

THE DOCTRINES OF INDEMNITY AND SUBROGATION

IN INSURANCE CONTRACTS

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of the requirements for the degree of
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PREFACE

Insurance law is just one of the many subject areas in the legal profession on which people undertake studies not merely for the sake of passing examinations but also because it affects human relations in the day-to-day undertakings to a very considerable extent. With the human society becoming more and more complex in every imaginable aspect of it, there arises the corresponding need that people be made aware of their rights and obligations under the law, insurance law not excepted, so that in the event of disputes people can understand the need to solve their problems amicably or through arbitration rather than have to resort to the otherwise time-consuming process of court litigation.

The field of insurance law, relative to other areas of the law, is one which appears to have received little attention in so far as scholastic adventurism is concerned in the University of Nairobi's Law Faculty, as can be deduced from the fact that since the faculty's inception in 1970, only two dissertations have been presented on it at undergraduate level. This probably has something to do with the fact that insurance law is offered during third year in the faculty and normally few students

write dissertations on third year subjects but rather choose first and second year subjects on which they can research more confidently and complete their theses in good time.

It is partly due to the apparent lack of enthusiasm on the part of students to scholastically ~~ad~~venture into this subject area that I got inspired to research into some aspects of it with the hope of producing a work with relative mark of originality. The mode of presentation has been simplified as far as would make it possible for the general reader to get some sense out of it rather than confine the work to the comprehension of only those with some enlightenment in the juridical sciences. Thus the work is far from being purely professionally technical but is such that would appeal very easily to anybody with reasonable ability of comprehension, and therefore provide some useful first-hand information to him regarding the otherwise complex rules in insurance transactions.

I wish to extend my sincere thanks to my supervisor, Professor Onesmus Kimweli Mutungi, who not only allowed me access to his personal materials on the subject area, but also could spare his valuable time to read the entire script and make valuable suggestions for improvement. Any views

expressed are, of course, entirely my own.

Secondly, I would like to extend my gratitudes to the University Librarian in charge of the Law Section, Mrs. Mary Kimani, for the part she played in making easily available the relevant research materials. Finally, I would like to extend my sincere thanks to my brother, Paul Maurice Syagga, not only for the useful encouragement he has been according me throughout my academic career but also for undertaking the expenses of having the manuscript typed.

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INTRODUCTION.

For most people who take out insurance policies, they do so under the conviction that should the subject matter of insurance get lost or destroyed, they would be compensated for such destruction or loss without any limitations whatsoever - in other words, they deem insurance companies to be some sort of charitable organisations ready to reinstate their damaged, destroyed or lost properties in values far exceeding what they would have paid out as premium instalments at the time they make their claims on the policies. For instance, a person who insures his car would ordinarily think that should such car get lost even after he has paid only two premium instalments, then the insurance company would fully compensate him for the loss of the car in so automatic a manner and without any limitations whatsoever. This to such a policy holder would be an indication of the charitable nature of insurance companies and thus institutions worth engaging in transactions with.

In the practical nature of things, however, insurance companies are anything but charitable. Rather, they are profit oriented business enterprises bent on maximising their profits using all means possible so that in the very final analysis, the

face-value concept of the insurance industry being meant to compensate the policyholders for loss or damage relating to the subject matters of insurance is thrown into the obscure background with unlimited impunity. Any benefits that the policyholders derive from insurance transactions in the few cases that this happens are, to use a most rational language, merely incidental to the real and fundamental purpose of insurance companies - that is, the need to maximise their profits by all possible means.

It becomes quite absurd for many policyholders when they make their claims to be told of some legal technicalities that disentitle them from succeeding on such claims. It is with this background in mind that an attempt is made in this paper to analytically throw to light the one-sided nature of insurance law as it tends in practice to serve for the most part the interests of the insurance companies while conversely ignoring, undermining, frustrating or outrightly suppressing the interests of those taking out insurance policies.

For the purposes of this work, the terms policyholder, insured and assured are conveniently used to refer to a person who takes out an insurance policy, although in the mere professional nature of the subject area the term assured would be confined

to life assurance contracts. Likewise, the terms insurers and underwriters are interchangeably used to refer to the personnel who man the insurance companies. It has not been possible to refer to many East African cases due to the scanty nature of such cases in the Law Reports. This is possibly due to the fact that the local people have hitherto not been sophisticated enough to get involved in insurance undertakings in a massive scale and thus increase chances of court litigations in the subject area. Most of the cases referred to therefore derive from England. However, most of such English cases are pre-reception date cases, having been deliberated upon prior to 1897 and therefore by virtue of the reception clause, applicable in Kenya, even if only to a persuasive extent.

The work is divided into five chapters. Chapter One throws to light in general terms the background to insurance law and therefore to insurance contracts. Chapter Two deals with the principle of indemnity in insurance contracts and is therefore one of the two substantive chapters of the work. Under this chapter, it is analytically indicated how the principle of indemnity, rather than being aimed at serving the interests of the policyholder by having him reinstated when he suffers loss or damage in relation to the

subject matter of insurance, is more of a tool used by insurance companies in suppressing the interests of the policyholder under the contract. This is even more so when one considers the fact that the principle lays more emphasis on the rule that the policyholder shall not be more than fully indemnified.

It is also analytically indicated under the chapter the fallacious nature of the concept of reinstatement under the indemnity principle, since reinstatement in relation to the money value of the insured property at the time of entering into the contract is not always commensurate to the necessary reinstatement in real value of the insured property as at the time it is lost, destroyed or damaged. Hence where property has appreciated in value, more payment of money fixed on the policy to the policyholder will not really reinstate him at all. The principle of indemnity thus serves more the interests of the insurers rather than the interests of the policyholder under the insurance contract.

Under Chapter Three, an analysis is made of some of the major principles of insurance law that limit the policyholders' rights to indemnity. These are the rules relating to insurable interest, agency, utmost good faith, proximate cause and excepted causes, and conditions and warranties.

These are the so called special rules in insurance contracts that show fundamental departures from ordinary rules of contract. Such special rules serve the interests of the insurers under insurance contracts in such a way as would not be the case under ordinary contracts at all. On the other side of the deal, these special rules prejudice against the interests of the policyholders in such a way as would not be the case under ordinary contracts at all.

Chapter Four deals with the second of the two basic chapters of the dissertation. Under it the doctrine of subrogation in insurance contracts is analytically dealt with. The doctrines of Indemnity and Subrogation were chosen to form the substance of this work because they conveniently work hand-in-hand to serve the interests of the insurers and to suppress the interests of the insured parties under insurance contracts. The doctrine of indemnity stipulates very forcefully that the insured shall not be more than fully indemnified, and the doctrine of subrogation works as a corollary to the former one by ensuring that where it is possible for the insured to be more than fully indemnified, the insurers will be entitled to get into the shoes of the insured and get for themselves any benefits as the insured may have

derived from third parties after being paid indemnity money.

The doctrine of subrogation also enhances the insurers' rights of getting pure profits, since under it, they can recover from the tortious third parties what they have paid to the policyholder by way of indemnity, thereby leaving the premium sums they received from such policyholder as pure profits. Furthermore, it entitles the insurers to sue the tortious third parties with whom they were under no privity at all, thereby emphasising the privileges that insurers enjoy under insurance contracts, which privileges they would not enjoy under ordinary contracts at all.

Chapter Five serves as the focal point of the previous chapters, especially chapters two, three and four. Under this chapter a concluding analysis is made of the whole body of the dissertation.

Furthermore, some well considered recommendations are ^{made} for reform in the field of insurance law, which recommendations are geared towards creating a fair and equitable balance between the insurers and policyholders in the way their interests are served in contracts of insurance.

THE PRINCIPLES OF INDEMNITY AND SUBROGATION IN
INSURANCE CONTRACTS.

CHAPTER ONE: BACKGROUND TO INSURANCE CONTRACTS.

1.1 Meaning and Scope of Insurance Contracts.

Insurance, like many other technical phrases in the juridical arena, cannot be successfully defined in strictly rigid lines, as any given definition may only be relative to the circumstances under consideration. This is a view which has been realised by an American writer, Robert Keeton¹, who contends that because the purposes for which definitions of insurance are invoked differ, no single definition will serve always, even in a single jurisdiction. According to Keeton, an appropriate way of approaching this problem of the varied meanings of insurance is to identify some basic features that embrace all the transactions regarded as insurance.

This means that whereas there may be no single definition that can satisfy all insurance situations, there are nevertheless some fundamental attributes that are to be found in all insurance situations, and it is with such fundamental attributes in mind that an attempt can be made to formulate a classic

definition of insurance. Such classic definition has been given, it is submitted, by a western writer, E.R.H. Ivamy, who states that,

"a contract of insurance in the widest sense of the term may be defined as a contract whereby one person, called the Insurer undertakes, in return for the agreed consideration, called the Premium, to pay to another person, called the Assured, a sum of money, or its equivalent, on the happening of a specified event".²

This juristic definition of insurance is no doubt on all fours with the judicial definition given by Lawrence, J., in the House of Lords decision in Lacena v. Craufurd, when he contended that,

"Insurance is a contract by which one party in consideration of a price paid to him adequate to the risk becomes security to the other that he shall not suffer loss, damage, or prejudice by the happening of the peril specified to certain things which may be exposed to them,"³

From the above definitions, which are quite identical in substance, it becomes clear that a contract of insurance is an arrangement between two

parties, the insurer and the insured, under which the insurer undertakes to do something that is of value to the insured upon the occurrence of a specified harmful contingency, and the insured on his part undertakes to provide consideration thereto by paying premiums to the insurer. Thus every insurance, whatever its nature, postulates that a sum of money will be paid by the insurers on the happening of a specified event. There must, however, be uncertainty as to whether it will happen or not, or, if it is bound to happen, like the death of a person, uncertainty as to the time at which it will happen. From the viewpoint of the insured, an insurance contract can be deemed as a way of investing, through premium payments, against a future but uncertain calamity.

Insurance contracts can be broadly classified in three ways, the classification being based on the nature of interest affected in each case, that is, life, property, and liability. Under life insurance contracts, specially referred to as Life Assurance contracts, a person insures his own life or the life of another person against death or injury. *It* is therefore a contract under which the insurers undertake, in consideration of specified premiums being continuously paid throughout the life

of a particular person, to pay a specified sum of money upon the death of that person. Hence, as was judicially stated in the case of Dalby v. India and London Life Assurance Co.,

"The contract commonly called life-assurance, when properly considered, is a mere contract to pay a certain sum of money on the death of a person, in consideration of the due payment of a certain annuity for his life, ... This species of insurance in no way resembles a contract of indemnity",⁴

It is to be noted that assurance contracts differ from insurance contracts in the sense that in such assurance contracts the amount to be recovered at the death of the assured person is fixed and invariable, whereas in insurance contracts, it is the principle of indemnity, as will be seen later, that determines what amount to be recovered in a given situation, such amount being deemed to be enough to compensate the insured for the loss suffered and no more. A University of Nairobi writer, Professor Onesmus K. Mutangi,⁵ contends that life insurance might more properly be called premature death insurance. Since all must die eventually the risk covered is the uncertainty as to the time of

death, that is, premature death. And here, of course, the person whose life is insured does not himself receive the proceeds upon death when the policy matures, although his estate may file a claim thereto.

Secondly, there are property insurance contracts where one insures his property against loss or damage, as for instance, under fire insurance, one may insure his house against damage or destruction by fires. Thirdly, there is the liability insurance, where one insures the lives of third parties who may die or get injured in consequence of his fault. The most common type of insurance covering the liability of the insured to third parties is the motor vehicle third party risks insurance. It is to be noted that in Kenya, and indeed in many other countries, the motorists are under statutory obligation to take out third party risks insurance policies. Hence, as stated under section 4 (1) of the Insurance (Motor vehicles Third Party Risks) Act,

".... it shall not be lawful for any person to use, ^{or to cause or permit any other person to use,} a motor vehicle on a road unless there is in force in relation to the user of the vehicle by that person or the other person, as the case may be, such a policy of insurance or such a security in respect of

third party risks as complies with the requirements of this Act."⁶

Liability insurance is thus a situation where the insured has an interest in the safety of third parties and takes out a policy in their favour so that should he cause harm to them, the insurers will step into his shoes and compensate such third parties for the damage. It therefore serves the interests of such third parties in that they will be compensated even in cases where the insured might not have himself raised the compensation money, as for instance where such insured has gone bankrupt.

Finally, it should be noted that a distinction exists between the subject matter of insurance and the subject matter of the contract of insurance.

E.R. Hardy Ivamy contends that the subject matter of insurance is the item insured against loss or damage by peril, while the subject matter of the contract of insurance is the indemnity money to be given to the insured person in the event of loss or damage.⁷ This distinction is based on the fact that the insurers contract to give the insured money compensation in the event of damage or loss respecting the property insured, and that the insured item exists independently of this contract. It is to be submitted, however, that this distinction may not

hold water in every case of insurance contract, for in some such cases, where the insurers repair the damaged property, on their own, the contract embraces that property as its subject matter. It is therefore fallacious to contend that the subject matter of insurance contracts is all the times money, and that the property insured can only be the subject matter of insurance.

1.2 Basic Elements of Insurance Contracts.

For an insurance contract to get off the ground, there must be a person with an interest in some property or some life which he wants to guard against uncertain perils. Such a person, when the contract formally comes into effect, becomes known as the insured or the policyholder. Such property or life as he has an interest in must be subject to loss or damage by calamity. It is very fundamental that the specified event must have some element of uncertainty about it because, if it is certain, then the insured would take practical precautions to avoid it rather than insure against it. Furthermore, the specified event must be such that if it occurs, there would be adverse effects to the interests of the insured, for it would otherwise be naive for an insured to take out a policy against an event the occurrence of which would not cause him any loss at all.

That it is very essential that the subject matter of insurance be subject to loss or damage by an uncertain peril finds support in the judicial pronouncement in the case of Prudential Insurance Company v. Inland Revenue Commissioners, where it was stated that,

"where you insure a ship or a house, you cannot insure that the ship shall not be lost or destroyed, or the house burned, but what you insure is that a certain sum of money shall be paid on the happening of a certain event. That I think is the first requirement in a contract of insurance. It must be a contract whereby, for some consideration, usually, but not necessarily, for periodical payments called premiums, you secure to yourself some benefit of a sum of money upon the happening of some event." 8

Secondly, it is very fundamental in insurance contracts that a substantial number of people have interests in similar things subject to similar perils. This essence underlies the concept of sharing risks. Robert E. Keeton contends that, "Insurance, considered from the point of view of the insurer and from the point of

view of society, is an instance of risk distribution. It approaches the objective of reducing uncertainty by treating as a unit the combined risk of multiple venture of a given type."⁹

This apparently means that an insurance contract can only take place to any meaningful extent if many other people take out similar policies against similar perils. In such a case, the interests of the insurers would be served favourably in the sense that if a high number of people take out such policies, then there is a greater likelihood that many of such policies will not be claimed upon, or, put differently, that the number of policies claimed upon will be more than offset by the number of policies not claimed upon and thereby ensuring the insurers of profits.

It is only if more policies are unclaimed on than claimed on that the insurers will get some profits, for, if all policies were to be claimed on, then they will not continue in operation given the fact that policies may be claimed on before even adequate premium instalments have been paid, not to mention the administrative expenses. Hence as the number of ventures in the group under consideration is increased, protection is improved against the

chance that the severity and propensity of harmful events will be spread over time or in other ways in groupings disproportionate to the overall risk.

Thirdly, it is very necessary that the chances of loss from the peril be measured with some degree of accuracy. The prediction of harm to come from a single venture is still largely a guess. Hence, as Robert E. Keeton submits,

"....if the number of ventures is great and data about experience in like ventures in the past are very substantial, the prediction of total harm to come from the entire group of ventures can be close~~d~~ enough to accuracy for practical reliance." ¹⁰

From Keeton's argument, one can go further to say that by relying on data about experience in like ventures in the past, the insurers can be enabled to determine the probability that a particular event insured against will occur and hence determine the commensurate premiums accordingly. Thus the total cost of bearing the risk in such great number of like ventures can be reliably determined even though the cost of bearing the risk in any single venture in the group is quite uncertain.

Finally, it is essential that a substantial number of members in a particular insurance venture be able to share one another's losses. That is to say that should an insured in a given class make a claim on his policy, then parts of the monies paid by the other insureds in the same insurance venture will be used to indemnify him. Each policy holder pays as a premium an amount equal to a proportionate part of the total predicted cost of meeting specified types of losses in a great number of ventures like his, plus some extra sum for administrative and other costs.

The insurers, by collecting premiums from many policyholders, increase the number of ventures in the risk pool to the point that the principle of risk distribution operates satisfactorily to their favour. Accordingly, if a single insurer does not sell enough policies to reach this point of sufficient number of ventures at risk, he may, in order to avoid the danger of operating at a loss, employ the device of risk transference, turning to another insurer for reinsurance parts or all of the risks undertaken.

The above then are some of the fundamental prerequisites to be taken into account before a contract of insurance can be effected. Other

requirements, as for instance that the insured must have insurable interest in the subject matter of insurance; that the parties to the insurance contract must be uberrimae fides; and that for recovery to be made the loss or damage must have been proximately caused by the peril insured against, do not normally appear important for the purposes of setting an insurance contract off the ground. Such requirements only turn out to be important when a policyholder makes a claim pursuant to the contract and the insurers disclaim liability to pay under the contract.

1.3 Insurance Law that applies in Kenya.

In Kenya there is very limited statute law governing insurance contracts though under the Insurance Companies Act,¹¹ mention is made of no less than ten different types of insurance businesses that the Act is to regulate. These are life assurance, industrial assurance, accident insurance, fire insurance, bond investment, sinking fund, motor vehicle insurance, marine insurance, aviation insurance, and transit insurance businesses.¹² Despite the numerous types of insurance businesses given statutory recognition, or the existence of which is statutorily anticipated, only two types of these insurance businesses have substantive

statutes governing them. These are the motor vehicle insurance for third party risks governed by the Insurance (Motor Vehicles Third Party Risks) Act,¹³ and marine insurance governed by The Marine Insurance Act.¹⁴

From this it becomes clear that there are many types of insurance businesses that take place in Kenya without there being written laws directly touching on them. Such insurance businesses would no doubt be governed by the relevant English insurance common law principles by virtue of the Judicature Act, 1975,¹⁵ section 3(1)(a) of which provides to the effect that in areas of the law where there is no statute, the substance of the common law, doctrines of equity and statutes of general application in force in England as at 12th August, 1897 - on which date English law was officially received in this country - would apply in Kenya.

It would therefore appear that in substance most of the principles that govern insurance contracts in Kenya are on all fours with the principles governing such contracts in England. In fact, Gray Tsuma asserts in his dissertation that,

"the insurance law applicable to Kenya is imported, English law, imported almost entirely from statutes of general application,

the common law and rules of equity in force in England as at 12th August, 1897, by virtue of section 3 of the Judicature Act, 1967,"¹⁶

Similarly, a Ugandan writer, Joseph B. Byamugisha, asserts as follows,

"English common law is the basis (and also the bulk) of the insurance law applicable in the three East African countries."¹⁷

The contention that almost all legal principles governing insurance contracts in Kenya derive from England can be inferred from the fact that in all the major judicial decisions relating to insurance contracts in Kenya and East Africa for that matter, great reliance has been made by courts on English case law on such issues. Furthermore, the courts have heavily relied on English juristic literature on such insurance principles^{as} may be in issue. For instance in Sat Dev Sharma's¹⁸ case and Tarlok Singh's¹⁹ case, which cases related to insurance contracts in Kenya, the courts relied solely on English case law and juristic writings in their deliberations.

Since the substance of the common law and rules of equity are embodied in judicial decisions and juristic literature, and given the fact that such

English-oriented judicial decisions and juristic literature have been relied on so heavily by Kenyan courts when judicially deliberating on matters relating to insurance contracts, it can be safely submitted that it is the English common law and doctrines of equity relating to insurance transactions that apply in Kenya. This then means that all the types of insurance business that have no statutes governing them in Kenya are governed by the English common law and rules of equity relating to insurance contracts.

As for statutes of general application, only one of such English statutes has been judicially pronounced as applying in Kenya. This was done in Sat Dev Sharma's case when Farrell, J. contended,

"The difficulty arises from the provisions of the Insurance (Life and Accident) Act, 1974. That this is a statute of general application and as such in force in this country is agreed by counsel on both sides, and I can see no reason to disagree with their opinions,"²⁰

Although only one of such statutes of general application has been judicially recognised as applying in Kenya, it is quite probable that there are other statutes relating to insurance contracts which were applicable in all parts of England as at

12th August, 1897. Such statutes would be equally applicable in Kenya.

It is therefore to be emphasised that although there are only two types of insurance business that have statutes governing them in Kenya, all the other types of insurance business are governed by the uncodified English common law and doctrines of equity, and also where applicable, by the relevant English statutes of general application.

In any case, even the two aforementioned Kenyan statutes are to a larger extent mere codification of English common law and equity principles, or re-enactment of parts of the relevant English statutes. This is so in view of the fact that the two statutes are mainly codifications of English case law and juristic literature on the issues. Thus Kenyan insurance law is substantively English insurance law, with only some minor modifications to suit some peculiar features under the local circumstances.

CHAPTER TWO:

THE PRINCIPLE OF INDEMNITY IN INSURANCE CONTRACT

2.1 Meaning and Scope of Indemnity.

The word Indemnity as understood in insurance contracts means that where an insured suffers loss or damage, then on the strength of the insurance policy the insurers will reimburse him, subject to his compliance with the terms of the policy, for the loss or damage so incurred by him. As one writer, J.B. Saunders, puts it,

"a contract of indemnity is a contract where one party agrees to save the other harmless from loss. In the widest sense of the term, therefore, it will include most contracts of insurance and also a contract of guarantee. The term indemnity has, however, frequently been used to denote a contract by which the promisor undertakes an original and independent obligation to indemnify, as distinct from a collateral contract in the nature of a guarantee by which the promisor undertakes to answer for the default of another person who is to be primarily liable to the promisee,"²¹

From the above it becomes clear that the word indemnity as understood in insurance contracts

denotes a situation where an insured and the insurers enter into a contract on the understanding that - and subject to the insured complying with his part of the contract - in the event of the insured suffering loss or damage with regard to the subject matter of insurance the insurers will make good the loss or damage and thereby put the insured in the same position as he was in before incurring such loss or damage as the case may be. Hence it can be safely contended that a classic definition of indemnity is the one given by M.G. Eagle ^{when} he briefly states that,

"all insurances on property are contracts of indemnity; that is, their object is to place the insured, as nearly as possible, in the same financial position after a loss as that he occupied immediately before the loss."²²

The contention that the insured should be placed in as nearly the same position as he was in before the loss underlies the concept of reinstatement in indemnity principle. Under liability insurance, since the issue of the insured being personally reinstated does not arise, an indemnity would be said to denote a contract to save the promisee harmless

against claims of third parties, whether the liability to meet those claims arises out of some contractual obligation of the party indemnified or otherwise. It is to be noted at this point that due to the nature of indemnity contracts, i.e. that they are meant to reinstate the insured, the principle of indemnity cannot apply to life assurance contracts at all as it would be naive to talk of a lost life being reinstated, even though the beneficiaries of the deceased's estate may be paid compensation under the assurance contract.

To the extent that the principle of indemnity aims at reinstating the insured after he suffers loss or damage to status quo ante, i.e. to the position in which he was before he incurred the loss or damage, one can safely say, albeit with some reservations as will be seen in the final sub-topic of this chapter, that it is the only principle in insurance contracts which appears to be geared towards the protection of the insured's interests under such contracts. However, when the principle of indemnity goes ahead to stipulate that the indemnity rule is aimed at the reimbursement of the insured and not more, as is to be analysed presently, then the balance of the principle of indemnity starts, as is indeed the case with most if not all other principles

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of insurance contracts as will be analysed in the later chapters of this work, to shift in favour of the insurers while at the same time being prejudicial against the interests of the policyholders under such contracts.

From the mere wording of judicial pronouncements as well as juristic literature on the issue, one is left with no doubt that the principle of indemnity is more concerned with preventing the policyholders from being more than fully indemnified than with ensuring that they are fully indemnified. As one writer puts it,

"it is not the intention in any insurance contract to place the insured in a better financial position than before the loss, and the principle of indemnity ensures that no profit can be made out of any insured event."²³

Two other writers, Batten and Dinsdale, contend that indemnity is a common law principle by which an insured is not permitted to make a profit out of his misfortune. They continue to state that,

"if this were not so, there would then be ^{at} present the temptation to the insured to

destroy the thing insured for his own ends, and that would be contrary to public policy, In the words of Mr. Justice Lush, 'a policy of insurance is a contract of indemnity against loss and not to produce gains. The law does not sanction any insurance which would directly and immediately make the assured party a gainer by the destruction of the thing destroyed, because, if otherwise, there would be a temptation to destroy the thing insured and thereby get the money' "24

The two writers thus justify their opinion by relying on case law to the effect that more than anything else a contract of insurance should not produce gain to the insured, and that anything deviating from this opinion, and which would more than indemnify the insured, would be contrary to public policy. The view that the insured should only be fully indemnified but not more than fully indemnified was given strong judicial pronouncement in the court of Appeal in England by Brett, L.J., in the case of Castellain v. Preston, when he stressed that,

"The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance

contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified,... That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give the assured more than a full indemnity, that proposition must certainly be wrong."²⁵

Thus from all these it can be positively submitted that whereas the principle of indemnity appears at first sight to serve the interests of the insured by having him reinstated in the event of loss or damage pursuant to the policy, the principle tends to tilt in favour of the insurers when it prohibits in no uncertain terms the possibility of the insured being more than fully indemnified. [L. B. - J]

One writer, Greene, M.R.²⁶ gives a typical illustration on how the principle of indemnity works in favour of the insurers by reducing their respective liabilities where an insured takes out more than one policy in relation to the same subject

matter. He points out that one of the most important results of the principle of indemnity is the typical inclusion of clauses in insurance contracts regarding other insurance. The purpose of such clauses is to prevent the insured from taking out duplicating policies with different insurers in the expectation of recovering more than his actual loss.

Typically, such clauses provide that all policies covering the same risk will share pro rata in the loss. Thus, by operation of this type of clause, if one takes out an insurance policy valued at £2,000 in Company X; another policy valued at £3,000 in Company Y; and a third policy valued at £5,000 in Company Z, then in the event of the insured incurring a loss in respect of the subject matter of the insurance, companies X, Y and Z will make good the loss in proportions of 20 per cent, 30 per cent, and 50 per cent respectively.

This then means that where a company would have been responsible for full indemnity, it will be responsible for only a portion of the damage, and if the insured had paid premiums to the various companies to a considerable extent, he is bound to

lose much more than would be the case if he had taken out only one policy. In this respect the insurers will gain by having their burdens reduced, while the insured will be disadvantaged. This then is a clear case where the principle of indemnity serves the interests of the insurers while at the same time prejudicing against the interests of the insured.

It is to be submitted therefore that in respect to the above illustration the principle of indemnity is biased inasmuch as it prohibits anything that would more than fully indemnify the insured, while allowing each insurance company to profit by paying less than full indemnity under the policy - all this notwithstanding the fact that these companies had been receiving full premium instalments pursuant to the respective policies taken out with them. The principle also tends to set a side for the interests of the insurers the contractual principle of privity, when it allows the various insurance companies between which there had been no contract at any given time to share pro rata.

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Robert Keeton reinforces the submission that the principle of indemnity lays more emphasis on the insured not being more than fully indemnified than being fully indemnified when he indicates that,

"This principle does not imply, in converse, that the benefit must be no less than the loss. That is, partial reimbursement of a loss is not offensive to the principle of indemnity. Any opportunity for net gain to an insured through the receipt of insurance proceeds is inconsistent with the principle of indemnity."²⁷

This leaves no doubt then that whereas the insured is not allowed to make any gain on the policy, the insurer is for his part not obligated to pay full indemnity, that is, he is under no obligation to fully indemnify the insured, as partial reimbursement of a loss is not offensive to the principle of indemnity.

In the final analysis then, it can be safely submitted that the principle of indemnity, when demystified, departs a great deal from its face value concept of being geared towards reinstating the insured, and this departure becomes clearer when it is realised that the insurers are not under all circumstances obligated to fully indemnify the insured. On the other hand, the principle helps to enrich the insurers when, in the case where an insured takes out more than one policy in respect of the same subject matter with different insurance

Keele

companies, it allows such insurance companies to share pro rata in the event of claims being made on the policies, The next sub-topic will indicate how the principle further enhances the interests of the insurers in the quantification of reinstatement money.

*2.2 The Quantification of Indemnity Money.

As already pointed out, the principle of indemnity states that a person may not recover more than his actual loss in the event of damage or loss caused by the peril insured against. Thus, while a person may have purchased coverage in excess of the value of the property, he cannot make a profit by collecting more than his actual loss if the property is destroyed, whereas on the other hand, the failure by the insurers to fully indemnify him in the event of such loss or damage does not offend the principle of indemnity. From this it is necessary to determine what yardstick will be used in quantifying how an insured can be indemnified in any given situation under the policy.

→ It is a fundamental attribute of the principle of indemnity to obtain a measure of loss that the insured has suffered, as it is only through this that he can be reinstated to his position prior to

the loss. An assured may be said to be fully insured if in the case of an unvalued policy he is insured to the full extent ^{of} the insurable value of the subject matter insured. This means that although there is no value of the subject matter indicated in the policy in money terms, the assured would be fully indemnified in the event of loss or damage, such indemnity being assessed in relation to the value of the subject matter of insurance at the time of loss or damage as the case may be. In such cases the premiums are bound to be computed in such a way as to reasonably take care of the possibilities of the insured subject matter appreciating in value so that the insurers do not stand a chance of prima facie loss.

In the case of valued policies where the maximum value of the subject matter of insurance at the time of entering into the contract is indicated in the policy, the policyholder may be said to be fully insured if he is insured to the full extent of the value fixed in the policy and not only to part of it.²⁸ This means that in the event of him incurring loss in relation to the subject matter of insurance, he would, other things remaining equal, be indemnified for the full value of the subject matter of insurance as at the time that the policy was taken out.

This amount which the assured, if fully insured under the policy, can recover in respect of a loss is called the measure of indemnity because the insurer, or each insurer if there are more than one, is liable to indemnify the assured against such proportion of the loss as the amount of his subscription bears to the value fixed in the policy in the case of a valued policy, or to the insurable value in the case of an unvalued policy.

From the above it becomes clear that there is certainty in valued policies insofar as the maximum amount that the insured can recover under any circumstances is concerned, while in unvalued policies the amount to be recovered will depend on the market value of the subject matter of insurance at the time the loss or damage takes place. This makes it more realistic to speak in terms of a policyholder being fully indemnified with regard to unvalued policies ^{than with valued policies, as in valued policies} full indemnification in the real terms of the word may be impossible as even the amount of money fixed in the policy may not enable the policyholder to achieve or replace what he has lost from the peril.

Thus whereas in unvalued policies, despite the likely higher rates of premiums that the insured will be paying, he has the chance of being fully

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indemnified to the full insurable value of the subject matter of insurance, in valued policies this is less likely as full indemnity in the strict sense of the word will be limited by the amount fixed in the policy. Thus, as M.G. Eagle points out,

Valued
"the sum insured is the limit of the insurer's liability, and if this is adequate it is usually possible to indemnify the insured satisfactorily."²⁹

The above writer clearly recognises the fact that in valued policies the concept of indemnifying the insured satisfactorily is not guaranteed but is a mere possibility. *unless the property appreciates in value*

5657 ~~X~~ The contention that in valued policies it is the value of the subject matter of insurance that will be taken into account in quantifying the indemnity money insofar as this value was fixed at the time of taking out the policy, without any regard being had to the changes that might have taken place in the value of such subject matter so as to make it more costly than the sum fixed in the policy, was judicially laid down in the case of Elcock and Another v. Thomson,³⁰ The facts of the case were as follows:

By a Lloyd's policy, dated 22nd November, 1940, a mansion was insured against loss or damage by

fire and the underwriters agreed to pay or make good to the assured a stated fraction of all loss or damage to the property insured caused by perils insured against. The agreed value of the mansion was £106,850, and a clause in the policy stated that that sum,

"has been accepted by the underwriters and the assured as being the true value of the property insured and in the event of loss the said property will be assumed to be of such value and will be assessed accordingly."

On May 16, 1947, part of the mansion was destroyed by fire, the cubic content of the portion burnt being just over 21 per cent of the whole. The actual value of the mansion before the fire was £18,000, and its value after the fire was £12,600.

In an
~~Man~~ action for the amount due on the policy:

It was held that the agreement as to the value applied in the event of partial destruction as well as in the event of total destruction; the depreciation could not properly be determined by having regard merely to the proportion to the whole structure of the part burnt out; and the sum due to the assured should be arrived at by applying to the agreed value of £106,850 the percentage of actual depreciation

resulting from the fire. As the value of the mansion had fallen, as a result of the fire, from £18,000 to £12,000, there was a depreciation of £5,400, or thirty per cent, and the underwriters were liable to pay an amount representing thirty per cent, namely, £32,055.

From this it follows that if, for instance one insures a car at an agreed value of say, £5,000, then in the event of such car getting lost or destroyed when its value has depreciated to £4,000 under the current market conditions, the insurers will be liable to indemnify the insured only to the extent of the actual loss incurred, that is, £4,000. If, on the other hand, the market value of the car at the time it is lost or destroyed has appreciated to £6,000, then the insurers will indemnify the insured only to the extent of £5,000 as fixed in the policy, thereby meaning that the insured will not have been fully indemnified at all. Thus it can be averred in this respect that the value fixed in the policy is disregarded when the insurers are to pay less, and only called into play when the insurers would really have paid more to reinstate the insured.

linked policies

2.3 The Fallacy of the Indemnity concept of Reinstatement.

Insurance contracts being indemnity contracts are, as already indicated, indicative of situations

whereby insurers agree for money consideration termed the premium to indemnify or pay to the insured a sum of money in case of loss or damage in respect of the subject matter insured. The premium is the consideration in return for which the insurers undertake to underwrite the risk, and it is therefore of utmost importance that when loss or damage occurs the insured be indemnified fully. This is what it ought to be in principle. In practice, however, it is worth noting that the principle of indemnity itself tends to prejudice against the interests of the insured while serving the interests of the insurers.

That the principle of indemnity tends to serve more the interests of the insurers than the insured can be realised when the formula for the quantification of indemnity money is taken into account. The whole purpose of indemnity is universally acknowledged in the juridical arena as being to reinstate the insured to the position he was in before the loss or damage took place. However, reinstatement in money value does not of itself mean reinstatement in real value of the lost or damaged subject matter of insurance. If for instance a house is insured in 1980 to the value of £10,000, then if it is destroyed by fire in 1990, and the

insured is paid the agreed sum as per the policy, this will not have reinstated him to his position before the destruction of the house, for by 1990 the value of the house would have been much more than the £10,000, which money would be inadequate to replace the house.

Upon this it becomes clear that due to inflationary trends in human society,[?] the concept of reinstatement in indemnity contracts is fallacious,[?] as the money value of the subject matter of insurance as assessed at the time the contract is entered into will not always correspond to the real value of the subject matter of insurance at the time it is lost or destroyed. Thus the concept of reinstatement in the realistic sense of the word is fallacious, at least insofar as valued policies are concerned. It is therefore to be suggested that where the subject matter of insurance is destroyed or damaged, it is only just that the insurers reinstate the insured by either replacing or repairing the item as the case may be, and the practice of reinstatement being made in money terms should be abandoned.

Not true. What of reinstatement per se?

Alternatively, it is to be submitted that it is the real value of the subject matter of insurance at the time of loss or damage and not its money value at the time the contract was entered into that

I am reading your dissent in year 1993.

should be taken into account in determining how far the insured should be indemnified, in order that real reinstatement takes place. At any rate, if the principle of indemnity aims at ensuring that the insured be fully indemnified and not more than fully indemnified, then conversely, it should ensure that the insured is not less than fully indemnified in the realistic sense of the word. More payment of the money agreed upon at the time the policy was taken out may in most cases fall short of fully indemnifying the insured when loss or damage occurs to the insured property.

Secondly, since in cases where the damage incurred is less than the full value fixed in the policy the insured is reinstated only to the extent of such damage, the indemnity money being assessed in relation to the value of the property at the time of such damage, there is no need why in cases where such damage would tend to exceed the sum fixed in the policy ^{it is the value of the item at the time the policy} was taken out that is to be taken into account.

Thus, as Brett, L.J. put it in his dissenting judgement in the case of Pitman v. Universal Marine Insurance Company,

"It is true that the contract of insurance is a contract of indemnity, and that the assured must not be paid more than is

sufficient to indemnify him against the loss which the underwriter by the contract of insurance has agreed to indemnify. But the question is, what is the loss against which the contract indemnifies?.....

The business inconvenience to the shipowner, i.e. the loss in his business, can only be met by repairing the ship so as to make her as good a carrying machine as she was before. That is the object he desires to attain by the insurance. The loss he desires to cover, and which the underwriter knows he desires to cover, is therefore the cost of repairs, not the diminution in value of the ship to sell. The cost of repairs is therefore the matter to be indemnified."³¹

From the above opinion of Brett, L.J., it becomes clear that since it is the actual loss suffered that the insurers undertake to make good, the duty to make good such actual loss should not be merely limited to the value of the policy, as by being so limited real reinstatement will not be possible at all.

At any rate, the principle of indemnity should not only be concerned with the question of the insured being fully indemnified and not more than

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fully indemnified, but also with the question of the insurers fully indemnifying the insured. Hence while the insured should not be allowed by taking out many policies in respect of the same property to recover more than full indemnity, the insurers likewise should not be allowed to profit by each company paying only a portion of the full indemnity money. In other words, the need to prevent the insured from being more than fully indemnified should not be taken advantage of by the insurers to unjustly enrich themselves by withholding parts of the indemnity money that they would have been under obligation to pay were it not that the insured had taken out more than one policy in respect of the same subject matter of insurance. Furthermore, as the other insurers are strangers to one another, each insurance company being in privity only with the insured, the issue of such insurance companies sharing pro rata in the event of loss or damage with regard to the subject matter of insurance is contrary to the well established rules of contract law.

It is to be noted that an insured is more likely to be really reinstated only where there is a tortfeasor against whom he can file a suit in court. This is because court awards are quantified in relation to the real value of the damaged property

I urge you to know the motives behind operation of laws.

Insured to be reinstated by tortfeasor himself
 unjustly deprive insured

Yes this is sinister motive perpetrated by insurers

as at the time it was destroyed, and not at the time the policy in respect of it was taken out. Hence it would only be a matter of justice that indemnity is also based on the real value of the destroyed or damaged property as at the time of such damage or destruction, rather than as at the time the policy is taken out.

Thus the concept of the insured being reinstated to the position in which he was before the loss or damage occurred by mere payment of the money fixed in the policy at the time such policy was taken out does not hold water at all, and especially in cases where the subject matter of insurance has appreciated in money value at the time it is lost or destroyed, such appreciation in money value normally coming about as a result of inflationary trends in the economy.

CHAPTER THREE:

SOME LIMITATIONS ON INDEMNITY RIGHTS.

3.1 The Principle of Utmost Good Faith in Insurance Contracts.

As indicated in the previous chapter the principle of indemnity itself already puts the policyholder in a disfavoured position relative to that of the insurers in insurance contracts. Despite all this the mere taking out of a policy is no guarantee that the policyholder will be indemnified by the insurers in the event of loss or damage, as there are many stumbling blocks that will prevent the policyholder from recovering while at the same time entitling the insurers to avoid the policy. One such stumbling block that limits the insured's rights to be indemnified in the event of loss or damage is the principle of utmost good faith, otherwise known as the doctrine of uberrimae fidei. The basic theme of this doctrine in principle is that both parties to an insurance contract will disclose to each other all material facts within each party's exclusive knowledge so that each recipient party is in a position to choose whether or not to continue with the contract. But in practice as will be seen presently, the duty of disclosure lies almost entirely on only one party to the contract,

that is, the insured.

One jurist, E.R. Hardy Ivamy³² contends that it is a fundamental principle of insurance law that the utmost good faith must be observed by each party. There is an obligation to disclose what a party knows, and the concealment of a material fact by the assured, whether he thought it material or not, avoids the policy. Similarly, it is the duty of the insurers and their agents to disclose all material facts within their knowledge, since the obligation of good faith applies to them equally with the assured and hence all representations made by them during the negotiations with a view of inducing the assured to accept a policy must be true.

✓ The principle of utmost good faith in practice tends to lean more to the disadvantage of the insured and to the advantage of the insurers since more stress is placed on the fact that as the insured is in a position to know more about the subject matter of insurance, he is duty bound to disclose to the insurers all material facts regarding such subject matter so that both of the parties to the contract can deal with each other on equal footing. The view that the insured knows more about the subject matter of insurance was judicially laid down by Lord Mansfield in the case of Carter v. Boehm when he said:

"Insurance is a contract upon speculation.

The special facts upon which the contingent chance is to be computed, lie more commonly in the knowledge of the insured only; and the underwriter must trust to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist."33.

The above dictum laid down by Lord Mansfield in the eighteenth century has been followed in substance through time and from the wordings of such judicial pronouncements it becomes clear that when utmost good faith is mentioned, it is more of an obligation placed on the insured than equally on both parties to the insurance contract.

One of the cases in which Lord Mansfield's dictum was followed in substance is the twentieth century case of Joel v. Law Union and Crown Insurance Company, where Fletcher Moulton said:

"In policies of insurance, whether marine insurance or life assurance, there^{is} an undertaking that the contract is uberrimae fides, that, if you know any circumstance at all which may influence the underwriter's

opinion as to the risk he is incurring, and consequently as to whether he will take it, or what premium he will charge, if he does take it, you will state what you know. There is an obligation there to disclose what you know, and the concealment of a material fact or circumstance, known to you, whether you thought it material or not, avoids the policy."³⁴

Hence from the above it becomes quite clear that the principle of utmost good faith is just one of the many tools in insurance contracts which the insurers use to disclaim liability on the policy, and therefore make the insured lose his right of indemnity under the contract. This is so because case law appears to start on the presumption that the insured has greater knowledge of the subject matter of insurance and should therefore disclose all facts within his knowledge to the insurers, while the insurers themselves know little if anything of the subject matter of insurance and would as such have little if anything to disclose to the insured.

This view was further developed by Scrutton L.J. in the case of Greenhill v. Federal Insurance Company when he said that it is only through disclosure of all circumstances known to the insured to the insurers that would put the two parties in equal bargaining

position. He said:

"Insurance is a contract of the utmost good faith, and it is of the gravest importance to commerce that the position should be observed. The underwriter knows nothing of the particular circumstances of the voyage to be insured. The assured knows a great deal, and it is the duty of the assured to inform the underwriter of everything that he is not taken as knowing, so that the contract may be entered into on an equal footing."³⁵

Thus by placing an obligation on the insured to disclose all material circumstances to the insurers, the insured is highly disfavoured insofar as his rights to indemnity are concerned, as this obligation is one failure to discharge of which entitles the insurers to avoid the policy. This fact was judicially recognised by Fletcher Moulton in Joel v. Law Union and Crown Insurance Company when he said:

"Insurers are thus in a highly favourable position that they are entitled not only to bona fides on the part of the applicant, but also to full disclosure of all knowledge possessed by the applicant that is material to the risk."³⁶

Good faith, therefore, requires that the assured should not, by his silence, mislead the insurers into believing that the risk, as proposed, differs to their disadvantage or detriment from the risk which they will actually run. On the contrary, the insured is obliged to help the insurers by every means in his power to estimate the risk at its ~~property~~ value. Every contract of insurance proceeds on the basis that the duty of disclosure has been discharged by the proposed insured, and the failure to discharge such duty renders the contract voidable at the instance of the insurers. It is to be submitted at this juncture that the principle of utmost good faith, and especially to the extent that it tilts heavily to the disfavour of the insured by imposing obligations on him, is one of the areas where the special rules applicable in insurance contracts favour the insurers.

This is so because under ordinary contracts, the rule of caveat emptor relieves the sellers of any duty to disclose any circumstances as to the quality of goods to the buyers. But in insurance contracts, where the policyholder is deemed to be the offeror and the insurer is deemed to be the offeree, the situation is conversely manipulated to the benefit

of the insurers, by placing an obligation upon the policyholders to disclose all material facts to the insurers at the pain of the contract being avoided by the insurers should a policyholder fail to discharge this obligation.

To put the insured in an even worse position, the duty of disclosing material facts is not confined to such facts as are within the actual knowledge of the insured, it extends to all material facts which he ought in the ordinary course of business to know or to have known, and he cannot escape the consequences of not disclosing them on the ground that he did not know them. Although the duty of disclosure is supposed to be reciprocal, yet in the nature of the problem, it rests more heavily upon those proposing new insurances than upon those underwriting them. In fact it has been juristically observed that there is no reported case in either England or Canada in which a policyholder has complained of a failure by his insurer to contract in utmost good faith.³⁷

It becomes even more clear that the duty of disclosure lies mainly on the insured when one considers the fact that under the principle of insurable interest as will be seen later, the insurers may well know from the beginning that the insured has no insurable interest in the subject matter of

insurance, conceal this fact from the insured, continue to receive premiums from him, and at the end of it all disclaim liability on the ground that the insured had no insurable interest in the insured item, as happened in the Kenyan case of Sat Dev Sharma v. The Home Insurance Company of New York.³⁸ Thus in practice the principle of utmost good faith is one-sided as it serves more the interests of the insurers by strengthening their chances of disclaiming liability on the policy, while on the other hand it disfavors the insured by placing an obligation upon him to disclose to the insurers all matters within his actual and presumed knowledge, a procedure that is so converse to the caveat emptor rule in ordinary contracts.

Another feature of the utmost good faith doctrine which clearly indicates that the doctrine works in favour of the insurers while disregarding the interests of the insured is with regard to the test of materiality. One writer, M.G. Eagle³⁹, observes that the proposer, in negotiations leading upto the contract ^{and until the contract} becomes operative, must disclose to the insurers all material facts which he knows or ought to know regarding the risk which is proposed to be insured. Hence as far as the duty of disclosure of material facts is concerned, it lies mainly on the insured. But when it comes to the question of determining what such

material facts are, it is the yardstick of the insurers and not of the insured who is obliged to disclose such facts, that will be called into play. This highly prejudicial state of affairs has been given both judicial and statutory cognizance.

In the case of Rivaz v. Gerussi,⁴⁰ a material fact was defined as a fact which would affect the judgement of a prudent underwriter in considering whether he would enter into a contract at all, and if so upon what conditions, or enter into it at one rate of premium or another. Similarly, in the Privy Council case of New York v. Ontario Metal Products, Lord Salveen said:

"It is a question of fact in each case whether if the matters concealed or misrepresented had been truly disclosed, they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium."⁴¹

Thus from case law it is quite clear that it is the test of the prudent insurer and not of the insured that will be called into play in determining whether or not a fact not disclosed was material and therefore a ground on which the insured is to lose his rights of indemnity under the policy.

The same test of materiality applies in statute law. Under the English Marine Insurance Act, 1906, it is provided that:

"Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium or determining whether he will take the risk."⁴²

Similarly, under the Kenyan Marine Insurance Act, it is provided that:

"A circumstance is material if it would influence the judgement ^{of} a prudent underwriter in fixing the premium or determining whether he will take the risk."⁴³

And under the Kenyan Insurance (Motor vehicle Third Party Risks) Act, it is provided thus:

"In this section, material means of such a nature as to influence the judgement of a prudent insurer in determining whether he will take the risk, and if so, at what premium and on what conditions."⁴⁴

From the above statutory definitions, as well as the preceding judicial definitions of what is material, it becomes absolutely clear that in insurance contracts the insurers are put in a favourable position since it is them who determine whether a fact undisclosed by the policyholder was material and therefore avoid the policy.

The inherent danger in such state of affairs is that the insurers may pick on any minor undisclosed fact just as a means of disclaiming liability.

It is to be submitted therefore that the doctrine of utmost good faith is unfairly balanced against the insured who is obliged to disclose all material facts so that both parties are put on equal footing, yet when it comes to the test of materiality, the need to put the two parties on equal footing is disregarded and it is solely what is material to a prudent insurer that is taken into account.

* The fact that the policyholder's ^{ignorance} ~~ignore~~ with regard to the materiality of a fact is immaterial was judicially echoed in the case of Brownlie v. Campbell by Lord Blackburn as follows:

"..... that if you know any circumstance at all that may influence the underwriter's opinion as to the risk he is incurring, and consequently as to whether he will take it, or what premium he will charge, if he does take it, you will state what you know. There is an obligation to disclose what you know, and the concealment of a material circumstance known to you, whether you thought it material or not, avoids the policy."45

It is worth noting at this juncture, as Professor Onesmus K. Mutungi⁴⁶ indicates, that the rule of utmost good faith was founded on a notion that the insured possesses superior knowledge in respect of the subject matter of insurance and therefore at an advantage over the insurer in terms of knowledge. But if what is material and relevant, and therefore disclosable, is determined by the insurer, not the insured, then it is submitted that to contend that the insured knows more or possesses superior knowledge is a misnomer, as one should not be deemed to have superior knowledge of something whose materiality is to be exclusively determined by a different party altogether. All such seemingly technical contradictions are no doubt manipulated as such to serve the interests of the insurers at the corresponding expense of the policyholders.

Ref: Mutungi 1974. E.L.J. 193

Moreover, people taking out insurance policies are not well versed with insurance requirements and so cannot foretell how much of their knowledge about the subject matter of insurance they ought to disclose. As to the insurers, with the knowledge they have from long experience as regards the major circumstances that are relevant to these considerations, they should be able to extract from an

applicant by direct questions in the application form, sufficient information concerning what they deem material in the vast majority of cases. The insurers are also in a better position, due to their personnel and facilities, to investigate all crucial facts about the subject matter of insurance, since in some cases a proposer may be innocently ignorant of such facts.

Thus in the final analysis, it can be safely submitted that the principle of utmost good faith in insurance contracts is favourably balanced to the benefit of the insurers and unfavourably balanced to the detriment of the policyholders. It is therefore just one of the many tools that the insurers use to disclaim liability under the policy in the event of a claim being made thereon, with the converse result that the policyholder loses his rights to indemnity under the insurance contract.

The doctrine of utmost good faith thus reinforces the principle of indemnity itself, which already works mainly, as was seen in the previous chapter, to the benefit of the insurers, any benefit that may accrue to the insured being merely incidental to the very thematic fabric of insurance contracts, that is to say, the need on the part of the insurance companies to maximise their

profits by all means. The insurers are thus in a position to further their interests unscrupulously by taking full advantage of the special rules that are available to them under insurance contracts, which rules are detrimental to the policyholder's interests.

3.2 The doctrine of Insurable interest in Insurance Contracts.

Apart from the more common fundamental prerequisites inherent upon ordinary contracts in order that such contracts be enforceable in courts of law, the contracts of insurance, being deemed as a special class of contracts, go ahead of the basic requirements and stipulate that for a party to enforce his rights of indemnity under an insurance contract, he must establish that he had an insurable interest in the subject matter of insurance. The main theme of the principle of insurable interest is to be deduced from common law as embodied in judicial decisions, but the fact that lack of an insurable interest by the policyholder in the subject matter of insurance renders the insurance contract void and therefore unenforceable as against the insurers is statutorily laid down under the Life Assurance Act of England, 1774, as follows:

"From and after the passing of this Act no insurance shall be made by any person or persons, bodies politick or corporate, on the life or lives of any person or persons or any other event or events whatsoever wherein the person or persons for whose use, benefit, or on whose account such policy or policies shall be made, shall have no interest, or by way of gaming or wagering; and that every assurance made contrary to the true intent and meaning hereof shall be null and void to all intents and purposes whatsoever." 47

Similarly, under the Insurance (Life and Accident) Act of 1774, which Act has been judicially recognised as a statute of general application in Kenya,⁴⁸ it is provided as follows:

"No insurance shall be made by any person on the life of any person or on any event where the person for whose benefit or on whose account such policy shall be made shall have no interest." 49

This statutory principle originally enunciated for the life assurance and related contracts has been judicially applied to all types of insurance contracts, and it is as such a fundamental rule in

insurance contracts that an insured will not be indemnified for loss or damage accruing to the subject matter of insurance if he has no insurable interest in the subject matter of such insurance, since failure to have such insurable interest renders the contract void ab initio and therefore unenforceable in court of law. It is to be submitted therefore that the principle of insurable interest is yet another tool by which insurers disclaim liability under insurance contracts and policyholders are deprived of their indemnity rights under such insurance contracts. What, then, constitutes an insurable interest under indemnity contracts?

In Kenya, a statutory definition as to what constitutes an insurable interest under indemnity contracts is available under the Marine Insurance Act, as follows:

"Subject to this Act, every person has an insurable interest who is interested in a marine adventure.

"In particular, a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of the

What is to be done?

insurable property, or he may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof."⁵⁰

The above statutory definition of what constitutes an insurable interest echoes in substance the common law definition of the phrase, a classic one of which may be regarded as that given by Lawrence J. in the case of Lucena v. Craufurd, when he said as follows:

"A man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it.... And whom it importeth, that is condition as to safety or other quality should continue.... and where a man is so circumstanced with respect to matters exposed to certain risks or dangers, as to have a moral certainty of advantage or benefit, but for those risks or dangers, he may be said to be interested in the safety of the thing. To be interested in the preservation of a thing, is to be circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction." ⁵¹

The above dictum has been followed in substance in subsequent cases where judges were faced with the problems of determining what constitutes an insurable interest in indemnity contracts.⁵²

The same principle as to what constitutes an insurable interest has been adopted in the juristic arena. For instance, MacGillivray defines insurable interest as follows:

"Where the assured is so situated that the happening of the event on which the insurance money is to become payable would, as a proximate cause, involve the assured in the loss or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability."⁵³

From the above definitions, it may thus be contended that a person may be said to have an insurable interest in the subject matter of insurance where he has such a relation to or connection with it, or such a concern in it, that he will derive pecuniary benefit or advantage from its preservation and will suffer pecuniary loss or damage from its destruction, termination or injury by the peril against which he is indemnified by the insuring instrument. It may as such be emphasised that to

constitute an insurable interest it must be an interest such that the peril would by its proximate effect cause damage to the policyholder, that is to say, cause him to lose a benefit or incur a liability.

The principle of insurable interest works to the disfavour of the insured who may not always know whether or not he has an insurable interest in the subject matter of insurance. As for the insurers, the principle works to their advantage as they may well know from the beginning that the particular policyholder has no insurable interest in the subject matter of insurance, continue to receive premium payments from him and later disclaim liability to indemnify such policyholder. This was demonstrated in the Kenyan case of Sat Dev Sharma Trading as Seema Driving School v. The Home Insurance Company of New York.⁵⁴ In this case the contract of insurance was set out on a form headed Personal Accident Insurance and provided that in the event of the insured suffering death or disablement, the company would pay to the insured the compensation specified in the schedule.

The schedule set out the name of the insured as "Messrs. Seema Driving School on the lives of Messrs", and there followed the names of the four driving instructors, one of whose injury in a subsequent road accident was the cause of the court

action. The court, in invoking section 1 of the Insurance (Life and Accident) Act, 1774, held that the plaintiff had no insurable interest in the subject matter of the policy since the benefits under the policy were clearly meant to pass to the employees in the event of death or injury, and were not intended to secure the plaintiff against any liability in respect of their employment, and the action failed accordingly.

It is worth stressing then that this was a case where, as the court noted, "... the defendant company must be assumed to be familiar with the law,"⁵⁵ the insurers knew that the insured had no insurable interest yet they did not honour the doctrine of utmost good faith, and still got away with everything. That the insurers use the principle of insurable interest unconscionably to defeat the interests of the policyholders was judicially observed in the case of Stock v. Inglis, where Brett M.R. said:

".... it seems to me that after underwriters have received the premium, the objection that there was no insurable interest is often as nearly as possible, a technical objection, and one which has no real merit, certainly not as between the assured and the insurer"⁵⁶.

And even in Sat Dev Sharma's case, the court observed that,

" under these circumstances the insurance company lay itself open to a charge of unconscionable behaviour to accept a premium with no intention in any circumstances of honouring the policy,"⁵⁷

and counselled that the company should have considered itself under some moral obligation to meet the plaintiff's claim if only as an act of grace.

From the foregoing, one may thus reasonably conclude that to the extent that the doctrine of insurable interest is manipulated by the insurance industry to disclaim liability under indemnity contracts, it is just one of the many ways and means through which the insurers are highly favoured in insurance contracts unlike as under ordinary contracts. Conversely, it is just one of the many ways and means through which an insured loses his rights of indemnity under indemnity contracts, thereby putting him in an ever disadvantaged position relative to the position of the insurers under such insurance contracts. The concept of freedom and equality as understood in ordinary contracts does not therefore equitably operate in insurance contracts at all.

3.3 Proximate cause and Excepted causes.

The doctrine of proximate cause and the practice of inserting exclusion clauses in proposal forms are yet another device through which the insurers often disclaim liability under indemnity contracts while the policyholders lose their indemnity rights under the same contracts. One writer, E.R. Hardy Ivamy⁵⁸ contends that the application of the doctrine of proximate cause will vary according as to whether the issue to be decided is "was the loss caused by a peril insured against?" or whether it is "was the loss caused by an excepted cause?". This means that the doctrine of proximate cause and the issue of excepted causes work hand-in-hand in point of substance, for if a peril insured against is not the proximate cause of the loss or damage in a given case, then such loss or damage must have been caused by an excepted cause.

What the doctrine stipulates in substance is that where property insured against certain specified perils is involved in loss or damage, the insured must be in a position to prove that such loss or damage was proximately caused by one of the perils insured against, before he can be entitled to recover under his policy. In Fawsey and Company v. Scottish Union and National Insurance Company Limited, proximate

cause was defined as meaning:

"the active, efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source."⁵⁹

This definition revolves round the legal maxim that the proximate cause, not the remote cause, is to be regarded - causa proxima non remota spectatur. The time that elapses between cause and loss or damage is immaterial. In the case of Leyland Shipping Company v. Norwich Union Fire Insurance Society, it was contended that: "To treat proximate cause as if it was the cause which is proximate in time is out of the question. The cause which is truly proximate is that which is proximate in efficiency. That efficiency may have been preserved, although other causes may mean-time have sprung up which have not yet destroyed it, or truly impaired it, and it may culminate in a result of which it still remains the real efficient cause to which the event can be ascribed."⁶⁰

From this it becomes clear that for the policyholder to be indemnified the loss or damage must be proximately caused by the peril insured against, and

if a new and independent cause arises so that it breaks the natural sequence of events, the damage from the new cause must be considered separately from that caused by the original peril. Hence as stipulated under the Kenyan Marine Insurance Act:

" Subject to this Act and to any express provision in the policy, the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against."⁶¹

This provision is similar to the corresponding provision in the Marine Insurance Act of England, 1906.

In the judicial arena too, emphasis has been laid on the fact that the insured can only be indemnified if the loss or damage he incurs is proximately caused by the peril insured against.⁶² It is to be submitted therefore that this rule tends to work to the detriment of the insured insofar as it diminishes his rights to indemnity, while on the other hand it serves the interests of the insurers by enabling them to disclaim liability under the contract. M.G. Eagle indicates that:

" Where an insurance is expressed to cover specified perils, then following a loss the insured must produce sufficient evidence to provide a prima facie case that the loss was proximately caused by one or more of the insured perils. The onus of proof for this rests on the insured."⁶³

The principle thus places onerous burdens on the insured and thus makes it difficult for him to recover under the contract.

As already indicated, the doctrine of proximate cause works hand-in-hand with the issue of excepted causes as normally embodied in exclusion clauses in the contractual documents. Most of such clauses are so widely phrased that they may exclude the insurers from almost all possible liabilities. Moreover, unlike in ordinary contracts where the contra preferentum rule operates against the party who draws up the contractual document, in insurance contracts any ambiguity in the proposal form is construed against the policyholder, notwithstanding the fact that such documents are drawn by the insurers. *Are you sure?*

Furthermore, courts often interpret the excepted causes in such a way that one would only conclude that no cause is capable of falling within the policy.

For instance in the case of London and Lancashire Fire Insurance Company Limited v. Rolands Limited,⁶⁴ where on an insurance policy, loss arising, inter alia, from riots was excepted, and loss subsequently occurred as a result of armed robbery, it was held that the circumstances under which the loss occurred constituted a riot in the legal sense.

Thus it can be safely concluded that the doctrine of proximate cause together with the issue of excepted causes is just another tool in the field of insurance transactions which limits the rights of the insured to be indemnified for loss or damage incurred under the policy, while on the other hand it improves the position of the insurers by enabling them to disclaim liability on the ground that the loss or damage claimed against was not proximately caused by any of the perils insured against, or that such loss or damage arose from an excepted cause. This is even more so when one considers the fact that before the insured can successfully claim under the policy he has to prove to the satisfaction of the court that the loss or damage was proximately caused, and not remotely caused, by one of the perils insured against.

3.4 Agency in Insurance Contracts.

Agency is yet another area in insurance

contracts which diminishes the insured's rights to indemnity under the contract, especially in situations where mistakes of the agent are imputed to the insured and thereby entitling the insurers to avoid the policy. In insurance contracts the agents are originally employees of the insurance companies, yet at certain stages of the insurance transactions they are deemed to be agents not of the insurers but of the policyholders. E.R. Hardy Ivamy summarises this principle of an agent otherwise employed by the insurers becoming the agent of the insured as follows:

" The proposal is the document upon which the insurers act in deciding whether to accept or decline the insurance; it is the basis of the contract, and the validity of the contract depends upon its accuracy. The insurers, therefore, are entitled to assume that it is accurate and the knowledge of any fact inconsistent with the proposal is not to be imputed to them merely because the person responsible for the inaccuracy knew the truth and happened to be the agent who introduced the insurance.

"The Agent, in filling in the answers, ceases to be the agent of the insurers. He becomes the agent of the proposed assured, and

"therefore his knowledge cannot be imputed to the insurers. On the contrary, by signing the proposal, the proposed assured adopts the answers as his own, and makes himself responsible for any inaccuracy in them....

"It is, however, immaterial whether he had the opportunity of reading them or not; if he signs the proposal form before competition and leaves it to the agent to fill in the answers and forward the completed proposal to the insurers, he is nonetheless responsible for any inaccuracy."⁶⁵

From the above quoted summary by the learned author, it becomes indisputably clear that the issue of agency in insurance contracts is injurious to the interests of the policyholders who can be victimised for mistakes of agents whom they did not employ and did not even know to be their own agents at any stage of the transaction. Secondly, it is out of keeping with the ordinary rules of contract that the insured should be made liable for the acts of a third party to the contract, the legal nexus being there only between the insured and the insurers. This disregard for the long established rule of privity of contract serves mainly the interests of the insurers who can disclaim liability under the contract even for the

misdeeds of such third parties as they originally employed.

To demonstrate even further the imbalance created by agency in insurance contracts, which imbalance tilts against the interests of the policyholders, the insured has the burden of proving that at any given time in the course of the transaction, the agent was working for the insurers and not for him, the insured.⁶⁶ Mere receipt of authority from an insurance company does not make the recipient an agent of the company. The agent must be shown by the insured to have had an authority to acquire that knowledge which is being imputed to the insurers, otherwise no such imputation would hold water. Moreover, knowledge acquired in a different capacity by an agent cannot be imputed to the insurers, as such knowledge must be acquired only and only when the agent is acting in his capacity as agent in the specific field.

But as far as the insured is concerned, the *knowledge acquired by the agent, no matter in what manner acquired, is disclosable to the insurers and* failure to do so entitles them to avoid the policy to the detriment of the insured. All this goes along way in showing that the insured is highly disadvantaged under the issue of agency in insurance contracts. It is to be submitted by way of suggestion that for purposes of justice and equality, whatever is imputable

to the insured through his supposedly agent should equally be imputable to the insurers without the insured being given the onus to prove so.

Secondly, if it is necessary for the insurers to operate through agents, then the extra expenses inherent thereto should not be passed over to the insureds through high premiums. It would infact be cheaper for the insureds if they dealt directly with the insurers in that the commission charges payable to agents would not be included in premiums, and the insureds would also get their non-claim bonus in full. Since it is the insurers who are determined to promote their business through agency, they, rather than the insureds, should shoulder the extra expenses consequential thereof.

Thus it can be safely concluded that agents in insurance contracts, although infact employed by the insurers, are arbitrarily regarded as agents of the policyholders when this would help the insurers to avoid liability under the policy. This then means that agency is just one of the tools that serves the interests of the insurers in insurance contracts while on the other hand limiting the policyholders' rights to indemnity under such contracts.

This assertion is further demonstrated by the

fact that even in cases where the agents, actuated by the need to earn their commissions, induce proposers to enter into contracts whose substance they do not follow, it is such innocent proposers rather than the insurers who will be adversely affected by the unscrupulous acts of such agents, which agents were in fact employed by the insurers and not by the policyholders at all. It is equally absurd that the long established contra preferentum rule in contract law which stipulates in substance that ambiguously worded documents should be construed against their authors if they try to rely on them for defence purposes - is disregarded to the detriment of the policyholders in cases of ambiguities or inconsistencies in the proposal forms, yet such forms, having been drawn up by the insurers, were pressed upon the policyholders by agents who are in fact employed by the insurers.

3.5 Merger of Conditions and Warranties in Insurance Contracts.

Under ordinary contracts a distinct line is drawn between conditions and warranties and distinct remedial options are open to the aggrieved party in the event of a condition or a warranty being breached by the other party to the contract. In substance, the difference between conditions and warranties revolves

round the fact that a condition is an integral part of the contract the breach of which entitles the aggrieved party to rescind the contract, while a warranty is a less significant term of the contract the breach of which does not entitle the aggrieved party to repudiate the contract but only to sue for damages against the adverse party.

Hence, as one writer, Anson, W.R. puts it:

"A condition may be defined as a statement of the fact, or a promise, which forms an essential part of the contract. If the statement of fact proves untrue, or the promise is not fulfilled, the innocent party may treat the breach as a repudiation which discharges him from further performance of the contract."⁶⁷

A warranty, for its part, has been judicially defined in the case of Dawsons Limited v. Bonnin as follows:

"The proper significance of the word in the law of England is an agreement which refers to the subject matter of a contract, but, not being an essential part of the contract either intrinsically or by agreement, is collateral to the main purpose of such a contract."⁶⁸

Thus from the above it becomes clear that in ordinary contracts a condition is a fundamental term the breach of which entitles the aggrieved party to rescind the contract, while a warranty is a less important term the breach of which entitles the aggrieved party only to sue for damages. This then means that in ordinary contracts, not all breaches by a party will be an occasion for the contract being revoked to such party's detriment by the aggrieved party.

In insurance contracts, however, there is no distinction between a condition and a warranty, and these two carry equal weight, they having been conveniently merged for the benefit of the insurance industry while causing confusion to the insureds and the legal system as a whole. This merger has been juristically observed by Anson, W.R., when he contends that:

"The word warranty in insurance law is not infrequently equivalent to a term of the contract, whether a warranty proper or a condition."⁶⁹

From this it becomes clear that in insurance contracts conditions and warranties carry equal weight as far as the insurers are concerned, and failure by the insured to comply with any term, however

seemingly insignificant such term may be, entitles the insurers to disclaim the liability and conversely disentitles the insured from his rights of indemnity under the contract.

A warranty in an insurance contract is a term which precedes the liability of the insurers, that is to say, it is a condition by common law, and unless it be performed there is no contract binding on the insurers. It is immaterial for what purpose it is introduced and unless it is performed the contract will stand unenforceable as against the insurers, thus it is a condition precedent on the performance of which the validity of the policy or the liability of the insurers depend. Thus, as one writer, E.R. Hardy Ivany puts it:

"Such conditions relate to matters which precede the formation of the contract contained in the policy, and which are, or agreed by the parties to be, essential to its validity. They must be fulfilled, otherwise the policy never attaches, but is void ab initio."⁷⁰

The very fact that conditions and warranties are merged in insurance contracts puts the insured in a worse position than he would be in under ordinary contracts, while putting the insurers in

a better position. This is because the insured loses all his rights to indemnity under insurance contract for any mistake on his part, however insignificant such a mistake may appear to be, while the insurers on their part exonerate themselves from all liability under the contract for any minor mistake on the insured's part.

Thus as has been seen through the chapter, the mere taking out of a policy of insurance is no guarantee that the policyholder will be indemnified by the insurers in the event of loss or damage taking place in relation to the subject matter of insurance. The principle of indemnity itself, as was seen in the previous chapter, leans more favourably to the interests of the insurance industry, and any benefit as may accrue to many a policyholder is merely incidental to the overriding purpose of the insurance companies to maximise their profits. As if the principle of indemnity does not already create a favourable balance to the insurers and an unfavourable one for the policyholders, the insurers' position is further strengthened and the insureds' position further weakened by the special principles applicable to insurance contracts, the effects of which principles have been considered above.

From all this it becomes clear that insurance contracts will in the majority of cases not genuinely serve the interests of the policyholders at all. If anything, they will serve the interests of the insurers who will have all the grounds for disclaiming liability, while on the other hand they will most of the times find fault with the policyholders and as such disentitle them from their rights to indemnity.

This then means that an insured, to be fully compensated for any loss or damage as he may incur under the policy, will either totally disregard the insurance contract and sue the tortfeasor, or may, after receiving from the insurers - in the few situations where this is possible - a sum that does not really indemnify him for the loss or damage suffered, still sue the tortfeasor and recover more from him so as to be fully indemnified.

The right of the insured to recover from the tortfeasor is a legal right, and the mere fact that the damaged property was insured does not disentitle him from suing such tortfeasor. At any rate the tortfeasor is a stranger to the contract between the insured and the insurers, and cannot be allowed to invoke the insurance contract in order to escape from his tortious liability to the insured.

However, as will be seen in the following chapter of this piece of work, the rights of the insured to sue and recover from the tortfeasor is further frustrated by the insurers for their own benefits under the doctrine of subrogation. This is the doctrine which, as will be analysed at length in the following chapter of this thesis, deprives the policyholder of any benefits as he may derive from the tortfeasor, and instead bestows such benefits on the insurers, all this notwithstanding the fact that there is no privity between such insurers and such tortious third party. Suffice it to point out briefly at this juncture therefore that the doctrine of subrogation, as will be seen presently, is yet another doctrine in insurance law which mainly serves the interests of the already advantaged insurers, while conversely brushing aside the otherwise genuine interests of the already disadvantaged policyholders under insurance contracts.

CHAPTER FOUR:

THE PRINCIPLE OF SUBROGATION

IN INSURANCE CONTRACTS



4.1 Meaning and Scope of Subrogation in Insurance Contracts.

As was briefly indicated at the close of the previous chapter, an insured has personal legal rights to sue third parties who have caused him loss or damage in respect of the subject matter of insurance, and the mere fact that the damaged or lost property was insured against risks will not exempt such third parties from liability. This would then mean, in principle, that if what an insured recovers from the insurers under the indemnity contract is not sufficient to reinstate him, in real terms, to the position he occupied before incurring such loss or damage, as for instance where the real value of the property has exceeded its money value as fixed on the policy - that is to say, where the value of the subject matter of insurance has exceeded the value of the subject matter of the contract of insurance, then the insured would sue such third parties as were responsible for the loss or damage so as to recover something over and above the indemnity money and thus be fully reinstated in real terms.

However, as is to be seen presently in this chapter, the insurers, after indemnifying the insured

pursuant to the inden^mity sum fixed on the policy, are in a position, under the doctrine of subrogation, to defeat any attempts by the insured to recover anything from third parties, and to convert anything as the insured may receive from third parties to their own benefit, Suffice it to note here then that as the principle of indemnity and those collateral to it were seen to be mainly geared towards the protection of the interests of the insurers in any insurance contract, the principle of subrogation crowns everything in that respect as it is solely geared towards serving the interests of the insurers in insurance contracts.

A South African writer, Gerald Gordon,⁷¹ contends that the doctrine of subrogation is a corollary of the principle of indemnity, and that it applies to all contracts of indemnity. And Gray Tsuna⁷² contends that the doctrine of subrogation is so much a part of indemnity as to make the two look like Siamese twins. That the doctrines of indemnity and subrogation are inseparable revolves round the fact that subrogation is the machinery by which the law of insurance ensures that the insured is not more than fully indemnified. Thus, as one writer, E.R. Hardy Ivamy, puts it:

"The doctrine of subrogation has been adopted solely for the purpose of preventing the assured from recovering more than a full indemnity, by placing the insurers in the position of the assured."⁷³

The main theme of the doctrine of subrogation can be described as follows: If an insured on the occurrence of the event insured against possesses alternative remedies against third parties who cause such event to occur, then the insurers are allowed, after they have indemnified the insured pursuant to the policy, to take over those rights and to institute proceedings, or to take any other steps open to the insured in order to effect recovery in mitigation or extinguishment of what they have paid to the insured. In other words, the insurers are subrogated to the insured's rights as against such third parties.

To the extent that the sole purpose of the principle of subrogation is aimed at curtailing the insured's possible attempts of getting more than full indemnity - even though full indemnity with regard to the subject matter of the contract of insurance is not necessarily commensurate with full indemnity with regard to the subject matter of insurance - it can be safely contended that the doctrine is conversely aimed at serving the interests of the

insurers, insofar as it enables the insurers, after receiving premium payments from the insured, to also receive what else is receivable from third parties.

This, as will be seen later, means that whatever the insurers pay to the insured by way of indemnity will be offset by what they receive from the tortious third parties by way of subrogation, thereby leaving the premiums paid by the insured as pure profits for the insurers.

The view that the doctrine of subrogation is aimed at preventing the insured from getting more than full indemnity, apart from being propounded upon by juristic writers, is also emphasized statutorily as well as judicially. For instance, in the case of Castellain v. Preston, Brett L.J. contended as follows:

"The doctrine does not arise upon any terms of the contract of insurance; it is only another proposition which has been adopted for the carrying out of the fundamental rule of indemnity, and it is a doctrine in favour of the underwriters or insurers in order to prevent the assured from recovering more than a full indemnity;

It has been adopted solely for that reason. "74

It is contended by one writer, Professor M.L. Marasinghe⁷⁵ that the doctrine of subrogation was a development of equity which later came to be adopted by common law courts even long before the fusion of chancery and common law courts took place. He says that in the case of Randal v. Cockran:⁷⁶

"The basis advanced by Lord Hardwicke for the ipse jure transference of rights unquestionably used in equity, was readily accepted by the common law courts."⁷⁷

This view is no doubt deduced from the case of London Assurance Company v. Sainsbury,⁷⁸ which settled three issues both for the common law courts and courts of equity: that the trust concept enables the insurer to sue a tortfeasor of the assured once the payment was made pursuant to the policy; that such an action must be brought in the name of the assured; and that the subrogation process is ipse jure, that is, that it occurs by an operation of law. The case thus took the principles of subrogation as established by equity and forged them into the common law. Hence, as Professor Marasinghe says:

"By the end of the eighteenth century, both the common law and equity courts appeared thoroughly accustomed to applying this equitable doctrine. The accepted doctrine

had now developed so that a person who had paid a third party in discharge of another's obligation to him, acquired from that third party a right to sue that other person, upon whom lay the primary obligation to pay for a contribution or for an indemnity."⁷⁹

From the above it would appear that the principle of subrogation is deemed to be an equitable principle, but, as will come to light in due course, the doctrine is so unequitable that, to say the least, it unjustly enriches the insurers under insurance contracts.

* For the doctrine of subrogation to operate, there must have been a valid contract of insurance between the insured and the insurers and, consequently, loss or damage must have been sustained by the insured on the subject matter of insurance, such loss or damage resulting from a peril insured against. Since the principle of subrogation is concerned with the rights of the insurers to step into the shoes of the insured and utilize the rights of such insured against third parties, or to recover from him what extra benefits he may have derived from third parties, it follows that the principle cannot apply unless there are tortfeasors against whom the insured can make a recovery. Hence it is an essential element

that there be third parties against whom the insured can enforce his rights, in order that the principle of subrogation be applicable. *It does not follow*

Finally, and even more important, it has been stressed by one writer, E.R. Hardy Ivamy, that:

"The right of subrogation does not arise unless and until the insurers have admitted the assured's claim, and have paid the sum payable under the policy."⁸⁰

Another writer, MacGillivray, says:

"The assured is entitled to control any proceedings brought in his name until he has received complete indemnity, that is to say, if the insurer has not paid what is in fact a complete indemnity for all damage insured or uninsured arising from the same cause of action as the damage in respect of which payment has been made the assured remains dominus litis until he has recovered a complete indemnity and if he undertakes to prosecute his claim for the whole damage the insurers cannot interfere."⁸¹

This view is further stressed in the judicial arena. In the case of Castellain v. Preston, Brett, L.J. had this to say:

"It will be said that there did exist for a moment a right of action in favour of the assured, into which the insurer could have been subrogated. But he cannot be subrogated into a right of action until he has paid the sum insured and made good the loss."⁸²

And in the case of John Edwards and Company v. Motor Union Insurance Company, McCardie, J. had the following to say:

"... the principle of subrogation is ever a latent and inherent ingredient of the contract of indemnity, but it does not become operative or enforceable until actual payment be made by the insurer, It derives its life from the original contract. It gains its operative force from payment under that contract. Not till payment is made does equity, hitherto held in suspense, grasp and operate upon the assured's choices in action. In my view the essence of the matter is that subrogation springs not from payment only but from actual payment conjointly with the fact that it is made pursuant to the basic and original contract of indemnity."⁸³

The above extracts from juristic and judicial

opinions thus indicate that it is a fundamental prerequisite that the insurers fulfill their part of the contract by indemnifying the assured before they can exercise their rights of subrogation under the insurance contract. In the next sub-topic of this chapter, an attempt is to be made to analyse in detail what these rights of subrogation are that the insurers have under indemnity contracts.

4.2 Rights of the Insurers under the doctrine of Subrogation.

The doctrine of subrogation gives the insurers the right to step into the insured's shoes, subject to their duty to fully indemnify the insured, and thereby be entitled to any extra benefits that the insured may derive from the tortious third parties. This view was authoritatively laid down by Lord Justice Brett in the case of Darrell v. Tibbitts.⁸⁴ In that case, one Forbes owned a house which he leased. The lease placed the duty upon the lessee to make repairs in the event of an explosion. An explosion occurred, due to the negligence by an employee of the Brighton Corporation.

The lessee made the repairs and the corporation reimbursed him. The lesser then sold the house to Tibbitts with the benefit of the insurance policy.

The insurer, plaintiff in the action, without knowledge of the payment made to the original lessee by the Brighton Corporation, paid the new owner pursuant to the policy. Subsequently the insurers became aware of the first payment and sought to recover it. The insurers lost in the trial court but successfully appealed. In the appellate court, the doctrine of subrogation was clearly stated as follows:

"The doctrine is well established that where something is insured against loss either in a marine or a fire policy, after the assured has been paid by the insurers for the loss, the insurers are put into the place of the assured with regard to every right given to him by the law respecting the subject matter insured..."⁸⁵

Lord Justice Thesiger in the same decision affirmed the above view as follows:

"It is also maintainable as a kind of suit in equity founded upon the following ground; the assured having been indemnified against the loss sustained by him through the payment by the insurance company, the latter has a right to be subrogated in the place of the assured....."⁸⁶

The dictum in Darrel v. Tibbitts was adopted in subsequent cases, the most notable of which was Castellain v. Preston.⁸⁷ In this case, a vendor who had insured his house against fire was in the process of selling this house. After the contract of sale was executed, but before the actual transfer was made, a fire destroyed the house. The vendee, nevertheless, paid the full and previously agreed upon purchase price. The insurer, who had no knowledge of sale, paid pursuant to the policy. After the facts surrounding the sale became known, the insurer sued the vendor for return of the money paid. The court of Appeal held that as the contract of insurance was strictly one of indemnity, the assured could not be allowed to keep both indemnity money and the ~~same~~^{sale} price. Lord Justice Brett stated as follows:

"... as between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured... which can be, or has been exercised or has 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 or condition the loss against which the assured is insured,

can be, or has been, diminished."⁸⁸

From the above it is clear that under subrogation, so long as the insurers have fulfilled their part of the contract by indemnifying the assured pursuant to the policy, they have the right to pursue anything that the assured may recover from third parties over and above the indemnity money so paid by them to the assured. It is to be submitted therefore that the principle is so one-sided as it enables only the insurers to get anything recoverable from third parties over and above the premium payments that they received from the policyholder, while as for the policyholder the principle obliges him to be contented with indemnity money and nothing more than indemnity money.

The principle of subrogation does not merely enable the insurers to recover from the insured what he gets from third parties after being indemnified, but also entitles the insurers, after indemnifying the insured, to enforce the insured's rights against the tortious third parties so as to be recouped for what they have paid to the insured by way of indemnity. The right of the insurers to be recouped for what they have paid to the insured is statutorily recognised in Kenya by virtue of section 79 of the Marine Insurance Act of Kenya, which section is

*Article
by W.K. Shukri
Case*

totally in pari materia with section 79 of the Marine Insurance Act of England, 1906.

The view that the insurers are entitled to recover what they have paid to the insured from the tortious third parties was settled in the case of Stringer v. The English and Scott Marine Insurance Company,⁸⁹ which, in the opinion of Professor Marasinghe⁹⁰, was "the first English case to adopt the word subrogation." In that case, the plaintiffs insured a ship's cargo with the defendants for "taking at sea, arrests, restraints, and detainment of all kings, princes and people." The ship was subsequently captured by a United States Cruiser and taken into New Orleans, where a suit for its condemnation was instituted.

The plaintiffs contested the action successfully and the captors appealed. The court ordered the plaintiffs to furnish security against costs which they could not afford. As a result, the ship was condemned, and the plaintiffs gave formal notice of abandonment of the cargo, and requested the insurers to pay for their total loss. The court, in holding for the plaintiff noted that the plaintiff as the assured was free to choose between defending the appeal before the American court or claiming a loss

under the policy. Because the assured chose the latter, the insurers were obligated to pay.

However, having paid, the insurers were entitled "To be subrogated to them, and get what they can out of the hands of the Americans for their own benefit."⁹¹

This principle which enables the insurers to pursue third parties is unique in that it allows such insurers to enforce their claims against parties with whom they were under no privity at all. But even as against third parties the principle of subrogation is still one-sided in favour of the insurers, since it is only the insurers whom, after indemnifying the insured, can recover indemnity money from the tortious third parties, while the third parties, after paying the insured, cannot recover from the insurers at all.

This view was propounded in the case of Rayner v. Preston,⁹² where the court of appeal held that the vendee who had performed his contract in accordance with its terms could not recover from the vendor the insurance money which the vendor had received. The court emphasised that an insurance contract was a personal contract which did not run with the property, and that what was insured was not the property but the vendor's interest in the property.

Similarly, in a recent Canadian case of Drache

For what?
~~For what?~~
~~For what?~~
~~For what?~~

v. Winnipeg,⁹³ property was destroyed by fire after the effective date of expropriation by the city but while the owner was still in possession. The Manitoba court of appeal held that the defendant city was bound to pay the amount awarded by arbitrators in the arbitration proceedings, even though the plaintiff, the property owner, had collected from her insurer the amount of the loss. The result was consistent with the Rayner case in that the contract of insurance being personal and one which does not run with the land, the city was not entitled to the benefit of the insurance contract. In relation to this point, Freedman, J.A., contended as follows:

"The issue is not disposible on the simple view that the plaintiff should not be paid twice, once by the insurance company and once by the city. The source and nature of payments must be examined. Payment by the city arises under its statutory obligation to compensate the plaintiff for the value of the expropriated property as of the date when the by-law was passed.

"Payment by the insurance company is made pursuant to a contract entered into with the plaintiff, for which the plaintiff paid and the insurance company received an

appropriate premium. The city was not a party to the insurance contract nor, of course, did it pay the premium. It should not be entitled to receive the benefit thereof. To say that the city can compel the plaintiff to bring the insurance proceeds into account as an offset against the arbitration award would be, in effect, to transfer to the city something which the plaintiff had herself bought and paid for and to which the city was a stranger."⁹⁴

From the above two cases it becomes clear that whereas the insurers can recover what is received from third parties by the policyholder, such third parties cannot recover what is received from the insurers by the policyholder at all, as an insurance contract is deemed to be personal. It is to be submitted, therefore, that the principle of subrogation is merely out to serve the interests of the insurers even as against third parties.

At any rate, if an insurance contract is a personal contract between the insurers and the insured, then by no means is the contract between the insured and the tortious third parties less personal in character. That there is a contract

Personal

Should a Tortfeasor
recover from the
injured party?
- will recover
of tort and law.

between the insured and the tortious third parties is to be deduced from the fact that it comes about by operation of law, that is, that if X wrongs Y, then he is under legal obligation, should Y decide to enforce his legal claims, to compensate Y for the loss or damage sustained as a result of the tortious wrong.

Consequently, as the insurers are also strangers to such contracts by operation of law between the insured and the tortfeasors, they should not, in keeping with the principle laid down in the two preceding cases cited above, be entitled to anything that the insured may receive from such third parties, or even be entitled to in whatever way enforce their claims against such third parties with whom they were not under any privity at all.

*to be
confusing or
confused.*

One very peculiar, if not shocking, feature of the doctrine of subrogation is that it can at times be directly used by the insurers against the insured himself. This occurs under insurance contracts which cover third party risks, especially the motor insurance contracts under which the motorists are under statutory obligation to take out policies to cover third party risks. In such cases the insurers are also under statutory obligation, subject to the

terms of the insurance contract, to meet any damages that may be required to compensate the third party who gets injured by the vehicle that is the subject matter of insurance.

If it appears that, notwithstanding the statutory obligation placed on the insurers to compensate such injured third party, the third party would have successfully sued and recovered compensation from the insured, then the insurers will by the principle of subrogation get themselves in place of the third party and recover for their own benefit what such third party would have recovered from the insured. In this way, the insurers will be recouped by the insured for what they have paid to the third party under the third party risks insurance contract.

That would not be subrogation.

This contention is statutorily recognised in Kenya by virtue of the proviso to section 8 of the Insurance (Motor Vehicles Third Party Risks) Act, itself chapter 405 of the Laws of Kenya, as follows:

"Provided that nothing in this section shall be taken to render void any provision in a policy requiring the persons insured to repay to the insurer any sum which the latter may have become liable to pay under the policy and which have been applied to the satisfaction of the claims of third parties."

From the above cited proviso it becomes clear that although the motorists insure their vehicles against third party risks, so that in the event of third parties sustaining injuries therefrom the insurers can take care of that and compensate such injured third parties, yet in the very final analysis the insured motorists will find the whole bid to escape liability by shifting it to the insurers boomeranging on them, as the insurers will require the policyholders in many cases to recoup them, the insurers, for what they will have paid to the third parties. Hence one is left in no doubt that under any circumstances, the principle of subrogation serves the interests of the insurers and in the same process (defeats the whole purpose of insurance contracts from the viewpoint of the policyholders.) *Point! **

Another way in which the insurers are highly advantaged due to the principle of subrogation is that they are entitled to salvage of the damaged property after indemnifying the insured, and this is based on the view that the assured cannot claim both to receive from the insurers a full indemnity for his loss and to retain the salvage, since he would in such a case be more than fully indemnified. But, as will be indicated more fully in the next chapter,

such a view ignores the fact that the insurers do not lose much under insurance contracts since they receive premiums from numerous policyholders yet only few claims are made against such premium sums.

*show view
what? After all
it's a business.*

The principle is thus more concerned with preventing the assured from getting anything over and above the indemnity payment, whereas on the other hand the insurers are entitled to recover what they can above the premiums, which premiums formed the basis of the risk they undertook under the contract.

Finally, it is a sign of favour on the side of the insurers that where the insured has received something from third parties, the amount of indemnity money to be paid to him will be assessed while taking into account what he will have received from such third parties — that is to say, he will be paid full indemnity money less what he will have received from the tortious third parties.] But where a third party's liability towards an insured is being assessed, what the insured has received or is likely to receive from the insurers will not be taken into account at all. Thus, from all this one is left in no doubt that the insurers' interests under the doctrine of subrogation in insurance contracts are so unilaterally served with no regard being had to the interests of either the policyholders or the

tortious third parties, thereby emphasising the contention that the doctrine is a one-sided one.

4.3 The obligations of the Insured under the doctrine of Subrogation.

Any obligations as are imposed on the insured by the doctrine of subrogation may in one way be termed as the peculiar resulting benefits that the insurance companies derive from insurance transactions or undertakings, since such obligations are purposely geared towards, and in fact do result in, securing the interests of the insurers under the indemnity contracts. An insured is by the principle of subrogation duty bound to account to the insurers for anything that he may recover from third parties over and above the value of the subject matter of the contract of insurance, that is to say, the indemnity money fixed on the policy and paid to him by the insurers after the loss or damage regarding the subject matter of insurance.

This obligation in a way makes the insured a constructive trustee of the insurers, all this notwithstanding the fact that at no time was there a fiduciary relationship between the insured and the insurers. The principle thus arbitrarily lays it down that if an insured does make a settlement by reason of which he has received a sum which, added

*That is why
no is a constructive
trustee*

to the indemnity money paid by the insurers, is more than sufficient wholly to indemnify him, he must account for and pay over to the insurers the surplus sum to the extent of the payment they, the insurers have made to him. This duty, however, is limited to such extra money received from third parties that is either equal to or less than what the insurers paid to the insured by way of indemnity, and anything that goes over and above it is to be safely retained by the insured, as was judicially stipulated in the case of Yorkshire Insurance Company Limited v. Nisbett.⁹⁵

The main reason that has been forwarded for imposing the above - indicated duty on the insured is that it is meant to prevent the insured from getting a windfall over and above the full indemnity money that he may have received from the insurers.

~~But~~ in point of fact, the main if not the sole purpose of imposing this obligation on the insured is to enable the insurers to as much as possible recover what they paid to the insured by way of indemnity. This can be determined from the wording used by Lord Blackburn in the case of Burnand v. Rodocanachi, when he said:

"The general rule of law is that where there

"is a contract of indemnity and a loss happens, anything which diminishes or reduces that loss diminishes or reduces the amount which the indemnifier is bound to pay; and if the indemnifier has already paid it, then if anything which diminishes the loss comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back."⁹⁶

Similarly, in the case of Castellain v. Preston it was contended thus:

"A person who wishes to recover for, and is paid by, the insurers as for a total loss cannot take with both hands. If he has a means of diminishing the loss, the result of the use of those means belongs to the underwriter."⁹⁷

All this emphasis on the underwriter being entitled to any such recovery made from third parties, and the insured being prohibited from receiving a windfall after being indemnified, leaves no doubt, even in the mere literal sense, that the principle of subrogation, to the extent that it makes the insured a constructive trustee for the insurers for any sum received over and above the indemnity sum,

serves solely the interests of the insurers.

Secondly, the insured, by the principle of subrogation, is further under obligation to furnish the insurers with all material help within his means to enable such insurers to enforce their claims against third parties. This rule finds judicial authority in the case of Dane v. Mortgage Insurance Corporation, as follows:

"If the assured does obtain anything by way of salvage out of the subject matter insured, he must account for that to the underwriter; and, further than that, if anything is obtainable by way of salvage, he has no right to say to the underwriter that he will not take any step in order to obtain such salvage; he is bound to assist underwriters in obtaining it."⁹⁸

The insured is thus under the obligation to assist the insurers by giving them all the evidence that he would himself use against the third parties. Moreover, he has the duty to permit the insurers to use his name for this purpose, by joining him as a co-plaintiff and, "if he refuses, the court may compel him to do so upon receiving indemnity in respect of the costs to be incurred."⁹⁹

have become subrogated as regards a specific sum of money or other property, the money or property comes into the hands of the assured, he holds as trustee for the insurers. "100

It is thus clear that all the obligations ^{bestowed} ~~bestowed~~ on the insured by the principle of subrogation are purposely meant for the protection of the insurers' interests. As already seen, the principle of subrogation was originally founded in equity and later on incorporated into common law. This means then that the principle of subrogation ought for all purposes to be an equitable principle. It is to be submitted that in practice, however, the doctrine of subrogation violates some very fundamental aspects of equity.

For instance, the principle of subrogation unilaterally if not arbitrarily makes the insured a constructive trustee for the insurers, without there having been any fiduciary relationship between the two parties. This is indeed a fundamental departure from the practice in equity, where one can only be deemed as a trustee with his explicit consent. Secondly, the doctrine of subrogation places an obligation on the insured to enforce his rights

And that's why it is constructive trustee!!

There need not be consent → Constructive Trustee

No!
Indeed he misdirected himself on a vital point of law!

against the tortious third parties for the consequent benefit of the insurers. This shows a fundamental departure from the equitable rule of specific performance. Under the doctrine of specific performance in equity, one cannot be forced to do something that involves exclusively personal services, as this would be like enslaving such a person.

*This is utter
bullshit.*

Accordingly, since an insured's rights to enforce his claims against third parties are personal rights, and therefore analogous to personal services, it is unequitable that he should be forced under the doctrine of subrogation to render them for the benefit of the insurers. Thirdly, as will be analysed in some detail in the next chapter, the principle of subrogation is unequitable since it unjustly enriches the insurers, by enabling them to be subrogated for all they have paid to the insured by way of indemnity, then retain the premiums paid by the policyholders as pure profits.

Fourthly, the doctrine of subrogation violates the equitable rule that equity acts in personam, since it enables the insurers to recover from third parties with whom they were not under any privity at all. If anything it is the insured who has rights, and personal rights at that, against any

tortious third party, and it is highly unequitable that the insurers should (arbitrarily) ^{usurp} ~~usurp~~ such personal rights from the insured for their own ends.

Thus in the final analysis, it can be safely contended that the principle of subrogation, which is itself a corollary to the principle of indemnity, is just one of the numerous peculiar principles found in insurance contracts which place the insurers in a highly advantaged position that they would otherwise not be in under ordinary contracts. The principle of indemnity and those other principles that go with it tend for the most part to limit the policyholder's rights to indemnity and thereby relieve the insurers from liability under the contract.

This serves the interests of the insurers and prejudices against the interests of the assureds. When one of the few situations arises where the insurers cannot escape from their liability to indemnify the insured, they still go round the whole thing by invoking the principle of subrogation to ensure that whatever they pay to the insured by way of indemnity will be recouped to them from the hands of the tortious third parties, so that they gain at all events. This rather unfair, one-sided nature

of the doctrine of subrogation will be critically examined in the following concluding chapter of this piece of work.

Let's have 20

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary and Conclusions

From the foregoing chapters it has become clear that insurance contracts for the most part serve the interests of the insurance companies, which companies are business enterprises and therefore bent on maximising their profits by invoking all ways and means available to them. On the other side of the deal the interests of the policyholders under such insurance contracts are for the most part connived at if not frustrated, with the result that such insurance contracts, rather than being a means through which the insured parties can make meaningful and therefore useful investments, are instead a means through which the insured parties expose themselves to some form of institutionalised fraudulent activities by the insurance companies.

In the field of indemnity, much emphasis is laid on the fact that the insured should at best be fully indemnified but not more than fully indemnified. The yardstick for such full indemnity as may ensue is, in the case of valued policies, the amount fixed on the policy, but only to the extent that this works in the interests of the insurers. As has been seen,

if the real value of the subject matter of insurance at the time of its destruction exceeds the sum fixed on the policy, then the insurers will pay that sum and no more. If, on the other hand, the value of the subject matter of insurance is below the sum fixed on the policy by the prevailing market conditions at the time it is destroyed, then the insurers will not be bound by the sum fixed on the policy but will indemnify the insured only to the extent of actual loss he will have sustained.

While this leaves no doubt whatsoever that the principle of indemnity serves the interests of the insurers as they are aware of their maximum liability under any circumstances but which maximum liability they are not always bound by, it is on the other hand clear that this leaves the insured in the cold as he is not aware as to what extent he will be indemnified in terms of real loss or damage, since even if he is paid the full sum fixed on the policy, this will not necessarily be real full indemnity to him at all. The concept of full indemnity is thus a fallacious one from the viewpoint of the insured, although the insured only comes to realise this when he has received such indemnity money and finds it inadequate to repair or replace the damaged or lost

subject matter of insurance.

With regard to the principle of utmost good faith, it places onerous burdens on the policyholders who are not acquainted with insurance contracts requirements and so do not know what to disclose and how much of it to disclose to the insurers or their agents at the time of entering into the contract. To make matters even worse for the policyholders, it is the insurers who determine what is material and therefore ought to have been disclosed by the policyholder in any given situation. Failure by the policyholder to disclose what in the minds of the prudent insurers is a material fact, however innocently this omission may have been made, entitles the insurers to avoid the policy and conversely disentitles the policyholder from his rights to indemnity under the contract. This principle is no doubt far from equitable as it serves the interests of the insurers at the expense of the interests of the policyholders.

With regard to the issue of agency in insurance transactions, it was noted that at certain stages of the transactions the agents are deemed to be agents acting for the policyholders and not for the insurers. This takes place especially with regard to the filling in of the proposal forms, where agents are

regarded to be working for the policholders at the time they are dealing with issues which are deemed to be in the knowledge of the proposed insured rather than the insurers. In such cases the policyholders become liable for any misinformation, whether intentional or otherwise, that the agent may later tender to the insurers, and the insurers will be accordingly entitled to avoid the policy to the detriment of the otherwise innocent policyholder. All this happens notwithstanding the fact that agents in insurance undertakings are at all material times employees of the insurance companies for which they promote the insurance business.

Moreover, as such agents have no lasting personal interests in the insurance transactions but are only concerned with earning as high commissions as possible, it would not be uncommon for them to misadvice prospective policyholders and then leave such policyholders to their own fates of having the policies avoided against them by the insurers.

Thus the activities of the agents with whom the policyholders are under no privity bind such unfortunate policyholders, yet the insurers never take any steps that would enable prospective policyholders to know at what stages of the transactions they are deemed to be principals of the agents

and therefore bound by the activities of such agents for all purposes. This manner in which agents employed by the insurers are at certain stages unilaterally deemed to be agents of the policyholders enhances the interests of the insurers by enabling them to disclaim liability, while on the other hand it prejudices against the interests of the policyholders by disentitling them from their rights to indemnity.

With regard to the principle of insurable interest, it disfavors the policyholders who are laymen in the insurance business and do not therefore know what they have an insurable interest in and at what times. In any case, the insurers often-times use this principle unconscionably, especially where they know from the beginning that a policyholder has no insurable interest in the subject matter of insurance, yet they continue to accept premiums and only plead lack of insurable interest when the policyholder makes a claim on the policy.

As for many policyholders, it is only when their claims are being rebutted by the insurers that they become aware of their lack of insurable interest in the subject matter of insurance. This means therefore that the principle of insurable interest favors the insurers and conversely

disfavours the policyholders, as it enables the insurers to disclaim liability while it disentitles the policyholders from their rights to indemnity.

As for conditions and warranties, they are carefully merged in insurance contracts for the benefits of the insurers and to the disadvantage of the policyholders. This is because in insurance contracts, warranties are deemed to be conditions precedent to the conditions themselves, so that breach of any such warranty automatically defeats a condition and consequently the contract as a whole.

This then means that, unlike under ordinary contracts where breach of a warranty only entitles the aggrieved party to ask for damages and not to avoid the contract, a breach of warranty by a policyholder under a contract of insurance entitles the insurers to avoid the policy and disentitles the policyholder from making even the slightest recovery from the insurers under the contract.

There is yet another area where insurers find themselves at an advantage under insurance contracts, which advantage they would not have under ordinary contracts. This relates to the question of who is the offeror and who is the offeree under insurance contracts. In insurance contracts, the proposers are

deemed to be the offerors while the insurers are deemed to be the offerees, as any business efforts that may be made by the insurers or their agents into inducing prospective policyholders to take out policies as such is regarded as nothing more than a mere invitation to treat.

Moreover, any ambiguities as may appear in the proposal forms, once such forms have been signed by the policyholders, are construed to the detriment of such policyholders. This in fact constitutes a fundamental departure from the ordinary contract rule of contra preferentum, which in substance stipulates that in the event of there being any ambiguity or discrepancy in the contractual document, such ambiguity or discrepancy is to be construed against the party who drew up such document and then wants to rely on the ambiguity or discrepancy for his own defence.

Hence since in insurance contracts such irregularities in the proposal forms are construed against the insured signatories, notwithstanding the fact that such proposal forms are drawn up by the insurers, it can be concluded that in this respect such special rules of insurance contracts serve the interests of the insurers by enabling them to avoid

*Interests
- Ex. Insurers*

policies while conversely disfavouring the interests of the policyholders by limiting their rights to indemnity.

Under the rule of proximate cause, taken together with the fact that insurers include some exclusion clauses in the contractual documents, it becomes even more difficult for the insured to receive an indemnity while on the other side of the coin it becomes even easier for the insurers to disclaim liability by contending that the loss or damage being claimed upon does not fall within the policy, or that the cause of such loss or damage is not proximate to the peril insured against by the policy but is only remotely connected with it.

It is not unlikely that the insurers may in some cases draw up their contractual documents in such ambiguous terms that almost everything would by some construction be deemed as excepted. All this means that the insurers' interests are protected while the insureds' rights to indemnity are highly curtailed.

Notwithstanding the highly advantaged position in which the insurers are placed relative to the policyholders, insofar as they can disclaim liability and the insureds' rights to indemnity are diminished

if not suppressed, the insurers have yet another tool which serves their interests and their interests alone under insurance contracts. This tool which serves purposely and solely the interests of the insurers and ignores the rights of the insured parties is the doctrine of subrogation. Under this doctrine, the insurers, after paying to the insured the sum fixed on the policy or any part thereof depending on the nature and extent of the loss or damage sustained, are entitled to be recouped for what they have so paid to the insured. This means then that the insurers are at all times not in a position to lose at all, generally speaking that is, since where they pay out any money to the insured, they will be recompensed under the rule of subrogation. This is even more so since the insurers can only pay the insured to the extent that he was blameless for the loss or damage sustained, in which case there are tortious third parties from whom the insured would have recovered compensation, and against whom the insurers will now proceed.

At any rate, insurers will not normally take risks on which there may be no tortious third parties at all, and that is why risks arising from natural calamities or acts of God are more often than not excepted under the exclusion clauses in the contra-

ctual documents. As was seen in the previous chapter, even in the few cases where the insurers are under statutory obligation to make compensation under the policies, like under third party risks policies, they will still make a recourse to the person who would have been successfully sued by such third party, even if such person turns out to be the policyholder himself.

This then means that the principle of subrogation, by enabling the insurers to be recompensed for what they pay to the insured under indemnity contract, makes such insurers remain with the premium sums paid to them by the insured as pure profits and thus perpetuates unjust enrichment among insurance companies. It is interesting to note the one-sided proposition for the doctrine of subrogation: that it is meant to prevent the insured from getting anything over and above full indemnity money, while on the other hand, it enables the insurers to get something over and above the premium payments for which they undertook the risk, or, put in another form, it enables the insurers who have been recouped to what they paid to the insured, to retain in the form of premium sums something over and above what they paid to the insured.

It is also a unique feature of the doctrine of

subrogation that the policyholders, after being indemnified by the insurers, are deemed to be trustees for the insurers for what they may recover from tortfeasors over and above full indemnity, all this notwithstanding the fact that there was no fiduciary relationship between the insured and the insurers at all.

Furthermore, it entails an intrusion by the insurers into the contract by operation of law, that is, the ipso jure contract between the insured and the tortfeasors, since it enables the insurers to enforce their claims against such tortious third parties after indemnifying the insured, yet there was no privity at all between the insurers and such tortious third parties.

Finally, as was seen in the previous chapter, the doctrine of subrogation imposes an obligation, depending on the wording within the insuring instrument, on the insured to help the insurers enforce their claims against third parties. As already noted, the insured's rights as against third parties are personal rights, and to put him under an obligation to exercise them is like forcing him to perform personal services, which is not in keeping with the equitable doctrine of specific performance. All the foregoing analyses emphasise the fact that

the doctrine of subrogation in insurance contracts serves mainly if not solely the interests of the insurers, as it mitigates and in some cases totally removes any expenses that they might have incurred in indemnifying the insured, thereby enabling them to make pure profits under the contracts of insurance.

It is thus to be emphasised once again that insurance contracts serve for the most part the interests of the insurers who are bent on maximising profits for their various companies, and any real indemnity as may be acquired by some policyholders under insurance contracts is merely incidental to the insurance companies' basic purpose of profit-maximisation.

5.2 Recommendations for Reform.

The foregoing summary indicates in substance that the principles of indemnity and subrogation serve for the most part the interests of only one party to the insurance contract, the insurance company while in most cases ignoring or outrightly frustrating the interests of the other party to the contract, the policyholder. Such an imbalanced state of affairs in insurance contracts infringes the very motto of contractual transactions in general, that is to say, it infringes the principle of freedom

and equality in contractual undertakings. There is thus the need for reform in the field of the laws governing insurance contracts in order that real justice be seen at work in insurance contracts.

In the field of indemnity, it is submitted once again that mere payment of money fixed on the policy to the insured does not necessarily reinstate such insured in real terms to the position he was in prior to the loss or damage, and this is so in view of the fact that due to inflationary trends the price of the subject matter of insurance as at the time it is lost or destroyed may have gone ahead of the sum fixed on the policy when the contract was being entered into. This would no doubt mean that the insured is not reinstated in real terms at all.

It is therefore suggested that for real indemnity of the insured to be ensured, it is the real value of the subject matter of insurance at the time it is lost or destroyed that should be taken into account, and there should be no limitation on the sum to be paid by the insurers to the insured based on the sum fixed on the policy. This would be even a more equitable way of making compensation to the insured under the contract, as it would be consistent with the aim of indemnity, which aim is geared towards reinstating the insured to his position at the time

just prior to the loss or damage.

At any rate when the loss or damage suffered by the insured is less, in money terms, than the sum fixed on the policy, it is the actual loss as is incurred that is taken into account when assessing what money to be paid to the insured, and the sum fixed on the policy is not taken into account at all. Hence it would only be a matter of legalistic consistency and sound justice if the actual loss or damage suffered by the insured is used as the determinant factor in assessing the sum with which to indemnify him at every situation where loss or damage is so incurred, rather than use one yardstick in one situation and another yardstick in another situation, which yardsticks, as things are, are chosen so craftily with only the interests of the insurers in mind.

With regard to the principle of utmost good faith, it has been observed that it places onerous burdens on the insured and almost none at all on the insurers. It is therefore suggested that for sound justice to be seen at work, the principle of utmost good faith should be reciprocal not merely in theory but in practice as well. The insurers should be placed under obligation to reveal to the proposed assured, for instance, whether or not such proposed assured has an insurable interest in the subject

matter he is intending to insure against risks. Furthermore, all the terms of the contract in the proposal form should be adequately brought to the attention of the insured before the contract is concluded, so that there is real consensus ad idem between the parties to the contract.

Finally, the terms of the contract should be confined within the four corners of the proposal form which is in fact the contractual document. In this sense the policyholders should be under obligation only to disclose matters as are asked in the proposal form. It should be the duty of the insurers to indicate every question relating to matters they deem material in the proposal form, so that the proposal form should be exhaustive enough and hence the proposers will know the extent of disclosure required of them. And with regard to the determination of what is material, it should be the objective test, that is to say, the test of every prudent man which includes both the insured and the insurers, that should be applied, rather than the arbitrary test of the prudent insurer only.

As for the issue of agency in insurance contracts, it is recommended that as agents are at all material times employees of the insurers and not of the insured, their activities should not prejudi-

cially bind the insured at any time at all. The policyholders should not be made to suffer for the activities of agents they never employed or for whose appointments they were never consulted at all. It is the insurers who should at all times be principals to the agents, and the duty of principal should not at any time be arbitrarily and unilaterally imposed on the innocent policyholders at all.

With regard to the issue of insurable interest, it is suggested that the insurers should be placed under an obligation that they disclose to the prospective assured whether or not he has an insurable interest in the subject matter he intends to insure. This is only too necessary since the insured, not being in any way acquainted with insurance business, cannot be expected to know that under certain cases they cannot insure some subject matters.

Hence for the two parties to enter into a contract on equal footing the insurers should enlighten the prospective insured on the issue of insurable interest. Otherwise, where the insurers have accepted premiums from the insured and then later plead lack of insurable interest in order to disclaim liability under the contract, they should be estopped from avoiding the policy, as failure to

estop them by the courts would only encourage them to indulge in such unconscionable behaviours at the expense of the otherwise innocent policyholders.

With regard to conditions and warranties, it is suggested that the same rules as apply in ordinary contracts should be invoked in insurance contracts, and the distinction between conditions and warranties, together with the respective rights and liabilities inherent upon them, should be introduced in insurance contracts. It is only by keeping conditions and warranties separate that the insured may survive under the contract if he makes some rather minor mistakes under it, instead of the whole contract being revoked to his disadvantage for whatever minor mistakes as he may make under it.

As regards the issue of offerors and offerees under insurance contracts, it is suggested that since it is the insurers who either personally or through their agents induce the insured parties to take out policies in the first place, it is them, the insurers, who should be deemed as offerors for all purposes, and the question of their business - promotion techniques being deemed as mere invitations to treat should be regarded as untenable.

Moreover, as it is the insurers who draw up the contractual documents, insurance contracts

being just one breed of standard-form contracts, it is only just and equitable that any ambiguity or inconsistency in the proposal form should bind the insurers rather than the insured signatory, and the contra preferentum rule should be invoked accordingly.

As regards the principle of proximate cause together with the issue of excepted causes as normally embodied in the exclusion clauses in the insurance contractual documents, it is suggested that since the insured takes out a policy to secure himself against accidental damages and losses, it is the occurrence of such damage or loss by accidental means that should form the crux of the matter and not the way by which such damage or loss occurred.

In other words, it is the substantive nature of the damage or loss rather than its procedural nature that should be taken into account in determining whether or not the policyholder should be indemnified. Consequently, once the insured has sustained damage or loss with regard to the subject matter of insurance, he should be indemnified and the issues of proximate cause and excepted causes, which issues serve mainly if not solely the interests of the insurers, should not be called into play at all.

With regard to the principle of subrogation, it is to be noted once again that it serves solely the interests of the insurers in insurance contracts as it enables them to reap pure profits at the end of the whole deal. If the insurers indemnify the policyholder, they are recouped by anything recoverable from tortious third parties so that the premium payments they received from the policyholder stand out as pure profits for them, the insurers.

But in situations where there may be no tortious third parties to recoup them, the insurers are always careful to exclude such causes from coverage of the policy, for instances damages or losses arising from natural calamities, acts of God, civil commotions, and acts of war and hostilities. And even where they are under statutory obligation to indemnify, like under third party risks policies, the insurers can still be recouped by the policyholder if such policyholder would have been successfully sued by the third party victim of the loss or damage.

Is the principle of subrogation then, a really just and equitable one? It is to be noted that the insurers receive premiums which are so rated to take care of the risks they contract to undertake.

Moreover, only a few of the policies taken out are

successfully claimed upon. This then means that the insurers have calculated the degree of risks they are taking in advance and are as such not in a position to lose at all, other things remaining unchanged.

As such it should not be open for the insurers where they have indemnified the insured to talk in terms of the need to be compensated under the doctrine of subrogation. After indemnifying the insured as they contracted to do, the insurers have not sustained any loss at all, and it is nothing short of unjust enrichment if they are to be recouped just for having performed their part of the contract.

It is not being suggested, however, that third parties should take advantage of insurance contracts to which they are strangers and get away with their tortious wrongs. The tortious third parties are legally liable to account for their tortious wrongs by paying compensation. The big question which then arises is: Who is entitled to such money as is recoverable from the tortious third party? The insured has been indemnified and the insurers received premiums upon which they undertook the risks. None of them has lost anything.

Accordingly, none of the two parties has greater rights to such money as is paid by the third party than the other, at any rate the insurers have no greater rights to such money than the insured. If anything, the insured may be said to have greater rights to such money since there is an ipso jure contract between him and the third party, whereas the insurers are complete strangers to such contract. How then should such money be applied? Three propositions are to be put across.

In the first place, if the insurers can prove that the indemnity sum they paid exceeded the premium sums they had received, so that they can be deemed as having lost under the contract, then they should get only the sum equivalent to the full indemnity money less the premium monies that they had received from the insured, and anything that remains should go to the insured.

Secondly, it is suggested that as no party to the contract can be deemed to have lost anything as the insured has been indemnified while the insurers have received premiums, any sum as is received from the tortious third parties should then be shared pari passu as between the insured and the insurers. Thirdly, it is suggested that if none of

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the above two propositions can be acceptable, then any sum recoverable from the tortfeasors should, by the principle of bona vacantia, vest to the state. Otherwise, all in all, the insurers have no greater rights to such money than the insured.

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well known*

Finally, the practice of making policyholders ipso jure trustees of the insurers, and therefore putting such policyholders in a position where they can be compelled to exercise their rights against the tortious third parties for the benefit of the insurers should be done away with. This is because the policyholder's rights against third parties are personal rights and to place an obligation upon him to exercise them is unequitable since this would be like compelling one to perform personal services.

Why not water

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FOOTNOTES.

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