

SUBROGATION AND THE ASH WEDNESDAY BUSHFIRE DISASTER

1. INTRODUCTION

Zelling J observed in *Dunn v Electricity Trust of South Australia*¹ that:

'Ash Wednesday 16th February 1983, lived up to its name - though not for the reasons set out in any commentary on the calendar of the church.'

Bushfires caused the deaths of seventy-one people and extensive property damage in South Australia and Victoria when, in extremely hot and windy conditions, the fires consumed all in their path - houses, farm buildings, fences, trees, crops, pastures and livestock. The actual cause(s) of these fires remain a matter of speculation and allegation. However, in the *Dunn* case the Electricity Trust of South Australia (hereinafter ETSA) was held responsible for the fire which caused the plaintiff's loss; ETSA, it was held, was negligent in the inadequate suspension and improper tensioning of high voltage electricity wires; in high wind the wires clashed, with the consequence that molten particles of aluminium were ejected on to tinder dry vegetation which ignited.² ETSA is subject to a vast number of other claims in respect of the Ash Wednesday bushfires, and other persons and bodies are the subject of negligence claims. It is neither possible nor appropriate to address the merits or demerits of these claims in this article. However, some extremely fundamental and very important subrogation issues have arisen in the context of this disaster. This article explores these subrogation issues which may be isolated as follows:

- (a) Where there is a triangular situation of insurer, insured and third party tortfeasor, when, and to what extent, may the insurer participate in any recovery obtained from the third party tortfeasor?
- (b) Can the insured, or the insurer, recover interest from the third party tortfeasor on the amount of the indemnity paid by the insurer, or on the full amount of the loss where the total loss exceeds the indemnity payable under the policy? If so, at what rate?
- (c) Who bears the costs, direct and indirect, of seeking recovery against the third party tortfeasor?

These issues are considered below.

2. INSURER'S PARTICIPATION IN RECOVERY

Many, if not most, of the people who sustained property damage were privately insured and in the aftermath of the fire were indemnified by their insurers *in terms of their policies*. However, in numerous cases this indemnity did not amount to full compensation for the loss where the insured was under-insured, or where the policy in question did not cover all types of loss sustained or liability incurred. A question arises, therefore, as to the right and extent to which the insurer may participate in any

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1 (1985) 122 LSJS 201.

2 See judgment especially at 211-212.

recovery obtained from a third party tortfeasor. Consider the following example. The insured has a fire policy covering farm buildings; the total sum insured is \$50,000. These buildings are totally destroyed by fire. The insurer makes payment of \$50,000 which is the maximum payable under the policy, but much less than the assessed value of the farm buildings which is \$100,000. If the third party tortfeasor makes payment of \$50,000, must the insured account for this sum to the insurer on the ground that the insurer has fully indemnified the insured in terms of his or her policy, or does the duty to account only arise once the insured has been fully compensated for his or her loss?

Subject to any express subrogation clause to the contrary, it is submitted that the duty to account arises only when the insured has been fully compensated, not on full indemnification under the policy. In the example given above the insured has received in total no more than his or her uninsured loss and as such has been fully compensated, and no more, in respect of the total loss; consequently, it is suggested that no duty to account arises in respect of the \$50,000 obtained from the third party tortfeasor.

This submission is in accord with the underlying basis of subrogation. The doctrine of subrogation is the corollary of the principle of indemnity³ - the latter principle declares that an insured is to be compensated in respect of actual loss, while the former ensures that the insured does not receive 'double satisfaction'; that is, that the insured does not recover twice in respect of the same loss. There can be no question of unjust enrichment where the insured receives no more in total than full compensation for the loss. Indeed it is suggested by Fleming that:

'... it is generally treated as axiomatic that the private insurer assumes an unqualified obligation to his insured which is incompatible with any posture that would put his right of subrogation in competition with the interest of the insured in full compensation of the loss'.⁴

Moreover this submission does not offend what is sometimes described as the general purpose of subrogation to facilitate placement of the financial consequences of loss on the party primarily responsible in law for such loss.⁵ Clearly this purpose is achieved fully where the tortfeasor, for example, is liable for *and* makes payment to cover the whole of the insured's loss. In many situations this purpose will not be accomplished; for example, where on account of contributory negligence by the insured the tortfeasor is not legally responsible for the whole loss, or where the circumstances dictate that a settlement for less than full compensation is the only rational decision. In these situations where less than a full recovery is obtained or obtainable from a tortfeasor, any proposition that the insurer should nonetheless be entitled to fully recompense itself of its payout necessarily involves recognition of the fact that the insured is to be deprived of the benefit of his or her insurance. While subrogation may have as one of its major purposes the object of preventing the tortfeasor from benefiting from the fact of his victim's

3 See *Castellain v Preston* (1883) 11 QBD 380, 381 per Bowen LJ.

4 'Insurance - Subrogation - Priority between Insurer and Insured' (1974) 52 Can Bar Rev 103, 105.

5 See Horn, *Subrogation in Insurance Theory and Practice* (1964) 24.

cover under an insurance policy, it surely was never contemplated that subrogation would deprive the insured of full recovery for his or her loss. Therefore it is submitted that the purposes underpinning the doctrine of subrogation are perfectly compatible with the assertion that the duty to account arises only when the insured has been fully compensated, not on full indemnification under the policy.

Moreover this assertion finds overwhelming support in the case law.⁶ The Canadian authorities on the topic are particularly clear cut and, with respect, very persuasive. For example, in *Globe & Rutgers Fire Insurance Co v Truedell*⁷ the Appellate Division of the Ontario Supreme Court emphasised that the doctrine of subrogation only entitled the insurer to seek reimbursement from the insured, who was paid by a third party tortfeasor, if the total amount received from the third party and the insurer exceeded the extent of loss and only for that amount in excess of the loss.⁸ More recently, the Supreme Court of Canada in *Ledingham v Ontario Hospital Services Commission*⁹ cited with approval the description of subrogation advanced in *National Fire Insurance Co v McLaren*,¹⁰ where Boyd J held that:

‘In cases of insurance where a third party is liable to make good the loss, the right of subrogation depends upon and is regulated by the broad underlying principle of securing full indemnity to the insured, on the one hand, and on the other of holding him accountable as trustee for any advantage he may obtain *over and above compensation for his loss* ... The primary consideration is to see that the insured gets full compensation for the property destroyed and the expenses incurred in making good his loss. The next thing is to see that he holds any surplus for the benefit of the insurance company.’¹¹

Similarly, there is very strong support to be derived from the decisions of the courts in the United States.¹² For example, in *Garrity v Rural Mutual Insurance Co*¹³ the insured’s loss exceeded the amount recoverable under a standard fire insurance policy. The Supreme Court of Wisconsin held that the insured is ‘entitled to be made whole before the insurer may share in the amount recoverable from the tortfeasor’. The Court emphasised that it was the insured who had priority to the amount recoverable from the tortfeasor, notwithstanding the payment of a full

6 See, for example *National Fire Insurance Co v McLaren* (1886) 12 OR 682; *Driscoll v Driscoll* [1918] 1 IR 152, 159; *Globe & Rutgers Fire Insurance Co v Truedell* [1927] 2 DLR 659; *Baloise Fire Insurance Co v Martin* [1937] 2 DLR 24; *Glens Falls Insurance Co v Tom Peters Ltd* (1957) 10 DLR (2d) 459; *Lyon v Hartford Accident & Indemnity Co* (1971) 24 Utah 311, 480 P 2d 739; *Ledingham v Ontario Hospital Services Commission* (1974) 46 DLR (3d) 699; *Lawton v Dartmouth Moving & Storage Ltd* (1975) 64 DLR (3d) 326, 335-336; *Garrity v Rural Mutual Insurance Co* (1977) 77 Wis 2d 537, 253 NW 2d 512.

7 [1927] 2 DLR 659.

8 See Hodgins JA, 661-662; Ferguson JA, 668-669.

9 (1974) 46 DLR (3d) 699.

10 (1886) 12 OR 682.

11 *Ibid* 687. Emphasis added.

12 Fleming, *supra* n 4 at 105, comments that there are ‘few discordant voices’. Only very occasionally have American courts invoked the intermediate position of apportioning a shortfall pro rata between insured and insurer.

13 (1977) 77 Wis 2d 537, 253 NW 2d 512.

indemnity in terms of the policy.¹⁴ Fleming¹⁵ also records overwhelming European Continental authority for according priority to the insured in this situation,¹⁶ and it is therefore surprising that no clear English or Australian pronouncement on the situation appears to exist. In *Page v Scottish Insurance Corporation*,¹⁷ Scrutton LJ expressly reserved the question as to whether full compensation was necessary, and marine insurance cases such as *North of England Iron Steamship Insurance Association v Armstrong*,¹⁸ where priority was afforded to the insurer, are explicable on the basis that valued policies were under consideration. In such cases the policy valuation is conclusive, and the insured is not entitled to say 'my loss has been greater than that which has been covered by the policy'.¹⁹ Therefore it follows that the insurer has priority to any recovery from a third party tortfeasor.

While no clear authority may exist in Anglo-Australian jurisprudence, the general purposes of subrogation provide clear guidance as do the persuasive judgments of the Canadian and American courts. Moreover, there is no shortage of judicial pronouncements which in the more abstract sense support priority being afforded to the insured. For example, in *AFG Insurances Ltd v City of Brighton*²⁰ the High Court of Australia held that the doctrine of subrogation must not be allowed to infringe the principle of indemnity, so that the exercise of the right would result in the insured being less than fully indemnified for his or her loss. As Mason J explained, an insurer is not subrogated to those rights of the insured 'when the continued enjoyment of those rights by the insured is not inconsistent with the principle of indemnity'.²¹

In conclusion to this part the following propositions are advanced:

- (a) The right of subrogation exists from the moment of the making of the contract of indemnity, but the exercise thereof is dependent upon the insurer fully indemnifying the insured under the policy.²²
- (b) Where the insured has been fully indemnified under the policy in respect of his or her loss, and this indemnity amounts to full compensation for the total loss (that is, there is no uninsured loss), the rights which the insured has against third parties pass so completely to the insurer that 'an insurer may restrain the insured from taking

14 See also *Lyon v Hartford Accident & Indemnity Co* (1971), 24 Utah 311, 480 P 2d 739; *St Paul Fire & Marine Insurance Co v WP Rose Supply Co* 19 NC App 302, 198 SE 2d 482, 484, cert den 284 NC 254, 200 SE 2d 655. Generally see York and Whelan, *Insurance Law: Cases, Materials and Problems* (1982) 313-318.

15 *Supra* n 4 at 105.

16 Especially in France, Germany and Hungary.

17 (1929) 98 LJKB 308, 312.

18 (1870) LR 5 QB 244; see also *Thames and Mersey Marine Insurance Co v British and Chilian SS Co* [1915] 2 KB 214; [1916] 1 KB 30; *Goole & Hull Steam Towing Co v Ocean Marine Insurance Co* [1928] 1 KB 589; cf: *Yorkshire Insurance Co v Nisbet Shipping Co Ltd* [1962] 2 QB 330. Generally see *Arnould's Law of Marine Insurance and Average* (16th edn 1981) Vol II, para 1302-1305.

19 *Burnand v Rodocanachi, Sons & Co* (1882) 7 App Cas 333, 335; per Lord Selborne. See also *Elcock v Thomson* [1949] 2 KB 755, 761; *British Traders' Insurance Co Ltd v Monson* (1964) 111 CLR 86.

20 (1972) 126 CLR 655.

21 *Ibid* 664. See also *Castellain v Preston* (1883) 11 QBD 380, 386.

22 See *SGIO (Qld) v Brisbane Stevedoring Pty Ltd* (1969) 123 CLR 228, 240-241. See also *Marine Insurance Act 1909 (Cth)* s85; *King v Victoria Insurance Co Ltd* [1896] AC 250, 256; *Globe & Rutgers Fire Insurance Co v Truedell* [1927] 2 DLR 659, 661, 669; *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874, 882.

proceedings against those third parties'.²³ Of course, where the insured has been fully compensated for his or her loss there would be little inclination and no incentive to proceed against a third party contrary to the insurer's wishes. The decision to proceed, or not, against the third party would rest with the insurer and the insurer could elect to initiate and control proceedings on undertaking to indemnify the insured against costs.

- (c) Where the total loss suffered by the insured exceeds the indemnity payable under the policy, the insured may sue the third party to gain compensation for his or her uninsured loss and the insured remains the dominus litis, with the consequence that the court will not interfere with the insured's conduct of the action if he or she undertakes to claim for the full amount of the loss.²⁴
- (d) If in any court or other proceedings, or by way of settlement, the insured succeeds in recovering more than his or her uninsured loss, the insured must account to the insurer for the excess after recouping himself or herself fully for the loss, costs and expenses. The duty to account arises only when the insured has been fully compensated, not on full indemnification under the policy.²⁵ As Derham²⁶ points out, this view is not inconsistent 'with the theory that an enforceable right of subrogation arises upon payment by the insurer of the amount required by the policy, if it is accepted that this merely entitles the insurer to compel the insured to lend his name to an action against the third party'.
- (e) The rule as to participation, enunciated in paragraph (d), applies in the case of settlement of claims. Provided a settlement is made in good faith and was prosecuted with diligence the insurer may only seek recovery of the surplus monies to the extent of the payment it has made; if however the settlement was made with the intent and purpose of benefiting the third party at the expense of the insurers, or was made negligently, the insured must make good to the insurer any loss occasioned to it by his or her lack of good faith, honesty, and diligence.²⁷
- (f) The points above assert the position in the absence of an express subrogation clause in the policy. For example, consider the following subrogation clause:

'Any claimant under this Policy shall at the request and at the expense of the Company do and concur in doing and permit to be done all such acts and things as may be necessary or reasonably required by the Company for the

23 *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874, 885.

24 *Ibid* 885. However, note the comments of North P (at 883) where the President of the New Zealand Court of Appeal observed that an insured is obliged to fairly and justly assess the damages it has sustained by reason of the actions or omissions of the third party and may be able to justify its failure to sue for all or some of its loss. For a detailed discussion of this area, see Derham, *Subrogation in Insurance Law* (1985) 49-68.

25 See cases and arguments above.

26 *Subrogation in Insurance Law* (1985) 133, fn3.

27 See *Globe & Rutgers Fire Insurance Co v Truedell* [1927] 2 DLR 659, 662, 669; *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874, 885. Generally see Derham, *supra* n 26 at 126-130.

purpose of enforcing any rights and remedies, or of obtaining relief or indemnity from other parties to which the Company shall be or would become entitled or subrogated upon its paying for or making good any destruction or damage under this Policy, whether such acts and things shall be or become necessary or required before or after his indemnification by the Company.'²⁸

Not only does such a clause confer extensive rights of control upon the insurer, but it enables the insurer to exercise its rights of subrogation before it has indemnified the insured under the policy. The clause above is silent on the question of priority in respect of subrogation recoveries. Where a policy does contain such a clause the appropriate approach is to consider it first for a determination of the parties' rights and to refer to the general subrogation principles enunciated above in respect of those matters not addressed by the clause or in the event of ambiguity.

- (g) Moreover, in assessing rights and duties arising in respect of subrogation regard must be had also to ss65-68 of the Insurance Contracts Act 1984 (Cth). As this Act only applies, inter alia, to contracts of fire and liability insurance entered into after 1 January 1986,²⁹ it has no application to the contracts in force at the time of the Ash Wednesday bushfire disaster. Nevertheless particular note should be taken of s67 of the Act in the context of any deliberation on the destination of subrogation recoveries.³⁰ In essence this section declares that an insurer is entitled to any windfall profit which might accrue through the insurer exercising a right of subrogation in respect of a loss;³¹ however, the insured must be fully indemnified for his or her loss before such entitlement arises.³²
- (h) Finally, the rules as to the destination of subrogation recoveries, where the insured recovers in respect of uninsured losses, are modified in marine insurance³³ and also in the case of non-marine policies containing average (or co-insurance) clauses. Average clauses provide that, if at the time of the loss the value of the subject matter of insurance exceeds the amount of cover, the insured is deemed to be his or her own insurer for the difference in value and must bear a rateable proportion of the loss accordingly. The following formula is used to compute the loss:

$$\frac{\text{Policy value}}{\text{Value of the subject matter}} \times \text{Amount of Loss}$$

For example, suppose the insured owns a dwelling house worth \$100,000 but takes out cover of \$60,000. If the house is partially destroyed and the insured sustains a loss of \$40,000 and the policy

28 See, for example, Birds, 'Contractual Subrogation in Insurance' [1979] JBL 124, 131-132; *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874.

29 Insurance Contracts Act 1984 (Cth) s4.

30 See Tarr, *Australian Insurance Law* (1987) 264-265; Kelly and Ball, *Insurance Legislation Manual* (1986) 90-91.

31 For example, see *Yorkshire Insurance Co Ltd v Nisbet Shipping Co Ltd* [1962] 2 QB 330.-9d-

32 Insurance Contracts Act 1984 (Cth) s67(2)(b). See further discussion in paragraph 5, infra.

33 See the Marine Insurance Act 1909 (Cth) s87.

is subject to a pro rata average condition, the insured is only entitled to recover \$24,000. Moreover, in terms of subrogation recoveries such monies must be shared between insured and insurer in proportion to the insurance burden that each one bears.³⁴ It should be noted that the Insurance Contracts Act 1984 (Cth) has severely curtailed the operation of average clauses.³⁵

3. INTEREST

In recognition of the inconvenience occasioned through delay in payment of claims, and out of concern for the eroding effect which inflation can have on the real value of a claim during the period of delay, legislatures have sought to protect the insured against loss caused by delay in payment of claims by providing for the payment of interest at a realistic rate from the date of loss or such other specified time until settlement or payment of the claim.³⁶ Under various State and Commonwealth enactments³⁷ courts have been empowered to award interest on claims under contracts of insurance - such claims have to be litigated. Consider, for example, s30c of the Supreme Court Act 1935 (SA):

‘(1) Unless good cause is shown to the contrary, the court shall, upon the application of a party in favour of whom a judgment for the payment of damages, compensation or any other pecuniary amount has been, or is to be, pronounced, include in the judgment an award of interest in favour of the judgment creditor in accordance with the provisions of this section.

(2) The interest -

(a) shall be calculated at such a rate of interest as may be fixed by the court;

(b) shall be calculated -

(i) where the judgment is given upon an unliquidated claim
- from the date of the commencement of the proceedings to the date of the judgment;

or

(ii) where the judgment is given upon a liquidated claim
- from the date upon which the liability to pay the amount of the claim fell due to the date of the judgment,

or in respect of such other period as may be fixed by the court;

and

(c) shall be payable in respect of the whole or any part of

34 See Derham, *supra* n 26 at 139. Note, however, the effect of s67 of the Insurance Contracts Act 1984 (Cth).

35 Again in respect of contracts entered into after 1 January 1986. See the Insurance Contracts Act 1984 (Cth) s44; discussed in Tarr, *Australian Insurance Law* (1987) 240-41.

36 For example, under the Insurance Contracts Act 1984 (Cth) s57(2), interest is payable in respect of the period commencing on the day as from which it was unreasonable for the insurer to have withheld payment of the amount and ending on whichever is the earlier of the following days (a) the day on which payment is made; (b) the day on which payment is sent by post to the person to whom it is payable. See Tarr, *Australian Insurance Law* (1987) 243.

37 See, for example, Supreme Court Act 1979 (NT) discussed in *Jones v South British Insurance Co Ltd* (1984) 3 ANZ Insurance Cases 69-569; Supreme Court Act 1959 (Vic) discussed in *Zajc v Dillon and Associates* (1986) 4 ANZ Insurance Cases 60-753; Supreme Court (NSW) Practice Note 30 discussed in *Legal & General Insurance Australia Ltd v Eather* (1986) 4 ANZ Insurance Cases 60-749.

the amount for which judgment is given in accordance with the determination of the court.

(3) Where a party to any proceedings before the court is entitled to an award of interest under this section, the court may, in the exercise of its discretion, and without proceeding to calculate the interest to which that party may be entitled in accordance with subsection (2) of this section, award a lump sum in lieu of that interest.

(4) This section does not -

- (a) authorize the award of interest upon interest;
- (ab) authorize the award of interest upon exemplary or punitive damages;
- (b) apply in relation to any sum upon which interest is recoverable as of right by virtue of an agreement or otherwise;
- (c) affect the damages recoverable upon the dishonour of a negotiable instrument;
- (d) authorize the award of any interest otherwise than by consent upon any sum for which judgment is pronounced by consent;

or

- (e) limit the operation of any other enactment or rule of law providing for the award of interest.'

The following comments may be advanced in respect of this section. First, the scales are weighted in favour of the judgment creditor that interest is payable - it is only if good cause to the contrary is shown that no interest is recoverable. Second, while many of the cases are personal injury cases,³⁸ s30c is not so limited in its scope.³⁹ Third, in the case of claims for unliquidated damages interest is recoverable in respect of the period from the date of the writ until judgment, or in respect of such other period as may be fixed by the court. Fourth, the rate of interest payable is entirely within the discretion of the court. In *Masinovic v Motor Vehicle Insurance Trust*⁴⁰ White J observed that the generally prevailing rates of interest used by Judges of the Supreme Court of South Australia between 1974 and 1985 ranged from 10 per cent to 12 per cent. It is interesting to note that in the recent New South Wales case, *Legal & General Insurance Australia Ltd v Eather*,⁴¹ the Court of Appeal ordered that interest be payable at a much higher commercial rate in the interests of justice. Fifth, the Court has a discretion to award the interest in respect of the whole or any part of the amount for which judgment is given, and the Court may elect to award a lump sum in lieu of interest. Finally, s30c makes it quite plain that the award of interest on damages is contingent upon judgment being obtained;⁴² it has no application in the case of settlements.

38 See, for example, *Guley v Sabbadin* (1978) 21 SASR 139; *Dimond v Metcalf* (1982) 32 SASR 73; *Batchelor v Burke* (1981) 148 CLR 448; *Masinovic v Motor Vehicle Insurance Trust* (1986) 42 SASR 161.

39 See, for instance, *Legal and General Assurance Society Ltd v Stateliner Pty Ltd* (1982) 31 SASR 157.

40 (1986) 42 SASR 161, 168.

41 (1986) 4 ANZ Insurance Cases 60-749.

42 Compare the Insurance Contracts Act 1984 (Cth) s57; discussed in Tarr, *Australian Insurance Law* (1987) 242-243.

It is plain therefore that under s30c of the Supreme Court Act 1935 (SA), or any statute to like effect, successful plaintiffs are entitled to interest on any judgment for the payment of damages or other compensation. A qualification was raised in *Harbutt's Plasticine Ltd v Wayne Tank & Pump Co Ltd*⁴³ where the English Court of Appeal held that an insured should not recover interest on the damages awarded against a third party in respect of the period after he or she had been indemnified by his or her insurers. However, in the following year in *H Cousins & Co Ltd v D & C Carriers Ltd*,⁴⁴ the English Court of Appeal distinguished *Harbutt's* case, in essence confining it to the situation where any interest awarded would inure to the benefit of a fully compensated insured.⁴⁵ The correct position was that interest was recoverable in subrogation actions and that the insurer was subrogated to any award of interest in so far as it related to the period following indemnity. As Davies LJ states

'... if the insurers do not recover interest for the period between the date of payment by them and the recovery against the third party, then they are under-compensated since they have been kept out of their money for that period'.⁴⁶

As far as underinsured insureds are concerned this writer would respectfully concur in the suggestion of Derham⁴⁷ that such insureds should be entitled to share in any interest accruing after the date of indemnity in proportion to their interest in the action.

In conclusion to this part, therefore, the amount of interest recoverable is unpredictable - in South Australia the court has a discretion as to the rate upon which computation is to be made, and the period for which interest is to be awarded.

4. COSTS

The questions of costs and control of subrogation proceedings commonly are dealt with by express subrogation clauses in policies. For example, the express subrogation clause considered at paragraph 2(f) above gives extensive control to the insurer, regardless of indemnification, and also declares that the insured's conduct of an action or proceeding at the request of the insurer shall be 'at the expense of the Company'. Therefore where the insured is acting at the request of the insurer in pursuing a subrogation recovery, such a subrogation clause would entitle the insured to a full reimbursement in respect of costs.

In the absence of such express provision the common law would impose a similar obligation upon the insurer. In the absence of a formal assignment of the right of action,⁴⁸ the insurer cannot sue the third party in its own name; it must bring the action in the name of the insured and the insurer can go to equity to compel an uncooperative insured

43 [1970] 1 QB 447.

44 [1971] 2 QB 230.

45 See, for example, the judgment of Widgery J, 243.

46 At 244.

47 *Supra* n 26 at 138, fn26.

48 See *King v Victoria Insurance Co* [1896] AC 250; *Cia Colombiana De Seguros v Pacific Steam Navigation Co* [1965] 1 QB 101. Where there is an express assignment the cause of action vests in the insurer who can then exercise in its own name the rights originally belonging to the insured.

to consent to proceedings being taken in his or her name.⁴⁹ However, in *Australian Workers Union v Bowen*⁵⁰ Dixon J stated that as a general rule the person beneficially entitled in the subject of a proceeding must seek the consent of the nominal party and offer the party a sufficient indemnity against liability for costs to which the use of the party's name might expose the party. The learned judge added that:

'Unless the real actor does this, or unless special circumstances exist excusing him from doing so, the courts will not permit him to ... proceed in the names of nominal parties without their actual authority ...'⁵¹

Admittedly this statement was made in the context of the right of a judgment creditor who had paid other judgment creditors to enforce an order for costs and to use the latter's names in so doing; however the proposition is of general application and accurately reflects the insurance law position.⁵² Thus the insurer normally will be required to give an indemnity as to costs before exercising its subrogation rights as against the third party, and such an insurer will be subrogated to any award of costs given in favour of the nominal plaintiff.⁵³

Where the insurer elects to 'sit on the fence' as far as taking action against a third party tortfeasor is concerned, the insured is in an awkward position. The underinsured insured may decide to proceed against the tortfeasor to recover his or her uninsured loss, and in so doing must sue for the whole loss and not prejudice the position of the insurer.⁵⁴ If the insured is successful in recovering a sum from the tortfeasor, the insurer is entitled to recover from the insured any sum received by the insured in excess of his or her total loss; the insured, however, is entitled to his or her reasonable expenses in obtaining compensation from such tortfeasor.⁵⁵ As MacDonnell JA observed in *Baloise Fire Insurance Co v Martin*,⁵⁶ the insurer is not entitled to any portion of the costs awarded in that:

'The insurer did not care to take any part in the action or to incur any of the risk. It cannot reasonably claim any of the costs.'

Conversely if the insured is unsuccessful in the action brought, the insured cannot claim any part of the costs from the insurer on the ground that had the insured succeeded this would have been partly to the benefit of the insurers.⁵⁷

49 See *London Assurance Co v Sainsbury* (1793) 99 ER 636; *King v Victoria Insurance Co* [1896] AC 250; *J Edwards & Co v Motor Union Insurance Co* [1922] 2 KB 249, 254; *Re Miller, Gibb & Co* [1957] 1 WLR 703, 707; *Morris v Ford Motor Co Ltd* [1973] QB 792, 800.

50 (1946) 72 CLR 575.

51 *Ibid* 589.

52 See, for example *King v Victoria Insurance Co* [1896] AC 250; *Cia Colombiana De Seguros v Pacific Steam Navigation Co* [1965] 1 QB 101; *Morris v Ford Motor Co Ltd* [1973] 1 QB 792, 801. See Powles (1974) 90 LQR 34.

53 See Derham, *supra* n 26 at 139, and the cases there cited.

54 See, for example, *West of England Fire Insurance Co v Isaacs* [1897] 1 QB 226; *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874, 882, 885, 889.

55 See, for example, *Darrell v Tibbitts* (1880) 5 QBD 560; *Castellain v Preston* (1883) 11 QBD 380; *Assicurazioni Generali De Trieste v Empress Assurance Corp Ltd* [1907] 2 KB 814; *Baloise Fire Insurance Co v Martin* [1937] 2 DLR 24.

56 [1937] 2 DLR 24, 26.

57 See *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874.

As to what costs are compensable or allowable, in *Baloise* the underinsured insured was permitted to deduct expenses incurred in payment of an assessor and expert witnesses, solicitor and client costs and, unusually, his personal expenses associated with attending at Ottawa, where the trial was held. In *Assicurazioni Generali De Trieste v Empress Assurance Corp Ltd*⁵⁸ it was held that an insured could deduct whatever expenses 'may on investigation of circumstances of that action be found to be reasonably and properly attributable to the recovery of [the subrogation proceeds]'. However this statement should not be taken too widely; it is a frequent complaint that the successful litigant is often out-of-pocket in respect of direct expenses of litigation, let alone in respect of indirect costs incurred through time spent in court, in consulting lawyers and in travelling to and from court.⁵⁹ It is clear however that the insured is entitled to actual expenses paid by way of assessors' costs, expert witnesses' expenses, and legal costs. Where the court awards costs on a party/party taxation basis, the decision in *Assicurazioni Generali* would support an insured discounting the difference between such award and actual solicitor/client costs before accounting to the insurer for any excess; that is, the insured may deduct properly incurred unrecovered costs before accounting to the insurers for the proceeds.

5. CONCLUSION

The underinsured insured is often in an invidious position where his or her insurer adopts a 'wait and see' attitude. Any initiative to recover in respect of the uninsured loss must take account of the insurer, and the insured must exercise extreme caution so as not to prejudice the insurer's subrogation rights. For example, it is clear that the insured must prosecute a claim for the full amount of the loss,⁶⁰ and that the insured must proceed with diligence and good faith; failure on either count will render the insured liable to make good to the insurers any loss occasioned to them by his or her lack of diligence or good faith. Where a subrogation clause in the policy permits an insurer to refuse consent to any proposed settlement, any settlement by the insured in breach of such clause exposes the insured to a liability in damages.⁶¹ However some consolation can be found in the judgments given in the High Court in *Distillers Co Biochemicals (Aust) Pty Ltd v Ajax Insurance Co Ltd*.⁶² The insured had a public risks policy which was subject to an upper limit on indemnity. It was the defendant in a number of claims for injury arising out of the use of the drug thalidomide. The insurer elected not to take over and conduct the defence or settlement of those actions, and would not admit liability under the policy. In doing so it relied upon an admission clause which provided:

'The insured shall not without the consent in writing of the company make any admission, offer, promise or payment in connection with any accident or claim, and the company if it so desires shall be entitled to take over and conduct

58 [1907] 2 KB 814, 822.

59 See Phillips and Hawkins, 'Some Economic Aspects of the Settlement Process: A Study of Personal Injury Claims' (1976) 39 MLR 497.

60 *Arthur Barnett Ltd v National Insurance Co of NZ Ltd* [1965] NZLR 874, 885.

61 See *Broadlands Properties Ltd v Guardian Assurance Co Ltd* (1984) 3 ANZ Insurance Cases 60-552, 78,311; per Chilwell J.

62 (1973) 130 CLR 1.

in the name of the insured the defence or settlement of any claim.’

In an application by the insured for declarations as to its rights under the contract *Menzies and Stephen JJ* held that the insured would be in breach of the condition if it were to settle or compromise any claim. *Gibbs and Stephen JJ* both added the qualification that the consent of an insurer to a settlement or admission of liability on the part of the insured cannot be unreasonably withheld, and *Gibbs J*, in dissenting from the majority, held that the insurer’s repeated refusal to take part in the conduct of the defence or settlement of claims relieved the insured from compliance with the clause.⁶³

Moreover it should always be borne in mind that the contract of insurance is a contract of utmost good faith. Recent judicial pronouncements, as in *New South Wales Medical Defence Union v Transport Industries Insurance Co Ltd*,⁶⁴ have affirmed that, at common law,⁶⁵ there is an implied condition in each policy that the parties observe good faith toward each other at all material times and in all material particulars. An insurer who acts unreasonably in the claims settlement process, or in pursuit of subrogation recoveries, arguably exposes itself to a liability in damages for breach of such an implied obligation. Therefore, an insurer in seeking subrogation recoveries and in addressing claims settlement issues should be mindful of its duty to act in utmost good faith.

Finally, on principle and authority it is submitted that participation by insurers in subrogation recoveries should be restricted to those funds in excess of the amount needed to compensate the insured fully in respect of his or her loss. Subrogation is designed to prevent unjust enrichment of the insured and was never intended to deprive an insured of full compensation, and the insurer is the party which receives a premium in consideration for undertaking the risk of a loss eventuating. In the case of the Ash Wednesday bushfire victims it is to be hoped that a full compensation approach will prevail. In respect of contracts entered into after 1 January 1986,⁶⁶ the situation is clarified as far as proceeds of any judgment obtained against a third party are paid directly to the insurer; s67 of the Insurance Contracts Act 1984 (Cth) provides that the insured may recover all or part of the amount recovered by the insurer in the exercise of its rights of subrogation, subject to the major qualification that the insured may not recover an amount that would

63 As far as liability insurance is concerned, note the reforms introduced by the Insurance Contracts Act 1984 (Cth) s41; discussed in Tarr, *Australian Insurance Law* (1987) 217-218.

64 (1985) 4 NSWLR 107, 110; see also *GRE Insurance Ltd v Ormsby* (1982) 29 SASR 498; *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1987] 1 Lloyd’s LR 69.

65 Under the Insurance Contracts Act 1984 (Cth) ss12-14, the duty of utmost good faith is cast as the paramount obligation upon the parties to a contract of insurance and there is implied into every contract of insurance (covered by the Act) a provision requiring each party to act ‘in respect of any matter arising under or in relation to’ the contract, with utmost good faith.

66 See the Insurance Contracts Act 1984 (Cth) s4.

give him or her more than an indemnity against the loss.⁶⁷ Unfortunately, this section does not address the question of subrogation recoveries in the hands of the insured, and this matter may properly be the subject of supplementary legislative reform.

⁶⁷ Two further qualifications are contained in s67; namely, the insured may not recover more than the difference between the amount recovered by the insured and the amount paid to him or her by the insurer (s67(2)(a)); and, the rights of the insured to recover are subject to any agreement made between the insurer and the insured after the occurrence of the loss (s67(3)).