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Blindfolding the Courts: A Further Comment on Photo Production v. Securicor

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BLINDFOLDING THE COURTS: A FURTHER COMMENT ON PHOTO PRODUCTION v. SECURICOR

The decision of the House of Lords in Photo Production Ltd. v. Securicor Transport Ltd.\(^1\) has received the qualified approval of Professor Ogilvie in this journal\(^2\) and that of commentators in other journals.\(^3\) This is not altogether surprising. After all, Photo Production overrules the notorious decision in Harbutt's "Plasticine" Ltd. v. Wayne Tank and Pump Co. Ltd.,\(^4\) a decision which probably has the distinction of being the only important contract decision in recent legal history not to find a single academic backer.\(^5\)

Yet Professor Ogilvie\(^6\) and the other commentators\(^7\) are troubled by the uncertainties left by the decision in Photo Production. Their concern is justified.

That uncertainty will only be dispelled once the problem in Photo Production is seen as having nothing to do with exclusion (or exemption) clauses. An intelligent resolution of the problem raised in a case such as Photo Production can only be achieved by

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\(^5\) For comments critical of the decision see, e.g., P. N. Legh-Jones and M. A. Pickering, "Harbutt's 'Plasticine' Ltd. v. Wayne Tank and Pump Co. Ltd.: Fundamental Breach and Exemption Clauses, Damages and Interest", 86 L.Q.R. 513 (1970); B. Coote, "The Effect of Discharge by Breach on Exception Clauses", [1970] 28 Camb. L.J. 221, and the notes by J. A. Weir, [1970] 28 Camb. L.J. 189 and J. H. Baker, 33 Mod. L. Rev. 441 (1970). The most penetrating criticism of the decision is suggested by Professor P. S. Atiyah who asked "would the decision have been much more sensible in policy even if there had been no exclusion clause at all?"; see his review of Professor S. M. Waddams' book on Products Liability in 26 U. Tor. L.J. 118 (1976), at p. 120.
\(^6\) Supra, footnote 2. Professor Ogilvie thinks that much of the future uncertainty in this area of the law is to be attributed to the "frequency with which Lord Denning deals with these cases". In my view, the confusion and waste that will be generated in the post-Photo Production era cannot be blamed on the Master of the Rolls.
\(^7\) Supra, footnote 3.
abolishing the law of subrogation in so far as it relates to fire and liability insurance.

1. The Uncertainties after Photo Production

One does not need a vivid imagination to foresee the nice questions left for interpretation and construction by the decision.

It will be remembered that Musgrove, the patrolman employed by Securicor, caused the loss by starting a small fire which got out of control. The exclusion clause in Photo Production provided:7a

"Under no circumstances shall the company be responsible for any injurious act or default by any employee of the company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the company and his employer..."

Suppose that after Photo Production, an employee is sent by a firm like Securicor and causes a fire. The employee was hired despite the fact that he was dismissed for recklessness from his previous employment ten years ago. Suppose again that the employee who sets a fire is one who is sent by his company with full knowledge that the employee is under great emotional strain because his wife and children had been killed a week earlier. The courts will in these cases have the unenviable task of construing the exclusion clause and determining whether the defendant acted with "due diligence". The only certain answer to these questions is that their resolution is uncertain.8

The uncertainties increase, as Messrs. Nicol and Rawlings observe,9 when one turns from Photo Production to "consumer" cases such as Levison and Another v. Patent Steam Carpet Cleaning Co. Ltd.10 The Levisons owned a carpet worth £900 which they insured. They entrusted the carpet to the defendants for cleaning. The defendants failed to return the carpet and relied on an exclusion clause which sought to limit their liability to £40. In a subrogated action by the insurer, the English Court of

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7a Supra, footnote 1 at p. 559 All E.R., p. 286 W.L.R.
8 There is a considerable body of case law on the question of whether the insured acted with "due diligence"; see, e.g., Woolfall and Rimmer, Ltd. v. Moyle, [1942] 1 K.B. 66 (C.A.); Fraser v. B. N. Furman (Productions) Ltd., Miller Smith & Partners, Third Party, [1967] 1 W.L.R. 898 (C.A.); Hartley Ltd. v. Provincial Insurance Co., Ltd., [1957] 1 Lloyd's Rep. 121. How much assistance the courts will derive from this body of case law is, indeed, problematic.
9 See 43 Mod. L. Rev. 567 (1980), at p. 569.
10 [1978] Q.B. 69 (C.A.); see the comment by R. T. H. Stone, 41 Mod. L. Rev. 748 (1978).
Appeal held that the defendant could not rely on the exemption clause because it had committed a fundamental breach. It is probable that the same result would be reached after the decision in *Photo Production*. The House of Lords in that case left consumers to be protected by the Unfair Contract Terms Act, 1977. Under s. 3(2)(b)(i) of that Act the defendants would probably be found to have rendered "a contractual performance substantially different from that which was reasonably expected of him". This sounds reasonable enough; after all one should generally have different rules to deal with consumer contracts as opposed to commercial contracts. The difficulty with this is that *Levison* is not a "consumer" case; like *Photo Production* it is very probably a contest between two insurance companies.

2. Why the Charade?

If *Photo Production*, *Levison* and scores of other cases are contests between two insurance companies, why is this disguised from the world? It is necessary to identify the interests of various groups in helping maintain the charade. The insurance companies have an interest in concealing their identities because the revelation of their identities would disclose that there were at least two policies to cover one risk. This becomes particularly embarrassing when insurance brokers and the *Financial Times*.

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12 This section is subject to a "reasonableness" test. Whether a disclaimer clause can be upheld as being "reasonable" if insurance exists (or is available) is unknown and can only be known after litigation.

13 Thus, to take only one example, it seems reasonable to make damages the primary remedy in commercial sales whereas it would be calamitous to do so in consumer sales.

14 We know for a fact that in *Photo Production*, Photo Production were insured except for a deductible of £25,000 while Securicor carried liability insurance except for a deductible of £10,000; see the judgment of Lord Denning M.R. at [1978] 1 W.L.R. 856 at p. 866. In *Levison*, we know for a fact that the plaintiff was insured. It is possible that the defendant was uninsured but this seems highly unlikely.

reveal that it is not uncommon for one insurance company to underwrite the potential loss of both sides of a bargain. The legal profession has an interest in keeping the subrogation game going because it is a highly lucrative business. After all, the Harbutt's "Plasticine" saga generated two cases which went to the English Court of Appeal when, under a rational system of loss distribution, no litigation at all should have been permitted. Finally, academic commentators have an interest in maintaining the doctrine of subrogation. After all, many of our leading cases would disappear if property damage claims were to be abolished and we have an investment in the knowledge we have acquired so painfully.

3. The Arguments for Subrogation

It is necessary to examine the arguments (implicit and explicit) that have been advanced in favour of subrogation.

(a) Subrogation as a cost saver

According to one insurance authority, subrogation reduces insurance premiums because insurance companies fix their rates after having taken into account "net subrogation recoveries". There are two difficulties with this argument. In the first place, subrogation recoveries constitute only a minute fraction of the payouts made by insurance companies. Thus, in 1972, fire insurers in the United States paid out $973,636,000 in fire claims and recovered only $6,621,000 (.68% of the losses paid) through subrogation.
Secondly, and more important, one can only speak meaningfully of “net subrogation recoveries” if the insurer provides only first party (e.g., fire insurance) rather than first and third party liability insurance. In the course of a long search, I have yet to find a company which provided fire insurance but which did not provide liability insurance. Once an insurer underwrites liability insurance as well as fire insurance, then in addition to computing “net subrogation recoveries”, it will also be necessary to compute “net subrogation liabilities”. Since one would expect subrogation recoveries and subrogation liabilities to cancel each other out on a “swings and roundabouts” basis, it seems difficult to see how subrogation could help lower rates. On the other hand, it seems to be certain that subrogation actions have the effect of making insurance more expensive since it is a costly business to shift costs from one insurer to another.\(^{21}\)

(b) Subrogation as a deterrent against negligent behaviour

It will be argued by some that subrogation is needed to deter negligent behaviour. However, there are formidable difficulties with this.

If we truly believe that subrogation claims deter negligent behaviour by corporations, we should ban liability insurance by potential defendants in cases such as Photo Production and Leison. The argument that subrogation claims promote safety not in the individual case but by increasing premiums for delinquent companies with bad accident records\(^{22}\) is most unlikely to be true because insurance companies very infrequently bring subrogated claims.\(^{23}\)

Second, insurance companies very seldom bring subrogated claims because of the cost of determining negligence and other costs such as challenging the validity of exculpatory clauses. The fact that subrogated claims are brought infrequently is not lost on corporate defendants who are unlikely to regard subrogated


\(^{23}\) See text at footnote 20, supra. It is also significant that in automobile liability claims, insurers have virtually abandoned their right to bring subrogated claims by entering into “knock-for-knock agreements”.

\[^\text{freakish}\] Insurance companies will use subrogated actions infrequently because they are expensive. At the same time, insurers must sometimes use subrogated actions if they are to maintain the benefits that accrue to them because of overlapping coverage.
claims (against which they are insured) as much of a deterrent. Finally, the real deterrent against negligent conduct on the part of corporations is that corporations may be unable to operate their businesses after a serious loss. Thus, in Photo Production, Securicor would suffer a loss of business as a result of the conflagration. If a corporation does not fear the loss of business as a result of an accident, it is unlikely to fear the possibility of a subrogated claim against which it is insured. Further, if a corporation has been truly delinquent, the criminal law is likely to be a more satisfactory weapon against corporations because the criminal law is interested in culpability rather than quantum of loss.

4. The Shape of a Reforming Statute

Some things are obvious when one gets down to draft a reforming statute in this area. First, one makes sure that assignments of claims are abolished together with subrogation claims in fire and liability insurance. Second, it is important to make sure that after the action for subrogation has been abolished the insured cannot bring an action to recover the deductible. The deductible may be large, in which case the problem of overlapping coverage remains. It is better to attack the problem of deductibles by negotiations between large enterprises and their insurers, and by legislation for consumers and small businesses.

Third, it is probably more desirable to allow those people who have underinsured to bear their own losses. It is, after all, difficult to distinguish this situation from that of the deductible.

Fourth, I would suggest that people who carry insurance should be forced to claim from their own insurers rather than suing tortfeasors. To some this may seem strong medicine but it is important if the evil of overlapping coverage is to be removed.

24 See, in this connection, the comments of the New York State Insurance Department on the utility of tort claims as a means of achieving safety on the roads: “Individual, last-moment driver mistakes — undeterred by fear of death, injury, imprisonment, fine or loss of licence — surely cannot be deterred by fear of civil liability against which one is insured”; see their Report, Automobile Insurance . . . for Whose Benefit? (New York, 1970), p. 12.

25 Even when the deductible is small, the waste caused by these actions is indefensible. See, e.g., the remarkable claim in Hobbs v. Marlowe, [1977] 2 All E.R. 241 (H.L.), noted by J. Birds, “Motor Insurance and the Knock for Knock Agreements”, 41 Mod. L. Rev. 201 (1978).

26 The law relating to the measurement of property losses caused by fire is in a profoundly unsatisfactory state; see J. A. Gilbert, “‘Actual Cash Value’ Revisited”, 4 C.B.L.J. 120 (1979).
Since the overwhelming number of insureds (consumers as well as business enterprises) would prefer to claim from their own insurers, it does not seem an unreasonable imposition to require a minute fraction of policyholders to do the same.

We are left with the problem of those who cannot obtain insurance whether because of poverty or because of "redlining". One possibility is to let these people continue to sue in tort. I do not think this is a desirable solution for two reasons: first, the people who are unable to obtain insurance are likely to be poor and will have difficulty finding a lawyer; second, a freak accident may occur in which, say, a hundred residential tenants lose their uninsured property as the result of a fire which has been negligently caused by a corporate defendant. The result of such a liability being imposed might well cause other corporate defendants to take out liability insurance and we would once again have expensive litigation. The choice then boils down to whether one assigns uninsurable risks to private insurers or to the government. In my view, there are great difficulties in devising and operating an assigned risk scheme. Further, a government-run scheme can be run more cheaply than a private insurance scheme.

**Conclusion**

Fourteen years ago, my colleague Professor Ison pointed out that our "system" of compensating property losses was as unsatisfactory as our "system" for compensating personal injuries. In the ensuing years, academic debate has, understandably, concentrated on the more important problem of compensation for personal injuries.

We have lost sight of the fact that our "system" of compensating for property losses is an expensive farce. It seems high time to put an end to a system which can only operate by blinding us to what is really going on.

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27 No one knows how serious a problem "redlining" is in either England or Canada. The problem is a serious one in the United States: see D. I. Badain, "Insurance Redlining and the Future of the Urban Core", 16 Columbia J. of Law & Social Problems 1 (1980).


29 See The Forensic Lottery, supra, footnote 21 at pp. 97-100.

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