International Commerce

June 2013

MARINE INSURANCE BULLETIN

Welcome to the June edition of our Marine Insurance Bulletin.

In this edition, we look at how disputes can arise as to whether damage to insured property has been caused by inevitable damage and deterioration and is therefore excluded as wear and tear. Insurers should have care when deciding any particular claim fails on this basis, because the case law has shown that damage which may at first sight appear to be wear and tear, may not always be found to be wear and tear.

The Law Commission's proposed reforms to the 1906 Marine Insurance Act are continuing to stimulate debate. We look at the likely impact on the London marine insurance market and in a series of two articles look firstly at the key suggested changes in relation to disclosure and warranties and then secondly at the proposed changes in respect of placement of risk and premium.

We also examine the future of the York Antwerp Rules and set out the changes that may be considered for the latest revision of the Rules.

Finally, we include the second of our twice yearly Case Updates, which summarises key recent marine insurance case law.

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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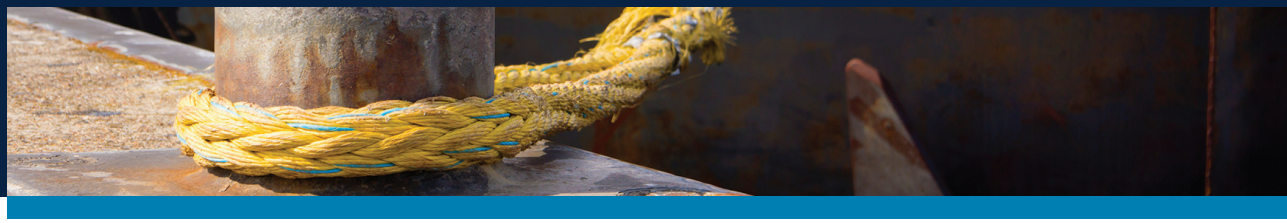


Wear and tear is not always what it seems

Insurance is designed to insure against a fortuity occurring – this is a fundamental principle of insurance. In the context of marine claims, the Marine Insurance Act 1906 (MIA), Section 55, expressly excludes insurers' liability for claims arising from wear and tear (a principle which the courts will also apply where there is a connection to a marine risk, for example in offshore energy matters). Wear and tear is usually expressly excluded in property covers, including hull, on the basis that it is not a fortuity.

In the 2011 case called the Cendor MOPU (*Global Process Systems Inc and another v Syarikat Takaful Malaysian Berhad* [2011] UKSC 5) the English Supreme Court cited and approved established case law to the effect that *"the purpose of insurance is to afford protection against contingenices and dangers which may or may not occur; it cannot properly apply to a case where the loss or injury must inevitably take place in the ordinary course of things"* (*Paterson v Harris* (1861) 1 B&S 336).

However, wear and tear is a common cause of damage, and is often the subject of disputes arising from claims brought by assureds. In this article we will try to define wear and tear, by looking at some examples which illustrate how wear and tear compares and contrasts with other causes of damage with similar characteristics. We will also look at some examples of cases where the English court has demonstrated that the position on wear and tear claims is not always as clear cut as one might think.

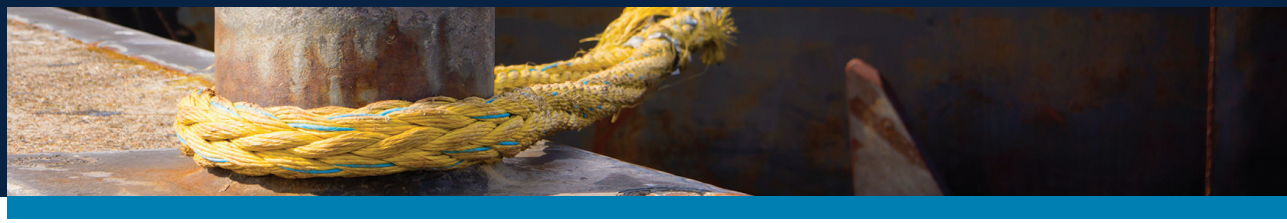
So what is wear and tear? The characteristics of damage or loss arising from wear and tear are often comparable with cases of inherent vice or latent defect, for example. Similarities between such cases may be that the "manifestation" of damage, could be either gradual or sudden. The damage might occur over a matter of years. However, the key significant point for insurers is that whilst insurers may cover defects, or damage arising from defects (although this is of course dependent on the policy wording), insurers will never want to cover damage or loss arising from wear and tear.

Defects are created by a positive act of human agency, usually a fault in the manufacture, design or materials within the insured property. A defect is a condition causing premature failure which was either present on construction or installation, or has resulted from the way the insured property has been designed, constructed or installed.

Compare this with wear and tear and the position is actually quite different. Wear and tear is the uncorrected result of ordinary, natural and inevitable incidents of trading or use. For example, this would include where the sections of the insured property requires renewal at intervals, and has merely worn out at the end of its normal working life. Alternatively, it could be where a part fails prematurely as a result of external circumstances, which are not due to an internal defect. So, for example, corrosion damage caused by a change of ambient temperature would normally be excluded from cover as wear and tear. However, if there is some other insured peril which has caused the damage to occur, such as someone's negligence, or a previous accident which was a fortuity, that could be deemed to trump wear and tear, this may bring the claim back within the cover. It is a matter of what is the proximate cause.

Characteristics of damage which may appear to be wear and tear may not always be wear and tear. Proximate cause can easily displace a claim for wear and tear. In the *"Caribbean Sea"* (*Prudent Tankers Ltd S.A. v The Dominion Insurance Co. Ltd* [1980] QBD (Comm Ct) 1 Lloyd's Rep. 338) defective welding led to a fatigue crack, the vessel sank and was a total loss. The insurers argued that the claim was excluded as the loss was caused by wear and tear. However, the court held that where a latent defect has developed in the ordinary use of a ship, as was held to be the case with this particular cracking, the proximate cause was the latent defect and not wear and tear. The court therefore held that the loss was covered. Incidentally, where possible the courts will try to identify only one proximate cause for each aspect of damage.

Wear and tear is an inevitable cause of damage through the ordinary course of use of insured property. The courts have made it clear that such inevitable damage and deterioration of insured property is not in the contemplation of insurance cover (unless of course it is expressly included). However, insurers should have care because as we have seen, characteristics of damage which may appear to be wear and tear, may not always be wear and tear.



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The future of the Marine Insurance Act

The 1906 Marine Insurance Act (the Act) is over 100 years old and has faced growing criticism over recent years with many feeling that the current regime requires modernisation to bring it in line with global practice. It has therefore been earmarked for change by the Law Commission who have set out proposals to modernise the law.

It is clear that the debate surrounding the proposed reforms is of key importance to the London marine insurance market, given that there are plenty of alternative markets (such as Norway, France, Germany, New York to name a few) now vying for London's business. Crucially, from the purchasers' perspective, these are all regarded as having a far less harsh insurance regime than England. None of us wants to see assureds moving business to other centres, and this is one reason why the Law Commission has been looking to update the Act, for example through creating a fairer system for the treatment of non-disclosure and breach of warranty. This being said, once the changes have been implemented, there are likely to be growing pains as a fairer system with proportional remedies will inevitably lead to some uncertainty.

This article examines some of the specific proposals that have been put forward by the Law Commission in relation to disclosure, placement of risk and premium and warranties.

Disclosure and the assured

Under the Act the assured is under a duty to disclose information to an insurer before the contract is concluded. Section 18(1) provides that the assured must disclose *"every material circumstance"* which *"in the ordinary course of business"* is known or ought to be known. If the assured fails to disclose such information then the insurer "may avoid the contract". The only remedy under the current system is avoidance of the contract and consequently an assured who fails to mention an arguably minor issue but is otherwise acting in good faith is at risk of losing the benefit of the policy. The absence of a clear definition of what is meant by *"is known or ought to be known"* has led to confusion and many differing views between the so-called leading authorities on the subject. The Law Commission is to propose the inclusion of a fuller definition in the statute.

The broker's knowledge

Section 19 of the Act imposes a pre-contractual duty on brokers to disclose material information that is known to them or which they are *"deemed to know"* (e.g. where material information is known to the broker but not to the assured). When a broker breaches these duties, the insurers may avoid the policy which the Law Commission believes is unfair on the assured. The position at law in relation to section 19 is confused and this is reflected by the number of contradictory judgments on the subject. Accordingly, the Law Commission's proposals include clarifying what a broker is "deemed" to know" with a recommendation that this is better defined for greater certainty.

New remedies for non-disclosure

Avoidance of the contract is the only remedy for non-disclosure under the current regime. The Law Commission has proposed a fresh set of remedies that will compensate the insurer putting it in the position it would have been in had it been provided with all the required information by the assured. The proposed remedies look at the position the insurer would have taken if it had been provided with the full picture at the start and includes:

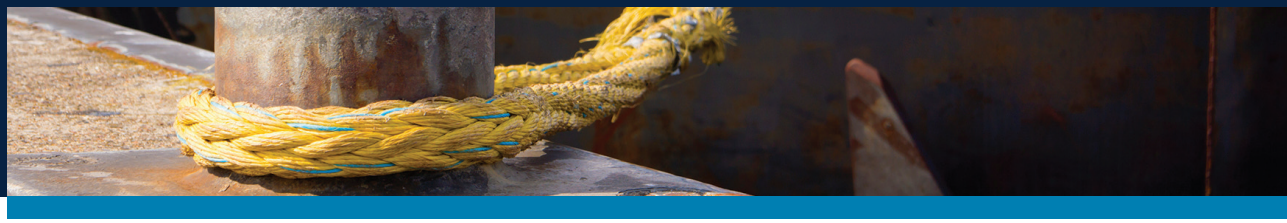
1. Where the insurer would have declined the risk altogether, the policy should be avoided, the claim refused and the premiums returned.

2. Where the insurer would have accepted the risk but included another contract term, the contract should be treated as if it included that term.

3. Where the insurer would have charged a greater premium, the claim should be reduced proportionately. For example, if the insurer would have charged double the premium, it need only pay half the claim.

Placement of risk and premium

Section 53(1) of the Act provides that for the placement of marine risks (only) the broker is directly responsible to underwriters for premium. This is the position regardless of whether or not the broker has been paid by the insured. Where this section applies, only the broker may sue the assured, underwriters have no right to claim premium from the assured. The Law



Commission's proposals provide that the assured should be liable for the premium on marine risks (as is the current position on non marine risks), although the default rule is that the broker will remain jointly and severally liable with the assured to underwriters for premium on marine risks, unless this has been varied by the contract.

Warranties

Section 33(3) of the Act states that a warranty *"is a condition which must be exactly complied with, whether it be material to the risk or not"*. If a warranty is not complied with then *"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"*. The consequences of a breach of warranty are severe for an assured and have been criticised for favouring the insurer rather than the assured as they apply even if the breach is minor, bears no relevance to the loss, or was remedied before the loss occurred. Other markets have moved away from this approach, in New York underwriters can only avoid the policy for a breach of warranty if the breach would materially increase the assured's risk of loss. The Law Commission has put forward proposals to reduce the severity of a breach of warranty by suggesting that they should be treated as *"suspensive conditions"* i.e. that they would suspend an insurer's liability but not discharge it. However, where the breach is remedied before the loss takes place, an insurer is required to pay the claim. From a broker's perspective the reforms should reduce the broker's own exposures to claims for breach of duty by their assureds for alleged breaches of claims notification and premium warranty provisions.

Further considerations

The proposals outlined above provide a brief insight into the Law Commission's wide reaching plans for reform. However, there are areas where one would expect further reforms and greater legislative clarity to be made, for example concurrent causes and sue and labour, particularly in a jurisdiction which has been dealing with such issues regularly for many years. London has an enviable status as the world's leading marine insurance market and the Marine Insurance Act has governed the sector well for over a century. However, in order to remain competitive it may be that the market now needs to accept statute led principles that are both clearer and perceived to be fair for all parties to insurance contracts.

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"From a broker's perspective the reforms should reduce the broker's own exposures to claims for breach of duty by their assureds for alleged breaches of claims notification and premium warranty provisions. "

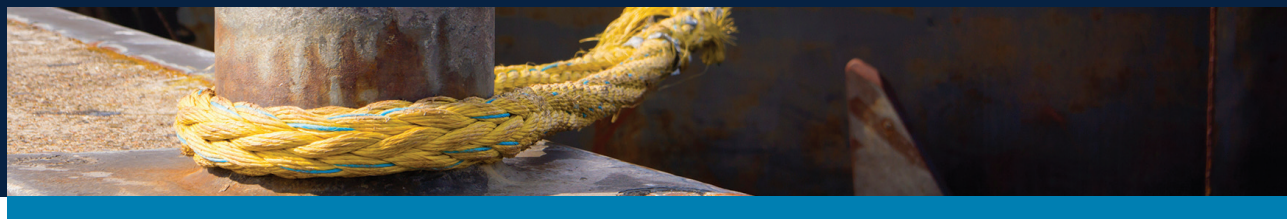
Section 53 of the Marine Insurance Act 1906 – the broker's liability for premium

Section 53(1) of the Marine Insurance Act 1906 is a complex and difficult provision, which appears to embody the common law rule that an assured is not liable to pay premium to its insurer, but is instead liable to pay the broker, who receives the money in its own name and has a separate debt to the insurer.

This can be contrasted with the non-marine insurance position, in which under CASS rules, the broker usually holds the money on trust for the assured until it is passed to the insurer (which arrangement is known as a "non-risk transfer TOBA"). Alternatively, the broker and insurer may agree that the broker receives the premium as agent for the insurer (a "risk transfer TOBA"). Under either of these arrangements, the assured is deemed to have paid the insurer when it pays the broker.

Quite apart from the inherent anomaly in having one rule for marine and one rule for non-marine insurance, practical concerns have been raised over the potential consequences of the s53(1) rule, such as for example the possibility that the section may require an assured to pay premium to a broker even after that broker has become insolvent and it is clear that the money will never be passed on to the insurer.

Section 53(1) further provides that where a marine policy is effected on behalf of the assured by a broker, "the broker is directly responsible to the insurer for the premium". It is rare in practice for an insurer to



demand payment from a broker, and insurers instead usually respond to non-payment by cancelling the policy in question. However, this is nonetheless another controversial provision, although it should be noted that some insurers feel that this protection is necessary, particularly for short-term policies which could not be cancelled, or when dealing with unknown assureds who might be located elsewhere in the world.

Although section 53(1) appears to be subject to contract (stating that it applies "unless otherwise agreed"), it is difficult in practice for a broker to contract out of its liability, as all three parties would need to agree to such a change. If the broker and the insurer agree that the broker is not liable for the premium, this does not make the assured liable; the result of such a contract is rather that no party is liable for the premium.

The Law Commission has proposed certain reforms to section 53(1) designed to address the issues identified above. First, the Law Commission has proposed that, where marine insurance is effected on behalf of an assured by a broker, the assured should be liable to the insurer for the premium. The market response to this has been largely positive, although it has been noted that such a change will only be truly effective if it is made clear that the underlying common law rules are abolished. Concerns have also been raised over the need to ensure that the assured does not become liable to pay premium twice, such as for example where a broker to whom premium has been paid becomes insolvent prior to paying that premium on to the insurer.

A further proposal is that the issue of the broker's liability for premium should be subject to a contract between the insurer and the broker, with the default rule being that brokers are liable to pay premiums (alongside assureds) unless they contract out. The rationale for this is that in the Law Commission's view it most closely resembles market practice and would cause minimum disruption in the market. The Law Commission proposes that the parties be free to contract out of the default rule without difficulty. These proposals have proven more controversial.

As to the ability of the insurer and broker to determine the position by contract, some have argued that the assured should have a part in any agreement, on the basis that it is after all their money that is in issue. As to the default position, it has been noted that making the broker liable by default for premium has the potential to put the broker in a position of conflict with its client and could also lead to uncertainty over the various cancellation rights of the broker and the insured that would undoubtedly be included in contracts as a result. The point has also been made that during the periods of Lloyd's Reconstruction & Renewal underwriters agreed to waive brokers' responsibility for premium and that for five years the default position was that brokers were not liable for premium. Furthermore, it has been argued that there is no good reason in today's market why uncreditworthy assureds should effectively be insured by their brokers in respect of their liability for premium.

Despite the controversy arising in some areas, the Law Commission's proposals are a welcome attempt to reform what has become an unclear and in some respects anomalous area of marine insurance law. Many in the market will await with interest to see how they will be taken forward.

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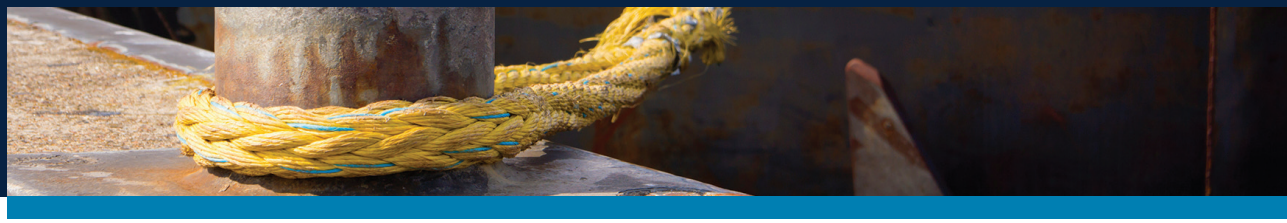
Another revision to General Average: York Antwerp Rules 2016?

Preparations continue by the Comité Maritime International (CMI) for revisions and amendments to the current set of York Antwerp Rules on general average. The CMI have recently written to the presidents of all the relevant national maritime law associations asking for their comments on a number of issues arising out of general average, so that these issues may be considered later this year at the CMI Symposium in Dublin.

This consultation is as a result of the conclusions of the CMI General Average Working Group at the 2012 Beijing Conference. The Working Group noted that the York Antwerp Rules 2004 had not found acceptance in the shipping community, and that a new set of York Antwerp Rules was desirable with a view to their adoption at the 2016 CMI Conference. It is hoped that an early consideration of the issues prior to the 2016 meeting of the CMI in New York will avoid what some in the maritime community considered a missed opportunity in Beijing to revise the York Antwerp Rules 2004, which have not been



quickly adopted. Indeed BIMCO have even issued circulars, such as that dated July 2007, recommending that the 2004 rules are not incorporated into contracts and stating that they would not be used in BIMCO standard forms, where the 1994 York Antwerp Rules would continue to be preferred.

There are a number of general issues which are being canvassed by the CMI for consideration by the various national maritime law associations, including the British Maritime Law Association. The CMI are canvassing opinion on a number of issues, including:

1. How the new 2016 York Antwerp Rules could help increase the use of absorption clauses which are now found in most hull policies. The CMI note that absorption clauses play a significant role in reducing the number of small, uneconomic collections of security and contributions from cargo.

2. Although the problem of piracy has diminished of late, the question is asked whether the payment of ransom as a legitimate expense should somehow be expressly provided for within any new revision to the York Antwerp Rules.

3. The CMI also ask whether there are any areas of the general average process where costs could be avoided, reduced or controlled, including adjusters' fees, costs of collecting security, the format of adjustments, and the involvement of legal and other representatives.

4. There is a suggestion that a rule of application should be included in any revisions to the York Antwerp Rules in order to make it clear that where clauses in contracts provide for the application of the York Antwerp Rules any revisions are also incorporated. It is realised that some courts may hesitate to accept the new rule of application can have an effect on the interpretation of older general average clauses. However, it is thought that other courts might find this rule useful. The problem envisaged is that when general average clauses include the language "any amendments hereof" it may be unclear which version of the Rules applies.

5. There is considerable discussion over the use of substituted expenses, and whether certain substituted expenses should be expressly allowed within general average where they are of clear general benefit to commercial interests without consideration to the savings incurred – e.g. towage to destination and/or forwarding cargo.

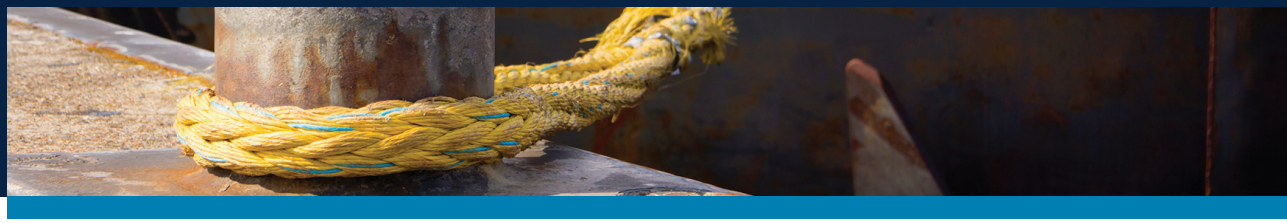
6. There is also debate over the application of non-separation allowances and, in particular, where there has been frustration by reason of delay. They ask whether there is any sort of formula that should be used for determining when there have been non-separation allowances arising from delay.

7. There is a suggestion that there should be no allowance in general average for crew wages at all. The position is, at the moment, that they are allowed while the vessel is detained at a port of refuge for the common safety, or to reflect repairs necessary for the safe prosecution of the voyage. There is discussion over whether further clarity is required as to when crew wages are allowed i.e. when they stop and when they start.

8. Whether there should be any allowance for permanent repairs at the port of refuge which would be less than the combined cost of temporary and permanent repairs.

There are many more minor issues that have been raised by the CMI for discussion by the national maritime law associations, and they will no doubt be published in any working papers of the CMI in the months to come.

What is clear is that there has been little adoption of the York Antwerp Rules 2004, and there is a definite desire to ensure that any new York Antwerp Rules revisions are well taken up by the maritime community. In order to achieve this, any changes will need to result in revised rules which are relevant and applicable to the type of disputes and problems that are seen today. We would imagine that, in particular, general average has to find a way to effectively deal with massive container casualties such as the "MSC FLAMINIA" and "AMSTERDAM BRIDGE". This will clearly be a challenge for the future of general average and will doubtless colour the revisions, if any, made by the CMI in 2016. There will be some who maintain that the 1994 rules remain



the most pertinent and that there should be no further tinkering lest the 2016 rules are even less popular than the 2004.

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Case Update July 2012 - December 2012

Welcome to the second of our HFW Marine Insurance Case Updates, which are now produced on a six monthly basis. The Marine Insurance Case Update aims to provide you with regular summaries of English Court cases relevant to the law of marine insurance including hull, war and cargo risks. We also include other cases which may be of interest in terms of procedural decisions, for example service out of the jurisdiction or anti-suit injunctions. This Marine Insurance Case Update forms the basis of a presentation and we have already been to many in the marine insurance market to discuss these cases. This second update includes issues of coverage, nondisclosure, the importance of carefully worded arbitration agreements and binding settlement agreements.

We hope you find the update useful and should you have any questions about any of the cases featured here, or think a presentation of the cases would be useful for your organisation, then please do not hesitate to contact Toby Stephens on toby.stephens@hfw.com, Geoffrey Conlin on geoffrey.conlin@hfw.com, or Alex Kemp on alex.kemp@hfw.com.

1. Valiant Insurance Company v (1) Sealion Shipping Ltd & (2) Toisa Horizon Inc ("The Toisa Pisces") [2012] EWCA Civ 1625. Court of Appeal decision on issues of aggregation and whether three separate breakdowns were one occurrence and whether the subsequent breakdowns broke the chain of causation.

2. Amlin Corporate Member and Others v Oriental Assurance Corporation ("Princess of the Stars") [2012] EWCA Civ 1341. Court of Appeal decision not to grant a stay of reinsurance proceedings in the English High Court pending the outcome of the underlying insurance claim in the Philippines.

3. Barbara Parker & Michael Parker v The National Farmers Union Mutual Insurance Society Limited [2012] EWHC 2156 (Comm). Commercial Court decision on whether insurers liable to pay fire damage in circumstances where a joint or composite policy had been avoided because of Insureds' failure to disclose fraudulent claims and whether there had been a breach of condition precedent.

4. Starlight Shipping Company v Allianz Marine & Aviation Versicherungs AG and Others ("Alexandros T") [2012] EWCA Civ 1714. Court of Appeal decision not to stay English proceedings because of connected proceedings which had been commenced in Greece allegedly in breach of settlement agreements.

5. Bunge SA v Kyla Shipping Co Ltd [2012] EWHC 3522 (Comm). Whether the H&M value stated in a charterparty prevents frustration of that charterparty by damage to the chartered vessel which costs less than the H&M insured value to repair.

6. Yilport Konteyner Terminali Ve Liman Isletmeleri AS v Buxcliff KG and Other [2012] EWHC 3289 (Comm). This case concerns disputes arising under two LOU's and a Club LOI issued to a container port regarding charges levied by the port authority following a serious containership casualty.

7. Sulamerica Cia Nacional de Seguros S.A. & Ors v Enesa Engenharia S.A. & Ors [2012] EWCA Civ 638. Court of Appeal decision continuing an anti-suit injunction restraining the appellants from pursuing proceedings against the respondents in the Courts of Brazil.

8. Te Hsing Maritime S.A. & Anr v CertAsig S.A. [2012] EWHC 2577 (Comm). Application for security for costs of defending an action on the basis that the claimants are resident out of the jurisdiction.

Conferences & Events

Reform of S53 Marine Insurance Act Seminar
HFW London
(27 June 2013)
Presenting: Richard Spiller, Jonathan Bruce, Costas Frangeskides

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