Hepburn,* that the focus should be on the policy in determining whether or not a policy covers beyond the interest of the insured. This is because with the landlord and tenant cases the issue is not whether the insured can insure the full value of the property, but whether the tenant has any entitlement to the benefit of the policy. In determining this, the relevant contractual document should be the lease which, through its terms, is evidence of the intentions of the landlord and tenant.

4.3 The Right of the Third party

Where the landlord takes out an insurance policy for the benefit of himself and the tenant and in the event of damage to the property, the tenant can compel the insured to use the policy proceeds for the reinstatement of the property. This is the effect of the decision of Harman LJ in *Mumford Hotels Ltd v Wheeler.*[40] In that case, the defendant leased property to the claimant for a fixed number of years. In the lease, the tenant covenanted, to pay a yearly insurance rent equal to the premium for keeping the property insured whilst the landlord covenanted to keep the property adequately insured against comprehensive risks. A fire subsequently damaged the property and as a result of this, the insurers paid out money to the landlords. The tenant thereafter brought an action against the landlords seeking, inter alia, a declaration that the landlords were bound to expend the insurance moneys in the reinstatement of the property. Harman L.J. construed the tenant's obligation to pay

[39] Also see the case of *Mumford v Wheeler* [1964] Ch. 117, discussed *Infra.*
[40] [1964] Ch. 117.

the premium and the landlord's obligation to take out adequate insurance as indicating an intention to take out a policy enuring to the benefit of both parties. The consequence of this was that the landlords, upon recovering the policy proceeds could not claim it as their own, but were under an obligation to expend it in reinstating the property if called upon by the tenant to do so. The tenant in effect had a right to compel the insured to use the money for reinstatement.

4.4 The Third party's right under s.83 of the Fires Prevention (Metropolis) Act 1774

Section 83 of the above Act, applies to fire policies on buildings. Where a building has been damaged by fire, any person interested in the building can request the insurer to apply the policy proceeds towards the reinstatement or rebuilding of the property. The policy motives behind the section was to prevent and deter owners from setting fires to their properties in order to be able to claim the insurance moneys and also to prevent other parties interested in the property, for example a tenant, from being at a disadvantage in the event that the insured upon recovering the moneys, decides not to use it to reinstate the property.[41] It therefore follows that in a situation where the insured landlord takes out a policy enuring to the benefit of the tenant and in the event of damage by fire, the tenant can request the insurer to use the proceeds for the reinstatement of the building. The Act therefore gives the third party tenant a direct right against the insurer. This right is however different from the right the tenant would have, if it were a party to insurance contract. First, the insurer is only under an obligation to reinstate when the interested party has requested it to do so. A request by the interested party that the insurer should not pay the insured does not satisfy this requirement and therefore does not prevent the insurer from paying the proceeds to the insured.[42] Secondly, the insurer upon the request being made is only obligated to use the moneys for reinstatement. The insurer is not obligated to pay the tenant an amount equal to its interest in the property. Third, the obligation to reinstate can only be discharged by the insurer.

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[41] *Reynolds v Phoenix Assurance Co. Ltd* [1978] 2 Lloyd's Rep. 440, at 462.

[42] *Simpson v Scottish Union Insurance Company* (1863) 1 Hem. & M 618, per Vice Chancellor Sir W. Page Wood, at 628-9.

Where the tenant expends money on reinstatement, it cannot subsequently ask for a reimbursement from the insurer nor can it demand for the moneys to be paid to him with the intention of carrying out the reinstatement.[43]

4.5 The right to the policy proceeds when reinstatement is impossible

Unlike goods which once damaged cannot be returned to their original form, buildings can be reinstated and it would only be in rare situations where the building cannot be reinstated that the issue as to who is entitled to the proceeds would arise. The case law suggests that the entitlement to the policy proceeds, very much depends on the intentions of the parties as construed from the terms of the policy. For example, in *Re King, Decd.*[44], the tenants of an eighty years lease, covenanted to keep the premises in repairs and to insure, at their own expense, the premises against loss or damage by fire. The insurance was to be in the joint names of the lessor and lessee and for a sum equal to three quarters of the value of the premises. The building was subsequently damaged by fire and thereafter the premises became subject to a compulsory purchase order, thus preventing the building from being reinstated. The insurers paid out the policy proceeds in the joint names of both parties and the issue faced by the court was as to which of the parties had a right to the money. The Court of Appeal, with Lord Denning dissenting, held that the policy proceeds belonged to the tenant. The majority decision was based on the view that the terms of the lease indicated that the parties only intended the insurance to aid the tenant in its obligation to reinstate and repair the premises after damage by fire. Where reinstatement was impossible, the Court's view was that the tenant was entitled to the policy proceeds, because the policy never intended to insure the respective interests of the parties. The requirement of the insurance in the joint names of the parties, was interpreted by the majority as being a way by which the landlord could ensure that the money was used by the lessee in performing its obligation. [45] It is argued that this construction can only be accurate if the nature of the policy was not a composite insurance, i.e. the policy did not insure the respective

[43] *Ibid.*
[44] [1963] Ch. 459.
[45] Per Upjohn LJ, at 492-3 and Diplock LJ, at 499.

interests of both parties. If the policy was a composite insurance, each party would have an independent right of action against the insurer for an amount equal to their respective interests.[46] Thus the proceeds would be shared according to these interests. The exact wording of the policy in *Re King* was not referred to in the case, and it is therefore unclear if the policy was in fact composite. However, the fact that the policy was said to be in the joint names of the parties suggests otherwise.

It is argued that there is an inconsistency in the reasoning of the majority. This is because the judgments accepted that the purpose of the policy was to benefit both parties by virtue of the tenant's obligation to reinstate. In his judgment, Upjohn LJ states that:[47]

> That was the whole object of the policy: to assist in the immediate reinstatement of the premises for the benefit of both, so that the lessee would have a factory to carry on his business during his term and thereafter the lessor would have the benefit on his land.

If the purpose of the policy is to benefit both parties in the form of reinstatement and where reinstatement is impossible, the only other way to benefit both parties is to share the proceeds according to their respective interests. The decision of the majority therefore ignores the fact that the true purpose of the reinstatement was to benefit both parties.

The decision in *Re King,* can be contrasted with another Court of Appeal decision. In *Beacon Carpets Ltd v Kirby*[48], the landlord leased his premises to the lessee for 14years. The latter covenanted to pay the premium for insurance, and also to keep the premises in repair. The lessor was under an obligation to take out insurance in the joint names of the parties and in the event of damage to the property, as a result of an insurable risk, was under a further obligation to lay out the policy proceeds in rebuilding and reinstating the property. The lessor insured the property in the joint names of both parties, 'for their respective rights and interests', for a sum less than the value of the property. A fire subsequently occurred which

[46] See the Judgment of Browne-Wilkinson LJ in *Beacon Carpets Ltd. v Kirby* [1985] Q.B. 755, discussed below, at 766.
[47] At 492.
[48] [1985] Q.B. 755.

damaged the property, and the insurer paid the policy proceeds into a joint account in the names of the parties' solicitors. Prior to the commencement of reinstatement, the tenants made it known to the landlord that they no longer wanted to occupy the building. On this basis, the landlord stopped its plan to rebuild the property. At the landlord's request, the tenant agreed to release half of the insurance moneys to the landlord, for his personal use. The tenant thereafter brought an action against the landlord claiming to be entitled to the insurance money or a proportion of it.

The Court of Appeal held that the terms of the lease disclosed an intention by the parties to effect a policy for the benefit of both parties, and this was evidenced by the fact that the policy insured the property for 'the respective rights and interests' of both parties. There was also the additional conduct of the parties in giving the landlord half of the proceeds which amounted to treating the proceeds as a source of money for the parties in proportion to the values of their respective interests. The decision in *Re King* was not followed for various reasons. Browne Wilkinson LJ felt that the case was not relevant on the basis that it involved 'the rights in the insurance moneys once the prime purpose of rebuilding has been wholly frustrated by a third party', and did not apply to the facts in *Beacon* because in that case, 'the parties were treating the insurance moneys as standing in the place of the building.' He further held that if *Re King* could not be distinguished, and had to be applied the parties would still be entitled to respective shares of the proceeds. This was because unlike *Re King*, where the obligations to insure and reinstate were the sole responsibility of the tenant, the landlords in this case were responsible for the insurance and were under an obligation to apply the moneys in reinstatement, and they therefore had an interest in the insurance along with the tenants who were indirectly responsible for the payment of the premiums.

A reading of both cases therefore suggests that where the obligations to insure, pay the premium and reinstate are the sole responsibility of one party, and in the event that reinstatement is impossible that party is entitled to the whole policy proceeds. On the other hand, when the obligations are shared between both parties, the proceeds are shared between both according to their respective interests in the property. The problem with this analysis is that it ignores the underlying intentions

of the parties by taking out an insurance policy. An insurance policy aimed at allowing the parties to reinstate the property, must have as its primary motive, an intention to preserve and protect the respective interests of the parties. Thus, in the event that reinstatement is impossible, the courts ought to give effect to this intention, by dividing the proceeds between the parties according to their respective interests in the property. It is therefore suggested that in a situation where a party is obligated under the lease to insure the property and where a loss has occurred and reinstatement is impossible, the courts should divide the proceeds between both parties based on the fact that by the obligations in the lease, the parties must have intended the insurance to benefit each other. The decision in *Beacon* should therefore be preferred to the decision in *Re King*.

4.6 The Effect of the Contracts Act 1999

Where a landlord takes out a policy enuring for the benefit of the tenant, the latter would be able to bring a direct action against the insurer once the requirements of the Act are satisfied. The application of the Act has already been discussed in relation to the bailment cases and it is argued that the same issues would be relevant in relation to the landlord and tenant scenario. Thus, s.1(2) of the Act would not be applicable where on a proper construction of the contract, the landlord and the insurer did not intend the term to be enforceable by the tenant. Professor Merkin[49], confirming this view, states that any term authorising the proceeds to be paid to the landlord would be sufficient to prevent the tenant from having a direct right. There is also the additional requirement of s.1 (3) that the tenant must be identified in the contract for it to rely on the Act. Professor Merkin also raises the point that with the 1999 Act, there is a potential overlap of the rights of recovery of the landlord and the tenant. This is because the landlord can recover the full amount insured by virtue of its insurable interest. If the insurer pays the whole proceeds to the landlord, is it still liable to the tenant? As Professor Merkin rightly argues, where the total payment is made to one of the parties, the insurers' liability to the other is discharged. The tenant's claim would have to be against the landlord. This view is

[49] *Merkin & Colinvaux,* A-0522, pg.10, 495.

supported by s.5 of the 1999 Act, which prevents the promisor from double liability by reducing an award to the third party, where the promisor has already paid a sum to the promisee in respect of the third party's loss.

5. Subrogation Immunity

5.1 Bailment cases

When a policy has been effected with the intention to enure to the benefit of a third party, the question whether this benefit includes subrogation immunity is obviously a crucial one as it determines whether or not the third party is protected against damage or loss to the goods caused by its negligent acts. In determining whether or not the third party has such immunity, it could be argued that since the purpose of the policy is to benefit the third party, such benefit should include subrogation immunity for the very fact that such immunity would be regarded as an important benefit to that party. This interpretation is consistent with the reasoning employed in the cases on bailment. It has been mentioned earlier that the court's explanation for recognising in a bailee an insurable interest up to the whole value of goods on bail, is to prevent both parties from taking out separate insurance policies against the same risk. The policy enuring to the benefit of both parties is therefore a substitute to both parties taking out separate policies. The consequence of this must be that since the parties would have been immune to a subrogated action under their respective policies, this immunity ought to be available to the third party in the policy enuring to its benefit.

The bailor is however immune from a subrogated action for additional reasons. First, it is highly unlikely that a situation would arise in which the bailor damages the goods while it is still under the responsibility of the bailee. Second, in the event that such a situation arises, the bailor would not be susceptible to a subrogated action. This is because the bailee is not under any liability to the bailor for losses caused by the latter, and in the event that the insurer indemnifies the bailee, who in turn holds the proceeds on trust for the bailor, the insurer cannot be subrogated to the rights of the bailee because the bailee has no right against the

bailor. The fact that the bailee is not liable for losses caused by the bailor himself would make a subrogated action impossible.

However consider the situation of a mortgaged property in which a policy is effected by the mortgagee for the full value of the property for the benefit of himself and the mortgagor. Where the mortgagor negligently damages the property and the insurer indemnifies the mortgagee for the loss, can the insurer by way of a subrogated action recover the proceeds from the mortgagor? Adopting the argument in the previous paragraph, the mortgagor ought to have such immunity because it would have been protected against such action, had it taken out a separate policy. The task is therefore to determine whether this aim can be achieved with the aid of established legal principles. Where the mortgagee is contractually obliged to effect insurance for the benefit of the mortgagor, such obligation could be interpreted, in light of the subsequent policy enuring for the benefit of the mortgagor, as showing that the parties intended that any loss to the property should be at the risk of the insurer. In effect, the courts would imply a term into the mortgage contract that the mortgagor would not be under any liability, where it was responsible for a loss caused by an insurable risk. Since the mortgagor would therefore not liable, the insurer would be unable to bring a subrogated action.

Where the mortgagee is not under an obligation to insure, but he effects a policy for the benefit of the other, the contract between both parties would not be able to provide an indication as to their intention, regarding subrogation.[50] This situation is however highly unlikely given the fact that the parties generally allocate the responsibility of insurance in the contractual document. In the unlikely event that such a situation should arise, and given the fact that the insurer would know that the mortgagee is insuring beyond its interest for the benefit of the mortgagor, the courts should imply a term into the insurance policy that it must have been the intention of the parties that the mortgagor would be protected against any subrogated actions arising from its negligent loss. The difficulty with this construction is that the mortgagor being a third party to the insurance policy would, as a result of the privity

[50] Unless of course, if the contract contains a term which excludes the mortgagor's liability in the event of loss or damage to the property.

rule, be unable to enforce the implied term. The only possibility of enforcing the term is by relying on the Contracts (Rights of third parties) Act. Assuming that the courts imply the above term into the insurance contract, the mortgagor could rely on s.1(1)(b) of the Act because such a term would be conferring a benefit on him.[51] The mortgagor would however have to satisfy s.1(3) of the Act, which states that the third party must be 'expressly identified' in the contract. It is however a common practice in such policies to note the interest of other parties in the policy. Where the interest of the mortgagor is noted, this should satisfy s.1(3), and therefore allow the latter to rely on the implied term in the policy. Where the mortgagor is not expressly referred to in the policy, it would be unable to use the 1999 Act to enforce the term. It is therefore suggested that in cases where either party is not under a contractual obligation to insure, the third party beneficiary can only rely on the implied term in the contract of insurance, as long as such party is expressly referred to in the policy.

5.2 Subrogation Immunity in landord and tenant cases

In *Mark Rowlands Ltd v Berni Inns Ltd*[52], the claimant freeholder of a building had leased the basement and part of the ground floor of the building to the defendant tenant. Under the lease, the landlord was under an obligation to insure the building against specified risks, including fire. The tenant was however to pay an insurance rent equivalent to the percentage of the premium paid by the claimant. In the event that damage was caused to the demised property by any of the insured risks, the landlord was under an obligation to use the insurance moneys to repair the premises whilst the tenant was relieved from his repairing obligations under the lease. A fire occurred damaging the property. The damage was alleged to have been caused by the negligence of the defendant. The insurers paid out money to repair the premises and thereafter brought a subrogated action against the defendants. The tenants resisted this action on the ground that the policy enured to their benefit and they were therefore protected against a subrogated action.

[51] S.1(1)(a) would be inapplicable as it only applies to express terms.
[52] [1986] Q.B. 211.

In the Court of Appeal, Kerr LJ, giving the only judgment of the court, held that the insurers could not succeed with its action because the terms of the lease precluded the landlord from recovering damages in negligence from the defendant. The effect of this was that the insurer could not bring a subrogated action since such action would be in the name of the landlord. Kerr LJ's decision was however not based on his finding that the benefit of the policy also enured to the benefit of the tenant. Affirming the view reached by the judge at first instance, he concluded that from the terms of the policy it must have been the mutual intention of both parties that the insurance should also benefit the defendant. He however held that this was not the decisive issue. In his view, the issue was[53]:

...whether the terms of the lease, and the full indemnification of the plaintiff by its receipt of the insurance moneys, preclude it from recovering damages in negligence from the defendant, or whether the plaintiff's right to recover such damages remains unaffected.

In reaching his decision, Kerr LJ, referred to a trio of Canadian cases[54] in which the Canadian Supreme Court held that a tenant had subrogation immunity by virtue of the obligation of the landlord under the lease. Relying on the above cases, Kerr LJ construed the terms under the lease as showing an intention by the parties that in the event of damage by fire caused by the negligence of the defendant, the claimant were to recover their loss from the landlord and were to have no further claim in damages against the defendant. The interpretation was therefore that the insurer was to solely bear the risk of loss caused by an insured risk.

[53] *Ibid.*, 228.

[54] *Agnew-Surpass Shoe Stores Ltd. v Cummer-Yonge Investments Ltd* (1975) 55 D.L.R. (3d) 676; *Ross Southward Tire Ltd. v Pyrotech Products Ltd.* (1975) 57 D.L.R. (3d) 248 and *T. Eaton Co. Ltd. v Smith* (1977) 92 D.L.R. (3d) 425.

5.3 The nature of the immunity.

Kerr LJ's dicta, suggests that the fact that the policy enures to the benefit of the tenant does not necessarily mean that the tenant is protected against a subrogated action. This raises the important question as to what terms are necessary to identify an intention by the parties to provide the tenant with subrogation immunity. In the case, Kerr LJ relies on the exact terms of the policy in which he also relied upon in determining that the policy enured to his benefit. For example, in reaching his conclusion, he states that:[55]

> This was what the plaintiff agreed to provide in consideration of, *inter alia, the insurance rent paid by the defendant.* The intention of the parties, sensibly construed, must therefore have been that in the event of damage by fire, whether due to accident or negligence, the landlord's loss was to be recouped from the insurance moneys and that in that event they were to have no further claim against the tenant for damages in negligence.

The fact that Kerr LJ relied on the same terms in reaching both conclusions, suggests that the benefit of the policy to the tenant extended to provision of subrogation immunity. This raises the further question as to whether a policy enuring to the benefit of a party would always extend to providing that party with subrogation immunity. The decision in *Lambert v Keymood Ltd*[56] seems to suggest this. The case arose as a result of fire damage to business premises. The premises were divided into five units, and were leased by the claimant freeholders to the defendants. Most of the units were leased to the defendant under oral tenancies and during negotiations the latter had insisted that the claimant should insure the premises. A subsequent fire, caused by the negligence of the tenant, resulted in damage to the units. At the time of the fire, the claimant did not have any insurance cover and brought an action against the defendants for its loss. The defendant argued that the claimant was under an obligation to insure the premises for its benefit and, relying on *Mark Rowlands,* had such insurance been effected the claimant upon a loss would have been restricted to recovering from the insurer and would not have

[55] At pg. 232.

[56] [1999] Lloyd's Rep. I.R. 80

any claim against it. Laws J held that the effect of the decision in *Mark Rowlands* was that where the terms of the lease can be construed as demonstrating a common intention by the parties that the policy would enure to the benefit of both, neither the landlord nor the insurer, by virtue of a subrogated action, could bring an action against the tenant, in the event of damage caused by the latter's negligence. He further held that from the facts of the case, there was no common intention by the parties to insure for the benefit of both. The facts only supported an intention to insure for the benefit of only the claimants.

The view in K*eymood* that a tenant has subrogation immunity where it was the common intention of the parties that the policy should also enure to his benefit is no different from the assertion that where the policy enures to his benefit, the tenant has subrogation immunity. This interpretation however conflicts with the decision in *Mark Rowlands*. It is however suggested that Laws J interpretation should be followed for the following reasons. First, from a practical point of view, his approach is a more realistic interpretation of the intentions of the parties. This is because a reasonable observer would assume that where it was the intention of the parties that the policy should enure to the benefit of the tenant, the benefit to him would include subrogation immunity for the very reason that it would have had this benefit if it were an insured under the policy.

Second, a reading of the Canadian cases in which Kerr LJ relies upon in reaching his decision suggests that when the policy was intended to benefit the tenant, the benefits included subrogation immunity. For example, in *T. Eaton Co. Ltd v Smith*[57], the tenant had been granted a lease of two contiguous properties, by their respective freeholders. The terms of the leases were identical and in both the landlord had covenanted to insure the premises against loss by fire. The tenant negligently caused damage by fire to the premises and upon paying the landlords for their losses, the insurer brought a subrogated action against him. Laskin CJC, giving the majority judgment of the Canadian Supreme Court, held that the only explanation for the landlord's covenant to insure the premises must have been to protect the tenant against liability for damages arising from his negligence, the

[57] (1977) 92 D.L.R. (3d) 425.

consequence of which was to protect the tenant against a subrogated action by the insurer.

This decision can be contrasted with the facts in *Lambert*, where the landlord's obligation to insure was held to have been solely for his benefit and not for the benefit of the tenant. In such a situation, the tenant cannot rely on the covenant because it was never intended to benefit from it. *Eaton* therefore suggests that where the landlord enters into a covenant with the tenant to effect insurance, the benefit of such covenant to the tenant must be to protect it against insured losses caused by its negligence. In *Ross Southward Tire Ltd. v Pyrotech Products Ltd*[58], the tenant was under an obligation to pay insurance premiums and the Supreme Court held that the effect of this obligation was that it was protected against the risk of loss by fire caused by its negligence. These cases therefore suggest that the relevant question is essentially whether the parties intended the policy to benefit the tenant. Where the intention is to benefit him, the effect of this is that the tenant has subrogation immunity.

Third and consistent with the approach in *Rowlands* is the fact that, terms justifying an inference that the policy enures to the benefit of the tenant, would also justify an inference that the tenant has subrogation immunity. Thus obligations on the tenant to pay rent and on the landlord to insure the premises are relevant to inferring both conclusions. In light of the above reasons, it is suggested that in determining whether a tenant has subrogation immunity, the appropriate question to ask is whether it was the common intention of the parties that the policy would enure to his benefit.

5.4 The possible extension of the rule in *Mark Rowlands* beyond landlord and tenant cases.

Kerr LJ's reasoning might however not be inconsistent with the above conclusion. An argument could be made that by focusing on the terms of the contract, Kerr LJ was laying down a rule applicable not only to landlord and tenant cases, but to any contractual relationship in which, from the terms of the contract, it could be said that

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[58] (1975) 57 D.L.R. (3d) 248

the parties must have intended that between one another, the insurer would bear the risk of all insured losses. It was therefore necessary to focus on the terms of the lease, in order to explain the general rule, even though in the case itself, it was sufficient that the policy enured to the benefit of the tenant. Support for this interpretation can be found in the case law. First, in the *National Oilwell* case[59], Colman J would have allowed the claimants to rely on a defence analogous to the principle had the contract between the parties been capable of such construction. Second, in the court of Appeal's decision in *Taylor Young,* Brooke LJ specifically referred to the *Mark Rowlands* principle, and applied its line of reasoning in reaching his decision in that case that the contractor and sub-contractor were, by virtue of the terms of their respective contracts, immune from losses arising from their negligent acts.

This interpretation however raises the question as to the requirements necessary for the principle to apply. Is it sufficient that the third party is under an obligation to insure or should the focus be on the intention of the parties construed from the terms of the contract? It is suggested that the latter is the more appropriate test as it resolves the issue according to what must have been the intention of the parties. For example in *Taylor Young,* Brooke LJ was of the view that the proper question to ask, regarding whether the parties had subrogation immunity was, 'what does the contract provide?[60] Since the focus is on the intention of the parties, as evidenced by the terms of the contract, it is suggested that there are no specific terms that would be relevant in all cases.[61] The focus must be on the contract as a whole and not on a particular term. For example in *The Yasin*[62], the court held that the owners of a vessel were not immune to a subrogated action, despite the fact that they were under an obligation to pay the premiums for the insurance of the cargo destroyed as a result of the unseaworthiness of the vessel. Lloyd J held that the

[59] [1993] 2 Lloyd's Rep. 582, 604 – 606.
[60] [2001] 1 Lloyd's Rep. I.R. 122, 137 para. 72. Also, see the judgment of Dillon LJ in *Surrey Heath Borough Council v Lovell Construction Ltd* (1990) 48 B.L.R. 108, 121, which Brooke LJ relied on.
[61] This however does not apply to a situation in which there is an express term protecting the parties against a subrogated action.
[62] [1979] 2 Lloyd's Rep. 45.

insurance was for the benefit of the cargo owners and there was no intention by the parties to provide immunity to the ship owners.

Although, there are no particular terms which would automatically indicate an intention to provide immunity to a party, the case law suggests that such an intention would be found where the contract between the parties have pre-determined the consequence to each party, in the event of an insured risk occurring. For example, in *Taylor Young*, the contract stipulated that in the event of a loss arising, the negligent party would restore the damaged works and thereafter recover such monies from the insurance proceeds which would be paid to the CRS, the main employer. Similarly in *Mark Rowlands*, the tenancy provided that in the event of an insured risk occurring, the tenant was relieved of its repairing obligation and the landlord was under an obligation to use the insurance proceeds in repairing the property. It is suggested that in such cases that the courts should recognise an intention by the parties to absolve one another from liability in the event of a loss arising from any of them and to look to the insurer to bear the loss.

5.5 The limit of the immunity

Although it has been argued that where the policy enures to the benefit of the tenant, the latter has subrogation immunity, the extent of this immunity can however be limited by the terms of the lease. In *Barras v Hamilton*[63], a Scottish case, the landlord of premises consisting of four industrial units, agreed with the tenant of one of the units that he would take out fire insurance to protect the unit against loss by fire. The tenant in turn, agreed to pay the share of the insurance premium which related to unit 2. A fire occurred in unit 2 as a result of the negligence of the tenant and spread to the other units, resulting in the destruction of all the units. The landlord sued the tenant for the uninsured losses which he had incurred as a result of the damage to all four units. The tenants resisted the action, arguing, in reliance on *Mark Rowlands,* that since the landlord was under an obligation to insure the premises against risk by fire, the intention of the parties must have been that in the event of damage to the whole premises by fire as a result of the negligence of the

[63] [1994] S.L.T. 949.

tenant, the landlord was restricted to recovering his loss from the insurer and could not bring any further claim against the tenant. The Scottish Second Division held that the decision in *Mark Rowlands* was applicable to Scottish law and that the landlord was only under an obligation to the tenant to insure unit 2. Thus, the tenant was only protected against any loss to unit 2, but was liable to the landlord in respect of damage to the other units. The terms of the lease therefore restricted the tenant's subrogation immunity to claims relating to unit 2.

Although the above is a Scottish decision, its reasoning is surely right and applicable to English law. This is because the landlord's obligation to the tenant was only to insure unit 2, thus the intention of the parties must have been to provide immunity to the tenant in respect of losses to only unit 2. The case can be contrasted with the facts of *Mark Rowlands*, in which the landlord's obligation to the tenant was to insure the whole premises, indicating an intention to protect the tenant against any liability arising from damage to the whole building.

5.6 Conclusion

Where a policy enures to the benefit of a third party, it is suggested that the benefit to that party not only includes having its interest insured against loss, but also extends to being protected against any subrogated action by the insurer. The benefits to the third party are therefore no different than if he were insured under a co-insurance policy. The enforcement of the benefits is however different than if the party was insured under the policy. This is because the third party is not a party to the contract of insurance and therefore does not have a direct right of enforcement against the insurer. For example, where the policy enures to the benefit of a third party and in the event of a loss the latter does not have a common law right against the insurer, but can only recover from the insured once he has recovered the proceeds from the insurer.

The third party could however rely on the Contracts (Rights of third parties) Act 1999, in order to establish a direct right against the insurer, if its requirements are met. The same problem would arise in relation to the benefit of subrogation immunity, where such immunity is not implied in the contract between the third

party and the insured, but in the contract of insurance which the former is not a party to. It is therefore suggested that despite the fact that such policies essentially provide the same benefits to a party that it would have, had it been insured under a co-insurance policy, the lack of privity in the former situation would seriously limit the ability of the third party to realize those benefits, where the 1999 Contracts Act is inapplicable. In light of this fact, it is suggested that insurance under a co-insurance policy is to be preferred to such policies as the means of protecting the interests of the party.

6. The third party as a trust beneficiary

A trustee of trust property has the legal title vested in him and can therefore insure the property to its full value. The beneficiary to the trust also has an insurable interest to the extent of its equitable interest in the property and can insure the property to this value. Where the trustee insures the trust property and an insurable loss occurs, the trustee has a right, by virtue of being the insured, to recover the proceeds from the insurer. Such recovery would be for the benefit of the trust property and thus would benefit the beneficiary. If the trustee declines to exercise his right, the beneficiary can bring an action against the insurer and joining the trustee as a co-defendant.[64]

In an appropriate situation, the trust concept can be applied to give a third party, equitable rights under a contract of insurance. This would be possible where the insured holds rights under the policy on trust for the third party. In such a case, it is the insurance contract and not the insured property that is the subject matter of the trust. The trust analysis will however only apply where the parties can show a clear intention to create a trust. An absence of this is fatal to the construction of the insured as trustee for the benefit of the third party and it is therefore necessary to consider this requirement.

[64] *Vandepitte v Preferred Accident Insurance Corporation of New York* [1933] A.C. 70, at 79.

6.1 Declaration of a trust

The position of the courts is that for a trust to be construed from the policy, an intention to create a trust must be shown.[65] This requirement however raises two important questions which presently seems unclear from the case law. First, in determining whether there is an intention to create a trust, should the courts' focus be restricted to the insurance policy, or can they consider other contractual documents? Secondly, what in terms of words and phrases, is sufficient to express such an intention? It is necessary to consider both issues in detail

6.2 The search for an intention: The insurance policy or beyond?

The cases which discuss the trust analysis in relation to a third party, are very few and in all it is unclear whether the search for an intention to create a trust is restricted to the insurance contract. In the Privy Council case of *Vandepitte v Preferred Accident Insurance Corporation of New York*[66], Lord Wright held that the insured of a motor insurance could not have effected the policy as trustee for the benefit of his daughter because such intention could not be construed from the general words of the policy. However in the more recent case of *D G Finance v Scott*[67], involving the insurance of a trailer on hire purchase, the Court of Appeal held that a similar intention could not be construed from either the insurance policy or the hire contract. From a practical point of view, it would be unduly restrictive of the courts if it focuses solely on the contract of insurance. The focus should be on the whether an intention exists, and as long as this is present, there seems no justification to require it to be in the contract of insurance. If the intention can be construed from a contractual document between the insured and the third party, it should be given effect to. Such construction would in no way be to the detriment of the insurer, because the insured would still be the only party to the insurance contract and it would only be in exceptional cases[68], that the third party beneficiary would be able to bring an action against it.

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[65] See *Vandepitte, Ibid.*, per Lord Wright at 80.
[66] *Ibid.*
[67] [1999] Lloyds Rep. I.R. 387
[68] i.e. where the trustee declines to sue the insurer.

6.3 The intention to create a trust

The common law position seems to be that there are no particular words required, as long as the intention can be construed from the relevant documents. The word 'trust' need not be used as long as it is made clear that the insured is acting for the benefit of the third party. Despite this flexibility, the requirement is still a difficult one to satisfy. In *Vandepitte v. Preferred Accident Insurance Corporation of New York,* the appellant obtained a judgment in British Columbia against B's daughter for damages for personal injuries caused by her negligence whilst driving B's motor car. B had effected an insurance policy in relation to his car and under the terms of the policy the insurer had agreed to extend protection to any person driving the car with the permission of B. The judgment remained unsatisfied and the appellant thereafter brought a claim against B's insurer to recover the amount, arguing that B's daughter was insured against liability under the policy.[69] One of the arguments advanced by the appellant was that B was holding the rights under the contract of insurance on trust for the benefit of both himself and his daughter. The Privy Council although accepting that the trust concept could apply in an appropriate circumstance, was of the view that from the facts of the case, no intention to create a trust was shown. Lord Wright declined to infer an intention from the general words of the policy and held that clearer words were necessary.

The strict application of the above requirement stems from the fact that the trust analysis is often used by third parties to avoid the privity doctrine, and the courts therefore require proof of a genuine intention to create a trust. For example, where the intention of the parties is capable of another construction, other than one to create a trust, the courts would adopt this construction. In *D G Finance v Scott,* the insured purchased a trailer on a hire purchase agreement. The hire contract required the insured to effect comprehensive insurance for the trailer for its full replacement value. The insured however effected an insurance covering specified risk and only against the market value of the trailer at the time of its loss. In an action against the insurer, the finance company argued that the effect of the

[69] The claim was brought under s.24 of The British Columbia Insurance Act 1925, which gives a third party entitled to damages from an insured the right to recover such damages from the latter's liability insurer, where the insured fails to pay the required amount.

insurance obligation in the hire contract was that the insured effected the policy as its trustee. The Court of Appeal rejected this construction and held that rather than showing an intention to create a trust, the documents before it indicated that the insured only intended to effect a policy which would protect its interest and the interest of the finance company. Thus, rather than being the beneficiary of a trust in the policy, the finance company only had an interest in the policy proceeds paid to the insurer. The point to be made here is that where the insured and third party have interests in the subject matter and one effects insurance for the benefit of both, in the absence of an unambiguous intention to create a trust, the courts would not recognise one and would rather construe the policy as one enuring to the benefit of the third party.

In light of the strict application of the above requirement, it seems that the courts would rarely infer a trust in favour of a third party, in the absence of express clear words to this effect. This seems more so with the enactment of the 1999 Contracts Act and following the approach of the Court of Appeal in *D.G. Finance v. Scott,* it could be argued that in cases where the Act would apply to give the third party enforceable rights, the courts would, and should resist, an argument inferring a trust in favour of a third party. If however a genuine intention to create a trust is expressed, then the courts should give effect to it. It is necessary to consider some of the issues relating to the enforcement of such a trust.

6.4 Must the third party have an insurable interest in the subject matter of the insurance?

It could be argued that since insurance contracts are contracts of indemnity, the third party should have an insurable interest in the subject matter of the insurance. Such an argument however assumes that the insured subject matter is the subject matter of the trust. As mentioned earlier, the trust property in this case is the insurance contract, and therefore as long as the trustee-insured satisfies the insurable interest requirement, there seems no reason why the third party should also satisfy it. However, in most cases in which the third party would attempt to use the trust analysis, it would usually be because it has an interest in the insured subject matter

which it seeks to protect against loss or damage.[70] It is however necessary for the trustee-insured to have an interest in the subject matter which is being insured for the benefit of the third party. Thus in *Vandepitte,* Lord Wright pointed out that a further difficulty in applying the trust concept to the facts of the case was that B did not have an insurable interest in his daughter's personal liability and he could therefore not insure this interest on her behalf.

6.5 The rights of the third party beneficiary

Where the insurance contract is held on trust for the benefit of the third party, the trustee by virtue of being the party to the contract has a right of indemnity in respect of any loss recoverable under the policy, holding the proceeds on trust for the beneficiary. If the insured declines to do this, the third party can bring a claim against the insurer, including the trustee as a co-defendant to the action.[71] Thus, although the third party is not privy to the contract, it has, by virtue of the trust, equitable rights to the benefits of the contract.

6.6 Subrogation immunity

Whether or not the third party beneficiary has subrogation immunity can be determined in two distinct ways, each not mutually exclusive of the other. The first is by construction of the contractual documents. If an intention to create a trust for the benefit of the third party is construed from the policy or any other relevant contractual document, the courts ought to infer from such intention that the parties must have intended to provide the beneficiary with subrogation immunity, because such immunity is consistent with the purpose behind the trust, i.e. to provide the beneficiary with adequate protection in respect of loss to the subject matter of insurance. For example, if the terms of the policy indicate a trust in favour of the third party, it must have been the intention of both the insurer and the insured that

[70] See for example *D.G. Finance v Scott* in which the hirer had an insurable interest in the trailer.
[71] See *Vandepitte,* at 79, and *Harmer v Armstrong* [1934] Ch. 65.

the beneficiary would be immune from any subrogated action and this would be given effect to as an implied term of the policy.[72]

Secondly, the beneficiary should have immunity applying trust law principles. A trustee owes a fiduciary duty to the beneficiary in the management of the trust property, and this same duty would apply to the insurance scenario. The argument could therefore be made that if the insurer were to bring a subrogated action against the third party in the trustee's name, this would amount to a breach of his fiduciary duty as such action would not be in the best interest of the beneficiary. Additionally, as the trust would be for the absolute benefit of the third party, such trust would be akin to a bare trust in which the beneficiary can override the powers of the trustee[73], and could in the present circumstance prevent the trustee from bringing a subrogated action against it.

6.7 The effect of the Contracts Act 1999

Where a policy has been effected to benefit a third party, the latter has often relied on the trust analysis to avoid the privity doctrine.[74] With the enactment of the Contracts Act 1999, such parties would therefore be able to rely on the statute, and thus no longer require a trust in their favour. This is to be expected given the relative simplicity of the requirements of the Act. Thus, applying the Act to the facts of *Vandepitte,* the fact that the policy included a term which protected persons driving B's car, with his permission, indicates an intention to benefit such third parties, and would fall under s.1(b) of the Act. B's daughter would therefore have a right of enforcement against the insurer, as long as this right is not inconsistent with any other terms of the contract (s.1(2) .) The obvious difference between the Act and the trust concept, is that with the former, the third party has a direct right of enforcement whilst with the latter, it is his trustee that exercises the right on his behalf. The point

[72] This implied waiver of subrogation clause would be enforceable by the third party relying on the Contracts (Right of third parties) Act 1999, as discussed in Chapter VII.
[73] See *Saunders v Vautier* (1841) 4 Beav. 115.
[74] Other than the cases discussed in this section, the argument was also relied upon and briefly discussed by the Court of Appeal in *Tomlinson v Hepburn* [1965] 2 W.L.R. 634.

should however be made that in accordance with s.1(3), the Act would only apply where the third party is expressly identified in the policy.[75]

6.8 Conclusion

Where the insurance contract is made the subject matter of a trust for the benefit of the third party, the third party is able to enjoy the twin benefits of subrogation immunity and a right of indemnity. The exercise of the latter right is however through the trustee, who is under a fiduciary duty to protect its interests and it is only in the extreme case where the trustee fails to recover that the third party can bring an action against the insurer, by joining the trustee as a co-defendant. The use of the trust analysis would therefore protect the interests of the third party. However this analysis has rarely been applied by the courts, due to the requirement that an intention to create a trust must be proven. With the enactment of the 1999 Contracts Act, it is even more unlikely that this analysis would succeed in cases where the Act is clearly applicable. Given this development, it is suggested that the concept would only apply where there is an express intention to create a trust in favour of the third party.

7. Noting

It has become a common practice to include in insurance policies, the names and interests of parties interested in the subject matter of insurance. This act is referred to as 'noting' and can be insisted upon by the interested party or the insurer. The aim of noting is to provide some form of protection to the interest of the noted party. The nature of this protection is however far from certain, and it is therefore necessary to discuss whether the protection extends to providing the party with a right to the insurance proceeds and subrogation immunity.

[75] This requirement would also have been satisfied in *Vandepitte,* as the policy extended to persons driving the car with the permission of the insured.

7.1 A right to the insurance proceeds?

The fact that a party has its interest noted in the policy does not make it a party to the contract of insurance. The point has never been raised directly in court, but there exists some guidance from the case law. In *First National Commercial Bank plc. v Barnet Devanney (Harrow) Ltd*[76], an insurer effected a composite policy in the names of a bank and the mortgagee owner of a house. The building was destroyed by fire and the insurer rejected the claims of the co-assureds on the grounds of misrepresentation, non-disclosure and breach of condition. The bank thereafter brought a claim against the brokers, alleging negligence on the part of the latter for not including in the policy a mortgage protection clause which has the effect of protecting the rights of the mortgagee, when the mortgagor has breached the policy and is thus prevented from recovering from the insurer. The basis of the bank's argument was that such a clause was necessary in composite policies, and in support of this, two Canadian cases[77] were referred to.

In both cases, the respective policies contained a mortgagee protection clause, and the interest of each mortgagee had been noted. The Canadian courts held that the effect of the mortgagee clause was to sever the policy into two separate contracts, one between the policy holder and the insurer and the other between the latter and the mortgagee. In *Barnet Devanney,* Gage J, at first instance, held that the Canadian cases were not relevant to the facts of the case, because in those cases, the mortgagee was not a party to the contract, and that the decisions were based on the interpretation of the mortgagee protection clause. This decision suggests that the act of noting does not make the noted party, a party to the contract. This very much makes sense, given the nature of noting, which is an acknowledgment in the policy that the party has an interest in the subject matter. This cannot possibly be interpreted to mean that the insurer has agreed with the party to insure against specified risks to its interests. Given the importance of the doctrine of privity in English law, the fact that noting does not confer this status on the noted party, would also prevent it from being able to rely on any policy terms. The obvious exception

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[76] [1999] C.L.C. 11.

[77] *Caisse Populaire v Société d' Assurances* (1984) 19 D.L.R. (4th) 411; *Canadian Imperial Bank v Dominion of Canada General Insurance* (1987) 46 D.L.R. (4th) 77.

being if the Contracts (Rights of Third Parties) Act 1999 applied. It is therefore necessary to consider if noting brings the Act into play.

7.2 Noting and the Contracts Act 1999

Professor Merkin has argued that noting *per se* would not bring the Act into play.[78] His reason being that the fact that a party's interest is acknowledged in the policy does not satisfy the requirements necessary for the Act to apply, i.e. the third party must be given, by express term, a direct right of enforcement[79] or the policy must purport to confer a benefit on him[80]. Thus, the noting of a parties interest in the policy cannot be equated as conferring a direct right of enforcement on the party. In respect of the alternative requirement, Professor Merkin argues that 'informing the insurers that there are other outstanding interests in the insured subject matter...appears to be a long way from amounting to a promise by insurers to confer a benefit on the holders of the those interests.'[81] This interpretation is surely right where the effect of the noting is to acknowledge that the party has an interest in the subject matter. However, where the noting acknowledges that the party has an interest in the policy, there is a strong argument to suggest that the insurer purports to confer a benefit on the party. An example of such wording can be found in the Privy Council decision of *Colonial Mutual General Insurance v ANZ Banking Group Ltd.*[82]

In the case, the mortgagor took out a second mortgage on his house. Under the mortgage, the mortgagor was under an obligation to insure the premises against fire in the name of the bank. The mortgagor effected an insurance policy, but without any reference to the bank. The bank thereafter sought to note its interest in the policy. In the subsequent insurance certificate, the bank was identified as 'Other parties interested in the insurance.' A fire destroyed the house, and the question faced by the courts was whether, after paying the first mortgagee, the bank was entitled to claim the remaining proceeds from the insurer. The Privy Council held

[78] *Colinvaux and Merkin,* at A-0614, pg. 10, 589.
[79] S.1(1)(a) of the Act
[80] S.1(1)(b) of the Act.
[81] *Supra fn.* 78.
[82] [1995] 1 W.L.R. 1140

that the insurance obligation in the mortgage gave the bank an interest by way of charge in the insurance proceeds, which amounted to a partial equitable assignment and the insurer had sufficient notice of this assignment when the request was made. In light of the 1999 Contracts Act, it seems arguable that the bank could have relied on the noted term as conferring a benefit upon it. The phrase, 'interested in the insurance' could only mean that the insurer accepts that the bank has an interest in the insurance proceeds and there seems no reason why this should not qualify as a term purporting to benefit the bank. It is therefore suggested that noting generally would not bring the Act into play, but where the effect of the noting amounts to a declaration that the party has an interest in the policy proceeds, this should be sufficient to bring s.1(1)(b) into play.

7.3 Subrogation immunity

The likelihood of a party having subrogation immunity by virtue of having its interests noted in the policy is very remote. This again has to do with the very essence of noting. All the noted party is doing, in most cases, is to declare that it has an interest in the subject matter of the insurance. This in no way amounts to a promise by the insurer not to bring a subrogated action against the party. There is also no reason to imply from such noting, an undertaking by the insured party not to bring proceedings against the noted party in respect of any loss to the subject matter. Noting could however provide some form of immunity to a party, where the noting amounts to a declaration that the party has an interest in the policy proceeds. If, as argued above, this term brings into play s.1(1)(b) of the 1999 Act, and allows the party to recover directly from the insurer in respect of its interests, that party has an immunity to the extent of its interest in the policy proceeds. This immunity would be effected through an implied term in the contract of insurance, essentially to give effect to the intentions of the parties as construed from the noted term. However, with the exception of the above scenario, the act of noting, *per se* is incapable of providing the noted party with subrogation immunity.

Noting might also allow the noted party to enforce an implied subrogated term in the insurance policy. This example was referred to in the previous section

on policies enuring for the benefit of third parties. The example given was of a mortgagee, not being under an obligation to insure, effecting a policy for the benefit of itself and the mortgagor. The argument advanced was that the courts would imply a waiver of subrogation clause in favour of the mortgagee, which could be enforced by the latter under s.1(1)(b) of the 1999 Act. However for the Act to apply, the party has to be expressly identified in the contract as stated in s.1(3). The noting of the interest of the party, should satisfy this requirement and therefore allow the noted party to rely on the implied term.

7.4 Conclusion

Noting in general is incapable of providing a party with the twin benefits of a right of indemnity and subrogation immunity. This is more so, where the noted term is only a declaration that the party has an interest in the subject matter. Such a party cannot be privy to the contract nor can it be entitled to enforce rights under the policy solely on the basis of the noted term. However, where the term is a declaration that the party has an interest in the policy proceeds, although the latter is not a party to the contract, it should be able to rely on the 1999 Contracts Act in order to recover proceeds equivalent to its interest and also to seek protection under an implied waiver of subrogation clause.

Chapter IX

Conclusion

1. General overview

The aim of this thesis has been to determine the relevance of co-insurance contracts in relation to its ability to provide co-insureds with the twin benefits of rights of indemnity and subrogation immunity. In achieving this objective, two distinct issues were discussed. First, an analytical examination of the nature of co-insurance policies was made, in relation to the twin benefits of rights of indemnity and subrogation immunity. The question that was being considered was the extent of which such policies provided and protected the above benefits to co-insureds. The second part of the thesis focused on some of the alternative means by which, in the absence of a co-insurance policy, a third party to an insurance contract could obtain the above benefits. A primary focus was on the Contracts Act 1999 with the aim of determining how it could be used by third parties in seeking to exercise the benefits under an insurance contract. In addition, the nature of policies enuring to the benefit of third parties were discussed with particular emphasis on whether such policies gave third parties a right of indemnity and subrogation immunity against the insurer. Finally, the possibility of the third party as a trust beneficiary of the insurance contract and the practice of 'noting' was discussed with a view to determining whether such devices could provide the third party with the respective benefits. It is necessary to discuss the various conclusions that were reached in the above discussions to provide a complete and clear picture of the nature of co-insurance policies and their relevance in insurance law.

2. The nature of co-insurance policies

An important issue in understanding co-insurance policies is the joint-composite distinction. It has been assumed that the main difference between such policies is on the nature of the interests, which they protect. Therefore when the co-insureds insure against loss to their separate interests the policy is composite but if the interests are joint the policy is joint. This distinction is very important because the courts have treated the distinction as determining the nature of the rights and obligations of the co-insureds. Thus, with composite policies, each co-insured has separate rights, whilst with joint policies the co-insureds have joint rights and obligations. In chapter I, this distinction was discussed, and it was shown that the focus on the interests was merely a rule of construction which only determined the right of indemnity of the co-insureds. Given the fact that a co-insured is subject to numerous obligations, it would be illogical if the nature of its interests would be determinative of the nature of all its obligations. This point was further emphasized in subsequent examinations of some of the obligations a co-insured is subject to.

The distinction between co-insurance policies and contingent policies was also highlighted with emphasis on the differences between both. An important development in co-insurance law has been the recognition of the pervasive insurable interest doctrine. Apart from the fact this doctrine is inconsistent with the orthodox view of insurable interest in property and the extent of its application is uncertain, its rationale suggests that it is a means by which co-insureds can have subrogation immunity. However, the recent judgments of the Court of Appeal and House of Lords in the case of *Taylor Young*[1] suggests an alternative way of resolving the immunity question and in light of this, there is a strong argument to suggest that the pervasive interest doctrine is no longer necessary and should therefore be abolished.

[1] [2001] 1 Lloyd's Rep. I.R. 122(C.A.); [2002] 1 All E.R. (Comm.) 918 (HL.)

3. Co-insureds and rights of enforcement

A co-insured, where it is a party to the contract has a direct right of enforcement against the insurer for losses caused by an insurable risk. This thesis focused on two main issues in relation to the exercise of this right. The first issue relates to the ability of the co-insured to enforce the right against the insurer. This is essentially a question of privity and it is an important one in most cases of commercial insurance, where the co-insured does not necessarily enter into the contract himself, but the contract is concluded on his behalf by another party, possibly another co-insured. The two ways by which a third party co-insured can enforce the insurance contract were discussed in separate chapters. In chapter II, the use of the agency rules expressed by Colman J in *National Oilwell* were discussed with particular emphasis on various issues like whether future co-insureds could rely on the rules. The conclusion reached was that the rules could be applied to all forms of co-insurance as long as its requirements were satisfied. In chapter VII, the use of the 1999 Contracts Act as an alternative to the agency rules was discussed. The scope of the Act was discussed and an extensive comparison was made between both approaches and the conclusion reached was that although the application of either would have the same consequences, the requirements of the Act are easier to satisfy and avoid the limitations, which a co-insured might face in relying on the agency rules.

The second issue relates to the possible limitations on the exercise of a co-insured's right caused by the act of other co-insureds. These include the obligations imposed by the duty of utmost good faith, warranties, the duty against wilful misconduct, and the right of termination. An analysis of the common law approach to these issues suggests that the courts position in determining the consequence to a co-insured in the event of such breaches is to fall back on the distinction between composite and joint policies. Where the policy is joint, the co-insureds are under a joint obligation and a breach by one would affect the rights of all, whereas with a composite policy, the obligations of each co-insured is separate and therefore a breach by one would not affect the rights of the rest. The major problem with this approach is that it determines the obligations of the parties without any consideration of the nature of the duties, which these obligations emanate from. For

example, with the duty of disclosure, it has been shown that the purpose of such an obligation is to ensure that the insurer makes an informed decision in its choice of whether to contract with the parties and on what terms. The effect of this is that the duty implies a joint obligation and the insurer should be able to avoid the whole policy irrespective of which co-insured has failed to disclose material information. The courts have however ignored the rationale behind the obligation and have adopted the joint-composite distinction. It is the view of this author that this approach should no longer be adopted and the courts should allow the rationale behind the respective duties to dictate the nature of the obligation to each co-insured.

The insistence on the above distinction has also created an additional uncertainty in relation to composite policies. In an attempt to avoid the perceived unfair consequences to co-insureds under such policies in the event of a breach of obligation by another co-insured, Rix J in *Arab Bank v Zurich*[2] construed such policies as being *prima facie,* bundles of separate contracts. Apart from the fact that such construction puts the insurer in an unfair advantage, since the onus of disproving this construction would be on him, it is suggested that such interpretation is far from being an accurate description of composite policies and it is also inconsistent with the decision of the Court of Appeal in *New Hampshire v MGN.*[3] The interpretation should be seen as an attempt by the courts to prevent such co-insureds from being liable for the acts of others, a position which is wrong in light of the rationale behind the particular obligation in question. It has however been pointed out that even if the separate contracts analysis is adopted, a co-insured could still be under a joint obligation, in relation to some obligations. For example with the warranty obligation, a composite co-insureds would, in most cases, still be under a joint obligation irrespective of whether or not the policy is construed as containing separate contracts. This analysis further emphasizes the point that the focus in determining the obligation of the co-insureds should be on the rationale behind the doctrine which the obligation emanates from and not on the nature of the interests of the co-insureds.

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[2] [1999] 1 Lloyd's Rep. 262.
[3] [1996] CLC 1,692.

The consequence to a co-insured's right of indemnity in the event of willful misconduct by another co-insured was also discussed. Again, the court's approach has been to use the joint-composite distinction to resolve this issue. However an examination of its application in relation to joint policies further highlighted the inadequacy of the rule of construction, as it can be argued that such co-insureds would not expect to lose their right of indemnity as a result of the wilful misconduct of another co-insured, nor would they contract on such terms. The obvious unfairness of this approach has led to the emergence of an alternative approach in other jurisdictions, which focuses on the contractual terms in determining the nature of the rights of the parties. The nature of this approach and its possible application in the English jurisdiction were discussed in Chapter III, and the conclusion arrived at was that the courts could and should apply it in determining the rights of the co-insured. The consequence of adopting this approach would however be to discard the present rule of construction which focuses on the interests of the co-insureds, in favour of the alternative modern approach which focuses on the contractual terms in determining the nature of the co-insured's right of indemnity. The consequence of this would be that the joint-composite distinction would no longer determine the nature of the rights of indemnity of the co-insureds, but would only determine the type of interests insured under each policy, i.e. composite policies insure separate interests of co-insureds, whilst joint policies insure their joint interests. In practical terms, the adoption of the modern approach would only affect the right of indemnity in joint policies. Essentially, it would mean that a co-insured under such policy would have a right to the whole policy proceeds in the event that the other co-insured is prevented from recovering as a result of his wilful misconduct.

An examination of the various obligations discussed suggests that in light of the different rationales underpinning each obligation, it is wrong for the courts to adopt the joint-composite distinction as a general rule of construction in determining the obligations of the co-insureds. The better view, as shown in this thesis, is to focus on the reasons behind the obligations and it is suggested that it is only through an understanding of the latter that one can determine the nature of co-insured's obligations and whether or not it would affect its right of indemnity under the

insurance contract. The consequence of adopting this approach would mean that in respect of the duty of utmost good faith and the warranties, co-insureds would be under joint obligations, whilst the consequence of the wilful misconduct by one co-insured would not affect the other co-insureds irrespective of the type of co-insurance contract in consideration. It has however been pointed out that these obligations could be altered where a contrary intention can be construed from the contractual terms.

4. Co-insureds and subrogation immunity

Subrogation immunity is the second of the twin benefits to a co-insured which has been explored in this thesis. The aim has been to determine whether a co-insured has such immunity and if he does the extent of such immunity. A conceptual analysis of the nature of co-insurance policies suggests that a co-insured should be protected against its insurer's subrogated action and this seems to be the view of the courts. The latter have, in the past, been unable to develop a coherent legal principle to justify this immunity, and have relied on the pervasive interest doctrine which, as argued is unclear and is an inadequate justification for the recognition of an immunity. It is however suggested that the judgments of the Courts in *Taylor Young,* provides an alternative justification which is more coherent and consistent with established principles. This justification recognizes an implied term in the contract between the respective co-insureds that in the event of loss or damage to the insured property, the insurer shall be responsible for the loss and that the parties have no rights against one another. Such an interpretation has the advantage that it is consistent with the reasonable expectations of the parties and is therefore a more persuasive interpretation than the pervasive interest doctrine which unreasonably stretches the insurable interest concept to justify the immunity. It is therefore suggested that the implied term justification should be adopted in recognizing subrogation immunity in co-insureds. The consequence of this would mean that in all cases of co-insurance, a co-insured would have subrogation immunity. However

such immunity would be subject to the exceptions discussed at the end of chapter VI.[4]

5. The Contracts Act 1999 as an alternative to co-insurance policies

The second part of this thesis discusses the possible alternatives to co-insurance contracts. In particular, the use of the Contracts Act 1999 by third parties, in order to obtain the benefits of a right against the insurer and subrogation immunity. The focus was essentially on the use of the Act by the third party to enforce the benefits available to the insured were it was the intended by the parties that the third party should enjoy such benefits. It was pointed out that in such a case, the insurable interest requirement would not be an obstacle to the third party as long as the insured had satisfied this. Where the third party could sue on the contract, the ability of the parties to vary the right of the third party was discussed with particular emphasis on how the Act controls the ability of the parties to achieve this.

In respect of subrogation immunity, the extent of which a third party can rely on a subrogation waiver clause in the insurance contract was discussed. The analysis involved a discussion of the relevant case laws to determine the approach of the common law on this issue. The conclusion reached was that despite contrary decisions in a few domestic cases and foreign jurisdictions, a third party should not have the right to rely on such clauses as a result of the privity doctrine. The enactment of the Contracts Act 1999 has however made it possible for third parties to enforce such terms where the requirements of the Act are satisfied and this possibility was discussed. It is the view of this author that where the subrogation waiver clause identifies the third party, the latter should be able to rely on the clause. A subsidiary issue also discussed was whether, in the absence of such clause, a third party who has a right of indemnity against the insurer by virtue of the Act, is automatically entitled to subrogation immunity. It was argued that where the intention of the parties to the contract is to benefit the third party, through a right of indemnity, it must also have been the intention of the parties, in the absence of an

[4] At pg. 137-8.

express contrary intention, that where the third party has caused the loss, the insured cannot bring an action against him and therefore the latter would have an immunity as a result of an implied term in the insurance contract.

6. Policies enuring to the benefit of third parties and other alternative means

The final chapter looked at possible alternatives means available to third parties to obtain the twin benefits. The first means were policies enuring to the benefit of third parties. Such policies were discussed in relation to the insurance of goods on bail and the insurance of real property in landlord and tenant relationships. An analysis of these policies showed that an insured with a limited interest in the subject matter of insurance is entitled to take out insurance of the whole subject matter for his benefit and the benefit of other limited owners. The other limited owners are however third parties to the insurance contract and therefore do not have direct rights against the insurer. The third party however has a right against the insured and in the event that the latter recovers from the insurer beyond its interest, it has a right against it for a share of the proceeds equivalent to its lost interest. A third party, in relation to the insurance of real property, however has, in relation to fire insurance, an additional right by virtue of s.83 of the Fires Prevention (Metropolis) Act 1774 which gives the latter a direct right against the insurer. This right is however subject to certain limitations as it only compels the insurer to apply the policy proceeds towards the reinstatement of the damaged building.

In relation to the possibility of the third party having subrogation immunity, the argument advanced was that if the intention of the parties to the insurance contract is to benefit the third party, it should follow that such benefit should extend to subrogation immunity. Support for the view was shown to be inherent in the rationale underlying the decisions in the bailment cases and also in the Court of Appeal's decision in *Mark Rowlands v Berni Inn.* It should however be emphasized that this view is dependent on the intentions of the parties as evidenced from the

terms of the contracts, and therefore this immunity can be excluded or restricted if a contrary intention can be construed from the contract.[5]

The possibility of the third party being a trust beneficiary of the insurance contract was also discussed. In such a case, the third party has a beneficiary would be entitled to subrogation immunity and also a right to the policy proceeds, through the action of the trustee. However, this analysis would only be possible where there is an intention to create a trust. The courts would not recognize such an intention in the absence of unambiguous clear words and where the insurance arrangement is capable of alternative construction. It is therefore suggested that this option can rarely be used by any third party and it is therefore an unlikely alternative to co-insurance policies.

The final alternative discussed was the effect of noting the third party's interest in the insurance policy. An understanding of the aim behind the act of noting, suggests that noting generally cannot provide the third party with a right against the insurer, because the declaration of an interest in the subject matter of the insurance does not amount to a promise by the insurer to indemnify the noted party, nor does the noted party become a party to the contract by virtue of that very act. This also suggests that the 1999 Contracts Act cannot be used by the noted party to become a party to the contract, solely on the basis that its interest has been noted. The aim behind noting also suggests that it does not provide the noted party with subrogation immunity. It has however been argued that noting could, in exceptional circumstances, provide the noted party with the twin benefits where the act of noting amounts to an acknowledgment by the parties that the noted party has an interest in the insurance contract. Such declaration is different from the general declaration that the party has an interest in the subject matter of insurance, and should be interpreted by the courts as an intention by the parties to benefit the noted party. This would then allow the noted party to use the 1999 Contracts Act to enforce the benefit under the contract. It is also suggested that the fact the policy intends to benefit the noted party to the extent of its interests should also be sufficient to imply a term into the contract that the noted party has subrogation immunity to the extent

[5] See the discussion of *Barras v Hamilton* [1994] S.L.T. 949, at pg. 199.

of its interest. It was therefore concluded that it is only in relation to this limited circumstance that noting would provide the third party with the twin benefits.

7. The continuing relevance of co-insurance policies

The primary aim of this thesis has been to determine the relevance of co-insurance policies in its ability to provide co-insureds with the twin benefits of a right of indemnity and subrogation immunity. As a co-insured, one is entitled to the twin benefits of a right against the insurer and subrogation immunity, but as it has been pointed out, these benefits could be forfeited as a result of a breach of an obligation by another co-insured. This possibility puts the security of such benefits beyond the control of a co-insured, and in this respect such contracts might be seen as being undesirable. The courts have sought to resolve this issue by relying on the joint-composite distinction, but as it has been shown this approach is defective and tends to ignore the aim behind the duties which the co-insureds are subject to. A better way to provide the co-insured with security of its benefits is if the co-insureds ensure that the insurance contract contains terms which effectively provide them with separate obligations. It is unlikely that insurers would be adverse to such terms since the courts interpretation of composite policies as containing separate contracts amounts to the same thing.

It is clear that there are legitimate concerns as to the security of the benefits under a co-insurance contract. Even with the present state of the law, a joint co-insured shall always be susceptible to the acts of the other joint co-insureds. However, when compared to the alternative options discussed, it can be argued that co-insurance contracts are still the more attractive option. First the nature of co-insurance policies, allows parties with a common aim or a shared interest in a commercial venture to jointly insure their similar risks. From an economic point of view, this has a major advantage as it avoids the multiplicity of insurance contracts and allows the parties to shift the risk of loss or damage on one party, the insurer. This in turn would avoid any unnecessary litigation between the parties in the event of a loss occurring to the subject matter of the insurance. Second, parties who have

limited interests in the same property and wishing to insure the property against any risks would find the co-insurance option more attractive and beneficial. Granted such parties could take out a policy in the name of one but also enuring to the benefit of the other, but as it has been shown, such third party would not have an independent right against the insurer and is dependent on the insured claiming for his benefit. Co-insureds however have direct rights against the insurer, which puts it in a stronger position, even in the case of joint policies. The analysis of the 1999 Contracts Act suggests that it cannot be used as alternative to co-insurance policies. At the most, it can be used to facilitate the implementation of such contracts, where third party co-insureds rely on it to avoid the privity doctrine, or as a means by which third parties can rely on subrogation waiver clauses which the parties to the contract intended that they should benefit from. In light of the above, it is suggested that co-insurance policies will continue to be relevant in the insurance industry. This in turn makes it necessary for the law in relation to these contracts to be coherent and consistent with established legal principles whilst at the same time reflecting the reasonable expectations of the parties which rely on such contracts. It is suggested that the analysis and conclusions which have been made in relation to these contracts if implemented, would go to some length in achieving this desired aim.

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