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An Analytical Review of the
Doctrines of Subrogation and
Abandonment in the Law of
Marine Insurance

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Summary

The problem of windfall has recently become more and more frequent in marine insurance. The solution to the problem would affect both international business and the insurance industry. The Marine Insurance Act 1906 has not specified clearly about the solution; relevant English cases seem to render different decisions as to the payment recovered from the third party. The problem is caused by the confusion between abandonment and subrogation. It is also caused by the confusion between the remedies from the third party and the proprietary interest of the subject-matter itself.

In order to solve the problem, it starts firstly with the differences between the total loss and partial loss. Differences between the constructive total loss and actual total loss should be also examined. Their preconditions, the causes, and the consequences should be included in the study.

It then goes on with the differences between subrogation and rights arising from abandonment. The partial loss and total loss can lead to the subrogation rights. At the same time, the abandonment can only be caused by the constructive total loss. In addition, subrogation arises upon payment and abandonment arises upon the insurer's acceptance of the notice of abandonment. Finally, after the loss, there are two main kinds of rights, the salvage and rights against the third wrongdoer. The subrogation right refers to the former and abandonment refers to the latter. Upon subrogation, the insurer can only get what he had paid for and the assured can get the amount exceeding the insured loss in the policy. Upon abandonment, the insurer can get more than what he has paid for through the proprietary interest of the subject-matter's remains, namely the salvage.

The solution to the windfall problem is a good illustration as to the difference between subrogation and abandonment in marine insurance. The Chinese law can get some inspiration from those significant points from the problem resolution in the English law.

Abbreviations

ICC
IHC
ITCF
ITCH
IVCH
IWC(C)
P & I Club
PPI
The Act

Institute Cargo Clauses
International Hull Clauses
Institute Time Clauses (Freight)
Institute Time Clauses (Hull)
Institute Voyage Clauses (Hulls)
Institute War Clauses (Cargo)
Protection and Indemnity
Policy Proof of Interest
The Marine insurance Act 1906 of
UK

1 Introduction

1.1 Purpose

This essay is to address the problem of windfall confronted in marine insurance. The central issue is after payment for a total loss, is the insurer entitled to all the assured's rights and remedies, only to the extent necessary to enable the underwriter to recoup themselves.

This problem should be solved in such a way that it neither discourages the maritime adventure, nor causes side effects upon the insurance industry.

At the same time, the solution of this problem would give a certain kind of inspiration for Chinese law. Chinese law has followed MIA 1906 to some extent. However, as to subrogation and abandonment, the relevant provisions in Chinese law are still ambiguous and create confusions. The thesis proposes appropriate legislation to amend the existing system.

1.2 Delimitation and Methodology

In the essay, mainly English law is examined, especially the Marine Insurance Act 1906 of United Kingdom. Many countries have followed the path of MIA 1906. For example, it is ruled that the U.S courts ¹should look into English law for applicable rules and England was referred to as the great centre of marine insurance business. In addition, Australia has used the Marine Insurance Act 1906 as a model for their own marine insurance legislation.

In addition, the practice in marine insurance should be examined. Thus the standard forms, i. e. the Institute Clauses, used in marine insurance will be studied in comparison with the legislation. The thesis will find out to what extent the standard clauses deviate from the MIA 1906. Finally, study of leading cases is another useful tool to illustrate subrogation and abandonment in marine insurance.

1.3 Outline

The first chapter is introduction. The second chapter will examine the definition of subrogation rights, its practice, basis, requirement, and consequences. In order to understand the doctrine of subrogation, the details of insured losses including partial losses and total loss will be studied.

¹ However, Supreme Court of U. S. decides that courts should apply the applicable state law in the absence of a controlling federal Admiralty law principle to guide the resolution of a particular issue.

Subrogation is closely related to doctrine of indemnity. The contract of indemnity is studied in order to understand the basis and function of subrogation. The third chapter will examine the rights arising from abandonment together with its functions, consequences and purposes. The fourth chapter will examine the differences between subrogation and abandonment. The fifth chapter is the chapter of analysis, in which the problem of windfall and the relevant Chinese law will be examined. The sixth chapter is the conclusion of the essay, which is to provide recommendations to the Chinese legal system.

2 Subrogation

2.1 Definition

Subrogation has long been established in English law. The relevant provisions on subrogation in the Marine Insurance Act 1906 of UK are as follows:

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

Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain, but he is thereupon subrogated to all rights and remedies of the assured in and in respect of the subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to this Act, by such payment for the loss.

In this provision, there are two main aspects. The remedies mean the assured's right of action against the third party wrongdoer². The rights mean any other methods by which the insurer can get back the overpayment from the assured. Secondly, the insurer can get the rights and remedies retrospectively when the losses happen, upon payment in satisfaction to the insured.

The right of subrogation has been recognised for more than 200 years³, even before the Act. There is the classic definition given by Brett L. J in *Castellain v. Preston*⁴:

...As between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has

² This is where the problem of the windfall arises.

³ *Mason v. Sainsbury* (1782)

⁴ (1883) LR 11 QB DL380

accrued, and whether such right could or could not be enforced by the insurer in the name of the assured by the exercise or acquiring of which right of condition the loss against which the assured is insured can be or has been diminished.

Subrogation is the right by which an underwriter, having settled a loss, is entitled to place himself in the position of the assured, to the extent of acquiring all the rights and remedies in respect of the loss which the assured may have possessed, either in the nature of proceedings for compensation or recovery in the name of the assured against third parties, or in obtaining general average contributions thereto⁵.

This is the description in the book of Templeman's Marine Insurance Law.

In this definition, loss means both partial as well as total loss. Where there is the total loss, the underwriter is entitled to take the remains of the property, if any, which means that the rights granted to the underwriters, are involved with proprietary interests. Moreover, total loss also renders the insurer the assureds' rights and remedies against third party. Where there is a partial loss, the insurer is entitled only to subrogation without proprietary interest in the property.

Subrogation only arises where the insurer pays the insured's claim under a contract of indemnity. Therefore, although subrogation will apply to indemnity policies such as third party liability, fire and motor policies, it will not apply to life insurance, which is not a contract of indemnity since sums payable under these contracts are not related to the actual financial loss suffered by the insured.

Therefore, in order to understand the subrogation rights of the insurer, and the concept of contract of indemnity, the insured losses should be studied carefully first.

2.2 Contract of Indemnity

The principle of indemnity exists not only in insurance contracts but also in other kinds of law. However, this thesis is mainly concerned about indemnification in marine insurance. The contract of indemnity can be clarified by comparing separately with the non-indemnity insurance contract and compensation.

⁵ R. J. Lambeth, *Templeman on Marine Insurance Its principles and Practice*, 6th edition, 1986, London, Pitman, p.451

2.2.1 Indemnity and Non-indemnity Insurance Contracts

Indemnity is a contractual arrangement, whereby one party agrees to provide payment for any losses suffered by another party. Indemnity specifies that the insured should not collect more than the actual monetary loss but should be restored to almost the same position as existed before the loss. For example - property, fire, theft, public liability or marine insurance are contracts of indemnity.

Contract of indemnity ⁶provides payment for the actual loss, at the same time; non-indemnity contract would pay an agreed value upon agreed occurrence of event. For example, life insurance contracts, personal accident and sickness insurance are examples of non-indemnity contract.

2.2.2 Indemnity and Compensation⁷

Both indemnity and compensation try to “make whole”, although in fact the actual loss may still be larger than the actual payment, where there is a valued policy.

However, compensation based upon breach of contract duty by another party or based on tort liability by legislation. At the same time, the indemnity is based on the content of the contract, not on the breach of duty or liability. Indemnity is a kind of voluntary payment in exchange for premiums paid in advance.

Indemnity is also to make whole, while at the same time prevent the indemnified from making a profit. At the same time, there is no such strict requirement for compensation.

2.2.3 Principle of Indemnity

As above mentioned, indemnity is based upon the agreement not upon breach of duty. The contract of indemnity is the mutual agreement by which the underwriter would pay the assured a certain amount for loss suffered by the assured to indemnify the assured and make him come back to the condition as if the loss had not happened before. It is thus a voluntary payment based upon agreement.

On the other hand, the assured is not permitted to recover more than his actual loss⁸. Thus, to the extent of which the insurer has agreed to indemnify him, the insurer is entitled to the benefit of the rights of the assured up to

⁶ M. P. Furmston, Geoffrey Chevalier Cheshire, Cecil Herbert Stuart Fifoot Furmston, M, *Law of Contract*, ed11, 2001, Oxford University Press, p.355.

⁷ M. P. Furmston, Geoffrey Chevalier Cheshire, Cecil Herbert Stuart Fifoot Furmston, M, *Law of Contract*, ed11, 2001, Oxford University Press p.743

⁸ *Castellian v. Preston*

that amount of indemnity payable under the policy. The insurer is entitled to the rights of subrogation⁹.

The principle of indemnity comes into game only if there is insured losses, including total loss and partial loss. The next chapter will examine the insured losses, the causes and legal effects.

2.3 Insured Losses

The Act draws a clear distinction between cases where an underwriter has paid a total loss, and cases where he has paid only a partial loss. Under partial loss, the qualification of his entitlement would be to the extent of his payment. At the same time, under total loss, underwriter's rights would extend to the proprietary interests. Thus, it is necessary to distinguish between partial loss and total loss.

2.3.1 Partial Loss

2.3.1.1 Defintion of Partial Loss

According to 56 (1) of the Marine Insurance Act, a loss may be either total or partial. Any loss other than a total loss is a partial¹⁰.

S. 64 (1) further defines that a particular average loss is a partial loss of the subject-matter insured, caused by a peril insured against, and which is not a general average loss.

Partial loss is different from general average. Particular average or particular loss must be accidentally and fortuitously caused by a peril insured against, and it concerns solely the person interested in the subject-matter of the insurance and his underwriter. To the contrary, if property were deliberately sacrificed for the general benefit of the common adventure in time of peril, the loss of the subject-matter would be a general average loss, to which the owners of the property saved would contribute¹¹. Thus, partial loss is any loss other than a general average loss, and other than a total loss.

The subject-matter in marine insurance may be ship, cargo or freight. Thus there are three kinds of partial losses: partial loss on ship, partial loss on cargo and partial loss on freight.

2.3.1.2 Partial Loss on Ship

On a ship policy, according to s.77 of the Act, the insurer is liable for successive losses, even though the total amount of such losses may exceed

⁹ Return of premiums is another way.

¹⁰ *Irvin v. Hine*. [1950] 1 KB 555

¹¹ Thomas J. Schoenbaum, *Admiralty and maritime law*, West Pub. Co., 1987, p. 35.

the sum insured. This provision is subject to other provisions in the Act and subject to the contrary express in the contract.

Where, under the same policy, a partial loss, which has not been repaired or otherwise made good, is followed by a total loss; the assured can only recover in respect of the total loss. If a vessel has been damaged during the currency of the policy, has been repaired, and is subsequently totally lost. The underwriter would, in such circumstances, have to pay a total loss in addition to the claim for particular average, provided the assured is personally liable for the repairs done¹².

2.3.1.3 Partial Loss on Freight

Section 70 of the Act stipulates that: “Subject to any express provision in the policy, where there is a partial loss of freight, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the proportion of freight lost by the assured bears to the whole freight at the risk of the assured under the policy.”

The Act further stipulates that subject to the contrary expressed in the contract, the liability of the underwriter is based upon the valuation of the freight in the policy. If only a part of the cargo is on board, or actually contracted for at the time when the loss occurs, then the underwriter is only liable to pay for such proportion of the amount insured, as it bears to the whole of the cargo which it was intended to ship¹³.

The above method of proportion is different from “distance” freight, *pro rata itineris peracti* (proportionate to the distance of the voyage actually performed), and in some cases even full freight. However, in English law, under “liberty” granted to carrier by express terms of bills of lading, full freight is payable on abandonment of voyage¹⁴.

The standard form “Institute Time and Voyage Clauses-Freight”¹⁵ states that except in respect of a claim arising under the total loss clause, the

12 *The Dora Forster* [1900] P.241; 16 T. L. R. 566

13 *Forbes v. Aspinall* (1811) 13 East 323.

14 *Renton & Co. Ltd. v. Palmyra Trading Corpn. Of Panama (The Caspiana)* H. L. [1956] 2 Lloyd’s Rep. 379. (H. L.)

15 Cl. 11. MEASURE OF INDEMNITY

The amount recoverable under this insurance for any claim for loss of freight shall not exceed the gross freight actually lost.

Where insurances on freight other than this insurance are current at the time of the loss, all such insurances shall be taken into consideration in calculating the liability under this insurance and the amount recoverable hereunder shall not exceed the rateable proportion of the gross freight lost, notwithstanding any valuation in this or any other insurance.

11.3 In calculating the liability under Clause 9 all insurances on freight shall likewise be taken into consideration.

11.4 Nothing in this Clause 11 shall apply to any claim arising under Clause

amount recoverable shall not exceed the gross freight actually lost. It also stipulates that where the freight is over-insured, the indemnity is not proportionately increased, whereas the indemnity is proportionately reduced in the event of under-insurance¹⁶.

Freight insurance is usually effected between the cargo owner and underwriter other than that between shipowner and the underwriter. In practice, nowadays, payment of freight in advance, on “ship and/or cargo lost or not lost” terms would vest the insurable interest¹⁷ in the cargo owner and the risk of the freight is thus vested in the cargo owner. When the cargo owner insures the freight, he usually includes it in the cargo valuation, and pays it in advance. On the policy it reads:

On Goods, valued at ...(including ... advanced freight) the court decides that in such a case, whether the amount of the advanced freight is specified in the policy or not, the policy is to be treated as a policy on valued goods and not as a separate insurance on advanced freight¹⁸.

2.3.1.4 Partial Loss on Cargo

Section. 71 of the Marine Insurance Act provides for partial loss of cargo:

Where there is a partial loss of goods, merchandise, or other moveables, the measure of indemnity, subject to any express provision in the policy, is as follows:—

(1) Where part of the goods, merchandise or other moveables insured by a valued policy is totally lost, the measure of indemnity is such proportion of the sum fixed by the policy as the insurable value of the part lost bears to the insurable value of the whole, ascertained as in the case of an unvalued policy;

(2) Where part of the goods, merchandise, or other moveables insured by an unvalued policy is totally lost, the measure of indemnity is the insurable value of the part lost, ascertained as in case of total loss;

Section 71 (1) deals with the cases of valued policies. The method of indemnity is to ascertain what proportion the insurable value of the part lost is of the insurable value of the whole interest insured, and applying that proportion to the insured value, s.71 (2) deals with the cases of unvalued policies where the liability is for the insurable value of the part lost.

16 N. Geoffrey Hudson and J.C. Allen, *The institute clauses*, London, LLP, 1999, p. 227.

17 S.12 of the Act.

18 *Thames & Mersey Marine Insurance Co. Ltd. v. Pitts, Son & King* [1893] 1 Q.B. 476; 7 Asp. M. L. C. 302.

Section 72 of the Act stipulates the situations where different species of property are insured under one valuation. In the case of *La Fabrique de Produits Chimiques S. A. v. Large*¹⁹ two cases of vanillin, valued at £ 462 and £ 363 respectively, and one case of caffeine, valued at £ 275, were insured under one policy for £ 1,100. The two cases of vanillin were lost by a peril insured against, and it was held that they constituted an apportionable part within the meaning of s. 76(1) of the Act, both on account of the difference in species and on account of the separate values. However, where goods of the same species are insured under one valuation, valued at an equal sum per package, e.g. 100 cases rubber, at £ 50 per case, £ 5,000, it would seem that the mention of a valuation for each package would not be sufficient to constitute a separate insurance on each package²⁰.

2.3.1.5 Effects of Partial Loss

On payment of partial loss, the underwriter is entitled to the rights and remedies in respect of the subject matter, being ship, cargo or freight but only to the extent of the indemnification paid by the underwriters, no more and no less. However, the underwriter cannot claim the salvage value, namely the proprietary interest of the subject matter.

2.3.2 Total Loss

On payment of the total loss, the underwriter is entitled to not only the rights and remedies of the assured against the third party but also to the proprietary interests of the subject matter. The former relates to the right of subrogation and the latter relates to rights arising from abandonment. The underwriter can exercise subrogated rights as well as proprietary rights of the subject-matter if it is constructive total loss. However, under actual total loss, subrogated rights is usually exercised without proprietary interests. Thus, it is important to know the difference between the actual total loss and constructive total loss.

According to s.56 (2) and (3) of the Act, unless a different intention appears from the terms of the policy, an insurance against the risk of total loss includes a constructive as well as actual total loss²¹.

19 [1923] 1 K.B.203; another relevant case is (1857) 3 C.B.N.S. 16.

20 *Entwistle v. Ellis* (1857) 6 W.R. 76;27 L.J.

21. A loss may be either total or partial. Any loss other than a total loss, as hereinafter defined, is a partial loss. A total loss may be either an actual total loss, or a constructive total loss.

Unless a different intention appears from the terms of the policy, an insurance against total loss includes a constructive, as well as an actual, total loss.

Where the assured brings an action for a total loss and the evidence proves only a partial loss, he may, unless the policy otherwise provides, recover for a partial loss.

Where goods reach their destination in specie, but by reason of obliteration of marks, or otherwise, they are incapable of identification, the loss, if any, is partial, and not total.

ACTUAL TOTAL LOSS

Total loss arises only if the whole of the subject-matter insured has become lost. In addition, there might be a total loss of an apportionable part, which is not as usual as the former kind of total loss, which is illustrated as the aforementioned in note 13.

2.3.2.1 Actual Total Loss

As state above, there are two kinds of total losses. The first kind is the actual total loss mentioned in s.57 (1) of the Act.

Where the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, there is an actual total loss.

According to this provision, there are three kinds of conditions where the actual total loss can arise: destruction, deprivation and alteration of species.

Destruction includes destruction by fire, foundering in hurricane at sea, sinking in deep water after collision, or destruction by an enemy.

Deprivation includes capture, seizure, etc. For example, a vessel had been barratrously taken possession of by the crew and after several weeks, during which time no news was heard of her, she was traced and arrested by the authorities. It was held on the facts of the case that the vessel was never irretrievably lost to her owners and was therefore not an actual total loss²².

The third situation arises where subject matter ceases to be a thing of the kind insured, from a “mercantile and business point of view”²³ owing to perils insured against²⁴.

“Loss of species” is different from the “unidentifiable cargo”, which is stipulated in s.56 (5) of the Act:

Where goods reach their destination in specie, but by reason of obliteration of marks, or otherwise, they are incapable of identification, the loss, if any, is partial, and not total.

The cargo becomes so unidentifiable owing to obliteration of marks at the arrival that it cannot be delivered to its various owners. In this contingency

Where the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, there is an actual total loss. In the case of an actual total loss no notice of abandonment need be given.

22 *Marstrand Fishing Co. v. Beer (The “Girl Pat”)* (1936) 56 Ll. L. Rep. 163.

23 Lord Esher M. R. in *Asfar v. Blundell*.

24 R. J. Lambeth, *Templeman on Marine Insurance Its principles and Practice*, 6th edition, 1986, London, Pitman, p. 213.

the cargo would still exist in specie and the assured can only claim as a partial loss other than a total loss²⁵.

The effects of actual total loss is different from that of constructive total loss. Where there is actual total loss, the notice of abandonment is not necessary since there is no salvage value left²⁶. The insurer, upon payment, cannot claim the proprietary interest of the subject-matter, but would give the underwriter the rights of subrogation. The underwriter, after payment of a total loss, is entitled to use the name of the assured to sue the wrongdoer or in any other legal proceedings. In cargo insurance, it is in practice usually for the assured to sign a formal letter of subrogation evidencing receipt of payment and embodying assured's assent to this course²⁷.

2.3.2.2 Constructive Total Loss

The second kind of total loss is constructive total loss. Constructive total loss is more complicated than actual total loss. It gives rise not only to subrogation rights but also to proprietary rights.

Subject to any express provision in the policy, constructive total loss arises under two main conditions. Firstly, it happens where actual total loss appears to be unavoidable but has not happened. Secondly, it happens where the preservation expenditure would exceed the value when the expenditure had been incurred²⁸.

Maule J. in the old case of *Moss v. Smith* stipulates an illustration of constructive total loss. A man may be said to have lost a shilling when he has dropped it into deep water, though it might be possible, by some very expensive contrivance, to recover it²⁹. This illustration has well explained "physically impossible" of the actual total loss, compared to the "economically impossible" of the constructive total loss. However, it has over-simplified the real situation, as there are many more factors needed to take into consideration as to what is "economically impossible". In *Templeman's book*, the author has given an illustration about this more complicated situation in practice. It seems to be foolish to spend £ 100,000 on repairs to a ship which, when repaired, would have a current market value of £ 90,000. The ship is a freight-earning instrument. The value of a ship to the owner may be considerably enhanced by any cargo engagements

25 R. J. Lambeth, *Templeman on Marine Insurance Its principles and Practice*, 6th edition, 1986, London, Pitman, p. 213

26 s.57 (2) of the Act, in the case of an actual total loss, no notice of abandonment need be given.

27 R. J. Lambeth, *Templeman on Marine Insurance Its principles and Practice*, 6th edition, 1986, London, Pitman, p214

28 s. 60 (1) of the Act stipulates that "Subject to any express provision in the policy, there is a constructive total loss where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred.

29 *Moss v. Smith* (1850) 9 C.B. 94.

she may have at the material time, such as long-term charters. The freight to be earned hereunder would be an additional matter that a prudent shipowner would take into account in deciding whether it would be economically worthwhile to have this ship saved and repaired³⁰.

After s. 62 (1) of the Act stipulates generally about the constructive total loss, which applies to a hull policy, cargo policy and freight policy, section 62 (2) of the Act goes on about the particular instances of constructive total loss.

Section 62 (2) of the Act has similar stipulations with s. 57 (1). The two provisions have stipulated two kinds of hazards that may cause both constructive total loss and actual total loss: destruction; deprivation. "Lost in species" may be included in the destruction category. The similarities can mean that the constructive total loss can potentially develop into actual total loss or might at the material time cause either actual total loss or constructive total loss.

It is meaningful to analyze two kinds of total loss separately. Section 60 (2) of the Act also deals with them differently. Subparagraph (i) deals with the cases where the assured is deprived of possession of the subject matter; Subparagraph (ii). deals with destructions to ships; Subparagraph (iii) deals with destruction to cargo only.

Destruction of cargo is different from destruction of ships. The former consists of not only the physical destruction but also the loss of adventure. One leading case is *Rodocanachi & others v. Elliott*³¹. A quantity of silk, shipped at Shanghai for London, was discharged from the steamer at Marseilles to be sent by rail through Paris to Boulogne and then to London, the route by which the silk was dispatched being the customary one and the one named in the policy. When the steamer arrived at Marseilles, France and Germany were at war, and although the silk was put on the railway and reached Paris, in consequence of the German armies having invaded the city of Paris, it became impossible to remove it from that city. Notice of abandonment was accordingly given to the underwriters, who denied liability on the grounds that there had not been a loss by perils insured against³². It was held by the Court that there had been a constructive total loss by "restraint of princes," as there had been not a mere temporary retardation of the voyage, but a breaking up of the whole adventure. Bramwell B. in addition said that: It is well established that there may be a loss of the goods by a loss of the voyage in which the goods are being transported, if it amounts, to use the words of Lord Ellenborough, "to a destruction of the contemplated adventure."³³

30 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p. 214

31 (1874) L.R. 8 C. P. 649; L.R. 9 C. P. 518; 2 Asp. M. L. C. 399.

32 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p. 224.

33 *Anderson v. Wallis* (1813) 2 M& S. 240.

The Act does not alter this particular point. In the case of *Sanday & Co. v. British & Foreign Marine Insurance Co. Ltd.* the House of Lords decided that the law remained unaltered. Even though no specific provision is contained in the Act to that effect, there is a constructive total loss of cargo when they are prevented from reaching the destination by a peril insured against, provided there has been a proper abandonment, even though the goods themselves are not damaged at all³⁴.

Loss of adventure is not actual total loss but is a classic constructive total loss. A business man can claim damages under this situation and rapidly get rid of the trouble. This is made for business efficacy and to encourage the export trade. At the same time, there is a possibility that the underwriter can get some remains or interests in the subject-matter, for example the insurance company has any other channel to sell the cargo. The constructive total loss would thus also balance the interest of the insurance industry³⁵.

Where there is constructive total loss, the assured can claim total loss as mentioned above, he can alternatively claim a partial loss and can still get a 100% for the insured loss. However, why does the assured claim a constructive total loss other than partial loss here? Maybe in the former case, it is a policy excluding particular average. Thus if he claims particular average, he may get no payment from his underwriter.

A constructive total loss is owing to the situation where it was unlikely that the goods would reach their destination or because the actual total loss appearing unavoidable within the meaning³⁶ of subsection 60 (1)³⁷. It means that either “unlikely” of recovery or “unavoidability” of the actual loss can be established, the constructive total loss can be maintained, provided other necessary conditions can be satisfied.

34 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p. 224.

35 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p. 225.

36 Herbert M. Lord, “The Hull Policy: Actual And Constructive Total Loss and Abandonment”, 41 TUL. L.R. 347, 350 (1967)

37 [1917] 1 K. B. 860; 22 Com. Cas. 185. A cargo of wood squares shipped in a Norwegian vessel was insured against war risks from a Baltic port to Garston. After sailing from Ranmo on 22nd November 1914, the vessel was stopped by German torpedo-boats, and the master was told that he would no be allowed to pass the Sound, the German Government Having on 23rd of that month declared wood to be contraband of war. Notice of abandonment, which was declined, was given to the underwriter by the assured on 3rd December, and it was mutually agreed that the assured should be placed in the same position as if a writ had been issued on that date. As a result of subsequent negotiations between the Norwegian Government and the Germany Government for the release of the ship and cargo, the German Government, whilst declining to allow the vessel to proceed on her voyage, required, for the release of the ship, a guarantee that the cargo would be discharged as Norwegian port. A guarantee to this effect was provided by the Norwegian Government, but no undertaking was given that the wood should remain at a port in Norway, and the ship proceeded to Grimstad, where the cargo was discharged. Eventually the cargo was re-shipped to England, but not until the autumn of 1915.

In most cases it arises as to whether or not it is unlikely that the subject-matter can be recovered other than that whether or not the actual total loss is unavoidable. In another case³⁸, Roche J. held that it was not merely uncertain whether her owners would recover her in a reasonable time³⁹. The balance of the probability was that they would never recover her at all during a time limit, which should be reasonably decided case to case. Again, this balance of probability is engaged with material date of the commencement of the action⁴⁰. After the time limit, the recovery of subject-matter does not affect the establishment of the constructive total losses.

In practice, this time limit is resolved by, the “limited to twelve months” clause inserted in insurance contracts against war risks on ships as well as on freight⁴¹. The one on ship is stated as the following.

In the event that the Vessel shall have been the subject of capture seizure arrest restraint detainment confiscation or expropriation, and the Assured shall thereby have lost the free use and disposal of the Vessel for a continuous period of 12 months then for the purposes of ascertaining whether the Vessel is constructive total loss the Assured shall be deemed to have been deprived of the possession of the Vessel without any likelihood of recovery.”

If any one of capture, seizure, arrest, restraint, detainment, confiscation or expropriation happens and after the time limit of 12 months, the assured are deprived of free use and disposal, the constructive total loss can be established. However, this clause does not specify the commencement of the 12- month period. It may well be on the day when the capture, seizure, arrest, restraint, detainment, confiscation or expropriation happen.

Deprivation and damage may either give rise to constructive total loss, where the recovery cost exceeds the value when repaired. The former needs no specification as it is already manifested in the Act. At the same time, the latter needs to be studied in detail where the recovery cost exceeds the value of the subject-matter repaired.

In addition, the differences exist between the ship and the cargo policy. In the case of a ship, it may happen where the repairing costs exceed the value repaired; in the case of cargo, it may happen where the cost of repairing and forwarding exceeds the value on arrival⁴².

38 *Roura & Fourgas v. Townend & others* [1919] 1 K.b. 189; 24 Com. Cas. 71; 14 Asp. M. L. C. 397; 35 T. L. R. 88.

39 *Irvin v. Hine*

40 *Polurrian S. S. Co. Ltd. v. Young*

41 Clause 3 of the Institute War and Strikes Clauses- Hulls and Freight.

42 S. 60 (2) (ii) (iii) of the Act are as following:

(ii) In the case of damage to a ship, where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired. (iii) In

On the ship policy, in order to specify whether it is a constructive total loss, it is necessary firstly to list costs which are included in repairing cost, which is not exhausted in the Act.

In the case of a vessel in ballast, only the repairing and refloating costs would be included in recovery costs. In the case of the vessel with engagement for the carriage of cargo, it is more complicated. The recovery costs include the general average expenditure but only to the proportion sustained by the subject matter⁴³. In addition, future salvage operations in the Act do not include the cost of salvage operations carried out anterior to the abandonment⁴⁴. This is because it is a charge in respect of “future salvage operations” within the meaning of the Act. Again, in respect of the cost of repairs no deduction is to be allowed in respect of amelioration by reason of new material replacing old; nor is there to be any abatement made on account of the increased cost of the repairs in consequence of the age of the vessel.

Problem arises as to whether the value of the wreck is included or not, which the Act has not mentioned. In the case of *Hall v. Hayman*⁴⁵, the reasoning employed here is to literally read the Act rather than to apply the test of “uninsured prudent shipowner”. Bray J. said that: “It seems to me that the word expenditure⁴⁶ is a perfectly plain word, and I cannot construe it as including the value of the wreck.” .

After the recovery costs are concluded⁴⁷, it is then to estimate the value when repaired. The Act does not specify the “value of ship repaired”, nor does it specify what considerations are to be given effect to in ascertaining the value.

Market value or insured value is the possible solution. Market value means the sum which other parties would be prepared to pay for the vessel when repaired or the value of the vessel at the material time to her owner; or the insured value, which is the value agreed upon by the two parties of the insurance policy, which the Act⁴⁸ stipulates as not necessarily the value to be regarded. In the case of a special ship for which there is no general demand or market, the cost of building and fitting for the specialized use, less a deduction for wear and tear, would be calculated as the value of the ship repaired

the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival.

43 *Kemp v. Halliday* (1865) L. R. I Q. B. 520.

44 *Hall v. Hayman*

45 [1912] 2 K.B. 5; 17 Com. Cas. 81; 12 Asp. M. L. C. 158; 28 T. L. C. 171.

46 S. 60 (1) of the MIA 1906.

47 In practice, it is usual for the assured and the underwriters each to have their own surveyor, or surveyors. The results arrived at often differ widely and frequently in such cases. The solution is offered by the *Lore Murray* : some discounting is required from the result on either side. A close study can be found in case of *Hall v. Hayman*.

48 S. 27(4) of the Act,

Another question is whether the freight earned should be taken into account in arriving at the value of the ship. The freight market tends to fluctuate a lot and the value of the ship, as a freight instrument, tends to fluctuate accordingly. However, s. 60 (2) (ii) of the Act refers only to the ship's value and it seems that the freight should not be included.

However, in practice, all those problems are solved, as the policy on ship usually contains a so-called "Constructive Total Loss Clause"⁴⁹.

In ascertaining whether the Vessel is a constructive total loss, the insured value shall be taken as the repaired value and nothing in respect of the damaged or break-up value of the Vessel or wreck shall be taken into account.

No claim for constructive total loss based upon the cost of recovery and/or repair of the Vessel shall be recoverable hereunder unless such cost would exceed the insured value...

These clauses in I. T. C Hulls contain express provisions that the insured value shall be taken as the repaired value, when determining whether the vessel is a constructive total loss and against which the estimated cost of repairing must be compared.

This clause has also made express provisions that the value of the wreck should not be included in the cost of repairs .

The clauses do not specify to what extent the ship shall be repaired. However, the holding in the case of *North Atlantic Steamship Co. Ltd. v. Burr* makes it clear. The repaired value of the vessel means only the repaired value with reference to the particular vessel as she was at the time when the insurance was affected. The vessel shall be seaworthy and of the same classification as at the time when the vessel was valued for the policy⁵⁰.

In practice another method is used, which is however not that popular as the one above. It is in the "Dual Valuation" in the hull policies.

(a) Insured value for purposes of Total loss (Actual or Constructive)

(b) Insured value for purposes other than Total Loss.....

In the event of a claim for actual or constructive total loss (a) shall be taken to be the insured value and payment by the underwriters of their proportions of that amount shall be for all purposes payment of a Total Loss.

49 Institute Time and Voyage Clauses.

50 *North Atlantic Steamship Co. Ltd. v. Burr* (1904) 9Com. Cas. 164.

In ascertaining whether the vessel is a Constructive Total Loss (a) shall be taken to be the insured value and payment by the Underwriters of their proportions of that amount shall be for all purposes payment of a Total Loss.

No claim for Constructive Total Loss based upon the cost of recovery and/or repair of the Vessel shall be recoverable hereunder unless such cost would exceed the insured value as in (a).

In no case shall Underwriters' liability in respect of a claim for unrepaired damage exceed the insured value as in (a).

Additional insurances allowed under the Disbursements Clause to be calculated on the amount of the insured value as in (a).

According to the dual valuation clause: there are two valuations; smaller one is the basis of liability for total loss, which is at the same time used for testing whether there is a constructive total loss. And the greater one is the limit for the loss other than the total loss. After the World War Two, values of the ship falls very sharply without a corresponding reduction in repair costs. R. J. Lambeth expresses the object of the clause in his book:

The object of this clause is to limit the liability under the policy for total loss to a sum more nearly approaching the approximate market value of the vessel insured, the higher value upon which the vessel had previously been insured being retained with a view to maintaining the premium for a sufficient sum to cover particular average claims based on repair costs, without the need to make a drastic increase in the premium rate expressed as a percentage of the insured value, and also with a view to maintaining the level of the franchise.

The constructive total loss of cargo owing to damage is easier to establish than that of the ships. Section 60 (2) makes it clear that two factors needed to be taken into consideration when it comes to cargo: the cost of repairing the damages; the cost of forwarding the cargo to destination. If these two costs together have exceeded the value of goods on arrival at their destination, the constructive total loss can be established. Then the prudent uninsured owner test should be a solution to the questions during the course of establishment of the constructive total loss.

The stipulation about the constructive total loss of the cargo in the Institute Cargo Clauses is almost the same with that in the Act. In the Institute Cargo Clauses it is provided as the following:

No claim for Constructive Total Loss shall be recoverably hereunder unless the subject-matter insured is reasonably

abandoned either on account of its actual total loss appearing to be unavoidable or because the cost of recovering, reconditioning and forwarding the subject-matter to the destination to which it is insured would exceed its value on arrival.

There the recovering, reconditioning is equal to “repairing” in the Act; “forwarding” is same word employed by the two sentences in the Act and in the standard form. On the other hand, the “repaired value” as the same words as the value on arrival in the Act. However, this is different from the “insured valued”, which is employed by the standard form of the hulls. The difference is caused by the freight whose market fluctuates a lot. The ship is the instrument for earning freight and thus affected by the fluctuation of the freight. The cargo, on the other hand is relatively stable in price.

Where the underwriter has settled a constructive total loss, he is then entitled to receive the net amount which the goods realized by sale at the port of distress, which is called “salvage”. In this situation, the underwriter is not only entitled to the subject-matter’s proprietary interests which is owing to the valid abandonment but also to the subrogated rights against the recovery from the third party, which is owing to the payment of the loss. Where the underwriter pays the difference between the total insured value and the net- proceeds of the goods, such a settlement is termed a “salvage loss”⁵¹, which is a particular average other than a constructive total loss. In this situation, the underwriter is only entitled to the subrogated rights.

Then it goes on to the constructive total loss of freight. In the Act there is no particular definition of constructive total loss of freight. The general express of constructive total loss in s. 60 (1) may be related to freight without relating to the name of it. The majority view is that the Act makes little or no reference to constructive total loss of freight. Some believe the supreme difficulty in the freight insurance is the reason why the Act has no particular mention of it⁵². Others believe that no mention in the Act is the reason why there is difficulty in the freight insurance⁵³. The causation and the result are obviously reverted in the two arguments

The common assumption behind the two arguments is that there is no particular reference to freight insurance in this Act, which is related to by s. 91(2). Thus, the common law test can be taken into consideration.

51 In the event of the cargo sustaining damage that it can be sold in its damaged state at a place short of its destination to better advantage than if it is reconditioned and forwarded even though the cost of reconditioning and selling would not exceed its value on arrival. This sale is due to mere commercial desirability.

52 55 L1. L. Rep.

53 *Kulukundis and others v. Norwich Union Fire Insurance Society Ltd.* (1935) 52 L1. L. Rep. 340

As to the freight, there is no significant difference between a constructive total loss and actual total loss. This is because if there is no benefit for the underwriter of freight, there is no necessity for the notice of abandonment.

In the case of *Kulukundis and others v. Norwich Union Fire Insurance Society Ltd.* Greene L. J. said that:

Upon the principle recently reaffirmed by this court in the *Yero Carras* case” a shipowner, in which expression I include a charterer by demise, is entitled to claim against his freight underwriter as for a total loss of freight, if the vessel suffers such sea damage as will free the shipowner from his obligation under the contract of affreightment to carry the cargo to its destination, provided, of course, that the cargo is not in fact carried either by the shipowner himself or by abandonees of ship so as to earn the freight. There may be, perhaps, a further exception where transshipment, although optional to the shipowner, is a reasonable and practical course.... The rule that a shipowner is entitled to be freed from his obligations to the freighter, if the vessel is lost in a commercial sense, is now well established, and it cannot in my judgment be treated as the same rule, or a branch of the same rule, as that which applied between owner and hull underwriter. It stands on foundations of its own, and its scope and effect must be ascertained accordingly.

The right of recovery under the freight policy will be largely dependent upon the position under the contract of affreightment other than the insurance contracts of cargo and/or ship, provided there are no provisions as to such opposite effects in the freight policy⁵⁴. It may happen where the constructive total loss of ship is owing to the commercial loss of ship⁵⁵. Where there is particular average settlement under the ship policy, there would be settlement of total loss under the freight policy. Again, that a constructive total loss of cargo does not necessarily give rise to a constructive total loss of freight.⁵⁶

However, the total loss of ship does, sometimes lead to the total loss of the freight. According to s. 63(2) of the Act:

Upon the abandonment of a ship, the insurer thereof is entitled to any freight in course of being earned, and which is earned by her subsequent to the casualty causing the loss, less the expenses of earning it incurred after the casualty;

54 This is especially true where there is advanced payment and risk has been shifted to the cargo owner.

55 *Yero Carras*. Commercial loss of ship means the shipowner is justified at common law in abandoning the adventure⁵⁵, even though the ship is not a total loss within the strict insurance meaning of those terms as defined in the Act.

56 52 L1. L. Rep.

and, where the ship is carrying the owner's goods, the insurer is entitled to a reasonable remuneration for the carriage of them subsequent to the casualty causing the loss.

This means that where the valid abandonment of the ship is accepted by the insurer, the insurer of the ship is entitled not only to the ship but also to the freight in course of being earned, and which is earned by the ship subsequent to the casualty⁵⁷. And the insurer here is the underwriter of the ship not the underwriter of the freight. In addition, as the freight is being earned or earned subsequent to the casualty, the owner cannot claim total loss from the freight underwriter.

The freight here is like the proprietary interest subsidiary to the freight earned instrument, and after the valid abandonment the underwriter becomes the owner of the freight instrument. Thus the underwriter of the ship is entitled to the freight earned subsequent to the casualty. As the owner of the ship earned the freight, the assured cannot claim a total loss from the underwriter of the freight⁵⁸.

In practice, to resolve this kind of dispute, the ship policy usually contains a “freight waiver clause”, which deviates from s. 63(2) of the Act.

In the event of total or constructive total loss no claim to be made by the Underwriters for freight whether notice of abandonment has been given or not.

In addition, the Institute Time Clauses- Freight, as well as the Institute voyage Clauses- Freight contain “Total Loss Clause-Freight”.

15.1 In the event of the total loss (actual or constructive) of the vessel named herein the amount insured shall be paid in full, whether the vessel be fully or partly loaded or in ballast, chartered or unchartered.

15.2 In ascertaining whether the vessel is a constructive total loss, the insured value in the insurances on hull and machinery shall be taken as the repaired value and nothing in respect of the damaged or break-up value of the vessel or wreck shall be taken into account.

15.3 Should the vessel be a constructive total loss but the claim on the insurances on hull and machinery be settled as a claim for partial loss, no payment shall be due under this Clause 15.

The first clause effectively makes the policy on freight increased value

⁵⁷ The exception is that the cargo is transshipped by another vessel to the destination.

⁵⁸ *Hickie v. Rodocanachi* (1859) 28 L. J. Ex.273

insurance on the vessel. To invoke payment under the freight policy it is only necessary to show that the vessel has been an actual or constructive total loss and the assured need not prove as to the amount of freight at risk at the relevant time. The second clause lays down the test for establishing whether the vessel is a constructive total loss and places it on the same basis as provided for in the I.T.C Hulls. The third clause means that the claim under the freight policy cannot be sustained, where the vessel was a constructive total loss within the definition of the Marine Insurance Act 1906, but she was never abandoned and settled as only a partial loss⁵⁹.

When those clauses are used, three points must be kept in mind. Firstly, even if the freight underwriter has paid in full for the total loss, he is still entitled to right of salvage. The entitlement granted to the underwriter arises from the effects of abandonment⁶⁰. The underwriter of the freight is also entitled to the subrogated rights. Secondly, there may be a set off between the payment for the loss and salvage⁶¹. Thirdly, assured is entitled to the payment fixed by the policy, even bigger than fixed under the charter party⁶², provided that a “freight and/or chartered freight and/or anticipated freight” clause is inserted. Fourthly, the clause here is for the charter-party without involvement with the cargo-owner. Fifthly, if the vessel is not an actual or constructive total loss within the provisions of the clause, it is still open to the assured to establish a claim for total loss of freight or partial loss of the freight according to the ordinary rule of the law⁶³ and the above mentioned clause is only applied where there is constructive total loss cases.

The distinction between constructive total loss and actual total loss is that in the former, it is a legal fiction, it is not in fact totally lost, but is likely to become so. In the latter it is practically impossible⁶⁴.

2.4 Nature of Subrogation

The nature of subrogation is still under discussion and there are three main trends. Firstly, it has roots in the common law, where it is seen as a matter of the implied term of the contract⁶⁵. Secondly, it has roots in equity, in the principle of unjust enrichment. In the English jurisdiction, subrogation is implied in the marine insurance contract and confirmed by the Act. It means that even in the absence of an express statement, subrogation exists in marine insurance, subject to contrary speculation in the contract⁶⁶.

59 This clause is introduced following the case of *Petros M. Nomikos Ltd. v. Robertson*.

60 [1912] 3 K.B. 315; 17 Com. Cas. 313; 12 Asp. M. L. C. 231.

61 [1912] 3 K.B. 315; 17 Com. Cas. 313; 12 Asp. M. L. C. 231.

62 *Papadimitriou v. Henderson K. B.D.* (1939) 64 L1. L. Rep. 345; 45 Com. Cas. 29.

63 Clause 13 of the I. T. C. (F) and Clause 11 of the I. V. C.

64 *George cohen, Sons & Co. v. Standard Marine Insurance Co.*

65 *Yorkshire Insurance Co Ltd v. Nisbet Shipping Co Ltd* [1961] 1 Lloyd's Rep. 479;

Hobbs v. Marlowe [1978] AC 16. A recent case relates to this view is *Bee v. Jenson* (No.2)

[2008] Lloyd's Rep. IR 221.

66 *England v. Guardian Insurance Ltd* [1992] 2 All ER (Comm) 481.

The notion of marine insurance has been stipulated in s.1⁶⁷ of the Act, that marine insurance contract is to indemnify the insured by the insurer, to the extent agreed in the contract, against the insured losses. Thus, the marine insurance contract is one of indemnification. In *Simpson v. Thomson*, Lord Cairns L.C described the basis for subrogation as follows⁶⁸:

...the well known principle of law that where one person has agreed to indemnify another, he will, on making good the indemnity, be entitled to succeed to all the ways and means by which the person indemnified might have protected himself against or reimbursed himself for loss.

Subrogation can only arise where it is a contract of indemnity. The principle of indemnification is fulfilled and strengthened by subrogation. Just as aforementioned, upon payment, the insurer will step into the shoes of the assured and inherit his rights in relation to the subject-matter⁶⁹ of the insurance contract⁷⁰. In addition, the assured cannot recover from the insurer more than the loss he has suffered⁷¹.

2.5 Functions of Subrogation

The insurance contract would bring two problems. The assured may be over-indemnified for the loss insured against by an accumulation of recoveries from the insurer and the third party. At the same time, an insured person, will sometimes prejudice the rights of the insurer, by a waiver clause or being negatively inactive with the third party. The function of the subrogation, thus, is to prevent the assured from being over-indemnified under the contract of insurance for the loss insured against, at the expense of the insurer and prevent the assured of prejudicing the right of the insurer against the third party.

Subrogation can achieve the two functions in the following ways. Firstly, where the loss is diminished before the assured obtains payment from his insurer, the insurer's liability is correspondingly reduced. Secondly, where the loss is diminished and the underwriter overpays for the loss, the underwriter has a claim against his assured to recover the amount of the overpayment. Thirdly, after the indemnification by the insurer, the assured

67 "A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby by agreed, against marine losses, that is to say, the losses incident to marine adventure."

68 (1877) LR 3 App Cas 279

69 To be indemnified, the assured must have suffered a loss, which means he must have something at risk of being lost, which is the insurable interest in the subject matter. Without the insurable interest in the subject matter, the contract of insurance is in fact contracts of gaming and wagering, which is prohibited.

70 Gottthard Mark cauci, *Marine Insurance*, chapter in the handout of the World Maritime University.

71 Susan Hodges, *Law of Marine Insurance*, London 2004, Cavish Publishing Limited, p. 7-12.

obtains recovery from wrongdoer, which diminishes the loss, the underwriter has a claim for this amount of recovery.

Fourthly, if, after indemnification by the insurer, the assured has a right of action against the wrongdoer, whose result would diminish the insured loss, the underwriter then is entitled to be subrogated to the assured's right of action. The assured should hold the right of action for the insurer's benefit to the extent that the insurer can recoup the amount of the over-payment. In English law, the insurer has an equitable proprietary right in the form of equitable lien over recoveries obtained by the insured and possibly over the assured's right of action against a third party⁷².

According to the above, the assured is not allowed to be overpaid from the underwriter. This overpayment shall return to the underwriters. Furthermore, it does not matter whether the recovery from the third party, is paid to the assured before or after the underwriter's indemnification. The underwriter has the right of subrogation, upon his payment to the assured.

Some authors⁷³ have categorized it into two groups. Where the insurer pays firstly, the insurer is entitled to insist that the subsisting rights held by the assured against third parties are exercised for the insurer's benefit. The insurer's benefit is only equal to the amount paid by the insurer. Where the third party pays firstly and the insurer then mistakenly overpays the assured, the insurer is also entitled to the amount of overpayment by him. Under this situation, the insurer can claim to recoup from the assured. And the claim to recoupment is secured by an equitable lien over the recoveries obtained by the assured from third parties, or equitable lien over the rights of action held by the assured against the third party.

Some authors⁷⁴ argue that it has long been established in English common law that an insurer A, who indemnifies a person, B, for loss sustained by B which was caused by C, is entitled to stand in B's shoes and exercise B's rights to recover the loss from C. The owner had in fact recovered twice for the same loss (once from the insurer and once from the prize money), ordered that the insurers were entitled to recover the amount they had paid out and that in fact the owner only held the funds in trust for the insurer.

It may also be argued that the assured has already been compensated for loss, the assured therefore suffered no loss at all and as a matter of fact the insurer has suffered a loss which results from the act of the third party.

However, the insurer is only entitled to the rights already accruing to the assured and cannot at the same time acquire new rights which the assured never possessed.

72 F. D. Rose, *Marine Insurance-Law and Practice*, 2004, LLP, London, Singapore, p.518
S. Derham, *Subrogation in Insurance Law*, Law Book Co Ltd, Sydney, 1985; C Mitchell, *The Law of Subrogation*, OUP, Oxford, 1994, p.241.

74 S. Durham, *Subrogation in Insurance Law*, Law Book Co Ltd, Sydney, 1985; C Mitchell, *The Law of Subrogation*, OUP, Oxford, 1994. p. 251.

2.6 Precondition of Subrogation

The precondition of subrogation consists of insured losses, payment of the underwriter. The insured losses include partial losses and total losses, which have been examined in last chapter. This chapter will clarify another necessary condition: the payment of the underwriter.

2.6.1 *The Time of Payment*

According to the Act, the underwriter can only commence effective action after his payment to the assured⁷⁵. If the underwriter commences action before he pays or gets the authority from the assured, the action is not effective in spite of that the underwriter indemnifies the assured later on⁷⁶. However, this is subjected to the opposite stipulation in the contract agreed by both parties, as in the standard forms, “International Hull Clauses” cl. 49.1.4⁷⁷:

Co-operate with the Leading Underwriter(s) in the taking of such steps as may be reasonably required to pursue any claims against third parties.

The insertion of the clause requires that even before the payment from the insurer, the assured shall assist the insurer in pursuing a suit against the third party.

2.6.2 *The Amount of Payment*

The Act has mentioned that the entitlement of subrogation rights depend upon the payment for partial loss or total loss. It, however, has not stipulated as to what extent he has paid it off, the whole or certain percentages.

According to English common law, the insurer cannot obtain the subrogated rights unless he has fully indemnified the insured losses agreed under the policy. Accordingly, an insurer who has reserved his rights as to liability, or withhold part of the indemnity, has no subrogation right. The Judge in *Castellain v. Preston (1883)*, one of the main cases on subrogation, said:

...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

75 *Danish Mercantile Co Ltd v. Beaumont* [1951] Ch 680 (CA)

76 *Government of Pakistan v. Ionian Trader* [1961] AMC 266; *Page v. Scottish Ins Corp Ltd* (1929) 33 Ll LR 134 (CA)

77 I. H. C. 03, cl. 49.1.4

will prevent the assured from obtaining a full indemnity, or which will give the assured more than a full indemnity, that proposition must certainly be wrong.

This means that the insurer shall not pay more than the amount agreed in the policy or less than the amount. It should be just the same as agreed.

The loss in the above sentences has two possible meanings. It can mean the actual total loss and it can also mean the agreed loss. Before the valued policy existed in the market, the loss in the sentences is not this ambiguous and definitely mean the actual loss. The valued policy has changed the operation of the indemnity principle through the agreement by both parties, which has been expressly sanctioned by the Act.

Valued policies are the policies for which a valuation is agreed which may not be the true valuation of the subject-matter. The agreed value is conclusive between the parties of the policy as to the value of the subject-matter, in the absence of fraud⁷⁸. The parties are estopped from disputing that the value of the thing insured is as agreed, even if the actual loss is more than the insured value.

2.7 Qualifications of Subrogation

After the insured has paid to the assured for insured loss under the policy, the insurer is entitled to the subrogation rights. There are exceptions.

If the assured has lost the rights of action against the third party, due to a prior valid contract, which excluded any liability between the assured and the third party, the insurer accordingly has no rights against the third party. However, it does not mean that the insurer has no remedies at all. If previously, the assured has gotten recovery from the third party in diminishing the loss, the insurer is entitled to the recovery to the extent of his overpayment.

In addition, if the assured's right of action is time barred, the insurer's right is also time barred.

There are five other situations which qualifies the subrogated rights, where the third party is co-insured under the policy, where the insurance policy itself is illegal, like a P.P.I policy, and where there is a waiver clause under the insurance policy between the assured and the underwriter. Again, the reinsurer is under a unique situation, whether he is entitled to exercise the right of subrogation depends on whether the original underwriter has been restituted for his overpayment.

78 MIA 1906, s. 27 (2).

2.7.1 Immunity to Co-insured

The insurers cannot exercise subrogation rights against their assured or a co-assured, which can be extended or qualified by express term in the marine insurance policy.

It has long been established in English law, that a man cannot sue himself. In marine insurance law, the assured cannot sue himself. The underwriter has no better rights than the assured and the assured cannot sue himself. The underwriter thus cannot sue the assured. In the case of *Simpson v. Thomson*, a ship was sunk in collision with another ship of the same ownership, that the underwriters who had paid a total loss on the ship that was sunk had no right of recovery from the owner, although the other ship was at fault. No remedy has been transferred to the underwriters.

This has been confirmed by the Lord Chancellor that:

But this right of action for damages they must assert, not in their own name, but in the name of the person insured; and if the person insured be the person who has caused the damage, I am unable to see how the right can be asserted at all

Even the negligence of the co-assured cannot deprive of him of this kind of immunity, unless there is the wilful misconduct of the co-assured⁷⁹.

This general principle is illustrated by the case *National Oilwell (UK) Ltd v. Davy Offshore Ltd*.

The explanation for the insurer's inability to cause one co-assured to sue another co-assured is that in as much as the policy on goods covers all the assured's on 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 (loss or damage even if caused by the assured's negligence) against which he had insured for the benefit of the very party against whom he now sought to exercise rights of subrogation...

79 *Sammuel & Co Ltd v. Dumas* (1924) 18 L1. L. Rep. 582.

2.7.2 No Subrogation Rights under P.P.I Policies⁸⁰

If the payment by an underwriter is not made under a legally enforceable contract of indemnity, he acquires no right of subrogation. In the case of *Edwards & Co. Ltd. v. Motor Union Insurance Co. Ltd.*, the plaintiffs sought a declaration from the Court that the defendants were not entitled to any share of a sum they had received in collision proceedings. The plaintiff's vessel had been sunk in collision, and the defendants had paid to them a total loss under a "P. P. I" policy. McCarie J. held that the defendants were not entitled to any recovery. The reason is "to enforce subrogative rights cannot be based on a document which is stricken with sterility by Act of Parliament."

2.7.3 Reinsuring Underwriters' Rights of Subrogation

The reinsuring underwriter can exercise the rights of subrogation only if the original underwriters' liability for insured loss is diminished by the third party. The original underwriters would not be entitled to recover from the assured if the assured had not received any payment in diminution of the wrongful doer⁸¹.

2.7.4 Waiver of Subrogation Clauses

Waiver of the subrogation clause means the insurer agrees not to exercise rights of subrogation against certain persons or categories of persons. There are express and implied waiver clauses.

This immunity of the co-assured to the underwriter's right of subrogation is usually reinforced by express terms in the contract. One way is to define the assured in a broad terms, which is employed in London market open covers, such as "ABC Limited, and/or as agents and/or subsidiaries and/or associated companies and/or for whom they may have instructions to insure". Another example is the "Affiliated Companies" clause in IHC 03 cl. 28. This allows for cases where assureds may have their own subsidiary carriers, particularly carriers by road but also occasionally carriers by sea, or warehouse-keepers, as part of a group of companies involved in the carriage and storage of cargo.

Another way is through the express Waiver of Subrogation Clause in the policy "Insurers waive all rights of subrogation and/or recourse against the Assured and/or subsidiary companies of the Assured engaged in the carriage of and/or storage of the subject-matter insured."

80 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman. p. 512

81 *Young v. Merchants Marine Insurance Co.*

Such kind of express waiver clause could only protect a co-assured against subrogated claims arising from loss or damage for which the co-assured itself could make a claim against the insurer under the policy. Where the subrogated claims against the co-assured was in respect of loss or damage which fell outside the co-assured's cover under the express terms of the policy, he could not rely on the waiver clause⁸². Again, where the co-assured would be prevented from making a claim against the insurer on some other ground, he could neither rely on the waiver clause. Those qualifications prevent the clause being construed too broadly and prevents the *de facto* extension of the cover against the insurer.

In addition to the express waiver clauses, there are also implied waivers of subrogation clauses in the marine insurance. This kind of implication by judicial decision is the explanation for the legal obstacle to an insurer bringing a subrogated action against a co-assured under the same policy^{83 84}.

There is limitation for the use of a waiver clause. Before the introduction of the Hague Rules, it was common for shipowners to insert in the bills of lading a provision entitling them to take advantage of the cargo-owner's insurance policy. To counter the effect, Institute Cargo Clauses (All risks) 1/1/63⁸⁵ introduced the "not to inure clause", which provided that the "insurance shall not inure to the benefit of the carrier or other bailee". After the Hague Rules, the beneficial position of the bailee as carriers has also been prohibited, which followed the way of Institute Cargo Clauses. This clause has the same effects with the "sue and labour clause" in the contract.

In all cases to take such measures as may be reasonable for the purpose of averting or minimising a loss or to ensure that all rights against carriers, bailees or other third parties are properly preserved and exercised.

Those clauses are intended to protect the rights of the subrogation rights and the insurer would retain the subrogated rights against the persons listed here. At the same time, in order to protect any claims against the third party, even though no claim is recoverable under the policy, if the assured has obtained the written agreement of the insurer to the incurring of such costs before they are incurred, the assured would not hesitate to lend his name to the insurer in the proceeding against the third party.

2.8 Exercise of Subrogation

Upon the payment from the insurer, subject to all the qualifications mentioned above, the insurer could exercise his rights of subrogation. The

82 *National Oilwell v. Davy Offshore*, [1993] 2 Lloyd's Rep 582

83 [1991] 2 Lloyd's Rep 288; [1993] 2 Lloyd's Rep 582

84 [1979] 2 Lloyd's Rep 45.

85 ICC, cl.16.2., also in IHC 03, cl.49.

underwriter has two main ways to exercise the right of subrogation. Firstly, the insurer are entitled to bring or continue proceedings, in the name of the assured, against the third party; secondly, the insurer are entitled to claim recovery directly from the assured, which in F. D. Rose's book, is worded as "the insurer's claim to recoupment" from the assured, provided the assured has received recovery already from the third party.

2.8.1 Proceedings in the Name of the Assured

In English law, an insurer is entitled to bring proceedings, or to continue existing proceedings, in the name of the assured, against the third party. The insurer has no new, independent cause of action. The underwriter cannot commence any action against a third party before he fully indemnifies the assured under the contract, without either the assured's initial authority or perhaps his subsequent ratification⁸⁶.

In practice, the assured would first claim against the insurer. After that, if there is any deduction or limitation in the policy, or saying if there is still some uninsured losses, the assured would then commence proceedings against the third party⁸⁷.

However, where the policy can cover all the actual losses and/or the assured is afraid of the costs incurred in the proceedings, the assured might lose his interest to bring proceedings against the third wrongful doer. If the assured refuses to lend the name, the insurer has two options. The insurer can choose to seek an order compelling the assured to lend his name. The insurer, on the other hand, can choose to bring an action against both the third party and the assured. In the latter action, the insurer would claim an order that the assured authorised him to proceed against the third party in the assured' name, and would, when authorized, seek to proceed against the third party.

There is a third method. On payment of a claim, it is the usual practice in the London market, and worldwide, for the assured to sign a subrogated form called a subrogation receipt or a letter of subrogation⁸⁸. It is called the Standard Subrogation Forms.

86 F. D. Rose, *Marine Insurance Law and Practice*, LLP, London, Singapore, 2004, p.525.

87 It is not to the advantage of the assured to claim to the wrongdoer firstly. There are two reasons. Firstly, it is easier and more convenient to get payment from the insurer. Secondly, the assured can recover the costs incurred in the proceedings from the insurance company if he lend the name to the insurer, after receiving payment from the insurer. But if the assured claimed firstly from the third party, he can get no restitution in respect of the costs incurred during the proceedings.

88 "I/ We acknowledge that by virtue of such payment you are subrogated to all my/our rights and remedies in and in respect of the goods as provided by the law governing the contract of insurance and in the case of total loss you are entitled at you option to take over my/our interest in whatever my remain of the goods it being understood that my/our delivery to you of the documents of title relating to the goods shall not be construed as an exercise of such option.

I/we also record that you have authority to use my/our name to the extent necessary effectively to exercise all or any of such right and remedies; that I/we will furnish you with

The first paragraph of the Standard Subrogation Form reflects the Marine Insurance Act 1906 Section 79. It has repeated two instruments in English law. Firstly, the subrogation is exercised only upon payment and retrospectively takes effect when the loss happens. Secondly, the underwriters do not automatically accept the abandonment and it is said “Documents of title relating to the goods shall not be construed as the exercise of such option”. Whether the underwriter accepts the abandonment or not, depends on the specific condition. There is big possibility that the insurer would not accept it, as they are not willing to be involved with wreck removing, pollution costs, etc.

The second paragraph introduces a new agreement between the two parties not expressly provided by English Law. It firstly relates to the assured’s duty to provide insurers with what they may reasonably require. Those requirements would most obviously relate to the claims against the third party. This paragraph has enhanced the binding obligation of the assured to assist the underwriters in pursuing the claim, even if the insurers has no continuing interest in the pursuit of the claim.

Then, it relates to the legal costs and makes it clear that where insurers take over such proceedings commenced by the assured they will be responsible for all the costs. The assured and insurers have a joint interest in the recovery; cost would be apportioned in accordance with their respective interests in the recovery⁸⁹, provided there is no express agreement to the contrary. In addition, the legal costs here include the legal costs incurred by the assured before settlement of the insurance claim (e.g., in commencing proceedings to protect the time limit against a carrier), which is recoverable under Clause 16 of the Insurance Cargo Clauses-the duty of Assured Clause. Clause 16 provides that insurers will reimburse the assured for “any rights against carriers and bailees are properly preserved and exercised”, which the subrogation form makes more clear.

While the insurer has a duty to reimburse the assured for the sums “properly and reasonably incurred”⁹⁰, the insured is obligated to preserve the actions and rights against the third party. The breach of the assured’s duty would entitle the insurer to claim damages from assured, to the extent of which would have been recoverable from the third party, which is “the insurer’s recoupment from the assured”.

any assistance you may reasonably require of me/us when exercising such rights and remedies on the understanding that you will indemnify me/us against any liability for costs charges and expenses arising in connection with any proceedings which you may take in my/our name in the exercise of such rights and remedies.”

89 *Duus Brown v. Binning* (1906)11 Com Cas 190. *England & England v. Guardian Insurance Ltd* [2000] Lloyd’s Rep. IR 404.

90 Even in a contract without the reimbursement clause but which impose the assured’s duty against the third party, the court even imply a similar reimburse duty under the contract.

2.8.2 The Insurer's Claim to Recoupment

Where the insurer has fully indemnified his assured for the insured loss, and the assured obtains a recovery from the wrongdoer, the insurer is entitled to have a claim to recoup against the assured, to the extent of his overpayment. This action by the insurer is triggered by the recovery from the wrongdoer.

“Full indemnification” means the full amount agreed on the policy rather than the actual loss suffered by the assured.

The right of recoupment from the assured would be helpful, especially when the assured is in insolvency. After the indemnification from the insurer, the assured may get recovery from the third party. The assured becomes insolvent. Insolvency of the assured would entitle the underwriter to the full amount due to him under subrogation; and not merely to rank with other creditors against the liquidation fund⁹¹.

2.8.3 Comparison with Assignment

The right of subrogation would, however, become helpless where the assured has a valid right of action against the third wrongdoer⁹², at the same time the assured is bankrupt. In this situation, the underwriter cannot sue in the name of the assured, since the assured does not exist anymore⁹³. The underwriter is incapable of claiming recoupment from the assured, because not only the assured does not exist but also the bankrupt assured has no positive assets at all.

Under this situation, assignment is a useful option. Assignment allows the underwriter to sue the third party in his own name other than the assured's name. The assignment here is different from the assignment in s.50-51 of the Act. Assignment in s.50-51 is the assignment of the policy, which is the precaution on the part of underwriter and enables them to ascertain that any claims are paid to the correct party⁹⁴. However, the assignment mentioned in this thesis means the assignment of assured's rights of action against the third party, the wrongdoer.

91 *Miller, Gibb & Co. Ltd. (in liquidation)* [1957] 1 Lloyd's Rep. 258

92 *King v. Vitoria Insurance Co* [1896] AC 250 (PC).

93 Especially, it happens where there is a one ship company.

94 F. D. Rose said there are two other instruments: ex gratia payment and subrogation receipt. Ex gratia payments are also problematic since they are often made because the insurer does not accept that it is liable to indemnify the insured for all of the sums claimed. On this basis, such payments may not give rise to a right of subrogate. A subrogation receipt when the claim is paid, apart from acting as a receipt for insurers' payment and confirming that insurers are subrogated to the insured's rights and remedies, should record that insurers will provide the insured with an indemnity in respect of the costs and expenses of any recovery action and that the insured will assist in the recovery proceedings by providing, for example, relevant documents and witness statements.

94 *King v. Vitoria Insurance Co*, [1896] AC 250 (PC).

94 Especially, it happens where there is a one ship company.

94 F. D. Rose, *Marine Insurance Law and Practice*, LLP, London, Singapore, 2004, p.523.

Under English Law, an assignment may be legal or equitable. An equitable assignment requires the assignor to be a party to the action or saying to be before the court. At the same time, a legal assignment under section 136 of the Law of Property Act 1925 would not require the presentation of the assignor before the court. The latter would require an express notice in writing given to the debtor. In addition, English law allows a party that has a legal claim against a third party to assign its rights to that claim to a party that “has a genuine and substantial interest in the outcome of the litigation” – in other words, an insurer. It is therefore possible for an insurer and insured to agree – usually in writing – that the insured will transfer all its rights against the third party (including the right to use the insured’s name in any litigation) so that the insurer can pursue the case without further involvement of the insured.

In the case of *King v. Victoria Insurance Co Ltd*, after payment, the underwriter has taken an express assignment of the insured’s rights and bring the action in their own name other than the assured’s name. The underwriter is entitled to do so and the third party cannot argue that the payment was a voluntary payment to a stranger, which in fact has diminished the losses suffered by the assured.

In clause 5 of Institute Time Clauses (Hull) 1/10/83⁹⁵, it is stipulated that

No assignment of or interest in this insurance or in any moneys which may be or become payable thereunder is to be binding on or recognised by the Underwriters unless a dated notice of such assignment or interest signed by the Assured, and by the assignor in the case of subsequent assignment, is endorsed on the Policy and the policy with such endorsement is produced before payment of any claim or return of premium thereunder.

There are two advantages of this assignment. Firstly, having taking an assignment of an insured’s rights, the insurer can simply pursue the subrogation action in spite of that the assured is not in existence. Also, it also removes the requirement of the full payment of the insured losses and precludes the dangers of the assured’s prejudice act against the insurer.

Again, the insurer can sue for as much as he can get, even more than he has paid before and has a potential of earning the windfall, provided the assured agreeing to assign its rights.⁹⁶ On the opposite side, subrogation only entitles the insurer to the amount paid to the assured, and there is no possibility for the insurer to get any kind of windfall.

95 Those wording is exactly the same under Institute Time Clauses (Cargo) 1/10/83 1/11/95, Institute Time Causes(Freight)1/10/83, 1/ 11/ 95.

96 *Compania Columbiana v. Pacific Steam Navigation* [1963] 2 Lloyd’s Rep. 479.

As aforementioned, the assignment is relatively useful when the insurer has been concerned about the possibility of liquidation of the assured. However, there are two main disadvantages, which prevent the popularity of assignment. The insurer has to call upon the insured to assign his rights after the loss, unless express contrarily in the contract. Secondly, the insurer has to sue the wrongdoer in his own name, which means the insurer's name would come into publicity⁹⁷.

2.9 The Extent of the Right of Subrogation

2.9.1 The Time Enduring

In *Arnould book*⁹⁸, it is pointed out that the right of subrogation is “for the purpose of diminishing the insurer's loss”. Upon the payment from the insurer, subrogation right starts retrospectively to the time when the loss happens, until the insurer has been fully recouped for the sums overpaid. At the same time, the assured's right, against third party, would endure as long as the insurer would have a claim to recoupment in respect of some or all of any recovery obtained by the assured from the third party.

2.9.2 The Amount

In the case of *Castellain v. Preston*⁹⁹, Lord Justice Brett has stressed the two sides of the indemnity, which the insurer shall be fully indemnified, but shall never be more than fully indemnified. It is the same that if before the insurer has paid under the policy, the assured recovers from some third party a sum in excess of the actual amount of the loss, he can recover nothing from the insurer because he has sustained no loss.

There is the pre-1906 judicial decision¹⁰⁰.

Once the insured has been indemnified, an insurer is entitled to receive the benefit of all rights and remedies that the insured has against third parties which, if satisfied, would extinguish or diminish the loss sustained.

This judicial decision is confirmed in 79(1) of the Act, the insurer is subrogated to the “rights and remedies” of the assured against the third party, and again the “rights and remedies” is “in respect of the subject-matter paid for” by the insurer. At the same time, insurer can never recover by way of subrogation a nominal sum greater than had been paid to the insured¹⁰¹.

97 Stuart R. Butzier <http://www.modrall.com/0928071191012013.art>

98 *Arnould's Law of Marine Insurance and Average*, 16 th, ed: vols 1-2ed by Sir M J Mustill and J C B Gilman (1981) ; vol 3 by J C B Gilman (1997), p.1268.

99 (1883) 11 Q. B. D. 380

100 *Casterllation v. Preston* (1883) 11 QBD 380 (CA);also in a more recently case, *England v. Guardian Insurance Ltd* [2000] Lloyd's Rep IR 404

101 *Yorkshire Insurance Co Ltd v. Nishet Shipping Co Ltd*, [1962] 2QB 330.

Sec. 79 (1) of the Act deals with the payment for the total loss by the insurer. It stipulates two distinct matters. Firstly, the interest of the assured in the subject-matter insured, which is also called salvage, which would be dealt with in chapter 3.

Secondly, the rights and remedies of the assured in and in respect of that subject-matter, which is namely the subrogation rights. The insurer, upon payment, is not forced to but is entitled to take over the whole interest in the subject matter. If and only if he accepts it, he can take over the whole interest and it does not pass to him automatically. At the same time, what the insurer can get is the overpayment, which not in excess of the amount that he has paid to the assured. The insured, however, should exercise remedies against third parties to reduce the amount of the loss upon indemnification by the insurer against loss; when the assured receives it, the insurer could recover it from the him, as moneys had and received¹⁰².

This is the question of the quantum of the insurer's rights of subrogation. It is clear, for the partial loss in the Act¹⁰³ that in so far as the assured has been indemnified, according to this Act, by such payment for the loss. At the same time, the problem of quantum in the case of total loss is rare and is not so clear specified as compared with that of the partial loss. However, it is implicit in the use of the word "subrogated" itself, that it may well be that the effects of subsection 79(1) would be the same of those words were omitted¹⁰⁴.

In the case of the *North of England Iron Steamship Insurance Association v. Armstrong and others*, the holding is different. The underwriter is entitled to the whole money paid by the third party wrong doer other than that the underwriter is only entitled to the overpayment by the underwriter. The reason would be explored later on in the essay.

2.9.3 Effects of Under-Insurance¹⁰⁵

Where the subject-matter is insured for only part of the valuation specified in the policy, or for part of the insurable value in the event of the policy being unvalued, it is the under-insurance. Under-insurance is explained in s.81 of the Act. The effects of the under-insurance, is that the assured is deemed to be his own insurer for the balance, which means that the assured is therefore entitled, in respect of the balance, to his relative proportion of any sums recovered in diminution of a loss, which is called as the "pro rata" approach used in the case of *the Commonwealth*.

102 R. J.Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p.460.

103 S. 79 (2) of the Act.

104 Lord Justice in the case of *Castellain v. Preston*.

105 *Thames & Mersey Marine Insurance Co. v. British & Chilean Steamship Co. C. f. North England Iron Steam ship Insurance Association v. Armstrong*.

In the case of *the Commonwealth*¹⁰⁶, the insurance on a vessel was for £ 1,000 valued in the policy at £ 1,350. The vessel was sunk in collision and the sum insured under the policy of £ 1,000 was settled as a total loss. Later a recovery of £ 1,000, being the assessed actual value of the vessel, was recovered from the other vessel, which was solely to be blamed for the collision. It was held that the insurers were entitled to 1,000/1,350^{ths} of the recovery of £ 1,000, while the assured, being his own insurer to the extent of £ 350, was entitled to 350/1.350^{ths} of that £ 1,000¹⁰⁷.

This *pro rata* rule, however, is amended by the “*deductible clause*” (clause 12) in Institute Time and Voyage Clauses-Hull¹⁰⁸.

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

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

This principle is called *top-down* approach, which means that the assured will still bear the first part of the net loss up to the amount deductible less any interest attaching, even after the recovery has been obtained from the third party. In another words, the recovery from the third party, less the counterpart interest and reasonable costs, shall go to the underwriter firstly. If there is anything left, it then goes to the assured. This rule has completely changed the *pro rata* approach in the Act.

The apportionment problem of the under-valued policies arises where the amount recovered from the third party is no greater than the amount paid by the insurer. However, where the amount recovered from the third party is greater than actual loss, whether it is an under-valued policy or not, to whom belongs of the excess money has not been stipulated in the Act neither in the institute clauses. This is the problem of windfall¹⁰⁹, which is the central point of the thesis.

106 C.A. (1907) 10 Asp. M. L. C. 538

107 R. J.Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p.462.

108 Institute Time Clauses (Hull) 1/10/83.

109 Marin cases: *Sea Insurance Co v. Hadden* (1884) 13 QBD 706 (CA); *Young v. Merchants' Marine Insurance Co Ltd* [1932] 2 KB 705 (CA); *Assicurazioni Generali De Trieste v. Empress Assurance Corp Ltd* [1907] 2 KB 814.

3 Abandonment

3.1 Definition of Abandonment

The word abandonment is used in different senses in marine insurance. Firstly, it means the physical quitting of a vessel. The master and the crew have left the subject-matter but the assured does not forego his rights over it. Secondly, the master and crew may abandon it without hope of recovery and without intending to return and leaving it as derelict. Thirdly, the assured may indicate that he no longer wishes to retain his interest in the subject-matter but that he is willing for his insurer alone to take over his interest in goods or possibly the proceeds. Such abandonment could be said to occur where a third party alone is informed. The insurer cannot avail himself of the abandonment unless he receives notification from the assured. Fourthly, the notice of abandonment is sometimes mentioned as abandonment. Fifthly, the assured actually gives up his interest in the subject-matter on its assumption by the insurer and the insurer accepts the liability or pays for a total loss¹¹⁰. In this essay, abandonment refers to the fifth one, which also follows the description in the Act.

Abandonment and its legal effects are stipulated in s. 57 (2), 62 (1) of the Act. It operates only in connection with the doctrine of constructive total loss and where the assured claims for a total loss other than a partial loss. It transfers the remains of the *res* from the assured to the insurer.

3.2 Notice of Abandonment

3.2.1 Object of Notice

Notice of abandonment is required where there is a constructive total loss and where the assured claims a total loss. There are two reasons for notice of abandonment as said by Cotton LJ in the case of *Kaltenbach v Mackenzie*¹¹¹

When the assured has once elected to treat the loss as a total loss, the underwriter can insist upon his abiding by the election, so as to enable them to take the benefit of any advantage which may arise from the thing insured. Therefore, the object of notice to take the benefit of any advantage, which may arise from the thing, insured. Therefore, the object of notice, which is entirely different from abandonment, is that he may tell the underwriter at once, what he has done, and not keep it secret in his mind, to see if there will be a change of circumstances.

110 F. D. Rose, *Marine Insurance Law and Practice*, LLP, 2004, London, Singapore, p.312

111 *Kaltenbach v. Mackenzie* (1878) 3 CPD 467, 479-480.

According to it, there are two reasons. Firstly, the notice facilitates the insurer to take use of the remains of the subject matter. Secondly, it prevents the assured to make use of the change of circumstances¹¹².

3.2.2 Nature of the Notice

F. D. Rose has mentioned the nature of the notice of abandonment in his book.

The notice of abandonment is effectively an offer by the assured to abandon his interest in return for payment for a total loss; and the insurer's acceptance constitutes a contract whereunder he must make such a payment whether he was liable anyway or he could have resisted that liability. The offer is, like any other contractual offer, prima facie revocable...thus the offer may be withdrawn before acceptance.

The notice of abandonment is the beginning of another contract, which is subsidiary to the main insurance contract¹¹³. Notice is like the offer before a contract. The offer can be withdrawn; therefore the notice can be withdrawn. A constructive total loss may be withdrawn by the assured before action, so as to remove the basis of the assured's claim for a constructive total loss.¹¹⁴ It may be withdrawn because the assured he may treat it as a partial loss, or it may happen that a breach of warranty by which the insurer can escape liability. It means that where the assured has given notice of abandonment, the assured's interest in the property does not automatically end in the assured or transfer to the insurer.

3.2.3 Requirement for the Notice

Requirement for a valid notice of abandonment includes: there is constructive total loss; there is an intention to abandon unconditionally the insured interests. There is no requirement for the form and contents of the notice of abandonment, as long as the intention is manifested in the notice.

3.2.4 Situation Where Notice is Unnecessary

There are three conditions where the notices of abandonment is unnecessary: where there is no possible benefit to insurer; where there is a waiver clause; where there is actual total loss.

112 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p.461.

113 The English Court tends to treat the payment of total loss as acceptance of the notice of abandonment.

114 It can not be withdrawn by the insurer.

As to the first “where there is no benefit to insurer”, which comes into effect in 1870 before the Act, Cockburn CJ ¹¹⁵ said that:

Where the interest to be made over to the insurer is of so shadowy and insubstantial, a character that it cannot be supposed that it could have been of any benefit whatever to the underwriter, or that the latter, as reasonable men, would have thought of availing themselves of it, so that for all practical purposes abandonment would have been a merely idle and useless formality, the assured ought not ... to be tied down to the necessity of giving notice of it; especially in these times, when it is notorious that the practice of underwriters is never to accept notice.

This judicial decision has been confirmed by s. 62 (7) of the Act “Notice of abandonment is unnecessary where, at the time when the assured receives information of the loss, there would be no possibility of benefit to the insurer if notice were given to him.” This kind of situation may also happen, for example, where the assured knows nothing of the fate of the subject-matter until it was too late for the insurer to gain any advantage from the notice ¹¹⁶. It may happen where any notion of salvage was completely impractical by reason of the place. It may also happen where at the war time circumstances in which, the insured vessel was sunk ¹¹⁷; where a constructive total loss by the insured peril of fire of which the insured was unaware was followed by an actual total loss ¹¹⁸; where there has been a right sale of the subject-matter ¹¹⁹.

The second situation is where there is a waiver clause. Such waiver clause may be either express or implied, but it must be clearly proved and must not be lightly inferred. The clause usually requires clear evidence with burden of proof on the assured that the neutral act of the insurer is in fact constitute acceptance of the (notice of) abandonment ¹²⁰.

The third situation is where there is an actual total loss. Where there is an actual total loss, there is nothing left in the subject-matter. In addition, where there is nothing left in the subject matter, there is no benefit for the insurer. As stipulated in the Act ¹²¹, where there is no benefit in the subject-matter, there is no necessity of giving notice of abandonment. This situation is similar to the situation in the first one.

115 *Potter v. Rankin* (1870) LR 5 CP 341 (Ex Ch), 371.

116 *Richards v. Forestal Land, Timber & Rys Co Ltd* [1942] C 50.

117 *The Litsion Pride* [1985] 1 Lloyd’s Rep 437, esp 438.

118 *Kastor Navigation Co Ltd v. AGF MAT (The kastor Too)* [2004] EWCA Civ 277; [2004] Lloyd’s Rep 119.

119 *Idle v. Royal Exchange Ass Co* (1819) 8 Taunt 755.

120 In English jurisdiction, as aforementioned, the payment of the insurerer for a total loss constitutes the acceptance of the notice of abandonment.

121 S. 62 (7) of the Act.

3.3 Rights and Liabilities of the Subject-Matter

The insurer cannot acquire an entitlement to benefit which is not incidental to the proprietary interest abandoned.

Before coming to study the ownership of the remains of the subject-matter and subsidiary rights and interest, it is necessary to examine what are the remains of the subject-matter. The remains of the subject-matter consists of rights and liabilities.

Proprietary interest in the subject-matter is likely linked to the value of the residue, if a hull policy, on a value of the wreck. Three situations are possible with respect to the wreck. The value of the wreck exceeds the measure of indemnity, it is in the assured's interest to retain his right of ownership and claim a 100 percent for a partial loss other than a constructive total loss. If it is less than the measure of indemnity but nonetheless of some value, the insurer has both a right to assume the benefit of the salvage and an advantage in doing so. If it is worthless and a burden, no one is likely to claim it¹²².

Problems often rise where the third situation happens: the assured would give a notice of abandonment and the underwriter does not want to accept it. The rights and liabilities of the subject matter are of three possible kinds of ownerships. It is property of the insurer; it is *res nullius*; it is the assured's property. The first view supports the automatic transfer of the ownership to insurer, which can be found in the case of *Simpson v. Thomson and North of England Steamship Insurance Association v. Armstrong*. The second view can be found in the case of *Mayor & Corp'n of Boston v. France, French & Co Ltd*. The third view that the ownership remains with the assured unless the insurer accepts the valid notice of abandonment, which can be found in the case of *Oceanic Steam Navigation Co v. Evans*.

Some may argue that the subject-matter becomes *res nullius*, this kind of view was mostly popular judicial decisions¹²³ before the Act came into effect. The Admiralty Court has recognized that maritime property may be abandoned to become derelict, for the purpose of entitlement to a salvage reward¹²⁴; in some cases, the shipowner may abandon his property to get rid of liabilities for wrecks¹²⁵.

122 F. D. Rose, *Marine Insurance Law and Practice*, LLP, 2004, London, Singapore, p.310

123 *Stuart v. Merchants' Mar Ins Co Ltd* (1898) 3 Com Cas 312, 314-315

124 *Pierce v. Bemis (The Lusitania)* [1986] QB 384; Kennedy & Rose.

125 *The Douglas* (1882) 7 PD 151; 160, per Brett LJ; *SS Utopia (Owner of) v. SS Primula (Owner of) (The Utopia)* [1893] AC 492 (PC: Gibraltar), 498, PER Sir Francis Jeune; *Arrow Shipping Co Ltd v. Tyme Improvement Commissioner (The Crystal)* [1894] AC 508,519, per Lord Herschell LC.

Bailhache J. said in the case of *Mayor & Corporation of Boston v. France, Fenwick & Co. Ltd*¹²⁶:

I have refrained from expressing any opinion as to whether a valid notice of abandonment unaccepted by underwriters while it divests the owner of his property to the underwriters. I will only say that there is good deal to be said against this view in favour of the wreck in such circumstances becoming a *res nullius*.

According to it, a valid notice unaccepted by underwriter would not lead to the subject-matter a *res nullius*. The same view is shared in a later case *Oceanic Steam Navigation Co. v. Evans*¹²⁷ Greer L.J said that :

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

In this case, it is argued that after the notice of abandonment being given, the vessel is not abandoned to the entire world¹²⁸.

This disapproval of *res nullius* is consistent with the common law rule that “an owner retains title to property unless and until his interest therein is acquired by *another*: it is a general rule that property cannot simply be abandoned so as to become ownerless, i.e. a *res nullius*.”¹²⁹,

In addition, s. 63 and s. 79 (1)¹³⁰ of the Act confirms that: if there is a valid abandonment, the insurer is entitled to take over all the proprietary interest of the subject-matter. According to it, the insurer does not acquire the proprietary interest automatically on abandonment or payment but depends on the insurer’s election. This means that the payment of an insured loss for a constructive total loss does not necessarily lead to the transfer of ownership from the assured to the insurer. Moreover, the presumption of s. 63 (1) of the Act stipulates that after the abandonment and the notice of abandonment is given, there is still interests of the assured in the subject-

126 (1923) 15 11.1. Rep. 85; 28 Com. Cas. 367; 16 Asp.M.L. 239;38 T. L. R.441.

127 C. A. (1934) 50 L1. L. Rep. at p.s;40 Com.

128 *Oceanic SN Co Ltd v. Evans* (1934) 40 Com Cas 108,111.; the same view is shared in the case of *Blane Steamships Ltd v. Minister of Transport* [1951] 2 KB 965, 991.

129 Rubina Khurram, “Total Loss and Abandonment in the law of Marine Insurance”, Journal of Marine Law and Commerce, Vol. 25, No. 1, January, 1994.

130 S.63 “where there is a valid abandonment the insurer is entitled to take over the interest of the assured in whatever remains of the subject-matter insured, and all proprietary rights incidental thereto”; and s.79 (1) states that, “where the insurer pays for a total loss...he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for.”

matter, which in addition proves it is not a *res nullius* and the ownership is still vested in the assured¹³¹.

The Act further provides that “The assured is not prejudiced by having started an action to recover a total loss: he may, if his claim fails, still recover for a partial loss provided the risk of partial loss is one covered by the policy.” The assumption of the stipulation is that the subject matter is still within the ownership of the assured. Therefore, after the rejection of the abandonment, the owner of the wreck is still the assured but the assured there can only claim for a partial loss. Again, the shipowner cannot avoid the liability by simply abandoning the ship, especially if the liability has been incurred by the shipowner through his own or his servant’s negligence¹³². In the case of pollution, the owner’s liability is strict within areas covered by legislation relating to oil pollution¹³³.

The insurer is deemed by the English courts to be the owner of the wreck and is thus responsible for the wreck removing and pollution cleaning. This is according to the common law rule that a person may be liable by virtue of his ownership of property because of his common law duty of care to avoid liability being caused to another by his property, e.g. from collision with an unmarked wreck, where strict liability is imposed on the current owner of the property. In addition, there is statutory liability for wreck removal expenses falling upon the “owner” of the vessel at the time at which the expenses are incurred¹³⁴. This is very similar to the action *in rem*, an action *in rem* is directed towards some specific piece of property, rather than being a claim for, say, monetary compensation against a person (which is an *in personam* or personal action). It focuses on proprietary title to property.

3.4 Rejection of the Notice

It was held in case of *Blaauwpot v. Da Costa*¹³⁵, one underwriter has made the satisfaction and is entitled to be repaid from the assured in proportion to what the assured has received from the Crown. In addition, the underwriter also stands in the place of the assured and therefore has in the court the same rights, which belong to the plaintiff by relation, by claiming under one of the sufferers. Salvage is considered as retribution to the underwriters as lessening the loss incurred by the capture. On the other hand, another

131 R. J. Lambeth, *Templeman on Marine Insurance Its Principles and Practice*, 6th edition, 1986, London, Pitman, p.457.

132 *Dee Conservancy Board v. McConnell C.A.* (1928) 30 L1. L. Rep. 200. Another case: American case, *United States of America v. Cargill U.S. Ct. of Apps.* [1966] 2 Lloyd’s Rep. 366; 1966 A.M.C. 1974.

133 The Merchant Shipping (Oil Pollution) Act 1971, giving effect to The International Convention on Civil Liability for Oil Pollution Damage, Brussels 1969.

134 *Arrow Shipping Co Ltd v. Tyme Improvement Commissioners (The Crystal)* [1894] AC 508; *Barraclough v. Brown* [1898] AC 615.

135 (1758) 1 Eden 130.

underwriter who has compounded and renounced the salvage is not entitled to get the recovery from the Crown.

The notice of abandonment is an offer and the acceptance of the notice is an acceptance. The insurer is entitled to accept or reject it. But once he accepts it he cannot revoke it.

Notice of abandonment is not an essential ingredient of the cause of action but an election of the assured between alternative quantum's damage. The assured thus can choose to give notice of abandonment and claim total loss or he can choose not to give notice of abandonment but claims a partial loss.

S. 63 (1) of the Act stipulates that where there is a valid abandonment "*the insurer is entitled to take over the interest of the assured in whatever may remain of the subject-matter insured, and all proprietary rights incidental thereto.*" the insurer does not automatically acquire proprietary rights in the subject-matter but obtains an entitlement to take over the assured's rights in the subject-matter¹³⁶. The underwriter can decline to accept a notice of abandonment while at the same time pay for a total loss. The underwriter can reject it by not exercising the election of acceptance or positively disclaiming an interest.

If the insurer rejects the notice, the assured retains the rights and liabilities that he had before the casualty. In *Brooks v MacDonnell* the Brazilian Government captured a British ship and its cargo and condemned them as a prize. The cargo insurer refused to accept an offer of abandonment but compromised the claim, the assured delivering up the policy for cancellation in return for 35 percent of the insurer sum. Subsequently, the Brazilian Government agreed with the British Government to return the goods and to pay compensation to the assured. It was held that, on the facts and in accordance with the agreement between the parties, the loss was only a partial loss and the insurer was not entitled to any share of the compensation.

3.5 Acceptance of Notice

However, as soon as the insurer pays for a total loss, the ownership transfers to the underwriter. And the underwriter is liable for the wreck removal.

This holding is to premise that the liability is related to the ownership of the vessel at the time of performance of the removal services¹³⁷.

However, another approach would make ownership unnecessary in relation to liability for wreck. The liability must be that the tortfeasor for his own

136 In earlier times, before the act, the judicial decision had hold that the proprietary interestes automatically passed to the insurer where the assured is entitled to claim a total loss and in fact makes such a claim.

137 *Arrow Shipping Co.v. Tyne Improvement Comm' re (The crystal)* [1894] A. C. 508.

negligence¹³⁸, he must be responsible for the wreck removal and pollution clean up. In addition, harbour authorities usually have statutory powers to light, buoy, raise, remove or destroy wrecks, often at the expense of the owners¹³⁹. However, the beneficial ownership and open-registration would make it almost impossible to find the real owner of the ship. Sometimes the one-ship company would make the situation worse by imposing the liability against the ownership¹⁴⁰.

The shipowner has the right to give away his ownership to the whole world, provided this conduct does not present negative effects upon the public interests. However, the wreck becomes a problem, which realized by the industry only recently. The wreck would potentially hazard the navigation, as more and more ships of huge tons are involved in the industry, especially when it is not in deep water harbour. If underwriter would not undertake it, it has to be left to the shipowner. Some of the liabilities would be handled by the shipowner 's mutual association and others can not. Thus, in practice, nowadays, in English jurisdiction, where the insurer pays for a total loss, the court would prefer to assume the ownership of the insurer. The insurer then would be liable for it. There are two main reasons for it. Firstly, it is usual for a one-ship company¹⁴¹ to own the vessel, and the company becomes bankrupt. Secondly, the insurer is more financially sound and can be easily traced. The problem is that the insurer would then enhance the premiums and insurance cover would become more expensive to buy.

3.5.1 Forms of the Acceptance

Acceptance of Notice is stipulated in s. 62 (5), "The acceptance of an abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer after notice is not an acceptance." According to this act, there is no particular form required for acceptance, but the intention shall not be equivocal. The act of the insurer as though he has rights consequent upon an accepted abandonment might constitute as acceptance of the notice. However, in practice, there is a suing and labouring clause which express the contrary: that acts of saving, protecting, recovering of the subject-matter shall not be treated as acceptance or waiver of abandonment or notice.¹⁴²

Furthermore, whenever the assured claim for a total loss, if the insurer wants to get proprietary interests of the subject-matter, he needs to positively accept it. As Bramwell L. J ¹⁴³ confirms it:

138 In some regime, it is strict liability.

139 *Oceanic Steam Navigation Co. v. Evans*. And Merchant Shipping (Liability of Shipowners and Others) Act 1958.

140 Dr. Proshanto K. Mukherjee, the lecture handout about the marine pollution.

141 It is also a beneficial ownership problem.

142 The clause seems to have limited effects, according to F. D. Rose and Arnould.

143 *Earl of Eglinton v. Norman* (1877) 3 Asp MIC 471,475.

A man cannot become the owner of anything without his assenting to the ownership. I think [the underwriter] had a right to the ownership which they would elect to exercise or not. If they did not, they might lose that right, but until they did they were not owners.

3.5.2 The Effects of acceptance

The notice once accepted by the insurer, he cannot revoke it. The ownership and the interest of the subject are transferred from the assured to the insurer. The insurer can only take over the interest to the extent the assured had in the subject-matter and which he insured. In *Whitworth Bros v. Shepherd*¹⁴⁴ a vessel was insured on a valuation of £9,000 with the Henderson syndicate for £8,000, with the pursuers for £500, and with a third syndicate for £500. When she stranded, the assured gave notice of abandonment to all the underwriters. It was rejected by the Henderson syndicate, who were held liable for a partial loss. The pursuers accepted liability for a constructive total loss. The ship was repaired for an amount of 20 percent of her value and was mortgaged for £13,168. The pursuers claimed a share in the vessel but the assured refused to transfer a share and, because of the mortgage, were unable to transfer an unencumbered share. Accordingly, the Court of Session ordered the assured to pay to the defendants £400, a sum equivalent to the value of their share, namely one-eighteenth of the value of the ship less the cost of the repairs.

In English law, the abandonee takes over the interest of the assured with full title need to comply with other rules for the holding, transfer and registration of interests. Before that, he has an equitable interest in the abandoned property which can be satisfied either by a formal transfer of that interest, if possible, or payment of its value. As Lord Truro said in the case of *Scottish Mar Ins Co of Glasgow v. Turner*¹⁴⁵

The act of abandonment, if it did not operate as an assignment of the ship, at least enured as a binding agreement to assign it, and thereby invested the insurers of the ship with all the rights, which belonged to the owners.

Furthermore, the Merchant Shipping Act¹⁴⁶ stipulates that

(Equitable interests) can be enforced ...in the same manner as in respect of any other personal property.

Like the in the actual total loss, it is the same where the insurer pays for a total loss after he accepts the notice of the abandonment. The insurer can claim the salvage of the interest remaining in the assured in the insured

144 (1884) 12SC (4th) 204; another case is *Attorney-General v. Glen Line Ltd.*

145 (1853) 4 HLC 312n.

146 S.16 of the Merchant Shipping Act.

subject-matter and any rights in respect of it¹⁴⁷, in particular to recovery for its loss. This is confirmed by the s. 79 (1) of the Act:

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

In the case of *Glen Line v A-G*¹⁴⁸, Lord Atkin said that;

On a valid abandonment the insurer becomes no doubt entitled to proprietary rights incidental to the subject-matter insured as from the time of the loss. He is put in the same position as though the subject-matter insured was assigned to him by way of sale immediately after the event which constitutes the loss.

Assignment here means the assignment of the subject matter insured. Abandonment has the effects of assignment. Thus, the abandonee is entitled to exercise proprietary rights over the subject-matter, whether those rights can be exercised immediately or whenever the subject-matter subsequently become available¹⁴⁹, or to the proceeds of sale of it. The insurer is entitled to hold the subject-matter or its proceeds in trust on behalf of the insurer¹⁵⁰.

The insurer is subrogated to claims of the assured against third parties And the subrogated rights is different from the proprietary rights of the subject-matter. Only the latter arises from acceptance of a valid abandonment.

147 *Barclay v. Stirling* (1816) 5 M&S 6.

148 (1930) 36 Com Cas 1, 13

149 *Houstman v. Thornton* (1816) Holt 242, 243.

150 *Randal v. Cockran* (1748) 1 Ves Sen 98.

4 Comparision Between Subrogation and Abandonment

By operation of law, subrogation and abandonment are incidence of all cases of total loss. In this point, abandonment is a corollary of the doctrine of subrogation. The differences between the two doctrines are very subtle; nonetheless, it affects the settlement of the windfall.

4.1 Different Preconditions

The precondition for the two doctrines are different. For the subrogation, it arises after the payment by the assured and the assured get it automatically after the payment for the insured loss. For the abandonment¹⁵¹, it arises because of constructive total loss; the insurer does not get it automatically. The insurer furthermore, after the notice of abandonment given by the assured, shall accept the abandonment in an unambiguous way.

4.2 Different Objectives

The objectives of the two doctrines are different. The object of the subrogation is to prevent the insured getting profits from the insured loss, at the cost of the insurer, which rests mainly on two notions. Firstly, there is no justification for giving a third person, who is neither privy to the contract nor a specified beneficiary, any benefit under it. This is strengthened by the moralistic basis of tort law. Secondly, most insurance contracts are in their nature contracts of indemnity-i. e. that the insurer's only obligation is to make the assured whole. If it were an entirely unrelated transaction, such as the gift of a stranger to the contract, the indemnity idea would not apply to prevent recovery under the insurance contract¹⁵².

The assured on one hand shall be indemnified for the insured loss, and on the other hand, he cannot get a benefit from the insurance contract. If the

151 In this case of actual total loss, the underwriters have exercised subrogation. The differences between actual total loss and constructive total loss is that there is still kind of remains in the subject matter when it is constructive total loss, while at the same time there is no interests left for the underwriter in the subject matter. In addition, s. 57 of the Act, "In the case of an actual total loss no notice of abandonment need be given". Therefore, the underwriter has no proprietary rights in the subject matter at all and the underwriter can only enjoy the subrogated right, which entitle him to the amount the same as he paid to the insured and no more.

If it is a constructive total loss, assuming the ship is damaged at the material time, the underwriter might argue that he can take over the interest of the assured in whatever may remain of the subject-matter insured and all proprietary rights incidental thereto. Two necessary conditions must be satisfied: the underwriter accept the valid abandonment by the assured; the money paid wrongful doer is to diminish the loss of the assured.

152 Spencer L. Kimball and Don A. Davis., "The Extension of Insurance Subrogation", Michigan Law Review, Vol. 60, May 1962, No.7.

insurance allows the assured to get profits, there are two disadvantages. Firstly, the assured would not be as careful as a person not insured; he may even fake a loss and earn money from the claims. Secondly, as it possibly encourages losses, the insurance company would pay more and the whole society would have more economical burden. This subrogation is to the advantage of the insurer. In another words, the insurer is seeking to effect marginal savings that make the difference between a loss and a modest profits. Subrogation is even now used outside the scope of marine insurance to prevent the claimants from unjust enrichment¹⁵³.

The objective of the abandonment¹⁵⁴ is to indemnify the insurer where there is a total loss. Abandonment is closely related to the constructive total loss, which is evolved to relieve shipowner of hardships produced by ship capture. It was broadened to cover other perils and embraces the commercial concept that a shipowner, in the event of a probable total loss, should be in a position to withdraw his capital from a losing venture¹⁵⁵. On the other hand, the abandonment is closely related to constructive total loss as aforementioned. The would also assist the assured to clean hands quickly in a business.

4.3 Different Legal effects

The results and effects of the two doctrines are different. In s. 79 of the Act, it is about the effects of the subrogation and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss. According to this, the insurer after the satisfaction stands in place of the assured. The assured holds them in trust for insurers who has paid them for a total loss¹⁵⁶. The third party does not pay to the insurer directly.

Where the claim is settled as a partial loss and is subject to deductibles, the policy may specify how the recovery is treated. Without express stipulation in the contract, the Act would apply. English law stipulates that the recovery from third party will be credited to underwriters in proportion to the net claim after applying the deductible; and to the assured in the proportion to the deductible borne by him¹⁵⁷. In the Act or in the standard ITC, however,

153 In the case of *Castellain v. Prestan*, 11 Q. B. D. 380. 387. (1883), it is said that the doctrine of subrogation does not arise upon any of the terms of the contract of insurance...it is a doctrine in favor of the underwriter or insurers in order to prevent the assured from recovering more than a full indemnity; it has been adopted solely for that reason.

154 A proper abandonment is revocable up to the time of issuance by the owner of a writ in his suit to recover a claim for constructive total loss, underwriters usually agree, by what has been termed the writ clause, to adjust rights under the policy as the suit had been brought at the time of tender of notice of abandonment.

155 *Moore v. Evans*, [1918] A. G. 185, 194 (1917)

156 (1748) 1 Ves Sen 98: insurer after satisfaction stands in place of the assured as to the goods, salvage, restitution in proportion for what he paid; the assured stands as a trustee for the insurers, in proportion for what he paid.

157 This is the pro rata principle stipulated in the Act and ITC is deviated from this by using a top-down principle:

the amount account to the underwriter can never be more than the amount he paid to the assured.

The acceptance of valid abandonment would entitle the insurer to take over the interest of the assured in whatever may remain of the subject-matter so paid for, as to the goods, salvage as well as the entire proprietary rights incidental, irrespective of the insured value, or to the amount which the insured paid.

At the same time, where there is a partial loss, there cannot be an abandonment.

Subrogation originates from the principle of indemnity. The assured is allowed to make a profit at the cost of the insurer. Subrogation will entitle the insurer only to the amount of his payment and the abandonment would entitle the insurer to the whole of the recovery.

The distinctions between subrogation and abandonment are well illustrated in the case of *Attorney-General v. Glen Line Ltd and Liverpool & London War Risks Association Ltd.* which will be carefully examined in the next chapter.

5 Analysis

5.1 Windfall

Does subrogation mean that all the assured's rights and remedies are only to the extent necessary to enable the underwriter to recoup themselves? The answer to the question can only be explained by studying the relevant cases carefully. The *Glen Line* case indicates the distinction between the abandonment and the subrogation. The *Burnand* case indicates that an insurer cannot claim a gift or payment based upon subrogation, the purpose of which is to indemnify the assured for that portion of the loss which the insurance has not covered. And finally the case of *Yorkshire v. Nisbet* explains to whom the windfall belongs.

5.1.1 *Attorney- General v. Glen Line Ltd.*

In this case, the underwriters had paid a total loss in respect of a vessel seized at the outbreak of war and abandoned to them by the owners. At the conclusion of the war, the vessel was returned to her former owners, and being the property of the underwriters, was sold to for their account, realizing a sum greatly in excess of the amount paid by the underwriters under the policies insuring the ship. Subsequently, the former owners succeeded in recovering from the German Government a large sum as compensation for the loss of the use of their vessel. The case has two main points. What kind of recovery the insurer can get in respect of subrogation? What is the nature of the money to be subrogated by the insurer?

In addition, it was claimed on behalf of the Crown that the right to recover that sum was a proprietary right incidental to the ownership of the vessel, to which the underwriters were entitled by virtue of the provisions of s.79 of the Marine Insurance Act. It was, however, held that the sum recovered by the former owners was not paid to them in respect of the loss of their ship, but in respect of the profits, they might reasonably have expected to make by the use of their ship. It was not therefore a sum to which the underwriters were entitled by reason of their payment of a total loss under policies insuring the ship itself.

The reason which Lord Atkin used in this conclusion as follows:

But a right to sue a wrongdoer for a wrongful act which causes a loss which gives rise to an subrogation appears to be something quite different from the proprietary rights incidental to the ship which pass on abandonment. If one treats the insurer by analogy as a purchaser after the marine peril had taken effect, it is plain that the sale by itself would not pass the right to sue which would remain in the vendor. The fact is that confusion is often caused by not

distinguishing the legal rights given by abandonment (s.63) from the rights of subrogation (s.79).

No one doubts that the underwriter on hull damaged by collision and abandoned as a constructive total loss is entitled to the benefit of the right of the assured to sue the wrongdoer for the damage to hull. But he derives his right from the provision of s.79, whereby he is subrogated to “all rights and remedies of the assured in and in respect of the subject-matter”, very different words from “all proprietary rights incidental thereto”. It is to be noted that in respect of abandonment the rights exist on a valid abandonment, whereas in respect of subrogation, they only arise on payment, and that subrogation will only give the insurer rights up to the extent of what he has paid.

It was a personal entitlement of the assured which arose once and for all at the time of the loss; and was different from the proprietary rights incidental to the ship which pass on abandonment.

Accordingly, the assured was entitled to retain it. It is therefore unnecessary to consider whether the Crown, as reinsurer, was entitled to the rights of the abandonee under MIA 1906, s. 63.

The insurer can only subrogate to the recovery which is to diminish the losses to the subject-matter¹⁵⁸. However, in this case, As Lord Blackburn said,

When the treaty did come into existence it awarded to the owners such rights as they had on August 4 th. to turn the ship to a profitable account, a right personal to them. That is a right to which in certain cases, the owners would not be entitled under English law.

Again, the treaty itself is clearly not a trading agreement but a war measure. It is not a recovery to diminish the losses insured. Therefore, the damage from the Germany government can not be subrogated to underwriter. This point is examined in more details in the next case of *Burnand v. Rodocanachi*¹⁵⁹

5.1.2 *Burnand v. Rodocanachi*

In the case of *Burnand v. Rodocanachi*, underwriters had insured cargoes under valued policies. The cargoes were destroyed by the cruiser Alabama, and the insurers paid the cargo-owners the insured value, which was less

158 *Simpson v. Thomson* 3 App, Cas. 279, p. 292, per Lord Black Burn.

159 *Burnand v. Rodocanachi* (1882) 7 App. Cas. 333; 4 Asp. M. L. C. 576. The similar situation in American Case Standard Marine Insce. Co. Ltd. V. Westester Fire Insce. Co. U.S.Ct. of Apps. (1937) 60 L1. L Rep. 202, where British reinsurers were not entitled to German war reparation specifically paid for benefit of U.S nations only.

than the actual value. Subsequently an Act of Congress was passed providing a fund for persons who had suffered damage and had either not been reimbursed at all or inadequately by insurers. No insurer was to receive any of the amounts paid. Nevertheless the insurers claimed to be subrogated.

It was held that the payment was not designed to reduce the loss against which the insurers had indemnified the cargo owners. The payment was made as a gift and did not give rise to rights as far as the insurers were concerned.

There are two main arguments for the underwriter. Firstly, since they had paid the total loss under the policies, they become entitled to the sum which the defendants had so received from the U. S. Governments. Secondly, according to the judges in the case of *Stewart v. Greenock Marine Insurance Co*, that in all cases of marine insurance in which the subject-matter is not actually annihilated, the assured claiming as for a total loss must give up to the underwriters all the remains of the property recovered, together with all the benefits incident to it, or rather that such property vests in the underwriter. It is given wholly in respect of the cargo which was lost, and it is in the nature of salvage, just as much as if the cargo had never been destroyed, but had been recaptured by the American government and restored to the owners.

It is true that upon payment for a total loss, the insurer is entitled to all the property and benefits incidental to the subject-matter, however, the judge in the Appeal Court pointed out that the payment is not such rights and is only a gift from an extraneous source.

It is a gift because the American government is under no obligation to pay to the assured and it is at the grace of the U.S. government to pay the funds to the assured or not. Again, according to the U.S. statute, namely the Act of the U.S congress, that the money was not paid by way of restitution of the thing insured, but as a free gift, or as if it were out of a subscription made to indemnify those who had sustained a personal loss from the war, and for which they were not compensated by any insurance. At the same time, the Act of the U.S. Congress also expressly prevented the plaintiff the underwriter from receiving this money whether the underwriter claimed it in their own name or in the name of the defendant.

This is the same as in the case of *Attorney- General v. Glen Line Ltd*. The reason is that the sum recovered by the assured was not paid to him in diminution of the loss in respect of which the underwriters had indemnified him. Where, however, compensation is paid to an assured in respect of a loss for which he has recovered from underwriters, the amount recovered is the property of the underwriters.

However, there seems to be totally different holdings between the *Burnand* case and the case of the *North of England Iron Steamship Insurance Association v. Armstrong and others*. In the latter case, the underwriter are entitled to the whole money paid by the third party wrongdoer. There are

two arguments for the underwriter. Firstly, the underwriters having paid for a total loss, are entitled to the whole of the damages recovered against the vessel which caused the loss. Secondly, the owner are in effect estopped from saying that the insured value (being less than the actual value), is not a complete indemnity to them, and whatever is afterwards recovered in the nature of salvage, and belongs to the underwriters.

As in the former one, the payment is a free gift and not to diminish the loss under the policy. In the latter case, the money is from the wrongdoer and is intended to diminish the loss under the policy. Also in the latter case, salvage is a proprietary interest, it is only possible that the insurer get it because of valid abandonment. Then it is possible that the value of the salvage together with the recovery from the third party can be greater than the amount paid by the insurer.

The above two cases refer to what kind of recovery can be subrogated by the insurer. The Yorkshire Insurance case would refer to that if the insurer is entitled to the subrogation rights, to what extent he is entitled to.

5.1.3 Yorkshire Insurance Co. v. Nisbet Shipping Co.

In *Yorkshire Insurance Co. v. Nisbet Shipping Co.*¹⁶⁰ the insurer had paid £ 72000 under a policy, following the loss of the ship after its collision with a Canadian vessel. The latter was held solely to blame, and the assured eventually received payment in Canadian dollar. Before the payment was made the pound sterling was devalued, and as a result the dollar compensation worked out at £ 55000 in excess of the £ 72000 received under the policy. The shipowner repaid £ 72000 of the insurer, but the latter claimed also the excess. Diplock held that the insurer was not entitled to more than he had paid under the policy. The profit in this case was not made at the insurer's expense, but was the result of an extraneous circumstances¹⁶¹

The case presents the question: does subrogation mean that all the assured's rights and remedies, only to the extent necessary to enable the underwriter to recoup themselves?

The underwriter argued that they were entitled to the whole sum recovered from the third party. They had three reasons which seemed to be possible. Firstly, the assured acted only as an agent or trustee for the underwriter. Secondly, the insurer received recovery through the proceeding, as an exporter receive money, therefore, the risk and benefit of the variation in the rate of exchange lies with the insurer. Thirdly, the underwriter paid for the actual total loss to the assured in 1945 and did not recover anything until

160 [1961] 2 All E. R. 487.

161 N. J. J. Gaskell, C Debattista and R J Swatton, *Chorley and Giles's Shipping Law*, 8th edition, Pearson Education, England, p. 520.

1958; they were out of their money for 13 years for which they were receiving no compensation if the defendants succeeded.

The judge rightly pointed out the fault in the underwriter's reasoning. Firstly, the right of action is vested in the insurers and exercised by the assured on their behalf. Subrogation will pass the right not the proceeds. Furthermore, in the case of "*Simpson v. Thomson*" Lord Cairns L. C. said that "But the right of action for damages they must assert, not in their own name, but in the name of the person insured.". The judge in the Simpson case also pointed out that the assured's right of action was a common law right personal to them as owners; the right cannot be vested in the underwriters and would not have passed even on abandonment. Furthermore, the assured is the real person control the whole proceeding against the third party. Thus, the assured does not act as an agent or trustee for the underwriter.

Secondly, section 79 of the Act should be examined more carefully. It refers to two points. One is the interest of the assured in the subject matter insured, which the underwriter is entitled to but not bound to. This is the right vested in the abandonment not subrogation. In this case, there is no salvage value and there is no such interest which can be claimed by the underwriter. The distinction between the abandonment and the subrogation has been clearly established in the case of "*Glen Line v. Attorney- General*". The insurer can make a profit out of a valid abandonment of the subject-matter insured where there is an abandonment and the insurer's right are proprietary. But he cannot make a profit out of the subrogation rights.

In s. 79 (2) for a partial loss, the subrogation is stipulated as "in so far, as the assured had been indemnified...by such payment for the loss". The same words are absent in s. 79 (1) for a total loss. This is because before 1906 there is no such problem as to the quantum of the subrogation rights for the total losses and only until 1961. The meaning and content of the subrogation should be that the quantum of the subrogation rights is limited to the amount paid by the insurer whether it being a partial loss or a total loss. Thus the same word should be implied to the s.79 (1) for a total loss.

The underwriter argued that the application of subrogation is based upon the fundamental principle of indemnity; therefore the assured shall be indemnified but shall never be fully indemnified. This argument seems to mean that the assured is not therefore entitled to the amount in excess of the payment by the insurer. In fact, the contract concerns the rights and obligations of only the two parties, namely the insurer and assured. At the same time, it confers no direct right or remedies against any one other than the assured and insurer. Thus, the assured shall not get a profit at the expense of the insurer but he can anyway be entitled to the excess from any other sources.

Some authors argue that the *Armstrong* case indicated that the insurer can get the whole rights and interest of the assured and in the case the underwriter get more than he paid to. The holding in the two cases the

Armstrong and the *Yorkshire* are not in conflict. In the former case, there is still salvage value, although the agreed value is less than the amount recovered from the tortfeasor. In the latter case there is no salvage value and the insurer has no proprietary interest. Mackinnon J. Suggest that the holding in *Armstrong* can still be right if it rests upon the cession of the property to the underwriter upon payment for a total loss.

As aforementioned, only through abandonment the underwriter can get more than he has paid. In addition, at the time of *Armstrong* case the distinction between the abandonment and subrogation had not been established.

5.2 Subrogation and Abandonment in Chinese Law

The legal framework of insurance law in China consists of laws, regulations, measures of both national and local governments. The main one concerning insurance contract law is in the insurance law of china and there is no seperate legislation of insurance contract law. In the insurance law of China there are only about 70 provisions governing insurance contracts, which is not enough to cover all aspects. Art 90 of the insurance law provides that where there is a lacuna, the relevant provisions of the general principle of Civil Law of the P. R. C and the contract law of the P. R. C shall apply¹⁶².

Marine insurance law is a separate regime laid down in chapter 7 of the Maritime Code. The marine insurance contract is an insurance contract, which should also be governed by the contract law of P.R.C; this is because it is provided that all contracts concluded in China including insurance contracts, together with marine insurance contracts should be governed by contract law of P. R. C¹⁶³.

According to Art. 216 of The Maritime Code, a contract of maritime insurance is one in which the insurer agrees to indemnify the insured' s loss of or damage to the insured subject-matter and the insured's liability caused by specified perils in consideration of the payment of insurance premiums by the insured¹⁶⁴. There is also no separate legislation of marine insurance law. It is chapter 7 of Maritime Code in China. In addition, by virtue of Art. 153 of the insurance law, provisions in the maritime code shall be applicable to marine insurance ; meanwhile, for matters not specified in the maritime code, the insurance law shall apply. The stipulations of the Maritime Code shall take precedence in matters of marine insurance business and the insurance law shall apply where the maritime code makes no pertinent stipulations.

162 Kevin X. Li, Tingzhong Fu, Ling Zhu, Yunlong Liu, "Marine Insurance Law in China", 32 Tul. Mar. L.J. 425 2007-2008Content,downloaded/printed from HeinOnline (<http://heinonline.org>) Fri Apr 9 11:02:29 2010

163 Contract Law (P. R. C) Art. 2 (1999)

164 Maritime Code (P. R. C) Art. 216

5.2.1 Subrogation in Chinese Law

In England and in USA, the basis of subrogation is that the insurer' right of subrogation exists as a matter of equity, and is not dependent upon the reservation of the right in the contract of insurance. In line with this practice in England and in USA, it is stipulated in insurance law of china ¹⁶⁵that

If a third party causes damage to the insured subject matter: the insurer shall, from the date of payment of indemnity to the insured, be subrogated to the rights of the insured to claim compensation from the said third party within the amount of indemnity paid.

In addition, Art 252 of the Maritime Code provides that “where the loss of or damage to the subject matter insured within the insurance coverage is caused by a third party, the right of the insured to demand compensation from the third person shall be subrogated to the insurer from the time the indemnity is paid.”

The two articles have given the whole view of subrogation in maritime law. It manifests two conditions for subrogation. Firstly, the third party is liable for the loss of or damage to the subject matter; secondly, the insurer has already paid for the insured loss. The two stipulations also have expressed that the consequences is that the insurer can be subrogated to the amount up to what he has paid to the insured¹⁶⁶. The two points have been shared in common with that in English law.

5.2.2 Abandonment in Chinese Law

Article 249 of Maritime Code stipulates, “Where the subject matter insured has become a constructive total loss and the insured demands indemnification from the insurer on the basis of a total loss, the subject matter insured shall be abandoned to the insurer. The insurer may accept the abandonment or choose not to, but shall inform the insured of his decision whether to accept the abandonment within a reasonable time.”

Article 250 of the Maritime Code stipulates that “Where the insurer has accepted the abandonment, all rights and obligations relating to the property abandoned are transferred to the insurer.”

Abandonment in Chinese law also shares in common with that in English law. After the insured demands total loss under the situation concept of constructive total loss, the insurer is not bound to but has the freedom of choosing to accept it or not. There is however, no requirement for notice of abandonment but is only stipulated as the assured demand; it does not

165 Insurance Law (P. R. C) art. 45 (2002)

166 The Chinese law has not stipulated the following: 1. the insurer upon payment can sue in his own name or in the assured's name; 2. the insurer need to fully indemnify the insured or partly indemnified the insured loss.

specify the reasonable period for the insurer to manifest his acceptance or rejection of the total loss claim, but rather it stipulates that there is a reasonable time. Again, it has not stipulated what if the insurer has not informed the assured within the period.

In Chinese law, it is clearly stipulated that the right against the third party arising from the subrogation and the proprietary rights arising from the abandonment. However, there is no stipulation as to the problem of the windfall.

6 Conclusions

The principal purpose of delving into English law in this thesis is to formulate proposals for the reform of the Chinese law relating to subrogation and abandonment. In this respect, three main points have been identified in the analysis carried out in this thesis which should be considered by Chinese lawmakers.

First, it must be noted that subrogation is quite different from abandonment in substantive terms. Subrogation comes into play where there is a third party wrongdoer. Abandonment is concerned only with a situation where there is a constructive total loss and the assured claims for a total loss. Subrogation entitles the insurer to sue the third party in the name of the assured unless there is an express and legal assignment of the assured's right to the insurer. The right is personal to the assured and therefore subrogation itself cannot transfer the right from the assured to the insurer. In subrogation, the right is not related to the proprietary interest in the subject matter. By contrast, abandonment is directly related to the proprietary interest in the res that is the subject of the insurance.

Second, the doctrine of subrogation was created to prevent the assured from obtaining a benefit at the cost of the insurer. Its object is to protect the insurer from suffering an overwhelming degree of payout and alleviate the burden of the insurance industry to some reasonable extent. In the long run, both insurer as well as assured is protected as a result of premiums not being too high making it relatively affordable for the assured. Thus, the insurer is not able to receive an amount greater than what he had paid to the assured and the insurer is not entitled to a windfall.

Abandonment entitles the insurer to the proprietary interest in the subject matter. The proceeds of sale of the subject matter might be higher than the losses of the assured, or higher than what the insurer has paid to the assured. Thus, it is possible that the insurer gets an amount greater than what he paid out to the assured. The excess amount received by the insurer under this situation is thus not a windfall by nature.

The insurer can, through proceedings against the third party, be entitled to the amount only to the extent of his payment. The payment should not be in the nature of a gift and should be only to diminish the loss insured through the policy. The nature of the payment should be examined by studying the payment itself.

Third, the definition of "windfall" should be specified although that is not quite an easy task given the sizeable amount of case law on the subject which attempts to clarify the legal concept. Whether or not there is a windfall depends on at least two factors. If it is from extraneous sources other than third party wrongdoer, there is a strong possibility that it is a

windfall. If it is from a third party wrongdoer, it will depend on the facts of each case. The intent of the payment should be examined. If it is to diminish the loss of the assured, it is a windfall. On the other hand, if it is a gift, it is not a windfall. Usually, if payment from the third party wrongdoer is in excess of the amount paid by the insurer, it is difficult to reject the gift nature of the excessive part. This, in the view of the writer is a fair summary of the law dealt with in this thesis presented in conclusion.

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