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Study on the Rights of Subrogation in Insurance

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Abstract: The system of subrogation can also pass proprietary rights such as a security interest or claim to ownership of goods. If a work of art is stolen, and the insurance company pays out under a policy of insurance to the owner and the art is later recovered, the art will belong to the insurance company under rights of subrogation. Thus the fundamental purpose of the system was stated as being to prevent an insured from obtaining more than full indemnity for a loss . In exchange for full indemnity, the insured impliedly transfers his rights to obtain further indemnity from other sources. It Is very important that everyone understands the terms and conditions of every contract they sign as well as the consequences that may follow whenever any incident takes place. I therefore justify the rights of subrogation. It is a doctrine which I can say is the voice of the voiceless in the face of an accident. Some people on their own fail to claim their compensation for the damage. And not only does this doctrine benefit one party , also it makes sure that there is no overcompensation. In my own opinion all the insurance companies must include the clause in every contract and make it known to their clients.

Keywords: Subrogation; Right; Insurance

1. Introduction

The earliest known statement of the right of subrogation in the context of insurance came in the
middle of the 18th century , when the court recognized the right of insurers to assert a right in the name of their insureds. That case arose out of a decree by King George II allowing compensation to be paid to those that suffered loses in a war with Spain. Some individuals had already been indemnified by their insurers for these losses,and the insurers successfully sought to be subrogated to the rights of their insureds to receive this compensation. Moving forward by a century, the basis for the doctrine of subrogation was articulated by Brett L.J. In the seminal case of Castellain v. Preston, [1881-85] All E.R. 493 at 495 (C.A.):

The very foundation, in the author's opinion, of every rule which has been applied to insurance law is this; namely: that the contract of insurance contained in a marine or fire policy is a contract of indemnity,and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity, that proposition must certainly be wrong.

So what is definition of subrogation ? Subrogation is a legal term that is widely used in the insurance industry. Subrogation derives from laws of equity (fairness). Subrogation is a doctrine by which one who has indemnified another for a loss suffered at the hands of a third party may pursue that third party for the amount of the indemnity. The process is achieved by a transfer of the rights of recovery against the third party from the person indemnified (the subrogor) to the one that made the indemnity (the subrogee). The subrogee then stands in the shoes of the subrogor and exercises all of the rights of the subrogor against the third party to recover what was paid out.

Subrogation is most commonly a medium through which insurers recover amounts paid to their
insureds and place the responsibility for the loss with those that caused it. However, because a
policy of insurance will not always fully indemnify the insured for the loss, difficulties arise respecting the extent, if any, to which the insured's rights against the wrongdoer pass to the insurer and the manner in which the insurer is able to exercise those rights. These difficulties lead to practical problems about who has the right to commence an action and control the litigation and who is to account to whom when a judgment is obtained or a claim is compromised.

The right of subrogation may also arise as a result of a contractual agreement. Many insurance contracts contain a subrogation clause that gives the insurer the right to recover loss payments from the party responsible for the loss. However, subrogation laws already exist in most states worldwide, so insurers would likely have these rights even if policies did not contain that clause.

The doctrine of subrogation can also by-pass proprietary rights such as a security interest or claim to ownership of goods. If a work of art is stolen, and the insurance company pays out under a policy of insurance to the owner and the art is later recovered, the art will belong to the insurance company under rights of subrogation. Similarly, if an insured ship sinks, the rights of salvage will pass to the insurer if the claim is paid out as a total loss. If a guarantee is paid out by a guarantor and the bank also held a mortgage over the debtor's home, the guarantor will be subrogated to the bank's rights as a mortgagee with respect to the debtor's home.

In many areas where subrogation arises as a matter of law, subrogation may be limited under the terms of the relevant contract. For example, in a contract of guarantee, the guarantee will often provide that the guarantor waives the right of subrogation or agrees not to exercise it unless the bank has been paid in full. In an insurance contract, in addition to right of subrogation at law, there will often be a right of subrogation bolstered by the insured party's agreement that the party will provide all necessary assistance to the insurance company in pursuing any subrogated claims.

Subrogation is sometimes misunderstood by lay people and criticized on the basis that payment under an insurance claim is simply a right based upon the payment of insurance premiums, and a belief that they should also retain a right to exercise any claims arising from the insured event. An insurance contract is a contract of indemnity, however, and to allow a party to receive insurance proceeds and claim against third parties would mean that the recipient might recover more than the total loss. Because subrogation operates to prevent such over-recovery, it is considered to form part of the general law of unjust enrichment (i.e. preventing a party by being unjustly enriched by pursuing a claim for a loss in respect of which they have already been indemnified).

Although the basic concept is relatively straightforward, subrogation is considered to be a highly technical area of the law, which may require qualified personnel.

Any time you sign a contract for professional services, you should understand the consequences of each clause in the agreement. This may sound like simple common sense, but do you really understand the waiver of subrogation {for example?} provision contained in most form agreements used in the industry {insurance}, why it is there, and how it helps you manage the risk of your business? This article will be of help to clarify up some of the misconceptions.

2. Kind of Subrogation Clauses

Most commercial auto, liability, property and workers compensation policies contain a clause that addresses subrogation. In the International Standardization Organization policies, this clause is often entitled "Transfer of Rights of Recovery Against Others to Us." The clause found in one type of policy may vary somewhat from that found in another. Yet, they all have the same general intent.

2.1. Property Policy

A property insurer pays claims directly to the insured. This is reflected in the policy's subrogation clause. In the standard ISO property policy this clause states that if the insurer makes a payment to someone (typically you, the insured) that has a right to recover damages from someone else, those rights are transferred to the insurer.

2.2. Liability Policy

The subrogation clause in the standard ISO general liability policy is straightforward. It states that if the insured has rights to recover all or part of any payment the insurer has made under the policy, those rights are transferred to the insurer.

2.3. Auto Policy

Like the standard property and liability policies, the ISO commercial auto policy contains a "transfer of rights" clause. It states that if any person or organization to, or for whom, the insurer makes payment under the policy has rights to recover damages from another, those rights are transferred to the insurer. In other words, if the insurer pays a liability or physical damage claim, and someone other than the insured is liable for the injury or damage, the insurer may sue that party to recover the amount it paid.

3. Common Waiver Clause

The most commonly used "family" of form documents is that promulgated by the American Institute of Architects (AIA). The AIA B141–1997, Article 1.3.7.4 contains the following clause:

To the extent damages are covered by property insurance during construction, the Owner and the Architect waive all rights against each other and against the contractors, consultants, agents and employees of the other for damages, except such rights as they may have to the proceeds of such insurance as set forth in the edition of AIA Document A201, General Conditions of the Contract for Construction, current as of the date of this Agreement. The Owner or Architect, as appropriate, shall require of the contractors, consultants, agents and employees of any of them similar waivers in favor of the other parties enumerated herein.

4. Subrogation in the Real World

Does the clause have real world application or does it only exist in the tangled netherworld of insurance? Not too long ago in Missouri, an owner had purchased a building to be used as an office and warehouse. After

property damage was encountered, the owner's insurer encountered the effects of a waiver of subrogation clause. See generally, Butler v Mitchell-Hugeback, Inc. et al., 895 SW2d 15 (Mo 1995).

The owner had contracted with an architect, engineer, and a contractor to retrofit an existing building. The owner and the architect had entered into the AIA B141, 1987 edition, agreement. The owner and construction contractor had also used the AIA standard form agreement, which incorporated the General Conditions for Construction, A201, 1987 edition.

During the retrofit process, a portion of the roof collapsed which resulted from insufficient steel reinforcing bars being placed in the hollow core of certain pilasters, from the reinforcing steel that was installed being improperly spliced, and from certain girders being improperly cut during construction. The owner's property insurer paid the owner for the loss. The owner's insurer in turn claimed that it was entitled to be "subrogated" to the rights the owner would have otherwise had against the parties responsible for the collapse. In other words, the insurer wanted to "step into the shoes" of the building owner and pursue damages against the parties it believed were "at fault" for the collapse.

Suit was filed against the architect, among others. The owner alleged that the architect had breached its contract with the owner and also was negligent in its provision of professional services. The owner had found in the post-collapse investigation that the roof had failed due to the defects mentioned above and some other defects in the original construction, which should have been corrected.

At the trial court level, the court ruled that the owner had "waived" its claims against the architect and granted the architect judgment in its favor before the lawsuit went to trial. The owner appealed.

On appeal, the Missouri Supreme Court was called on to determine what the parties had really intended and agreed to by the use of the form agreements. The court said as follows.

In order to determine the intent of the parties, it is often necessary to consider not only the contract between the parties, but "subsidiary agreements, the relationship of the parties, the subject matter of the contract, the facts and circumstances surrounding the execution of the contract, the practical construction the parties themselves have placed on the contract by their acts and deeds, and other external circumstances that cast light on the intent of the parties.

In light of this guiding principle, the court concluded that all the contract documents of the owner/architect, owner/contractor, and the general conditions must be read together to capture what was intended by the parties.

In reliance on the provisions of the contract documents, the Missouri Supreme Court found that the owner had waived its rights against the architect for damages covered by property insurance. Since the insurer "steps into the shoes" of the owner, the insurer can have no greater rights than the owner, and, as a result, the insurer had no rights against the architect for the damages. The court went on to confirm its finding by noting that its interpretation of the contract documents finding the waiver of subrogation was strengthened by the contract clauses requiring the contractor to purchase and maintain insurance for damages.

5. Conclusion

A waiver of subrogation may allow you to avoid becoming engaged in the complexities of lawsuits and insurance claims, while managing the risk and associated expenses. The Mitchell-Hugeback case helps to demonstrate the importance of keeping the "family" of documents in place. As the Missouri Supreme Court noted, the agreements had to be read together. No one could predict the result if part of the "family" is missing or if the clauses are edited without attention to the ripple effect throughout the "family."

Thus the fundamental purpose of the doctrine was stated as being to prevent an insured from
obtaining more than full indemnity for a loss. In exchange for full indemnity, the insured impliedly transfers his rights to obtain further indemnity from other sources.

There has been some disagreement in English courts about whether subrogation is an equitable or legal doctrine.2 Canadian courts have treated it as the former. The leading case in Canada is
National Fire Insurance Co. v. McLaren (1886), 12 O.R. 682 at 687 (H.C.J.) which states:

The doctrine of subrogation is a creature of equity not founded on contract, but arising out of the
relations of the parties. In cases of insurance where a third party is liable to make good the loss,
the right of subrogation depends upon and is regulated by the broad underlying principle of
securing full indemnity to the insured on the one hand, and on the other of holding him accountable as trustee for any advantage he may obtain over and above compensation for his loss. Being an equitable right, it partakes of all the ordinary incidents of such rights, one of which is that in administering relief the Court will regard not so much the form as the substance of the transaction.

The primary consideration is to see that the insured gets full compensation for the property
destroyed and the expenses incurred in making good his loss. The next thing is to see that he
holds any surplus for the benefit of the insurance company.

Whether the doctrine is equitable or not, the Canadian and English jurisprudence is agreed that

subrogated rights do not come from the contract of indemnity but arise by operation of the common law to govern the relationship that such a contract creates.

At common law, no subrogated rights arise until the insured is fully indemnified for its loss. Once full indemnity is made, the insurer has the right to commence proceedings against the wrongdoer in the insured's name and make all decisions in the litigation. The insured has a duty to co-operate in the litigation in matters such as giving evidence at trial. The insurer is entitled to recover no more than itpaid out, and any excess goes to the insured: Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd., [1962] 2 Q.B. 330. In the event that the insured, after receiving full or partial indemnity,commences an action and makes a recovery in respect of the loss, the insured must account to the insurer.

References

[1] Mason v Sainsbury (1782) 3 Dougl KB 61; Morris v Ford Motor Co [1973] QB 792

[2] Castellain v Preston (1883) 11 QBD 380; Re Miller, Gibb & Co [1957] 1 WLR 703

[3] Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd., [1962] 2 Q.B. 330 at 339 per Lord Diplock; and Lord Napier and Marianne Bonner: Business Insurance Expert

[4] S.R. Derham, Subrogation in Insurance Law (Melbourne, The Law Book Company Limited, 1985) at 4-5.

[5] Charles Mitchell, The Law of Subrogation, ISBN 0-19-825938-7

[6] Advanced English Dictionary

[7] SUBROGATION: BASIC PRINCIPLES, EMERGING TRENDS AND PRACTICAL CONSIDERATIONS, by: John M. Moshonas, John A. Vamplew and Sean R. LernerFebruary 2006