LIMITATIONS OF LIABILITY AND THIRD PARTIES

A. Introduction

In insurance law, the issue may arise whether and to what extent a third party can avail himself of an immunity, a limitation of liability or other defence which is based on the insurance contract made by the assured with the insurer but intended by them, either expressly or impliedly, to benefit him. The problem arises most frequently when the insurer is pursuing subrogation proceedings against the wrong doing third party.

Subrogation is the primary instrument by which insurers attempt to salvage losses incurred by paying on insurance policy claims. When an assured suffers a loss covered by an indemnity policy[1] and is paid by his insurer, the insurer is prima facie entitled to be subrogated to whatever subsisting rights of action the assured may possess in respect of the loss against third parties. In practice, most insurance policies contain express subrogation clauses, entitling the insurer to acquire the assured's rights of action against third parties following payment of the policy.[2] In absence of such a clause, the insurer will on payment request the assured to sign a letter of subrogation ('subrogation receipt') authorising the insurer to proceed in the name of the assured against the wrong doer who has caused the relevant damage to the assured.

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[1] Subrogation applies only to contracts of indemnity: traditionally, all contracts except life and personal accident insurance: Simpson & Co v Thomson (1877) 3 App Cas 279, 284; Theobald v Railway Passengers Assurance Co(1854) 10 Wxch 45, 53.

[2] An insurer's right to bring a subrogated action against a third party does not arise until it has paid the assured under the terms of the policy:Dickenson v Jardine (1868) LR 3 CP 639, 644; AFG Insurance Ltd v City of Brighton (1972) 126 CLR 655, 663.

English courts have considered the issue of whether an insurer, paying on an insurance policy for losses sustained by the assured, should be able to exercise a right of subrogation against the third party alleging ordinary negligence on the third party's part. It should be reiterated that the problem is immediately resolved if the third party is not liable to the assured for the losses. Since the scope of subrogation rights is defined by the liability of a given party to the assured, if the individual is not liable to the assured he likewise cannot be liable to the insurer by reason of subrogation.

Under certain circumstances in common law, insurers have been prevented from bringing subrogated actions against third parties. This has happened where the insurers, by a waiver of subrogation clause, have undertaken that they will not proceed against the third party by way of subrogation.[3] The insurer's subrogation rights have also been curtailed, even in the absence of such waiver of subrogation clause, on the basis that on construction of the policy the third party is either a co-assured or otherwise a third party entitled to the benefit of coverage under the so-called benefit of insurance clause.

The Contracts (Rights of Third Parties) Act 1999 ('the 1999 Act'), enacted to reform the doctrine of privity,[4] has now added another defence to the third party facing a subrogated action. In practice, the provisions of this new legislation may operate to curb that subrogated right.

In this article, limitation of liability of third parties from subrogation proceedings brought by insurers is examined. This exercise is carried out in two parts. The first deals with the circumstances where common and statutory law do not permit an insurer to exercise subrogation rights against the third party. The second, considers the scenario when there is an undertaking by the insurer that he is waiving his right of subrogation in favour of the third party, in the event that he is called upon to indemnify the assured for a loss caused by a third party, which precludes such an action.

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[3] In the event that they are called upon to indemnify the assured for a loss caused by the act or default of the third party.

[4] No one may enforce all or part of a contract to which he is not a party: *Dunlop Pneumatic Tyre Co Ltd v Selfridge Co Ltd* [1915] AC 847.

It will be submitted that the mechanism of the 1999 Act has enlarged the scope of the defences available to the third party and may be used to override the conflict of authority in English common law regarding the availability of waiver of subrogation clauses to third parties.

B. Exercising Subrogation Right

1 Subrogation

Through the principle of subrogation, the insurer has the ability to take over the rights of the assured against a third party who has caused the assured to suffer an insured loss and to bring proceedings in the assured's name. In insurance law, the function of subrogation is twofold.[5] The first is to preserve the principle of indemnity.[6] The law of subrogation enables the insurer to recover from his assured the extent that he has been over-indemnified by the wrong doer or other party. The second function is to allow the insurer, once he has compensated the assured for the damage or loss covered, to exercise any rights that the assured has against the third party wrongdoer.

Subrogation acts as a remedy that seeks to impose ultimate responsibility for a wrong or loss on the party who ought to bear it. This transfer of responsibility is accomplished by the fiction that the paying insurer steps into the shoes of the party who suffered loss for purposes of enforcing the latter's rights against the ultimately responsible person.

So far as any right of subrogation is concerned, the rule is that an insurer may not exercise subrogation rights against its own assured.[7] No one pays a premium to purchase insurance cover only to have the insurer turn around and seek to recover the payment of the loss. If the person assured is the person who caused the damage it is impossible

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[5] M Clarke *Polices and Perceptions of Insurance* (Clarendon Press Oxford 1997) 253.

[6] The object of indemnity under insurance contracts is generally to restore the fortunes of the insured as if the insured loss had not occurred. The insurance indemnity is restricted to loss which is effectively an inevitable result of the peril insured.

[7] *Simpson & Co v Thomson* (1877) 3 App Cas 279, 284.

to see how the right can be asserted at all. In principle, insurance extends to loss caused by the negligence of the assured. He would lose that cover if the insurer could take back with subrogation what he had given with the insurance. The rule also prevents the possibility that the subrogee will use information gained from its defendant assured in support of its subrogation claim.

The general rule that an insurer cannot exercise subrogation rights against its own assured makes perfect sense when the potential target is the party that paid the premium. However, in the circumstances when the third party provided no premium or where the purchaser of the policy may have no interest in protecting the third party from suit, it is more difficult to accept. English courts have nonetheless recognised that in two sets of circumstances, even in the absence of express waiver of subrogation clauses, the insurer cannot exercise subrogation action against a person not strictly the assured. The first is where the third party is insured under the policy as co-assured, particularly in the construction context. The second is where the purchaser of the insurance clearly intended to protect the third party by the so-called benefit-of-insurance clause.

It is pertinent to start by considering how the courts have arrived at the conclusion that the insurer's subrogation rights against the co-assured should be curtailed. The benefit of insurance clauses cases will be dealt subsequently.

2. Co-insurance

Commonly, co-insurance can be effected in a single contract of insurance by the insurer agreeing that two or more named persons are assureds under the policy, whereby insurance covers their respective (separate) interests as co-assured. Insurers of construction projects have the common practice of including in their policies wide definitions of assureds whereby cover is extended to include not only the principal assured or head contractor, but also other entities such as sub-

[8] Other examples include mortgagor and mortgagee, companies within a group or joint tenants.

[9] *Co-operative Retail v Taylor Young* [2000] 1All ER (Comm) 720, affirmed [2001] 1 Lloyd's Rep IR 122 (CA).

contractors, suppliers and associated companies which have a connection with the contract works.[8] If insured loss is caused by one of the co-assureds, the insurer usually has no rights in subrogation against the co-assured who caused the loss.[9] The immunity operates even where the co-assured has caused the damage to the property insured such as through negligence.

Another important method is for co-insurance to be effected by means of agency. This was analysed by Colman J in *National Oilwell v Davy Offshore Ltd* where three requirements were listed for an assured, who procured a policy in his own name, to be deemed as acting as agent for a third party. These are that: (a) the assured was authorised to insure on the third party's behalf; (b) the assured intended to insure on the third party's behalf; and (c) the policy does not preclude coverage of the third party. The complication with the agency approach is that it does require evidence of an undertaking on the part of the main insured to act as agent for the sub-contractor and of course the latter's authority for him to do so, or at least subsequent ratification.

The rule against subrogation where there is co-insurance, however, does not apply if one co-assured has ceased to be covered by the insurance.[10] In circumstances where there is wilful misconduct by one co-assured, the innocent co-assured could enforce the insurance, and if he did so, the insurer would be subrogated to the rights of the innocent co-assured against the other co-assured.[11]

(a) Basis for immunity

The courts have meandered between several alternative bases of immunity of a co-assured. Broadly, the reasons given for the rule not allowing subrogation against a co-assured are the following.

The first basis to be accepted by the English courts, in *The Yasin*[12] and *Petrofina (UK) Ltd v Magnaload Ltd*,[13] was the 'circuity' argument. If the insurer indemnified the assured and then sought to bring subrogation proceedings against the second assured for bringing

[10] *Deepak v ICI* [1999] 1 Lloyd's Rep 387 (CA).

[11] *Samuel v Dumas* [1924] AC 431.

[12] [1979] 2 Lloyd's Rep 45.

[13] [1984] 1 QB 127.

about the assured loss, the latter would then have the right to claim under the policy. To avoid this circuity of actions, subrogation against the second assured was precluded. Underlying this conclusion were reasons of 'commercial convenience' of allowing the head contractor to take out a single policy covering all contractors and sub-contractors in respect of loss or damage to the entire works.

The second basis is that the contract between one assured and the other assured exonerates the second assured for negligence, whether explicitly or by a benefit clause. The first assured has no rights against the second assured to which the insurer can be subrogated.

A further reason is that to allow the insurer to exercise rights in subrogation would give rise to conflicts of interest. This is based on equity and it would be inequitable to allow an insurer to exercise a right of subrogation against one of its assured. This prevents the possibility that the subrogee will use information gained from its defendant assured in support of its subrogation claim. This is the favoured approach in the USA.

The fourth view grounds the immunity of the co-assured on an implied term of the policy preventing such an action. To allow insurers to exercise rights of subrogation in respect of the same loss and damage against a co-assured, as held in *Stone Vickers v Appledore Ferguson Shipbuilders*,[14] would be so inconsistent with the insurer's obligation to the co-assured that there must be implied into the contract of insurance a term to give it business efficacy that an insurer will not in such circumstances use rights of subrogation in order to recoup from a co-assured the indemnity which he has paid to the assured. To exercise such rights would be in breach of such a term. The court in the *Stone Vickers* case relied on the assumption that the sub-contractor was a co-assured under the policy to hold that they were sufficiently interested in the whole of the contract works to be able to resist the insurer's claim. In the judge's view, the exercise of subrogation rights would be so inconsistent with the insurer's obligation to a co-assured that there

[14] [1991] 2 Lloyd's Rep 288, 302.

must be implied into the contract of insurance an exclusion of those rights. A similar view was taken in *National Oilwell (UK) Ltd v Davy Offshore Ltd.*[15]

More recently, the Court of Appeal, in *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd,*[16] has favoured the implied term basis, rather than the circuity of action basis, for denying subrogation rights against a co-assured. The insurers could not have pursued subrogation rights against the negligent co-assured (third parties) as the insurers were precluded by an implied term in the insurance contract from doing so.

The fifth reason is a development or variation of the fourth basis of immunity and has been described as the 'fiction' of one assured. It is an inference from the law's view of the situation of the single assured, in which subrogation is impossible. Basically it is that which was adopted in *Stone Vickers* and approved in *Co-operative Retail Services*, although dressed up in the language of implied terms.

(b) Inconsistencies of bases

According to Clarke,[17] in England, there is widespread reluctance to allow subrogation against a co-assured.[18] However, the way in which the courts in England have gone about protecting third parties claiming to be entitled to the benefit of the insurance chain on grounds of co-insurance may be based on questionable foundations. For instance the courts in the *Petrofina* case treated the third party as one of the assured on the basis of commercial convenience. Moreover, even on the basis found in *National Oilwell* case, this view is open to attack on the basis that the co-assured is not a party to the contract.

While it is recognised that co-insurance may be a convenient way of proceeding where there are, or may be, more than one person

[15] [1993] 2 Lloyd's Rep 583, decided by Colman J who was also the judge at first instance in the Stone Vickers case.

[16] [2000] 2 All ER 865.

[17] M Clarke The Law of Insurance Contracts (Loose-leaf ed LLP London 2000) para 31-5D.

[18] The exception arises when the co-assured has been fraudulent or guilty of wilful misconduct: *Samuel v Dumas* [1924] AC 431. See Mitchell [1996] LMCLQ 343, 354.

interested in a particular insurance, it could equally be regarded as a somewhat clumsy way of proceeding. There is no fundamental rule of law preventing one co-assured, ie the insurer exercising subrogation rights suing another. Moreover, these possible theories provide neither a unified doctrine, nor any satisfactory theoretical basis as to why an insurer should not be able to bring proceedings in the name of one co-assured against another co-assured.

The cases in which the basic rule immunising the assured from suit by its insurance company has been extended to protect a co-assured party are of limited value. In each case, the status of the party as a co-assured needs to be established. The cases do not help with overcoming the hurdle of determining whether the third party is immune from subrogation action where the party is not found to be a co-assured. In cases where the question arose whether a non-party to an insurance contract is granted immunity from subrogation, courts attempted to avoid entering the co-insurance arena by analysing the case by finding a clause benefiting the third party.

3 The Benefit of Insurance Cases

English courts decided that, as a general rule, an insurer may not bring a subrogated action in the name of its assured against a third party where the assured has previously agreed with the third party that the insurance should enure to his benefit, even though he is not a party to the insurance contract. The basis for this rule is that if the assured is not permitted to sue a third party for a loss because he has exempted him from liability, his subrogated insurer likewise is also not permitted. The exemption from liability for loss covered by the policy arises from the agreement between the assured and the third party that the benefit of insurance should enure to the third party.[19]

These are not co-insurance cases, like the situation in the *Petrofina* case. In such cases the answer to the insurer's claim would be that they could not have rights against one of their assured. Under co-

[19] *Mark Rowland Ltd v Berni Inns Ltd* [1986] 1 QB 211 (CA) 232-233; *Darlington BC v Wiltshier Northern Ltd* [1995] 1 WLR 68 (although leave to appeal was granted, case was settled before it reached House of Lords).

insurance it is necessary to prove that the third party is party to the contract ie he is co-assured. Under the benefit of insurance category it is sufficient for the third party to show that the policy was taken out partly for his benefit, whether or not he was a party to it. Once it is found, as in *Mark Rowlands Ltd v Berni Inns Ltd*,[20] that the lessee was intended to benefit from the insurance the landlord would look to the insurer and not to the tenant to make good any loss, and as the landlord had no action against the tenant then neither did the insurer by way of subrogation.

The cases dealing with the benefit of insurance case revolve on the key question of whether the assured has agreed that the benefit of the insurance should enure to the third party. The first case to deal with this issue is the *Rowlands* case. In that case a policy was taken out by a landlord in his own name and covering his own interest. The lease with the tenant obliged the landlord to insure, and to use the insurance moneys on reinstatement. The tenant covenanted to pay the landlord an insurance rent related to the premium paid by the landlord for the insurance of the whole building. The premises were damaged due to the tenant's negligence, and the insurers, having paid the landlord sought to exercise subrogation rights against the tenant.

The Court of Appeal found that, although the tenant was not a party to the insurance contract, under the lease the insurance was taken for the joint benefit of landlord and tenant. The arrangement revealed party intention to exempt the liability of the tenant for loss covered: to substitute the fire insurance for the tenant's liability for fire loss. Kerr LJ said that party intention to excuse the tenant could be inferred because given the fact the tenant can reasonably rely in the landlord's covenant to insure and can refrain from insuring against any liability to the landlord for its own negligence, the landlord must then look to its own insurance if it suffers loss and cannot sue the tenant for loss that it had promised to insure. Inference about party intention was supported by the fact that it was the tenant who paid the premium relating to the basement.

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[20] [1986] 1 QB 211 (CA).

Later, in *Lambert v Keymood,*[21] Laws J found that, although the landlord had promised to arrange and pay for fire insurance on the buildings, and the tenant had consequently refrained from covering the loss, that was not enough to show that the landlord had agreed to insure for the benefit of the tenant. In the *Lambert* case, the key question was whether the owner of the building had agreed to insure on behalf of the tenant who was occupying the building. Mr Justice Laws reviewed the evidence and concluded that while there were various oral and written terms whereby the owner agreed to insure for the tenant, the *Rowlands* case required the existence of a common intention between the landlord and tenant to the effect that any insurance was to be at least in part for the defendant's benefit. In the Lambert case the judge held that this could not be shown and the owner's agreement to insure was purely in respect of his own interests.

In case of subrogated actions by mortgage lenders' insurer against defaulting borrowers, the defendants attempted to argue that because they were obliged to pay the premiums of the policy, it was an implied term of the loan contract that the policy should enure to the borrower's benefit. However this was rejected.[22] The main ground being that it is inconceivable that any insurance company would be unintelligent enough to provide insurance in favour of individuals in the event of their not paying their debts.[23]

It seems that if one party to a lease is to have the benefit of insurance and the insurer is to be deprived of the action of subrogation, it is enough that the lease should include an agreement to insure, particularly if the lessee contributes to the cost of the insurance. The courts are most unlikely to find that the assured has agreed to exempt a third party from liability for an insured loss where the agreement between the assured and the third party does not oblige the assured to take out insurance.

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[21] [1997] 2 EGLR 70.

[22] *Woolwich Building Society v Brown*, The Independent January 22, 1996.

[23] *Mortgage Corp v McNicholas* unreported CA September 22 1992.

However the danger, as shown by the *Lambert* case, is that of one person attempting to rely upon the insurance of another in the hope that the insurance benefits him. As Laws J concluded, it did not follow automatically from a covenant to insure that the tenant was exonerated in respect of loss covered by the insurance. Not every promise to insure has the effect of conferring an interest on the tenant so that he becomes immune from subrogation proceedings. There are other cases where no intention is inferred such as in *Lister v Romford Ice & Cold Storage Ltd*[24] and *BT plc v James Thomson & Sons Engineers Ltd*.[25]

In the *James Thomson* case, BT entered into contract with a main contractor, under which the former had to take out insurance cover. Thomson was appointed as sub-contractor. Fire broke out and BT sued the sub-contractor. The House of Lords held that under main works contract, the ordinary subrogation rights of the insurer to the benefits of any action against a person who had caused the loss were expressly dealt with by a specific provision. By the latter provision, any nominated sub-contractor was to have the benefit of an assured under the policy or the benefit of a waiver. But, there was no such provision in the case of a domestic sub-contractor. The head contract recognised that a domestic sub-contractor would not be protected from subrogation proceedings.

The principles relating to subrogation immunity in benefit of insurance cases established by the courts are replicated in a different fashion by the operation of the 1999 Act. It is to the requirements and workings of the 1999 Act to which we now turn.

4 The Contracts (Rights of Third Parties) Act 1999

The Contracts (Rights of Third Parties) Act 1999[26] ('the 1999 Act') reforms that part of the privity doctrine that prevents a person who is

[24] [1957] AC 555.

[25] [1999] 1 WLR 9 (HL).

[26] Became law on November 1999 and applies to contracts entered into six months after that date. Contracts (Rights of Third Parties) Act, s 10(3).

not a party to a contract from enforcing it.[27] The 1999 Act applies to all contracts[28] including insurance and reinsurance contracts. It enables the contracting parties to confer a right to enforce the contract term on a third party.[29] The contracting parties cannot, unless the contract says otherwise, generally, cancel or vary the terms of the contract after the third party has communicated his acceptance of the term or, in certain circumstances, has relied on it.[30] The promisor (in our context the insurer, in direct insurance) shall have all the same defences to a claim by a third party that the insurer would have had against the promisee (the insured),[31] and the rights of the promisee are not affected by the rights of the third party.[32]

Bringing English law in line with much of the rest of the world, a person who is intended by the insurer and the assured to be covered by the policy may enforce the contract against the insurer, under the 1999 Act, despite not being a party to the contract and has provided no consideration for the insurer's promise of indemnity. It is not necessary that the third party relies on the insurer's promise or even be aware of it.[33]

Section 1(1) of the 1999 Act provides that subject to the provisions of the Act, a third party may in his own right enforce a term of the contract if (a) the contract expressly provides that he may, or (b)

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[27] Law Commission, Privity of Contract: Contracts for the Benefit of Third Parties (Law Com No 242, 1996).

[28] Unless excluded by the Act e.g. negotiable instruments and employment contracts: Contracts (Rights of Third Parties) Act, 6.

[29] The parties to the contract can exclude the legislation in its entirety, if they wish.

[30] Contracts (Rights of Third Parties) Act, s 2.

[31] Contracts (Rights of Third Parties) Act, s 3.

[32] Contracts (Rights of Third Parties) Act, s 5.

[33] Reliance or acceptance become relevant where the parties to the contract attempt to rescind or vary the contract. Contracts (Rights of Third Parties) Act, s 2.

subject to subsection (2), the term purports to confer a benefit on him.[34]

Without expressly providing so, the right of enforcement conferred on a third party by the 1999 Act may be both positive and negative. It is positive in that it allows the third party to bring an action on a term for his benefit. It is negative in that it allows him to rely upon terms in the contract and operates as a defence to a claim by the promisor. It is this negative right of enforcement which comes into play when the insurer is exercising subrogation rights against the third party.

The 1999 Act potentially offers a third way for third party to avoid subrogation proceedings in respect of loss caused by him. The issue is to consider the extent to which the 1999 Act will enable the third party to avail himself of a defence to a subrogated action conferred by both the 1999 Act and also by a limitation of liability clause in a contract made by others but intended by them to benefit the third party. The question is whether the court should infer on the facts a common intention to insure for the third party's benefit. The test of enforceability according to s 1 of the 1999 Act is twofold. The third party should have a right to enforce a term of the contract where the contract expressly provides that he may.[35] Alternatively, a third party should have a right to enforce the clause if the term purports to confer a benefit on him, unless on a proper construction of the contract the parties did not intend the term to be enforceable by him.[36] The first test is concerned with the express conferral of rights on a third party while the second test is possibly concerned with the implied conferral of rights on a third party. In each case the third party must be

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[34] Contracts (Rights of Third Parties) act,s 1(1) and (2) provides:

(1) Subject to the provisions of this Act, a person who is not a party toa contract (a 'third party') may in his own right enforce a term of the contract if-

(a)the contract expressly provides that he may, or

(b)subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection 1(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

[35] Contracts (Rights of Third Parties) Act , s 1(1)(a).

[36] Contracts (Rights of Third Parties) Act, s 1(1)(b) and s 1(2).

identified by name, class or description, although he need not be in existence when the contract is entered into.[37]

The answer to when should a third party have the defence against an insurer's subrogation action, on the basis of a right of enforcement on a term of the contract, depends on the proper construction of the contract between the parties concerned. It is the terms of the insurance contract which should be examined to determine whether the third party has any rights.

Subject to there being a reversed burden of proof, the normal objective approach to contractual interpretation should be applied.[38] It is legitimate to have regard to the surrounding circumstances of the case or the factual matrix.[39] This includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man, subject to the requirement that it should have been reasonably available to the parties.[40] The law, however, excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent.[41]

The law uses a rebuttable presumption where there is implied conferral of rights. The problem is how to resolve the issue when there is a clause expressly conferring rights and also a clause providing for a prohibition of conferring of a benefit on third parties. For instance, a clause in the bill of lading may provide that the carrier is entitled to the benefit of the shipper's insurance so far as this shall not avoid the policies. The shipper's policy, however, may provide that coverage shall not enure, either directly or indirectly, to the benefit of

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[37] Contracts (Rights of Third Parties) Act, s 1(3).

[38] A Burrows 'The Contracts (Rights of Third Parties) Act 1999 and its implications for commercial contracts' [2000] LMCLQ 540, 545; R Merkin Privity of Contract (London 2000) para 5.29.

[39] *Reardon Smith Line Ltd v Yngvar Hansen-Tangen (The Diana Prosperity)*[1976] 1 WLR 989 (HL) 995-996 (Lord Wilberforce).

[40] *Investors Compensation Scheme Ltd v West Bromwich Building Soc* [1998] 1 WLR 896 (HL) 912-913 (Lord Hoffmann).

[41] *Investors Compensation Scheme Ltd v West Bromwich Building Soc* [1998] 1 WLR 896 (HL) 912-913.

any carrier or bailee and that, in the event that the parties to the bill of lading permit the benefit of insurance to the carrier, the insurer shall be discharged from liability for any loss under the policy. This creates an apparent conflict between the clause benefiting the third party carrier and the insurance policy provisions.

The provisions in the bill of lading were written for the purpose of getting the benefit of the insurance. If their effect is to avoid the policy then nobody could recover under the policy and that result was not intended. Since giving the benefit of insurance would have the effect of avoiding the policy, the benefit of insurance clause falls of its own language. The policy stands but the carrier is not entitled to the benefit of the insurance because it is to get the benefit only of such insurance as would not be avoided by giving it such benefit. Since the carrier is not insured despite the benefit of insurance clause, there is no bar to enforcement of the insurer's subrogation claims against the carrier. In this situation the conflict is resolved in favour of the insurer and the negligent carrier is not entitled to the benefit of the shipper's insurance.

5 A Better Option for Third Party?

When comparing the 1999 Act with common law, various differences emerge. The first is that the court decisions on co-insurance are devoted to the question of whether, under common law, the sub-contractor falls under the heading of assured; whilst under the 1999 Act, the courts need no longer consider whether a third party is a co-assured or not. The issue would be to assess whether the requirements set out by the 1999 Act for the conferral of rights are fulfilled or not. Recourse must be had to the wording of the contract to enable him to enforce the term of the contract term for his benefit.

Another important effect of the 1999 Act is that the defence of the third party under the 1999 Act is much broader than co-insurance in the situation of a third party, such as a subcontractor, which enters into a subcontract after the commencement of the policy of insurance and which was not expressly contemplated at the time of that policy. The sub-contractor may be engaged by the head contractor after both the construction contract and policy of insurance were entered into and who may know nothing of the terms of the head contract, nor of the parties' insurance arrangements. The sub-contractor arguably falls

within the class of persons contemplated by the insurance. According to traditional principles of common law, such a subcontractor could not be a co-assured under the policy and would most probably not be so entitled to a defence. It was not a party to the insurance and was not in contemplation at the time of the insurance. By contrast, pursuant to the 1999 Act, a sub-contractor in such circumstances can be entitled to the benefit of the insurance. The 1999 Act has arguably enlarged the scope of the defence afforded to third parties from subrogation proceedings.

To resolve the issue of whether the court should permitted the insurer's subrogated action, the courts will look to whether a party claiming to be a third party beneficiary was entitled to rights or benefits under the contract or was just an incidental beneficiary who is not so entitled. In other words, to claim a negative right, the third party must show that the contracting parties expressly agreed or purported to confer a benefit on him. This approach makes a great deal of sense, in that it comports with the intentions of the parties to the contract.

In many of the cases in the area of benefit of insurance clauses the courts usually look at the terms of the lease for evidence of the parties' intentions. The case law suggest that they are most likely to hold that a tenant is intended to have the benefit of insurance on the property where the lease contains a covenant by the landlord to insure on his behalf and/or a covenant by the tenant to pay insurance premiums.

Generally speaking, a party is only entitled to claim rights under a contract to which he is not a party if the parties to the contract intend for the third party to be a beneficiary of the contract. In the context at issue, the question is whether the parties to the insurance policy, the person purchasing the policy and the insurer, intend to protect the third party from a particular type of claim. Obviously, assureds such as owners of projects and general contractors, do not intend to confer gifts on subcontractors, so traditional contract methodology would look whether the assured was contractually obligated to provide the party sub-contractor with protection from subrogation actions.

The test of enforceability under the 1999 Act will give the courts greater flexibility in determining the issue of third party defences from a subrogated action by the insurer.

C. Construing A Waiver of Subrogation Clause

1 Introduction

It is common in many classes of insurance to contain a waiver of subrogation clause. Under such a clause, as the name implies, the insurer undertakes not to exercise rights of subrogation otherwise available to him against named individuals or companies. The waiver of subrogation clause may arise in the following scenario. An employer enters into a contract with a contractor to design and build a certain structure. The contractor contracts with sub-contractors and suppliers to provide various services and goods. The employer concludes a construction all risks insurance with insurers, with the employer named as the principal assured. The policy will cover 'other assureds' who are defined by reference to a class including contractors, subcontractors, and suppliers. One of the sub-contactors is negligent and causes damage to the building. The employer claims for repairs under the policy. After paying out, the insurers wish to exercise their right of subrogation to sue the negligent subcontractor. The subcontractor raises a defence that there is a waiver of subrogation clause in the terms of the policy. The issue is when can the third party wrongdoer successfully plead the waiver clause in his defence.

Under common law, as stated in *Scruttons Ltd v Midland Ltd*,[42] the general proposition is that a person had to be a party to a contract before he could invoke in his own name any waiver or limitation of liability in that contract as a defence to a claim brought against them. In the insurance context the third party defendant, such as a sub-contractor, cannot rely on such a clause, unless he is a party to the insurance contract or a co-assured, otherwise the defence would run counter to the principle of privity of contract. Under the provisions of the 1999 Act, the waiver of subrogation clause may effectively bar the insurer's right of subrogation against the third party relying on this clause as a defence, without the need to show he was a co-assured

[42] [1962] AC 446.

under the policy. The purpose of the following discussion is to consider the extent to which the 1999 Act will enable the third party, when faced with a subrogated action, to avail himself of contractual waiver based on a contract made by others but intended by them, either expressly or impliedly, to benefit the third party.

2 Common law

As noted above, as a rule, reliance on this type of provision by a person other than the assured, who is not a party to the contract, is barred by English common law. The party has to demonstrate that he was a co-assured under the policy. Often this means showing that the main assured had acted as the sub-contractor's agent in obtaining the benefit of the insurance on the sub-contractor's behalf, perhaps as an undisclosed principal. In the cases of *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd*[43] and *National Oilwell v Davy Offshore Ltd*[44] the court had to review the contractual relationship between the principal assured (who had arranged the policy), as the main contractor, and the sub-contractor, in order to determine precisely what agreements existed under the construction contract between them. In the *Stone Vickers* case, the court found that there was no agreement by the main assured to procure any insurance for the subcontractor. The defence raised by the third party, concerning the waiver clause, failed. In the *National Oilwell* case, however, it was clear that the subcontractor was insured under the policy to some limited extent.

In that case the sub-contractor had agreed with the contractor that the contractor would obtain insurance for all risks up to the date of delivery of goods by the sub-contractor. Losses occurred thereafter, for which the insurers, having indemnified the contractor, sought to recover by way of subrogation from the sub-contractor. The sub-contractor pleaded the subrogation waiver clause in the insurance contract. The subrogation clause waived the underwriters' subrogation rights against 'any assured and any person, company or corporation whose interests are covered by this policy.'

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[43] [1992] 2 Lloyd's Rep 578.

[44] [1993] 2 Lloyd's Rep 582.

The court held that this clause confines the effect of the waiver to claims for losses which are insured for the benefit of the party claimed against under the policy, stating that one does not qualify for the benefit of the waiver clause merely by being a party to the contract of insurance. The supplier's argument that it could claim the benefits of the waiver of subrogation for losses, for which it was not insured, was rejected as leading to a consequence that would 'indeed be remarkable' since 'the policy would limit the cover with one hand and indirectly by waiver remove the limit by another hand.' The court concluded that the waiver of subrogation as to parties whose 'interests are covered by the policy' waived only subrogation as to those interests.

On the basis of Colman J's decision, since only a party to the contract of insurance can take advantage of its terms, that makes any attempts by a third party such as a co-assured to enforce the waiver of subrogation clause under the 1999 Act futile.

By contrast, in the later decision in *Enimont Supply SA v Chesapeake Shipping Inc The Surf City*[45] the conclusion was opposite to the one by Colman J in *National Oilwell,* although surprisingly the latter case was not cited. In *The Surf City* case it was decided that the exercise of subrogation would not be equitable in the presence of a waiver provision. Both parties were prepared to proceed on the basis that a subrogation waiver clause was binding. In this case the contract contained a subrogation waiver clause which extended to subsidiaries of the assured. The owner of the goods, insured them, sold them and assigned the policy, but a subsidiary company (of the first owner) damaged them in transit to the assignee. The assignee was paid by the insurer who then sued the subsidiary. Mr Justice Clarke held that whilst an intended beneficiary has no right to enforce the clause as it is not a party to the contract, a court could nevertheless enforce the obligation in equity.

The decision in *The Surf City* has been criticised since it is not reconcilable with authorities on privity of contract.[46] Moreover, it is

[45] [1995] 2 Lloyd's Rep 242.

[46] J Mance, I Goldrein and R Merkin Insurance Disputes(Loose-leaf ed LLP London 2001) para 8.99 fn 3.

thought that the better view is that subrogation can be denied on equitable grounds only in extreme cases.[47]

The result achieved by Clarke J in *The Surf City* case, however, was arrived at by a decision of the Supreme Court of Canada *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*[48] without reference to equitable grounds. The Supreme Court held that waiver of subrogation clauses in contracts of insurance constitutes an exception to the doctrine of privity of contract in circumstances where the third party beneficiary is not a party to the policy but falls within the contractual definition of those to whom coverage under the policy is extended.

In that case the claimant owner chartered a barge and crane to the defendant. The claimant held an insurance policy which provided that the charterer of an assured vessel was considered an 'additional assured.' Under a subrogation clause in the policy the insurer waived any right of subrogation against any charterer. Whilst on charter the barge sank and the claimant recovered under the policy. The insurer wished to sue the charterer for loss. The claimant agreed to waive any rights it had under the waiver of subrogation clause and the insurer brought a subrogated claim for damages, alleging negligence by the charterer. The defendant argued that even if it was not a party to the contract of insurance, it was entitled to invoke the waiver of subrogation clause to prevent the insurers bring a subrogated claim.

The trial judge found in favour of the underwriters and held that the doctrine of privity prevented Can-Dive from enforcing the waiver of subrogation clause. He found that Can-Dive's situation did not fall within any of the previously established judicial exceptions. He went on to say that Can-Dive was not a co-assured because there was no intention on the part of Fraser River as its purported agent to act on its behalf, and that in any event even if Fraser River and the underwriters had entered into their agreement to revoke the waiver of subrogation clause.

The British Columbia Court of Appeal reversed the judgment and held that the defendants were entitled to immunity since Can-Dive fell

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[47] *Woolwich Building Society v Brown* [1996] CLC 625 (Waller J) 629.

[48] [2000] Lloyd's Rep 199.

within the contractual definition of those covered. Fraser River's appeal to the Supreme Court was also dismissed.

The Supreme Court did not comment on the Court of Appeal's agency holding but preferred to follow the stipulation for the benefit of third parties option. It felt that it was appropriate to develop a 'principled exception' to the doctrine of privity on the facts before it. The intentions of the parties to the insurance contract were clear, and the defendants had as charterers performed precisely the activities which were stated to benefit from the subrogation waiver clause. The court declared that this new exception is contingent on the parties intending to benefit the third party whose activities must fall within the contract.

The Supreme Court found that the language of the insurance policy was plain so that Fraser River was held to the intention of obtaining a waiver of subrogation benefit for future charterers, irrespective of its actual intention. The court said that sound policy reasons required the doctrine of privity of contract to be relaxed. When sophisticated parties enter into a contract of insurance which expressly extends the benefit of a waiver of subrogation clause to an ascertainable class, effect must be given to the plain language of the contract.

The question of who can enforce a waiver of subrogation clause in an insurance contract has also been determined in Australia by the Full Court of the Supreme Court of Western Australia in *Woodside Petroleum Pty Ltd et v H&R-E&Y Pty Ltd et*.[49] The decision of the Full Court is that a defendant who is not a party to the contract of insurance that contains a waiver of subrogation clause can nonetheless enforce it against an insurer claimant that is trying to exercise its rights of subrogation and sue for damages.

Essentially the facts in the *Woodside* case involved a construction of an oil gas platform insured by the contractors covering various other categories of entities as 'other assured' including sub-contractors and suppliers. Severe damage to the platform was discovered. Woodside claimed on the all risk policy. The insurers then attempted, in the name of Woodside to claim against some subcontractors, using their rights of subrogation. One of the defences of the defendants was that they

[49] (1999) 20 WAR 380.

could defeat the claim by relying on a waiver of subrogation clause of the policy terms.

The Full Court held that when the parties have expressly agreed to a waiver of subrogation clause, such a clause prevents any rights of subrogation since its effect is that the underwriter has never had any right to be subrogated to claims which could be made by an assured. It continued that the waiver of subrogation clause may be relied on by a person falling within the description of persons against whom subrogation has been waived, notwithstanding that such person is not a party to the contract of insurance or named as an additional assured for whose benefit the scope of cover extends. The decision on this point was based on 'a general rule of insurance law deriving from the first principles of the law of contract'.[50]

The problem with this reasoning is that the application of these principles in this way to a contract of insurance is a conflicting development in English insurance law.[51] This is because it appears to be contrary to the common law principle of privity of contract, and as contrary to the approach of the Court of Appeal in the *Stone Vickers* case and Colman J in the *National Oilwell* case mentioned above.

3 Identity of assured

Colman J in the *National Oilwell* case went on to hold that the sub-contractor could rely upon the subrogation waiver clause only to the extent that he was a party to the policy. This was decided on the basis that the clause waived insurers' rights against any assured, any person, company 'whose interests are covered by this policy'.

The court held that the suppliers, who were only assured under the contract for a limited period (until they delivered goods to the contractor), could only take advantage of the subrogation waiver clause to the extent that they were actually assureds under the contract. Thus, if the insurer made a claim (against the tortfeasor) in respect of

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[50] (1997) 18 WAR 539, 572 (Anderson J), approved by the Full Court.

[51] R Aikens 'Who can enforce a 'waiver of subrogation' clause in an insurance contract? (2000) International Trade Law Quarterly 73.

the damage for which the co-assured had no cover, the co-assured could not take advantage of the subrogation waiver clause.

Therefore, to use the subrogation waiver clause effectively, there has to be a community or identity of assured interest between the assured who has been paid and the co-assured who is trying to rely on the subrogation waiver clause. A subrogation waiver clause will therefore only protect a third party to the extent that he is assured under the contract and a claim wider than 'his' insurance coverage can still be brought against him unless specifically excluded.

This construction of the waiver of subrogation clause severely restricts its effects. The waiver of subrogation clause is to cover persons who are not entitled to cover. If the waiver had been construed more widely, the judge recognised the effect would be indirectly to give the third party full policy cover.

The problem of 'identity of assured interest' may still remain despite the 1999 Act. Mr Justice Colman based his view in the *National Oilwell* case on the construction of the particular provision and it seems that there is nothing in his judgement that would prevent the proper operation of a more widely worded waiver of subrogation clause. In addition to a waiver of subrogation against any assured, the clause records a waiver of subrogation against any person whose interests are covered by the policy. Apart from providing for a waiver of subrogation against all assured persons, the clause provides for a waiver of subrogation against any person having an interest in the subject matter of the insurance. There are no reasons why parties to an insurance policy should not agree that the insurer should waive his rights of subrogation against persons additional to those insured by the policy. Effect should be given to such clause, notwithstanding that the third party is not the assured.

4 The Contracts (Rights of Third Parties) Act 1999

The provisions of the Contracts (Rights of Third Parties) Act 1999 Act contemplate that third parties may rely on the Act to obtain the benefit of limitation or exclusion clauses in contracts between others when sued by the promisor. Section 1(6) of the 1999 Act provides that 'where a term of a contract excludes or limits liability in relation to any

matter, references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.

In practice it seems that the waiver of subrogation clause would constitute an express term conferring a benefit on the third party. In the alternative, a subrogation waiver clause may fall under the category of a term for the benefit of a third party.

If there is a term excluding liability on the part of the subcontractors and the insurers sue, the subcontractor will be able to rely on the waiver clause by reason of s 1(1)(a). Additional words, such as 'and the third party shall be entitled to rely on that exclusion clause', over and above words clarifying that the clause is for the third party's benefit, seem unnecessary. This is because, by definition, an exclusion clause is intended to affect the legal rights of beneficiaries of such clauses.

Section 1(1)(b) provides for enforcement by the third party of any term which purports to confer a benefit on him. Where the requirements of enforceability by a third party are satisfied in relation to such a clause, the third party can avail himself of the clause.

The third party must satisfy the intention requirement. Did the contracting parties intend to extend the benefit in question to the third party seeking to rely on it? Taking the case where the third party such as the sub-contractor is included as one of the categories as 'additional assureds' does the waiver of subrogation clause expressly refer to the third party intended to benefit therefrom?

Section 3(6) of the 1999 Act restricts the third party relying on subrogation waiver to those rights permissible if he had been a party to the contract.[52] Where proceedings are brought against a third party who seeks to rely on an exclusion or limitation clause contained in the contract, he may not do so unless the provisions would have been available to him had he been a party to the contract. If the subrogation waiver clause is unenforceable for some reason, the third party cannot

[52] The 1999 Act s 3(6): Where in any proceedings brought against him a third party seeks in reliance on section 1 to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he may not do so if he could not have done so (whether by reason of any particular circumstances relating to him or otherwise) had he been a party to the contract.

enforce either. The phrase 'had he been a party to the contract' refers to matters that affect the validity of the clause as between the contracting parties as well as matters affecting the validity or enforceability that relate only to the third party.

5 Practical Effects

In common law, for a non-party to obtain benefit of waiver of subrogation clause he had to prove he was a co-assured. Under 1999 Act, even if the third party is not assured or co-assured may still obtain benefit of waiver clause. Professional indemnity policies may protect employees of the assured by excluding subrogation rights against the employees of the assured.

Waiver of subrogation clauses have much broader effect under the 1999 Act than under common law co-insurance cases. A waiver of subrogation clause under the 1999 Act could be effective in respect of persons who are not co-assureds at all. Had the facts of the *Fraser River* case or the *Woodside Petroleum* case arose under the new 1999 Act, the English court would be obliged to hold that the third party would be entitled to rely on a waiver clause in the insurance policy.[53]

Where an insurer has agreed to an express clause in a policy waiving its subrogation rights eg in respect of a type of loss or against a class of people responsible for causing an insured loss, the third party can rely on this clause against the insurer under the 1999 Act without the need to resort to equitable principles as held by Clarke J in *The Surf City* case. Thus the benefit of waiver clause can be enforced as a contractual benefit rather than in equity and arguably is more certain as a result.

The third party can avail himself of the clause if the contract expressly so provides or if the term purports to confer a benefit on him, unless it appears on a proper construction of the contract that the

[53] However there was also the important issue of revocation of the third party right by the insurer.

parties did not intend the term to be enforceable by him. The operation of the 1999 Act depends on a question of construction of the clause. The mere fact that the proposed assured is obliged to insure does not raise a conclusive presumption that any insurance was to enure for the benefit of the third party as well as the assured. The true question is whether the court should infer on the facts a common intention for the contractual waiver to be for the third party's benefit.

Under the 1999 Act, English courts have the opportunity to prevent subrogated actions against third party, such as a sub-contractor, who is entitled under the same policy which gives rise to the right of subrogation because of the use of a waiver of subrogation clause. The waiver of subrogation could be effective in respect of third parties such as employees of an assured. It is standard practice for certain types of policy, such as professional liability policies, to exclude subrogation rights against employees of the insured firm. With the application of the 1999 Act, there is no bar to reliance on a waiver. The only issue will be as to its extent, a question of construction, particularly to providing a cut off point as regards revocation of the waiver clause.

In practice, the 1999 Act would provide a solution to the conflict raised by cases in the insurance of construction risk on waiver of subrogation clause such as the *National Oilwell* and *The Surf City* cases.

D. Conclusion

Subrogation is the primary means of salvage for the insurer when a loss occurs. Although the rule that the insurer has no right of action against the assured is easily stated, its application may be difficult because it is not always clear whose interest are insured under the policy. This article has attempted to demonstrate first, how common law, with some difficulty, determined whether a subrogation action might be available and secondly, how the 1999 Act provides a flexible mechanism for the third party in defending himself against an action of subrogation.

According to the language in which the 1999 Act is drafted, it is likely that the court will look only at the terms of the insurance policy

and nothing else. If the policy purports to confer the benefit of a waiver of subrogation on a class of third parties and the defendant is a member of that class then on the face of it he can rely upon the waiver, even if he never gave instructions to the assured to procure the benefit of the insurance on his behalf and would otherwise be a complete stranger to the insurance contract. He need not be a co-assured under the policy and might not even have existed at the time the contract of insurance was formed. To that extent the 1999 Act may be the obvious way for third parties being sued. Indeed, use of the 1999 Act lessens the force of insurer's arguments that a person is not properly a co-assured under the policy of insurance. The defence granted by the 1999 Act to third party seems wider than co-insurance and the benefit of insurance cases since it has enlarged the scope for recovery.

Moreover, the 1999 Act may be used to override the conflict of authority surrounding the subrogation waiver clauses. It enables the court to set aside the privity doctrine and give effect to the terms of the policy. By virtue of this Act, those who are not party to the contract of insurance can now enforce waiver of subrogation clauses. A waiver of subrogation clause in an insurance policy may be relied upon by a person specifically identified in the contract and falling within the description of the person against whom subrogation has been waived, notwithstanding that he is a stranger to the contract. The third party must come within the terms of the subrogation waiver clause. The intentions of the parties under the 1999 Act are the determinative factor as to whether or not the third party is entitled to take the benefit of the subrogation waiver clause.

In practice, it is difficult to imagine circumstances in which the parties to the insurance contract would decide to extend the protection of being a co-assured in the policy, or being for the benefit of the third party but not the benefits of a waiver of subrogation. Similarly, if it is clear that the parties to the insurance contract did not intend to protect a particular class or persons (by naming them as co-assured or intending them to benefit), it is difficult to understand why they would want to waive subrogation as to that class of persons.

Insurers should be aware of the possibility that under the 1999 Act, parties not even in existence at the time at which the contract of insurance is entered into may seek the benefit of a policy which loosely refers to all sub-contractors and contractors participating on a building project.

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MODERNISATION AND REFORM OF CORPORATE LAW AMIDST THE INFLUENCE OF GLOBALISATION AND DEVELOPMENT IN INFORMATION TECHNOLOGY

Introduction*

Regulatory measures aimed at reforming corporate law is a daunting and difficult task in view of the dynamic and ever-changing corporate environment. Nevertheless, the process of globalisation and developments in information technology has acted as a catalyst for corporate law reform in a number of jurisdictions. Amidst a meticulous, detailed and comprehensive re-examination of the current law, corporate regulators often face the dilemma of finding an appropriate niche that balances the conflicting needs of economic enterprise and shareholders' interest. At the initial stage of corporate law development, countries tend to adopt and apply the established model of another jurisdiction. This was evident in countries such as Australia, New Zealand and Malaysia where the English Companies Act had a dominant influence in the respective jurisdiction's corporate regulations. The "one size fits all" principle seems to play an effective role in the corporate regulatory framework during the embryonic stage of growth in the history of corporations. An illustration is that of the case in Malaysia.

In Malaysia, corporations are governed subject to the provisions encapsulated in the Companies Act of 1965.[1] The other relevant legislation comprised the Securities Commission Act of 1993,[2] the

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[1] The Companies Act 1965 (Act 125).

[2] Securities Commission Act (Act 498).