

## THE LIMITS OF SUBROGATION

1. What is subrogation?
  - a. Insurers' right to take advantage of claims against third parties.
  - b. There are two limbs to the doctrine:
    - i. the right to step into the shoes of the insured to bring a claim against a third party where such a claim would have reduced the insured loss;
    - ii. the right to receive from the insured any benefit conferred on him by third parties with an aim of compensating for the insured loss.
  
2. The origins of subrogation:
  - a. An equitable right? *Morris v. Ford Motor Co* [1973] 1 QB 792.
  - b. An implied term in the insurance contract? Insurance is a contract of indemnity. The insured is entitled to be fully indemnified, but not more than fully indemnified. *Yorkshire Insurance Co v. Nisbet* [1962] 2 QB 330.
  - c. The better view is the latter, i.e. that subrogation is a legal, rather than an equitable, doctrine.
  - d. Note that no express term is required in the policy to give effect to subrogation. But it is very common for insurers to insert clauses both establishing the right and dealing with its administration.
  
3. When will subrogation be denied?
  - a. Where there is an express or implied term in the insurance policy preventing subrogation. For a recent example of the latter, see *Rathbone Brothers v. Novae* [2014] EWCA Civ 1464.
  - b. Where there is an implied exclusion in the underlying contract between the insured and the third party excluding liability where the loss is covered by the insurance. Typically, this can occur where there is a provision for a "joint names" policy. But that is not a necessary requirement, nor always a sufficient one; ultimately it is a question of construction of the contract. See *Co-operative Retail v. Taylor Young* [2002] 1 WLR 1419; *Scottish & Newcastle v. GD Construction* [2003] Lloyd's Rep IR 809; *Gard Marine v. China National Chartering* [2015] EWCA Civ 16.
  - c. Where the insurers' payout to the insured is regarded as extinguishing his loss viz a viz the claim against the third party. Normally the proceeds of insurance are regarded as *res inter alios acta* in the context of a claim by the insured against a third party. But there are exceptions for reasons of "justice, reasonableness and public policy." In such an exceptional case, the insurers' payout is not ignored, and thus the insured has no loss to claim against the relevant third party. Examples of cases in which this technique has been

used to prevent subrogation include *Mark Rowlands v. Berni Inns* [1986] 1 QB 211 and *Rathbone Brothers v. Novae* [2014] EWCA Civ 1464. For further detail in relation to both, see below.

4. Important cases:

*Mark Rowlands v. Berni Inns* [1986] 1 QB 211

- a. The claimant was the freeholder of a building, while the defendant was the tenant of a restaurant in the basement. There was a fire at the building caused by the negligence of the tenant. The lease incorporated provisions:
  - i. obliging the freeholder to insure the entire premises against risks including fire;
  - ii. for the tenant to pay the freeholder an “insurance rent” reflecting that part of the insurance premium that related to its demise;
  - iii. for the tenant to repair that part of the property leased to it, but subject to a proviso that it was not required to repair damage caused by insured risks.
- b. Insurers, having indemnified the freeholder, sought to be subrogated to its claim in negligence against the tenant. The claim failed because:
  - i. there was an implied term in the lease excluding the tenant’s liability for negligence in the event of an insured peril;
  - ii. in any event, the tenant was entitled to say that the freeholder had been fully indemnified in respect of its loss pursuant to the insurance policy and that, exceptionally, the principle of *res inter alios acta* did not apply.

*Co-operative Retail Services v. Taylor Young* [2002] 1 WLR 1419

- c. Co-op was the prospective owner of a building under construction. The main contractor was Wimpey. Co-op also employed a firm of architects and a firm of engineers in relation to the construction. There was a fire in the building during the course of construction and the Co-op brought proceedings against the architects and engineers alleging that the fire had been caused by their negligence. The professionals brought third party proceedings seeking a contribution against *inter alios* Wimpey. Wimpey contended that there could be no contribution claim because, as a result of the insurance provisions of the construction contract, it could not have been held liable for the damage to the works had the Co-op brought a claim against it.
- d. There was a detailed contractual scheme in the main contract dealing with what was to happen in the event of damage to the works by certain risk:
  - i. there was a clause providing for Wimpey’s liability for loss or damage to property caused by its negligence;

- ii. but this clause did *not* apply to damage to the works;
  - iii. under clause 22A.1, Wimpey was to take out a joint names policy for all risks for damage to the works;
  - iv. under clause 22A.4, the proceeds of that insurance were to be used to pay for the reinstatement of the works, which was to be carried out by Wimpey;
  - v. in the event of an insured risk, Wimpey was entitled to an extension of time for completion of the works. But it was not entitled to claim loss and expense in respect of that additional time. So in effect, each party was to bear its own loss referable to the delay while the damage was reinstated.
- e. The House of Lords held that the effect of this scheme was that Wimpey was not liable to the Co-op for damage to the works, even if that damage was caused by Wimpey's negligence. Instead funds for reinstatement were to be sourced from the proceeds of the joint names policy. "*The ordinary rules for payment of compensation for negligence and for breach of contract [had] been eliminated*".
- f. *Obiter*, the House of Lords considered the effect of the provision for the joint names policy: it would be "*nonsensical*" that a joint insured should be able to make claims against another joint insured, and there was an implied term to that effect. Subsequent cases have interpreted the House of Lords' conclusion on this point that the implied term is to be found in the underlying contract between the parties, rather than in the policy itself.

*Tyco Fire v. Rolls-Royce* [2008] Lloyd's Rep IR 617

- g. Rolls-Royce was the employer in a project to construct a new manufacturing plant. It engaged Tyco as a contractor to install the sprinkler system. During the course of the construction, a pipe burst causing a flood and damage to the existing structures. Rolls-Royce brought a claim against Tyco in respect of the damage. Tyco contended that it was not liable because of the joint insurance provisions of the contract.
- h. The contract required Rolls-Royce to maintain "*in the joint names of the Employer, the Construction Manager and others including, but not limited to, contractors, insurance of existing structures.*" It also provided that Tyco was to indemnify Rolls-Royce in respect of loss arising out of its negligence, and there was no carve-out from this indemnity for damage caused by insured risks.
- i. The Court of Appeal held that, on a true construction of the contract, Tyco was not one of the entities in whose name the insurance was to be taken out. But in any event, the absence of an express exclusion in Tyco's indemnity would have meant that the joint insurance only needed to cover risks non-negligently caused.

- j. *Obiter*, Rix LJ questioned whether a joint names provision would always mean that a claim by one co-assured against another was excluded:

*“I can well see that a provision for joint names insurance may influence, perhaps even strongly, the construction of the contract in which it appears. It may lead to the carving out of an exception from the underlying regime so far as specified perils are concerned. But an implied term cannot withstand express language to the contrary. Moreover, if the underlying contract envisages that one co-assured may be liable to another for negligence even within the sphere of the cover provided by the policy, I am inclined to think that there is nothing in the doctrine of subrogation to prevent the insurer suing in the name of the employer to recover the insurance proceeds...”*

5. Recent developments:

*Rathbone Brothers plc v. Novae Corporate Underwriting* [2014] EWCA Civ 1464

- a. PEV was a solicitor practising in international trust business in Jersey. In that capacity he was a trustee of a trust known as the Walker Trust. PEV’s firm established a company to administer trust business, which subsequently became known as “Rathbone Trustees”. PEV was a director of that company and an employee.
- b. In July 2003, PEV was given an indemnity for up to £40 million by Rathbone Trustees and its parent company, Rathbone Brothers plc.
- c. In 2007, PEV became a consultant, and the consultancy agreement provided that Rathbone Trustees would provide professional indemnity insurance. That insurance was in the event effected by Rathbone Brothers plc for its own benefit and for the benefit of its subsidiaries. PEV was (it was held by the CA) an insured under that policy.
- d. The beneficiaries of the Walker Trust brought a claim in the Jersey courts against PEV, and PEV sought an indemnity under the Rathbone PI policy. Amongst other arguments, insurers contended that, if they were liable to indemnify PEV, they were entitled to be subrogated to PEV’s claim against Rathbone Brothers plc under the 2003 indemnity.
- e. At first instance, the judge agreed that insurers were so entitled. He held that this was not a “co-assured” type case because Rathbone Brothers plc was not a defendant to the Walker beneficiaries’ claim. Nor was it a case in which there was anything in the underlying contract(s) from which it was possible to say that the parties had excluded Rathbone Brothers plc’s liability in respect of insured risks. The judge’s conclusions are shortly stated in the judgment, but it is plain that he was significantly influenced by Rix LJ’s *obiter* comments in *Tyco*.
- f. The Court of Appeal reversed the decision on both counts. It held (by a majority) that there was an implied term in the insurance policy that insurers would not seek to be subrogated to PEV’s rights under the 2003 indemnity.

If it were otherwise that would “*seriously undermine the purpose of the policy.*” It also held (unanimously) that insurers could not have claimed under the indemnity in any event because, once PEV had been paid by insurers, exceptionally that payment would not be treated as *res inter alios acta*. As a result, Rathbone Brothers plc would be entitled to say that PEV no longer had a loss to claim, and the subrogated claim would fail for that reason. The analysis that the court applied to reach this result was that there was an implied term in the 2003 indemnity to that effect.

*Gard Marine v. China National Chartering* [2015] EWCA Civ 16

- g. This case concerned the loss of a bulk carrier ship in a storm as it was exiting the port at Kashima in Japan. The owners alleged that the charterers were in breach of the safe port warranty in the charterparty and that therefore they were liable for the loss. In fact, the Court of Appeal, reversing the judge, held that Kashima was a safe port. But it went on to deal *obiter* with the question of whether the owners would have had a valid claim in any event, given the insurance provisions of the charterparty.
- h. Under clause 12 of that contract, the vessel was to be kept insured by charterers at their expense against marine risks “*to protect the interest of both the owners and the charterers*”. There was an express term that “*all insurance policies shall be in the joint names of the Owners and the Charterers as their interests may appear.*”
- i. The Court of Appeal held that those provisions would have had the effect of excluding a claim by the owners against the charterers in respect of insured risks. It said:

“*If a loss occurs as a result of a breach of contract or negligent conduct on the part of the party who pays the premium, can the insurer use the name of the ‘innocent’ party to sue the ‘guilty’ party once the insurer has paid for the loss? Since insurance is usually intended to cover an insured for any breach of contract or duty on his part, it is generally thought that the answer to this question must be ‘no’; otherwise the party paying the premium has not secured the insurance cover he was entitled to expect.*”
- j. In relation to *Tyco* it said:

“*Although, therefore, we would not disagree with Rix LJ about the need to construe the underlying contract between the parties making agreements about insurance, we would... say that the prima facie position where a contract requires a party to that contract to insure should be that the parties have agreed to look to the insurers for indemnification rather than to each other. That will be all the more so if it is agreed that the insurance is to be in joint names for the parties’ joint interest or if there are other relevant circumstances, as in the recent case of [Rathbone], where the underlying contract consisted of an employer’s indemnity granted to an employee.*”

- 6. The impact of *Rathbone* and *Gard Marine* remains to be seen. It does suggest a movement away from the rather strict approach to exclusion of liability (and hence

subrogated claims) represented by Rix LJ's analysis in *Tyco*. There are grounds upon which both recent cases might be distinguished, in particular in the *Rathbone* case with the emphasis that was placed by the court on the fact that Rathbone Brothers plc was an innocent, rather than a negligent, party. But it is rather difficult to see why this is valid point of distinction: either there is an insurance scheme in place that excludes claims between insureds under the policy or there is not, and it is hard to see why the nature of the liability in the particular case should influence that conclusion. In any event, one can say that *Gard Marine* represents an authority for the proposition that, where a joint insurance scheme is in place, that will be a powerful reason for holding that insurers should not be able to bring claims in the name of one insured against another, irrespective of whether there are express clauses elsewhere in the contract that recognise that exclusion.

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