Subrogation in Insurance and Unjust Enrichment: An Examination of English and Japanese Laws from a Comparative Standpoint

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Subrogation in Insurance and Unjust Enrichment

—— An Examination of English and Japanese Laws from a Comparative Standpoint* ——

Satoshi Nakaide

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* This thesis is derived from my work on the doctrine of subrogation in insurance law, for which I was awarded a Diploma in Legal Studies from the University of Cambridge in 1996. I wish to offer my sincere thanks to Dr. Malcolm A. Clarke, St. John's College, for his valuable comments and suggestions. The thesis was written using materials available at the end of September 1995.

1. Introduction

What is insurance subrogation and for what purpose does it exist?

The aim of this thesis is to clarify the essence and the foundation of the doctrine of subrogation in insurance law.

The doctrine is complex. Difficulties in understanding it appear to arise from its character. First, the concept is not confined to insurance. Secondly, it is often a contractual term in insurance contracts. It appears that these points obscure the function of the doctrine as a device to prevent unjust enrichment where there are multiple sources of compensation.

This thesis attempts to clarify the essence of the doctrine from three angles. It examines first the concept of subrogation and its legal basis, secondly the conditions to be satisfied for subrogation and thirdly the position of the doctrine in contract. This will make clear how the doctrine is understood and applied in reality.

An examination is made of the two different legal systems of English and Japanese laws, aiming to obtain a wider perspective on this issue. After making clear the position in each legal system, the author attempts to consider the idea underlying the doctrine generally, by examining, in particular, how the doctrine relates to the prevention of unjust enrichment.

2. Subrogation under English Law

(1) Concept of Subrogation in Insurance Law

(a) Classic Definition

To begin with, let us clarify the concept of insurance subrogation[1] under English law.[2]

The word 'subrogation' is used in various contexts. It is not just confined to insurance. Literally it means 'substitution'.[3] In law, generally, the term is used to denote a technique by which one party (P) steps into the shoes of another party (X) so as to have the benefit of X's rights and remedies against another party (D).[4] The rights[5] of subrogation are given not only to insurers but also sureties, indorsers of bills of exchange and creditors of a business carried on

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1) In this thesis, 'subrogation' means 'subrogation in insurance law' i.e. the law covering the insurers' right of subrogation, unless otherwise stated.

2) This is important for a comparative study, since the basic concept is often not identical between different legal systems.

3) *The Compact Edition of the Oxford English Dictionary* (Oxford, 1987)

4) A. Burrows, *The Law of Restitution* (London, 1993), 76.

5) Goff & Jones suggest that the subrogation is in essence a remedy. Lord Goff of Chieveley & G. Jones, *The Law of Restitution* (4th edn., London, 1993), 589. However, in this thesis an expression of 'right' is used, because it is the expression commonly used.

by a trustee or personal representative.[6] What is the meaning of subrogation in insurance law? Is it identical with the above general definition? Let us examine what meanings have been conferred on the term in the context of insurance law. The classic definition is that of Brett L. J. in *Castellain* v. *Preston*[7]:

> "....as between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, 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."

This definition must be understood in the context where it was given. A vendor contracted with a purchaser for the sale of a house at a certain sum and insured it against fire. After the date of the contract of sale but before the date fixed for completion, the house was damaged by fire and the insurance company paid the insurance money to the vendor. Subsequently, the purchase was completed and the purchase price agreed was paid to the vendor irrespective of the fire damage. The insurance company tried to recover the sum paid from the vendor.

Chitty J. at the first instance decided that the claim by the insurer must fail, since there was no right to which the insurer could possibly be subrogated.[8] The purchase money was actually in the hands of the vendor. The Court of Appeal, however, reversed the decision and held that the insurer was entitled to recover the sum. Brett, L. J. gave the above definition and stated;[9]

> "...it (the doctrine of subrogation) goes much further than a mere transfer of those rights which may at any time give a cause of action either in contract or in tort...."

It is observed that Chitty J. understood the concept of subrogation as meaning to place the insurer in the position of the assured for the purpose of enforcing a right of action to which the assured might be entitled. This appears to be the same concept as the above definition in general law. Brett, L. J. applied the doctrine of subrogation to the case by extending the traditional concept.

Brett L. J. explained that the doctrine applies whether the right under the contract is fulfilled or unfulfilled, whether the remedy for tort has already been insisted upon or not, and whether any other right has been exercised or not. This means that the doctrine covers at least two distinct rights. The first is to receive the benefit of all the insured's rights and remedies against third

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6) See generally Goff & Jones, *supra*; Burrows, *supra*; P. Birks, *An Introduction to the Law of Restitution* (Oxford, 1985); C. Mitchell, *The Law of Subrogation* (Oxford, 1994); A. Tettenborn, *Law of Restitution* (London, 1993).

7) (1883) 11 QBD 380 at 388.

8) (1882) 8 QBD 613 at 615.

9) (1883) 11 QBD 380 at 389.

parties and the second is to recover from the insured any benefit received which reduces the loss for which the insured was indemnified. The latter was clearly established by this judgment. After this decision, this appears to have become the common understanding of the doctrine of subrogation in insurance law.[10] It is generally understood that the concept has been given a wider meaning under insurance law than the general definition which we have seen at the outset.

Considering the two distinct rights conferred under the doctrine, the first is a remedy (or a right) against a third party while the second is a right against the assured. In the author's view, a remedy (or a right) against the third party and a right against the assured are different in nature, though they may be justified under the same principle of ensuring indemnity. Logically it is difficult to understand that one concept contains two distinct parts. Brett L. J. covered these distinct rights under one concept.

James criticises *Preston's* case as a source of confusion, while in the main not of injustice. His analysis is that what Brett L. J. was really defining was the 'equity' and not, as he purported, 'subrogation'.[11] Mitchell's analysis is that the misuse of the term 'subrogation' by Brett L. J. has been echoed in many of the cases and in much of the academic commentary and that its long-term effect has been to introduce confusion into the heart of the law in this area.[12]

On behalf of Brett L. J. it should be mentioned that he used the term '*doctrine* of subrogation' and not just 'subrogation'. It appears that he tried to differentiate the concept of subrogation as a remedy from the underlying principle by using the term of '*doctrine* of subrogation'. It must be admitted, however, that he obscured the essence of the concept by widening its application. By doing this, his definition of the doctrine became similar to his explanation of the principle of indemnity. In fact, the following words of Brett L. J. appear to be sufficient to justify his judgement, without employing the concept of subrogation:[13]

> "The very foundation ... 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

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10) M. Parkington, N. Legh-Jones, A. Longmore and J. Birds, *MacGillivray & Parkington on Insurance Law* (8th edn., London, 1988) (hereinafter referred to as MacGillivray & Parkington) at 477 states that the doctrine confers two distinct rights on the insurer after payment of a loss. See also J. Birds, *Modern Insurance Law* (3rd edn., London, 1993) at 275.

11) Philip S. James, "The Fallacies of *Simpson* v. *Thomson*" (1971) 34 MLR 149 at 154.

12) Mitchell, *supra*, at 69. Mitchell claims that there are three remedies developed by the courts to enforce the principle of indemnity as follows; (1) the right of the insurer to recover money paid to the assured by mistake of fact, believing erroneously that the insured had suffered a greater loss than was in fact the case once the insured had received the third party's payment, (2) the right of the insurer to take over the insured's right of action against a third party in the insured's name for its own benefit and (3) the right of the insurer against the insured for as much of the money paid by the third party to the insured as more than fully indemnifies the insured for his loss. He argues that the usage of 'subrogation' for these three distinct remedies is misleading and points out that only one of them is the remedy of subrogation and the other two are not.

13) (1883) 11 QBD 380 at 386.

more than fully indemnified."

The author makes no comment on whether this is a source of confusion, as James and Mitchell point out. However, it appears that the case obscured the relationship between the subrogation doctrine and the principle of indemnity. It is not clear in that case how the doctrine of subrogation is different from the principle of indemnity. It appears that, to our regret, the issue has not been clarified in case law to this day.[14]

(b) In Statutes

Next, let us examine how the term 'subrogation' is used in statutes. The Marine Insurance Act 1906 (hereafter referred to as M. I. A. 1906)[15] section 79 sets out the rights of the insurer on payment.[16] It will be noticed that M. I. A. 1906 deals with total and partial loss separately under the title 'RIGHTS OF INSURER ON PAYMENT-RIGHT OF SUBROGATION'.

79. Right of subrogation

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

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

Apparently, M. I. A. 1906 deals with two distinct rights, i. e. the right to take over the interest of the assured in whatever may remain of the subject-matter insured and the right to subrogate to all rights and remedies of the assured in and in respect of the subject-matter insured. These two rights are similar in that both prevent compensation beyond the limit of indemnity, but the nature of the rights is different. The first right is to the subject-matter insured and the second normally against a third party. While M. I. A. 1906 uses the word 'subrogate' for the latter, does M. I. A. 1906 consider that the concept of subrogation cover both rights ?

It appears that writers on marine insurance take the view that subrogation covers both of these distinct rights.[17] A slightly different view is taken by the writers of Arnould.[18] They explain that both s. 79(1) and s. 63(1) deal with the subject of abandonment (although s. 79 is headed

14) The author's view is developed further in Chap. 4.

15) M.I.A. 1906 applies only to marine insurance. However, as regards subrogation, it has been suggested that fire and marine insurance are regarded not to differ. *Page* v. *Scottish Insurance Corp.* (1929) 33 Ll.L.Rep. 134 at 138, *per* Scrutton L.J.

16) There is no other statute covering insurance subrogation in England.

"right of subrogation" and is primarily concerned with that subject) and that abandonment is looked at from the point of view of constructive total loss in s. 63(1) and of actual total loss in s. 79(1).

Abandonment is closely related to the doctrine of subrogation, yet they differ.[19] Admitting, however, that it is generally understood in the field of marine insurance that subrogation covers two distinct rights, does such a view apply equally to indemnity insurance in general?[20] The affirmative view is taken by Ivamy who includes the right over the subject-matter in the rights in respect of which subrogation arises.[21] A different view is taken by Clarke who regards such a concept as 'salvage', as being distinct from subrogation.[22] Merkin argues that M. I. A. 1906 s. 79 confuses the concept of subrogation with the related concept of abandonment.[23]

If we take the definition of subrogation by Brett L. J. in *Castellain* v. *Preston*, the right over the subject-matter will be covered by the doctrine of subrogation, since it is a right which prevents over-compensation of the assured. On the other hand, the concept of subrogation might then deviate further from the general usage of the term which we have seen first. The author takes the view that the right over the subject-matter must be distinguished from the doctrine of subrogation when the essence of subrogation is examined closely. Usage which includes this right may have to be confined to marine insurance for the following reason:

If total loss means total loss in value, there should not be any need for considering the enrichment of the assured, and thus there is no need for the provision on the right over the subject-matter in s. 79(1). This means that a total loss recognised as such under M. I. A. 1906 is not necessarily a total loss of value whether it is classed as a constructive total loss (C. T. L.) under s. 60 or an actual total loss (A. T. L.) under s. 57. While A. T. L. was formerly called an absolute total loss,[24] it is not necessarily an absolute loss of value. If A. T. L. means a total loss of value, M. I. A. did not have to describe the situations where A. T. L. is recognised.[25] This view will be supported by showing, as an example, that M. I. A. treats a situation of loss of specie as A. T.

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17) D. O'May and J. Hill, *Marine Insurance - Law and Policy* (London, 1993) at 463 explain that the right (of subrogation) extends, in cases where underwriters have settled a total loss, to entitle underwriters to take over what may remain of the subject-matter insured. See also R. J. Lambeth, *Templeman on Marine Insurance* (6th edn., London, 1986) at 451; E.R.H. Ivamy, *Marine Insurance* (4th edn., London, 1985) at 455.

18) Sir M.J. Mustill & J.C.B. Gilman, *Arnould's Law of Marine Insurance and Average* (16th edn., 1981) (hereinafter referred to as Arnould) at para. 1298.

19) Derham comments that subrogation and abandonment occasionally have been confused in the case law, despite the differences between them. S. R. Derham, *Subrogation in Insurance Law* (Sydney, 1985) at 20.

20) If so, the position will be similar to that of Japanese law which finds two kinds of subrogation under one concept. See Chap. 3.

21) E.R.H. Ivamy, *General Principles of Insurance Law* (6th edn., London, 1993) at 498.

22) M. Clarke, *The Law of Insurance Contracts* (2nd edn., London, 1994) at 802.

23) R. Merkin, *Insurance Contract Law* (Issue 28, London, 1995) at C.4.3-03.

24) Arnould, *supra*, at para. 1134.

25) S.57.

L.

In the author's view, both A. T. L. and C. T. L. are technical concepts recognised as such in case law, reflecting commercial necessity in maritime trade. The distinction between A. T. L. and C. T. L. may not be so clear, since both are more or less an economic total loss. The distinction between them is the requirement of notice of abandonment under C. T. L. This requirement works to prevent the assured's misconduct in claiming his loss, by forcing the assured to part with his property. If not, in the author's view, M. I. A. did not have to separate C. T. L. and A. T. L., since any enrichment is prevented by s. 79(1).

If this view is supported, it will be clear that the provision of M. I. A. on the right over the subject-matter is based on the technical concept of total loss in marine insurance. If so, it may not be proper to apply the provision of M. I. A. in respect of the right over the subject-matter universally to other indemnity insurance. The right over the subject-matter may have to be examined with the concept of total loss.

(c) Short Summary

We have found that the term 'subrogation' has a broader meaning in insurance law than in general usage. This tendency is found both in case law and statute.

Broadening application of the concept may be a convenient way to achieve justice in similar situations. Certain rights may be regarded correctly as being within the doctrine. However, broadening usage will obscure the essence of the doctrine. *Castellain* v. *Preston* became a source of inflation of the concept. The author feels that English case law has not sufficiently distinguished the doctrine of subrogation from the principle of indemnity. The inflation of the concept is even greater in the M. I. A. 1906 if it is to include the right over the subject-matter under the total loss payment.

Such enlargement is not, in itself, unjust. The usage in insurance law does not have to be the same as in other branches of law. However, it may cause confusion when we examine various issues on the doctrine closely. For this reason, in the following discussion, unless otherwise stated, the author uses the term 'subrogation' for the remedies, or the methods, to prevent over-compensation as a result of double recoveries, and 'doctrine of subrogation' as covering rules and principles relating to such remedies or methods. We distinguish the insurer's right over the subject-matter under total loss payment. This right may be better seen from the point of view of total loss.

(2) Legal Basis of Subrogation

(a) Importance

The legal basis of subrogation has been a matter of some debate. One theory attributes it to a rule of equity, while another attributes it to an implied term in contracts.[26] In marine insurance, as was seen above, the basis is set out in the M. I. A. 1906. Moreover, both in marine and non-marine insurance, in practice, the doctrine is frequently expressly incorporated into the contract by a relevant clause.[27] The issue of the legal basis is important, however, even where there is an express term in the contract or a statutory provision for the doctrine.

First, even where an express term provides the basis, it may not set out detailed rules on its application, such as the rules on the allocation of recoveries and the scope of the insurer's right. How to interpret the particular term and apply the doctrine cannot be judged without considering its basis.

Secondly, the effect of an express term must be examined in the light of that basis. If it is an implied term, the application of the doctrine may be denied completely or altered freely by express terms in the contract. If it is based in equity, it may be argued that equity still applies irrespective of the contract wording, i. e. an alteration will only be permitted in so far as it is not considered to be against equity.[28]

Thirdly, the nature of the rights may affect the procedure for actions. If the subrogation right is based on an implied term, an assured may refuse to lend his name to the insurer, although he will be in breach of contract. If it is based on equity, the insurer may use the assured's name irrespective of the consent of the assured. The issue will also be important in the assured's bankruptcy or liquidation, since the insurer's rights to the proceeds may be determined by the nature of the insurer's rights.

Bearing the importance of the basis in mind, let us consider both theories.

(b) Conflicting Theories on the Legal Basis

The statement attributing the doctrine to equity existed as long ago as 1748.[29] In *Randal* v. *Cockran*,[30] a vessel was captured by the Spaniards and insurers paid insurance money. Subsequently the owners became entitled to share in the prize money from the sale of captured Spanish vessels in accordance with a Royal Proclamation. In upholding the insurer's right to receive the

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26) See Derham, *supra*, Chap. 1-2, for detailed analysis of both theories. After examining old cases, he concludes that the equitable theory is the correct one.

27) For discussion of such clauses see J. Birds, "Contractual Subrogation in Insurance" [1979] *JBL* 124.

28) James L.J. stated in *Morris* v. *Ford Motor Co. Ltd.* that "it is open to the parties to a contract of indemnity to contract on the terms of their choice, and by the terms they choose they can exclude rights which would otherwise attach to the contract." ([1973] 1 QB 792 at 812) However, in that case there was no express term that excluded subrogation right which equity would have otherwise found. Therefore, the question appears to remain unsettled.

29) Derham, *supra*, at 4.

30) (1748) 1 Ves. Sen. 98; 27 E.R. 916.

compensation, Lord Hardwicke L. C. stated;[31]

> "... the plaintiffs had the plainest equity that could be. The person originally sustaining the loss was the owner; but after satisfaction made to him, the insurer."

A basis of equity was supported in later cases.[32] Courts applied the doctrine describing it as a right in equity. Thus in *Burnand* v. *Rodocanachi Sons & Co.*, Lord Blackburn stated;[33]

> "... it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back."

On the other hand, the statement was made periodically that subrogation was a common law right.[34] However, it was not until the judgment of *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.* that the common law theory gained prominence. Diplock J. (as he was then) stated:[35]

> "The doctrine of subrogation is not restricted to the law of insurance. Although often referred to as an "equity" it is not an exclusively equitable doctrine. It was applied by the common law courts in insurance cases long before the fusion of law and equity, ... The expression "subrogation" in relation to a contract of marine insurance is thus no more than a convenient way of referring to those terms which are to be implied in the contract between the assured and the insurer to give business efficacy to an agreement whereby the assured in the case of a loss against which the policy has been made shall be fully indemnified, and never more than fully indemnified."

The issue was whether an insurer who had paid an actual total loss could recover the amount exceeding the amount of his payment under the doctrine of subrogation embodied in s. 79 of M. I. A. 1906. The plaintiff insurers argued that the right of action was vested in the insurers and exercised by the assured on their behalf and that it was the right which passed, not the proceeds.[36] Diplock J. rejected this and analysed the case as recovery from the assured of the amount of the overpayment as money had and received.

Diplock's theory (hereinafter referred to as the implied term theory) can be summarised thus, that there is an implied term in a marine insurance contract that the assured is never more than fully indemnified, that such a contractual relationship does not confer or impose any rights or liabilities beyond the contractual parties and that the claim of the insurer is regarded as a claim against the assured for overpayment. We find that in his theory the money in question for subrogation recovery is not the money received from the third party but the money which the insurer had paid in excess of the due amount under the contract. Based on this theory, he reached the conclusion that the insurer could never recover more than the amount he paid to the

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31) *Ibid.*
32) Such as *Yates* v. *Whyte* (1838) 132 ER 793; *John Edwards and Co.* v. *Motor Union Insurance Co. Ltd.* [1922] 2 KB 249; *Re Miller, Gibb & Co. Ltd.* [1957] 1 WLR 703.
33) (1882) 7 AC 333 at 339.
34) Derham, *supra*, at 5.
35) [1962] 2 QB 330 at 339.
36) *Ibid.*, at 335.

assured, despite that the insurer had born the risk of recovery and exchange rate for about 14 years.

Lord Diplock adopted the same theory in later cases. In *Hobbs* v. *Marlowe*[37], he stated that he preferred to regard the doctrine of subrogation in relation to contracts of insurance as having its origin at common law in the implied terms of the contract and calling for the aid of a court of equity only where its auxiliary jurisdiction was needed to compel the assured to lend his name to his insurer for the enforcement of rights and remedies to which his insurer was subrogated.[38] In *Orakpo* v. *Manson Investments Ltd.*, Lord Diplock reiterated that insurance subrogation is contractual in its origin.[39]

If the essence of the doctrine of subrogation is nothing more than to ensure indemnity under an insurance contract, it may be argued that there exists no positive need to set up such a doctrine, because such right can be found as implied in the contract as the essence of indemnity, without employing the concept of 'subrogation'. On the other hand, the implied term theory may have the effect of confining the application of subrogation strictly to insurance and may deny any generalisation of the subrogation doctrine as a remedy of restitution.

The implied term theory was partly supported by James L. J. in *Morris* v. *Ford Motor Co. Ltd.*[40] as well as in some academic works.[41]

(c) *Napier and Ettrick*

The issue of the basis of subrogation was raised again recently in the *Napier and Ettrick* case.[42] Preceding this action, some 246 Names belonging to the Outhwaite Syndicate at Lloyd's brought proceedings against the Syndicate's managing agent and members' agents at Lloyd's to recover losses attributable to allegedly negligent underwriting. A compromise was reached and settlement money was paid by or on behalf of the defendants to the Names' solicitors. The issues in the *Napier and Ettrick* case were how the settlement money should be apportioned between the Names and their stop-loss insurers and whether the stop-loss insurers were entitled to recoup their losses from the settlement sum before any payment was made to the Names. For the present purpose here, let us examine how the judges favoured the conflicting theories on the basis of subrogation.

Saville J. at first instance, in denying insurers' actual or contingent equitable proprietary

37) [1978] AC 16.
38) *Ibid.*, at 39.
39) [1978] AC 95 at 104.
40) [1973] 1 QB 792.
41) MacGillivray & Parkington, *supra*, at 485. Arnould, *supra*, para. 1298.
42) *Lord Napier and Ettrick* v. *Hunter* [1993] 1 AC. 713; *Napier and Ettrick* v. *R. F. Kershaw Ltd.* [1993] 1 Ll. L.Rep. 10 (CA); 1 Ll.L.Rep. 197 (HL).

interest in any of the money paid in settlement of the litigation, stated as follows:[43]

> "In short, subrogation is a right to avoid or recover over-payments under contracts of indemnity arising implicitly out of the nature and intent of such contracts."

Clearly Saville J. favoured the implied contract theory propounded by Lord Diplock. The essence of the implied contract theory is contained in the expression of Saville J. that characterises the right of subrogation as 'the right of adjustment'. Thus he stated;[44]

> "This right of adjustment is called subrogation. It arises out of the very nature of ordinary contracts of indemnity, out of the bargain made by the parties, which is to make good the loss (or part of the loss) but no more than the loss."

The implied term theory was accepted uncritically in the Court of Appeal.[45] But the House of Lords has expressed the view that subrogation originated in equity, after analysing early cases, and that the doctrine later developed as an amalgamation of common law and equity.

After examining a series of early cases, Lord Browne-Wilkinson found[46] that the decisive case in the line of equity cases was *White* v. *Dobinson*.[47] Lord Goff of Chieveley agreed with this and pointed out[48] that the case was not cited in *Yorkshire Insurance Co. Ltd.* v. *Nisbet Shipping Co. Ltd.*[49] in which Lord Diplock propounded the implied term theory.

While attributing the basis of the doctrine to equity, their Lordships recognised that the subrogation rights were embodied in the contract. Lord Goff stated that he could discern no inconsistency between the equitable proprietary right recognised by Courts of Equity and the personal rights and obligations embodied in the contract of insurance itself.[50] Lord Goff recognised that the principle of subrogation in the law of insurance might arise in a contractual context and concerning the relationship between the equitable right and the contract:, stated:[51]

> "Even so, an important feature of these cases is that the principle of subrogation in the law of insurance arises in a contractual context. ... But I do not see why the mere fact that the purpose of subrogation in this context is to give effect to the principle of indemnity embodied in the contract should preclude recognition of the equitable proprietary right, if justice so requires."

Lord Templeman showed a somewhat different analysis and did not directly conclude which of the conflicting theories be supported. After showing various promises implied in the contract, he stated that contractual promises might still create equitable interests.[52] It appears that in his

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43) [1993] 1 Ll.L. Rep. 10 at 13.
44) *Ibid*., at 12.
45) *Ibid*., at 19.
46) [1993] 1 Ll.L. Rep. 197 at 213.
47) (1844) 14 Sim. 273. The case was concerned with an interlocutory injunction on the funds of damages recovered from a third party in a collision case.
48) [1993] 1 Ll.L. Rep. 197 at 208.
49) [1962] 2 QB 330.
50) [1993] 1 Ll.L. Rep. 197, at 208.
51) *Ibid*., at 208-209.

view the equitable basis of the subrogation may not have to be a pre-requisite for the insurers' equitable remedies.

While the House of Lords unanimously decided that the insurers have an equitable lien or charge over the money recovered[53], are we to understand that the decision finally put an end to the arguments about the basis of subrogation?

It was shown that subrogation originated in equity in earlier cases, and developed in equity as well as at common law. Thus, the statement of Lord Diplock that subrogation had been applied by the common law courts in insurance cases long before the fusion of law and equity, was proven to be doubtful. It was made clear that an insurer has equitable rights over the money recovered under the subrogation doctrine. It appears that the decision strengthened the aspect of subrogation as a restitutionary measure. However, was it shown whether the *doctrine* of subrogation was based on equity in origin?

The case involved the nature of the insurer's right over the money recovered from third parties and the decision does not cover all the likely issues relating to the basis of subrogation. The House of Lords, in the author's view, did not develop arguments on the grounds for subrogation, i. e. on the reason *why* the insurer acquires such an equitable right under the insurance contract.

Considering the inconsistency in the usage of the term 'subrogation', which we observed before, any generalisation is unwise. We have seen that the concept has a wide meaning when the term is used to refer to the doctrine. If the concept of subrogation as a doctrine comes closest to the principle of indemnity, it can still be argued that the doctrine of subrogation arises from the contractual promise underlying the principle of indemnity.

To develop this argument further, however, it appears that we need to examine how the doctrine of subrogation differs from the underlying principle of indemnity and why the doctrine is applied in insurance law.

(3) Conditions for Subrogation

The previous study has shown that prevention of over-payment lies at the centre of the doctrine and the doctrine has been applied to indemnity insurance. Although this observation may be generally true, it needs careful examination. In *Burnand* v. *Rodocanachi Sons & Co.,* Lord Blackburn stated that subrogation arose "where there is a contract of indemnity (it matters not whether it is a marine policy, or a policy against fire on land, or any other contract of indemnity)".[54] However, is an indemnity contract a *precondition* for subrogation? Is there any

52) *Ibid.*, at 203.
53) Creation of constructive trust was denied.
54) (1882) 7 AC 333, at 339.

possibility that subrogation rights arise even under non-indemnity insurance if unjust enrichment exists?

To consider this question, two different, though interrelating, questions must be answered. The first is on the type of insurance. The second is the extent of indemnity required to satisfy the precondition. Insurance money payable under an indemnity insurance might not necessarily be the same amount as the assured's actual loss.

(a) Types of Insurance

The types of insurance product where subrogation rights have been allowed are marine[55], fire[56], fidelity[57], burglary[58], insurance of securities[59], solvency[60], motor[61], jewellery[62], contingency insurance against non-receipt of money within specific time[63] and export credits guarantee insurance[64]. The reason, in all these cases, is that the insurance in question is regarded as an indemnity contract. However, does the cover afford a complete indemnity for the loss?

Let us consider this question under marine insurance as a typical example of indemnity insurance. M. I. A. 1906 defines a contract of marine insurance as "a contract whereby the insurer undertakes to indemnify the assured in manner and to the extent thereby agreed..."[65] The wording show clearly that the amount payable is not necessarily the same as the assured's actual loss. It might also be different from the amount allowable as a loss under other branches of law, such as in tort. In marine insurance the sum which the assured can recover under the policy is, in the case of an unvalued policy, the full extent of the insurable value, and in the case of a valued policy, the full extent of the value fixed by the policy.[66] Obviously in the case of a valued policy, the insurance money is calculated based on the agreed sum, which might be different from the amount of the actual loss. Even an excessive over-valuation or under-valuation is binding so far as the contract remains unimpeached.[67] In the case of an unvalued policy, the full extent of the insurable value is payable. This amount, however, does not

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55) M.I.A. 1906, s. 79.
56) *Castellain* v. *Preston* (1883) 11 QBD 380.
57) *Employers Liability Assurance Corp.* v. *Skipper and East* (1887) 4 TLR 55; *London Guarantie Co.* v. *Fearnley* (1880) 5 AC 911.
58) *Symons* v. *Mulhern* (1882) 46 LT 763.
59) *Finlay* v. *Mexican Investment Corp.* [1897] 1 QB 517; *Dane* v. *Mortgage Insurance Corp.* [1894] 1 QB 54.
60) *Parr's Bank Ltd.* v. *Albert Mines Syndicate Ltd.* (1900) 5 Com. Cas. 116.
61) *Page* v. *Scottish Insurance Corp. Ltd.* (1929) 33 Ll.L.Rep. 134; *Horse, Carriage and General Insurance Co.* v. *Petch* (1916) 33 TLR 131.
62) *Allgemeine Versicherungs Gesellschaft Helvetia* v. *German Property Administrator* [1931] 1 KB 672.
63) *Meacock* v. *Bryant & Co.* [1942] 2 All ER 661.
64) *Re Miller, Gibb & Co. Ltd.* [1957] 1 WLR 703.
65) S. 1.
66) S. 67 (1).
67) S. 27(3) & 68(1).

necessarily correspond exactly to the actual loss. Insurable value is calculated based on the provisions in M. I. A. 1906[68], which may be different from the assured's actual loss depending on the situation.[69]

Discrepancies between the insurance payment and the actual loss can exist, whether in marine or in other indemnity insurance. Firstly, valuation for insurance may be different from that for the assured. Secondly, consequential loss is normally not covered by insurance, whether or not it is such that may be allowed as part of damages under other branches of law, unless the policy specifically provides for it. Furthermore, insurance does not normally cover any economic loss or loss for mental suffering. Thirdly, an express term in the policy may restrict the amount payable by insurance. An excess or deductible clause requires the assured to bear a certain portion of the loss himself. There may be a limit of liability clause, limiting the total liability of the insurer.

These situations do arise. Insurance, even though it may be called indemnity insurance, does not necessarily provide perfect compensation for the loss. The payment is always calculated based on the express or implied terms in the contract. We may conclude that the types of insurance for which the court will find rights of subrogation are not necessarily contracts which afford perfect indemnity.

Next, let us examine types of insurance where subrogation rights were denied.

It was decided that subrogation did not apply to life insurance[70] or personal accident insurance.[71] Value on life is something difficult to measure. Insurance on life is certainly different from a contract of indemnity. However, in some situations such insurance may be arranged to cover a certain amount of measurable loss.

One example is a life insurance taken by a creditor on the life of his debtor.[72] Lord Ellenbrough held such an insurance to be a contract of indemnity.[73] However, the decision was overruled in *Dalby* v. *India and London Life Assurance Co.*[74] In that case, a creditor effected on the life of his debtor life insurance containing the following clause:

> "And be it further enacted, that, in all cases where the insured hath interest in such life or lives, event or events, no greater sum shall be recovered or received from the insurer or insurers, than the amount

68) S. 16.
69) For example, under M.I.A. 1906, insurable value on a ship is calculated based on her value at the commencement of the risk. It may be different from the market value at the time of loss. Insurable value of cargo is calculated based on the prime cost, expenses of shipping and insurance charges. This C.I.F. value is most likely different from the market value at the destination.
70) *Solicitors' and General Life Assurance Society* v. *Lamb* (1864) 1 H&M 716.
71) *Theobald* v. *Railway Passengers Assurance Co.* (1854) 10 Exch. 45.
72) Another example is a "keyman" policy effected by employers on the lives of their employees.
73) *Godsall* v. *Boldero* (1807) 9 East 72.
74) (1854) 15 CB 365.

or value of the interest of the assured in such life or lives, or other event or events."

The issue was whether the circumstance of the interest of the assured in life ceasing before the death invalidated the contract or not. Parke B. overruled *Godsall* v. *Boldero*[75] and held that the circumstance in question did not invalidate the contract and stated that the contract commonly called life-assurance was a mere contract to pay certain sum of money on the death of a person, in consideration of the due payment of a certain annuity for his life.[76]

Certainly, life insurance has characteristics different from a contract of indemnity. However, is it always so, theoretically? Does the situation for enrichment not occur under life insurance? Where life insurance is intended for a certain ascertainable economic loss, double recoveries from collateral sources might bring some enrichment to the assured. Is the decision convincing?[77]

Generally, life insurance is arranged to compensate the loss of earnings and other economic losses of the dependants. Life insurance must be distinguished from a gambling or a wagering policy because of the requirement of an insurable interest. Insurable interest is an economic interest which is quantifiable, although the amount may not be specific in life insurance. As far as the life insurance affords economic compensation, enrichment can arise, depending on the circumstances, if the assured recovers compensation from collateral sources. In many cases, it may not be regarded as 'unjust enrichment' if the assured has further unmeasurable losses, and if the premium which the assured paid to the insurer has the nature of savings. However, in a case where a creditor arranges an insurance on his debtor, double recoveries might bring unjust enrichment to the assured, since the assured in such a case does not suffer any unmeasurable loss, for example, mental suffering.

In the writer's view, Parke B. 's reasoning appears to be based on the structure of life insurance rather than on the element of enrichment. Certainly the assured paid the premium for it, which may be characterised as an annuity.[78] However, can we neglect any enrichment if the assured paid a premium for it? Is the premium for life insurance so different from that of other insurance?

The decision in *Dalby* v. *India and London Life Assurance Co.*[79] is clearly binding and has not been overruled. Despite possible criticisms, however, the decision appears to have had merits in

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75) (1807) 9 East 72.

76) (1854) 15 CB 365 at 387.

77) Kimball and Davies (1962) 60 Michigan L. Rev. 841 criticise this decision and argue that the life insurer should be subrogated to its insured's claim against the estate of the debtor. They argue, in essence, that the purpose of life and accident insurances is to compensate a pecuniary loss and that these insurances should also give rise to a subrogation right.

78) Life insurance is often a long-term policy. However, there is also a short term life insurance. In the latter case, the premium may not have the characteristics of 'annuity'.

79) (1854) 15 CB 365.

contributing to convenience in business transactions. If the criterion is enrichment in each case, parties to the contract have to find whether enrichment exists or not in each case. Clearly this is not easy because of the difficulties in ascertaining various types of loss, especially in case of insurance on life. The classification by product type may have promoted convenience by making the position of the parties clear in advance.

However, such a criterion based on the characteristics of the product may also have a disadvantage in the trend of a new line of products. Various types of insurance have been created in the areas of liability, expense insurance and medical or accident insurance. Insurance cover tends to afford comprehensive coverage on different types of loss. Growing financial markets together with an increasing interrelationship between insurance and finance may further accelerate any combination of insurance products and other financial products. It is becoming difficult to classify various types of insurance into traditional groups. This may call into question whether the traditional criterion of subrogation rights continue to be a convenient method for preventing unjustness in insurance transactions.

(b) Extent of indemnity

Next, let us consider the extent of indemnity required to satisfy the precondition. The insurance payment does not necessarily cover the assured's whole loss. Questions arise whether the assured must be fully indemnified under the terms of insurance or whether he must be completely compensated for his loss before the subrogation rights arise. The question was left open in *Page* v. *Scottish Insurance Corporation, Ltd.; Forster* v. *Page*.[80] The question is solved in practice at least partially by using express subrogation clauses or by way of an assignment of the assured's rights. However, the issue remains important, as it goes to the fundamental question of the relationship between subrogation and unjust enrichment in general.

In the area of marine insurance, the issue has been solved, at least partially.[81] Where a policy is a valued policy, insured value is treated as conclusive between the insurer and the assured. Therefore, the insurer is entitled to be subrogated to the assured's rights even though the assured is not fully indemnified because of the difference between the insured value and the actual value of the insured thing. This rule has been firmly established in case law,[82] although there exist criticisms of it.[83]

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80) (1929) 33 Ll. L. Rep. 134, at 138 per Scrutton L.J.

81) Following arguments are where there is no specific clause in the policy. Many of the practical difficulties are solved by the use of standard clauses, such as the Institute Clauses.

82) *Thames & Mersey Marine Insurance Co. Ltd.* v *British & Chilian Steamship Co. Ltd.* [1915] 2 KB 214, [1916] 1 KB 30; *North of England Iron Steamship Insurance Association* v. *Armstrong* (1870) LR 5 QB 244.

83) See Arnould, *supra*, para. 1304; Goff and Jones, *supra*, at 611.

This rule is beyond doubt where there is a difference between the insured sum and the actual value. However, it appears to be open to doubt as to the extent the insurer is subrogated to the assured's position where the assured has uninsured further loss, different in kind. For example, an insured vessel is damaged and the ship owner suffers consequential loss such as a loss of hire or other incidental charges. What is the position of the insurer who paid for the property damage only? How is the money from the negligent party apportioned between the insurer and the assured, if the recoveries are less than the aggregate claims of loss and if it is not clear how the recovery money corresponds to the insurance payment?[84] Situations where there is an excess or a deductible must also be examined. Does the assured have priority over the recovery money in recouping his uninsured loss? The issue is important not only for non-marine insurance but also for marine insurance.

As we have seen, *Napier and Ettrick*[85] involved a question on the apportionment of recovery money, in addition to the issue of the nature of insurer's rights to the recovered money. Does the case answer this question?

Because of the various patterns of insurance arrangement involved, the Court examined the issue based on relatively simple hypothetical figures. The insurance in question was a liability cover with an excess of 25, 000 and limit of liability of £125,000. The assured suffered a loss of £160,000 and received from the insurer £100,000 representing the sum of £125,000 less excess. The liability of the third party was compromised and £130,000 was paid to the assured's solicitors. The issue was how to apportion this £130,000 between the assured and the insurer.

At first instance, Saville J. decided that the assured would be entitled to be fully indemnified for his loss of £160,000. The assured received from his insurer £100,000, thus he is entitled to keep £60,000 and pay £70,000 to the insurer. Saville J. stated that the question to be asked was whether the recovery together with the indemnity would more than compensate the assured for the loss.[86] As we have seen, Saville J. regarded the subrogation right as the right to avoid or recover over-payments.[87]

However, this view was rejected in the Court of Appeal[88] and House of Lords. Lord Templeman criticised the decision of Saville J. and stated;[89]

> "This analysis however ignores the fact that the Name agreed to bear the first £25,000 excess of any loss. The problem must, in my opinion, be solved by assuming that the Name insured the first £25,000

84) Such a situation may arise where the basis adopted in the calculation of damages is different from that of insurance or where the liability of the third party is compromised by a lump sum figure.
85) [1993] 1 Ll.L.Rep. 10; [1993] 1 Ll. L. Rep. 197.
86) *Ibid.*, at 17.
87) *Ibid.*, at 13.
88) [1993] 1 Ll. L. Rep. 10.
89) [1993] 1 Ll. L. Rep. 197 at 199.

of any loss and insured the excess over £125,000 as well as insuring the £100,000 payable under his policy with the stop loss insurers. ... In my opinion the Name is not entitled to be in a better position than he would have been if he had taken out the three insurances I have mentioned."

The Lords held that the settlement money was to be allocated from the top down; first to the Name against the uninsured portion, second to the insurer and third, if any, to the Name for the excess portion.

In the light of this decision, how can our question be answered? Primarily, the case involved a situation where the assured could not receive full compensation because of the excess clause in the policy. As an analogy, this decision may be applied to other situations where the assured is not fully compensated because of an express term in the policy.

However, as Birds comments,[90] it can be argued that it may not be easy to show in other contexts that the assured 'agreed' to bear the amount of excess, especially where there is no choice. This argument is persuasive especially for insurance mass-produced for consumers. In fact, it may not be possible for the assured to insure only for his uninsured excess with another insurer, unless the original insurer agrees to cover without excess.

In the author's view, this decision deals only with the case of liability insurance where the coverage was provided in layers. The rationale might still produce a different result with other types of insurance. The reasoning of Lord Templeman was to consider that three different policies existed in effect. Let us consider a simple situation where the assured suffers fire damage to his house. He insured his house for an amount less than the actual value. He also suffers incidental loss. If we consider this situation as three possible insurances existing, the assured is his own insurer for the amount of the difference between the actual value and the insured sum as well as for the incidental expenses. These insurances are mutually independent, different from the liability policies in layers. If the recoveries are insufficient to cover all these losses and if it is not clear as to which part of the loss the recovery money is directed, the recovered sum may have to be apportioned proportionally among three insurances.

The alternative view is to separate the transaction between the interest which is intended to be covered by insurance, i. e. the insured interest, and the interest which is not. In the above example, the insurance is arranged to cover the interest in the value of the house. Therefore, the portion for the uninsured incidental expenses is outside the insurance in question. It may be justified that the assured is his own insurer for such uninsured loss. It may be reasonable to apportion the recoveries between the assured and the insurer proportionally based on each loss. However, for the amount of value which remained uninsured because of the difference between

90) Birds, *supra*, at 280.

the sum insured and the actual value, the assured may have to have priority in recoveries, unless there exists clear intention of under-insurance, because he covered such interest by his insurance.

The third view is that the assured has priority for any loss until his entire loss is compensated. This argument will be supported if we consider unjust enrichment as the reason for subrogation. However, it appears that the reasoning adopted in *Napier and Ettrick* does not support this idea. Moreover, this view may have weaknesses, because it is not always easy in each case to ascertain various types of loss. In the above example, the assured might insist on retaining all of the recovered money, alleging that he has further economic or mental loss which makes his position not 'enriched' in any event.

In any case, the reasoning of Lord Templeman suggests to us that subrogation rights arise even where the assured has not been compensated completely.

(c) Short Summary

What can we infer from our examination of the conditions of the subrogation rights?

Types of insurance where subrogation is applied are those commonly described as indemnity insurances. However, these insurances do not necessarily provide perfect indemnity. On the other hand, enrichment can arise in a type of insurance where subrogation was denied. We may conclude therefore that the right of subrogation arises not from the particular circumstance of unjust enrichment but rather from the characteristics of the insurance product. This observation is reinforced by our observation that the insurer is entitled to subrogate to the assured's position even where there remains uncompensated loss, such as where there is an excess clause.

It may be generally true that subrogation was created to prevent unjust enrichment. However, this statement appears not to be the entire truth when we consider the conditions for the right. Convenience in commercial transactions may also lie behind it.

As it seems, the dispute over the origin of subrogation has been settled in *Napier and Ettrick* in favour of equity. However, analysis of the conditions for subrogation shows us that in reality the application of the doctrine has been limited to certain situations. This reality requires us to examine the role of subrogation as a device to prevent unjust enrichment in a more precise manner. Before going into this analysis, however, let us investigate how the doctrine is modified in contract.

(4) Alteration of the Doctrine of Subrogation by Contractual Agreement

(a) Types of Contractual Agreement

It is commonly understood that insurers' rights of subrogation may be modified or excluded by an express term in the policy.[91,92] It is also accepted that insurers may waive their subrogation

rights or agree mutually not to exercise their rights. An example of the latter is the 'Knock-for-Knock' Agreement among British motor insurers.

May we understand, then, that parties may alter the application of the doctrine freely? In this subsection, let us consider the effects of the various contractual agreements in order to examine the function of the doctrine.[93] The various agreements may be classified into two types. One is the agreement between the insurer and the assured. Such an agreement may be incorporated into the insurance contract as an express term or may be made after a loss.[94] The other is the agreement between the insurer and a third party, such as the 'Knock-for-Knock' Agreement.

(b) Agreement between the Parties to the Insurance Contract

Indemnity insurance policies often contain a clause on the rights and duties of the parties concerning possible recoveries against third parties. Many of them are no more than a restatement of the rules of law. There are, however, clauses which seemingly aim at modifying the application of the doctrine of subrogation.

Probably, the clauses which are most widely used are those reinforcing the insurers' rights and the duties of the assured. An example is a clause which extends the application of the subrogation doctrine before indemnification by the insurer. These clauses impose on the assured greater duties than those which the law otherwise requires. While the court may interpret them *contra proferentem*, these clauses are considered legitimate. This type of contractual alteration may not greatly change the financial position of the parties.

Some policies contain a clause requiring the assured to assign his rights against third parties to the insurer. This will have the dynamic effect of eliminating subrogation and creating totally different legal rights. Generally, a bare cause of action, whether in tort or in breach of contract, is not assignable.[95] However, in the case of insurance, an insurer has a genuine and substantial interest in recouping payment of the assured's loss which was caused by the responsible party. For this reason, assignment in connection with insurance is considered to be legitimate.[96]

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91) MacGillivray & Parkington, *supra*, p. 491. Birds, *supra*, at 275 & 289.
92) *Morris* v. *Ford Motor Co*. [1973] 1 QB 792 at 812 per James L.J.
93) See generally, Birds, "Contractual Subrogation in Insurance" [1979] *JBL* 124.
94) The latter example is a 'letter of subrogation' or a 'subrogation form', used widely in marine cargo insurance. Strictly, this is not an agreement, being a form of a letter signed by the assured addressed to the insurer. By signing the letter, the assured is estopped from denying the rules stated in his letter. For a standard form used in London market, see O'May and Hill, *supra*. Appendix 39.
95) Because of the principles of maintenance and champerty. Traditionally, assignment of choses in action was not permitted at common law, while equity permitted assignment in certain situations. Section 25 (6) of the Judicature Act 1873, thereafter enacted into section 136 of the Law of Property Act 1925, gave a statutory effect to the assignment. However, assignment is not permissible for a bare cause of action in contract or tort, except in certain situations including insurer's recovery.
96) See *Compañía Columbiana de Seguros* v. *Pacific Steam Navigation Co*. [1965] 1 QB 101 at 121.

Assignment must be made pursuant to section 136 of the Law of Property Act 1925.

Assignment has advantages for the insurer, since he can exercise his rights whether or not he indemnifies the assured fully and can receive recoveries including any windfall, provided that the assignment is valid.[97] Furthermore, the insurer's position is better in case of the assured's bankruptcy after the assignment.[98] One disadvantage may be the publicity. Generally, recovery actions do not create a favourable image for the insurer. Another difficulty is the prohibition on partial assignment of choses in action in English law. As seen, insurance payment does not necessarily cover the assured's actual loss. Can the insurer acquire the assured's rights by assignment, where, for example, the insurer paid a claim for loss of property but not for any consequential loss? Under assignment, the insurer's recovery is not limited to the amount of his payment. Thus, where the assured has a further loss, assignment might profit the insurer. While the insurer might not attempt to recover beyond the amount of his payment, it may be argued that the assignment is in itself void in such situations.[99]

Despite the legal differences between assignment and subrogation, it appears that a clause which substitutes assignment for subrogation may not, after all, greatly change the financial status of the parties.

Next, let us consider a clause excluding the insurer's subrogation rights, partially or entirely, generally known as a 'waiver clause'. It may be a detailed clause or a short phrase in a slip affixed to the policy stating that "the insurer hereby waives his subrogation rights". An example of a partial exclusion is a clause which specifies the group of people against which the insurer waives his rights of subrogation.[100]

Since a 'waiver clause' is an agreement whereby the insurer agrees not to exercise his rights, its inclusion is arranged for the benefit of the assured. In return, the assured may have to pay a higher premium.[101] The intention of the assured may be to protect the party responsible for

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97) Mr. Justice Roskill (then he was) stated, *per curiam*, in the *Compañía Columbiana de Seguros* v. *Pacific Steam Navigation Co.*, above at 121, that underwriters, suing as assignees under a valid legal assignment, could recover more than their payment. It was argued for the plaintiff that where the underwriters recover more than their payment, the underwriters would hold the excess as trustee for the assured. Mr. Justice Roskill stated that he saw "no justification for imposing such a trust upon an assignee under a valid legal assignment".

98) Under the doctrine of subrogation, the insurer has a proprietary right to the recovered money. See *Lord Napier* v. *Kershaw* [1993] 1 Ll.L.Rep. 197. However, if the assured goes into liquidation and ceases to exist prior to the recoveries, the insurer is not able to pursue the recovery. Under assignment, the insurer's right is not lost even in such a case as the assured's liquidation after the assignment.

99) Sir John Megaw in *Brownton Ltd.* v. *Edward Moore Inbucon Ltd* [1985] 3 All ER 499, at 506, stated that an agreement to assign was not champertous merely because the assignee, or the assignor, or both, had as a part of his genuine commercial interest the contemplation that he would be better off as a result, although, if there were a prospect of excessive profit, that might properly be a factor in deciding whether the commercial interest was genuine.

100) Such as the 'Waiver of Subrogation against Employees Clause' approved by Lloyd's Underwriters' Non-Marine Association (10/10/57 N.M.A. 1088)

the accident from the insurer's subrogation claim. Normally, under such arrangements, the assured will not pursue his claims collaterally against both the insurer and the responsible third party. However, is the assured entitled to do so under the waiver clause?

In English law, the payment of insurance money to the assured does not exempt or reduce the liability for damages of the negligent party.[102] The assured is entitled to recover in full from the responsible party irrespective of the insurance payment.[103] The insurer cannot deduct from his payment the amount of money which the assured can recover in future from the third party,[104] unless the contract so provides.[105] If the assured's loss has been compensated by the third party before he claims from the insurer, the insurer is entitled to deduct from his payment such part of the loss as is already compensated,[106] because the assured has not suffered that 'loss'. The waiver clause will not change these rules. Then if the assured recovers money after the insurance payment, can the insurer insist on any recovery or the refund of money from the assured? Obviously, the insurer has difficulty in alleging his rights on the ground of subrogation, because he expressly waived them. A waiver clause does not usually contain any express requirement by the assured not to claim any damages from the responsible party.

Various arguments can be advanced on behalf of the insurer.[107] First, the insurer may argue that he has paid the insurance money based on the promise of the assured that he would not recover from the third party and that such a promise is implied either in the contract of indemnity or in the particular waiver clause. In this case, the insurer would ask the assured for a refund of insurance money on the ground that the promise was broken by the assured.[108]

A second possibility is for the insurer to argue that the insurer paid the insurance money on the basis that the assured had suffered the loss and to claim the refund of his payment on the ground of payment by mistake because the assured did not in the end suffer the loss.

A third possibility is for the insurer to argue that the waiver of subrogation means the waiver of positive action by the insurer only, not the total waiver of various rights covered by the doctrine of subrogation, and insists on his right to the proceeds from the third party. In this

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101) Individual arrangements vary depending on the situation. However, the premium under a waiver condition may be higher, theoretically, than the premium for coverage where the insurer has the rights of subrogation, so far as the risk involves a substantial possibility of recovery.

102) *Bradburn* v. *GWR* (1874) LR 10 Exch. 1.

103) The position is different in other jurisdictions, such as in Japan. See Chap. 3.

104) *Collingridge* v. *Royal Exchange Assurance Corp.* (1877) 3 QBD 173.

105) *Construction Finance Co. Ltd.* v. *English Insurance Co. Ltd.* (1924) 19 Ll.L.Rep. 144.

106) *Hamilton* v. *Mendes* (1761) 2 Burr 1198; *Burnand* v. *Rodocanachi Sons & Co.* (1882) 7 App Cas 333; *James Nelson & Sons Ltd.* v. *Nelson Line (Liverpool) Ltd.* [1906] 2 KB 217.

107) Following arguments are the author's view. They are not directly supported by cases.

108) If the assured stated that he would not pursue his claim against the third party in order to persuade the insurer to agree on the waiver clause, it will be possible to argue misrepresentation or a breach of good faith on the assured.

argument, it is the proceeds from the third party that the insurer claims against the assured.

Against the above, the assured might argue, first, that the waiver clause does not create any duties on the side of the assured other than the payment of a higher premium.

Secondly, the assured might argue that the waiver of subrogation rights means, when agreed expressly between the parties, a total waiver of any kind of subrogation right, unless otherwise stated in the clause. The assured might cite the subrogation doctrine in *Castellain* v. *Preston*[109] to the effect that the rights of subrogation are not confined to a mere positive recovery action.

Thirdly, the assured might argue that the assured has paid a consideration for this special deal, which changes the strict application of the principles of indemnity. The assured might further argue that it would bring the insurer 'profits' if the insurer benefits from the recovery, so far as the additional premium for the waiver clause was calculated on the basis that the insurer could not recover any money from the third party.

In *Castellain* v. *Preston*, it was stated that the assured "shall never be more than fully indemnified".[110] However, it is generally accepted that parties to an insurance contract may modify the principle of indemnity by the express terms in the policy,[111] so far as the agreement is not illegal or against public policy.[112] The argument that the principles of indemnity may be altered might support the arguments for the assured. However, if we adopt them, this may result in a curious situation. The amount of money which the assured recovers may vary, depending on whether the assured claims first from the insurer or not.

The issue here is a matter of interpretation of the clause. If the intention to modify the nature of an indemnity contract is clear, judging from the contract as a whole, the waiver clause may have to be interpreted as the insurer's waiver of any subrogation right. However, if the intention is not to alter the nature of the indemnity contract, the waiver clause must be construed so that it will not be against the principles of indemnity, i. e. the assured must never be overcompensated by collateral sources. Waiver clauses may have to be interpreted as the waiver of positive action by the insurer only. Nevertheless, this illustrates the confusion over the doctrine of subrogation, which we have observed in our previous discussion. It is confusing if we have to interpret the concept of subrogation differently depending on whether it is used in the affirmative or in the negative context.

In the above discussion we presupposed that the insurer would insist on recovery from the assured. For a complete analysis, however, we must consider a situation where the insurer is not

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109) (1883) 11 QBD 380.
110) *Ibid.*, at 386.
111) *Maurice* v. *Goldsbrough Mort & Co.* [1939] AC 452.
112) *Fender* v. *St. John-Mildmay* [1938] AC 1 at 36.

interested in the assured's conduct after payment. In fact, it is rare that the insurer keeps watching the assured's conduct after payment where he has waived subrogation rights. How will the insurer know if the third party pays some compensation to the assured?

Where the assured is collaterally compensated, and if the insurer does not claim the refund of his payment or a recovery from the third party, the assured will be compensated for more than his loss. The assured will be enriched by the accident. Such enrichment may not be welcomed socially. But, must it be prevented?

Since the subrogation rights are the rights of the insurer, it is up to the insurer whether to exercise the rights or not. Parties to the contract may agree to exclude the insurer's rights. If the parties so agree, the assured is placed in a position to potentially recover more than his loss. However, is the enrichment 'unjust'? If so, then, at whose expense?

If the intention of the exclusion of subrogation rights is clear, it is difficult to argue that the assured's enrichment has been at the expense of the insurer. It will be argued, on the contrary, that it would be unjust if the insurer is able to receive both additional premium and benefit of the recovery.

One solution might be that the third party benefits from the waiver clause and is relieved from his liability for compensation where the assured's loss has already been compensated by other sources.[113] Against this, however, the assured may argue that it is 'unjust' if the negligent third party benefits at the expense of the assured.[114] The assured may argue that it is always the assured's option whether or not he pursues his right against the third party. Situations where the subrogation rights are excluded or waived are not simple.

The foregoing discussion may, by now, have shown the limits of subrogation as a method of adjusting collateral sources of compensation. Subrogation doctrine becomes effective to prevent the enrichment of the assured only when the insurer exercises his rights of subrogation. If the insurer waives his rights, the result will be that the assured is placed in a position where he could be more than fully compensated for the loss, if the assured so wishes. This appears to be an inevitable consequence of the legal structure which formulates subrogation as the 'rights' of the insurer.[115]

(c) Agreement among Insurers - 'Knock-for-Knock'

Next, let us consider the 'Knock-for-Knock' Agreement[116], once commonly used among British

113) In any event, English law does not take this approach.
114) Because the party who paid the consideration for the waiver clause is the assured.
115) This legal structure is contrasted to the Japanese law. See Chap. 3.
116) See Standard Market Wording (Revised 1/5/90).

motor insurers, as an example of an agreement between the insurer and the third party. It is a reciprocal undertaking between insurers. Under the agreement, if two vehicles collide, each insurer pays the repair costs of his assured and does not exercise his subrogation claim against the other. In effect, the agreement means the mutual waiver of subrogation rights between insurers. The system greatly reduces the insurer's administration costs in recovery actions and such reduction of expenses may also benefit the assured.

The agreement creates a situation similar to a legal regime where each victim recovers compensation from his own insurance. It has the effect of changing the allocation of loss under tort law. The advantages and disadvantages of the system must be considered from the point of view of the allocation of loss in society as well as the deterrence of accidents.[117] In this thesis, however, let us focus our discussion on how the Agreement affects the financial position of the parties. Let us consider a collision of two vehicles owned by A and B, insured with X and Y respectively, under comprehensive conditions covering both physical damage of his own vehicle and third party liability.

Since the agreement is between insurers, the assured is not prevented from suing the other party, liable in tort for negligence.[118] If A claims against B for his loss including the repair costs covered by his own insurance and recovers compensation for it, X may exercise his rights against A, under the doctrine of subrogation, because X has not waived his rights of subrogation as between X and A. X must, however, refund the money so received from A to Y who in fact paid the money to B under the agreement. No enrichment arises to A under this agreement. Nonetheless, there is a possibility that A is adversely influenced by the scheme if his future premium is affected by this system.[119]

How, then, is B affected by the scheme? B is relieved from the liability to pay damages for A's loss, to the extent that A's loss is covered by X's insurance. The more fully A's loss is covered by A's insurance, the greater the benefits B may gain from this scheme.

This brief example highlights the secondary effect of subrogation, i. e. the prevention of unjust exemption of the responsible party. The mutual waiver of subrogation might weaken the effect of punishing the guilty. It may, in a limited degree, 'enrich' the tortfeasor by lessening his liability. A similar exemption arises also under the waiver clause between the assured and his insurer. However, in that case, the exemption, if so made, is the intention of the assured, i. e. the

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117) See generally: Fleming, "The Collateral Source Rule and Loss Allocation in Tort Law" *California Law Review* vol. 54 (1966) 1478; Fleming, *The Law of Torts* (8th edn., 1992); Cane, *Atiyah's Accidents, Compensation and the Law* (5th edn., 1993).

118) *Morley* v. *Moore* [1936] 2 KB 359, approved in *Hobbs* v. *Marlowe* [1978] AC 16.

119) For example, where the accident is caused by the 100% negligence of the other party, the assured might lose his no-claim bonus because of receiving insurance money from his own policy. However, the insurer may, in such a case, allow the no-claim bonus of the assured.

victim in the accident. Under the 'Knock-for-Knock' Agreement, B benefits from the fact that his insurer, by chance, has entered the Agreement with A's insurer.

A subrogation agreement between insurers is in itself valid. The insurers are, under liability insurance, the ultimate bearers of the loss. However, it may be found that the agreement between X and Y affects the balance of the relationship between A and B. Naturally, the relationship between X and Y is not identical to that of A and B. The relationship between A and B is governed by the law of tort. The balance between X and Y is based on a different consideration. The system is well balanced between X and Y, where the portfolio of insurance products is similar between X and Y, not only with regard to the type of insurance but also the nature of the risk involved.[120)]

It will be readily understood that the system can not survive if this economic balance is not maintained. This is why more and more insurers are now withdrawing from the 'Knock-for-Knock' Agreement, with the emergence of insurers with smaller portfolios of comprehensive coverage.

(d) Short Summary

The analysis of situations where subrogation rights are denied or waived has brought out the function and the importance of the subrogation doctrine. The denial or waiver potentially causes a situation where either the assured is enriched by the loss or the liable third party benefits by being relieved from paying compensation. This is because subrogation works to adjust the relationships of at least three parties involved.

Generally, it is understood that the doctrine may be altered freely or denied completely by an express agreement. This may be, but the effect of alteration must not be overlooked. The subrogation doctrine may have to be understood, rather, as a device to adjust the tripartite relationships in a situation where the victim has collateral sources of compensation. If we attach importance to this function, we will be less confident in saying that the use of the subrogation doctrine should rest entirely upon the choice of the parties to the agreement.

120) If X underwrites comprehensive coverage for 90% of his whole business, while Y of only 50%, the rest being third party liability cover only, Y has a substantial advantage over X under the Agreement. Similarly, if X's assureds have, on average, more expensive cars than Y's assureds, Y has an advantage over X.

3. Subrogation under Japanese Law

(1) Concept of Subrogation

(a) General Structure of Japanese Law[1]

Japanese law has a codified law system and statute law is the primary source of law. Among various statutes, the Constitution and the five major statutes called Codes[2] form the basic framework. Written laws are hierarchical and the Constitution is regarded as the Supreme Law of the nation, followed by the statutes enacted by the Diet, thereafter, cabinet orders and ministerial ordinances. In applying the statutes, provisions of statutes of a specialised nature have priority over those of a more general nature.

Article 41 of the Constitution provides that the Diet is the highest embodiment of State power and that it shall be the sole law-making body of the State. However, this does not mean that legal sources other than statutes made by the Diet have no significance. Judicial precedents as well as administrative practices play an important role in complementing the rather general provisions of the Codes and other basic statutes.[3] Precedents, in practice, affect subsequent decisions of the courts and may ultimately create 'judge-made' law. Scholars' opinions are not regarded as a source of law, but they are also important. Judges study these opinions in forming their opinions. Moreover, law professors play an important role in the process of making new laws.[4] Now, let us look at the statutes covering insurance transactions.

First, civil activities are generally covered by the Civil Code. The Code is made up of five books and comprehensively covers property, contract, tort, family law and the law of succession. Insurance, as a contract, is governed by the principles in the Civil Code. Secondly, commercial activities are covered by the Commercial Code which modifies and supplements the Civil Code. The Commercial Code contains provisions on insurance contracts in Chapter X (Insurance) of Book III (Commercial Transactions) and sets forth special provisions on marine insurance in Chapter VI (Insurance) of Book IV (Maritime Commerce). Where there is an overlap between the Civil Code and the Commercial Code, the latter has priority. Where there is no applicable provision in the Commercial Code, commercial custom (*shôkanshûhô*[5]) is applied.[6] Only where

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1) For literature on Japanese law written in English, see H. Oda, *Japanese Law* (London, 1992).
2) They are the Civil Code, the Criminal Code, the Commercial Code, the Code of Criminal Procedure, and the Code of Civil Procedure.
3) Statutes are binding. However, in interpreting and applying them, courts may take a flexible approach if it is desirable to attain equitable results.
4) Normally, the relevant ministry drafts a bill to be submitted to the Diet. Where the advice of specialists is needed, or where the reform relates to the major codes, an advisory committee is formed and consulted. This committee consists of law professors as well as judges and practitioners.
5) Commercial usage established as a customary law.
6) Article 1, *supra*.

there is no such custom, the Civil Code is applied.[7] The provisions on insurance contracts in the Commercial Code were drafted in 1899 and have not undergone any fundamental amendment since then, except for partial amendment in 1911. A major updating operation is needed in view of the modern development of insurance business.[8]

(b) Concept of Subrogation

Before looking at the provisions covering subrogation in insurance, it is necessary to comment briefly on the terminological issue. As we have seen, the usage of the English word subrogation is not confined to insurance. Generally, the word subrogation corresponds to *daii* in Japanese, meaning to stand in another person's position or act on behalf of another person.[9] The use of the word daii is normally confined to the legal context. However, the word is used to denote various concepts in law in addition to the usage in insurance as shown below. Examples found in the Civil Code are; *saikensha-daii*[10], *daii-bensai*[11], *baishôsha-no-daii*[12], and *butsujô-daii*[13]. The word is also used in more general contexts, such as *daii-sôzoku*[14], *daii-soshô*[15]. The mere enumeration of the examples may sufficiently show the width of the area where the word daii is employed in law.

It will be noticed that each concept is expressed as a combination of words such as XXX-*daii* or *daii*-YYY which differentiates it from other concepts. It must be understood that each concept is self-contained although the word *daii* loosely unites these different concepts. Now, let us look at the provisions corresponding to subrogation in insurance.

The Commercial Code contains two separate Articles on the effect of insurance payment as follows:[16]

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7) *Ibid.*

8) *Hoken-hôsei-kenkyûkai*, a private academic circle studying insurance law, has published their ideas for amendment of the provisions in the Commercial Code. See *Songai-hoken-keiyakuhô-kaisei-shian oyobi Shôgai-hoken-keiyakuhô-shinsetsu-shian Riyûsho* [Proposals and reasons for amending the law on the indemnity insurance contracts as well as proposals and reasons for creating a new law on the contract of injury insurance] (Tokyo, 1982).

9) See *Kôjien*, 1993, a dictionary of Japanese words, under the heading of *daii*.

10) Article 423. No exact corresponding concept in English law. The concept is said to be the equivalent of *Action oblique, action subrogatoire* in French law.

11) Article 499 and 500. Meaning *Paiement avec subrogation* in French law or *surrogierte Erfüllung* in German law.

12) Article 422. Subrogation by the obligor. To be discussed *infra*.

13) Article 304, 350 and 372. No exact corresponding concept in English law. *Surrogation* (German), *subrogation* (French).

14) Inheritance per stirpes, inheritance by representation.

15) Derivative suit.

16) There is no official English translation. The author has tried to translate the Articles to show the original Japanese meaning. The author also relied on the following translations: Eibunhôreisha, *The Commercial Code of Japan* (1992). T. Koike (translation) *Japanese Insurance Laws, Ordinances and Regulations* (Tokyo, 1990).

Article 661

Where the subject-matter insured is totally lost and the insurer has paid the whole of the insured amount, the insurer acquires the rights of the assured on the subject-matter insured; however, where part of the insurable value is insured, the insurer's right shall be determined in such proportion as the insured amount bears to the insurable value.

Article 662

Where the loss was caused by the act of a third party and the insurer has paid to the assured the sum for which he is liable, the insurer acquires, to the extent of the amount paid by him, the rights which the person effecting the insurance or the assured has against such third party.

2. If the insurer has paid to the assured only a part of the amount for which he is liable, the insurer may exercise the right provided in the preceding paragraph only to the extent that neither the right of the person effecting the insurance nor that of the assured is prejudiced thereby.

The doctrine contained in Article 661 is called *zansonbutsu-daii*, meaning 'subrogation over the remains', while the doctrine in Article 662 is called *kyûshôken-daii* or *seikyûken-daii*, meaning 'subrogation over the rights of claim for compensation or damages'. These doctrines are covered by the wider concept of *hoken-daii* or *hokensha-no-daii*, meaning 'insurance subrogation' or 'insurer's subrogation'. There is no other provision or detailed rule on subrogation in insurance in the Code. These provisions must be understood as showing the essence of the doctrine.

Roughly, both Articles provide for the acquisition of the assured's rights by the insurer, which becomes effective by the insurance payment. The assured's rights in question under Article 661 are the rights on the subject-matter insured,[17] normally the property,[18] though not confined to it. The assured's rights in question under Article 662 are the rights of damages against a third party.[19] In both cases the insurer's acquisition arises on insurance payment by operation of law; the assured's rights are transferred to the insurer automatically.[20] The assured loses his rights to the extent of this transfer and the insurer can exercise those rights in his own name.[21]

Although these two rules are different in that the former acquisition arises only in a total loss situation and the latter arises irrespective of the degree of loss, both, in effect, transfer the assured's rights to the insurer. If this element is the essence of the concept of *hoken-daii*, from which two subsidiary rules of *zansonbutsu-daii* and *kyûshôken-daii* follow, does it in any way correspond to the English concept of subrogation?

Our analysis shows[22] that the concept of subrogation in English law is not simple. The word

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17) The existence of Article 661 may show us that the concept of total loss does not necessarily mean the total loss of value under Japanese law, although the Code does not contain any definition of total loss.

18) *Shoyûken*. Strictly, the concept is not identical with the English concept of property.

19) The claims are not confined to those based on tort. The claims based on the breach of contract are also included. See the decision of the *Supreme Tribunal, 16. 5. 1911, Minroku* (17-287).

20) No notice is required. No further action is required for completion.

21) The effect of transfer means that the assured loses his rights of damages against the responsible third party even where the insurer does not exercise his subrogation rights. See the Judgement of the *Supreme Court, 19. 1. 1989* (*Hanji* 1302-144).

22) See above Chap. 2 (1).

is used differently depending on the context. When it is used as a remedy, it represents the position where one party acts for his own benefit in the other's name. If this characteristic is the indispensable element of the English concept of subrogation, the transfer of rights from the assured to the insurer must be considered to be totally different. However, even under Japanese law the insurer is not placed in a better position than the assured. The insurer only acquires the rights of the assured to the extent of the amount of his payment and no more or less. On the other hand, in English law, when the word subrogation is used as a doctrine, a wider meaning is given to it in insurance law. From this, we may consider that the doctrine of *hoken-daii* corresponds roughly to the 'doctrine' of subrogation.[23] Moreover, the structure of Japanese law on the concept may resemble that of M. I. A. 1906 which, seemingly, covers two types of subrogation.[24]

In the following discussion, therefore, let us use the word 'insurance subrogation' for *hoken-daii* when it is used *as a doctrine*. The word 'insurance' is attached, since the usage of English word subrogation is not confined to insurance, whereas *hoken-daii* is a concept confined to insurance. As the offspring from *hoken-daii*, let us refer to the rule of the transfer of rights under Article 661 as 'subrogation over the subject-matter insured' and the rule of the transfer of rights under Article 662 as 'subrogation over the rights against a third party', respectively. When the author denotes this process of transfer, he will not use the word 'subrogate'. Instead, he will use 'transfer' or 'acquire'.

(c) Related Concepts

Firstly, attention must be drawn to a comparable provision in the Civil Code. Article 422 of the Civil Code provides for *songai-baishôsha-no-daii* [subrogation by the obligor][25] as follows:[26]

> **Article 422**
> If an obligee has received by way of compensation for damages the full value of the thing or right which forms the subject of his claim, the obligor shall *ipso jure* be subrogated into the position of the obligee in respect of such thing or right.

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23) In *Napier and Ettrick, supra*, it was not decided whether an insurer has an equitable lien or charge also in the rights of action vested in the insured person to recover from a third party. If this equitable right is allowed, the difference between English concept and Japanese concept would be smaller in practice.

24) Japanese Code was enacted earlier than M.I.A. 1906. It is said that the model for Articles 661 and 662 were Article 859 and 804 of *Handelsgesetzbuch*, the German Commercial Code.

25) The concept is said to come from Roman law and is also found in German Civil Law (Article 255 of *Bürgerliches Gesetzbuch für das deutsche Reich, BGB*) However, Article 422 is not exactly the same as Article 255 of *BGB*. See generally M. Okuda (ed.), *Chûshaku-minpô* [Commentary on the Civil Law], vol. 10 (Tokyo, 1987), 717.

26) There is no official English translation. The writer adopted the translation by the Eibunhôreisha, *The Civil Code of Japan* (Tokyo, 1992).

In the case of payment of damages,[27] full compensation is the condition for this type of subrogation.[28] The Article covers two kinds of subrogation, one in respect of a thing and another in respect of a right. The wording "the obligor shall *ipso jure* be subrogated into the position of the obligee"[29] is interpreted as meaning that the right in question transfers from the obligee to the obligor automatically upon the fulfilment of the condition. No notice or procedural step is required for that transfer.[30] How does this rule relate to the doctrine of insurance subrogation?

Certain similarities are found in the rule. The situations covered are, in both Articles, compensation of loss. What is intended to be precluded is enrichment which might arise by the compensation. In this respect, both Articles are, broadly speaking, intended to further common objectives in similar situations. However, the situations covered are not identical in that the payment of insurance money is in the nature of 'debt'; its payment is the purpose of the insurance arrangement for which the assured has paid premium, whereas the payment of damages is for breach of the intended promise. This difference appears to be important when we come to study the doctrine closely. In any event, as has been explained, each doctrine is self-contained and it is generally accepted that no recourse shall be had to Article 422 of the Civil Code in interpreting Articles 661 and 662 of the Commercial Code, since the Commercial Code has priority over the Civil Code. Whereas private insurance activities are covered by the Commercial Code, the application of Article 422 in the insurance context is confined to limited situations where the Commercial Code does not apply, such as the case of insurance payment under the Labour Standards Law.[31]

Next, let us examine the concept of *ifu* (abandonment, right of abandonment) in marine insurance.[32] In English law, as we have seen, abandonment is to be clearly differentiated from subrogation. In Japanese law, both subrogation over the subject-matter insured and abandonment transfer the property from the assured to the insurer by operation of law. On this point, a similarity is found between them. Yet, they are different. Abandonment is the right of the

27) The Article provides for situations of damages in breach of contract. However, the majority view is that the Article may be applied also to tort cases. There exists a minority view, confining the application of the Article to cases of breach of contract. See Okuda, *supra*.

28) This requirement differs from that of subrogation over the rights against third party. Article 662 (2) of the Commercial Code makes it clear that subrogation rights arise even in the case of partial payment by the insurer.

29) This is the translation of the following Japanese words; *tôzen Saikensha ni daii-su*. The word daii is used as a verb in this Article. It is curious for the writer why the Civil Code adopted an expression different from that in Articles 661 and 662 in the Commercial Code to express similar transfer of rights.

30) On this legal nature of the transfer, Article 422 differs from the German Civil Law. See Okuda, *supra*, at 723.

31) The Supreme Court applied Article 422 to a situation of insurance payment under Article 79 of the Labour Standards Law, though the Article 422 provides for the case of 'compensation for damages' (*Minshû* 15.1.35.)

32) Abandonment is provided for under Articles 833 to 841 of the Commercial Code.

assured to treat certain types of loss as a total loss in situations specified in the Commercial Code.[33] In abandonment, the transfer of the property is a condition for treating a quasi-total loss claim as a total loss.[34] Transfer of the rights may be justified as a condition in exchange for special treatment by the insurer. Transfer of rights is made, in the author's view, for the adjustment of the interests of the parties involved, rather than for the prevention of enrichment. From this, despite a certain similarity, abandonment under Japanese law must be separated from subrogation to the rights over the subject-matter. In addition, abandonment is only allowable in marine insurance, which reduces its importance. Moreover, abandonment is scarcely used in practice these days,[35] despite the existence of provisions of the Commercial Code. The present standard marine clauses both for hull and cargo explicitly deny the assured's right of abandonment by introducing, instead, a wider concept of total loss in the contract.[36]

To sum up, under Japanese law the insurer who pays insurance money acquires the assured's rights automatically by operation of law. There are two types of transfer, and they are embraced by a wider concept of the doctrine of insurance subrogation, although the English word 'subrogation' does not exactly correspond to the Japanese concept. Its doctrine is self-contained and must be understood separately from the related concepts of 'subrogation by the obligor' under the Civil Code and the right of abandonment in marine insurance. In our subsequent discussion, we will focus our attention on subrogation over the rights of the assured against the third party.

(2) Conditions for Subrogation

Next, let us examine Japanese law in respect of the conditions for subrogation, first on the type of insurance, and secondly on the requirements which must be satisfied for the transfer.

(a) Types of Insurance

The Commercial Code, hereinafter referred to as 'the Code', classifies insurance contracts into indemnity insurance[37] and life insurance, and sets out separate provisions. Since the provision on subrogation[38] is contained in Section 1 (Indemnity Insurance), it applies only to indemnity insurance. This structure might appear to be simple. Questions arise, however, as to how

33) Article 833. Parties of the contract may modify these conditions of abandonment.
34) There is no concept in the Code corresponding to C.T.L. and A.T.L. under the M.I.A. 1906.
35) The survey by a committee of the Japanese Insurers Association showed that there was virtually no case of settlement by way of abandonment in these years. M. Kanda, "*Hoken-ifu no Haishi nitsuite* [On the abolition of insurance abandonment]", *Hokengakuzasshi* 516 (1986) 76.
36) For example, Article 3 (4) of General Clauses of Hull Insurance 1/4/90 provides; "Under this contract of insurance, the Assured may not make a claim for indemnity by way of abandonment of the Vessel to the Company." See The Japanese Hull Insurer's Union, Hull Insurance Clauses, tentative translation, 1990.
37) The translation of the Japanese word, *Songai-hoken*.
38) Article 662.

various insurances are classified in the two types of insurance. Before considering the issue of the grey middle area, let us investigate how the Code defines the two types of insurance contracts.

The Code defines an indemnity insurance contract as follows:[39]

> **Article 629.** An indemnity insurance contract shall become effective by an agreement whereby one of the parties to the contract agrees to indemnify the other party for his loss which may occur by a specified accident or accidents and the other party agrees to pay a consideration to the former party for its undertaking.

A life insurance contract is defined as follows:[40]

> **Article 673.** A life insurance contract shall become effective by an agreement whereby one of the parties to the contract agrees to pay a fixed amount of money depending on the life or death of the other party or of a third party and the other party agrees to pay a consideration to the former party for its undertaking.

It will be found that this classification of insurance contracts is not logical. Indemnity insurance is a term indicating the basis of the insurance payment, whereas life insurance is a term indicating the risk covered. The corresponding term for indemnity may be a fixed sum payment. That of life insurance may be non-life insurance. On behalf of the draftsman of the Code, however, it must be mentioned that the types of insurance which were handled when the Code was drafted about one hundred years ago[41] were life and casualty insurance, such as marine or fire. Naturally, the Code reflected the classes of business conducted at that time. The development of insurance products as well as the growth of the insurance industry have introduced a variety of products into the market, which may not be classified in either of the two classes or may be covered by both.

The most important area in dispute is insurance on human-beings. Possibly the most common products in this area are injury or sickness insurance. Injury insurance covers accidental injury to the assured. Sickness insurance covers loss caused by sickness of the assured. Some products cover the actual expenses incurred by the assured, such as medical expenses and incidental charges up to the limit of the policy. Others cover a loss by payment of a fixed sum agreed between the assured and the insurer. There are various methods of fixing the amount. One example is to fix the daily amount payable for medical treatment. Another is to fix a total insured amount, with insurance payment based proportionately on the degree of seriousness. These lines of personal insurance are handled either as independent products or included in a life insurance or an indemnity insurance.[42]

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39) Translation by the author.
40) Translation by the author.
41) The Code was enacted in 1899 and has not undergone any fundamental revision since then.
42) For example, the standard comprehensive fire insurance covers injury of the assured caused by the fire. Comprehensive motor insurance covers the death or injury of the assured.

The issue of the classification of these new lines of products has received much attention, since the Insurance Business Law[43] prohibits the concurrent operation of life and indemnity insurance businesses[44] and both classes of insurer wished to handle these new lines of products. The debate over these products will be settled at least partially by a major amendment to the Insurance Business Law which to be implemented on 1.4.1996.[45] Both life and indemnity insurers will be allowed to handle these products.[46]

The solution in the regulatory framework may not, however, solve the legal issue on the classification of these products under the Code. Moreover, deregulation in the business area may further accelerate the development of new products. Restructuring of the Code is necessary to cope with the development of these products. The solution suggested by *Hoken-hôsei-kenkyûkai*[47] is to introduce a new section on injury insurance into the present Code.[48] They propose to introduce separate provisions on injury insurance depending on whether the insurance is on an indemnity basis or a fixed sum basis. Before considering this proposal, let us examine the approach taken by the courts.

In the case of the *Supreme Court 1. 5. 1980*[49], the issue was whether the subrogation doctrine of Article 662 applied to injury compensation and hospital benefits payable under a life insurance contract. The payment was made on a fixed amount basis. There was no provision on subrogation in the policy. The court denied the applicability of Article 662.

In the case of *Mito District Court, 9. 3. 1979*[50], income compensation insurance[51], covering the assured's loss when he became unable to work because of injury or disease, was in question. The policy contained no provision on subrogation. The court regarded it as an indemnity insurance and applied the subrogation doctrine of Article 662.

An issue involving income compensation insurance was heard in another case[52] and was brought before the Supreme Court.[53] A car driven by the plaintiff X was hit, when stationary, by a lorry owned by Y company. X suffered injury and asked Y for compensation for X's loss

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43) Law No. 41, 29.3. 1939, as amended.
44) Article 7, *supra.*
45) The new law was approved by the Diet on 31. 5. 1995, coming into effect within one year after the approval.
46) However, a licence for these products will be given after a lapse of certain time. See Schedule No. 121 of the new law.
47) See Chap. 3 (1).
48) *Ibid.*
49) *Hanji* 971-102.
50) *Hanji* 935-89.
51) Writer's translation of *Shotoku-hoshô-hoken.* In view of the decisions of the courts seen below, the term may be translated as "income indemnity insurance". However, the writer has adopted the direct translation of the original word.
52) *Osaka Appellate Court, 16. 9. 1987.* (*Kôminshû* 40-3-76)
53) *Supreme Court, 19. 1. 1989.* (*Hanji* 1302-144)

including loss of income. X had income compensation insurance with A non-life insurance company and received insurance money. Y argued that X lost his right to claim for loss of income because X's right transferred to the insurer upon insurance payment. It had been the practice for insurers covering this type of insurance not to exercise their right of subrogation against the third party. In fact, A did not make any recovery action against Y. The insurance covered the loss suffered by the assured when the assured became unable to work and insurance money was calculated proportionately on a fixed amount which was agreed, at the inception of the policy, based on the assured's past income. The method of calculation of payment was similar to that adopted in fixed sum injury insurance. There was no provision on subrogation.

The Supreme Court found that this insurance should be regarded as a type of indemnity insurance on the ground that the insurance covered the actual loss which arose to the assured because of the accident which rendered him unable to work, up to the policy amount, and held that X lost his right against Y to the extent of the insurance payment, because A acquired X's right against Y by subrogation upon A's payment. It was argued for X that the application of the doctrine of subrogation was implicitly excluded between the parties, even if this insurance should be regarded as a form of indemnity insurance. The Supreme Court held that reasonable interpretation of the clauses did not allow such an interpretation and that the fact that the insurer was not in a position to exercise its right of subrogation did not alter this finding.

Comments by academics on these decisions on income compensation insurance are generally in favour of the reasoning of the decisions.[54] However, there have also been critical comments. One criticism is that the decision does not reflect the market practice that insurance money is calculated in a similar way to that of a fixed sum injury insurance and that insurers in this market have never in fact exercised the right of subrogation.[55] Another argues more fundamentally that the doctrine of subrogation should not be treated as mandatory for insurance on human-beings.[56] Despite these criticisms, however, the decision is influential in view of the standing of the Supreme Court.

As we have seen, the logic of the Supreme Court as well as the proposals for amendment of the Code by scholars may be summarised as follows:

- Insurance contracts are classified into two types, indemnity insurance and fixed sum insurance, based on the measure of insurance payment.

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54) See following case comments; Ishida, *Hanji* No. 989 p.186; Tanabe, *Songaihoken-hanrei-hyakusen* (Tokyo, 1980), p.161; Yoshikawa, *Jurist* No. 1012, 1992; Fujiwara, *Hanreitaimuzu* No.706 p.202; Seto, *Jurist* No.932, p. 74; Nishizima, *Hanji* No.1318, p.220.

55) Harada, His case comment on the case of *Mito District Court 9. 3. 1979, Hanreitaimuzu* No. 404, p.36.

56) Suzaki, "*Hoken-daii to ritokukinsi-gensoku* [Insurance subrogation and principles of prohibition of enrichment]", *Hôgakuronsô* 129-1 & 3(1991) at p. 19 of 129-3. His critical comment on the case must be understood together with his study of the subrogation doctrine in German law.

- The doctrine of subrogation applies to indemnity insurance.

- Whether the doctrine applies to the insurance in question is decided by whether it is regarded as an indemnity insurance or not.

- If so, the doctrine applies by operation of law unless there is any express agreement to the contrary.

This reasoning is logical, but, does it give us a reasonable solution? It appears that the key element is the basis of the insurance payment. Whether there is enrichment or whether there is a possibility of enrichment is not necessarily a decisive element. This standard might even create a situation where subrogation works independently of the assured's enrichment.

Turning to income compensation insurance, it must be mentioned that a similar product is now sold by life insurers, too.[57] The protection afforded is very similar to that given by income compensation insurance. However, the payment is based on a fixed amount arranged by the parties. Judging from its form, it may be regarded as a fixed sum insurance, and if so, subrogation will not apply to it. However, is the difference between these two insurances so great that subrogation applies to one, even where there is no express agreement to this effect, and does not apply to the other? Is there any distinctive difference in the assured's interest in these products? The motive of the assured in procuring coverage under either type might be very similar; i. e. for compensation of the loss of income when the assured became unable to work.

This is just one example. The development of insurance products will continue to grow in the future, too. Can the criteria based on form continue to provide us with fair results? These questions lead us to a more fundamental question of whether the doctrine rests on the contractual agreement of the parties as to the type of payment.

(b) Conditions to be Satisfied

Article 662 provides that the insurer acquires the assured's rights "where the loss was caused by the act of a third party and the insurer has paid to the insured the sum for which he is liable".[58] Let us examine the conditions required by this provision.

First, the part of the sentence "where the loss was caused by the act of a third party" must be examined. The third party in this context has been interpreted as covering a contractual party in addition to a genuine third party.[59] To satisfy this provision, the person responsible for the loss does not have to be the person who caused the loss.[60] There are conflicting views whether

57) *Shûgyô-funô-hoshô-hoken* [Disability compensation insurance].
58) Author's translation.
59) Judgement of *Supreme Tribunal 16.5. 1911.* (*Minroku* 17-287)
60) *Ibid.*

a third party can include a member of the family of the assured living with the assured.[61]

Do we have a similar requirement in English law? Normally, situations of collateral compensation arise from acts of third parties. However, they may also arise in other situations. We may recall that the loss was not caused by the act of a third party in *Castellain* v. *Preston*[62], a leading case on the doctrine of subrogation in English law. Does Japanese law limit application of the doctrine to situations where the act of a third party is the cause of loss? It appears that there are no reported cases on this question nor any detailed argument in academic works. However, let us attempt possible interpretations of the provision, since it appears that the issue is important for our comparative study.

First, it may be argued that the provision "where the loss was caused by the act of a third party" describes a situation where collateral sources of recovery arise and that the provision does not have to be interpreted as *sine qua non*. If we take this view, we may argue that the doctrine contained in Article 662 applies to a double recovery case not attributable to the act of a third party.

It may be argued, alternatively, that the application of Article 662 must be confined to situations where the act of a third party is involved. This may be the more straightforward interpretation of the wording of the provision. The assured has paid the premium for the insurance. It may be argued that where there is no illegal act of a third party there is no justification for putting the third party responsible for compensation in a worse position than the insurer who has received a premium for his undertaking. This argument may be reinforced by the argument that one of the purposes of subrogation doctrine is to punish the guilty. It may be argued that other methods of adjustment such as that used for double insurance[63] must be applied in such situations.

We are not in a position to decide which of the above two interpretations is to be preferred. However, in the author's view, the Article needs to be interpreted narrowly, because the Japanese subrogation doctrine has the dynamic effect of transferring the assured's right to the insurer automatically upon insurance payment, thus depriving the assured of his right against the third party, even where the assured is not compensated fully by the insurance, as will be seen in our analysis later in this section. This argument, denying the application of subrogation, does not mean, however, that the assured should be compensated for more than his actual loss. Compen-

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61) *Hoken-hôsei-kenkyûkai, supra*, proposes that Article 662 be amended to make it clear that the insurer's subrogation against a member of the family living with the assured is not allowed.

62) (1883) 11 QBD 380.

63) Rules of adjustment under double insurance is provided in Article 632 (simultaneous double insurance), 633 (Successive double insurance), 634 (Exceptions to Article 633) and 635 (Waiver of right of claim against one of double insurers).

sation should be confined to the amount of the assured's loss. However, this principle itself may not justify the insurer's priority among various indemnifiers. The most appropriate method of adjustment may have to be chosen, judged by the character of the compensation in question.

Secondly, let us consider the part of Article 662 providing that "the insurer acquires the assured's rights when ... the insurer has paid to the assured the sum for which he is liable". The Article does not say anything about the assured's economic position. The Article does not say, for example, "when the assured is in a position to be compensated in excess of his actual loss". If the insurance payment is the only requirement, what will the situation be where the assured is not able to receive compensation in excess of his actual loss?

To take a simple example: An assured suffered a loss of 1000 and received insurance money of 500 from his insurer. The assured's right against the third party is for 500, the liability of the third party being reduced by the comparative negligence[64] of the assured or limitation of liability.[65] The situation may arise, in the author's view, in cases such as;

a) where the insurer does not pay the whole of the amount he is liable,

b) where there is under-insurance,

c) where there is loss not covered by the insurance in question.

Let us examine the first situation. Article 662(2) provides that where the insurer pays a part of the amount for which he is liable the insurer may exercise his right only to the extent that the assured's right is not prejudiced. This means that the assured has priority in recouping his loss in such a situation. It is curious that the Code applies the doctrine of subrogation even where the insurer does not fulfil its obligation. It appears that the Code considered that the transfer of the assured's right is necessary even in such a case since the assured might be enriched by double recovery if the insurer's subrogation right is denied. The situations to which this provision applies may be, in practice, very limited. Such a situation might arise in the case of the insurer's bankruptcy.[66] Despite the limited scope of application, however, it appears that the provision has important implications.

First, the insurer acquires the assured's right even where the insurer does not fulfil his obligation. In the author's view, it may be inferred from this provision that the Code treats subrogation as more than a mere contractual right. In this context, subrogation is understood as a tool for preventing the assured's enrichment rather than a right of the insurer.

Secondly, the Code provides for the assured's priority only in a situation where the insurer does

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64) *Kashitsu-sôsai* provided in the Civil Code; Article 418 for breach of contract and Article of 722(2) for tort of negligence.

65) Such as the limitation of liability of the ship owners under *Senpaku no Shoyûshatô no Sekinin no Seigen ni kansuru Hôritsu* [Law on the limitation of liabilities of ship owners], Law No. 94, 1975 as amended.

66) *Ibid.*

not pay the full amount of his liability. This implies that the rule is otherwise where the insurer pays in full.

Bearing these implications in mind, let us consider a second situation; a case of under-insurance. On this, conflicting theories have been proffered.[67]

The first is that the insurer is, under Article 662, entitled to recover from a third party up to the amount of the insurance payment.[68] This means that the insurer has priority over the money recovered. In the above example, the insurer, having paid 500, recovers 500 in full from the third party. The theory argues that this is the natural interpretation of the Code, which, of course, may be modified in the contract.

The second is that recoveries are adjusted between the parties proportionally according to the amount of their interest.[69] In the above example, the insurer who covered 500 of 1000 is entitled to 50% (500 / 1000) of the amount recovered, i. e. 250. This adjustment is based on the principle of average in a case of under-insurance. The advantage of this method is that it will create the same result whether the insurer pays before the recovery action or after the assured recovers.

The third is that the assured has priority in the recovery and that he is entitled to the amount recovered until his loss is fully compensated.[70] In the example, the assured, having suffered a loss of 1000 and received insurance money of 500, can receive the recovery of 500 in full. This theory is suggested by the scholars who attribute the grounds of subrogation to the prevention of unjust enrichment. This theory has been criticised on the ground that it is not fair to treat a person who did not arrange full insurance in the same way as someone who did so by paying a higher premium.[71]

Among these theories, the majority view is the second one[72,73] and this theory has also been adopted by the courts.[74] This means that the assured must bear 250 himself, although the accident was brought about by the negligence of the third party.

What, then, will be the solution in the third situation where the assured has a further loss not covered by the insurance? It appears that this situation has not been the subject of academic debate.[75] However, if we adopt the second theory for the situation of under-insurance, the

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67) For this issue, see Yamashita, "*Kasaihoken niokeru Hokensha-daii* [Insurer's subrogation under fire insurance]", *Shin-songaihoken-sôsho* (Tokyo, 1982), at 375.
68) The theory is commonly referred to as *Zettaisetsu* [absolute theory].
69) Referred to *Hireisetsu* [proportional theory] or *Sôtaisetsu* [relative theory].
70) Referred to as *Sagakusetsu* [balance theory].
71) In addition, it contradicts the provision of the Code which provides the priority of the assured only where the insurer does not pay in full of his payment.
72) Yamashita, *supra.* p.389.
73) *Hoken-hôsei-kenkyûkai* proposes to amend the present Code to clarify the application of this theory.
74) Decision of the *Supreme Court. 5.29.1987.* (*Minshû* 41-4-723).
75) Probably because it is generally understood that subrogation works within the insurable interest and does not override to uninsured interest.

solution will be that the assured and the insurer may recover proportionally from the third party based on the ratio of each interest. However, there may be difficulties in applying this theory. To apply it, we must be able to locate the loss to which the insurance payment is directed. This is not always easy. Insurance payment is made, based on the conditions of the policy. The basis of the insurance payment may not necessarily be the same as the basis of calculation of loss adopted under other systems.[76]

It may be that the second theory is the most reasonable method of adjusting conflicting interests between the assured and the insurer, in spite of the above difficulty. However, the result will be that the assured might not be able to recover for his loss fully, according to the case as shown in the above example.

(3) Alteration of the Doctrine of Subrogation by Contractual Agreement

In this subsection, we shall examine the effect of contractual alteration of the subrogation doctrine. While it is generally understood that Article 662 of the Code is not mandatory,[77] is that entirely correct?

(a) Types of Contractual Alteration

Let us overview, first, the insurance clauses used in practice.

Policies issued by life insurers do not contain any provision relating to subrogation, whether the policy is on life, maturity, pension, or sickness or disability to work.[78] On the other hand, standard clauses of marine, fire, automobile or any other property insurance invariably contain a clause on subrogation. As seen before, no provision on subrogation is contained in the loss of income compensation policy.[79] Application of the doctrine is expressly excluded in the standard clauses of injury insurance[80] where the payment is made on an agreed amount basis irrespective of the actual expenses.[81] In another type of injury insurance where the payment is made for actual expenses, a provision is included in the policy to the effect that the insurer subrogates to the assured's rights on payment. There is no example of denial of subrogation in lines of products where the payment is made on an indemnity basis. However, subrogation is sometimes waived even in these products. For example, in marine cargo or construction insurance, 'Waiver of Subrogation Rights Clause' is used where the assured does not want its insurer to exercise

76) To be discussed further in Chap. 4.
77) U. Nishijima, *Hokenhô* [Insurance Law] (Tokyo, 1991) at 188.
78) The author's investigation on the materials provided by the Life Insurance Association of Japan.
79) Chap. 3 (2).
80) Equivalent of personal accident insurance in England.
81) Article 26 of the Standard Insurance Clauses on Injury Insurance.

subrogation rights against certain parties.

(b) Judicial Decisions and Academic Views

Apart from the issue over the applicability of subrogation doctrine to insurance on human-beings,[82] it will be found that practices do not alter the application of the doctrine very much, at least in the area of indemnity insurance.[83] However, is it an option for the parties whether they follow the doctrine or not? The issue has not been, at least directly, considered in the courts. We find only some comments in academic works on this question.

Generally, it is understood that Article 662 is a directory provision. However, it is not clear whether this means that the doctrine contained in the Article may be altered freely, or that the parties do not need to follow the provision exactly as it is. Professor Suzaki argues that the doctrine should be treated as mandatory in insurance on property.[84] He suggests, however, that it does not necessarily have to be so for insurance in respect of human-beings, such as injury and compensation of loss of income insurance, whether the insurance money is payable on an indemnity basis or on an agreed amount basis. Subrogation doctrine, in his view, must be taken as mandatory in property insurance to prevent unjust enrichment and any agreement which is substantially against this principle must be treated as void.[85]

Subrogation may have a function to prevent unjust enrichment and the fraudulent use of insurance. However, can this be a reason for treating the doctrine as mandatory? In addition, is it well-balanced logic to raise this doctrine in property insurance to the position of a mandatory provision, while in the insurance on human-beings lowering the doctrine to one which parties can change freely? If unjust enrichment can arise in both cases irrespective of the subject-matter insured, is the logic persuasive? To evaluate the importance of the doctrine, let us examine the position of parties where subrogation is denied in contract.

(c) Effect of the Denial of the Doctrine of Subrogation in Contract

Under Japanese law, the assured's rights transfer to the insurer automatically upon insurance payment. Therefore, in examining the effect of its denial, a distinction must be made between a situation where the denial means a waiver of the exercise of subrogation rights by the insurer

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82) Chap. 3(2).

83) In the author's view, supervision by the Government has operated to prevent a radical alteration of the doctrine. The Japanese Insurance Business Law requires insurers to obtain authorisation to conduct insurance business. Authorisation is given individually for each type of insurance. Insurers must submit standard insurance clauses for this authorisation. This process works to prevent any radical deviation from standard practices.

84) Suzaki, *supra*.

85) *Ibid*.

and a situation where the denial prevents such transfer of rights. Let us refer to the former as the 'waiver of subrogation' and the latter as the 'denial of transfer'.

i) Agreement on the Waiver of Subrogation

It is generally accepted that the insurer may waive his subrogation right and that an agreement to this effect is valid unless it brings unjust enrichment to the parties involved.[86] Let us examine whether the agreement can introduce any unjust enrichment.

Under Article 662, the assured's rights against a third party transfer to the insurer automatically upon insurance payment. This transfer has the effect of depriving the assured of his rights against a third party in respect of a loss for which he has received insurance payment. Waiver by the insurer will not change this position. This finding may be supported by the *Supreme Court decision of 19-1-1989* which we examined in the previous subsection,[87] in which the assured could not recover compensation from the third party for his loss of income for which he has received insurance money, despite the fact that insurers did not exercise their subrogation right. The Supreme Court came to this conclusion based on the grounds that the assured's rights transfer to the insurer whether the insurer exercises his right or not, unless otherwise agreed. We may conclude that the assured will not be able to recover more than his loss even where the insurer waives his subrogation right.

Nevertheless, the assured may enjoy an advantage under the waiver of subrogation in addition to the merit that the agreement protects the third party from the insurer's subrogation action. The assured will be able to recoup his uninsured loss from the third party more easily. However, is such an advantage unjust?

A waiver clause is an agreement where the insurer agrees not to exercise his subrogation right in return for some consideration, normally an extra premium. Since the insurer has agreed to the waiver and received its consideration, the advantage enjoyed by the assured cannot be regarded as taken at the expense of the insurer. How about the position of the third party? The third party will be relieved from paying compensation for the insured loss because the assured can not exercise any action against him in respect of his insured loss. If the assured elects to allocate the limited fund payable by the responsible party to his uninsured loss, the third party can not object to it. The assured's advantage is not at the expense of the third party as far as the extra premium for the waiver is not born by the third party. For these reasons, we may conclude that the waiver of subrogation does not bring unjust enrichment to the parties involved.

Even though the above argument is sustainable in law, as we found in our analysis of English

86) Yamashita, *supra*, at 375.
87) Chap. 3(2).

law, is there a possibility, in practice, that the assured is compensated for more than his loss from collateral sources? The insurer will not be interested in watching whether the assured attempts a separate claim against the third party or not. However, the Japanese position is different from that of English law in that the third party does not have to pay compensation for the assured's loss which has been covered by insurance. If the third party pays it knowing that the loss has been covered by insurance, the payment is in the nature of a voluntary payment. The assured may be able to retain compensation from both sources. If the third party was deceived by the assured or he simply made a mistake, he may be able to receive a refund under the law of unjust enrichment.[88]

In addition to these general points, different consideration must also be given to another point. Professor Suzaki argues that, while the waiver agreement is in general permissible, the agreement must not be allowed from the point of social justice if it covers a situation where a third party deliberately causes an accident, because such insurance might induce a deliberate accident.[89] Imagine a situation where the assured asks the third party to destroy his property to obtain insurance money. If the assured's conspiracy is apparent, insurance payment is not made on the ground of wilful misconduct of the assured. However, it is not always easy for the insurer to prove this. For this reason, a waiver clause where the insurer waives his subrogation rights in any case might be used for a fraudulent claim.

Although this potential danger must not be overlooked, the author wonders whether it is reasonable to invalidate the waiver clause if it does not in fact exclude the situation of deliberate accident. Wilful misconduct is in any event excluded in the policy. Waiver clauses are often used where the assured wants to protect the interests of the bailee or its subcontractor. The assured might want to protect his subcontractor from the insurer's recovery action even where the accident is caused deliberately by one of the employees of the subcontractor. It is true that the insurer must well recognise the potential danger of this agreement and is advised to enquire of the assured for its reason.[90] However, in the author's view, the agreement must not be treated as void.

ii) Denial of Transfer of Assured's Rights

Next, let us examine an agreement on the denial of transfer of the assured's rights. While no such example is to be found so far in the field of property insurance, is it permissible?

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88) Law on unjust enrichment is provided in the Articles 703-708 of Civil Code.
89) Suzaki, *supra*.
90) The statement will be treated as a material fact under the duty of disclosure. Article 644 of the Commercial Code.

The denial of the transfer appears, at first glance, to enable the assured to make claims against both the insurer and the responsible third party. To this arrangement, however, the insurer will have no objection if he receives adequate consideration. Naturally, the arrangement will not bring unjust enrichment to the insurer. Therefore, let us examine the assured's financial position.

First, if the assured does not exercise his right against the third party, no enrichment is brought to the assured. The responsible third party will enjoy the benefit that he need not compensate for the assured's loss. However, it is always an option for the victim whether to claim against the responsible party or not. There should not be any problem in this situation.

Secondly, even where the assured claims against both the insurer and the third party, if the assured claims against the latter for his uninsured loss only, there will be no unjust enrichment to the assured.

Thirdly, more fundamentally, can the assured receive money legally from separate sources beyond his entire loss under the denial of subrogation agreement? The question is hypothetical, because such an agreement is not used in practice.[91] However, let us consider a possible answer to it.

If the assured claims against the third party after receiving insurance money, there is a possibility that the payment to be paid by the third party be reduced so that the payment does not bring enrichment to the assured. There is a doctrine of *son-eki-sôsai*[92] in civil law which ensures that the victim does not benefit from an accident by requiring benefits derived from the accident to be deducted from the amount of damages payable to the victim by the responsible party.[93] The doctrine is not stated in the Civil Code but is regarded as the corollary of the principle of indemnity that the victim must not be enriched by the accident. It is generally understood that an insurance payment is not regarded as interest falling under this principle.[94] The Supreme Court has held that life insurance money does not fall under this principle since the payment must be regarded as *taika* [consideration] for the assured's payment of premium.[95] The Supreme Court also held that payment under fire insurance is not covered by this principle because of the existence of subrogation.[96] Nevertheless, the author wonders whether the Supreme Court would

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91) As far as indemnity insurance is concerned. Situations are different in insurances on human-beings, as has been seen before.

92) No corresponding term exists in English law. The concept is equivalent to *Vorteilsaufrechnung* in German law or *compensatio lucri cum damno* in Latin. *Sin-hôritsugaku-jiten* [New Dictionary on Legal Studies] (3rd edn., Tokyo, 1989).

93) Ikuyo & Tokumoto, *Fuhôkôi-hô* [Law on Tort] (Tokyo, 1993), at 303.

94) *Ibid.*, at 304.

95) Judgement of the *Supreme Court 25-7-1964* (*Minshû* 18-7-1528). The reasoning has been criticised because the consideration in return for the premium is, theoretically, risk-taking by the insurer.

96) Judgement of the *Supreme Court 31-1-1975* (*Minshû* 29-1-68).

reach the same conclusion if the subrogation were denied in the particular contract of indemnity insurance. If the situation creates enrichment, the court might reduce the amount which the third party ought to pay to the assured. However, in the author's view, such a reduction in the damages must be made with caution. Reasons must be shown why the insurance arrangement made by the victim reduces his right of damages against the responsible party. It must be examined how each payment made separately under each system overlaps with others.

Next, how about a situation where the assured has already been compensated by a third party prior to the insurance payment? If the policy is one of indemnity, the assured may not be able to claim insurance payment beyond his actual loss. However, it may be necessary to establish that the compensation which the assured has obtained from the third party corresponds exactly to the part of the loss which is covered by his insurance. This position will not be affected by a denial of transfer agreement.

(d) Conclusion

We have considered the importance of the subrogation doctrine by examining hypothetical situations where the doctrine is denied in contract; first where subrogation is waived and second where it is denied. Unlike English law, the waiver of subrogation will not automatically result in enrichment of the assured. A denial of transfer agreement, however, may create difficulties. The doctrine of *son-eki-sôsai* might work to reduce the amount of damages in such a situation.

Is the doctrine of subrogation mandatory? To answer this, we still need to examine how the doctrine relates to the prevention of unjust enrichment in more detail.

4. Subrogation and Prevention of Unjust Enrichment

(1) The Position So Far

We have examined how the subrogation doctrine is understood and applied in two different legal systems. It is not easy to make any generalisations based on a short comparison between two systems with different legal backgrounds and this must be done with caution. Our examination, however, has revealed that there remain unresolved issues in each system. It is noteworthy that similar ambiguities are found in both systems. Ambiguities are found in;

- the concept in each system,
- the reason the doctrine is applied to certain types of insurance and not to others,
- the extent of indemnity necessary for the acquisition of rights, and
- whether the contractual parties can modify the doctrine freely or not.

While we have tried to show possible answers to these issues under each legal system respec-

tively, we have also realised that these issues require us to explore the foundation of the doctrine.

A factor which has emerged occasionally in our discussion is the prevention of 'unjust enrichment'. The term may be used differently depending on the context. Its exact meaning may also be different among different legal systems. However, if we use the term broadly as meaning an enriched condition which must be regarded as unjust, disregarding any particular usage in the law of unjust enrichment in Japan and the law on restitution in England, it may be generally supported that the subrogation doctrine relates to the prevention of unjust enrichment of the assured.

However, more precisely, how does the subrogation doctrine relate to unjust enrichment? It appears that neither English nor Japanese law has answered this question clearly. In the following discussion, therefore, we will consider the theoretical foundation of the doctrine and how it relates to the prevention of unjust enrichment of the assured.

(2) Principle of Indemnity and Loss

The doctrine of subrogation is applied only to indemnity insurance both in England and in Japan. Since indemnity insurance is governed by the principle of indemnity, we must look into this principle first.

The principle of indemnity may be described as the principle that the assured must not be compensated in excess of his actual loss. The principle is found throughout the rules peculiar to indemnity insurance, such as the rule for the calculation of insurance payment, the rule about double insurance, the principle of average and so on. The principle might appear to be beyond doubt. However, what does 'loss' mean where it is stated that the principle of indemnity secures payment of actual loss?

(a) Meaning of Loss

Generally, an event affects the activities of human-beings in various ways, whether the activities are of an individual, a family or a group, such as a corporation or a government. An event influences these activities like the ripple effect of a stone thrown into a pond.

Loss may be defined generally as an undesired decline in, or disappearance of, value arising from a contingency.[1] Value is a concept not confined to economic activities, so the concept of loss is not confined to economic aspects of human activities. However, let us focus our attention on loss which is measurable in money. There are various types of loss. Loss can be physical such as damage to tangible property. It also arises with intangible property or any intellectual property, fame or reputation. Loss includes any extra expense or liability incurred because of

1) R. Mehr and E. Cammack. *Principles of Insurance* (6th edn., Illinois, 1976) at 24.

the contingency. Some loss is apparent immediately after the event, and there are other losses which may be slow in revealing their entire extent.[2)]

Loss is subjective, so is value. If there is no absolute and universal basis for the assessment of value, there is no such basis for the assessment of loss. Even the same type of loss may be calculated differently by different people, in different fields and in different legal systems.

(b) Loss in Insurance

If it is accepted that the amount of loss can be understood differently depending on the person involved and the field in question, it follows that the method of assessing loss under insurance law is one of various methods. Where the insurance contract states that the insurer is to pay for the loss, the term 'loss' here is a concept of loss under insurance law. Even where the policy states that it covers the 'actual loss' of the assured, the actual loss is assessed based on the measures adopted in insurance law.

In addition to this possible discrepancy in the concept of loss, the 'indemnity' given by the insurance is in fact limited. First, the payment is under the insurance agreement. Only types of loss covered by the particular policy are payable. Normally, any indirect loss or incidental loss is not covered by the insurance, whether or not the assured in fact suffered this loss, unless otherwise agreed. Secondly, insurance depends on statistics. Standardisation of the evaluation of loss is necessary. This will require an objective standard basis for the assessment of loss. If not, calculation of the proper premium itself will be difficult. Thirdly, the variety of coverage afforded by the insurer is in fact limited. Insurers are providing cover as a business. An assured cannot arrange an insurance which is not provided in the market. Especially in personal lines, types of coverage available in the market are in fact very similar.

If the coverage afforded by insurance does not exactly conform to the loss actually suffered by the assured, does the payment qualify as an indemnity payment in the pure sense of the term? It is rather an agreed payment for a specific loss in respect of an agreed event, which is calculated based on the rules established in insurance law and practice, which the parties have agreed to observe.

(c) Meaning of Indemnity in Insurance Law

If the above view is sustainable, the principle of indemnity may be restated as the principle which secures that the payment must not exceed the amount which is assessed as the actual loss under the law of insurance. Insurance law and practice may not be independent of the rules in

2) One example may be a loss caused by damage to the environment.

other branches of law, such as the law governing the assessment of damages in tort. What we want to emphasise here is that the payment under insurance might not correspond exactly to the assured's actual loss. If so, the payment beyond the basis of insurance may not be seen as an enrichment from another viewpoint even though it is an overpayment under insurance law.

If the principle of indemnity is described as being based on the idea of prohibiting 'enrichment', it just means, in the author's view, that the insurance payment must be subject to the rules of assessment of loss established in the law of insurance.

(3) Meaning of Unjust Enrichment in the Context of Insurance Law

(a) Situations where the Doctrine of Subrogation Operates

If we accept that the principle of indemnity in essence works to prevent payment exceeding the actual loss of the assured as understood under the law of insurance, how does the subrogation doctrine relate to this principle? It is often stated that the doctrine of subrogation is a corollary of the principle of indemnity. However, is it a doctrine created to support this principle? To consider this question, let us examine the situations where the subrogation doctrine operates.

The doctrine of subrogation operates where there is a source of compensation other than insurance. The issue in such situations is the prohibition of over-payment arising from the overlap of different systems. This character differentiates it from the general principle of indemnity. Then, when does the assured come to be in an unjustly enriched condition by multiple sources of compensation? Let us examine, first, the meaning of enrichment and secondly situations where such enrichment is regarded as unjust, by considering hypothetical situations where the assured recovers collaterally from multiple sources of compensation.

(b) Enrichment

Enrichment may mean, in general, a condition where the wealth is greater than before. Where there is a payment from insurance only, an enriched condition may be defined as a condition where the assured, by the insurance payment, comes to be in a better position at least economically than before. How about a situation where the assured can receive compensation from multiple sources? Let us assume that the compensation to be made under each system is less than the assured's entire loss. In the following discussion, the phrase "the assured's entire loss" includes any type of loss measurable by money which the assured in fact suffered because of the event.

First, when the aggregate of the payments exceeds the amount of the assured's entire loss, the part of the payment which exceeds the assured's entire loss will be regarded as enrichment. This will be accepted generally, although the assessment of the assured's entire loss involves difficult

issues, especially where economic and social activities are negatively influenced by the accident or where the death or injury of human-beings is involved.[3)]

Let us consider a second situation where there is an overlap of payments from different sources while the aggregate of the payments does not exceed the assured's entire loss. Imagine a situation where the assured's parcel is damaged during transportation. The assured is in a position to claim insurance money for the damaged property based on the valuation of the insurance and to claim damages against the carrier compensation calculated based on the C. I. F. value of the goods or a smaller amount fixed by the limitation under the law of carriage of goods applicable to the carriage in question. The assured must pay compensation to the buyer because he could not deliver the goods within the required period of time. In addition, the value of the goods has increased by the time when he obtained replacements. He also incurs various incidental charges and sacrifices his precious time in negotiation with the buyer and the carrier. Let us assume that the assured's entire loss is not compensated wholly even if he is allowed to retain payments from both sources.

In this situation, an overlap of payments is found between insurance and compensation from the carrier, since both are for the lost value of the property. If the payments simply overlap, can we regard it as enrichment, disregarding the overall economic position of the assured? It might depend on the definition of enrichment. However, if it is a concept referring to the general economic position, in the situation shown by the above example the assured was not 'enriched'. The author wonders whether a simple overlap of payments is rightly regarded as 'enrichment'. It appears that it is important to distinguish between a situation where there is clear overcompensation from multiple sources of compensation and a situation where there is an overlap only.

Apart from the issue of whether a simple overlap is also considered to be enrichment, a more fundamental question might be posed. Is there really an 'overlap' between different systems of compensation? In the above example, we have presumed that there is an overlap between the insurance payment and compensation by the carrier because both payments are directed to the loss of value of the goods. However, can we really say that this is an overlap?

The insurance money is paid under the insurance contract. As we have seen, it is not a complete indemnity for the loss even where the insurance in question is described as an indemnity insurance. It appears that the essence of the payment is the payment of a certain amount in case of certain specified events to be calculated based on the rules in the insurance contract. Naturally, the money is paid to the assured and not to the loss itself. The insurance money may be used to recoup his financial loss whether or not it is calculated based on the degree of physical

3) This question itself involves difficult issues. The thesis does not discuss these issues, since the aim of the thesis is to examine the essence of subrogation doctrine.

damage to his property.

In addition, it must also be considered that the payment by the insurer is what the assured entered into the insurance contract for and has paid a premium for. This character of payment must be distinguished from payments in other situations. For example, the payment by the carrier in the above example is the damages for the breach of contract by the carrier who failed to perform the safe carriage of the goods. Its payment is not the service which the assured wanted originally under the carriage contract.

The ideas and considerations in one situation might be different from those in other situations. Payment is made in each situation on its own principles. At least, we can state that the basic idea in the payment under insurance is not necessarily identical with that in another situation.

If the basis of payment is identical among different systems of compensation, it is easy to recognise an overlap between the payments. However, if the basis, or in other words the philosophy, of each system is not identical, we can be less confident in alleging that the multiple payments overlap for the same loss.

In summary, where we can recognise a loss by monetary figures and when a payment or payments are made for the loss exceeding the amount of the loss, the surplus may be regarded as enrichment. It is less clear whether the simple overlap between payments is rightly regarded as enrichment. Furthermore, it must be examined whether the insurance payment in fact overlaps with the payment made by other sources, since each payment is made based on its own considerations.

(c) Unjustness

Next, let us consider when the enrichment is regarded as unjust in the context of insurance.

Firstly, it may be regarded as 'unjust' when the enrichment is at the expense of another person. This is judged by examining the balance between the parties. We may regard the enrichment brought to the assured as unjust if it was made at the expense of the insurer. When does it arise in practice?

Imagine a hypothetical situation where the assured receives payment under his indemnity insurance and at the same time receives compensation for the same loss from a third party collaterally. In our examination, let us disregard a situation where the third party pays the money as a gift, a payment without obligation, since such a payment is not regarded as compensation for the loss in question. If there is an enrichment by the double payments, disregarding our previous discussion on whether enrichment really exists or not, can we regard it as having arisen at the expense of the insurer?

In insurance, the assured must pay a premium for the undertaking by the insurer. If the

premium which the assured has paid was calculated on the condition that the insurer has a right of subrogation, any enrichment arising by depriving the insurer of his right may be regarded as unjust, because the enrichment has occurred at the expense of the insurer.

However, if this logic is adopted, it will follow that the enrichment made by collateral sources is not unjust if the insurer agrees to it or if he has received a premium on the condition that he does not subrogate to the assured's rights upon insurance payment. Unjustness will be judged by whether or not the assured has paid the premium for the non-exercise of the right of subrogation by the insurer. If unjust enrichment in this sense is the basis for subrogation, it may follow that the subrogation doctrine is a doctrine founded on the agreement between the assured and the insurer in respect of the extent of coverage, i. e. a matter which is adjusted by premium.

Secondly, the enrichment itself might be regarded as unjust whether or not it occurs at the expense of any party. Insurance is a device protecting the assured in case of a certain event. A situation where the assured gains from such an event by means of insurance might be regarded as unjust in terms of social justice. If profits arising from accidents are allowed, this might encourage accidents or at least reduce the assured's attention for loss prevention. It is important for society to keep insurance as insurance, not as a means for profit.

We might be able to accept this view more easily if the insurance itself produces enrichment without the combination of other sources of compensation. When the aggregate of the multiple compensations exceeds the assured's entire loss, the surplus may also be regarded as unjust on the same ground that the victim in the accident must not gain profits by the event. However, the position is not clear in a situation where there is an overlap of payments but the aggregate of the payments is less than the assured's entire loss. If we do not regard such a situation as an enrichment, the matter will be simple. We do not need to discuss a situation until the aggregate of the payments exceeds the assured's entire loss. If we regard the simple overlap as enrichment, then, is it unjust? Is it so unjust that society must not allow the assured to use some part of the payments for the uncompensated part of his loss? The author wonders if such a simple overlap is rightly regarded as 'unjust' to the extent of depriving the assured of the right to have full compensation. There are types of loss recovery in fact which might not be allowed in law. Often pure economic loss is excluded from compensation. Insurance may be arranged, theoretically, covering such pure economic loss. However, the coverage sold in the market is in fact limited. It may not be possible to say that the victim was negligent in not arranging full protection for his possible loss.

In conclusion, it appears that the doctrine of subrogation has to be understood separately from the principle of indemnity to be given significance as a doctrine which operates where there is a

source of compensation other than insurance. If we raise this doctrine to a mandatory position, i. e. to a position where the parties cannot alter it, in return, its application must be confined to situations where there is 'real' unjust enrichment from the overlap of payments.

5. Conclusion

What is insurance subrogation and for what purpose does it exist?

The doctrine of subrogation has certainly been well established in insurance law. The doctrine is unique in that it also affects the assured's rights outside insurance. In English law, the insurer will stand in the assured's position and enjoy the benefits of the assured's rights against parties outside the insurance contract. Japanese law will deprive the assured of his rights against third parties. It is a powerful right. Why has the law created such a right in insurance?

If the doctrine is founded on contractual agreement between the parties to insurance, the matter is simple. Ambiguities found in this doctrine may be solved by attaching a detailed clause to the policy. However, our examination has revealed that this is a doctrine which has more importance than a simple term in a contract.

Let us focus our attention on the doctrine where it operates as a rule of law or in equity. The doctrine operates where there is another source of compensation in addition to insurance. Sometimes, it is confused with the principle of indemnity itself. No doubt it works as a remedy to fulfil the purpose of the principle of indemnity. However, if its purpose is confined to this, it appears that the law did not have to create such a doctrine. The principle of indemnity alone may sufficiently prevent overcompensation in insurance, without the doctrine of subrogation. We must not forget that the doctrine is more than a mere right of adjustment to the insurance payment.

Beyond doubt, this important position has been supported by the belief that it prevents unjust enrichment, and thus injustice. However, if we are to afford such a position to this doctrine, it appears that we need to apply this doctrine where there is a real unjust enrichment.

Situations where the doctrine operates are ones where multiple systems of compensation operate. If each system has an identical philosophy and basis for payment, it may be easy to recognise unjust enrichment. However, the basis for payment in insurance might not be identical with that in other compensation systems.

Enrichment as well as unjustness must be judged by the overall economic position of a person. If we claim there is unjust enrichment, we must be sure about it. Mere overpayment beyond the basis adopted in insurance might not always be regarded as unjust enrichment, even if it is overpayment from the viewpoint of the principle of indemnity.

The doctrine of subrogation will continue to be an important doctrine in insurance law. In addition, it may be expected that the doctrine serve as a device for eliminating real unjust enrichment in duplication of compensations. If it serves this function, it has the elevated status of a doctrine which co-ordinates different systems of compensation in modern society.

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