

# Overview of Marine Insurance Law

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## 1. INTRODUCTION

- **“Warming up”**: The lecturer and students introducing themselves. Your professor studied law in Ljubljana (Slovenia), Split (Croatia) and Montreal (Canada) where he obtained his doctorate at McGill under the supervision of Professor William Tetley. He practiced law for over ten years in a law firm, shipping and reinsurance business. He has been Full Professor of Commercial, Transport and Insurance Law at the University of Ljubljana since 2004 and he also taught law in Belgium, Luxemburg and Australia. Prof. Pavliha has been a Visiting Fellow at the IMO IMLI (Malta) since 1998/99 where he is also an external examiner, as well as a member of the Board of Governors and Academic Board. In 2003 he was elected as Secretary General of the Comité Maritime International, until he has been invited to the Slovenian Government as Minister of Transport (2004). Later he has been elected as Deputy Speaker of the Parliament of the Republic of Slovenia (2004-2007). He was chosen seven times by the Ius Software Poll as one of the Ten Most Influential Slovenian Lawyers and won the 2001 Lawyer of the Year Award granted by the Slovenian Federation of Lawyers’ Associations. He participated in drafting most of the Slovenian transport and insurance legislation after its independence. Prof. Pavliha is also President of the Maritime Law Association of Slovenia. He is author and co-author of 20 books and over 500 articles and scientific papers. He lives with his wife and two children in a small village Nova vas nearby the Slovenian Adriatic coast.
- **Scope of lectures**: see this course outline.
- **First exercise**: on Thursday morning, January 14, 2010, we will be discussing *the Institute Cargo Clauses* 1982 and 2009 (see sections 22 and 23 of this course outline). Please make copies of the A, B and C clauses, read them in advance and compare both versions.
- **Second exercise**: please study and prepare *the case study* (see the “Appendix I” at the end of this course outline), split into three groups (the insured, the underwriters and the arbitrators or the judges) and present the case during the last lecture on marine insurance law on Thursday, January 14, 2010.
- **Basic course material**: available at the IMO IMLI library (M. Pavliha: *Lectures on Marine Insurance*, IMO IMLI, Malta, 2000, 334 pages). See also the “Suggested Bibliography” and “Interesting Websites” at the end of this course outline, Sections 29 and 30. The most recent publications on marine insurance law will be presented during the first lecture.

## 2. DEFINITION OF INSURANCE AND THE CLASSIC LONDON INSURANCE MARKET DIVISION OF INSURANCE

- **Introduction to risk management:** (1) identification of risks, (2) evaluation of risks, (3) control of risks, (4) finance the risks: *insurance*, bank deposits, captives, other.
- **What is insurance:** the primary function of *insurance* is risk transference and distribution. By effecting insurance, the insured transfers the risk of economic losses to the insurer, who in turn redistributes the risk through investment and reinsurance arrangements. *Contract of insurance* is a contract under which one person (the insurer) is legally bound to pay a sum of money or its equivalent to another person (the insured), upon the happening of a specified event involving some element of uncertainty as to time or likelihood of occurrence, which affects the insured's interest in the subject-matter of the insurance (F. Marks & A. Balla). The insured is actually buying his "peace of mind", the "invisible product".
- **Non-marine insurance:**
  - *insurance of persons:* it deals with the life, physical integrity or health of the insured and is divided into individual insurance and group insurance.
  - *damage insurance:* property insurance and liability insurance.
- **Marine insurance:** the object is to indemnify the insured against losses incident to marine adventure.
- Identical division of insurance in continental markets and *civil codes* (e.g. France, Italy).
- Another possible division of insurance (e.g. under the EU directives): **life insurance** and **non-life insurance** (including marine insurance).
- **World insurance at the beginning of third millennium:** In 2007, worldwide insurance premiums amounted to USD 4.061 billion (USD 2.393 billion life insurance and USD 1.668 billion non-life insurance). Total premium volume grew by 5% in real terms and in 2008, it rose to USD 4.270 billion. See *Swiss Re, sigma No.3/2008* and *Appendix II* of this outline.

The first half of 2006 has created new milestones for the insurance-linked securities (ILS) sector with issuance from January to August already surpassing year-end levels for 2005 by 53%. New issuance was nearly USD 3.3 billion in the non-life sector and over USD 3.6 billion in the life sector. This brings total 2006 new issuance to nearly USD 7.0 billion, surpassing 2005 new issuance of USD 5.7 billion. The primary driver of such a dramatic increase in non-life new issuance was the US wind capacity constraint in the traditional reinsurance market. Due to the constraint, many new sponsors looked to the capital markets for additional capacity. See *Insurance-linked securities market update*, October 2006, <http://www.swissre.com>.

In September 2008 when a traditional reinsurance Monte Carlo meeting was held no one could imagine that one week later the Lehman Brothers would become the world's largest bankruptcy and the American International Group (AIG) would be nationalized in the 80 billion USD bailout. Life and non-life insurers alike have been affected by the financial crisis, not least because the value of their assets and their own share prices have fallen.

Overall, the financial guarantee insurers are likely to be the worst hit, with potential losses of up to 75% of their capital. Mortgage guarantee insurers follow close behind due to their high exposure to subprime assets. See *Financial Crisis: The Client Markets View*, [http://www.swissre.com/expertise/financial\\_crisis/the\\_clientmarkets\\_view/clientmarkets\\_view.html](http://www.swissre.com/expertise/financial_crisis/the_clientmarkets_view/clientmarkets_view.html)

- **Marine insurance markets:** The 2005 hurricane season was the worst on record, with 14 hurricanes causing billions of dollars in insured losses and around three million claims. Possible future developments: (1) the return to co-insurance practices, (2) the achievement of market internationalization, (3) the search for alternative risk financing tools. See a comprehensive report on marine insurance markets in <http://www.brs-paris.com> and *Appendix III* of this outline.
- **Lloyd's of London:** Lloyd's is the world's leading insurance *market* (it is not a company!) with a capacity to write about £15.95 billion in 2008. It is a society of members, both corporate and individual, who underwrite in syndicates on whose behalf professional underwriters accept risks. Supporting capital is provided by investment institutions, specialist investors, international insurance companies and individuals. In 2008, Lloyd's was home to 46 managing agents and 75 syndicates. In 2008, there were 176 firms of brokers working at Lloyd's, many of whom specialize in particular risk categories. Lloyd's is regulated by the Financial Services Authority. Those bringing capital to the Lloyd's market include 1017 corporate members (private companies) and 1124 individual members (within this number are those with unlimited liability "Names" and individuals underwriting via limited liability companies). Lloyd's is licensed to underwrite business in 79 territories and can accept risks proposed from over 200 countries and territories in accordance with local laws and regulation. Lloyd's licences offer broad access to major direct and reinsurance markets worldwide. The year 2007 was a strong year for Lloyd's where profit before tax rose to £3.8 billion. These positive results stem from an appetite for risk and an ability to turn risk into reward. While the number of catastrophic events was higher than in 2006, the year was relatively benign when considering insured losses. It's strong balance sheet has yielded significant investment returns which, together with prior year releases, have made a substantial contribution to these results. See <http://www.lloydsolondon.com>.

### 3. DEFINITION OF MARINE INSURANCE

- **Definition:** the contract of marine insurance is a special (insurance) *contract of indemnity* which protects against physical and other losses to moveable property and associated interests, as well as against liabilities occurring or arising during the course of a sea voyage (R. Thomas). S. 1 of MIA 1906: A contract of marine insurance is a contract whereby the insurer undertakes to *indemnify* the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure.
- **Contract of indemnity:** "The great principle of the law of insurance is that it is a contract for indemnity. The underwriter does not stipulate, under any circumstances, to become the purchaser of the subject-matter insured; it is not supposed to be in his contemplation: he is to indemnify only." – *per* Lord Ellenborough in *Brotherston v. Barber* (1816) 5 M & S 418 at p. 425. Ideally, the insured should be compensated only to the extent of his loss. In practice, however, this is not always easy to attain (e.g. underinsurance, deductible,

franchise). Thus, a policy of insurance is not a perfect contract of indemnity. See *Irving v. Manning* (1847) 1 HLC 287.

- **Common law and civil law definitions of marine insurance:** they are very similar.
- **Terminology of marine insurance in a nutshell:** *the insured* (assured, policyholder), *the insurer* (underwriter, assurer, insurance company), *the subject-matter insured* and many other terms peculiar to marine insurance, which will be explained throughout the course.
- **Lawful marine adventure:** one where any ship, goods or other movables are exposed to maritime perils; the earning or acquisition of any freight etc., any third party liability etc.
- **Maritime perils:** (1) **Perils of the seas** = fortuitous accidents or casualties of the sea (heavy weather, sinking, stranding, collision, contact), not including the ordinary actions of the winds and waves. (2) **Fire, war perils, pirates, rovers, thieves, barratry** etc. See *The Captain Panagos DP* [1985] 1 Lloyd's Rep. 625. The element of *fortuity* is of crucial importance. Also: (3) **The Inchmaree clause** = the scope of this clause is to cover loss or damage to the subject matter insured caused by the bursting of boilers, breakage of shaft or any latent defect in the machinery or hull; negligence of the master, officers, crew or pilot; negligence of repairers or charterers, provided they are not insured under the policy; and barratry of master, officers, or crew. See *Thames & Mersey Marine Insurance v. Hamilton (The Inchmaree)* (1887) 12 AC 484. (4) **Pollution hazards.** (5) **Collision liability (The Running Down Clause).**
- A contract of marine insurance may cover **mixed sea and land or sea and inland waters risks** (e.g. the *Transit Clause* under the Institute Cargo Clauses: “warehouse to warehouse”).
- Difference between *insurance law* and other legal branches, e.g. *maritime law*. Example of a typical marine cargo claim.

#### 4. ORIGINS

- **9<sup>th</sup> century B.C.:** *Lex Rhodia de iactu* (the birth of “modern” *general average* = an extraordinary sacrifice or expenditure which is intentionally and reasonably made or incurred, for the common safety, for the purpose of preserving from peril the property involved in a common maritime adventure).
- **7<sup>th</sup> century B.C.:** *Phoenician maritime law*, e.g. *general average* and *marine insurance* (traces to be found in the Talmuds of Jerusalem and of Babylon at the beginning of our era).
- **384 – 322 B.C.:** *the shipping loan (foenus nauticum)* of Greek and Roman origin (the oldest texts are to be found in certain pleadings of Demosthenes). If the loan was based on the ship (*bottomry*), the borrower had to repay it with high interest only in the case of a successful voyage. Loan could be also based on cargo (*respondentia*).
- **1347:** *the oldest marine insurance policy* (Genova).
- **1370:** *the birth of marine reinsurance.*

- **15<sup>th</sup> – 16<sup>th</sup> century:** *fragmentary insurance regulation in medieval cities* (e.g. Barcelona, Venice, Florence).
- **1562:** *Ordo super assecuratoribus* (Dubrovnik) - probably one of the oldest insurance legislation.
- **1563:** *the King Philip II Ordinance on Marine Insurance* (Belgium).
- **End of 16<sup>th</sup> century:** *Le Guidon de la Mer* (private collection of marine customs).
- **1681:** *The Marine Ordinances of Louis XIV* (also received with great respect in the courts of England and the United States).
- **1688:** first mention of *Edward Lloyd's Coffee House* in Tower Street, London.
- **1779:** Lloyd's standard marine policy – *the SG (Ships and Goods) Policy*.
- **1808:** *Code de Commerce* (France).
- **1859:** *The Antwerp Marine Insurance Policy*.
- **1871:** *The Norwegian Marine Insurance Plan*.
- **1884:** *The Institute of London Underwriters*.
- **1906:** *The Marine Insurance Act 1906* (U.K. – Sir Mackenzie Chalmers). The “mother of all marine statutes”.
- **1919:** *The German General Rules of Marine Insurance (ADS)*.
- **Modern era:** the Institute Clauses (1982, 1983, 1995, 2003, 2009), the Antwerp Marine Policy, the new policy form MAR (1982, 1991), the American Clauses, the UNCTAD Clauses (1984), the German Clauses (DTV Cargo 2000), the CMI attempts to unify the law, etc.

## 5. TYPES OF MARINE INSURANCE

- **Hull insurance:** insurance of the vessel with its gear.
- **Cargo insurance:** insurance of goods carried by sea.
- **Insurance against the liability of the carrier:** protection and indemnity (P & I Clubs); *compulsory insurance* (e.g. CLC 1992, HNS 1996, Bunker 2001, Athens 2002, etc.); *voluntary insurance* (e.g. liability for cargo).
- **Other types of marine insurance:** e.g. freight, salvage expenses, general average contributions.

## 6. SOURCES OF LAW

- ***Lack of international law:*** no international convention on marine insurance.
- ***Recent attempts to unify the law:*** The CMI International Working Group has identified non-disclosure, good faith, alternation of risk and warranties as being the most controversial areas of marine insurance. However, there is no prospect for international instrument (e.g. convention, model law).
- ***Statutes:*** e.g. MIA 1906. Much of the world's marine insurance business is transacted in London and is governed expressly or impliedly by English law.
- ***Acquis communautaire:*** the three generations of EU directives, unfortunately nothing on insurance contracts. The European Civil Code is under preparation.
- ***Standard clauses:*** e.g. the Institute Clauses (ICC, ITCH, IVCH, etc.) reflecting an international *lex mercatoria* (about 70% of all marine insurance contracts are based on those clauses).
- ***Commercial practice:*** e.g. the Lloyd's slip placing system.
- ***Court decisions (case law):*** especially in the common law countries (e.g. England, USA, Canada, Australia).
- ***Arbitration decisions.***
- ***Doctrine:*** articles, books, etc. written by eminent scholars.

## 7. EXAMPLES OF MARINE INSURANCE LEGISLATION

- ***Law on companies*** ("status" law) and ***contract law***.
- ***Belgian marine insurance legislation, August 21<sup>st</sup>, 1879:*** the statute became a part of the *Code of Commerce*, sections 191-250.
- ***German Commercial Code 1897 (HGB):*** including rules on marine insurance (§§ 778-900).
- ***The U.K. Marine Insurance Act 1906 (MIA 1906):*** "the mother of all marine insurance statutes" (94 sections + First Schedule (Form of Policy: Lloyd's S.G. policy + Rules for Construction of Policy) + Second Schedule (Enactments Repealed). It came into force on 1<sup>st</sup> January, 1907.
- The Australian *Marine Insurance Act 1909* (based on MIA 1906).
- The Canadian *Marine Insurance Act 1993* (based on MIA 1906).
- The French *Code des Assurances* (including Law No. 67-522 of July 3, 1967 and Decree No. 68-64 of January 19, 1968 which comprise marine insurance).

- *Civil Code of Quebec 1991*, Articles 2505 – 2628.
- Other legislation.

## **8. WHO PROVIDES MARINE (RE)INSURANCE?**

- **Insurance companies:** stock/shareholding companies, mutual companies.
- **Reinsurance companies:** marine reinsurance and retrocession. See Section 28.
- **Lloyd's of London:** it is a market, not a company. See Section 2.
- **The role of insurance brokers and insurance agents:** the agent – the insurer, the broker – the insured. However, there may also be the possibility of the broker acting also on behalf of the insurer. In fact, there is an element of uncertainty as to the law regarding insurance brokers where they are acting in a dual capacity as brokers for the assured and the insurer, in that a conflict of interests may sometimes arise between the broker's duties to the assured and those to the insurer. At Lloyd's as in other areas of the insurance market, codes of practice exist, and a code of practice exists for Lloyd's brokers, which was issued by the council of Lloyds on November 1<sup>st</sup>, 1988 to regulate any potential conflicts of interest. It is very important to determine in law, exactly for whom a particular broker is acting for. Dual agency may arise when a broker performs functions on behalf of the insurer as well as the assured. See *Woolcot v. Excess Insurance* (1978) 1LLR 633. Dual agency is permitted provided that there is no conflict of interests.
- **Protection and Indemnity Clubs (P & I Clubs):** liability insurance. See Section 27.
- **Insurance and reinsurance pools:** for huge risks (e.g. oil rigs, aviation, nuclear plants), based on co-insurance (joint and several liability of the members).

## **9. CONCLUDING AND ENFORCING MARINE INSURANCE CONTRACTS: THE LONDON MARKET**

- **Consensus ad idem:** a marine contract is deemed to be concluded when the proposal of the insured is accepted by the insurer.
- **Brokers:** they play a central and dominant role. See Lord Diplock in *American Airlines Inc. v. Hope* [1974] 2 Lloyd's Rep. 301 at 304.
- **The slip placing system:** the slip sets out a brief and abbreviated statement of the subject matter of the risk and the proposed insurance conditions, as well as type of insurance, policy form, information about the insured, interest, sum insured, value, voyage, ship and premium. The slip is first presented to a lead underwriter, then to the subsequent underwriters. Amended slip = counter offer.
- The broker is directly responsible to the insurer for the premium.
- Where a slip is subscribed to by more than one underwriter, there is established a distinct and separate contract with each underwriter (*no joint or joint and several liability*).

- **An oversubscribed slip:** signing down.
- **A discrepancy between the slip and the marine policy:** *prima facie* the primary document is the slip, because it is the basis of the contract of marine insurance.

## 10. INSURABLE INTEREST

- **The insured must show:** (1) financial loss, (2) the loss was caused by the peril insured against, (3) the subject matter was covered by the policy, (4) insurable interest (see sections 4-15 of MIA 1906).
- **Avoidance of gaming or wagering contracts:** such contracts in marine insurance are void (e.g. a policy in P.P.I. form = Policy Proof of Interest).
- **Definition of insurable interest:** *Lucena v. Crauford* (1806) 2 B & PNR 269 (the restricted view = legal relationship + economic interest); *Section 5 of the 1906 MIA* defines insurable interest by providing that: (1) Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure. (2) In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

*The Moonacre* [1992] 2 Lloyd's Rep. 501 (towards a broader view: was the relationship between the insured and the subject matter of the insurance sufficiently close to justify his being paid in the event of its loss or damage).

- **When interest must attach:** “at the time of the loss”. Exception: “lost or not lost” (e.g. in case of the FOB contract the buyer insures his goods while they are already at sea, not being aware of damage or loss).
- **Defeasible or contingent interest:** it is insurable. In particular, where the buyer of the goods has insured them, he has an insurable interest notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller’s risk, by reason of the latter’s delay in making delivery or otherwise.
- **Partial interest:** it is insurable.
- **Reinsurance:** the insurer has an insurable interest in his risk and may reinsure in respect of it.
- **Bottomry and respondentia:** the lender has an insurable interest in respect of the loan.
- **Master's and seamen's wages:** the master or any member of the crew of a ship has an insurable interest in respect of his wages.
- **Advanced freight:** the person advancing the freight has an insurable interest (e.g. CIF).
- **Charges of insurance:** the insured has an insurable interest in the charges (e.g. CIF).

- **Quantum of interest:** the mortgagor, the mortgagee.
- **Liability interest.**
- **Assignment of interest:** the rule prevents a mere sale of the insured subject matter from transferring the policy unless there is agreement to that effect between seller and buyer. This principle is different from the non-marine insurance. In other words, e.g. selling the property does not mean automatically transferring the policy.

## 11. DISCLOSURE AND REPRESENTATIONS – DUTY OF UTMOST GOOD FAITH

- **The principle of utmost good faith (*uberrimae fidei*):** a contract of marine insurance is a contract based upon the utmost good faith and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party (s. 17 of MIA 1906). See *Carter v. Boehm* (1766) 3 Burr. 1905 which made the contract void, however the MIA 1906 makes it avoidable. The principle applies prior to the conclusion of contract and also during the contract. See sections 17-21 of MIA 1906. See the “*Appendix IV*” at the end of this course outline
- **The continuing duty of utmost good faith:** duty of utmost good faith (section 17 of the MIA) continues to apply after the conclusion of the insurance contract. Once the parties are in litigation it is the procedural rules which govern the extent of the disclosure which should be given in the litigation not s. 17 as such though s. 17 might influence the Court in the exercise of its discretion – *Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co. Ltd. and La Réunion Européene (The Star Sea)* [2001] 1 Lloyd’s Rep. 389 (HL).
- **The duty of disclosure of insureds and brokers:** every material circumstance must be disclosed; the objective test of materiality - *Pan Atlantic Insurance Co. v. Pine Top Insurance Co. Ltd.* [1995] 1 AC 501 (HL). The “*decisive influence test*” unfortunately rejected. Lord Mustill: A circumstance is material if it was one which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk. It is not necessary to show that the disclosure would have had a decisive or conclusive influence. A circumstance may be material even though a full and accurate disclosure of it would not in itself have had a decisive effect on a prudent underwriter’s decision whether to accept the risk and if so at what premium. The insurer must also show that he was in fact induced to enter the contract on the relevant terms (the “*actual inducement test*”). In other words, the proposer must disclose not only the facts which he actually knows but rather the facts which in the ordinary course of business he ought to have known (so called *constructive knowledge*).
- **Better view:** the insurer could only escape liability if the undisclosed matter was something which would have partially induced a hypothetical prudent insurer to refuse the risk or accept it on different terms (S. Derrington).
- **Another possible solution:** the precise questionnaires.
- **Which circumstances need not to be disclosed:** any circumstance which diminishes the risk, which is known or presumed to be known to the insurer, etc.

- **Remedies:** (1) *common law*: If the duty of utmost good faith is breached – avoidance of the contract *ab initio*; (2) *civil law*: also possibility of increasing the premium, damages.
- **The duty of insureds and brokers not to misrepresent:** In practice the law of misrepresentation exists in close alliance with that of non-disclosure. The difference should be abolished.
- **The duty of disclosure of insurers:** e.g. *Banque Financiere de la Cite SA v. Westgate Insurance Co. Ltd.* [1991] 2 AC 249.

## 12. THE POLICY

- **The contract must be embodied in a policy:** the absence of a marine policy means that the contract can only operate voluntarily without the aid and remedial powers of the courts or arbitrators. See sections 22-31 of MIA 1906.
- **Rules for construction of policy:** see First Schedule of MIA 1906.
- **MAR 91:** all the standard Institute Clauses may be used only with the current Lloyd's Marine Policy (MAR 91) and the Institute of London Underwriters Companies Marine Policy Form (MAR 91), both of which are subject to the "exclusive jurisdiction of the English Courts, except as may be expressly provided herein to the contrary".
- **What a policy must specify:** the name of the insured, the subject-matter, the risks, the voyage or period of time covered by insurance, the sum insured and the name of the insurer.
- **Signature of insurer:** a marine policy must be signed by or on behalf of the insurer, provided that in the case of a corporation the corporate seal may be sufficient. Where a policy is subscribed by or on behalf of two or more insurers, each subscription, unless the contrary be expressed, constitutes a distinct contract with the insured.
- **Designation of subject matter:** with reasonable certainty.
- **Types of policies:** time, voyage, valued, unvalued, floating, etc.
- **Time policy:** for a definite period of time; a policy may be a "mixed" time and voyage policy. A specific date for the commencement and termination of the risk must be stated in the policy. It is generally understood that a day starts from 00:00 and ends at 24:00 (or 23:59:59). A policy on ship is nowadays almost invariably insured for a period of time, whereas cargo is usually insured by a voyage policy.
  - **Extension or cancellation clause:** a policy for a period of time does not cease to be a time policy merely because the period of time may be extended or abridged pursuant to one of the policy's contractual provisions. *The Eurysthenes* [1977] 1 QB 49 (CA).
  - **The navigation clause:** see clauses 1.1., 1.2. and 1.3. of ITCH(95). Coverage "at all times", towage and salvage warranty, the use of helicopters, loading and discharging operations at sea, scrapping voyages.

- *The continuation or 'held covered' clause*: the vessel is only held covered if, at the expiry of the policy, the vessel is (1) at sea *and* in distress or missing; or (2) in port *and* in distress. See cl. 2 of ITCH(95).
- *Automatic termination*: see clauses 5.1 and 5.2. of ITCH(95). E.g. change of Classification Society; change, suspension, discontinuance, withdrawal or expiry of the ship's class; overdue periodic survey, change of ownership or flag. The "net result" of breach of warranty or termination of insurance is the same: the underwriter is freed from liability as from the date of breach. Compare to *The "Caribbean Sea"* [1980] 1 Lloyd's Rep. 338. A *pro rata* daily return of premium shall be made.
- **Voyage policy on ship**: "from" or "at and from" one place to another.
  - *From*: Where the subject-matter is insured "from" a particular place, the risk does not attach until the ship starts on the voyage insured (rule 2 of the Rules for Construction of Policy, MIA 1906). With respect to "the voyage" see sections 42-49 of MIA 1906.
  - *At and from (ship)*: see rule 3. Where a ship is insured "at and from" a particular place, and she is at that place in good safety when the contract is concluded, the risk attaches immediately. With respect to "good safety" see *Parmeter v. Cousins* (1809) 2 Camp 235. The standard of "good (physical) safety" is lower than that of seaworthiness.
  - *Implied condition as to the commencement of risk*: the adventure shall be commenced within a reasonable time, otherwise the insurer may avoid the contract.
  - *Alteration of port of departure*: the risk does not attach.
  - *Sailing for different destinations*: the risk does not attach.
  - *Change of voyage*: the insurer is discharged from liability as from the time of change. Manifest intention to change the voyage is sufficient. See *Tasker v. Cunningham* (1819) 1 Bligh. 87. There must be a voluntary change of destination. See *Rikkards v. Forrestal* (1942) AC 50.
  - *Deviation*: the insurer is discharged from liability as from the time of deviation (non-contractual route).
  - *Several ports of discharge*: proceed in the order designated by the policy. If not = deviation.
  - *Delay*: the adventure must be prosecuted with reasonable despatch.
  - *Excuses for deviation or delay*: authorisation ("held covered" provisions), safety of the ship, saving human life, beyond master's control, etc.
- **Voyage policy on goods**:
  - *cl. 8(1) of ICC*: it sets out the general rules relating to attachment and termination of the insurance (the transit clause);
  - *cl. 8(2) of ICC*: it covers the particular circumstance where a change of destination occurs after the completion of the sea voyage;
  - *cl. 8(3) of ICC*: in declaring that the insurance "shall remain in force" confirms that the events listed therein (e.g. delay beyond the control of the insured, deviation, forced discharge) will not terminate the insurance. Its purpose is to dispel any doubts which one might have as regards the continuance of the cover should any one of the enumerated events arise (S. Hodges);
  - *cl. 9 of ICC*: it relates specifically to a termination, not of the contract of insurance, but of the contract of carriage and its effects on the insurance contract;
  - *cl. 10 of ICC*: the "change of voyage" clause states that a change ordered by the insured is covered.

- **Valued policy:** it specifies the agreed value of the subject matter, which is conclusive in the absence of fraud. Valued policies are almost universal in marine insurance. See *Irving v. Manning* (1847) 1 HL Cas 287. However, the value must not go beyond what is “reasonable and fair”, and the insured is meant only to have an “indemnity”, the very basis of a contract of insurance. What constitutes excessive over-valuation is a question of fact.
- **Unvalued policy:** it leaves the insurable value to be subsequently ascertained (see s. 16 of MIA 1906):
  - *insurance on ship, freight and any other subject matter other than cargo:* the insurable value is the value at the inception of the risk;
  - *insurance of goods or merchandise:* “prime cost” (price paid by the insured, e.g. CIF).
- **Floating policy by ship or ships:** it allows the insured to insure an unascertained cargo on an unspecified vessel (open covers).

### 13. CONTRACTUAL TERMS

- **Terms defining the risk and exclusions from risk:** general principle, all risks covers.
- **Warranties (see sections 33-41 of MIA 1906):**
  - *nature of warranty:* it must be strictly and exactly complied with. Upon breach, even if non-causative or immaterial, the insurer may repudiate the contract as from the date of the breach of the contract, i.e. *ex nunc*. See *Pawson v. Watson* (1778) 2 Cowp 785; *Overseas Commodities v. Style* (1958) 1 LLR 546; *Yorkshire Insurance v. Campbell* (1917) AC 218; *Vesta v. Butcher* [1989] 1 LLR 331; *John Pratt v. Aigaion Insurance Co SA* [2008] EWHC 489 (Admiralty).
  - how an underwriter's liability is *automatically* discharged for breach of warranty: *The Good Luck* [1992] 1 AC 233.
  - *when is a breach of warranty excused:* The “held covered” provision (e.g. the Breach of Warranty clause under the ITCH(95)). Notice, additional premium.
  - express warranties.
  - implied warranties.
  - warranty of neutrality.
  - no implied warranty of nationality.
  - warranty of good safety.
  - *warranty of seaworthiness of ship:* difference between time and voyage policy! In a *voyage policy* there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured. In a *time policy*, however, there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the insured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness. If the shipowner deliberately refrains from examining the ship in order not to gain direct knowledge of what he has reason to believe is her unseaworthy state, he is privy to the ship putting to sea in that unseaworthy state (the “blind eye” knowledge). A finding of negligence to a very high degree does not suffice for a finding of privity. See *The Star Sea* [2001] 1 Lloyd’s Rep. 389 (HL).
  - no implied warranty that goods are seaworthy.
  - warranty of legality.

- **Conditions precedent:** e.g. sections 42-48 of MIA 1906 (the voyage). Avoidance of the contract.
- **Mere conditions:** e.g. the avoidance of delay clause in the Institute Cargo Clauses; the notice of claim provisions in the Institute Time Clauses Hulls. Damages.
- **Interpretation of marine insurance policies:** common intention. See Rules for Construction of Policy, First Schedule, MIA 1906.

#### 14. ASSIGNMENT OF POLICY

- **When and how a policy is assignable:** Marine policies, unlike other policies of indemnity, are assignable unless there are express terms to the contrary. They can be assigned before or after the loss, by endorsement or in some other customary manner. If the assignor loses insurable interest, the policy lapses and there is nothing to assign. In the converse case, where the insured assigns the policy without assigning the subject-matter, the assignee has no insurable interest and is thus unable to sue on the policy. See sections 50-51 of MIA 1906; *Lloyd v. Fleming* (1872) L.R. 7 Q.B. 299.
- **The effect of assignment:** where a marine policy has been assigned so as to pass the beneficial interest in such policy, the assignee of the policy is entitled to sue thereon in his own name (e.g. in a typical case of cargo claim). The defendant (the insurer) is entitled to make any defense arising out of the contract which he would have been entitled to make if the action had been brought in the name of the person by or on behalf of whom the policy was effected.

#### 15. THE PREMIUM

- **When is the premium payable:** unless otherwise agreed, the duty of the insured or his agent to pay the premium, and the duty of the insurer to issue the policy to the insured or his agent, are concurrent conditions, and the insurer is not bound to issue the policy until payment or tender of the premium. See sections 52-54 of MIA 1906.
- **If no arrangement is made:** a reasonable premium is payable, e.g. by reference to the market rate for the degree of risk in question (see s. 31 of MIA 1906).
- **Policy effected through a broker:** the broker is directly responsible to the insurer for the premium. It is a rule unique to marine insurance and to other policies issued by Lloyd's (R. Merkin). See *Power v. Butcher* (1829) 10 B. & C. 329 and *Universo of Milan v. Merchants Marine Insurance* [1897] 2 Q.B. 93.
- **Effect of receipt on policy:** the broker's failure to settle obliges the underwriter to look to the broker or its liquidator, and not to the insured.
- **Return of premium:** see sections 82-84 of MIA 1906 (enforcement of return, return by agreement, return for failure of consideration).

## 16. MEASURE OF INDEMNITY

- **Definition:** the measure of indemnity is the sum which the insured can recover in respect of a loss on a policy by which he is insured. See sections 67-78 of MIA 1906.
- **Extent of liability of insurer for loss:**
  - *unvalued policy:* the insured can recover to the full extent of the insurable value.
  - *valued policy:* most policies are valued; the insured can recover to the full extent of the value fixed by the policy.
- **Total loss:** (1) valued policy = the measure of indemnity is the insurable value of the subject-matter insured, (2) unvalued policy = the measure of indemnity is the insurable value.
- **Partial loss of ship:** the reasonable cost of the repairs less the customary deductions, but not exceeding the sum insured in respect of any casualty; the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage (e.g. cl. 18 of ITCH(95) and cl. 16 of IVCH(95)).
- **Partial loss of freight:** the measure of indemnity is such proportion of the sum fixed by the valued policy, or of the insurable value in the case of an unvalued policy, as the proportion of freight lost by the insured bears to the whole freight at the risk of the insured under the policy.
- **Partial loss of goods, merchandise, etc.:** see s. 71 of MIA 1906.
- **Apportionment of valuation:** see s. 72 of MIA 1906.
- **General average contributions and salvage charges:** see s. 73 of MIA 1906, cl. 2 of ICC(82), cl. 10 of ITCH(95) and cl. 8 of IVCH(95).
- **Liabilities to third parties:** the measure of indemnity is the amount paid or payable by the insured to the third party. E.g. cl. 8 of ITCH(95) and cl. 6 of IVCH(95).
- **Particular average warranties:** an F.P.A. warranty confines the insured to recovering for total losses only, subject to the ordinary rules concerning the recovery of general average losses and salvage charges.
- **Successive losses:** the insurer is liable for such losses even though the total amount of successive losses may exceed the sum insured.
- **Suing and labouring (sue and labour) clause:** it covers the charges properly and reasonably incurred in pursuance of the insured's duty to minimize the loss. The sums payable under the clause are additional to the policy indemnity. See cl. 16 of ICC(82), cl. 11 of ITCH(95) and cl. 9 of IVCH(95).
- **Deductible and franchise:** participation of the insured in the loss, the purpose of which is more care on the insured's side and lower premium. See cl. 12 of ITCH(95) and cl. 10 of IVCH(95). *Example:* (1) if the deductible is 10 and the loss is 9, the insurer does not pay anything; if the loss is 11, the insurer pays 1, etc.; (2) if the franchise is 10 and the loss is

9, the insurer does not pay anything: if the loss is 11, the insurer pays 11, etc. Thus, the franchise does not really motivate the insured to minimize or prevent the loss.

- **Under-insurance:** where the insured is underinsured under an unvalued policy and suffers a partial loss, he may recover only that proportion of his loss which the sum insured bears to the insurable value of the subject-matter. *Example:* if the value of the subject-matter insured is 100, the sum insured is 50 and the actual loss is 30, the insured will recover 15 only. In the case of total loss the insured will recover 50.
- **Double insurance:**
  - *definition:* it is over-insurance where the sums insured of two or more policies exceed the indemnity allowed, which is against the principle of indemnity. See s. 32 of MIA 1906; e.g. *The Gunford Case* [1911] AC 529 (HL);
  - *consequences:* each insurer is bound to contribute rateably to the loss in proportion to the amount for which he is liable under his contract. “The assured may, at his unfettered discretion, proceed against any one or combination of insurers for the whole sum due, leaving any insurer who pays more than his rateable proportion of the loss to recover contribution from the other insurers” (Bennett, p. 425).

## 17. LOSS AND ABANDONMENT

- **Covered losses:** the insurer is liable for any loss proximately caused by a peril insured against. See sections 55-63 of MIA 1906.
- **Proximate cause:** *causa proxima non remota spectatur*. See *The Leyland Case* (1918) AC 350 (HL).
- **Excluded losses:** e.g. any loss attributable to the willful misconduct of the insured, delay, ordinary wear and tear.
- **Effect of transshipment:** the liability of the insurer continues.
- **Partial loss:** see above and below.
- **Total loss :**
  - *actual total loss:* definition, a missing ship (after the lapse of a reasonable time).
  - *constructive total loss:* reasonable abandonment (as the total loss appears to be unavoidable); the occurrence of damage which renders the vessel beyond economic repair.
- **Abandonment:** the insured must give notice; otherwise the loss can only be treated as a partial loss. However, in most cases the underwriters would not accept the notice.

## 18. PARTIAL LOSSES

- **Particular average loss:** it is a partial loss caused by a peril insured against. Particular charges are not included (recoverable under the supplementary contract in the “sue and labour” clause). In other words, with the exception of general average and particular charges, all partial losses (including salvage charges) are particular average losses.

- **Salvage charges:** the fundamental difference between salvage and general average is that in the case of the former, the salvage service is performed by a person who intervenes voluntarily, whereas in the latter, it is performed by a person who is specially hired or employed by the shipowner, on a *quantum meruit* basis, to save the whole adventure from a common danger (S. Hodges). See *Aitchison v. Lohre* (1879) 4 App Cas 755.
- **General average loss:** it is caused by a general average act which is any extraordinary sacrifice or expenditure voluntarily and reasonably made or incurred in time of peril for the purposes of preserving the property imperilled in the common adventure. See *Birkley v. Presgrave* (1801) 1 East 220.
- **Marine insurance v. general average:** “Marine insurance has made general average redundant; in fact, because of the risk involved in general average, all parties now insure against responsibility for general average contribution” ... “General average should therefore be abolished and excluded from contracts ...”(Tetley).

## 19. RIGHTS OF INSURER ON PAYMENT

- **Subrogation (see s. 79 of MIA 1906):**
  - *total loss:* where the insurer pays for a total loss, he becomes entitled to take over the interest of the insured in whatever may remain of the subject-matter insured, and he is thereby subrogated to all the rights and remedies of the insured.
  - *partial loss:* the insurer acquires no title to the subject-matter insured, but he is thereupon subrogated to all rights and remedies of the insured.
- **Right of contribution and effect of under insurance:** see sections 80-81 of MIA 1906.

## 20. LIENS FOR MARINE INSURANCE PREMIUMS

- **The key issue:** whether the insurers or the brokers have liens on the insured’s ship or cargo or insurance proceeds for unpaid insurance premiums (Tetley).
- The 1926, 1967 and 1993 *Liens and Mortgages Conventions* do not specifically provide such a lien (Tetley).
- **The 1999 Arrest Convention:** “*Maritime claim*” (in respect of which arrest of the ship is permissible) means *inter alia* a claim arising out of “insurance premiums (including mutual insurance calls) in respect of the ship, payable by or on behalf of the shipowner or demise charterer” (art. 1(q)). However, art. 9 provides that “nothing in this Convention shall be construed as creating a maritime lien”.
- American maritime law grants such a lien, although no such traditional maritime lien is recognized in the U.K., Canada or France. The U.K. and Canada provide the broker with a possessory lien on the policy, while France permits the cancellation or suspension of the marine policy in the event of non-payment of the premiums (Tetley).

## 21. CONFLICT OF LAWS

- **National conflicts of laws (federal law v. state or provincial law):** e.g. USA, Canada.

- ***International conflicts of laws:*** according to Prof. Tetley, “the law of the marine insurance contract should be determined by studying and weighing all the contacts, especially express choice of the parties, as well as considerations of public order, mandatory rules, evasion of the law, etc., as evaluated in a *uniform methodology*”.
- ***The contacts used to determine the properly applicable law (Tetley):*** express choice, the country of contracting or the place of performance, the country in which the insurer carries on its business, the insurance market with reference to which the contract was made, the place where the whole process of formation of the contract occurs, policy-holders residence, location of the risk, etc.
- ***European Union:***
  - *Second Council Directive on direct insurance other than life insurance of June 22, 1988:* “large risks”; freedom of choice of applicable law subject to mandatory rules; where no choice of law – the law of the country with which the contract is most closely connected (the most significant relationship), being either the law of the place where risk is situated or the law of the habitual residence or the central administration of the policy-holder.
  - *Third Council Directive on direct insurance other than life insurance of June 18, 1992:* it amends the Second Directive so as to widen the freedom of parties to an insurance contract to choose the law.
  - *The Rome Convention 1980:* it does not apply to marine insurance risks in the EU, but does apply to risks outside the EU and to all reinsurance; the three-stage process (express choice, implied choice and the most significant relationship). It was incorporated into EU law by the Regulation 593/2008.

## **22. INSTITUTE CARGO CLAUSES (1982)**

- ***Institute of London Underwriters (ILU):*** it is an organization established in 1884, representing the interests of member insurance companies, maintaining a close liaison with Lloyd's marine market. Drafting of clauses (hull, cargo, etc.) is carried out through the ILU's Technical and Clauses Committee.
- The introduction of the 1982 Clauses was ***a radical step that finally liberated cargo policies from the old S.G. Policy.*** Their clear and accurate drafting put the fears of possible uncertainty to rest and there has been remarkably little litigation regarding coverage.
- ***Freedom of contract:*** the clauses are purely illustrative and different policy conditions may be agreed.
- ***English law, practice and courts:*** all the standard Institute Clauses are subject to English law and practice, and may be used only with the Lloyd's Marine Policy (MAR 91) and the Institute of London Underwriters Companies Marine Policy Form (MAR 91).
- ***The reform of the pre-1982 Institute Cargo Clauses:*** the ICC 1963 were offered on the basis of the old Lloyd's SG policy. The reform was driven by UNCTAD.
- ***The 1982 (general) clauses:*** risks covered, exclusions, duration (the “Transit Clause”), claims, benefit of insurance, minimizing losses, avoidance of delay, law and practice.

- *Institute Cargo Clauses (A): all risk cover* – see *Brothers v. Stevens* [1906] 2 KB 665 and *The Gaunt Case* [1921] AC 41 (HL). The insured discharges his onus by proving that the loss was caused by some event (casualty) covered by the general expression. The clauses include the “Both to Blame Collision” Clause and exclusions (e.g. wilful misconduct of the insured, ordinary leakage, unseaworthiness, war, strikes).
- *Institute Cargo Clauses (B): restricted (named) perils cover*. Risks covered: e.g. fire or explosion, collision, earthquake, entry of sea, lake or river water into vessel). See the “Both to Blame Collision” Clause and exclusions (e.g. wilful misconduct of the insured, ordinary leakage, unseaworthiness, war, strikes).
- *Institute Cargo Clauses (C): restricted (named) perils cover*. Risks covered: (there are no clauses 1.1.6., 1.2.2. (except jettison), 1.2.3. and 1.3. which can be found under the “B” cover). See also the “Both to Blame Collision” Clause and exclusions (e.g. wilful misconduct of the insured, ordinary leakage, unseaworthiness, war, strikes).
- *Institute War Clauses (Cargo)*.
- *Institute Strikes Clauses (Cargo)*.
- **Other clauses:** e.g. The Computer Millennium Clause, The Cargo ISM Endorsement Clause.
- **Special Institute Trade Clauses:**
  - *Commodity Trades Clauses:* e.g. coffee, cotton, fats, metals, oil seeds, sugar;
  - *Other Trades Clauses:* e.g. coal, jute, rubber, timber.

### 23. INSTITUTE CARGO CLAUSES (2009)

- The 1982 clauses have been reviewed and updated by the Joint Cargo Committee, made up of members of the International Underwriting Association and the Lloyds Market Association.
- The new clauses can be found on the LMA website at [www.lmalloyds.com](http://www.lmalloyds.com). See the comparison of the 1982 and 2009 clauses at [www.rhlg.com](http://www.rhlg.com).
- The scope of certain clauses has been narrowed and of some others widened. There are also various minor changes in terminology.

### 24. INSTITUTE TIME AND VOYAGE CLAUSES HULLS (1983, 1995, 2003)

- **Main amendments of the 1983 Institute Time Clauses Hulls (ITCH) and Institute Voyage Clauses Hulls (IVCH):** they were put into effect from 1 November 1995, introducing the Classification Clause, the extension of the due diligence proviso of the Inchmaree Clause and a 12-month time limit for the notification of claims.
- **The 1995 clauses:** navigation, continuation, breach of warranty, classification, termination, perils, pollution hazard, three fourths collision liability, sistership, general average and salvage, new for old, bottom treatment, wages and maintenance, agency commission, unrepaired damage, constructive total loss, freight waiver, assignment, disbursements warranty, returns for lay-up and cancellation, war exclusion, strikes exclusion, malicious acts exclusion, radioactive contamination exclusion clause.

- ***The market has not accepted the 1995 clauses:*** the shipowners still want to insure under the 1983 clauses, mostly because of the strict warranty regarding the classification, which is provided by the 1995 clauses (cl. 4.2 of ITCH(95) and 3.2. of IVCH(95)).
- ***Description of certain 1995 clauses: (A. Mandaraka-Sheppard)***
  - *English law and practice (preamble):* an express choice of English law and practice to the insurance contract has been declared; the exclusive jurisdiction of the English courts is separately provided for in the new MAR policy form.
  - *Navigation (clause 1 in both ITCH and IVCH):* it prescribes and defines the scope of the liabilities accepted by the insurer with respect to the hull policy, within which the insured risks operate; assistance to ships in distress; “ship to ship transfer”; “scrapping voyages”.
  - *Continuation clause (clause 2 ITCH):* this is a straightforward “held covered” provision provided certain conditions exist; the insured may have the cover extended, provided prior notice is given, only if the ship is at sea and in distress or missing.
  - *Breach of warranty (clauses 3 ITCH and 2 IVCH):* the “held covered” provision (a conditional waiver of the insurer's automatic discharge from liability for breach of a warranty or change of voyage, being subject to prior notice).
  - *Classification (clauses 4 ITCH and 3 IVCH):* the insured has to ensure throughout the period of insurance that the vessel is classed with a Classification Society agreed by the insurers and that her class is maintained, etc.
  - *Termination (clause 5 ITCH):* the clause is designed to protect underwriters from drastic changes in the risk undertaken (e.g. a change of the vessel's classification society, ownership, flag, etc.); the importance of periodic surveys!
  - *Assignment (clauses 21 ITCH and 19 IVCH):* a notice must be endorsed on the policy and produced prior to the payment of a claim or return of premium; *nemo dat quod non habet*.
  - *Perils (clauses 6 ITCH and 4 IVCH):*
    - *perils not subject to due diligence proviso:* perils of the seas, rivers or other navigational waters; fire or explosion; violent theft by persons from outside the vessel; jettison; piracy; breakdown of or accident to nuclear installations or reactors; contact with aircraft or similar objects, or objects falling there from, and conveyance, dock or harbour equipment or installation; earthquake, volcanic eruption or lightning; accidents in loading, discharging or shifting cargo and fuel.
    - *perils subject to the due diligence proviso (the Inchmaree Clause):* bursting of boilers/breakages of shafts or latent defects in machinery or hull; negligence of master, officers, crew or pilots; negligence of repairers or charterers; barratry. See *The Inchmaree* (1877) 12 AC 484 (HL).
  - *Importance of statutory exclusions:* the ITCH and the IVCH do not have a general exclusion clause, so s. 55(2) of MIA 1906 will apply (e.g. wilful misconduct of the insured, delay, ordinary wear and tear). All the exceptions can be contracted out but the one regarding the wilful misconduct (no man can take advantage of his own wrong – *per Salmon J, Slattery v. Mance* [1962] 1 All ER 525).
  - *Pollution hazard (clauses 7 ITCH and 5 IVCH):* it covers the risk of loss or damage to the insured vessel arising from the activities of governmental or state authorities aimed at the prevention or mitigation of pollution hazards.
  - *Collision liability (clauses 8 ITCH and 6 IVCH):* the insurer pays three quarters of any sums paid by the insured to third parties in consequence of legal liability arising from a collision.

- *Sistership (clauses 9 ITCH and 7 IVCH)*: it provides cover against collision and salvage services rendered to or by a ship within the same management as the insured vessel.
- *Notice of claim and tenders (clauses 13 ITCH and 11 IVCH)*: the notice must be given to underwriters promptly after the date on which the insured, owners or managers, become or should have become aware of the loss or damage and prior to survey; a 12-month time limit.
- ***Other time clauses (hulls)***: restricted perils, total loss, general average and three fourths collision liability; total loss only; disbursements and increased value; excess liabilities; war and strikes; war and strikes – limited conditions.
- ***Other voyage clauses (hulls)***: total loss, general average and three fourths collision liability; war and strikes.
- ***The Institute Mortgagees Interest Clauses Hulls (1986)***: to protect his interest fully, a mortgagee would be well-advised to take out these clauses.
- ***The new International Hull Clauses 1/11/2003***: published on 5<sup>th</sup> November 2003. The new clauses are designed to update both the 1/10/83 and the 1/11/95 Institute Time clauses – Hull and the earlier version of these new clauses, the 1/11/2002 version. These clauses are designed to compete with clauses found in other marine insurance markets. The IUA has all but removed reference to the English ‘warranty’ from the hull clauses. The navigational limits clause is no longer referred to as a warranty, and the consequences of its breach are now spelled out - in a way similar to the change of class/management clauses. The effect of a breach of navigational limits clauses is now *suspension* of cover for the duration of the breach (even in relation to loss or damage not caused by the breach of warranty) but cover is restored on remedy of the breach. See <http://www.geocities.com/Heartland/Hollow/5666/form2.html>.

## **25. UNCTAD MODEL CLAUSES ON MARINE HULL AND CARGO INSURANCE (1984)**

- ***UNCTAD***: the United Nations Conference on Trade and Development was established on December 30, 1965, by a UN General Assembly resolution as a permanent organ of the General Assembly, with the purpose to promote international trade especially amongst emerging nations.
- ***New standard insurance clauses***: they were drafted in order to decrease “the monopoly” of the London market and its Institute Clauses. Unfortunately, they have remained a “dead letter” as they are not used in practice.
- ***Marine Hull Insurance (All Risks Cover)***: coverage, general exclusions, additional coverage, period of coverage, duties of the assured, measure of indemnity, claims settlement, annex of additional coverage which may be available under all risks cover (extended cover clause).
- ***Marine Hull Insurance (Named Perils Cover)***.

- **Cargo Insurance (All Risks Cover):** coverage, general exclusions, additional coverage, period of coverage, measure of indemnity, insurable interest.
- **Cargo Insurance (Intermediate Cover).**
- **Cargo Insurance (Restricted Cover).**

## 26. OTHER EXAMPLES OF STANDARD MARINE INSURANCE TERMS AND CONDITIONS

- **Marine Insurance Policy of Antwerp put into Force on 1<sup>st</sup> July 1859 (+ Clauses 1900, modified in 1931):** nowadays the policy is only used for cargo.
- **The Norwegian Marine Insurance Plan 1996, Version 1999 (NSPL):** an agreed document established by the Norwegian marine insurance market to regulate insurance of ships and offshore structures (P&I insurance no longer included). Separate conditions were adopted for cargo: *Conditions Relating to Insurance for the Carriage of Goods, 1995*.
- **DTV Cargo Insurance Conditions 2000 (DTV Cargo 2000):** “the most modern conditions for cargo insurance in the world today”. All risk; Limited Cover; Open Policy; War Clauses; Strikes, Riots and Civil Commotions Clause; Confiscation Clause; Contingency and DIC Insurance Clauses; Classification and Age Clause.

## 27. PROTECTION AND INDEMNITY INSURANCE (P & I)

- **Mutual insurance:** one where two or more persons mutually agree to insure each other against marine losses. See s. 85 of MIA 1906.
- **Origins:** P & I insurance came into common use after the 1835 case of *De Vaux v. Salvador* 111 Eng.Rep. 845 (K.B.1836): collision liability was not a “peril of the sea” and thus not covered under the basic Lloyd's S.G. policy.
- **Running Down Clause:** it covers only three fourths of the collision liability.
- **P & I clubs (mutual insurance societies):** they were founded to cover the remaining one fourth of the collision liability; now they also cover other third-party risks and risks not covered by hull policies; approximately 25 P & I clubs in the world, a large majority located in the U.K. (the largest club is U.K. P& I Club with approx. 5000 vessels insured). 13 Clubs are members of the International Group of P% I Clubs (a special pool).
- **Problems regarding competition law:** the European Commission adopted two formal decisions clearing the co-operative arrangements between the International Group of P&I Clubs (1985, 1999).
- **Examples of risks covered:** personal injury to or illness or loss of life of crew members, passengers and others, loss of personal effects, life salvage, collision liabilities, pollution, towage contract liabilities, wreck liabilities, cargo liabilities.

- **“Pay to be paid”**: the P & I clubs only indemnify the insured if he has paid the third party claimant, is up-to-date in his “calls” and has complied with the other exigencies of club membership; no *direct action* in the U.K. and the U.S.

## 28. MARINE REINSURANCE

- **Definition**: the insuring of a risk or part of a risk by the principal insurer (the insurance company, the ceding company, the cedant, the reinsured) with another insurer (the reinsurer, the reinsurance company). The insurer under a contract of marine insurance has an insurable interest in his risk and may reinsure in respect of it (s. 9(1) of MIA 1906). In simple words, reinsurance is “insurance of insurance”.
- **Difference between reinsurance and co-insurance**: the latter is effected by a number of insurers and it is based on the principle of joint and several liability.
- **The role of reinsurance**: (1) providing capacity, (2) creating stability and (3) strengthening finances.
- **Marine reinsurance contract**: it is based on the principles laid down in law for the conduct of direct marine insurance (insurable interest, utmost good faith, proximate cause, indemnity, subrogation).
- **No legal relationship between the insured and the reinsurer**: unless the policy otherwise provides, the original insured has no right or interest in respect of reinsurance (s. 9(2) of MIA 1906).
- **The “Cut-Through” clause**.
- **Forms of reinsurance**:
  - *facultative*: each risk is considered separately by the reinsurer. *Drawbacks*: e.g. the large amount of clerical work, the time taken to place a risk, lower commission. *Purposes*: e.g. to reinsure special risk or excess of the existing treaty limits;
  - *treaty*: the reinsurer no longer examines each risk individually and he has no power to decline or rate a risk as long as it falls within the scope of the treaty. There are also facultative obligatory treaties and open covers.
- **Categories (types) of reinsurance**:
  - *proportional*: quota share, surplus;
  - *non-proportional*: excess of loss, stop loss, aggregate excess of loss.
- **Retrocession**: “reinsurance of reinsurance”.
- **Fronting reinsurance**: one reinsurer “fronts” for another reinsurer.
- **Tonnage policies**: this is a contract between two underwriters whereby one reinsures with the other the likelihood of total losses in certain classes of vessel over an agreed period.

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## Articles

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- Derrington S., *Non-disclosure and misrepresentation in contracts of marine insurance: a comparative overview and some proposals for unification*, [2001] LMCLQ 66
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- *UNCTAD Model Clauses on Marine Hull and Cargo Insurance*, TD/B/C.4/ISL/50/Rev.1, United Nations, Geneva, 1989.

## 30. INTERESTING WEBSITES

### Maritime Law

- *Australian law:* <http://www.alrc.gov.au/>  
<http://www.law.uq.edu.au/cml>  
<http://www.aar.com.au/services/insurance/index.htm>
- *British Mar. Law. As.:* <http://www.bmla.org.uk>
- *Chinese maritime law:* <http://www.qis.net/chinalaw/prclaw28.htm>
- *CMI:* <http://www.comitemaritime.org/>
- *EU law:* <http://europa.eu.int/eur-lex/>

- *German transport law:* <http://www.jura.uni-hamburg.de/~issr/>;  
<http://www.transportrecht.org/>
- *IMO:* <http://www.imo.org>
- *IMO IMLI:* <http://www.imli.org>
- *International law etc.:* <http://www.lexadin.nl>  
<http://lexmercatoria.org/>
- *Italian law:* <http://www.altalex.com/>  
<http://www.giustizia.it/>
- *Legal browser:* <http://www.lawguru.com/>
- *Maritime law:* <http://www.admiraltylaw.com>
- *Tetley's Law:* <http://tetley.law.mcgill.ca/>
- *UN - Law:* <http://www.un.org/law/>
- *UNCITRAL:* <http://www.uncitral.org/>
- *UNCTAD:* <http://www.unctad.org>
- *UNIDROIT:* <http://www.unidroit.org/>
- *US Congress Library:* <http://www.loc.gov/harvest/query-lc.html>

## **Insurance**

- *Institute Cargo Clauses:* <http://www.lmalloyds.com> , <http://www.rhlg.com> .
- *Insurance browser:* <http://www.ambest.com/directory/ascdire.html>
- *Int. Underwriting Assoc.:* <http://www.iua.co.uk/>
- *Int. Union of Mar. Ins.:* <http://www.iumi.com>
- *Lloyd's of London:* <http://www.lloydsolondon.com>
- *Loss Prevention:* <http://www.containerhandbook.de>
- *Marine insurance:* <http://www.swissre.com> (search for “*Marine insurance*”  
and see the excellent publication which can be  
downloaded in English)  
<http://www.admiraltylaw.com>  
<http://www.insurance-marine.com/>  
<http://www.lssso.com/>  
<http://www.members.tripod.com>  
<http://www.llplimited.com>  
<http://www.brs-paris.com>  
<http://www.geocities.com/Heartland/Hollow/5666/form2.html>  
<http://www.marineinsureservices.com/c42.html>
- *Munich Re:* <http://www.munichre.com>
- *Mutual insurance (TT Club):* <http://www.ttclub.com/>
- *Norwegian marine ins. plan:* <http://exchange.dnv.com/nmip/index.htm>
- *South African Ins. Institute:* <http://www.iisa.co.za/>
- *Swiss Re:* <http://www.swissre.com>
- *UK Ins. Association:* <http://www.abi.org.uk/>

## **Freightforwarding**

- <http://www.altalex.com>
- <http://www.amacarga.org.mx/search.htm>
- [http://www.apat.pt/e\\_APAT.html](http://www.apat.pt/e_APAT.html)
- <http://www.bifa.org>

- [http://www.btl.se/schenker\\_btl/schenker\\_btl\\_denmark/about/english/nsab\\_5f2000.html](http://www.btl.se/schenker_btl/schenker_btl_denmark/about/english/nsab_5f2000.html)
- <http://www.cargolaw.com>
- <http://www.cargolog.com>
- <http://www.ciffa.com>
- <http://www.ffa.com/>
- <http://www.e-tlf.com/index.htm>
- <http://www.fedespedit.it/index.htm>
- <http://www.fenex.nl>
- <http://www.feteia.org>
- <http://www.fiata.com>
- <http://www.fog.it>
- <http://www.forwarderlaw.com>
- [http://www.gestiv.com/podmienky\\_en.html](http://www.gestiv.com/podmienky_en.html)
- <http://www.haffa.com.hk>
- <http://www.handylex.org>
- <http://www.iifa.ie/conditions.doc>
- <http://www.intracen.org/>
- <http://www.mantraco.com.tw/stc.htm>
- [http://www.maxx.be/trade\\_conditions/index.html](http://www.maxx.be/trade_conditions/index.html)
- <http://www.otenet.gr/syndde/indexen.htm>
- <http://www.sla.org.sg/>
- <http://www.sslczech.cz/index.en.html>
- <http://www.ssvschweiz.com>
- <http://www.user.ro/>
- <http://web.uzt.kiev.ua/uzt/>

### **Combined transportation**

- <http://www.uirr.com/>

## **APPENDIX I**

### **Case Study**

In January 2002, Best Trading Co Pty Ltd contracts with Double Happiness Pte Ltd of Hong Kong for the sale of 15MT of stilton cheese, 15 MT of gorgonzola cheese and 30 MT of cheese spread in jars, all on terms CIF Hong Kong. Best trading engages Sendit & Hope Forwarders Pty Ltd to arrange for door to door carriage from its Melbourne cool store to Double Happiness's Hong Kong cool store.

The consignment of cheese is stuffed into 4 reefer containers by Sendit & Hope at Best Trading's Melbourne cool store. The stilton is in one container, the gorgonzola in another and the cheese spread in two others. All of the cheese is to be carried chilled but the stilton and the gorgonzola are to be carried at much lower temperature than the cheese spread.

Best Trading fills out an insurance certificate in the standard Institute Frozen Food Clauses A form, issued by Inherently Equitable Insurance Co., which is in identical terms to the Cargo A Risks form except for Clause 1 which provides:

- 1. This insurance covers, except as provided in Clauses 4, 5, 6 and 7 below,*
- 1.1 all risks of loss of or damage to the subject-matter insured, other than loss or damage resulting from any variation in temperature howsoever caused.*
- 1.2 Loss of or damage to the subject-matter insured resulting from any variation in temperature attributable to*
  - 1.2.1 breakdown of refrigerating machinery resulting in its stoppage for a period of not less than 24 consecutive hours*
  - 1.2.2 fire or explosion*
  - 1.2.3 vessel or craft being stranded grounded sunk or capsized*
  - 1.2.4 overturning or derailment of land conveyance*
  - 1.2.5 collision or contact of vessel craft or conveyance with any external object other than water*
  - 1.2.6 discharge of cargo at a port of distress*

The certificate refers to 30MT cheese spread and 30MT "cheese various". Best Trading sends a copy of the completed certificate to Inherently Equitable.

Sendit & Hope arranges road carriage of the four containers to Melbourne container terminal where they remain for five days awaiting arrival of the "Platter", the ship on which they are to be carried to Hong Kong. During their stay at the container terminal, the settings and Partlow charts on the containers are monitored by Amnesiac Monitors Pty Ltd. The weather is very hot and unseasonably humid.

On arrival of the "Platter" at Melbourne, the containers are shipped on board and Three Monkey's Inc, the operator of the "Platter", issues a bill of lading naming Sendit & Hope as the shipper. The ship's departure is delayed for three days because of engine problems. The weather continues to be hot and humid. Finally, the "Platter" departs Melbourne.

After departure from Melbourne, the "Platter" experiences further engine trouble necessitating a salvage tow to Sydney, the next port of call. The vessel is detained there for a week, while

spares are air-freighted from Singapore and repairs are undertaken. Sydney is now experiencing hot and humid weather. Finally, the “Platter” departs Sydney.

By the time the vessel arrives in Brisbane, nearly three weeks after leaving Melbourne, the crew members have noticed an overpowering and unpleasant smell of decay from two of the four containers. Three Monkeys contacts Sendit & Hope, saying that the ship’s crew is revolting (as, by their smell, are the contents of the containers), and that the containers should be discharged from the ship in Brisbane. Sendit & Hope contacts Best Trading. Further investigation reveals three things:

1. that the powerful smell is coming from the two containers containing the stilton and the gorgonzola;
2. that the temperature setting on those two containers is at the level intended to chill the cheese spread;
3. that the temperature setting on the two containers containing the cheese spread is at a level colder than that intended for the stilton and the gorgonzola.

Best Trading agrees that the two foul smelling containers should be discharged from the ship at Brisbane, saying that it wishes to protect its commercial relationship with Double Happiness. It also requests the discharge of the two containers of cheese spread as it suspects it may have been damaged by over chilling. Three Monkey’s discharges the goods in return for the original bill of lading which had not yet been sent to Hong Kong.

When the containers are opened in Brisbane, it is found that the stilton and the gorgonzola are in an advanced state of decay. Much, but not all of the cheese spread has frozen solid. When thawed, the frozen cheese spread separates into a thick curd sludge and an unpleasant astringent whey.

Discuss the insurance implications.

*[This problem is an adaptation of one set by Professor Martin Davies as an insurance hypothetical at the MLAANZ Conference 1996. The adaptation was made by Dr. Sarah Derrington of The University of Queensland, T.C. Beirne School of Law, Brisbane]*

## APPENDIX II

### World insurance in 2008

*Sigma, Swiss Re, 30 June 2009*

World insurance premium volume rose slightly to USD 4270 billion in 2008. However, adjusted for inflation, premiums declined by 2%. Global life premiums fell by 3.5% in 2008, mainly driven by a sharp fall in the sale of unit-linked and single premium life insurance products in the industrialised countries. Non-life premiums decreased by 0.8%.

The global financial crisis hit life insurance premium growth in particular, mainly in the second half of 2008. Sales of unit-linked products and products linked to equity markets were severely impacted by falling stock markets in 2008, causing life insurance premiums in industrialised countries to drop by 5.3% (USD 2 219 billion). Sales of non-linked savings products, such as fixed annuities and traditional life savings, continued to increase in many countries, but failed to offset the declines seen in the unit-linked business.

In contrast to the industrialised countries, life premium growth in the emerging markets accelerated to 14.6%. Daniel Staib, one of the authors of the new *sigma study*, said: “Since many emerging market countries profited from a sharp increase in commodity prices during the first half of last year, their economies continued to perform well, even as the decline in industrialised countries set in from September.”

As a result of the turmoil in financial markets in 2008, shareholder capital in the life insurance industry shrank by 30-40% on average, with some companies suffering declines of up to 70%. Staib noted: “The size of the loss of shareholder capital in the life insurance industry is a reflection of the fact that a life insurer not only assumes insurance risks, but also asset risks. It has to be said though that the extent of the losses does demonstrate the extraordinary dimension of the crisis.”

#### **Non-life insurance remains profitable, despite falling premiums**

In contrast to life insurance, non-life premiums declined only marginally by 0.8% in 2008 (USD 1 779 billion), mainly due to lower demand for cover and softening rates. While non-life premiums fell 1.9% in the industrialised countries, growth in the emerging markets remained strong at 7.1% compared to 2007 levels.

At the same time, underwriting results in non-life remained equally positive in most markets, despite very high losses from natural catastrophes. Towards the end of the year, rate increases were observed in selected countries and lines of business.

#### **Outlook: subdued in 2009, recovery to be expected in 2010**

“Though financial markets remain vulnerable, they have stabilised recently, reducing pressure on asset prices and shareholder capital,” said Staib. Still, according to Swiss Re’s economists, growth in life insurance premiums in 2009 is expected to remain subdued or may even turn negative as turbulent stock markets and gloomy employment prospects continue to negatively

impact sales of unit-linked savings products. Markets with a large volume of single premium unit-linked business in proportion to total in-force business will be impacted the most.

Staib said: “As the economy recovers, we expect both higher life premiums and better investment results as asset prices are expected to improve. This will not only have a positive impact on profitability, but also on shareholder capital and the ability to raise capital. In the medium and long-term, the outlook for life insurance remains positive.”

In non-life, real premiums, i.e. premiums adjusted for inflation, are expected to remain flat in 2009, as the economic downturn is likely to curb demand, particularly in the commercial lines of business. Staib said: “Demand for personal lines of insurance, for example motor, is likely to be less affected, since insurance spending is less discretionary, particularly in the industrialised markets. Nevertheless, the economic situation will also impact this segment.”

Staib concluded: “While it is expected that the recession will reduce demand for insurance cover, capital shortages will support the upward movement of prices. Furthermore, demand for additional cover should increase in 2010 along with the economy. Profitability in non-life is likely to improve, mainly due to rising prices and stronger investment results.”

## **APPENDIX III**

### **Marine insurance 2009/2010**

*AON, Marine Insurance market Outlook 2009/10*

#### **Unprecedented challenges for shipowners**

The world economy ran out of steam in 2008 and the momentum has finally stopped carrying the shipping industry forward. While 2008 was a record year for some as the economic boom reached its peak in the first half of the year, the first quarter of 2009 looks set to be the worst in many years.

As a result, the shipping industry issues identified in Aon's 2008 Marine Insurance Market Review have been turned sharply on their head. The challenges of under-supply of tonnage have violently switched to severe cases of supply overhang.

The industry may therefore be somewhat relieved to know that, so far at least, the recession has had much less impact on the marine insurance market. While showing signs of firming or even hardening prices, insurers continue to offer attractive terms to well managed risks.

#### **Firming insurance markets**

Commercial marine insurance underwriting results have been acceptable or better in recent years, particularly in the dominant London market. While the markets may attempt to talk up pricing simply because it seems logical to do so in the present difficult economic circumstances, the evidence suggests there is no reason to overreact at this point.

Even so, commercial underwriters are in business to make profits and it would be misleading to imply that the marine insurance industry does not face challenges in these difficult times, which may become more entrenched as the economic situation develops.

Insurers are struggling to adapt to the prospect of falling revenues due to reduced activity and decreasing investment income through lower asset values, equity and bond yields and interest rates. With a much slimmer stream of investment income, insurers are likely to be forced to focus more on pure underwriting profit, which has been elusive in some classes. Protection and Indemnity (P&I) insurance is a good example: rates have been forced up sharply in recent years but most P&I clubs still lose money on their underwriting account.

These challenges to the top line combined with increasing costs, (including higher reinsurance prices as a result of catastrophe losses in 2008 – particularly Hurricanes Ike and Gustav), probably sounded the death knell for the soft phase of the commercial marine insurance markets. The market perceptibly turned a corner during the January 2009 renewal season. Although the commercial insurance markets may not have the same ability to force rate increases as their counterparts in the mutual P&I industry, there is an increased sense of determination on the part of underwriters to move rates back up again.

This desire applies more or less to all areas. Protected by their competition dispensation, at the 20 February 2009 renewal the International Group P&I clubs probably achieved an average

increase in rates approaching 15%. Hull and machinery rates are moving up in the range of 2.5% to 7.5% for clean business. Liability is seeing similar rises. The only area that remains flat is cargo, though not for want of trying on the part of underwriters.

Moves to harden the marine insurance market come at a very challenging time for the shipping industry, but in view of the pressures on insurers generally, the situation could be much worse.

For the time being at least, abundant capacity in most classes of insurance is generally tending to keep a lid on rate rises, and there are no obvious signs that capacity for marine insurance risks will significantly decline in the short term.

This knowledge will not comfort insurers, who still have to pay the claims despite possible falls in revenue. Underwriters will be hoping that the reduction in activity will bring about a concomitant reduction in claims. Whether this will be so is open to debate.

### **Claims**

Six months or so into a recession is too early to see any change in the pattern of marine insurance claims but the downturn could influence claims patterns in conflicting ways.

On one hand, claims costs should fall because fewer ships are at sea and repairs are likely to cost less as lower prices for steel and spare parts start to work through. On the other hand, there could be a short term surge in claims if vessels are laid up in large numbers and owners take the time to make the inspections that could lead to the discovery of unsuspected damage. That said, less activity tends to reduce losses and, as the downturn comes to an end, another surge in claims is possible as activity once again increases.

### **Hijackings hit new high**

Opinion is divided as to how serious a financial threat piracy poses to shipowners and insurers. The cost of kidnap and ransom (K&R) cover for the Gulf of Aden has certainly risen sharply in 2009, sometimes by as much as a factor of 10, and premiums in the region of US\$30,000 for a limit of US\$3 million for a single voyage have been quoted. Those shipowners opting to purchase K&R cover presumably prefer the certainty offered by these products rather than diverting around the Cape with the increased running costs that this entails.

A broader range of products is now becoming available. For example, in 2008 Aon launched a policy covering loss of earnings from a ship detained by pirates. The policy is available to shipowners, charterers, cargo owners and all other parties with an insurable interest. The cover responds from the day the vessel is detained and is a standalone policy to complement existing hull, war, cargo and P&I cover.

### **Conflicting requirements**

The relationship between the marine insurance markets and their customers is currently finely balanced. The squeeze will come when the understandable desire of the shipping industry to reduce costs in the face of a dramatic market about to turn meets the requirement for insurers to continue to generate acceptable margins, without the benefit of investment income. There will

be challenging negotiations ahead across the spectrum of marine insurance during 2009 and into 2010.

## **APPENDIX IV**

### **Utmost good faith**

*Based on articles and other sources summarized by  
Miss Jana Rodica, LL.M (IMLI'09)*

#### **Origins of the Common Law Duty of Good Faith**

The common law doctrine of “good faith” in insurance contracts originated in the 18th Century.

Lord Mansfield is credited with first articulating this concept in *Carter v. Boehm* (1766) 3 Burr 1905. Whilst many practitioners are aware of the reason for the celebrity of this case, they may not be familiar with its facts. They are worth summarizing, to put the learned Judge’s reasoning into context.

The action was based upon a 12 month policy of insurance, commencing 16 October 1759, taken out for the benefit of the governor of Fort Marlborough, George Carter, against the loss of Fort Marlborough on the island of Sumatra by its being taken by a foreign enemy. The governor also had an insurable interest in goods, which he owned, which were kept at the fort. In fact the event insured against occurred: the fort was taken, by Count D’Estaigne, during the policy period.

The defendant underwriter, Mr Charles Boehm denied that underwriters were liable to indemnify the insured because of a fraud, as a result of the concealment (non-disclosure) of circumstances which ought to have been disclosed - particularly, the weakness of the fort, and the probability of it being attacked by the French. In support of the insurer’s defense, two letters from the governor were relied upon - one to his brother, his trustee, the plaintiff in the case and the second to the governor of the East India Company.

The first letter to his brother indicated that the governor was more afraid than before that the French would attack. The governor wrote to his brother that rather than remain idle, (since they could not muster a force to relieve their friends at the coast), the French may pay him a visit. The governor speculated to his brother that the French had such an intention the previous year. In the same letter he asked his brother to arrange the insurance.

In his second letter to the East India Company, the governor wrote that the French had, in the previous year, a plan on foot to take the fort by surprise and that they would probably revive that idea. He also stated that the fort was badly supplied with arms, stores and ammunition and expressed his view that if there was an attack by a European enemy, it could not be repelled.

The underwriters argued that they had a right to know as much as the insured himself knows about the weakness of the fort. They asserted that if the governor had disclosed what he knew or, what he ought to have known, he could not have obtained the insurance of the fort. Therefore, this was a fraudulent concealment and the underwriters were not liable.

The Court held that...“*the insurance is a contract upon speculation*”. Lord Mansfield further stated that the keeping back of such circumstance is a fraud, and therefore, the insurance policy is void. Although the suppression of information may happen through a mistake, without any fraudulent intent, Lord Mansfield felt that, in such a situation, the underwriter was still deceived and the policy is void, because the risk run is really different from the risk understood and intended to be run, at the time of the agreement.

In crystallizing the duty of good faith, Lord Mansfield held that:

*“The reason of the rule which obliges parties to disclose, is to prevent fraud, and to encourage good faith. It is adapted to such facts as vary the nature of the contract; which one privately knows, and the other is ignorant of, and has no reason to suspect.”*

On the specific facts, the Court determined that the underwriter in London, in May 1760, could make a much better judgment about the probability of the contingency occurring than Governor Carter could at Fort Marlborough, in September 1759. The underwriter knew the success of the operations of the war in Europe. He knew what naval force the English and French had sent to the East Indies and much more. In these circumstances, and with this knowledge, he insured against the general contingency of the fort being attacked by a European power. If there had been any plan or design on foot, or any enterprise begun in September 1759, to the knowledge of the governor, it would have varied the risk understood by the underwriter; because not being told of a particular design or attack then subsisting, he estimated the risk upon the footing of an uncertain operation which may or may not be attempted. However, the governor had no notice of any design subsisting in September 1759. There was no such design in fact.

Lord Mansfield found that the general state and condition of the fort, and of its strength was, in general, well known by most people acquainted with Indian affairs or the state of the company’s factories or settlements and could not be kept secret or concealed from persons who should endeavor, by proper inquiry, to inform themselves.

The noble Lord concluded that the underwriter here, knowing the governor to be acquainted with the state of the place; knowing that he apprehended danger, and must have some ground for his apprehension; being told nothing of either; signed the policy, without asking a question, etc. It is a withering conclusion which has valid resonance, when applied to analogous circumstances, today.

In consequence, it was clear that although the insured is under a duty to disclose material facts to the insurer, he need not disclose facts which the insurer knows or is deemed to know. This seems to be fair enough. From its earliest days, the duty of good faith in making insurance contracts was a mutual obligation. It contemplated an active process of disclosure and questioning between the insured and the insurer but, within sensible boundaries.

### **The Marine Insurance Act 1906**

The principle of good faith and fair dealing in insurance contracts was codified in the *Marine Insurance Act 1906*, (“MIA 1906”). Under the major heading “Disclosure and Representations”, section 17 of the Marine Insurance Act 1906 provided as follows:

*“17 Insurance is uberrimae fidei”*

*“A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.”*

It is notable that at this point, the bar was raised from the standard of mere “good faith” contained in the previous case law to “utmost good faith” in the statutory expression of the duty. One may reasonably suppose that “utmost” good faith means something more than plain “good faith”. One would ordinarily understand it to mean the highest degree of good faith.

The fundamental components of the duty of utmost good faith are to ensure proper disclosure of all material circumstances and to avoid making misrepresentations about material facts, circumstances or beliefs.

Up until the mid-1980’s, Court time was mainly taken up with resolving disputes concerning alleged breaches of the duty of utmost good faith, in the context of the formation of the contract - namely the underwriting process. During the last 10 - 15 years, the English Courts have become accustomed to dealing with closely fought issues concerning allegations of breach of the duty of utmost good faith, in the context of the performance of the contract and particularly, the claims process. It is instructive to evaluate, as the doctrine moves from the 18th to the 21st Century, whether the English Courts are managing to strike a fair balance between the interests of the policyholder in having legitimate claims paid and the interests of the insurer/reinsurer in receiving the risks that they bargained for. In the words of Lord Mansfield:

*“The question therefore must always be whether there was, under all the circumstances at the time the policy was underwritten, a fair representation; or a concealment; fraudulent, if designed; or, though not designed, varying materially the object of the policy, and changing the risque understood to be run”.*

### **Interpretation of Sections 17-20 MIA 1906**

It is important to bear in mind that section 17 of MIA 1906 prescribes that if utmost good faith is shown not to have been observed by either party the contract may be “avoided”, (rescinded) by the other party. The statutory duty imposed by section 17 enables the aggrieved party to rescind the contract *ab initio*, thereby restoring the parties to the position they were in, as between themselves, as if they had not entered into the contract. This may involve a complex unravelling of numerous financial transactions. The process of putting the parties back into their pre-contract position does not take place under the terms of the relevant contract, because this has been rescinded but, under the law of restitution. Accordingly, the remedy for breach of the statutory duty of utmost good faith cannot be the payment of damages. It is much more severe.

Furthermore, in avoidance, it is not simply the relevant claim which is avoided but the whole policy. An attempt by an insurer to keep the policy alive but argue that it is not obliged to pay the claim on the grounds of non-disclosure, may risk the loss of the right to avoid, as was shown in the case of *West v. National Motor and Accident Insurance* [1955] 1 Lloyd’s Rep 207. Rescission is also retroactive. The insurer is not liable for claims arising

between the making of the contract and the time of avoidance (*Standard Accident v. Pratt*, 278P 2d, 489). In order to constitute a valid avoidance, the insurer must return the premiums paid under the policy.

For some time, the remedy of avoidance of the contract *ab initio*, has been criticized as being too severe, in certain circumstances. It is said that other remedies should be available which are proportionate to the harm or damage caused by the non-disclosure and reflecting the culpability and conduct of the offending party.

However, the advocates of radical reform in this area should not lose sight of the fact that the purpose of the doctrine “*is to prevent fraud and to encourage good faith*”, thereby giving a fair presentation to enable the insurer to understand and evaluate the risk to be run. A sanction which is too lenient may encourage proposers of insurance and reinsurance, (and their agents), to cut corners and take a chance.

Such fluidity and the resultant uncertainty would not be in anyone’s interests. Yet, the English Courts have shown signs of interpreting the requirements imposed by the duty of utmost good faith, in keeping with the standards of the times, and the nature of the particular transaction, and the conduct of the parties, in an effort to maintain the appropriate balance of interests and to do justice.

In the formation of an ordinary contract, unless expressly stated otherwise, the legal maxim of *caveat emptor* (let the buyer beware) applies, despite Lord Mansfield’s assertion that good faith (perhaps as distinct from utmost good faith) is applicable to “*all contracts and dealings*”. This means that one contractual party is under no general positive duty of disclosure to the other party. In the case of insurance and reinsurance contracts, the legal duty of *uberrima fides* (utmost good faith) does apply.

This difference of approach (and obligation) in relation to contract formation, can sometimes lead to misunderstandings and differences of expectation between the parties. There are signs that this may have occurred, during the last few years, where insurers and reinsurers have been asked to support and participate in complex specialist transactions involving interaction with the banking and capital markets. In such circumstances, it is advisable for all parties to analyze the true nature and substance of the transaction, not only to understand the commercial deal proposed but also to determine which legal principles and obligations may apply.

In view of the statutory duty of utmost good faith, imposed since 1906 upon each contractual party to inform the other with all material information relevant to their decision to participate, each party must conduct themselves in negotiations and contract formation in a more rigorous way than if they were negotiating a non-insurance contract. On the one hand there is the positive obligation on the prospective insured to consider and disclose all material facts and on the other, the burden on the prospective insurer to consider that information and other relevant information in the public domain which need not be disclosed but which the insurer ought to know in the ordinary course of his business, and thereafter make all necessary enquiries both to understand and evaluate the risk and not waive disclosure of any important information.

## **The Oceanus and Pan Atlantic phase**

Over 50 years later, when the world of trade and commerce had changed very significantly, the Court of Appeal was faced with a similar predicament in the case of *Container Transport International v. Oceanus Mutual Underwriting Association* [1984] 1 Lloyd's Rep 476.

In his comprehensive and well known judgment, Kerr L.J. considered extensively the theoretical and practical difficulties concerning the interpretation of section 18(2) MIA 1906 concerning materiality. He balanced the competing interests in the following way:

*“the principle is that if a certain fact is material for the purposes of ss. 18(2) and 20(2), so that a failure to draw the underwriter's attention to it distorts the fairness of the brokers presentation of the risk, then it is not sufficient that this fact could have been abstracted by the underwriter from material to which he had access or which was cursorily shown to him. On the other hand, if the disclosed facts give a fair presentation of the risk, then the underwriter must enquire if he wishes to have more information.”*

It seems therefore, that once the threshold point has been reached, in any specific circumstances, where a fair presentation has been made, the burden transfers to the insurer or reinsurer to request more information, if he wishes. However, at that time, the insured's duty of disclosure has been satisfied. In such a situation, the preferable view seems to be that, after the disclosure threshold point had been reached, in any individual case, a failure by the insurer to ask further questions should not lead to an inference of waiver against the insurer because this may result in the dangerous erosion of the duty of disclosure which Lord Justice Scrutton feared, over 50 years previously. In any event, the Oceanus case became notorious for interpreting the definition of materiality in s. 18 MIA 1906 in a much criticized way.

The facts are as follows: CTI hired out containers for ocean transportation. Frequently, problems occurred regarding the liability of the container lessees for repairs under the container hire contracts. It was agreed that CTI would cover an initial part of certain repair costs. CTI obtained insurance of their exposure to the cost of repairs for the containers, initially through Crum & Forster. As a result of their concerns with the claims experience, Crum & Forster quoted renewal on terms which were not acceptable to CTI. The cover was placed subsequently with Lloyd's but, Lloyd's also became unhappy with the claims experience - following which the insurance was proposed to and placed with Oceanus. Subsequently, Oceanus, became unhappy with the claims and alleged that incomplete information concerning the claims history was presented to them, constituting a material misrepresentation. Expert evidence was produced to the Court, on behalf of Oceanus, that a prudent insurer, within the terms of s. 18 (2) of MIA 1906, would have been influenced in his judgment in determining whether he would take the risk or in fixing the premium, if he was made aware of the full facts.

The Court of Appeal decided that the correct test of materiality was whether the fact which was undisclosed or misrepresented was one which a notional prudent insurer would have taken into account in reaching his decision whether or not to accept the risk or in fixing the premium. Controversially, the Court of Appeal determined that it was not necessary to show that the actual underwriter would have been influenced by the non-disclosure or misrepresentation to act in a different way.

The decision was criticized in the English market because it encouraged ingenious reinsurers to base rescission defenses on the objective test of what a prudent underwriter would have done, whilst ignoring what the actual underwriter had done. It was relatively easy for an insurer to show that the facts not disclosed or misrepresented were worth consideration by the underwriter in formulating his decision by calling expert underwriting evidence, even though their actual underwriter would not have acted any differently if the withheld or misrepresented facts were made known to him.

Such was the extent of the concern in the English insurance market, immediately following the decision, at what was portrayed as a charter to protect the incompetent underwriter, that it was necessary to find another case, to take to the House of Lords, to re-address some of the more unsettling aspects of that judgment.

A landmark judgment arrived within the next decade, in the case of *Pan Atlantic Insurance Company Limited v. Pinetop Insurance Company* [1994] 2 Lloyd's Rep 427. The facts were relatively straightforward and for present purposes can be easily summarized. A predominantly US casualty account was reinsured by Pine Top with Pan Atlantic, under various excess of loss reinsurance contracts in 1980, 1981 and 1982. As part of the placing information to the underwriter of Pan Atlantic, the placing broker had shown the underwriter the loss record for the risk for 1980 and 1981. The loss record for 1981 was inaccurate. It showed losses of US\$ 235,768, whereas, as the reinsured were aware, the true position was that US\$ 468,168 of claims had been incurred.

Also, Pine Top's broker had failed to disclose to Pan Atlantic's underwriter the loss record for the years 1977 - 1979. When the case was heard in the Commercial Court, the Judge held that, in relation to Pine Top's failure to disclose their loss record for 1977 - 1979, there had been a fair presentation of the risk. He weighed up whether the duty of disclosure had been fulfilled either on the right side of the borderline or, whether the doctrine of waiver should defeat any reliance on the alleged material non-disclosure. On the facts, the Judge concluded that an underwriter knows full well that the earlier years are the only real guide to assessing a risk and its rate. The Court held, on the evidence, that the broker brought along for the underwriter to see the history in relation to the earlier years and that history, if the underwriter had bothered to study it, was a perfectly fair presentation of those earlier years. The Judge felt that the broker did not have an obligation to tell the underwriter how to do his job.

The Court of Appeal agreed with the Judge and so did the House of Lords. In relation to the alleged material non-disclosure of the additional US\$ 230,000 of losses in respect of the 1981 underwriting year, - Pan Atlantic were entitled to avoid. The Court of Appeal, applying the prudent underwriter test previously formulated in the *Oceanus* case, upheld the trial Judge, as did the House of Lords, who adopted the conclusion of the trial Judge that:

*“If these additional losses had been brought to his...[i.e. the actual underwriter of Pan Atlantic]... attention in the way that he was looking at this business by reference to the short record, it might well have influenced him as to the terms of the renewal”.*

Even so, the House of Lords took the opportunity of reformulating the test of “materiality”. There is now a two part test which needs to be satisfied. The House of Lords did not change the first limb. It is still necessary to demonstrate materiality by reference to a hypothetical prudent underwriter. However, as the second limb, it is now necessary to show that the

actual underwriter was induced by the misrepresentation or non-disclosure to enter into the contract.

As ever, Lord Mustill gave some helpful guidelines in his speech in the House of Lords [1994] 2 Lloyds Rep 427 at p. 453:

*“I have concluded that it is an answer to a defence of misrepresentation and non-disclosure that the act or omission complained of had no practical effect on the decision of the actual underwriter. As a matter of common sense however even where the underwriter is shown to have been careless in other respects the assured will have an uphill task in persuading the Court that the with holding or misstatement of circumstances satisfying the test of materiality has made no difference. There is ample material both in the general law and in the specialist works on insurance to suggest that there is a presumption in favour of a causative effect”.*

Although the judgment was viewed as striking a fairer balance on the question of “materiality” between the reinsured and the reinsurer, it is significant that ss.17 - 20 MIA 1906 make no reference to a concept of “inducement”.

Things settled down during subsequent years, as the English Courts applied the refined tests set out in *Pan Atlantic*, in a variety of non-disclosure cases. Many of these were settled but, Judges became concerned about the explosion of documentation being called for in the disclosure (discovery) process in litigation and the amount of expert evidence which they were being asked to consider on market practice and issues of construction. Fortunately, the Commercial Court Judges are generally well versed in the practices and procedures of the English insurance market. Therefore, they were becoming increasingly keen to disallow “fishing expeditions,” in the discovery process, for materials of dubious relevance and to reserve to themselves the duty of placing a legal construction upon disputed contracts of insurance and reinsurance. This was, after all, the function of the Court.

In *Marc Rich v. Portman* [1997] 1 Lloyds Rep 225, Lloyd’s underwriters alleged that the brokers had failed to disclose the loss experience of the insured and the demurrage claims made or paid by them as charterers to ship-owners for vessels performing voyages from Kharg Island/Ain Sukhana or voyages out of Constantza and pleaded further non-disclosure of particular features of the port of Ain Sukhana which would be likely to give rise to demurrage claims - such as bad weather, difficult tides, likelihood of congestion and other such matters. The insured argued that, even if the allegedly material facts had been disclosed, it would not have affected the judgment of the actual underwriter who was described in submissions to the Court on behalf of the insured as ...“a man who had abrogated his underwriting functions and existed in an intellectual stupor”. In consequence, the insured asked that their insurers disclose their actual underwriter’s writings, over a period of five years, presumably in order to try to undermine his competence. Understandably, insurers had declined to agree to such broad ranging disclosure.

At the trial, Mr Justice Longmore (as he then was) observed that it would be most unfortunate, as a consequence of the *Pan Atlantic* case:

*“...if cases of this kind were to be saturated with inquiries about a plethora of risks written by the actual underwriter on occasions other than the time when the relevant risk was itself written.... the question whether the actual underwriter was induced to write the relevant*

*risk is to be determined by reference to the actual risks underwritten and their immediate context. The question in this case is then whether the underwriter abrogated his functions in relation to these risks, not in relation to numerous other risks written on different occasions”.*

In *Manifest Shipping Co Limited v. UniPolaris Insurance Co Limited (The “Star Sea”)* the insurers relied on s. 17 of MIA 1906, pleading that the owners of the vessel failed to disclose facts relating to an earlier fire aboard another vessel, *Kastora*, at the time when the insurers’ solicitors were investigating the *Star Sea* claim. In giving the leading speech in the House of Lords, Lord Hobhouse distinguished between a contractual obligation of good faith in the performance of a contract and the statutory duty imposed by s. 17 MIA 1906. He pointed out that the right to avoid the contract, *ab initio*, in s. 17 is different from the applicable remedy for breach of the duty of utmost good faith during the performance of the contract. The right to rescind under s. 17 enables the innocent party to rescind the contract *ab initio* thereby totally nullifying the contract and requiring everything done under the contract to be undone, including any adjustment of the parties’ financial positions. Lord Hobhouse explained that this was entirely appropriate where the lack of good faith has preceded and been material to the making of the contract. However, when the want of good faith first arises after the making of the contract and during its performance, he felt that it becomes anomalous and disproportionate that a breach should entitle the aggrieved party to avoid the contract, from inception. Accordingly, Lord Hobhouse considered that there was a clear distinction between the pre-contract duty of disclosure and any duty of disclosure which may exist after the contract has been made.

The Courts have consistently set their face against allowing the insured’s duty of good faith to be used by the insurer as an instrument to enable the insurer himself to act in bad faith. Lord Hobhouse concluded that for the insurers to succeed in avoiding the contract, *ab initio*, under s. 17 MIA 1906, due to non-disclosure during the performance of the contract, the insurers would have to show that the claim was made fraudulently.

It is becoming increasingly common, in certain species of commercial insurance and reinsurance policies, to try to exclude the full force of the consequences of the avoidance remedy under s. 17 MIA 1906, by including an inadvertent non-disclosure clause. This provides that the insurers can only rescind the policy for non-disclosure if the non-disclosure arose otherwise than from fraudulent conduct or an intention to deceive. Sometimes such clauses expressly allow insurers the right to exclude losses relating to non-fraudulent non-disclosure, rather than allowing the policy to be rescinded, *ab initio*.

As previously mentioned, it is clear that banks and financial institutions are not protected by the common law duty of utmost good faith in their day-to-day lending and financing business. Where serious and substantial sums of money are at stake or professional reputations are involved (or both), banks frequently demand bullet-proof protection and instant recourse, rather than run the risk of insurers seeking out a breach of some perceived and intangible archaic utmost good faith obligation. Furthermore, in soft market conditions and where there is premium hungry excess capacity, insurers have been persuaded to dilute or dispense with the “all or nothing” remedy of avoidance under s.17 MIA 1906. Banks, capital providers and financiers often demand a less harsh approach to the consequences of breach.

## **So where does that leave us?**

Even hardliners in the insurance industry opposed to change, may accept privately that reform is long overdue. The duty of disclosure, as it presently stands, can operate too harshly against the insured.

For example, the insured may not be aware that, after giving his responses to questions on a proposal form, he is still under a duty to disclose any other material facts to which none of the questions related. Also, in relation to renewals, an insured may not know that in law a renewal constitutes a new contract of insurance and so his duty of disclosure arises afresh, at every renewal, so that he is under an obligation to disclose any material facts arising in the interim. Perhaps after all, the duty of disclosure is not too stringent but, the range of remedies available do not adequately allow for different degrees of culpability which merit different remedies, in order for the dispute to be dealt with fairly. The ultimate sanction of avoidance should remain but, only for the ultimate breach (e.g. fraud). An all or nothing sanction in the modern world should not apply regardless. It is perhaps for this reason, that the BILA report makes an additional suggestion to the effect that there should be a change in the law so that insurers are put under a duty to ask reasonable questions about a risk on matters it considers are material and which require further information. This may signal a future and welcome market-wide emphasis on true underwriting skill and judgment, combined with verbal craftsmanship in documenting contracts of insurance and reinsurance. There is still room for underwriting flair but, with discipline.

In conclusion, it is almost impossible to do better than repeat the clearly expressed advice and underwriting approach of Mr Robert Kiln, the well known former Lloyd's underwriter, in seeking to minimize the risk of being involved in disputes concerning alleged non-disclosures and breaches of the duty of utmost good faith. These comments were made in Mr Kiln's book "*Reinsurance Underwriting*" - the first edition of which was published in England in 1989. Mr Kiln's views are as appropriate today, as when they were first committed to paper:

*"My experience during the last few years as an arbitrator, expert witness or consultant in some seventy disputes in the reinsurance field has been any eye opener. The disputes have involved a total of several billion dollars in total, nearly all of them arising out of bad faith by one or all parties allied to sheer greed or stupidity. For example, by reassureds and their brokers deliberately misleading their reinsurers by "clever wordings" or by non-disclosure or veiled non-disclosure. Reinsurers not even reading slips, or if they have, not understanding them and producing them and producing no wordings and not asking questions. The courts in the UK (but not so in the USA) have come down strongly in favour of requiring disclosure of any information which would influence a prudent reinsurer. They have placed less stress on the duty of the reinsurer to ask questions."*

*"There are two views on most of these disputes. One is that some reassureds, and in particular placing brokers, have deliberately and consistently taken innocent reinsurers for a ride. The second view is that reinsurers have imprudently taken on contracts, and having deliberately done so, are now ratting on those contracts, often years later for any reason they think will delay payment and force a compromise, or even a verdict, in their favour. Good faith and integrity, if it ever existed, has long gone out of the window. In my view both views have validity and both are equally common."*

*“Never underwrite something you do not fully understand. Never agree to initial something you do not understand. Never worry about asking questions, never worry about being considered ignorant or foolish. Much better to admit your ignorance before accepting the business. In most cases everyone will be ignorant too.”*

It is difficult to argue with Mr Kiln’s good sense and long experience of both active underwriting and reviewing the underwriting of others in his capacity as a leading arbitrator. His cynicism is understandable. Fortunately, the English Courts will step in decisively, when required to do so, to enforce the long standing duty of utmost good faith, in the underwriting process. However, before seeking assistance from the Courts, it is advisable for insurers to have taken all reasonable steps to help themselves, in the underwriting process, and to be able to produce evidence to demonstrate that they have done so.