

THE MARINE INSURANCE ACT CENTENARY **A CAUSE FOR CELEBRATION?**

Studying for the Association of Average Adjusters exams when the Act was a mere 75 years old, it seemed to me as an impatient young man that it already contained much that was old-fashioned. Provisions regarding bottomry and respondentia bonds was clearly archaic, and having to learn seven sections on voyage policies seemed a real imposition, since I had yet to encounter any hull policies on voyage terms. Having now exchanged the sharp suits of youth for the cardigans of middle age, the MIA feels more like a familiar friend than an elderly bore to be avoided, and a centenary toast or two seems to be in order.

It is difficult to over-estimate the influence of the MIA; many of those countries that did not actually use it as a model for their own statutes have adopted the standard Institute Clauses which are subtitled as being “subject to English Law and practice”. In these circumstances it is perhaps surprising that English Law was itself rather a late developer in terms of codifying marine insurance, after a promising start in the closing years of the reign of Elizabeth I. In a 1601 statute the purpose of marine insurance was memorably defined as ensuring that *“...it cometh to pass on the loss or perusing of any ship, their (sic) followeth not the undoing of any man, but the loss lighteth rather easily upon many than heavily upon few, and rather upon them that adventure not than on those that do adventure, whereby all merchants, especially the younger sort, are allured to adventure more willingly and more freely.”*

This act was intended to set up a Court of Arbitration to deal with insurance disputes but its procedures were found to be cumbersome and it was little used. The next Act was passed in 1746 in response to the many abuses and frauds that are referred to in its preamble, chiefly concerning “wager” or gambling policies which were insurances taken out by parties with no actual interest in the adventure, with obvious attendant moral hazard. Interestingly, the Act also prohibited re-insurance in most cases, a restriction that was not withdrawn until 1864.

In matters of regulation, our European neighbours are often ahead of us and things were much better organised on the Continent at an early stage. In Venice, state papers from 1411 show that marine insurance had been conducted for some years, although insurances on foreign interests were discouraged. A Court was set up there in 1468 to enforce the honouring of marine insurance contracts and to repress fraudulent claims. A 1523 ordinance published in the powerful city state of Florence in Italy provided for all policies to be underwritten on a standard form and a commission was set up to control insurance transactions and regulate premiums. The most

detailed codification took place in France under Louis XIV and this model was followed by other countries; it also formed part of the Napoleonic Code de Commerce of 1807. Other examples were to be found in Flanders, Spain and amongst the Hanseatic League.

The failure of the English legal system to cope with the growth of maritime trade was deplored by Lord Campbell who wrote that "*The legislature had literally done nothing to supply the insufficiency of feudal laws to regulate the concerns of a trading population: and the common law judges had, generally speaking been too unenlightened and too timorous to be of much service in improving our code by judicial decisions.*" The law reports were no help on commercial matters but "*swarmed with decisions about lords and villeins... and about the customs of manors whereby an unchaste widow might save the forfeiture of her dower be riding on a black ram and in plain language confessing her offence.*"

Riding, rather less ignobly, to the rescue came Lord Mansfield, who towers above all others in the development of maritime law. He was born in Scotland and, after graduating from Oxford, was called to the bar in 1730. He followed a political career, becoming Attorney-General and acting as Leader of the House of Commons for two years, before becoming Chief Justice of the King's Bench in 1756. He never entirely left politics behind him and his judicial career was often controversial, not least for the role he played in defending the rights of conscience and putting an end to slavery in England. However, his interest to marine practitioners is that he is widely recognised as the founder of English mercantile law, creating the beginning of order out of medieval chaos.

Lord Mansfield had read widely amongst the work of European jurists and had studied Roman Civil Law. He saw the incorporation of appropriate elements of this body of legal and practical experience as the only solution, arguing that "*The maritime law is not the law of a particular country but the general law of nations.*" He began to give reasons for his judgements in public and instituted a system of specialised jurors, consisting of prominent merchants, who served regularly on commercial cases. He identified general principles that should be applied consistently. As a contemporary judge put it "*... the great study has been to find some certain general principle which shall be known to all mankind, not only to rule the particular cases then under consideration but to serve as a guide for the future.*"

The volume of litigation continued to give rise to concern during the nineteenth Century and many long hours of discussion took place in underwriters' committees in London and Liverpool. Largely due to the efforts of a Birmingham County Court Judge, Sir M. D. Chalmers, in collaboration with a practising Underwriter, Douglas Owen, a Bill

entitled the “Marine Insurance Codification Bill” was first introduced by Lord Herschell in the House of Lords in 1894.

The aims of the bill were innately conservative – the intention was to codify previous Court decisions and to crystallise accepted practices. The Lloyd’s S. G Form was already several centuries old and its obscurities and short-comings were much commented upon. Douglas Owen himself said that *“if such a contract were to be drawn up for the first time today it would be put down as the work of a lunatic endowed with a private sense of humour”*. However the S.G. form was approved for use in the First Schedule of the Bill since the generations of legal interpretation that clung to it were felt to outweigh any faults of age.

The bill received a rough ride particularly in the House of Commons and had to be put forward several times before reaching the Statute books in 1906. How has it served us since?

One striking feature of the Act is that refers only to perils of the seas, although steam-powered vessels had been in wide use for many years and the Inchmaree Clause had been in use since the famous case of 1887 involving the vessel of that name. It will be recalled that a steam driven pump was damaged probably due to negligence of the crew. Although the loss had occurred on the sea it was held not to be a peril of the sea and nor was it covered by the other S.G. Form perils. The so-called “Inchmaree Clause” was introduced promptly to cover negligence of crew as a named peril, and other perils were added over time to cover problems arising from an increasingly mechanised age.

Amongst such perils was that of damage caused “through” (later “caused by”) latent defect in the hull or machinery. Section 55 of the Act, dealing with ‘included and excluded losses’ says that “Unless the policy otherwise provides, the insurer is not liable for (inter alia) inherent vice” and a latent defect is of course a type of inherent vice. In the Inchmaree Clause the policy does indeed “otherwise provide”, but latent defect cover has never really sat entirely comfortably with Section 55 and the sea perils from which the Act essentially takes its character. The topic of latent defect is worthy of a lengthy article in itself, but suffice it to say that it was not until the Court of Appeal decision on the “Nukila” in 1997 that a degree of clarity was restored.

The fundamental requirement for utmost good faith is set out in Section 17 of the Marine Insurance Act 1906 (echoing Lord Mansfield’s comments in *Carter v. Boehm* (1766)). There have been a number of cases in recent years to try and clarify whether this obligation existed only when the policy was being negotiated or continued thereafter and whether it related only to matters of disclosure etc or also related to the presentation of claims. It is also a topic that continued to prompt numerous articles by leading academic lawyers.

It has been settled under English law for some time that, if part of a claim is fraudulently presented, the Assured loses all right of recovery, including those losses that were properly put forward (*Orakpo v Barclays Insurance Services*, LLR 1995), and this was confirmed recently in a marine insurance context in the "AEGEON" [2002].

More recently, the House of Lords ruled in the "STAR SEA" [2001] that the duty of good faith imposed on both parties to an insurance contract by section 17 continues to apply after the conclusion of the insurance contract. However, once the parties are engaged in litigation, the conduct of the parties as to what should or should not be disclosed is governed by the procedural rules of the court rather than by section 17. In the International Hull Clauses 2003 wording has been introduced "(whether legal proceedings be commenced or not)" to reverse the effect of this decision and to create a general duty of the Assured not to mislead the Underwriters or conceal material circumstances from them, even after litigation has been commenced.

It is in fact extremely rare that an insurer will seek to avoid liability under the terms of section 17, but disputes relating to the more specific problem of non-disclosure are more common. Section 18 requires the Assured to disclose every material circumstances which might influence the judgement of a prudent insurer in fixing the premium or accepting the risk. This again follows the judgement of Lord Mansfield in the case referred to above – "*Good faith forbids either party, by concealing what he privately knows to draw the other into a bargain from his ignorance of the fact...*" and makes obvious commercial sense. The potential Assured is always going to be the party with the fullest information and the insurer must be able to trust he will be given the right information to consider the risk fairly.

However, the wording of the Act has proved difficult to pin down in a number of respects, and the Courts have since had to wrestle with a number of difficult issues relating to the objectivity of the test, whether an actual inducement has occurred and whether the influence or inducement had to be decisive.

Since the earliest days of insurance, policies have contained warranties that control the nature of the risk by placing restrictions on, for example, where the vessel can trade or what cargo it can carry. Under Section 33 of the Marine Insurance Act 1906, a warranty "*is a condition which must be exactly complied with whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.*" For example, if a vessel breaches a warranty regarding cargo to be carried and the vessel later grounds for

wholly unrelated reasons, the breach is still fatal to that claim, even if the breach has been remedied by the prior discharge of that cargo.

Although most policies have "held covered" provisions in the case of breach of warranty, it has long been felt in many quarters that the Marine Insurance Act 1906 imposes too severe a penalty in many cases, particularly when the breach is unrelated to the loss.

The Australian Law Reform Commission carried out a detailed review of their 1909 Marine Insurance Act that was completed in July 2000 and they singled out warranties as the most significant area in need of reform. Such views are widely shared and the International Hull Clauses 2003 have therefore adopted a graduated approach that gives a more proportionate remedy for each kind of breach, while enabling underwriters to maintain control over key areas of the risk. There are still some breaches that terminate cover, but others merely suspend or restrict cover until the breach is remedied.

If the Act's provisions regarding warranties are now felt to give insurers powers that are disproportionate and draconian, there is a related area in which the Act arguably left insurers with too little protection. Section 39 deals with the seaworthiness of the vessel and states that *"In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness."*

For an insurer to use this defence successfully he has to prove firstly that the alleged unseaworthiness was actually causative of the loss – to say that the vessel was unseaworthy in some particular or unspecified regard is insufficient. Secondly he must prove that the Assured was privy, i.e. knew of, or deliberately turned a blind eye to, that unseaworthiness. The defence will also fail if the Assured was simply negligent in not appreciating that the unseaworthiness existed. For many years the only significant case dealing with this point was the "Eurysthenes" in 1976, dealing with P & I cover, which confirmed the principles set out above, and that the "Assured" meant the very top level of the company – its directing will and mind. These findings were reaffirmed at the highest level by the House of Lords in the "Star Sea" in 2001, although arguably widening the definition of the "Assured" slightly.

It may be that Section 39(5) was felt to provide Insurers with adequate protection in the days when Shipowners had a much more "hands on" relationship with the running of their vessels, without ship management companies or complex corporate structures to cloud the issue. Nonetheless, since then Section 39(5) has presented insurers with a very steep mountain to climb and they have looked to other means to safeguard their position.

For the Inchmaree Perils (that is Clause 6.2 of ITC Hulls 1.10.83) such as crew negligence, a proviso has been added, excluding any claim that has arisen from a “want of due diligence by the Assured, Owners or Managers”. The term “due diligence” is well defined in contract of affreightment cases and, although the proviso still relates only to the top level management, it encompasses a negligent failure to run things properly rather than just a deliberate decision to do so. It is worth noting that an attempt to extend this proviso to include Superintendents and onshore staff in the 1.11.95 ITC Hulls failed, indicating that it is important to obtain a realistic balance between positive cover and exclusions.

In general, Insurers have used the “Class Maintained” warranty as a means of ensuring that vessels are maintained in an appropriate fashion up to recognized Class standards. This confidence has in the past sometimes proved to be misplaced with regard to some of the less reputable Class Societies, but the International Association of Classification Societies has worked very hard to ensure that the standards of their members are uniformly high. Port State Control Surveys have also had a positive effect on maintenance and safety standards.

Constructive Total Loss can often be a frustrating area for the practitioner. By definition these are very serious casualties but the Act and the standard Clauses do not always provide a clear route map to which one can direct the parties for guidance. In his 1982 address as Chairman of the Association of Average Adjusters, the Rt Hon Lord Justice Donaldson provided a fascinating commentary on the areas of difficulty relating to CTL’s which is highly recommended, with the proviso that several of his conclusions remain controversial and are not accepted by other authorities.

Under Section 60 (2), the Act states that a ship is a CTL if the cost of repairing the damage would exceed the value of the ship when repaired. It goes on to say that in making that calculation you can bring in the “expense of future salvage operations”. It will be recalled that if an Assured wishes to claim for a CTL he must, under Section 62, give Notice of Abandonment to his Insurers with reasonable diligence after the receipt of reliable information of the loss. The question therefore arises as to whether the Act means future salvage that is future to the casualty or future to the notice of Abandonment. Where the salvage costs are significant and the repair costs are marginal this can be a very significant issue.

Secondly, in Section 63 (1) the Act outlines the effect of abandonment stating that the insurer is entitled to take over the interest of the assured and all proprietary rights incidental thereto. The Act therefore emphasized that this is an entitlement, i.e. an option the Insurer can exercise or not, which removed any lingering doubt on

this point. However, the practical reality is that an Insurer will never accept a notice of abandonment since exercising proprietary rights brings with it all the liabilities attaching to the vessel and the hull insurer would have no benefit of the current P & I cover. The Act offers no guidance as to how the relationship stands between Assured, Insurer and the vessel where a valid CTL claim exists, whether before or after settlement. Although the Insurer will expect and be entitled to any net proceeds from the sale of the wreck, this entitlement arises from the general doctrine of indemnity (the assured would clearly be over-indemnified if he received the full insured value and retained also the value of the wreck) rather than any express provision in the Act.

Some aspects of CTL claims have been dealt with in standard clauses – for example the Insured Value (or a percentage of it) is universally adopted as the yardstick for proving a CTL, rather than the market value which will often be open to dispute. It was suggested during the drafting process of the International Hull Clauses that additional wording should be considered to deal with some of the remaining grey areas, but sadly the opportunity was not taken, perhaps due to the complexity of the issues involved.

Although it is total losses that attract most public attention, particularly if pollution is involved, the greatest area of activity in marine hull insurance is the day to day calculation and settlement of partial loss claims for Particular Average, and, to a decreasing extent these days, General Average.

With regard to Particular Average repairs the Act says in Section 69(1). *“Where the ship has been repaired, the assured is entitled to the reasonable cost of the repairs....”* I would suggest that these few plain words “reasonable cost of the repairs” represent the hidden jewel amongst such a virtuoso exercise in drafting. At the time some commentators called for the statements of principle in the Act to be more fully expressed, or even to be supplemented by illustrative examples. The wisdom of opting for simplicity is demonstrated by the almost complete absence of litigation on this point in the succeeding hundred years.

There is one exception to the absence of modern authority on this topic, and it is a very significant one, “The Medina Princess”. The judgment in this case, given in 1962, runs to several hundred pages and is a truly formidable document. The plaintiff owners were looking to prove that the vessel was a constructive total loss and much of the argument concerned which costs could be brought in as part of the estimated reasonable cost of repairs, in order to see whether the total cost reached or exceeded the insured value.

Throughout the case counsel for the defendant underwriters, Mr Brandon, argued that when section 69 used the phrase ‘reasonable

cost of repairs' it is referring only to the reasonable cost of *permanent* repairs: nothing else could be included, for example towage, salvage, cost of discharge of cargo or even the cost of temporary repairs. Mr Dunn, counsel for the plaintiff shipowners, understandably argued for a much wider interpretation as to what could be included in the phrase. Roskill J referred to the earlier case of *Irvine v. Hine*, in which the cost of temporary repairs and towage were allowed and said:

"...it is clear that all concerned in the case thought that what I would call Mr Dunn's broad approach was the right approach to adopt, namely 'what would have to be expended to put the ship right', including (in relation to that particular case) the cost of temporary repairs and of towage... I reject the suggested narrow approach which Mr Brandon invited me to adopt... I think it would be wrong to hold that certain categories of expenditure must of necessity fall (without) the reasonable cost of repairs. I think it is a question of fact in every case what that phrase includes."

By choosing such a simple formula the Act has retained a high degree of flexibility which enables the same guiding principles to be used whether adjusting a claim on a coal barge or a LNG carrier.

The most common objection to codification of the law is that there is a loss of flexibility and a tendency to freeze the law so that it cannot cope with future changes. This is a price that has to be paid for the desired objective of certainty, but the drafters of the Act were careful to be no more prescriptive than was necessary, so that the Act has largely stood the test of time.

The "all or nothing" penalty for breach of warranty and non-disclosure (where the only remedy is complete avoidance of the policy) has often been criticised, with considerable justification. The position regarding warranties has been given a more rational and balanced basis by the recent International Hull Clauses, but it remains to be seen whether the same will happen with regard to disclosure. Both areas will doubtless be looked at in detail by the Law Commission in their forthcoming review of Insurance Contract Law. Aspects of CTL claims also remain a nettle to be grasped.

Whether you send or carry goods by sea it remains a challenging adventure and the support offered by an effective system of insurance remains as important as ever. I would suggest that, despite some imperfections, the Marine Insurance Act remains an excellent platform from which to build that support.

Richard Cornah
Chairman – Richards Hogg Lindley
Vice Chairman – Association of Average Adjusters
20th April 2006