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A Critical Evaluation of the Dual Doctrines of Subrogation & Contribution in Fire Insurance

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ABSTRACT

A Fire Insurance is a contract of indemnity between the insured and the insurer. The Doctrine of Subrogation and Contribution are an extension of the principle of indemnity. This article primarily focuses on the fact that insurance contracts are contracts of indemnity wherein there is no gain or profit in any way to the insured as a consequence of an accident or loss. Fire Insurance is an insurance against any loss caused by fire. This article initially discussed the different aspects of how the doctrine of Subrogation and Contribution operate with regards to Fire Insurance. Then it moves on to specifics as regards fire insurance such as a Special Perils Policy, Standard Fires, Policy Coverage, Depreciation and Status of Salvage Value. By way of this analysis the article aims in arriving at the courts take on different aspects of such applications of the principle of indemnity in Fire Insurance. The Primary focus is on the stance of the Indian Courts while also discussing International Decisions. The Ramifications of Indemnity on Fire Insurance Contracts is discussed through both an individual analysis and a study of the doctrines. Finally, The Author also suggests recommendations after discussions involving the doctrine of Subrogation and Contribution.

Keywords: Contribution, Fire Insurance, Indemnity, Perils, Subrogation.

I. INTRODUCTION

Subrogation is the transfer of the legal right to recover damages from the insured to the insurer². Contribution is that right vested with insurers who have already paid for a particular loss of the insured, these insurers have a right to claim a proportionate amount from the other insurers who are liable for the same loss³. These doctrines clearly exhibit the principle of indemnity in ensuring that the insured does not profit from a contract of indemnity⁴. The Fire Insurance is a

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² Hasson, R. (1985), Subrogation in Insurance Law-A Critical Analysis, *Oxford Journal of Legal Studies*, 416-438.

³ Hasson R. (1985), *Supra* 1.

⁴ Parkinson, M. A. (1981), *Insurance Law*, London, Sweet & Maxwell, p. 471-512.

Contract of Indemnity⁵. *Indemnity* is provided by means of (a) Cash Payments, (b) Repairs, (c) Replacements, (d) Reinstatement. As Regards Subrogation in the absence of this doctrine the insured might recover an insurance claim and also damages as the aggrieved party from the third party⁶. This creates a profit for the insured, thus Subrogation cannot be denied when the contract is one of indemnity, as the insured is, for the Fire Insurance⁷. As Regards Contribution in the absence of this doctrine the insured might recover the insurance claim from all the insurers as he is eligible to do so in the absence of this doctrine, thus effectively preventing a profit out of insurance contracts⁸. Denial of the right of Subrogation rests on the Fact that a particular contract is not one of Indemnity⁹. Such as a Life Insurance is not a contract of Indemnity. In such instances Subrogation feature has no application. In India there is no statute governing Fire Insurance it is regulated by the Indian Insurance Act, 1983¹⁰. The Term Fire Insurance is defined under *Section 2 (6A)* of the Insurance Act¹¹. A Fire Insurance is a Contract as per the Law, with a few additional principles governing it which is meant for insurance transactions such as *Utmost Good Faith, Insurable Interest, Contribution, Subrogation, Indemnity and Proximate Cause*¹².

(A) Research Methodology

The Research Methodology is in the form of doctrinal Research, wherein the Secondary Sources used to collect information is through research papers, journals, research articles, insurance law books, Newspaper and other Online resources. This paper is strictly limited to the theoretical underpinning as regards the present topic.

(B) Research Objectives

The author has inferred from this article that the doctrines of subrogation and contribution often alluded to Lord Mansfield¹³ as to have been pronounce in the process of making these concepts so profound that it is indispensable in the study of the law of insurance. The author has further dived into the present scenario in India and has compared how these principles operate and has provided thorough analysis. Through this research the author aims in creating a simple

⁵ *Lucena v. Crawford*, 127 Eng Rep. 1805, p. 180.

⁶ Ivamy. (1979), *General Principles of Insurance Law*, London: Butterworths.

⁷ Patterson, S. (1957), *Essentials of Insurance Law*. New York: McGraw-Hill Book Co.

⁸ LJ., J. (1966), *The Collateral Source Rule and Loss Allocation in Tort Law*, *Calif L Rev*, 1478.

⁹ *Driscoll v. Driscoll*, 1 Ir. 1918, p. 152-159.

¹⁰ Danzon, P. (1984). *Tort Reform and the Role of Government in Private Insurance Markets*. *The Journal of Legal Studies*, 517, 548.

¹¹ *Ibid*.

¹² Singh, Avtar, (2017)., *Law of Insurance, New Delhi*, Lexis Nexis.

¹³ *Castellian v. Preston*, 380 (QBD 11 1883).

understanding of these concepts in the fire insurance regime for both the insured and the insurer to thereby benefit.

II. BRIEF HISTORICAL DEVELOPMENT OF FIRE INSURANCE

Fire Insurance was popular after the development of Marine Insurance, its origin could be dated to the Great Fire in London which caused a loss of about € 10 Million, at a time where London's annual income was € 12,000. This led to the Poor Relief Act, 1666. Thus, by the end of the 17th century there was Nicholas Barbon's Fire Office, 1680 and the Friendly Society established at 1683¹⁴. The First Fire Insurance Company in the United States was installed in Charles Town, South Carolina, in 1732. Colonization was also a contributing factor which led to the spread of the idea of Fire Insurance¹⁵. Presently, in India there exists a fire insurance policy which also includes other perils such as storms, lightning, Strike, Aircraft Damage etc., and is covered under the header of 'Standard Fire and Allied Perils Policy'. Fire insurance are more prevalent in the non-life insurance category because the unexpected occurrence can leave behind heavy damages¹⁶. Fire Insurance helps rebuild the economy by providing jobs in the insurance sector at the same time covering heavy losses incurred by businesses and thereby at times even help restoring damages and reinstate to original¹⁷.

III. SUBROGATION

When a Loss occurs, there are three legally valid approaches that can be pursued, the insured party can be allowed to keep both the insurance proceeds and full recovery against the third party¹⁸. Or the insured party can be allowed to recover its own loss and the insurance company can be denied the right to undertake proceeding against a certain defaulter, it can be a contract breaker or tortfeasor¹⁹. Or the insured can recover from the insurer and the insurer can use the insured's name to recover from a third party for liability or any such breach. Subrogation is the third option, and is most relevant in the eyes of law²⁰. The English Law states that Insurance Contracts are personal contracts between the insured and the insurer. The Rationale is from the case law *Rayner v. Preston*.²¹, The American Courts after several vendor-purchaser contract cases state that insurance was not a personal contract. The field of insurance law is dominated

¹⁴ Marasinghe, (1975), An Historical Introduction to the Doctrine of Subrogation (Parts I & II), *Valparaiso U L Rev*, 45, 275

¹⁵ Keeton, (1971), *Insurance Law*, St Paul, Minn, West: 157-8.

¹⁶ *Ibid.*

¹⁷ *Supra.*, n 11.

¹⁸ Davis, S. L., (1962), *The Extension of Insurance Subrogation*, *Michigan Law Review*, 33.

¹⁹ Hasson R. (1985), *Supra* 2.

²⁰ Andrews, N, (1993), *Subrogation and Contracts of Insurance*, *Cambridge Law Journal*, 223-225.

²¹ *Rayner v Preston*, 18 CH D 1881.

by the third and first legally permissible approaches. Each of these approaches have their own drawbacks as the first has the drawback wherein the insured is over compensated, while in the third option usually insurance rates are not fixed to anticipate such recoveries by the way of subrogation²². The Second Option has a major drawback if insurance contracts are considered to be personal contracts between the insured and the insurer. In *Padmanabha Pillai Case* (Krishna Pillai Rajasekharan Nair v. Padmanabha Pillai, 2004), the Supreme Court has held that Subrogation arises out of doctrine of equity and the principles of natural justice but not out of the privity of contract. The principles of Subrogation as applicable under the Indian Insurance Regime has been dealt with under *Charan Spinning Mills (P) Ltd. Case* (Economic Transport Organization v. Charan Spinning Mills (P) Ltd, 2010), wherein the rights of the insured and the insurer have been delimited as regards subrogation and there has also been discussions on letters of subrogation wherein the insured and the insurer can make more specific terms as regards Subrogation rights and thus be governed by the same.

Subrogation arises out of (a) *Tort*, (b) *Contract*, (c) *Statute*, (d) *Subject Matter of Insurance*. Subrogation allows the insured party to be indemnified for the damages from the insurer. In return the insurer obtains the legal right to pursue compensation on behalf of the claim of the insured²³. This compensation to damages is something the insured is entitled to, however, since the insurer has already paid for damages arising out of the fire, on the basis of the policy, the insurer becomes entitled to institute a legal process against the third party to obtain compensation. It is pertinent to note that the insured has to co-operate with the insurance company when the company institutes such suits²⁴. Originally, the transfer of legal rights from insured to insurer happens only when the insurer has indemnified the insured, however, in recent circumstances taking cognisance of the need to act immediately to obtain relief from the courts, the insurance company may issue a note to pay at the earliest and initiate a suit²⁵. Even in these instances the insured needs to be validly compensated by the insurer as per terms of the policy. If the claims out of the suit is higher than what was paid to the insured, where there is a excess interest etc. If the insured cannot make a profit neither can the insurer, because even if there exists a transfer of legal rights the claim still originates from the damage which was incurred by the insured.

²² Patton, T. R., (1999), Recent Developments in Title Insurance Law, *Tort & Insurance Law Journal*, 695-706.

²³ Rinaldi, E. M., (1994), APPORTIONMENT OF RECOVERY BETWEEN INSURED AND INSURER IN A SUBROGATION CASE, *Tort & Insurance Law Journal*, 803-817.

²⁴ Hasson R. (1985), *Supra 2*.

²⁵ Veal, G. R., (1992), Subrogation: The Duties and Obligations of the Insured and Rights of the Insurer Revisited, *Tort & Insurance Law Journal*, 69-89.

Life Insurance Contracts²⁶ and Accident Insurance Contracts²⁷ are not Contracts of Indemnity thus the doctrines of Subrogation and Contribution cannot be applicable to the same. In Rahee Industries Ltd. Case²⁸, variance from ordinary policy of subrogation is permitted in a pre-agreed arrangement between the insured and the insurer. Further Salvage and Abandonment are extremely important concepts when it comes to discuss Subrogation rights. Salvage is the property that is saved after loss from fire. While in such cases insurers pay only to the amount that is required to compensate damages and excludes that would be recovered if there was no salvage. In cases of abandonment the insurance companies get to possess the Salvage and the full amount is paid to the insured. This Principle is laid down in Kaltenbach v. Mackenzie Case.²⁹ It is important to note that in subrogation the insurer can initiate a suit on the behalf of the insured but the insurer is not the plaintiff but only entitled to the recoveries. It is a practice that for a legal claim the insurer cannot get compensated by the insured for ensuring his legal right is used to obtain compensation for damages., the burden to initiate the suit is with the insurer. This concept has been clarified in the Oberoi Forwarding Agency Case.³⁰, Wherein the insurer cannot obtain the legal status of the consumer although he has initiated the suit. Initially there existed a confusion wherein in the United Insurance Case.³¹, the apex court said that the insurer can file complaint against a tortfeasor. The Supreme Court has reiterated its judgement in Economic Transport Organization Case, wherein it firmly laid down that the Insurer can only apply on behalf of the insured and not as a party to the suit.

Can Insurance Companies Sue the Employees of a company under Subrogation under Fire Insurance? I found this question very relevant. There are two courses and outcomes firstly the insurance company is only on a contract with the insured and he is eligible to sue others for compensation³². The other approach taken by the courts was in instances of a fire caused by negligence of employees the insurance company cannot undertake a suit against the employees³³. However, then the question was whether the firm will eligible to be duly compensated the answer was in the positive and dependent on the circumstances of the Insurance Policy. In Greenwood Shopping Plaza Case., the fire was caused by negligence of tenant it was held that the insurer cannot undertake a suit against the tenant. However, in Lister

²⁶ Dalby v. India and London Life Assurance Co., 15 CB 365 1854.

²⁷ Bradburn v. Great Western Railway Co., 20 LR 10 1874.

²⁸ Rahee Industries Ltd v. Export Credit Guarantee Corporation of India Ltd., 2 SCC 138 2009.

²⁹ Kaltenbach v. Mackenzie, 3 CPD 467 1878.

³⁰ Oberoi Forwarding Agency v. New India Assurance Co. Ltd, 2 SCC 407 2020.

³¹ Taj Mahal Hotel v. United India Insurance Co. Ltd., 2 SCC 224 2000.

³² Lister v. Romford, 1 NZLR 46 1981.

³³ Greenwood Shopping Plaza v Buchanan et al., 99 DLR 3d 289 1979.

Case³⁴. it was firmly established that individuals who cause damages to a firm can be sued by the insurer under subrogation. Further in Marlborough Properties Case.³⁵, the tenant paid fire insurance in the name of the landlord and a fire was caused due to the negligence of the tenant but the insurer paid the fire insurance pay-out and it was restored. In this case the insurer proceeded to undertake claims against the tenant, it was firmly laid down by the New Zealand Courts that it would not be possible to do so. Another important concept is that an insurer can only proceed against a third party if the insured has a right to do so. In Som Prakash Case.³⁶, the insurer was not allowed to recover from the wife of the insured as the insured did not have the right to recover from his wife for damages caused due to the fire.

IV. CONTRIBUTION

Common Law allows the insured to recover full amount from any one of the insurers and the insurers can then later claim the remaining from the other insurers³⁷. It is important to note here that the several conditions must be justified for there to be contribution³⁸. Firstly, there must be in existence two or more contracts of insurance. Secondly, there should be a common policy covering a common peril for loss and with a common subject matter. Lastly, such policies should be in operation at the same time. The insurance policies need not be identical but need to be similar in subject matter and policy³⁹. At present to avoid law suits wherein other insurance companies suggest that one has taken the responsibility to pay the full amount to the insured this relieving the others to prevent unnecessary suits at present the insurance companies are only entitled to pay their rate-able proportion of loss as regards the policy entered into with the insured⁴⁰. As for the remaining claim the insured should take it to the other insurer with whom there has been an insurance policy⁴¹. If an insured enters into a Fire Insurance Policy with three insurance companies A, B and C to the extent of \$ 10,000, \$20,000 and \$30,000 and there arises a claim of \$ 6,000. As regards the rate-able proportion theorem the insurance companies will have to pay as they would be thus liable. A would have to compensate to the extent of \$1,000, B to the extent of \$ 2,000 and C to the extent of \$ 3,000. In QBE Insurance Case.⁴², it has validly been stated that the common law approach to contribution and the fire insurance policy differs. Under common law it is said that insured can obtain claim from any one insurer

³⁴ Lister v. Romford, I (NZLR 46 1981).

³⁵ Marlborough Properties v Marlborough Fibreglass, I NZLR 464 1981.

³⁶ Economy Fire and Casualty Co. v. Som Prakash, 2 SCC 287 2017.

³⁷ North British v. London, Liverpool and Globe, 569 CH 5 1855.

³⁸ Srinivasan, M. (2009), Principles of Insurance Law, New delhi, Butterworths.

³⁹ American Surety Co. v Irrighton, 91 TLR 12 1910.

⁴⁰ Sarma, K. (2009), Modern Law of Insurance in India, New Delhi, Lexis Nexis.

⁴¹ Jenkins v. Deane, 103 LKBJ 4 1933.

⁴² QBE Insurance (Australia) Limited v. Lumley General Insurance Ltd., 2 VSCA 223 2009.

and later the insurer can obtain compensation from other insurers to the extent the other insurers are liable. However, under Fire Insurance Policy the pay-out to the insured from the insurers is in a Rate-able proportion as per individual policy agreements entered into between the insured and the respective insurers.

V. TYPES OF FIRE INSURANCE POLICIES – VALUES AND UNVALUED

Valued Fire Insurance Policies are policies when the subject matter is values while entering into the policy and complete pay-out is possible in cases of total loss. As regards partial loss pay-out is made to the extent of the loss incurred⁴³. Further a Valued Fire Insurance policy is void if it is based on a fraud or misstatement. Unvalued Fire Insurance Policies are policies wherein the subject matter is analysed on its intrinsic value based upon the present market fluctuations. i.e., the market value of the subject matter is calculated as it would have been on the date of fire⁴⁴. India recognizes open policies as comparable to valued policies because valued policies have a higher risk of profit or loss for the insured and it defeats the purpose of indemnity.

(A) Calculations of Indemnity as Regards Fire Insurance

1. Actual Cost Value

Actual Cost Value is a principle which is to ensure that the damages are so payable such as the insured is brought back to the original condition before the loss. (a) Market Value: Indemnification can be calculated on the basis of the effect the damage had on the market value of a particular property. (b) Replacement Value – Depreciation: the damaged property will be replaced with similar materials that existed at the time of loss. It is not as popular as the market value approach⁴⁵.

When we compare the actual cost value and the replacement cost value approaches it is seen that in the actual cost value approach, depreciation cost is included and then pay-out is provided. While in replacement cost value policies the premiums are a bit higher. The former approach can cause distress to a business if the cost of apparatus was high initially and thus is subject to depreciation later⁴⁶.

⁴³ Combe, M. M., (2013). Insurance, Commercial Law Essentials, Edinburg: Edinburg University Press, p. 121-151.

⁴⁴ Greenberg, A. S., (1998), Ensuring Protections: Fire Insurance and the Era of Steam Engine, Cause for alarm: Fire in the 19th Ce. p. 125-151.

⁴⁵ Betts, W. C., (1903), Fire Insurance Rates and Methods, The Annals of American Academy of Political and Social Science, 1-14.

⁴⁶ *Ibid.*

2. Underinsurance

It is usually a case where the insurance amount will not cover the total damage claim. In such cases it is a cause of loss to the insured⁴⁷. This insufficiency causes monetary losses to the insured⁴⁸.

3. Limited Interest

The insured's recovery on damages depends on the interest he holds in a particular property. Insurable interest need not only arise on ownership it can also arise on a person having a financial interest in a particular property⁴⁹. This is decided by the courts on the basis of firstly when a person has limited interest in a property when there are damages caused by way of fire, the insurance company calculates the pay-out for damages for indemnification. At times there are also cases of restoration of the property to the original condition by a third party in cases of fire. These limited interest relationships can be one of bailees, mortgagor-mortgagee, trustees, part ownerships, agents, husband and wife, vendor-vendee etc.

VI. RECOMMENDATIONS

1. It is to be noted that Subrogation is necessary for the insurance industry to stay afloat: Subrogation helps replenish the funds of insurance companies to a certain extent. Subrogation does not mean the insurance companies will be able to obtain the complete amount given to the insured, however even a partial recovery from pay-out will help the health of the insurer in the long run.
2. Subrogation is a cost saver both directly and indirectly: Subrogation entails lower premiums for the insured and the insurers can be indemnified for the pay-out to the insured. This is a saver for both the insurer and the insured. The insured gets a timely pay-out, for a lesser premium and the insurer gets indemnified later by the tortfeasor.
3. Subrogation could be viewed as a deterrent from negligent behaviour: It is seen that such pursuits by insurance companies can be seen to be deterrents against negligent behaviour and damage thus caused. People would be more cautious and this would lead to lesser opportunities for accidents.
4. It is necessary to note that people who have underinsured need to take care of their own loss, otherwise this underwriting could be prone to litigation.

⁴⁷ *Sikka Papers Ltd. v National Insurance Co Ltd*, 7 SCC 777 2009.

⁴⁸ *Commercial Union Assurance Co. v. Lister*, 483 CH App CR 9, 1874.

⁴⁹ *Mcaura v. Northern Assurance Co.*, 619 HL 3 1925.

5. There needs to be a separate law to deal with real and personal property. Relationships such as vendee-vendor, lease, mortgage are oft under litigation.
6. It is important to note that in Contribution the Rate-able proportion function must be used to avoid confusion. There have been several suits between insurance companies when it came to contribution as to what extent and whether the other company was liable. Thus, it is in fact better if the insurance companies paid to the extent of the liability and asked the insured to claim from the other insurers.
7. The Insured must accordingly help the insurer at due times as regards the subrogation suit. There have been instances when the insurer filed a suit on behalf of the insured was unable to obtain due compensation because of date of limitation and other practicalities. This should be avoided for subrogation doctrine to work efficiently in practice.

VII. CONCLUSION

It is to be noted that in fire insurance policy a fire that is used for domestic manufacturing purposes is not a fire as long as it can be contained. Fire is meant to be the production of heat and light caused due to combustion or burning⁵⁰. It is to be noted that the valued policy which has been discussed in this paper is not prevalent much in India. It is only used for artwork, sculpture and things whose value fluctuates and is not easily determinable thus a valued insurance policy would be easier to claim. Fire Insurances policies usually do not cover fires caused due to riots, civil revolts, rebellions etc. However sometimes they might include comprehensive perils for homeowners. Fire Insurance is one of the areas of Insurance law that has always been under constant litigation. There is a need for clarity in the area of fire insurance as regards concepts such as subrogation and contribution. Especially, at times insurance companies may fail to make pay-outs for claims they believe not in the purview of the fire insurance policy. In Fire Insurance the insurer adheres mostly to the abovementioned approaches to indemnify. Fire Insurance mostly works on indemnification, however, in instances wherein the insured who owns a partial claim on a property receives pay-outs from the insurance company this at times goes against the grain of the principle of indemnity. There have been instances where a tenant for repair costs has been provided complete pay-out of total damages which at times exceeds the repair cost. And also examples wherein the tenant and the other party receives complete compensation of total cost. These are the lacunae in the area of indemnity operations in Fire Insurance and there needs to be a well-defined policy that aims to

⁵⁰ Bernstein, H. B. (1926), *Fire Insurance Terminology*, American Speech, 523-528.

cover entities such with limited interests in a particular property. Thus, to conclude fire insurance is one of the insurance policies that help in the growth of the economy due to an operation of different factors and there needs to be a more structured legislation to govern the same and delimit the extent of liability at the same time defining a comprehensive indemnity paradigm to ensure that at the end of the day neither the insured nor the insurer end up making a profit. (Well to quote Jeffrey Archer, 'Not a Penny More, Not a Penny Less'.)
