

Subrogation

Introduction

1. What is Subrogation?

- o Basics
 - o Subrogation is the substitution of one party for another as creditor – in other words it allows one person to step into another’s shoes and take over their rights as against the defendant.
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- o Terminology
 - o Not strictly correct to say that subrogation is a remedy, strictly speaking you are subrogation *to another’s rights*, which thereby give rise to causes of action to secure remedies.
2.
- o Types of Subrogation
 - o (1) Subrogation to subsisting rights
 - o (2) Subrogation to extinguished rights – they are revived for the benefit of the claimant.

2. Justification for Subrogation Rights

- o Three potential juristic bases for subrogation –
 - o (i) Consent or contract
 - Likely to explain insurers’ rights.
 - o (ii) Unjust enrichment
 - Watterson supports this – subrogation preventing unjust enrichment arising
 - Note that Virgo disagrees that this is a juristic base for subrogation
 - o (iii) Other sources?
 - Sometimes if the subrogation rights are not underpinned by contract or tort, sometimes it is statutory or equitable.
 - Some may appear to have no clear underlying rationale, should we see them as *sui generis*?
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- o May well be that there are simply multiple rationales.

3. Workings of Subrogation

- o Introduction
 - o Concept of subrogation was undeveloped until Mitchell published his doctoral thesis which was a watershed work.
 - o In some cases, where insurers’ subrogation rights are a key example, C would be subrogated to X’s subsisting rights against D.
 - o But some cases look like subrogation rights are being acquired when C seems to have extinguished or discharged X’s rights.
 - o The latter sort of case is where C pays off X’s debt to D as guarantor. In principle, this has the effect of discharging the debt and the rights. But if the guarantor is subrogated, something else must be going on.

- o Mitchell thought there had to be an extra process whereby X's extinguished rights were brought back to life then transferred to C for enforcement. Extra process of revival led Mitchell to describe this second class of cases as **reviving subrogation**, as opposed to **simple subrogation**. But later decided it should be distinguished as subrogation to subsisting rights and subrogation to extinguished rights.
- o New language -
 - (1) Expresses the key structural difference between the two category of cases more clearly.
 - (2) Second reason for the change is that language of subrogation to extinguish rights explains the structural difference and fundamental contrast in the second case.
 - (3) Third reason is that we don't want to leave courts into error - 'reviving subrogation' is misleading, because it implies that C gets the *actual* rights that X had. But need to accept the real position is that C, having discharged X's rights, C may get new rights against D. These new rights of C generally mirror those that X had but nevertheless they are **new rights**.
- o Two Types of Subrogation
 - (i) **'Simple subrogation'**
C - (payment for loss) □ X □ D
The payment for loss has no effect on the tort-claim by X against D.
 - (ii) **'Reviving subrogation'**
C □ X - (rights extinguished) □ D
C discharges X's rights. E.g. C provides money to pay off a debt owed by D to X.
- o Mitchell said the extinguished rights are brought back to life so that C can enforce them.
- o Reclassification
 - o 2007, Watterson and Mitchell reclassified the types of subrogation as -
 - (i) **Subrogation to subsisting rights**
 - (ii) **Subrogation to extinguished rights**
 - o Reviving subrogation refers to where C has discharged D's liability to X and takes over X's former rights and remedies against D
 - o Now clear that they are **entirely new rights** conferred on C, it only replicates X's right rather than revives it.
 - o **Authority** - *Banque Financiere v Parc*

Subrogation to Subsisting Rights (Insurers)

1. Insurers' Rights of Subrogation and Recoupment

- o Two Relevant Rights
 - o There are two distinct rights that might be relevant for an insurer - the right of subrogation in the narrow sense and the right of recoupment.
- o **4.**
- o Insurers' Right of Subrogation

- o C against D
- o Insurer's procedural right - the right to bring proceedings in the insured's name to enforce their rights against the third party for his own benefit, recovering the indemnity paid.

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- o Insurers' Right of Recoupment
 - o C against X
 - o Insurer's right to recoupment from the insured - there is a risk that the insured X will be over-indemnified, if he could take the insurer's pay out and also recover from the tortfeasor, it would lead to double compensation.
 - o If D pays the insured before the insurer does, this should make the insurer no longer obliged to pay out. But if they are not aware of the recovery from the tortfeasor, it may mistakenly pay out to the insured themselves.
 - o Alternatively it could happen the other way round, tortfeasor could pay after indemnity recovered.
 - o Law's solution in both cases is to give the insurer a recoupment right against the insured to recover indemnity over paid.

2. Juristic Basis

- o Contract
 - o Insurer has these subrogation rights, simply because the relevant parties, insurer and insured have agreed that he should.
 - o No doubt that an insurance contract could expressly confer such rights, and often do so. But even where it does not expressly say so, implied subrogation rights can be found as a sort of default.
 - o But once we talk of implied standard default terms, might wonder whether the term is implied because it is such a standard reasonable term of the relationship that the parties would obviously want to agree to it, saving them the bother from having to say it.
 - o Or is the implied term on the basis of more general policy argument?
- o Policy-based
 - o Even if the parties do not intend to confer subrogation rights, there may be policy arguments that would confer these rights.
 - o If the insured has two rights - against the defendant and the insurer, then what happens when the insurer pays out first? The defendant cannot raise the plea that you have already been indemnified. Leads to two mischiefs underlying policy concerns:
 - (1) **Over-indemnification of the insured by the insurer & third party** - Insured may be over-indemnified if he can accumulate a pay out from the insurer and additional sum from the defendant, but the indemnity insurance contract was not designed to confer a windfall upon him but to indemnify him against one loss. **This explains the recoupment right.** But alone, this does not fully explain the right of subrogation, why should the insurer be able to take over a right of action against a tortfeasor. Recoupment claim would prevent double indemnification, so why should the law give additional right of subrogation to allow insurers to sue, even when it is clear that X would never want to sue the defendant.
 - **Authority** - Brett LJ in *Castellain v Preston* 1883 -
 - o "[The] doctrine [of subrogation] does not arise upon any of the terms of the contract of insurance, ... it is a doctrine in favour of the

underwriters or insurers in order to prevent the assured from recovering more than a full indemnity; it has been adopted solely for that reason.”

- **Authority** - *Caledonia North Sea Ltd v British Telecommunications plc* 2002
- (2) **Avoiding an inappropriate distribution of the liability burden** - Need to ensure that the burden of paying for the loss is shifted from the insurer to someone the law thinks is the more appropriate burden bearer. In effect the tortfeasor is relieved from liability – technically subsisting but no one to hold him to it. Ends up being the insurer bearing the burden even though it should be the wrongdoer as a matter of policy that is responsible for the loss. Therefore focused on **inappropriate distribution of liability burden** explaining the **subrogation right**.
 - **Authority** - *John Edwards & Co v Motor Union Insurance Co* 1922
 - **Authority** - *Caledonia North Sea Ltd v British Telecommunications plc* 2002

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3. Relationship with Unjust Enrichment

- o Unjust Enrichment & the Right of Recoupment
 - o The problem with this and unjust enrichment is identifying the unjust factor.
 - (i) **Mistake** Insurer paying the insured again after he has already been compensated. The money is paid under a mistake that he is liable to indemnify the loss of the insured.
 - (ii) **Failure of Basis** as the insurer paid the insured on the basis that there is an un-indemnified loss.
 - (iii) **Policy Factor**, restitution may just be explained by policy against accumulation or double recovery.
 - Supported by Degeling - Degeling suggests that there is a new unjust factor of policy against accumulation. (He said unjust factors are either intention-based (that C's intention in paying D has been vitiated) or policy-based.)
 - If X receives value of a debt or damages from a third party, and receives value for *the same debt or damages as against another third party*, he should not be allowed to retain value paid by both parties. One of the transfer must be reversed. The threshold question is whether X should be allowed to accumulate.
 - The reason that the law says he should not be able to accumulate lies in the nature of relationship between the parties. The obligations of both the insurer and the wrongdoer are referable to the actual loss suffered by the insured, and the insurer is preferred to the wrongdoer.
 - But in contingency insurance (e.g. life insurance), the parties may have accepted the risk of accumulation and thereby allowing the insured to retain both benefits.
- o Unjust Enrichment & the Right of Subrogation
 - o How can the procedural right be explained? Looks harder to explain.
 - o Enrichment is hard to find which is reversed by the subrogation right. Could say that these rights will prevent unjust enrichment, the risk that the insured may not sue the third party so that he is enriched. But what is the unjust factor?
 - o Could only really be a policy-based unjust factor.

- o Right of subrogation is justified as a means of ensuring the burden of liability is borne by the more appropriate party - the third party wrongdoer who is primarily liable, rather than the insurer who is only secondarily liable.
- o The unjust enrichment analysis, although not impossible is not really explained in the case law.
- o Even if it was explained in these terms, would it add anything of use? It is already well-explained on the contractual basis.
- o Note the connection with recoupment and contribution.

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4. Availability and Extent of Rights

o **Insurers' Right of Subrogation**

- o Preconditions for Insurers' Subrogation Rights
 - o (1) A contract of indemnity insurance
 - Which must be for the loss which is in fact suffered
 - Subrogation rights do not arise in relation to contingency policies i.e. life insurance - where they will pay out whatever.
 - **Authority** - *Banque Financiere de la Cite SA v Parc (Battersea) Ltd* 1999
 - o (2) Insured has been fully indemnified in accordance with the policy
 - The insurer only needs to do what is required by the policy - no need to make good all of the insured's losses if the insured is under-insured.
 - **Authority** - *Page v Scottish Insurance Co* 1929
 - **Authority** - *Brown v Albany Construction Ltd* 1995
 - **Authority** - *Scottish Union & National Insurance Co v Davis* 1970
 - o (3) The insured holds rights against third parties whose exercise will diminish the losses insured against
 - **Authority** - *England v Guardian Insurance Ltd* 2000

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o Circumstances Preventing Subrogation Rights Arising

- o (1) Insured no longer exists
 - **Authority** - *MH Smith (Plant Hire) Ltd v DL Mainwaring* 1986
- o (2) Insured cannot sue himself
 - *Simpson & Co v Thomson* 1877
- o (3) Co-insurance
- o (4) Waiver of subrogation
- o (5) Public policy

o Key Features of Insurers' Subrogation Rights

- o (1) **A right to bring/have proceedings brought in the insured's name, to enforce his rights.**
 - Subrogated proceedings are brought to ensure the loss of insured is made good. So the right to bring proceedings has to be made **under the insured name to enforce his rights.**
 - Cf. Assignees can sue in their own name. The insurer can ask the insured to transfer the right to them.
 - Insurer will have to request the insured to sign a letter of subrogation on payment of indemnity. If he refuses to do so, he can bring proceedings against him to compel him to do so and at the same time proceed against the wrongdoer.
 - **Authority** - Lord Goff in *The Esso Bernicia* 1989
- o (2) **The insurer's interest in the proceedings is ignored**

- **Authority - *Castellain v Preston* 1883 -**
 - House insured against fire, damaged by fire - insurer paid out to the property owner in circumstances when the property owner was able to sell the property for its full price from the buyer
 - **Authority - *Darrell v Tibbitts* 1880**
 - Must the insured have had a legal right in tort or contract for it to count as indemnity?
 - Doubts about whether a gift could be taken into account, but the modern view is different - that you *might* treat a voluntary payment to the insured as reducing their losses, if the payment was made to insure the loss, and was not made purely to benefit the insured.
 - Quantification
 - Seems straightforward - the amount to which he would be over-indemnified if he kept both pay-outs.
 - But what is the maximum extent that can be recovered?
 - What happens if the insurer pays out £10,000 but in proceedings against a third party £30,000 is recovered. If the insurer had taken an absolute assignment of the insured's right, then they could *prima facie* recover the whole £30,000 - but a subrogated insurer is in a different position, **he cannot recover more than the indemnity paid - acts as a cap.**
 - **Authority - *Yorkshire Ins Co Ltd v Nisbet Shipping Co Ltd* 1962**
 - This makes sense in light of the policy behind the recoupment right - preventing over indemnity.
 - Could say there is a correspondence principle to shove it into unjust enrichment but don't need to, just stick to underlying policies.
 - Allocation of Recoveries
 - Default rules -
 - (1) Allocation to the insured's uninsured losses first
 - Until the insured's losses have all been good, the insurer cannot claim the balance of compensation given by the third party.
 - **Illustration - *Napier v Kershaw Ltd* 1993 -**
 - The excess was 25000 and the limit was 100000; i.e. the policy covers loss up to 125000. The insurer has paid 100000. The actual underwriting loss is 160000. The uninsured loss is therefore 160000-125000 = 35000
 - The judge thought that there could be no recoupment until the insured has recovered the whole of his *uninsured loss*. And so the recovered value should cover:
 - First, the uninsured loss of £35000
 - Then, the policy excess of £25000
 - Only then would the remainder go to the recoupment of £100000.
 - (2) Allocation to the insurer first
 - Where it is a value policy.
 - The insurer will be repaid first therefore the insured will suffer the risk of any shortfall.
 - (3) Pro-rata (proportionate) allocation between insurer and insured's uninsured losses
 - **Authority - Marine Insurance Act 1906, s 81**
 - The insured amount is less than the agreed value. Any third party recover is to be divided according to the proportion of loss borne by one another.
 - **Authority - *The Commonwealth* 1907**