

 NORTON ROSE FULBRIGHT

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Subrogation demystified

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Introduction

Subrogation is a fundamental doctrine in insurance law, allowing the insurer to recoup its outlay from the responsible third party and preventing the insured from obtaining double compensation from both the insurer and the third party. It operates at the intersection of common law and contract, and its practical application is shaped by the relationships between insurers, insureds, and third parties. This volume sets out the position under South African law as at the date of publication.

The nature and rationale of subrogation

Subrogation arises primarily in contracts of indemnity insurance and serves two principal objectives:

- Prevention of double recovery: Ensuring that the insured does not receive compensation from both the insurer and a third party for the same loss.
- Loss allocation: Ensuring that the party responsible for the insured's loss bears the financial burden, rather than the insurer.

Subrogation is often described as the insurer "stepping into the shoes" of the insured. The description is common but misleading. Subrogation is a procedural device: the insurer does not acquire ownership of the insured's right of action. The insurer acquires the right to control proceedings, subject to the terms of the insurance contract and the common law.

Subrogation is different to the insurer taking assignment of the insured's claim against the third party and thus acquiring ownership of the right of action.

The third party cannot raise as a defence to the action by the insured that the insured has not suffered a loss because it was indemnified by its insurer. The insurance payment is deemed to be a collateral benefit (*res inter alios acta*) and does not serve to diminish the actionable loss. The justification for this principle is that wrongdoers should not benefit from the victim's prudence in taking out an insurance policy and paying the premium.

There is a distinction between contractual and common law subrogation.

Common law subrogation: Requirements and operation

At common law, subrogation is implied into contracts of indemnity insurance unless expressly excluded or varied by the policy. The requirements for the operation of common law subrogation are:

- There must be a valid contract of indemnity insurance.
- The insurer's right to subrogation under common law arises only after it has fully indemnified the insured for the loss. Under common law, if a deductible applies or the insurer has not paid the full amount due, the right does not vest, and the insured retains the right to pursue the third party.
- The insured must have a valid cause of action against a third party. For example, subrogation cannot be invoked in circumstances where the insured is personally or vicariously responsible for a loss covered by the policy. An insured has no claim for compensation against himself.
- The insured must not have waived its right of action against the third party prior to the loss or indemnification.

Once these requirements are met, the insurer is entitled to control the proceedings against the third party, but must do so in the name of the insured. The insurer does not become the plaintiff in its own right; the claim remains vested in the insured, and the insurer acts as controller of the litigation (*dominus litis*). The third party's rights and defences are unaffected by the insurer's involvement.

Contractual subrogation: Policy wording and variations

Most insurance policies contain express provisions that alter or extend the operation of subrogation under the common law. These contractual terms may:

- **Dispense with full indemnification:** Many policies allow the insurer to exercise subrogation rights even where no indemnity has yet been provided or only partial indemnity has been provided. Examples include where the insured's claim is still in the process of being settled, where the insured is required to pay a significant deductible and where the insured's claim is subject to average.
- **Regulate cooperation:** Policies should require the insured to cooperate with the insurer, provide information, grant access to property, and give evidence as needed in the proceedings against the third party.
- **Control of recovery:** The insurer should be given the right to settle with the third party, while the insured is typically prohibited from doing so without the insurer's consent.
- **Direct recovery:** The insurer may be permitted to recover the loss directly from the third party, obviating the need to recover indirectly through the insured. This may potentially be beneficial in the event of the insolvency of the insured.

The “once and for all” rule

Under the “once and for all” rule, all damages arising from a single cause of action must be claimed in one proceeding. This principle operates with full force in subrogated claims. When the insurer sues the wrongdoer in the insured's name, it must therefore claim the entire loss, including any deductible or other uninsured component, so that a single judgment exhaustively determines liability.

As only one recovery action can be brought, the insured may not recover only their deductible and thereby prejudice the insurer's right of recovery of the insured loss. In principle the insured is entitled to the first bite of any recovery to reimburse the deductible, unless there is an agreement to the contrary.

The action is usually brought in the insured's name

The action is usually brought in the insured's name. Courts have also permitted the action to be brought in the insurer's name, although this is rarely done in practice.

Remedies for breach

If the insured breaches its obligations under the subrogation provisions, such as by releasing the third party from liability without the insurer's prior consent, the insurer is entitled to remedies at common law and/or under the terms of the insurance contract.

Damages:

The insurer may claim damages for breach of contract. This remedy is available where the insured's conduct has prejudiced the insurer's subrogation rights, resulting in a loss to the insurer. The quantum of damages would typically be the amount the insurer is unable to recover from the third party as a result of the insured's breach.

Contractual sanctions as set out in the policy:

- Many insurance policies expressly provide for specific consequences in the event of a breach of subrogation provisions. These may include:
 - Restitution:
The insurer may be entitled to reclaim the indemnity paid to the insured. This is particularly relevant where the insured's breach has deprived the insurer of its right to pursue recovery from the third party. In such circumstances, the insurer may demand repayment of the indemnity as restitution, effectively placing the parties in the position they would have been in had the indemnity not been paid.
 - Voidability:
Some policies stipulate that a breach of the subrogation clause renders the relevant section of the policy voidable at the insurer's election which is not a remedy of much practical use.
- The precise remedies available will depend on the wording of the policy and the nature of the breach. In the absence of an express contractual provision, the insurer's remedies will be those available at common law, which will be less advantageous than those provided for in a well-drafted policy.
- A policy that expressly provides for restitution, allowing the insurer to reclaim the indemnity paid in the event of a breach, is generally more favourable to insurers than one that limits remedies to a claim for damages. Restitution provides a direct and effective remedy, whereas a damages claim will require the insurer to prove the extent of its loss, which can be complex and uncertain.
- Clear policy wording also reduces the risk of disputes and litigation, as both parties are aware of their rights and obligations, and the consequences of any failure to comply with the subrogation provisions.

The role and duties of insurers, insureds, and attorneys

The insurer, in exercising subrogation rights, must act in good faith and not unreasonably prejudice the interests of the insured. In conducting the litigation, the insurer must consider the common interests of both itself and the insured. The insurer is obliged to bear the costs of the litigation conducted by it.

The insured must not do anything to prejudice the insurer's subrogation rights. This includes releasing the third party from liability without the insurer's consent or settling with the third party without recovering the insurer's loss. The insured is also required to cooperate with the insurer, provide information and documents, and allow proceedings to be instituted in its name.

Attorneys acting in subrogated claims owe duties to both the insured (as the nominal plaintiff) and the insurer (as the party controlling the litigation). Where a conflict of interest arises, the attorney must inform the insured and advise them of their right to seek independent legal advice.

Waivers of subrogation: Express and implied

A waiver of subrogation is a term—either in the insurance policy or in a contract between the insured and a third party—that prevents the insurer from exercising subrogation rights against certain parties. Waivers may be:

- Express: Clearly set out in writing, either in the policy or in a separate contract.
- Implied / tacit: Arising from the circumstances or the overall contractual arrangements between the parties.

There are two methods of achieving a waiver:

- Contractual waiver: The waiver is a term of the underlying contract between the insured and a third party. For example, in a lease or construction contract, the parties may agree that one party will take out insurance cover and that they will look to the insurance to cover any losses that arise and that they waive claims against each other where losses are insured under the policy. The term may even state that the parties' insurers have no right of subrogation against either party. As the insurer is not a party to this contract, the insurer's right remains intact in theory but is rendered unenforceable in practice because the insured has no right to pursue the third party.
- Policy waiver: A term of the insurance policy may provide that the insurer waives its right of subrogation against specified parties in the insurance policy wording.

Where waivers are express and clearly drafted, there are unlikely to be disputes. Disputes are likely to arise in the event of an allegation of an implied / tacit waiver. These disputes are highly fact sensitive.

Disclosure of waivers and material non-disclosure

The existence of a waiver of subrogation may be material to the insurer's assessment of risk. In sectors where waivers are common (e.g. construction), insurers could be expected to be aware of their presence and to request the relevant contracts during underwriting. If a waiver is not standard or is included in a side agreement or variation, the insured may have a duty to disclose it.

The failure to disclose a waiver could potentially give the insurer the right to avoid the policy if:

- The waiver is deemed to be material where a reasonable person would consider that the particular information should have been disclosed to the insurer so that the insurer could form its own view as to the effect of the information on the assessment of the relevant risk.
- The misrepresentation / non-disclosure actually induced the insurer to enter into the contract or induced it to do so on terms or for a premium it would not otherwise have agreed to.

Subrogation and co-insureds: Construction and project insurance

As a general rule, where there are multiple insureds who have a joint interest in the property insured under a policy—such as co-owners of a property—an insurer cannot exercise a right of subrogation against a co-insured. This principle is rooted in the logic that subrogation is intended to allow the insurer to recover from third parties responsible for the loss, not from parties who are themselves insured under the same policy for the same interest.

A recurring issue in construction and project insurance is whether an insurer can exercise subrogation rights against a composite co-insured under the same policy. This question is particularly relevant in the context of policies that cover multiple parties (for example, owners, contractors, and sub-contractors) for their respective rights and interests. The complexity arises because such policies often insure parties with different roles and interests in the project, and the extent and nature of the cover for each party may not be identical under the construction contract and the policy.

Subrogation in marine insurance

Subrogation occupies a position of particular practical importance in the marine insurance market. While the doctrine derives from the same indemnity rationale discussed above, the maritime context introduces distinct statutory, contractual and procedural dimensions that must be appreciated if the insurer is to preserve and optimise its recovery rights effectively.

Marine policies written for South African risks almost invariably incorporate the Institute of London Underwriters' standard clauses. Although the forms make no express reference to subrogation, they are nevertheless declared "subject to English law and practice." The prevailing construction is that the English law reference is confined to the interpretation and application of the Institute of London Underwriters' clauses; the remainder of the policy remains governed by South African law. Nevertheless, the hybrid choice of law means that the South African insurer must be familiar with section 79 of the Marine Insurance Act 1906 (incorporated by the English law reference) as well as South African common-law principles.

Section 79 provides that, upon payment for a total loss, the insurer is "thereupon entitled to take over the interest of the assured" and becomes subrogated to "all the rights and remedies of the assured in and in respect of that subject-matter from the time of the casualty causing the loss." Although the provision refers only to a total loss, modern practice, reflected in both English and South African authority, accepts that subrogation applies equally upon payment of a partial loss. The significance of section 79 is twofold: First, it fixes the vesting of subrogation at the moment the indemnity is paid; secondly, it confirms that, in marine insurance, the insurer acquires a proprietary interest in the insured property itself. That proprietary character can be strategically advantageous when pursuing recovery actions abroad, where certain jurisdictions allow the insurer to sue in its own name once it has succeeded to the insured's proprietary interest.

Given that marine commerce typically involves multiple bailees, carriers and intermediaries, time-sensitive steps must be implemented well before indemnity is provided. Most Institute clauses oblige the assured to "take reasonable measures to avert or minimise loss" and to "preserve rights against third parties." Failure to secure evidence, lodge notices of protest, or comply with contractual time-bars imposed by carriage conventions (such as the Hague-Visby Rules) can fatally prejudice the insurer's eventual recovery.

South African courts have not yet considered the precise consequences of such prejudice, but English authority suggests that the insurer may resist all or part of the claim or seek restitution of the indemnity after payment. The prudent underwriter therefore ensures that pre-loss and pre-indemnification obligations are clearly set out in the policy schedule rather than being relegated to an informal questionnaire or claims instruction letter delivered after the event.

A distinctive feature of South African marine insurance practice is the routine use of subrogation forms once payment is made. These documents typically record the policy particulars, voyage details, nature and quality of the goods, quantum of loss, deductible, identity of carriers and any security already obtained. They also require the insured to cede or assign its claim or, at the very least, to authorise the insurer to sue in the insured's name. Where the form effects a true assignment, the insurer sues as plaintiff in its own right; where it is merely an authority, the action proceeds in the name of the insured with the insurer controlling the litigation. Unfortunately, many forms are not incorporated into the policy wording and therefore risk being characterised as stand-alone agreements. To eliminate uncertainty, the better approach is either to stipulate in the policy that execution of the form is a suspensive condition for payment, or to provide that the policy automatically assigns the claim to the insurer upon payment, thereby reducing the form to an administrative record only.

Marine claims often give rise to two special categories of expenditure – general average contributions and salvage charges, that blur the distinction between property and liability insurance. Under the York-Antwerp Rules the cargo owner (and therefore its cargo insurer) is obliged to reimburse the shipowner for expenses incurred for the common safety. Although payment is often secured by a general average guarantee furnished by the insurer, the underwriter will wish to preserve rights against, for example, a negligent third-party shipyard or a defaulting charterer. Similar considerations apply to salvage awards. To protect these rights, insurers should insist that guarantees and salvage security agreements contain express reservations of subrogation, coupled with undertakings by the cargo owner to provide documents and witnesses. Failure to incorporate such protective language may later preclude the insurer from exercising subrogation if the salvor or average adjuster has been induced to believe that no recovery action is contemplated.

Because many voyages involve successive sea, road, rail and occasionally air carriers, the insurer must confront multiple, potentially overlapping time bars. Under the Hague-Visby Rules an action against the sea carrier must be commenced within twelve months of delivery or the date the goods should have been delivered; the CMR Convention (road carriage) imposes a similar one-year limit, while rail carriage under CIM imposes twelve months as well. These deadlines often expire before indemnity negotiations are finalised. To avoid losing the claim, insurers commonly instruct correspondents to obtain bills of lading that specify the value of the cargo, security bonds or stand-still agreements pending final adjustment of the cargo claim. The policy should make the assured's cooperation in securing such protective measures an express obligation; otherwise the insurer may find that, by the time payment is made, the subrogated claim has prescribed.

Finally, attention must be paid to the interface between subrogation and double insurance. Marine cargo interests frequently arrange primary cargo cover and, at the same time, benefit from the shipowner's P&I cover or from contractual indemnities afforded by a Himalaya or network clause. The South African courts have yet to articulate a clear priority regime in this context. However, applying general principles, if both policies respond to the same loss, contribution rather than subrogation will be the correct mechanism; the insurers will share liability equally. If, however, the contractual arrangement merely affords a right of indemnity against the carrier (as opposed to a policy on the cargo owner's interest), subrogation remains available and is unaffected by the collateral cover.

Co-authors

Andrew Robinson

Director

Tel +27 31 582 5630

andrew.robinson@nortonrosefulbright.com

Byron O'Connor

Director

Tel +27 11 685 8917

byron.o'connor@nortonrosefulbright.com

Daniel Breier

Director

Tel +27 21 405 1269

daniel.breier@nortonrosefulbright.com

Donald Dinnie

Director

Tel +27 11 685 8847

donald.dinnie@nortonrosefulbright.com

Ina Iyer

Director

Tel +27 11 685 8752

ina.iyer@nortonrosefulbright.com

Patrick Bracher

Director

Tel +27 11 685 8801

patrick.bracher@nortonrosefulbright.com

Kriyanka Reddi

Senior Associate

Tel +27 11 685 8897

kriyanka.reddi@nortonrosefulbright.com

Nicholene Mazibuko

Associate

Tel +27 11 685 8731

nicholene.naidoo@nortonrosefulbright.com



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