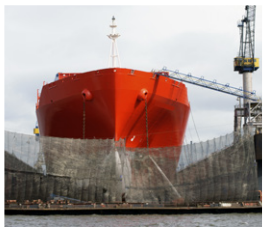
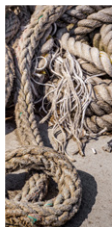
Shipping

October 2015

MARINE INSURANCE BULLETIN





Welcome to the October edition of our Marine Insurance Bulletin.

The first article in this bulletin is about the Australian experience with their 1984 Insurance Contracts Act (the Aus ICA), which the United Kingdom's 2015 Insurance Act has adopted in parts. It also considers that while the UK Insurance Act has moved into line with the Aus ICA there are differences, not least of which is that the Aus ICA does not govern marine insurance. This divergence in law is also reviewed.

We then consider a recent case in the English High Court concerning the *MY GALATEA*, a yacht which was destroyed by fire in an Athens Marina. The owners sought €13 million from the insurers of the vessel as she was a constructive total loss, but only succeeded in a claim against the insurance brokers for €2 million. Interestingly the judge highlighted that had the case been heard after the Insurance Act 2015 had come into force the owners would have achieved a different result.

Finally we review a case from Hong Kong's Court of Final Appeal that arose as a result of a vessel being lost with a cargo of logs on board. The claimants made a claim on the relevant insurance policy and the insurers rejected the claim because of a breach of the deadweight warranty of the carrying vessel. The question that was asked of the court was, if the vessel is named in the cargo insurance contract, then could or should the insurer have known the size of the vessel?

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this bulletin, or your usual contact at HFW.

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hfw Marine insurance law reform: England: 1, Australia: 0

The Insurance Act 2015 (UK Act) was passed on 12 February 2015. The vast majority of the UK Act's provisions enter into force on 12 August 2016. The UK Act reforms both marine and non-marine insurance. Conversely, Australia's principal legislative reform of insurance contracts, the Insurance Contracts Act 1984 (Cth) (Aus ICA), does not apply to marine insurance. The Australian Marine Insurance Act 1909 (Cth) (Aus MIA) governs Australian marine insurance and is a substantive copy of the English Marine Insurance Act 1906. Australia now trails England in marine insurance law reform.

This article compares the UK Act, the Aus ICA and the Aus MIA; describes, based upon Australia's experience, what UK Act's stakeholders might expect to result; and considers what is next for Australian marine insurance law.

Key UK Act's reforms

The UK Act's key reforms include:

1. Enacting a *"duty of fair presentation"*. This *"duty of fair presentation"* requires that, *"[b]efore a [non-consumer insurance contract] is entered into, the insured must make to the insurer a fair presentation of the risk"*. The Aus ICA and the Aus MIA also imposes a duty of disclosure on insureds. The Australian Law Reform Commission (ALRC)'s May 2001 review of the Aus MIA (ALRC review) suggested that Australia reform the duty of disclosure in the Aus MIA, so that an insured is only required to disclose those factors which it knows to be material, or which a reasonable person in its position ought to know. Under this formulation, if a reasonable person in the insured's position would make the same mistaken non-disclosure, the insured will not be in breach. This recommendation is un-enacted.

2. Creating a new system of proportionate remedies where the duty of fair presentation is breached, except where the policyholder has breached the duty deliberately or recklessly. This replaces the current single remedy, which is avoiding the contract. In comparison, the Aus ICA provides that, in certain circumstances, an insurer may avoid a contract of insurance if an insured's breach of its duty of disclosure involves fraud or a misrepresentation. Otherwise, an insurer cannot avoid the contract for non-disclosure. Australian marine insurance law, in this respect, now stands apart, retaining the traditional remedy of avoidance for innocent non-disclosure.

3. Like the Aus ICA's reforms, the UK Act effectively abolishes clauses that convert an insured's representations about a proposed non-consumer insurance contract into warranties[1] (which are often referred to as *"basis of contract clauses"*). The ALRC review also recommended this abolition in respect of marine insurance, but this reform has not yet been enacted.

4. The UK Act provides that, if the insured shows that its non-compliance with a contractual term could not have increased the risk of the actual loss, an insurer may not rely on that non-compliance to deny cover. In this respect, the Aus ICA is different. Some contracts of insurance may allow an insurer to refuse to pay a claim because of the insured's post-contractual conduct (such as breaching a contractual term). In this case, the Aus ICA ensures that the insurer may only refuse to pay the insured's claim if the post-contractual conduct *"could reasonably be regarded as being capable of causing or contributing to"* the relevant loss. The insurer may not refuse to pay the claim on the basis of that conduct alone, but its liability is reduced. Unlike the UK Act and the Aus ICA, under the Aus MIA, an insurer can deny a claim because of non-compliance with policy terms, including breach of warranty or non-compliance with a condition precedent.

5. The UK Act provides that, if an insured's claim is tainted by fraud, the insured forfeits the whole claim. Before the Aus ICA was enacted, an Australian insurer was entitled to avoid a contract of insurance upon which an insured had made a fraudulent claim. The Aus ICA now ensures that, if a claim is made fraudulently, the insurer may not avoid the contract, but may refuse payment of the claim.

6. The UK Act removes the remedy of avoiding the contract for breach of the duty of good faith. Before Australia enacted the Aus ICA, the only remedy for breach of this duty was rescission of the contract and

1 A warranty is an insured's statement either that a state of affairs exists at the date that the statement was made (a present warranty) or a promise that the insured will act, or refrain from acting, in a given way during the currency of the policy (a future warranty).



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refund of the premium. The Aus ICA, in effect, provides that breach of that duty gives rise to an action for damages, not rescission of the contract. In contrast, under the Aus MIA, the only remedy for a breach of the duty of utmost good faith is avoiding the policy.

What can UK stakeholders expect?

Based on Australia's almost 30-years of experience with the Aus ICA, UK stakeholders can expect that it will take some time for courts to settle the correct interpretation of the UK Act's provisions. In 2014, after 29 years of the Aus ICA, the High Court of Australia (equivalent to the English Supreme Court) revisited the operation of the Aus ICA's provisions that seek to limit an insurer denying liability on the basis of an insured's post-contractual conduct. These provisions, and accompanying factual issues, are oft-litigated. Similar experiences can be expected in respect of the UK Act's provisions.

What next for Australia?

Australian marine insurance law finds itself without the benefit of considerable reform. There is much force in the comment of the Chief Justice of Australia's Federal Court, James Allsop, that,

"[w]hilst the [Aus MIA] has served the community for a century, one wonders whether the marine insurance markets would not be better served by a more up to date and comprehensively adopted contemporary model."

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hfw The risks of over insurance...

Following the constructive total loss by fire in an Athens marina of the yacht the *MY GALATEA*[1] (the yacht), it was held that insurers validly avoided an insurance policy due to non-disclosure by the insured of material facts relating to the over-insurance of the yacht.

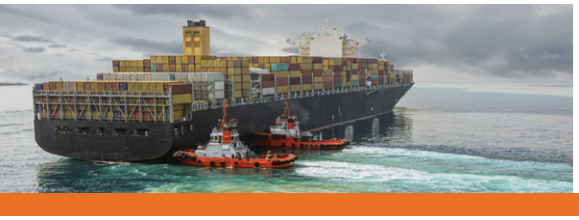
Background to the claim

In May 2011 the claimant entered into an insurance policy against all risks with the defendant insurers for the insurance of a 115ft Riva yacht for an agreed value of €13 million (split between Hull & Machinery and Increased Value cover). Seven months later, in December 2011, the yacht was substantially damaged in an Athens marina by a fire on board, resulting in the owners tendering a Notice of Abandonment and claiming a constructive total loss. In this action the claimant sought to recover the full insured value of €13 million from the defendants.

Insurers accepted the fire was an accident that the policy was intended to cover but denied liability on the grounds that they were entitled to, and did, avoid the policy on account of material non-disclosure. During the course of the litigation, various items came to light that had inadvertently not been disclosed to the insurers at placement, namely that:

- The claimant had received a professional valuation of the yacht at approximately €7 million.
- The yacht was on the market for €8 million when the insurance policy was concluded.

1 *Involnert Management Inc. v Aprilgrange Ltd. & Others* and *AIS Insurance Ltd. and OAMPS Special Risks Ltd.* [2015] EWHC 2225 (Comm)



Conclusions of the judgment

It was held by the judge that these facts were material to the insured's request to insure the yacht, and should have been disclosed at placement. It was held that had these circumstances been disclosed, insurers would not have agreed to insure the yacht for €13 million, and so were entitled to avoid the policy, as they did. In the judgment, that will be of interest to the marine insurance and yacht market, the judge stated that *"the logical amount of cover to buy would have been the amount which the claimant was hoping to get from a sale, that is, the asking price of €8 million"*, and also that *"in the absence of a valuation or other information which allows the owner to make a realistic estimate of current market value, it may be reasonable to treat the price paid as an objective yardstick of value and to insure for this amount, even though the owner knows in general terms that the market value is probably less"*.

Notice of abandonment

In the proceedings insurers also relied on the defence that the claimant could not treat the loss of the yacht as a total loss because it did not give a valid notice of abandonment. Insurers maintained that a notice of abandonment was not given with reasonable diligence following the receipt by the claimant from naval architects of reliable information of the loss, as required by s62(3) of the Marine Insurance Act 1906. The insurers argued that the consequent inability to treat the loss as a total loss meant that the claimant could not recover under the Increased Value section of the policy as it only provided cover for a total loss.

The claimant argued that notice of abandonment was unnecessary as there would have been no possibility of benefit to insurers if notice had been given to them, which was agreed by the judge, having regard to the following clause in the Increased Value section of the policy:

"In the event of a Total Loss, the Underwriters waive interest in any proceeds from the sale or other disposition of the vessel or wreck".

It was held that the claimant did not fulfil the requirements of notice of abandonment, though the judge did not consider that the omission to give this notice, which was unnecessary so far as the Increased Value cover was concerned, prevented the claimant from treating the loss as a total loss for the purpose of a claim under the Increased Value section of the policy.

Claim time-barred on the policy terms

Insurers also ran the defence that the claimant failed to comply with three policy terms, as follows:

- That the claimant failed to provide a sworn proof of loss to the insurers within 90 days from the date of loss. Although the claimants argued that providing such a proof of loss would not have added anything significant to insurers' understanding of the claim as insurers' agents attended the scene of the fire almost immediately. The judge, however, held that the claimant's failure to provide a sworn proof of loss in accordance with the policy barred the claimant from bringing proceedings for the recovery of its claim under the Hull & Machinery section of the policy, though not under the Increased Value section, to which this particular clause did not apply.
- Insurers argued that the claimant persistently failed to provide documents relating to the valuation, sale and marketing of the yacht, in breach of the "Examination under Oath" clause of the policy. However, it was held that as the insurers had not designated a time and place at which the documents were to be produced, as required by the clause, there was no breach of this clause.
- Insurers also argued that the claim was contractually barred due to a clause which prevented the claimant from bringing legal proceedings unless it had fully complied with all requirements of the policy. The failure to provide a sworn proof of loss was sufficient to bar the claim under the Hull & Machinery section of the policy, to which this clause applied, with the judge not accepting the claimant's argument that a breach under this clause merely suspends the claimant from bringing proceedings.

Insurers accepted the fire was an accident that the policy was intended to cover but denied liability on the grounds that they were entitled to, and did, avoid the policy on account of material non-disclosure.

ANDREW SPYROU, ASSOCIATE



Would the outcome have been different under the Insurance Act 2015?

It was importantly highlighted by the judge that had the Insurance Act 2015 been in force, the claimants would have achieved a "just" result. The act, which comes into force in August 2016 will introduce a system of proportionate remedies with regard to non-disclosure. Under the new regime the insurance would be treated as valid in a reduced amount of €8 million, a sum in accordance with the insured value at which the insurers would have written the risk had all material facts been disclosed.

Broker's negligence

Alongside the insurers, the insured also joined to the proceedings the placing and producing brokers who had arranged the insurance. It was held that although the placing brokers did not owe any relevant duty to the insured directly, the producing brokers were liable for part of the loss as they had been negligent in completing the proposal form: but for the producing broker's negligence, the claimant would have had a valid policy for €8 million. The broker was found liable to pay damages of €2 million, the proportion of the Increased Value cover that would have been in place and recoverable by the claimant.

For those interested to read more about this case we recommend the article produced in our weekly Insurance Bulletin issued on 1 October 2015, which can be found at http://www.hfw.com/Insurance-Bulletin-1-October-2015.

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hfw Hong Kong Court of Final Appeal upholds marine insurance warranty

A recent marine insurance dispute has made its way to Hong Kong's Court of Final Appeal for determination[1]. Because the statutory regime in Hong Kong is materially identical to that in England, the decision has attracted significant international legal interest. The case concerns a claim arising out of the assured's alleged breach of warranty.

In January 2008, Zurich entered into a contract of marine insurance with Hua Tyan Development in respect of a shipment of logs from Malaysia to China. The contract identified the carrying vessel as *M.V. HO FENG NO. 7* (the vessel). The cover note incorporated a clause warranting that the deadweight capacity of the carrying vessel was not less than 10,000 tonnes.

The vessel sank during the voyage, and the cargo was a total loss. When Hua Tyan Development made a claim under the policy for the insured value of it loss, Zurich rejected the claim on the basis that Hua Tyan Development was in breach of the deadweight warranty because the vessel only had a deadweight capacity of about 8,960 tonnes.

The assured brought proceedings against Zurich, arguing as follows:

1. Whatever the legal construction of the deadweight warranty, in this case it was of no effect because Zurich knew or ought to have known that the deadweight capacity of the vessel was less than 10,000 tonnes, as the contract of insurance identified her by name.

The Court of First Instance held that there was a "clear inconsistency" between the naming of the vessel in the contract and the stipulation regarding her deadweight capacity.

ELIZABETH SLOANE, SENIOR ASSOCIATE

2. As the parties clearly intended to effect insurance cover for the carriage of the cargo of logs on board the vessel, the intention of the parties that there be cover should prevail, and it was inconsistent for Zurich to then deny liability on the basis of the deadweight warranty.

3. Insofar as necessary, the assured sought rectification of the contract to delete the deadweight warranty, also relying on arguments of waiver and estoppel.

The Court of First Instance held that there was a "clear inconsistency" between the naming of the vessel in the contract and the stipulation regarding her deadweight capacity. Further, in rejecting a submission by Zurich that the assured had breached its duty of disclosure by failing to

1 *Hua Tyan Development Limited v Zurich Insurance Co Limited* [2014] HKEC 1489

disclose the true deadweight of the vessel, the Court of First Instance gave weight to the fact that the insurer itself had easy access to information about the vessel from the internet. Judgment was given in favour of the assured.

Zurich appealed to the Court of Appeal, which reversed the decision at first instance, finding that there was no inconsistency at all between the naming of the vessel in the contract and the deadweight warranty. The cargo was covered, subject to the deadweight warranty. The Court of Appeal held that although an insurer is presumed to know matters of common notoriety and matters which it ought to know in the ordinary course of its business,[2] the fact that information about the vessel's deadweight capacity could be obtained from the internet did not mean that the insurer was to be fixed with such knowledge, either actual or presumed. The fact that information *could* be obtained did not mean that it should be obtained, as a matter of law.

The assured then appealed to the Court of Final Appeal, which agreed with the Court of Appeal that Zurich was entitled to rely on the deadweight warranty. Pursuant to section 33 of the Marine Insurance Ordinance (Cap 329), a warranty is a condition which must be exactly complied with, whether it be material to the risk or not. If it is not complied with, then subject to any express provision in the policy, there will be an automatic discharge from liability which will provide a complete defence to any claim made. There need not be any causal connection between the breach of warranty and any loss suffered.

The Court of Final Appeal saw no inconsistency in the contract between the identification of the vessel and the existence of the deadweight warranty. It held that the mere fact that a vessel is named in a contract of marine insurance does not mean that an insurer is somehow prevented from insisting by way of warranty on that vessel possessing certain characteristics. Moreover, though a party's knowledge may, in appropriate circumstances, result in some form of waiver or estoppel being applicable, the court held that there was no evidence to support a finding that Zurich had actual knowledge of the Vessel's deadweight capacity. Accordingly, the assured's appeal was dismissed.

This decision confirms the willingness of the Hong Kong Courts to interpret strictly warranties in contracts of marine insurance, promoting certainty for insurers contracting in Hong Kong.

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2 Marine Insurance Ordinance (Cap 329), section 18.

hfw Conferences and events

FIDES Conference
Chile
25-28 October 2015
Presenting: George Eddings
Attending: Jonathan Bruce, Christopher Cardona and Geoffrey Conlin

Xchanging London Market Conference
London, UK
5 November 2015
Attending: Andrew Bandurka

HFW Dubai Maritime Conference
Dubai, UAE
11 November 2015
Presenting: Edward Newitt

Arctic Shipping Summit
London, UK
11-12 November 2015
HFW is sponsoring this event and George Eddings will be attending.