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The editors wish to thank all members of the University of Southampton School of Law who have helped in the creation of this volume

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Foreword

It is my great pleasure to add a few words on the launch of the Southampton Student Law Review. Southampton LLB and LLM courses both feature extended dissertations and essays, and the unlimited imaginations and interests of our students regularly produce a fascinating array of material which is carefully researched, well argued and of an extremely high standard. My own experience of teaching over too many years is that the best work comes from students with a genuine interest in the subject matter when coupled with the freedom to explore it in detail. It has long been a matter of regret that the fruits of student research have been confined to the examiners and the store in the library, and there are very few journals that have the space (and, in many cases, the inclination) to publish student work. SSLR has tackled these issues head-on. The enthusiasm with which staff and students alike have approached the task of launching SSLR is inspirational.

This second issue, a Marine Insurance special, is a response to the almost unprecedented concentration of highly significant marine insurance decisions handed down in the first half of 2011, and the case comments focus on various different aspects of those decisions. The longer articles address wider concerns presently under review by the English and Scottish Law Commissions.

Good luck to SSLR and to all who sail in her.

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Southampton, 2 August 2011

Editor's note

The case comments in the first part of this issue arose out of the sudden flood of very important cases in spring 2011, including the Supreme Court case *Global Process Systems Inc & Anor v Syarikat Takaful Malaysia Berhad* [2011] UKSC 5 on causation and the Court of Appeal case *Masefield AG v Amlin Corporate Member Ltd & Anor* [2011] EWCA Civ 24 on insurance cover for losses by piracy. This generated a natural setting for an essay competition among the LLM students. The students were invited to comment on any recent case, with the above two representing the bulk of the resulting submissions. The terms of the competition were that brief and clear case summaries would be just as welcome as submissions containing more ambitious analysis. This issue of SSLR contains case comments representing both types of submissions and a spectrum in between, each worth reading on its own merits. The articles in the second part of the issue are some excellent examples of work arising in other ways out of the LLM course.

Most of the authors were at the time of writing LLM students at the University of Southampton Law School, with just one exception noted on that article.

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Southampton, 2 August 2011

Inherent Vice: What About It?

A Case Comment on *Global Process Systems Inc v Syarikat Takaful Malaysia Berhad (The Cendor Mopu)* [2011] UKSC 5

Vasiliki Digoni

Background

In 2005, Global Process Systems bought the oil rig *Cendor MOPU* and arranged for her to be transported from Texas to Malaysia on a barge with her three massive tubular legs extending some 300 feet into the air. The oil rig was insured with Syarikat Takaful (the insurers), on a policy which incorporated the Institute Cargo Clauses (ICC A), in particular clause 4.4 which states that 'loss, damage or expense caused by inherent vice or nature of the subject matter insured' is excluded from cover.

When the barge arrived at Saldanha Bay some repairs were made to the legs. Afterwards, the barge proceeded to its final destination. On the evening of 4 November 2005, however, one of the legs broke off and fell into the sea. The following evening, the other two legs fell off as well.

Global Process Systems brought a claim under the policy arguing that the loss was caused by perils of the seas. The claim was rejected by the insurers, who contended that the real cause of the loss was the weakness of the legs themselves, which constituted inherent vice and was thus an excluded peril.

At first instance, Blair J held that the proximate cause of the loss was the fact that the legs were incapable of withstanding 'the normal incidents of the insured voyage including the weather reasonably expected',[1] and therefore fell within the inherent vice exclusion.

The judgment was overturned by the Court of Appeal where Waller LJ in the leading speech stated that the correct test to apply was whether the rig was capable of withstanding weather that was bound to occur, rather than whether she was capable of withstanding the weather which was reasonably expected to occur. Given that Blair LJ had found that the loss was 'very probable but not inevitable',[2] it followed that it did not fall within the limits of the exclusion.

The Supreme Court

The insurers appealed to the Supreme Court, where their claim was unanimously dismissed. Their Lordships held that the loss of the legs of the

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[1] Per *Mayban General Insurance v Alstom Power Plants Ltd* [2004] 2 Lloyd's Rep 609
[2] [2009] 2 All ER (Comm) 795 at [87]

Cendor MOPU was neither expected nor contemplated. In effect, it occurred only under the influence of a 'leg-breaking wave' of particular direction and strength which caught the first leg at just 'the right moment',[3] leading to increased stress on and collapse of the other two legs.

Following the judgment of the Supreme Court, there is now authority for the proposition that a loss is caused by inherent vice only where the sole reason for that loss is the nature of the cargo, in the sense that the cargo would suffer loss even without the intervention of any external fortuitous event.[4] This conclusion is depicted in the words of Lord Clarke who stated that

> the sole question [...] is whether the loss or damage is proximately caused, at least in part, by perils of the seas (or more generally, by any fortuitous external event or casualty). If that question is answered in the affirmative, it follows that there was no inherent vice, thereby avoiding the causation issues that arise where there are multiple causes of loss, one of which is an insured risk and one of which is an uninsured or excluded risk.[5]

In other words, their Lordships determined that for the purposes of s 55 of the 1906 Act the exclusion of losses caused by inherent vice is limited to circumstances in which this loss is caused by something internal to the cargo. The effect of this ruling is stark: irrespective of the original condition of a cargo or of how fragile it is, where the actions of wind and waves have played a part in causing a loss, it will be almost impossible for insurers to deny liability based on the exclusion.

The implications of the decision

Perils of the seas and inherent vice

According to Rule 7 of the Schedule to the 1906 Act the term 'perils of the seas' refers 'only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the winds and waves'. In approving the decision of the *Miss Jay Jay,*[6] the Supreme Court confirmed that the word 'ordinary' describes the 'action' of the wind and waves and not the 'wind and waves'. Thus, the question to be answered is whether the winds and waves had some *extraordinary effect* rather than whether they were extraordinary themselves. On this ground, the Supreme Court rejected the long-held practice of assessing the weather gradations in order to prove a fortuitous loss, upholding that 'it is not the state of the sea itself which must be fortuitous, but rather the occurrence of some accident or casualty due to the conditions of the sea'.[7]

On the face of Lord Mance's analysis in paras 80-81 therefore, anything that can count as a fortuitous external accident or casualty will be sufficient to

[3] [2011] UKSC 5, per Lord Mance at [65]
[4] *Soya v White* [1983] 1 Lloyd's Rep 122; followed
[5] [2011] UKSC 5 at par 137
[6] [1985] 1 Lloyd's Rep 264
[7] [2011] UKSC 5, per Lord Clarke at [103]

prevent a loss from being attributed to inherent vice, without due regard to whether the event is exceptional or unforeseeable, or reasonably expected or ordinary. In essence, if loss is sustained as a result of foreseeable (as was the case in the *Cendor Mopu*) but not inevitable actions of wind and waves, the policy will bite and the insurers will be liable to pay. It would only be if the loss or damage could be said to be due either to uneventful wear and tear in the prevailing weather conditions or to inherent characteristics of the cargo not involving any fortuitous external event, accident or casualty, that insurers would have a defence.

The fact that *Mayban* was overruled is arguably to be approved. In considering the present, or equivalent, circumstances, the application of the test as set out above would frustrate the purpose of the cargo insurance. In fact, the insurers would be required to pay under the policy if damage was caused by perils of the seas only where this peril was exceptional, unforeseen, or unforeseeable, leaving out of protection a great number of risks. On the other hand, the reasoning itself is not comprehensive. For instance, it is still difficult – or perhaps now even more difficult – to conceptualize the distinction between the damage done to the gloves in *TM Noten v Harding*[8] which occurred as a result of the normal temperature in which they were stored; and the damage to the rig's legs which occurred as a result of the normal (usual and expected) waves that it encountered on its voyage. Given the circumstances, the line between the 'leg breaking wave' and an uneventful wave is undoubtedly rather thin.

Section 55 of the 1906 Act and cl 4.4 ICC

According to the judgment of the Supreme Court, there is now no possibility of the two particular perils working in tandem - if there is a loss by perils of the seas then there can be no loss by inherent vice. The effect of this conclusion is that since inherent vice needs to be the sole cause of the loss, if it is not the sole cause, it cannot in turn be a proximate cause for the purposes of s 55 (1) of the 1906 Act. Equivalently, the rule of the concurrent causes established in *Wayne Tank & Pump Co Ltd v Employers' Liability Assurance Corp Ltd*[9] is reduced to circumstances where the two so-called concurrent causes are independently capable of causing the loss. Given the above interpretation, it can be concluded that in cases of a peril of the sea and inherent vice as potential causes, the former prevails and there is therefore no need to get into a discussion of the exclusion clause.

Both Lord Clarke and Lord Mance in their respective judgments touched upon the exclusion issue. Lord Clarke considered that the exclusion of inherent vice by s 55 (2) (c) of the 1906 Act was not an exclusion at all, *but merely an amplification of the proximate cause rule and thus an example of a circumstance of a loss not proximately caused by a peril insured against*. Lord Mance for his part added that the exclusion of inherent vice in the insurance contract ought not to make any difference to its status as a mere uninsured peril under s 55 (2) (c), since this would lead to a fundamentally

[8] [1990] 2 Lloyd's Rep 283
[9] [1974] QB 57

different result between the two. This reasoning does not chime well with the issue outlined in the previous paragraph, especially keeping in mind that cl 4.4 is headed 'exclusions' and s 55 in the 1906 Act is headed 'included and excluded losses'. As for the latter, it is true that s 55 (2) (c) itself does not make any particular reference to 'exclusions'. It can thus be concluded that they may be non-excluded (ie uninsured) perils, but not included ones. Lord Mance seems to suggest that the same interpretation is appropriate for cl 4.4, but unfortunately goes no further than just setting out the issue.

The particular facts of the present case, namely fatigue failure as a result of a combination of the fatigue strength of the rig's legs and the stresses induced by sea conditions depending upon the weather conditions, was arguably one of the risks that both parties had in mind. It seems fair to say that both intended that it should be the subject of insurance. The dismissal of the insurers' claim may be said to respect in part this commercially-oriented interpretation. However, whether the reasoning can also be fully justified remains questionable. For instance, their Lordships accepted that *Wayne Tank and Pump* has survived in principle; on the facts of the *Cendor Mopu* itself, it was not applicable because there were no concurrent causes. Nevertheless, even if Lord Mance and Lord Clarke were not right in the way they dealt with s 55 and cl 4.4, does it really matter given the judgment of the Supreme Court on inherent vice and its 'new' relationship with perils of the seas?

In fact, as the court narrowed the test for losses arising from inherent vice to losses solely attributable to the nature of the subject matter, the question whether inherent vice was the proximate cause or only a cause of the loss would arguably not change the outcome substantially, so long as perils of the seas was one of the causes.

Conclusion

The narrow construction of inherent vice established by the Supreme Court in the *Cendor Mopu* provides a strong weapon to policyholders, who will now be able to attack their insurers' defence of inherent vice on the grounds of the occurrence of a peril of the seas. In summary, their Lordships rejected the uncertainty that would be caused if inherent vice were to be defined by reference to the gradations of weather conditions. Instead, they preferred the simplicity of the analysis that an external fortuitous event (namely a peril of the sea) forecloses the possibility of inherent vice as the proximate cause. So long as there is evidence of such a fortuitous event, the insurer will be liable to pay under the policy for the resulting loss, irrespective of whether that loss had a probability of 5% or 95% of occurring.

The Scope of Inherent Vice after *The Cendor MOPU*

Siv Kristiansen

Introduction

On 1 February 2011, the Supreme Court issued judgment in the case *Global Process Systems Inc v Syarikat Takaful Malaysia Bhd* [1] hereinafter called '*The Cendor MOPU*'. The case concerns important questions and answers as to when insurers will be liable under an all risk policy; including questions on proximate and concurrent causes and the interpretation of the phrases "perils of the sea" and "inherent vice". These questions and answers which will be analysed in the following.

Facts of the case

An oil rig was transported on a tow barge from the United States to Malaysia with its legs pointing upwards. This caused severe stress on the legs which cracked and eventually broke and fell off in turn during the transit.

The rig had been insured under a policy which incorporated the Institute Cargo Clauses A (1982). ICC (A) covers "all risks". An 'all risks' policy covers loss or damage from any external cause, subject only to the express exclusions in the policy. It is settled law that this includes 'perils of the sea'. Expressly excluded from ICC (A) is notably "loss, damage or expense caused by inherent vice or nature of the subject matter insured"[2], also referred to as 'inherent vice'. Inherent vice is also subject to exclusion under s 55(2)c of the Marine Insurance Act 1906 ('the 1906 Act') and it can be argued that the propositions in the judgment regarding inherent vice are transferable to the section in the 1906 Act.

Accordingly 'perils of the seas' needs to be the proximate cause of the loss[3] for the insurers to be liable under the policy, since loss caused by inherent vice was expressly excluded. It was common ground that the cracking was due to 'inherent vice'. The critical question was the cause of the *loss* of the legs. There were two candidates to proximate causation: perils of the sea in the form of the stress put upon the rig by the height and direction of the waves encountered by the barge; and inherent vice of the subject matter insured.

To determine whether the leg breaking wave which hit the tow or the inherent vice in the legs was the proximate cause of the loss, the courts had to establish

[1] *Global Process Systems Inc v Syarikat Takaful Malaysia Bhd (The Cendor MOPU)* [2011] UKSC 5
[2] Institute Cargo Clause cl 1 and cl 4(4). But damage due to inherent vice is also excluded by the 1906 Act, s 55(2)c.
[3] Marine Insurance Act (1906), s 55(1).

the meaning of both 'perils of the sea' and 'inherent vice', before deciding the question of proximate causation. The test for proximate causation was set out in *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd*.[4] However, as shown below, that test is difficult to apply when the competing causes of the loss are 'perils of the sea' and 'inherent vice'.

Appeal history

Mr Justice Blair at first instance found the proximate cause of loss to be inherent vice after applying the test set out in *Mayban General Insurance v Alstom Power Plants Ltd*[5] ('*Mayban*') and gave judgment in favour of the insurers.[6] This test will be discussed below. The Court of Appeal rejected the aforesaid test and found the loss to be caused by perils of the sea and gave judgment in favour of the assured.[7] The insurers appealed. The Supreme Court affirmed the judgment given by the Court of Appeal and dismissed the appeal for reasons which will be explained below. Four of the five Lawlords gave speeches and the decision to dismiss the appeal was unanimous. In the following, focus is placed on the speeches given by Lord Saville and Lord Mance.

Perils of the sea

Perils of the sea is part of the group of risks insured under a marine all risk policy and "refers only to fortuitous accidents or casualties of the sea. It does not include the ordinary action of the winds and waves"[8]. In *JJ Lloyd Instruments v Northern Star Insurance Co* (*The Miss Jay Jay*)[9] 'ordinary' was held to refer to "action" and not to "winds and waves". This interpretation leads to the result that the meaning of perils of the sea is not confined to cases of exceptional weather. In *Mayban,* on the other hand, "ordinary" was held to refer to "winds and waves". The result of this interpretation is that the policy only covers loss or damage caused by extraordinary winds and waves.

Blair J at first instance[10] applied the interpretation set out in *Mayban*. Both the Court of Appeal and the Supreme Court disagreed with this interpretation and reaffirmed the position stated in *The Miss Jay Jay*. The reasoning is based on considerations of the purpose of an all risk policy, which is to give the assured a wide cover against loss and damages under the policy. By interpreting perils of the sea as referring only to loss or damage caused by exceptional weather conditions, the scope of an all risk policy is narrowed to fewer cases than what is the real purpose of it. The Supreme Court therefore gives the term a wider interpretation and it must now be clear, despite the

[4] (1918) AC 350: the proximate cause is the "dominant cause" of the loss. It was decided in *TM Noten BV v Harding* [1990] Lloyd's Rep 283, per Bingham LJ at page 286 – 287 that the dominant cause of loss is to be determined by "applying the common sense of a business man or seafaring man".
[5] [2004] EWHC 1038 (Comm.)
[6] *The Cendor MOPU* [2009] EWHC 637 (Comm) at [111].
[7] *The Cendor MOPU* [2009] EWCA Civ 1398 at [64].
[8] Schedule 1, rule 7 to the 1906 Act
[9] [1987] 1 Lloyd's Rep 32, CA
[10] [2009] EWHC 637 (Comm)

'slip' in *Mayban*, that arguments that perils of the sea includes only exceptionally heavy weather will not be accepted by the courts.

However, it can be noted that perils of the sea is part of the group of insured perils under an all risk policy without being expressly mentioned in ICC (A), cl 1. It can be argued that what is being stated in the case concerning perils of the sea is *obiter dicta* since perils of the sea are not expressly mentioned in the wording. I do not agree with this approach. As long as perils of the sea so clearly is part of the group of insured perils under a marine all risk policy, the use of perils of the sea is arguably simply a clarification of which peril out of the group the case concerns.

Inherent vice

Unlike perils of the sea, the phrase 'inherent vice' has no statutory definition. In *Soya GmbH Mainz Kommanditgesellschaft v White*,[11] Lord Diplock stated that inherent vice means

> the risk of deterioration of the goods shipped as a result of their natural behaviour in the ordinary course of the contemplated voyage without the intervention of any fortuitous external accident or casualty[12].

This definition raises questions both as to what is meant by "ordinary course of the contemplated voyage" and "intervention of any fortuitous external accident or casualty".

The insurers in *The Cendor MOPU* alleged that the definition in *Soya v White* meant that because the rig was unable to withstand all bad weather conditions which it would forseeably meet during the voyage, the assured could not recover in respect of the lost legs. This interpretation arguably introduces a requirement for the cargo to be seaworthy. This differs from the traditional understanding of the term and widens the scope of the exclusion for inherent vice. It is, however, supported by the judgment of Moore-Bick J in *Mayban*. He held that the shipped goods must be capable of withstanding the forces that they can ordinarily be expected to encounter in the course of the voyage and that if the conditions encountered by the vessel were no more severe than could reasonable be expected, the conclusion must be that the real cause of the loss was the inherent inability of the goods to withstand the ordinary incidents of the voyage.[13] This test was applied by Blair J at first instance of the present case as he gave judgment in favour of the insurers; but his decision was overruled by both the Court of Appeal and the Supreme Court, both of which gave judgment in favour of the assured.

There are both practical and legal reasons as to why *Mayban* was overruled on this point. A practical reason is that the wide interpretation of inherent vice expands the situations were inherent vice will exclude cover under all risk policies. By expanding the traditional understanding of inherent vice to

[11] (1983) 1 Lloyd's Rep 122
[12] Ibid. At page 126
[13] *Mayban General Insurance v Alstom Power Plants Ltd* (2004) EWHC 1038 (Comm.) at [21].

include also the normal behaviour of the sea, much of the purpose with an all risk policy is diminished. The whole purpose of an all risk policy is to give a wide cover against losses.

Another reason for why *Mayban* was overruled is that the test introduces to marine insurance a requirement for the cargo to be capable of withstanding the normal and expected sea conditions on the insured voyage. In other words, *Mayban* introduces seaworthiness as a condition precedent for recovery in respect of lost goods under an all risks policy.

In the 1906 Act, s 39 there is a requirement of seaworthiness for ships. But it follows from s 40(1) that there is no such implied requirement with regards to cargo. Nor is there support in case law prior to *Mayban* supporting the proposition that inherent vice encompasses any fortuitous external accident or casualty, and therefore seaworthiness. Indeed, Lord Mance considered the introduction of such a requirement an "oddity"[14].

It may also cause uncertainty as to what requirements are applicable to cargo under all risk policies. As explained by Lord Macnaghten

> in marine insurance it is above all things necessary to abide by settled rules and to avoid anything like novel refinements or a new departure[15]

This does not prevent case law from interpreting the 1906 Act to fit modern times if that is necessary, but in the present case there is no reason why a requirement of seaworthiness should be adopted for goods.

A distinction should be made compared to the concept of seaworthiness adopted for the purpose of international trade, where there is an implied term of seaworthiness.[16] The seller must only ship goods which are in such a state as to withstand the strains and stresses of a normal voyage.[17] Provided that the goods shipped are seaworthy, this creates certainty for the buyer as to who to sue if the goods are lost or damaged.[18] He can and must sue the carrier, since the risk for the goods in shipment sales passes from the seller to the buyer 'on or as from shipment'[19]. This requirement of seaworthiness relates to the relationship between the seller and buyer under the sale contract agreed between them, ensuring in the best possible way that the buyer receive the goods which he actually bought under the sale contract. This purpose behind a requirement of seaworthiness in international trade law does not apply to insurance and cannot contribute to a requirement of seaworthiness in marine insurance.

[14] *The Cendor MOPU* [2011] UKSC 5, at [57].
[15] *Thames and Mersey Marine Insurance Co LTd v Hamilton, Fraser & Co* (1887) 12 App Cas 484 at p. 502.
[16] Sale of Goods Act (1979), s. 14(2).
[17] *Mash & Murrell Ltd v Joseph I. Emanuel Ltd* (1961) 2 Lloyd's Rep 326
[18] Both for the buyer who buys on C and on F terms. See Incoterms 2010.
[19] *Comptoir d'Achat et de Vente du Boerenbond Belge SA v Luis de Ridder Limitada* (The Julia) (1949) AC 293

A requirement for goods to be seaworthy could also lead to disputes as to the conditions of the goods at the time of shipment. This will create an uncertain position for a buyer on C terms as to where he should seek indemnification for damaged or lost goods: from the seller, from the insurer or both.[20]

On these grounds the Supreme Court, supporting the definition laid down in *Soya v White*, finds that the term inherent vice is limited to situations where the loss is caused solely by the nature of the cargo and where the loss would have occurred irrespective of external fortuitous events.

What the Supreme Court does, as a reaction to *Mayban*, is in effect to widen the meaning of perils of the sea while narrowing the meaning of inherent vice. This enables the assured under an all risks policy to recover in an increased number of situations compared to *Mayban*; which may be said to be the purpose of an all risks policy. If the insurers are not willing to underwrite the risk of an all risks policy with these interpretations, they can seek to limit their exposure under the policy by other means; either by inserting special provisions in the policy or by amending the standard clauses upon which most insurances are underwritten today.[21]

Concurrent causes

When applying the definitions of perils of the sea and inherent vice set out above, both causes are "rival candidates"[22] as the cause of the loss of the three legs. For the insurers to be liable under the policy the insured peril needs to be the proximate cause of the loss.[23] It is settled law that the proximate cause is the "dominant cause" of the loss.[24] This is to be determined by "applying the common sense of a business man or seafaring man".[25] It is equally clear that concurrent causes can be the proximate cause of the loss.[26] If one of those perils is insured, while the other is unmentioned, the assured can still recover under the policy.[27] However, when one peril is insured, while the other is expressly excluded in the policy, the excluded peril prevails and the insurer is not liable for the loss under the policy.[28] This suggests that the assured in the present case is not able to recover under the policy.

However, the Supreme Court notes that situations involving the concurrent causes of perils of the sea and inherent vice invite a weighing exercise grading the weather in order to find out whether this was the dominant cause of the loss, and accordingly whether the assured can recover or not. Such an exercise to determine coverage is not attractive[29] as the exercise itself is difficult, despite expert evidence. The result might therefore be both uncertain and

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[20] *The Cendor MOPU* [2011] UKSC 5 by Lord Mance at [52]
[21] Ibid. by Lord Mance at [81]
[22] Ibid. by Lord Mance at [49]
[23] Marine Insurance Act (1906), s 55(1).
[24] *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* (1918) AC 350 at p 363.
[25] *TM Noten BV v Harding* (1990) Lloyd's Rep 283, page 286 – 287 per Bingham LJ.
[26] *Samuel v Dumas* (1924) AC 431 per Lord Sumner at page 467.
[27] *JJ Lloyd Instruments v Northern Star Insurance Co* (The Miss Jay Jay) (1987) 1 Lloyd's Rep 32, CA.
[28] *Wayne Tank and Pump Co Ltd v Employer's Liability Assurance Corp Ltd* (1974) QB 57
[29] *The Cendor MOPU* [2011] UKSC 5; Lord Mance at [79].

doubtful. As a result of these considerations the Supreme Court finds that these two perils cannot 'pair up' as concurrent causes and that perils of the sea will be the prevailing cause in these situations. Consequently, the assured in the present case could recover for the loss of the legs under the policy.

The consequences of *Cendor MOPU*

It is now clear that loss is only caused by inherent vice where the sole reason for the loss is the nature of the cargo itself and that the loss had occurred despite external fortuitous accidents or casualties. With this clarification many issues arising out of *Mayban* as to whether the loss was caused by the unseaworthiness of the goods shipped or by perils of the sea may be avoided. Still there will need to be a case by case assessment of whether the loss was caused by inherent vice or perils of the sea; but the line will be easier to draw since the grey zone between seaworthiness of cargo and perils of the sea has been removed.

As regards concurrent causes, it is clear that perils of the sea and inherent vice cannot stand together as equal dominant causes since the impact of perils of the sea is so difficult to measure against the impact of a (potential) inherent vice. In these situations, the assured will be able to recover in the future. What is more uncertain is how far-reaching this principle is. Can it for example be applied in a situation where the rivalling causes are perils of the sea and the exclusion of insufficient packing?[30] It will be up to future case law to determine this.

[30] ICC (A), cl 4(3)

Concurrency of Causes and *The Cendor MOPU*

Roberto Barriga

The scope of the defence of inherent vice was strictly delimited in the Supreme Court's judgment in *The Cendor MOPU* [2011] UKSC 5, handed down on 1 February 2011. The Court held that the test for inherent vice is whether the loss was proximately caused by something solely attributable to an element within the subject matter insured and not by an external event.

Dealing with the issue of proximate causation, the Court explained the difficult divergence between perils of the seas and inherent vice, broadening the scope of the former and limiting that of the latter, and finding against the possibility of concurrency between them.

By doing this, the Supreme Court has cleared a highly uncertain issue and has settled the law in a controversial aspect of the law. The explanation given by the Court on causation issues in situations where perils of the sea and inherent vice appear to be rival causes of the loss should help avoid some liability disputes.

Factual Background

The *Cendor MOPU* was an oil rig laid up in Texas that was purchased in May 2005 by the assured for conversion into a mobile offshore production unit for use in Malaysia. The rig was what is called a 'self elevating mat supported jack-up rig' that consisted of a working platform, which could be moved up and down three legs extending to the seabed. The legs were tubular, welded steel, cylindrically shaped with a length of 312 feet and a weight of 404 tons.

The rig was to be dry towed to Malaysia, and was insured for that purpose under a policy on cargo dated 5 July 2005 incorporating the Institute Cargo Clauses (A) of 1982, thus covering "all risks of loss or damage to the subject-matter insured except as provided in Clauses 4, 5, 6 and 7...".[1] Clause 4.4 expressly excluded "loss, damage or expense caused by inherent vice or nature of the subject matter insured".

The rig was towed with the three legs extending into the air. Because towing the rig in this way exposed it to a risk of fatigue cracks during the voyage, the assured arranged for inspection of the legs at Texas and the insurers required as a condition of the policy that appointed surveyors approve the arrangements for the tow. The surveyors issued a Certificate of Approval where it was required that the legs were re-inspected when reaching Cape

[1] ICC (A) cl 1

Town at the half way point of the voyage so that remedial work could be undertaken if necessary.

The rig left Texas on 23 August 2005 and reached Cape Town on 10 October 2005 where it was inspected and repairs were undertaken. On 19 October the voyage continued until 4 November 2005 where one of the legs broke off and fell into the sea. The following day the two other legs also broke off and fell into the sea.

The loss resulted from metal fatigue in the three legs, which is a cracking mechanism resulting from stresses that in this case were generated from the effect that the height and direction of the waves had on the motion of the barge. The initial fatigue cracks were subjected to what was described as a "leg breaking" stress that fractured one of the legs, weakened by fatigue. When the first leg broke, the stresses on the remaining legs increased causing them to also break. The weather experienced by the barge was within the range of weather that could reasonably have been contemplated for the voyage.

The assured claimed for the loss of the three legs and the insurers rejected the claim raising different arguments, including that the loss was caused by inherent vice.

The decisions in the High Court and the Court of Appeal

Mr Justice Blair at first instance rejected an argument advanced by the insurers that the loss was the inevitable consequence of the voyage, and found that although probable, the loss was not inevitable and that the failure of the legs required a "leg breaking wave" to cause the first leg to break. The judge also rejected the argument that the loss resulted from the failure to effect adequate repairs at South Africa. However, applying the test in *Mayban General Assurance BHD v Alstom Power Plants Ltd* [2004] EWHC 1038 (Comm), Blair J concluded that inherent vice was the proximate cause of the loss as the legs were not capable of withstanding the normal incidents of the voyage, including the weather reasonably to be expected.

The Court of Appeal did not uphold that argument and concluded that the proximate cause of the loss was an insured peril in the form of the occurrence of a "leg breaking wave", which resulted in the starboard leg breaking off, leading to greater stresses on the remaining legs. The insurers appealed to the Supreme Court arguing that inherent vice was if not the only proximate cause of the loss, a concurrent cause thereof.

The decision in the Supreme Court

By a unanimous decision the Supreme Court dismissed the appeal on the basis that the loss was proximately caused by perils of the seas, a peril insured against in the all risks policy, and not by inherent vice. Lords Saville, Mance, Collins and Clarke gave concurring reasoned judgments with Lord Dyson agreeing with all of them.

In determining the proximate cause of the loss, the Court recognized that it had to find the cause that was proximate in efficiency, and that to do so they had to apply the test of the common sense of a business or seafaring man as expressed by Bingham LJ in *Noten (T M) BV v Harding* [1990] 2 Lloyd's Rep 283. Since in *The Cendor MOPU* the competing candidates as cause of the loss were a fortuitous external accident expressed as a peril of the sea on one hand and inherent vice on the other, the Court sought to clarify the meaning and extent of these rival concepts to determine the true proximate cause. In doing so, the Court rejected the possibility that perils of the seas and inherent vice could be concurrent causes of a loss and commented on the suggestion that the provisions in s 55(2) of the Marine Insurance Act 1906 and cl 4.4 of the ICC(A) ought to be interpreted not as proper exclusions but as limitations of the scope of cover.

The question in *The Cendor MOPU* was essentially one of causation: was the loss of the rig's legs proximately caused by an inherent vice in the legs, or by a peril of the seas, or by these two causes in concurrency? The competing causes were on one side the physical state of the rig (the argued inherent vice), and on the other the "leg breaking wave" (the peril of the sea). The Court decided that only the "leg breaking wave" could be considered as the proximate cause of the loss. To reach this conclusion, the Supreme Court analysed the meaning of perils of the seas and of inherent vice.

Perils of the sea

According to s 55(1) of the 1906 Act, the insurer is only liable when the loss is proximately caused by a peril insured against. The policy in *The Cendor MOPU* was an "all risks" policy, covering any fortuitous external accident or casualty. The assured claimed that the fortuity that caused the loss was a peril of the sea, which is defined in Rule 7 of the Schedule to the 1906 Act as fortuitous accidents or casualties of the seas, not including the ordinary action of the winds and waves.

The Supreme Court in *The Cendor Mopu* clarified the meaning of perils of the sea approving the decision of Mustill J in *JJ Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (The Miss Jay Jay)*[2], making clear that perils of the seas are not confined to cases of exceptional or unforeseeable weather. The test is to ask if the sea conditions caused a fortuitous accident or casualty, in the sense that what is to be looked for is any extraordinary effect of the wind and waves rather than extraordinary conditions of weather (i.e. of the wind and waves themselves). Lord Saville stressed that in Rule 7 of the Schedule of the 1906 Act the word "ordinary" attaches to the word "action" and not to "wind and waves", so that if the action of the wind and waves is extraordinary and causes a loss, a claim lies under the policy irrespective of the weather conditions. A defence against perils of the sea based on the normal, ordinary or foreseeable conditions of the weather is thus no longer admitted.

[2] [1985] 1 Lloyd's Rep 264. This part of the decision was not modified upon appeal; [1987] 1 Lloyd's Rep 32.

Lord Mance nevertheless recognized that a fortuitous accident or casualty had to be proven or inferred, and that it is the assured's burden to demonstrate it. As a result, the mere entry of water into a vessel is not axiomatically a peril of the sea, as an external fortuity needs to be proven for recovery under this peril.

Inherent vice

The insurers for their part argued that the loss was proximately caused, solely or concurrently, by the excepted peril of inherent vice. The Court looked to the definitions given in *Soya GmbH Mainz Kommanditgesellschaft v White* [1983] 1 Lloyd's Rep 122, especially that of Lord Diplock in the House of Lords who defined inherent vice as

> the risk of deterioration of the goods shipped as a result of their natural behaviour in the ordinary course of the contemplated voyage without the intervention of any fortuitous external accident or casualty.[3]

The insurers sought to rely on a definition given by Donaldson LJ in the Court of Appeal in the same case, and in the decision given by Moore-Bick J in *Mayban* (*supra*) to contend that goods tendered for shipment must be capable of withstanding "the ordinary course of the voyage", and if the conditions encountered were no more severe than what could be reasonably expected, the real cause of the loss would inevitably be the inherent inability of the goods to withstand the ordinary course of the voyage. This explanation was accepted by Blair J at first instance in *The Cendor MOPU.*

The Supreme Court declined to accept this interpretation and held that *Mayban* was wrongly decided, as the effect of the meaning given by the insurers, Moore-Bick J and Blair J would be to effectively imply a warranty of fitness for the voyage or seaworthiness which could not be traced to any prior case before *Mayban* and which the 1906 Act expressly excludes in s 40(1). As a result, the test for inherent vice was not whether the cargo was able to survive ordinary or reasonably foreseeable weather or wind and waves condition.

> Lord Saville construed the definition given by Lord Diplock in *Soya v White* to mean that for it to amount to an inherent vice, the deterioration of the goods should not result from an external fortuity but "because of their natural behaviour in the ordinary course of the voyage". Lord Mance explained that "the ordinary course of the voyage" was not a reference to weather conditions foreseeable for the voyage, but was used to describe a voyage where a fortuitous external accident or casualty did not occur. Furthermore, Lord Diplock's definition of inherent vice had the qualification that deterioration had to occur "without the intervention of any fortuitous external accident or casualty," therefore the intervention of an external fortuity is enough to prevent the loss from being caused by inherent vice.

[3] At page 126.

The Court in *The Cendor MOPU* found that *Noten v Harding* was an example of a situation where inherent vice had effectively caused the deterioration of the goods, as in that case leather gloves were damaged when moisture contained in the gloves evaporated away from the gloves and then condensed and dripped back onto them. There was no external fortuity causing the loss, which was caused entirely from something internal in the goods, the moisture. Lord Mance expressly stated that inevitability was not the test of inherent vice, and when damage was foreseeable due to an inherent characteristics of the goods, it is the internal characteristic which causes damage without an external fortuity that results in the inherent vice and not the fact that it was foreseeable or inevitable. Lord Mance deliberately left open the interesting question of whether inevitable damage resulting from external causes without the knowledge of the parties could be recovered.

When analyzing the juxtaposition of "ordinary wear and tear, ordinary leakage and breakage" with "inherent vice" in s 55(2)(c) of the 1906 Act, Lord Mance reached the conclusion, although not attempting an exact definition, that the first would cover loss or damage resulting from the normal use of the vessel, or of handling and carriage of cargo, "while inherent vice would cover inherent characteristics of or defects in a hull or cargo leading to it causing loss or damage to itself"[4]; in both cases without the intervention of an external fortuity. Finally, Lord Clarke considered that s 55(2)(c) should not be construed as an exclusion to cover but as a clarification on the scope of cover. Lord Mance considered that on its face, the exclusion contained in cl 4.4 of the ICC(A) simply made clear the continuing relevance in the context of all risks cover of the limitation on cover against perils of the sea already contained in s 55(2)(c). These observations could have an interesting effect on causation.

Concurrency of causes

The Supreme Court in *The Cendor MOPU* reached the decision that perils of the sea was the sole proximate cause of the loss. Applying the wide definition given to perils of the sea and the limitation of the concept of inherent vice, the Court found that the external fortuity that caused the loss of the legs was the "leg breaking wave".

In dismissing the concurrency issue raised by the insurers, Lord Clarke stated that where loss or damage is caused by a combination of the physical condition of the goods and the sea conditions, if it is found that the loss or damage is proximately caused -totally or partly- by an external accident or casualty, the result is that there is no inherent vice and no issues regarding concurrent causes arise. As a result, in *The Cendor MOPU* the "leg breaking wave" was enough to dismiss the concurrency argument.

The result of the reasoning in *The Cendor MOPU* is that perils of the sea and inherent vice are mutually exclusive perils, which can never occur as joint proximate causes of a loss. Furthermore, according to Lord Mance's analysis of the decisions in *The Miss Jay Jay*, perils of the sea is to be understood as a paramount provision, in the sense that it will be considered the only

[4] At para 81.

proximate cause of the loss, since an attempt to weigh perils of the seas and other causes in an effort to render them equal or concurrent will inevitably mean to measure the weather conditions. Thus the decision of Mustill J in *The Miss Jay Jay* wherein he held that perils of the sea was the only proximate cause seems to be preferred to that of the Court of Appeal finding unseaworthiness as an equally concurrent cause.

Furthermore, in considering the exclusion contained in cl 4.4 of the ICC(A), Lord Mance was of the view that had it been relevant it would have been considered as a limitation of cover and not as a concurrent cause that was excluded, and therefore the principle established in *Wayne Tank and Pump Co Ltd v Employers Liability Assurance Corporation Ltd* [1974] QB 57 would not have been applicable to this case; namely that when there are two concurrent causes, one insured and one excluded, the exclusion would take priority. Lord Mance distinguished the situation in *The Cendor MOPU*, where two concurrent risks arose independently but combined to cause a loss, from those where the previous rule was applied, namely where there were true exceptions which took out of cover against an insured risk a specific type of situation giving rise to such risk. Unfortunately, the discussion was obiter and inconclusive and it remains to be seen whether the result would be different in such situations.

Comments

The Cendor MOPU discussed concepts intrinsic to marine insurance law, which were complex and controversial, which had created some uncertainty in a core area of insurance law such as causation. The decision clarified the concept of inherent vice, narrowing its reach to cases where the loss or damage was caused by something internal, in the nature of the goods which would damage the goods irrespective of an external fortuity. As a result, insurers should not rely on this defence when an external fortuitous accident or casualty (such as perils of the sea) can be considered, at least in part, a proximate cause of the loss, such as the "leg breaking wave" that made *The Cendor MOPU* such a unique case.

The Supreme Court, in finding that *Mayban* was wrongly decided, stated that no consideration should be given to weather conditions. As a consequence, expert evidence on gradation of weather or foreseeability of the sea conditions will be of no value on determining the existence of inherent vice. The meaning given by Lords Mance and Saville to the phrase "ordinary action of the winds and waves" focus only on the effect that the winds and waves have on the subject-matter insured and not on their size or strength. This should reduce the need for litigation and in particular the need for expert evidence in this respect.

The Court recognized the practical difficulties inherent in allowing a wide construction of inherent vice, as it would limit the situations where cover is effective, as assureds are unlikely to seek insurance for situations that are unlikely and unforeseeable and the purpose of the 'all risks' cover would be defeated. On the other hand, if insurers are not prepared to cover for situations similar to *The Cendor MOPU* where loss or damage was not only foreseeable but likely, modifications to their policies should be effected. An express warranty of seaworthiness of the subject-matter insured would protect the insurers in similar scenarios; although it seems unlikely that the loss would be considered to be caused by inherent vice even with the inclusion of the warranty.

The test to determine the proximate cause of the loss or damage will ultimately depend on the facts of each case and on what the Court, applying the common sense of a business or seafaring man, finds to be the proximate cause of the loss. So in cases where damage arises from the way the cargo is prepared for the voyage, an external fortuity will need to be found to be causative to be under the scope of cover.

Finally, an interesting point was left open relating to concurrent causes where one is inherent vice. The comments expressed by Lord Clarke and Lord Mance about the nature of the provisions contained in s 55(2)(c) of the 1906 Act and cl 4.4 of the ICC (A) leave a doubt on whether inherent vice is an excluded peril or only a limitation of the scope of perils of the seas. If the latter, the rule established in *Wayne Tank* will not apply to inherent vice at all, so that when it is a concurrent proximate cause with any assured peril (including perils of the seas) the assured would be able to recover.

Reflections on *The Cendor MOPU*

Viktor Weber

The Cendor MOPU[1] concerned a mobile off-shore production unit characterised by three legs of 312 feet each which was carried on a barge. During the transit the legs broke off. While the structure of the legs was weakened as a result of the motion of the waves, expert evidence established that this weakness was not in itself sufficient for the loss to occur and that the first leg to fall off had to be hit by a particular wave to collapse. The two other legs broke off as a result of the strain on the structure caused by the collapse of the first leg.

The Institute Cargo Clauses (A), on which the policy was written, provides in cl 4.4 that "[i]n no case shall this insurance cover loss damage or expense caused by inherent vice or nature of the subject-matter insured". Section 55(2)(c) of the Marine Insurance Act 1906 states that "...the insurer is not liable for...inherent vice or nature of the subject-matter insured...".

The insurer rejected the claim on the ground that the loss was caused by inherent vice, and the question arose whether the assured should be able to recover. As a preliminary step the following scenarios should be considered:

A) The cargo is loaded on board having a vice and this vice causes further damage to the cargo irrespective of the prevailing state of the sea. This is clearly a case of inherent vice.

B) The cargo is loaded on board in a good condition and the prevailing state of the sea damages the cargo. This is a clear case of damage caused by the sea.

C) The cargo is loaded on board having a vice; this in itself would not cause further damage, but the prevailing conditions of the sea cause further damage as a result of the initial vice of the cargo. In other words, the prevailing state of the sea in itself would not cause damage to the cargo if the cargo had been loaded on board in good condition. This is a case of inherent vice.

D) The cargo is loaded on board in good condition but
   a. the prevailing state of the sea causes damage to it (the cracks on the legs) and
   b. as a result of the first damage and the state of the sea further loss occurs (the legs falling off)

In *The Cendor MOPU* the cargo was loaded on board in good condition, and therefore, following the ordinary meaning of the words, the case falls under Scenario B. The insurer argued that the concept of inherent vice includes the

[1] *Global Process Systems Inc v Syarikat Malaysia Takaful Berhad (The Cendor MOPU)* [2011] UKSC 5

inability to withstand an ordinary voyage. If this was right the case would fall under Scenario C. However, the argument suffers from a logical malaise: If something is on board in good condition then it may be weak or fragile, which in turn represents a disadvantageous risk to the insurer, but construing this weakness as an inherent vice is distorting the meaning of both 'inherent vice' and 'good condition'. Accepting this construction would make the issue technical at best and would turn against the parties' intentions at worst. Scenario D is an elaboration of Scenario B on the facts of *The Cendor MOPU*. Giving 'inherent vice' its natural meaning, it demonstrates that both the cracks and the falling off of the legs were caused by the sea.

This reasoning is also supported by earlier authorities on inherent vice. Lord Diplock in *Soya v White*[2] held that loss through inherent vice refers to loss arising "without the intervention of any fortuitous external accident or casualty"[3]. Similarly, in *Noten v Harding*[4] the Court of Appeal held that "the goods deteriorated as a result of their natural behaviour in the ordinary course of the contemplated voyage, without the intervention of any fortuitous external accident or casualty"[5], that is, as a result of inherent vice. In *Nelson Marketing International v Royal and Sun Alliance*[6] the same reasoning was applied to wet truck flooring[7]. On these authorities, the loss of the *Cendor MOPU*'s legs was not due to an inherent vice and recovery should be available.

However, the insurers' argument also originated from case law, namely, the judgment in *Mayban v Alstom*[8]. Mr Justice Moore-Bick held that if the goods are not able to withstand the ordinary conditions of the voyage that amounts to inherent vice and recovery is not possible. There are two points to consider in relation to this case. First, as it has been shown above, the argument seems to turn against ordinary language. Secondly, the judge was not examining the goods in themselves, but in fact, he considered the goods together with their packaging.[9] It was the lack of adequate protection that constituted the inherent vice rather than the inability of the cargo in itself to withstand the voyage. Therefore, the judgment should have been based on Institute Cargo Clauses (A) cl 4.3. The fact that the Supreme Court had not corrected and distinguished the case on this ground is, nevertheless, fortunate as it permitted the restoration of the original meaning of 'inherent vice'.

The court overruled *Mayban* on more pragmatic grounds than the above arguments. Mayban introduces, in effect, a seaworthiness requirement for cargo. Although the judges at first instance deciding *Mayban* and *The Cendor MOPU* did not discuss seaworthiness, the Court of Appeal and the Supreme Court in *The Cendor MOPU* did draw a parallel. This is not surprising if we read the phrase 'ordinary conditions of the voyage' in *Mayban* together with s 39(4) and Schedule 1 Rule 7 of the 1906 Act. The assured submitted that if this

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[2] [1983] 1 Lloyd's Rep 122
[3] *The Cendor MOPU* at [24]
[4] [1990] Lloyd's Rep 283
[5] *The Cendor MOPU* at [29]
[6] 57 BCLR (4th) 27
[7] *The Cendor MOPU* at [30]
[8] [2004] EWHC 1038 (Comm)
[9] *Mayban* at [19]

interpretation was right then cargo insurance would not provide cover for losses attributable to ordinary perils of the seas but only to exceptional perils; the insurance policy would be deprived of most of its purpose. Lord Saville accepted this argument.[10] Also, once the criterion in *Mayban* was made analogous with seaworthiness; it was pointed out that there is no seaworthiness requirement for cargo in the 1906 Act.[11]

Since it became certain that the cause of the loss was not inherent vice, the question remained as to what was the proximate cause of the loss and whether that cause was covered by the policy. Lord Saville stated that perils of the seas include "external fortuities that were unexceptional or which were foreseen or foreseeable"[12] and held that

> ...in the present case the proximate cause of the loss, applying commonsense principles, was ... an external fortuitous accident or casualty of the seas. This took the form of the rolling and pitching of the barge in the sea conditions encountered catching the first leg at just the right moment...[13]

In conclusion it can be established that after a brief deviation the exception of inherent vice for cargo has returned to the position where it was before *Mayban*. The regime is particularly favourable to cargo owners. It is certain that if the cargo is stowed with due expertise, i.e. the goods are prevented from damaging themselves, and a loss occurs for any other reason, the cargo interest will be covered under the insurance policy. On the other hand, where the cargo is fragile or damage is highly likely even during an ordinary voyage, insurers may be reluctant to write the risk or they may underwrite it only for a significantly higher premium.

[10] *The Cendor MOPU* at [35]
[11] *The Cendor MOPU* at [41]
[12] *The Cendor MOPU* at [46]
[13] Ibid.

Comment on the Decision of the Supreme Court in *The Cendor MOPU*

Hari Narayan[1]

Introduction

The recent decision of the Supreme Court in *The Cendor MOPU* has somewhat settled the controversy regarding the application of the doctrine of proximate cause in respect of claims falling under s 55(2)(c) of the Marine Insurance Act 1906. Under the 1906 Act, the insurer is not liable for any loss caused by inherent vice. Similarly, under Institute Cargo Clauses A, cl 4.4 specifically excludes from insurance cover any loss caused by inherent vice or nature of the subject matter insured. Thus disputes often arise as to what is the proximate cause of the loss; whether it is the perils of the sea or the excluded peril of inherent vice. The Supreme Court has given a quietus to the above issue by holding that the defence of inherent vice cannot be applied if the proximate cause of the loss is due to an external fortuitous act. In other words the defence of inherent vice can be raised only if the cause of loss emerges from within the subject matter.

Factual matrix

The subject matter of the insurance, a jack-up rig was covered under the ICC (A) for 'all risks', excluding loss caused by inherent vice or nature of the subject matter insured. The rig had three legs extending 312 feet into the air. Halfway through the voyage, the legs were inspected and certain repairs were effected for fatigue cracking. Thereafter the voyage was resumed. When the vessel was being thus towed on its voyage to Malaysia the starboard leg fractured initially and the other two legs also cracked subsequently and fell into the sea. The loss resulted from metal fatigue, a progressive cracking mechanism resulting from fluctuated stresses at each level. The stress was generated from the height and direction of the waves and it was common ground that the weather was as reasonably contemplated for the voyage. The loss of the legs is the subject the claim under the policy. The insurance company rejected the claim on various grounds contending inter alia that the loss was caused by inherent vice and therefore excluded from liability.

Legal issues and reasoning

The trial Court, applying the principle laid down in *Mayban General Insurance v Alstom Power Plants Ltd* [2004] 2 Lloyd's Rep 609 held that the cause of loss was the inability of the legs to withstand the normal incidence of the voyage which constituted an inherent vice and thus the insurers were held

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not liable. The Court of Appeal took a different view, holding that the proximate cause of the loss was an insured peril in the form of a 'leg breaking wave', and therefore the insurers are liable for the loss. The matter was thus taken up on appeal by the insurers before the Supreme Court.

The Supreme Court considered the issues of proximate cause, inherent vice and perils of the seas in detail before arriving at the conclusion. The Supreme Court declared that the *Mayban* case was wrongly decided as the net effect of that decision would be to defeat the very purpose of cargo insurance and against the specific provision contained under s 40(1) of the 1906 Act. Accordingly the Court held that in order to attract the exclusion of liability on the ground of inherent vice, the loss must be caused by some reason attributable to the cargo itself and not by any external fortuitous action.

Perils of the seas are defined in Rule 7 of the Schedule to the 1906 Act, which refers only to fortuitous accidents or casualties of the seas and does not include the ordinary action of the winds and waves. The Supreme Court approved the decision in *The Miss Jay Jay* [1985] 1 Lloyd's Rep 264 on the interpretation given to perils of the seas and reiterated that the word 'ordinary' describes the action and not the 'wind and the waves'. The Court gave a wide definition to 'perils of the seas' and a narrow interpretation to 'inherent vice'. It held in clear terms that if there is a loss by perils of the seas then there cannot be a loss due to inherent vice also.

The Supreme Court thus unanimously held that the proximate cause of loss, applying common sense principle was not inherent vice, nor indeed ordinary wear or tear or the ordinary action of the wind and waves, but an external fortuitous accident or casualty of the sea. Accordingly the appeal of the insurers was dismissed.

Conclusion

By the decision of the Supreme Court it has now become settled and conclusive that in order for a loss to come within the purview of inherent vice, the cause of the loss must be the cargo itself and that it would still suffer loss, irrespective of any fortuitous event. It is further clear from the judgment that inherent vice and perils of the seas cannot together be regarded as the proximate cause concurrently. The principle laid down in this decision will certainly help in identifying the true proximate cause of loss in claims raising such issues.

Melinda Holdings v Hellenic Mutual: A case comment

Ayodeji Sasegbon

In *Melinda Holdings SA v Hellenic Mutual*[1], the insured's vessel was insured by the defendant in respect of war risks. The policy specifically excluded losses arising out of: ordinary judicial process; action taken for the purpose of enforcing or securing payment of a claim; or any financial cause of any nature. Moreover, the policy contained within it a sue and labour clause which provided that it was the duty of the insured and his agents to take and to continue to take all steps as may be reasonable for the purpose of averting or minimising loss, failing which the directors of the insurer could decide to reject any claim brought by the insured against the defendant. On 24 December 2008, the vessel was arrested as security for unpaid 'court dues' owed by the owners of another vessel in relation to a pollution incident. No connection existed between the insured and the owner of the other vessel and the insured brought an appeal against the arrest. Nevertheless, more than two years after the initial arrest, the vessel remained in the custody of the Egyptian authorities. It was accepted by the defendant that the vessel was a constructive total loss, and that *prima facie* there was an insured cause of loss under the war risk policy ("capture, seizure, arrest, restraint or detainment, and the consequences thereof"). However, it attempted to avoid liability by relying on the above policy provisions.

Issues

Two issues were raised for consideration: whether, on the facts of the case, the 'ordinary judicial process' exclusion in the policy had arisen and, whether there had been a breach of the sue and labour clause (also contained within the policy). Leaving aside the former, as regards to which it was emphatically held by the trial judge, based upon the evidence presented to him, that there had been clear failures in judicial procedure such that it could not legitimately be suggested that the provision in the policy excluding the insurer's liability for "cost or expense arising out of ordinary judicial process" had been satisfied, the true significance of this case stems from certain obiter comments made by the trial judge (Burton J) in addressing the second issue put to him for consideration.

Had there been a breach of the sue and labour clause?

In answering this question Burton J sought to address a number of sub-issues which had arisen in relation to the sue and labour clause:

[1] [2011] EWHC 181 (Comm)

The proximate cause rule

In *State of Netherlands v Youell*[2], Phillips LJ made it clear that an insured could not be found in breach of his statutory obligation to sue and labour unless the breach was the proximate cause of the loss. The Court of Appeal in *The Aliza Glacial*[3] subsequently extended this interpretation to cover contractual sue and labour clauses worded in similar terms to the duty in s 78(4) of the Marine Insurance Act 1906. In delivering its judgment, no mention was made by the Court of Appeal of the conclusions which had been reached in *The Grecia Express*[4], a case decided a month prior. In that case, Colman J had taken the view that, as he was dealing with a contractual condition[5] and not s 78(4),

> its construction is at large and does not need to be identical to that of similar words in the statute, unless there is some compelling reason for the meanings to coincide.[6]

On this basis it had been held that the proximate cause interpretation did not apply to the contractual sue and labour clause. In *Melinda Holdings*, despite it being argued by counsel for the insured that the Court of Appeal trumped Colman J. this simplistic way of approaching the inconsistency was promptly rejected by Burton J. In particular he noted that, as compared with the clause under consideration in *The Aliza Glacial*, both the clause with which Colman J had dealt and the one which formed the basis of the dispute before him contained an extra sentence which conferred a discretion on the Directors of the insurance company to reject a claim in the event of a breach of the contractual duty to sue and labour. Although in *The Grecia Express*, Colman J had not made express reference to this extra sentence, counsel for the insurers in the case before Burton J argued that its presence did indeed make all the difference.

As they explained, whereas, if there is a breach of the sue and labour clause, it is understandable for the courts to interpose a proximate cause provision, thereby protecting an insured against the rigours of loss of cover, this is not necessary where the situation is covered by an express provision, namely an agreement in the contract that the directors may then exercise a discretion. Therefore, the effect of this express provision, it was claimed, is to take the place of the proximate cause test. Burton J, despite expressly recognising the strength of this submission, went on to comment that, because, in the instant case, there had been no breach of the contractual sue and labour clause, this was an issue which he did not need to resolve. However, he explained *obiter* that had there been such a breach, he would have concluded that

> on the face of it, there would be a discretion for the directors to consider but…if the breach were such that no reasonable board of

[2] [1998] 1 Lloyd's Rep 236
[3] [2002] 2 Lloyd's Rep 421
[4] [2002] 2 Lloyd's Rep 88
[5] Rule 3.14 of the then current Hellenic Rules
[6] *The Grecia Express* at page 160.

> directors could have relied on it to oust or limit recovery, [the insurers would not be allowed to do so].[7]

The effect of such an approach is that, whilst any discretion afforded by a contractual sue and labour clause will take the place of the proximate cause rule, in a roundabout way the rule, as manifested within the test of the reasonable board of directors, would remain applicable to such clauses. In other words, it is at least strongly arguable that a breach of a contractual sue and labour clause which is not the proximate cause of the loss suffered would not be relied upon by a reasonable board of directors to oust or limit recovery.

Agents referred to in a sue and labour clause

It was contended by Counsel for the insured, drawing on Phillips LJ's judgment in *State of Netherlands v Youell* , that the reference to 'agents' in the sue and labour clause, whose failure would render the shipowner in breach of obligation, did not include the Egyptian lawyers employed to secure the release of the vessel arrested by the Egyptian authorities but merely those agents to whom the shipowner had delegated for the purposes of a maritime adventure, i.e. the Master and the crew. As such, it was argued that, even if Burton J held that there were failures on the part of the Egyptian lawyers, the sue and labour clause was not breached so long as the insured could show that it had properly selected adequately qualified lawyers.

Advancing an alternative argument in support of this proposition, counsel for the insured referred to the express mention, in Rule 39 of the Hellenic Rules, of the power to appoint and employ "lawyers, surveyors or other persons for the purpose of dealing with any matter which may give rise to a claim by an Owner upon the Association" which, they submitted, suggested that lawyers are not intended to be covered by references to agents within the policy. Satisfied that, even if the insured *was* responsible for the failings of their Egyptian lawyers, no such failing had occurred, Burton J did not need to resolve this point. Significantly, however, he commented that, had he been obliged to do so, he would not have been persuaded by the reference to Phillips LJ's judgment, noting that in *State of Netherlands v. Youell*, despite having reached the same conclusion on the facts, Buxton LJ had disagreed with his approach to the interpretation of 'agency' for the purpose of suing and labouring. Moreover, commenting on the "possible comparability of cases as to mitigation of loss", Burton J claimed that he would have found it difficult to be persuaded by the alternative argument advanced by counsel for the insured.

It is highly unfortunate that the facts of this case did not necessitate that Burton J resolve the difference in approach to the interpretation of 'agency' which had been apparent in *State of Netherlands v. Youell*. However, it is noteworthy that he seemed prepared to dismiss Phillips LJ's restrictive approach, the logic behind which he described as 'subtle'. In light of Burton J's comments, and of Buxton LJ's refusal to endorse this restrictive approach, it seems unlikely that in future cases it would be considered correct to say that

[7] At [49]

'agency' for the purpose of suing and labouring is limited to the individuals to whom the shipowner has delegated for the purpose of a maritime adventure.

Applying the test in The Talisman

Having established that there was no need to resolve the issues raised as to whether a breach of a contractual sue and labour clause is required to be the proximate cause of the loss suffered, and whether the Egyptian lawyers employed by the insured could be regarded as their agents, Burton J set out to explain why he was of the opinion that there had been no breach of the sue and labour clause. Applying the standard of the 'ordinarily competent person', which he drew from the decision of the House of Lords in *The Talisman*[8], Burton J recognised that, in order to find that there had been a breach, he would have to conclude that any ordinarily competent Egyptian lawyer would have acted differently. He went on to comment that this test would include what should have been done "in all the circumstances" and, as such, it would be necessary to consider whether any other suggested action would have had any realistic prospect of success in achieving a different result. After considering, in great detail, the steps which it had been suggested ought to have been taken, Burton J concluded that 'any alternative course would have made no difference whatsoever to the outcome' and that the actions of the Egyptian lawyers had been entirely competent such that they satisfied the test in *The Talisman*.

Conclusion

Despite the fact that Burton J was not required to resolve a lot of the issues raised in relation to the sue and labour clause, he *did* make some highly significant obiter comments when considering whether a breach of a contractual sue and labour clause is required to be the proximate cause of a loss and, whether the insured's Egyptian lawyers could be regarded as their agents for the purpose of suing and labouring. As regards the former, it is now at least arguable, following Burton J's comments in *Melinda Holdings*, that any discretion afforded by a contractual sue and labour clause will take the place of the proximate cause rule. However, this discretion is not absolute and is subject to the test of a reasonable board of directors. As such, it could very much be argued that the proximate cause rule will manifest itself within this test, and would remain applicable in this way. It is also noteworthy, in relation to the issue of agency for the purpose of suing and labouring, that Burton J seemed prepared to dismiss the restrictive approach adopted by Phillips LJ in *State of Netherlands v Youell*. In light of Burton J's comments in this regard, and of Buxton LJ's refusal in that same case to endorse Phillips LJ's approach, it seems unlikely that in future cases it would be considered correct to say that 'agency' for the purpose of suing and labouring is limited to the individuals to whom the shipowner has delegated for the purpose of a maritime adventure.

[8] [1989] 1 Lloyd's Law Rep 535

Masefield AG v Amlin Corporate Member Ltd
Case Comment

Karishma A. Galliara

Introduction

The recent decision of the Court of Appeal in *Masefield AG v Amlin Corporate Member Ltd*[1] is probably one of the first to comprehensively consider the impact of piracy on marine insurance and to reiterate the status of ransom payments in English Law. With piracy increasingly posing a menace to the shipping industry in general and a hindrance to the economic efficiency of shipping operations in particular, it is common ground that hull and cargo interests would be looking towards their respective insurers to make good any loss caused by piratical seizures. In this context, the decision certainly goes some distance in clarifying aspects pertaining to recoverability of the assured under its marine policy.

The present case comment sets out, the factual circumstances of the decision along with the rationale for the decision itself and further attempts to highlight the issues left unanswered therein, before concluding that this decision, although a significant recent development in marine insurance law, should be regarded as one decided in a specific factual matrix and as only the tip of the iceberg when it comes to truly analysing the intersection of marine insurance and piracy.

Facts

The vessel *Bunga Melati Dua* was carrying the appellant assured's cargoes of biodiesel on a voyage between Malaysia and Rotterdam when she was captured on 19 August 2008 in the Gulf of Aden by Somali pirates and taken with her crew into Somali coastal waters. Negotiations for seeking release of the vessel, crew and cargoes were commenced almost immediately by the vessel's owners and although the assured was not a party to these negotiations, it was kept informed of the progress of the negotiations as well as of the possibilities of recovery, from time to time.

The cargo had been insured with the respondent insurers, the insurance covering loss by both piracy and theft. Almost a month after the piratical capture, whilst negotiations for release were continuing, the assured served a notice of abandonment on the insurers. Though the notice was rejected, proceedings were by agreement deemed to have been commenced on the date of tender of the notice of abandonment. Meanwhile, about 11 days later, the

[1] [2011] EWCA Civ 24

vessel, her crew and cargoes were released on payment of a ransom of US $2 million by the shipowner.

The insured cargo subsequently arrived at the contractual port of discharge on 26 October 2008 and as a result of the delay in arrival, missed its market which had closed towards end of September. When the cargo was sold in the following year, it fetched a price considerably less than its insured value. The assured therefore claimed a sum of about US$7 million under the policy for total loss of the cargo, the sum being the difference between the insured value of the cargo and the amount realised on sale thereof.

Given the fact that an economic loss could not be recovered under the policy, the issue was as to whether the assured had a valid claim for total loss of the cargo on the date of tender of the notice of abandonment to the insurers.

The first instance decision

At first instance, the assured sought to base its claim on both actual and constructive total loss, the contention being that an actual total loss, under s 57(1) of the Marine Insurance Act 1906, occurred immediately on capture of the vessel by the pirates and *in arguendo*, that there was a constructive total loss of the cargo under s 60(1) of the Act, the cargo having been reasonably abandoned by the assured on account of its actual total loss appearing to be unavoidable.[2]

Mr Justice Steel at the High Court held in respect of the submission pertaining to actual total loss that an assured was not irretrievably deprived of property if it was legally and physically possible to recover it, however difficult or expensive such recovery may be. Since, on the facts, the assured was kept updated on the status of the negotiations, and it was aware that the cargo would be recovered, it could not be said to be irretrievably deprived of the insured cargo. As for the submission on constructive total loss, Steel J held that in light of the assured's knowledge of prospects of recovery of the cargo, the subject matter insured had not been abandoned on account of its actual total loss appearing unavoidable.

Steel J having dismissed the claim on both grounds, the assured appealed, this time confining its claim to actual total loss only.

The contentions

The assured sought to support its claim on two grounds—(a) the capture by pirates immediately resulted in an actual total loss of the cargo; (b) the possibility of recovery against payment of ransom ought not to be considered since payment of ransom could not be regarded as truly legitimate. Therefore,

[2] It may be noted here that the policy, on its wording, excluded from its scope recovery for constructive total loss on the basis of ***unlikelihood of recovery*** of the subject matter insured, which forms a part of s 60(2) of the Marine Insurance Act 1906. Therefore, insofar as constructive total loss was concerned, it was only open to the Assured to argue such loss on the basis of s 60(1).

since the cargo had not been recovered by the time proceedings were deemed to have been commenced, the assured was entitled to succeed.

The insurers on the other hand contended that the statutory test for an actual total loss was proof by the assured that it had been 'irretrievably deprived' of the subject matter insured as per s 57(1) of the 1906 Act which connoted a physical or legal impossibility of recovery. Given the fact that there was a very strong probability of the cargo being recovered against payment of ransom, the test of s 57(1) had not been satisfied. Furthermore, the payment of ransom, per se, was not illegal under English law and hence could be taken into account to ascertain the prospects of recovery.

The assured subsequently accepted that payment of ransoms was neither illegal nor against the public policy of England. However, it was submitted that given the fact that payment of ransom was undesirable on a moral plane, recovering property against payment of ransom could not be justifiably said to be part of the assured's duty to preserve property from loss under s 78(4) of the 1906 Act. Therefore, if there was in fact no duty to pay ransom, and if the only way of recovering the property was by payment of ransom, then the property could be considered as having been irretrievably lost.

The appellate decision

The decision of the Court of Appeal hinged broadly on two grounds.

Actual total loss of the subject matter insured did not ensue immediately on a piratical capture

Lord Justice Rix, who gave the leading judgment, agreed with Steel J at first instance that the test for 'irretrievable deprivation' as a means to ascertain an actual total loss was to determine if it had been physically and legally impossible for the assured to recover the property insured. Once the vessel with its cargo had been captured by pirates, it could not be said that an actual total loss of the cargo ensued immediately since the property insured was being held by the pirates against a demand for ransom and as soon as this demand was met, it was common ground that the property would be released. In this regard, Rix LJ observed, at [56]:

> piratical seizure in the circumstances of this case, where there was not only a chance, but a strong likelihood, that payment of a ransom of a comparatively small sum, relative to the value of the vessel and her cargo, would secure recovery of both, was not an actual total loss. It was not an irretrievable deprivation of property. It was a typical "wait and see" situation .... There is no rule of law that capture or seizure is an ATL.

Rix LJ went on to observe that it could be possible for a piratical seizure to amount to an actual total loss in a circumstance where the pirates intended to escape with their prize for their own use and there was no prospect of ever recovering the vessel or her cargo, but where there was a possibility of recapture, even such a seizure would not give rise to an immediate actual total loss.

In fact, it appears that according to Rix LJ, so strong was the possibility of recovery of the cargo against payment of ransom, that, in what seems to be an *obiter* observation, he stated that the facts would not even have supported a claim for a constructive total loss, for the test of that was unlikelihood of recovery. [3]

Where the assured sought to contend loss by theft as an alternative ground of claim, Rix LJ noted that the assured was still required to satisfy the requirement of 'irretrievable deprivation' under s 57(1) of the 1906 Act to establish that it had suffered an actual total loss as a result of the theft. Since this requirement had not been satisfied, the alternative submission also stood rejected.

Legitimacy of ransom payment

The Court of Appeal, on this ground as well, upheld Steel J's view that payment of ransom was not contrary to public policy and hence, could be taken into consideration for ascertaining the prospects of recovery from pirates.

Rix LJ observed that payment of ransom was in fact not illegal under English law, given that there was no legislation outlawing it and instead there were authorities like *Royal Boskalis Westminster NV v. Mountain*[4] that held (albeit *obiter*) that ransom payments could be recoverable as sue and labour expenses. Moreover, it was observed that though there was no clear consensus on such matters, the opinion on this issue being divided in *Royal Boskalis* itself, there was no evidence before the Court of ransom payments being illegal anywhere in the world. This was despite the realisation that ransom payment could be said to encourage the incidence of piracy for the purposes of exacting more ransoms.

The apparent discomfort of the Court in declaring payment of ransom illegal was evident in Rix LJ's observation that there was an 'unexpressed complicity' between the pirates, the world of commerce, and the world of government and that in these 'morally muddied waters', there was no universally recognised principle of morality, no clearly identified public policy, no substantially incontestable public interest, which could lead the courts to declare payment of ransoms as illegal.

Finally, as regards the assured's submission that because there was no duty to pay ransom under s 78(4) of the 1906 Act, a piratical seizure which could be ended only by the payment of a ransom must be regarded as though it provided no prospects of recovery at all, thereby fulfilling the test of an actual total loss, the Court observed that this was a non sequitur. Rix LJ stated that "the fact that there may be no duty to make a ransom payment did not turn a

[3] At [56]
[4] [1999] QB 674

potential total loss which may be averted by the payment of ransom into an actual total loss" and that in any event, all such questions of reasonableness were pertinent to constructive total loss, not to actual total loss. In other words, Rix LJ held that occurrence of an actual total loss was a matter of fact and did not depend upon whether the assured was or was not obliged to pay ransom for recovery of the property insured.

In conclusion, Rix LJ observed that the Court was not concerned with the consequences of a failure to pay a ransom since in the instant case, ransom was paid by the shipowner and the vessel along with her cargo had in fact been released. With respect to the element of causation in s 78(4), it was observed that the function of s 78(4) had been limited to the question of causation, in rare cases where negligence or misconduct could be said to break the chain of causation between the peril and the loss[5] and that there had apparently been no example of s 78(4) providing insurers with a defence to a claim since 1906.

The assured's appeal was therefore dismissed.

The unanswered issues…

In the wide discussion fuelled by this case, right from its inception to the final dismissal of the appeal by the Court of Appeal, it has been consistently observed that the decision, both at first instance and at appeal, reflected a market understanding of the issues raised by piracy. The judgment confirmed that a piratical capture did not immediately result in an actual total loss of the property captured and clarified the status of ransom payment as being neither illegal under English law nor against the public policy of the State, partly relying on the findings of a report of the House of Lords European Committee in respect of Somali piracy, entitled *Combating Somali Piracy: the EU's Naval Operation Atalanta*, while doing so.

The significance of this decision however lies, more than the issues it resolved, in the issues it raised through fleeting references to the same, the unanswered questions being left behind partly by constraints created by the merits of the case and partly by what appears to be the reluctance of the Court to delve deeper into legal and moral principles apparent in the case, especially when there seemed to be a straight answer on the merits.

Firstly, the Court of Appeal clarified that pirates were not classified as terrorists and that it may be that the position with regard to terrorists would be different. It is submitted that this is a pertinent observation in light of the fact that though there has been no evidence brought forth so far linking piratical activities to terrorism, it is not entirely improbable for such a link to surface in the near future. To bring forth evidence confirming an established suspicion that the proceeds from ransoms collected by the pirates could be channelled into terrorist activities or towards fuelling the ensuing state of civil war in Somalia, at the very least, would then only be a short step, before re-examining this question in a new light.

[5] *State of the Netherlands v. Youell* [1998] 1 Lloyd's Rep 236

Secondly, the Court of Appeal seemed to have brushed aside the need to definitely decide whether payment of ransom could be said be a part of the assured's duty to sue and labour under s 78(4) of the 1906 Act, by holding that whilst there is no duty to pay ransom, there is also no obligation to not pay ransom. The position thus expounded by the decision was this: payment of ransom is neither illegal nor against the public policy of England. All the same, the assured has no duty as such to pay ransom in the event of a piratical seizure. However, where the property insured could be recovered by payment of ransom, the court would be unprepared to recognise either actual total loss (on account of the 'irretrievable deprivation' test) or constructive total loss (based on the 'unlikelihood of recovery' test, as is apparent from the *obiter* comment of the Court of Appeal in this regard, as mentioned above). This would imply that in a case where the assured chooses to not pay ransom, while a court would be ungracious towards an insurer trying to avoid the policy on grounds of the assured's failure to sue and labour (by paying ransom), it is possible that it would be equally reluctant to recognise a loss under the policy if the ransom demanded was a relatively small sum and could have been easily paid. The anomaly in principle that thereby seems to arise was unfortunately never ironed out by the Court of Appeal because it categorically refused to elaborate on the consequences of non-payment of ransom since, on the facts of the case, it was not concerned "with the consequences of a failure to pay a ransom". In the instant case, the assured was not even party to the negotiations with the pirates, the ransom was ultimately paid by the shipowner, the vessel and the insured cargo were released within a few months of the capture and the loss sought to be recovered by the assured was in effect an economic loss attempted to be disguised as a loss within the policy cover. It is submitted that these facts probably justifiably disincentivised the Court from deciding on this issue as a matter of principle.

Thirdly, with regard to the aspect of causation arising under s 78(4), it is submitted that it could be possible, as stated above, that where the property captured was lost due to non-payment of ransom, the Court would have been reluctant to hold that the assured was disentitled from recovering on its policy owing to a failure to sue and labour under s 78(4), given the apparent discomfort it faced, in any event, to acknowledge the moral vis-à-vis the legal status of ransom payment. However, the Court in this case refused to take this step.

Finally, in the light of President Obama's executive order of 13 April 2010, the decision's ascertainment of the English position that ransom payments are not contrary to public policy raises an immediate concern for the need to develop international uniformity on an issue of such global significance, more so due to possibilities of American cargo (or hull) interests insuring in the London market, insurers in the London market seeking reinsurance with American insurers or English insurers seeking to reimburse ransom payments made by the assured as sue and labour expenses, wherein the payments may be channelled through New York.

Conclusion

The surge of piratical acts is an unwelcome development in modern day shipping operations. With insurers looking to offer risk mitigation strategies to their assureds through provision of private security on vessels transiting high risk areas as part of an additional piracy cover, it unfortunately seems that this unwelcome development could be here to stay for some time. While the Court of Appeal in *Masefield* did address issues pertinent to the context of the case, the exact implications of piracy on marine insurance remain to be expounded more completely. At the heart of the matter will therefore lie the need to resolve the legal-moral conflict surrounding ransom payments whilst examining the consequences of non-payment of ransom on the ability of an assured to recover on its policy as well as the necessity, in the broader context, of developing a uniform global policy on the legal status of ransoms. On a slightly different note, given that public international law recognises piracy as a crime with universal jurisdiction for its trial, it should certainly not be surprising to expect 'universality' in treatment of its economic and legal implications on parties involved in the marine adventure. The decision in *Masefield v. Amlin* could then only be the beginning of the attempt by law to come to terms with the repercussions of piracy, at least insofar as the insurance ramifications thereof are concerned.

Court of Appeal Reviews the Doctrine of Actual Total Loss and Legality of Ransom: *Masefield AG v Amlin Corporate Member Ltd* [2011] EWCA Civ 24

Lyn Seo

The facts

The claimant and appellant was Masefield AG, the owner of two parcels of biodiesel and the insured under a cargo policy on Institute Cargo Clauses (A) terms covering loss by piracy. The cargo was carried by the vessel *Bunga Melati Dua*, and the voyage was from Malaysia to Rotterdam. On 19 August 2008, the vessel was seized by Somali pirates in the Gulf of Aden. The defendant and respondent was Amlin Corporate Member Ltd, the insurer of the cargo.

Negotiations for the payment of a ransom for the release of the vessel, her crew and cargoes were commenced promptly by the owner of the vessel, MISC. On 18 September 2008, the claimant sent a notice of abandonment which was rejected by insurers. On or around 29 September 2008, the payment of ransom was made, and the vessel and the cargoes were released. The voyage was completed on 26 October 2008.

The claimant, at the outset, argued that upon capture there was an actual total loss of the cargo because the event resulted in the insured being irretrievably deprived of its possession; s 57 of the Marine Insurance Act 1906. Alternatively, it was contended that there had been a constructive total loss in terms of s 60(1), since the cargo was reasonably abandoned on account of its actual total loss appearing to be unavoidable. Furthermore, they alleged that the payment of ransom could not be a factor to determine the irretrievable deprivation, since it was undesirable from the point of view of public policy.

The Judgment at first instance

The High Court considered three issues; (1) whether or not the capture of the cargo by the pirates was an actual total loss in spite of the possibility of recovery by the payment of ransom, (2) whether the aforementioned event could be considered a constructive total loss and, (3) whether or not the payment of ransom was made in breach of public policy.

Mr Justice Steel rejected all of the claimant's arguments on the following reasoning.

(1) As for whether the cargo had been an actual total loss, the judge considered that in the light of the evidence, the claimants must be taken to have been aware that the cargo was likely to be released following negotiations and the

payment of a ransom. Therefore, the claimant was not irretrievably deprived of the cargo because the cargo was going to be recovered at a later time.

(2) Further, it was held that the cargo had not become a constructive total loss even though notice of abandonment had been served because the precondition for a constructive total loss in the sense of s 60 of the 1906 Act was not just a notice of abandonment, but the abandonment of any hope of recovery. Again, the cargo was expected to be restored to the possession of claimants. Accordingly, the case for a constructive total loss was not made out.

(3) The payment of ransom was not a breach of public policy under English law.

Judgment of the Court of Appeal

Test of actual total loss

In the Court of Appeal, Lord Justice Rix discussed several old authorities on actual total losses, demonstrating the strictness of the test. He particularly considered two authorities, namely *Panamanian Oriental Steamship Corporation v. Wright* [1970] 2 Lloyd's Rep 365 and *Fraser Shipping Ltd v Colton* [1997] 1 Lloyd's Rep 586. Citing these authorities, Rix LJ held, upholding Steel J's judgment, that the assured is not irretrievably deprived of property unless it is physically and legally impossible to recover it; even if such recovery needs extraordinary effort and expenses.

Irretrievable deprivation of possession – piracy and capture

The assured's claim was that the capture by pirates operated in and of itself as an actual total loss. Furthermore, it is not the claimant's duty to provide unreasonable measures to recover the subject-matter. The argument depended on the authority *Dean v. Hornby (1854) 3 El & Bl 180*. In that case, where the vessel was captured by pirates and recaptured by an English warship afterwards, the court unanimously held that a capture by pirates would be a total loss.

Furthermore, the authority *Stringer v. The English and Scottish Marine Insurance Company, Limited* (1869) LR 4 QB 676, (1870) LR 5 QB 599 was cited. The court in that case held that the assured had a right to elect to abandon the subject-matter insured to the underwriters and claim for total loss where the subject-matter was captured and sold by order of the Prize Court. In *Kuwait Airways Corporation v. Kuwait Insurance Co SAK* [1996] 1 Lloyd's Rep 664, the judge held that in a case of capture, because the intent is from the first to take dominion over a ship, there was an actual total loss straightaway, even though there later be a recovery.

Rix LJ nonetheless distinguished these authorities and explained why he was not convinced by the claimant's contentions. First, his understanding of *Dean v. Hornby* was that it related to constructive total losses, not actual total losses. Moreover, even though the loss in *Dean v Hornby* could be regarded as an actual total loss, there was not any opportunity for the cargo owner to take steps for the recovery of the possession. He went on to say (at para 33):

> In particular in a case where there was no issue as between ATL and CTL, and no prospect of recovery from the pirates by means of a ransom (the recapture was merely serendipitous), this hardly seems to be the firm authority in the assured's favour that [the claimant] would seek to make of it.

The *Stringer* case is rejected on similar reasoning. Finally, Rix LJ expresses the opinion that in marine cases, capture by pirates is not an irretrievable deprivation of property such as required for an actual total loss to be at hand, because it is a situation where a "wait and see" test would apply.

As for the payment of ransom, applying the case *Royal Boskalis Westminster NV v. Mountain* [1999] QB 674, Rix LJ stated that ransom payments could be recoverable as suing and labouring expenses. Furthermore, he pointed out that this expense in this instance was paid by the shipowner and not by the claimant. For these reasons, the appeal was dismissed.

Comments

Once a vessel is captured by pirates, various parties are compelled to concentrate on the recovery of their losses. Generally, it is shipowners and their underwriters who have suffered the most problems so far. It is usually shipowners who have paid the ransom with a view to the release of the vessel and cargo. This case demonstrates that there is another point of view namely that of the cargo owner.

Test of actual total loss

In marine insurance cases, the court has a tendency to interpret the concept of irretrievable deprivation of the subject-matter narrowly. This is due to the concept of constructive total loss, which is unique to the law of marine insurance. The two separate concepts of total loss in marine insurance seem to compel the court to retain a balance between marine and non-marine cases, when the issue of total loss arises. As Mocatta J said in *Panamanian Oriental Steamship Corporation v. Wright*, the test of actual total loss is clearly far more severe than the test of constructive total loss. Contrary to the test of constructive total loss, the court expressed the view that no matter how much the effort and expense must be required to recover the subject-matter, it does not give any effect to assess the actual total loss. Therefore, the irretrievable deprivation can be defined as the physical and legal impossibility of recovery.

Piracy and capture

Where the subject-matter insured is seised by pirates, the question is whether or not the actual total loss is accomplished by means of the capture itself. The court did not accept actual total loss by the capture in itself, since at all times it appeared likely that the cargo would be released subject to the payment of ransom. This is based on the "wait and see" test which the court extracted as a criterion to examine the total loss situation from *Kuwait Airline Corporation* (*supra*). A total loss depends on the fact of whether or not or at which stage permanent dispossession occurs. Following this test, the capture by piracy seems not to be a fact from which the permanent dispossession arises. This was supported by the expert evidence, which indicates that the intention of these particular pirates is to receive money in return for the vessel or cargo. This point is important because the Court of Appeal distinguished the capture by terrorists or enemy as prize with the political purpose shown in the *Kuwait Airline Corporation*. Comparing to these captures, the event of the capture by pirates carries a higher expectation of recovery of the subject-matter. In the light of the statutory test of actual total loss, namely impossibility of recovery, the Court, with respect, was correct to consider this a question of fact. Although this case revolved around the interpretation of the ICC(A), the same standard would apply equally to claims under a hull and machinery policy.

The Court of Appeal did not consider constructive total losses. This issue was not pursued by the claimant on appeal, because there was a special constructive total loss clause in the policy, namely cl 13 of the ICC(A) pursuant to which deprivation of possession in a situation where recovery is unlikely does not qualify as a constructive total loss. Without cl 13, if a constructive total loss by capture by pirates is to be made out, there must be an unlikelihood of recovery under s 60(2)(i)(a). In other words, the scope of constructive total loss under the 1906 Act is wider than that of actual total loss which requires not just unlikelihood of recovery but irretrievable deprivation.

It is not settled by *Masefield v Amlin* whether or not a claim for a constructive total loss could have be made out, absent cl 13. However, available evidence on trends of piracy illustrates that recovery of possession is to be expected, usually by the payment of a ransom. Under the “wait and see” test, this fact would be unlikely to meet the unlikelihood of recovery because (1) pirates are assumed not to intend to possess the vessel or cargo in question, (2) the negotiation and the ransom payment would, in most cases, provide a high probability of recovery of the subject-matter. Accordingly, even if cl 13 were absent in this case and the claimant raised the issue of constructive total loss, the court would be unlikely to determine that unlikelihood of recovery were at hand. It may supply a good argument against assureds, possessing a cargo policy without a constructive total loss clause.

Also, the court was not concerned with the consequences of a failure to pay a ransom. This was owing to the fact that the shipowner had already paid. However, it does call into question whether the failure to pay a ransom can give rise to an actual total loss and if so, at what stage the actual total loss can be said to have occurred. In general, two situations can be envisaged. The first is that the amount of ransom is so high that the concerned party gives up the payment. This case has been explained above. The other is that the subject-matter including vessel or cargo was captured for the usage of pirates. Although there has been no authority as yet, it could be the one of the typical events of capture which irretrievably deprives the assured of his possession of the subject-matter.

As for the question as to at what stage an actual total loss takes place in a “wait and see” situation, *Scott v. Copenhagen* provides some authority. In the event of a capture subsequent to the destruction of the subject-matter, Rix J, in this case, held that there was an actual total loss only at the time when the subject-matter was destroyed. Therefore, actual total loss will be determined at the point when the impossibility of recovery is obvious.

Legality of ransom and recoverability by suing & labouring clause

One of the merits in this case is that it raises the issue of payment of ransom. It is now a critical issue due to the significant increase of piracy matters. Accepting the ratio of *Fender v St John-Mildmay*, the court said the breach of public policy should be invoked only if the damage to the public was substantially certain. Aside from the above, there is no legislation which lays down the effect of ransom. But the payment of ransom has historically been accepted by statutory and common law. Thus the Ransom Act 1782, which was repealed in 1981, stipulated that only ransoms in respect of UK ships taken by enemies was outlawed. As for the common law basis, *Royal Boskalis* provides authority for the legality of ransom payments. It is therefore reasonable that the payment of ransom to pirates is legal.

Firstly, as noted by Rix LJ, pirates are not classified as terrorists. As far as the matter related to pirates is concerned, it can be discussed without the influence of the international anti-terrorism consensus which assumes that negotiation with terrorists may be a breach of public interest. Secondly, common practice in captures by pirates is that if lives and property can be saved by paying sums at a level that the shipowner can tolerate, they are willing to pay. This is well illustrated in the recent Report of the House of Lords European Committee in respect of Somali piracy. In consequence, the report said as follows:

> There is no universally recognized principle of morality, no clearly identified public policy, no substantially incontestable public interest, which could lead the courts, as matters stand at present, to state that the payment of ransom should be regarded as a matter which stands beyond the pale, without any legitimate recognition.

Rix LJ appears to have relied on this report to explain the legality of ransom payments.

Conclusion

In the market, measures have been introduced to resolve problems arising out of pirate attacks. In reality, the kidnap and ransom (K&R) policy, designed specially to deal with ransom payments, has been welcomed by assureds who run potential risks of encountering pirates. The decision of the Court of Appeal gives positive signals to these market practices by giving legal support into them.

As a rule, the attack or capture by pirate unavoidably results in losses by delay in trade. Given that losses by delay are usually excluded from the insurance policy, one of the assured's options when capture happens is to seek the insurance money by claiming a total loss from the moment of capture. This case seems to start on the basis of this assumption. Against this approach, the decision indicates that if the subject-matter insured can be released in return for the payment of ransom, this would be a typical "wait and see" situation, where the determination of an actual total loss would be subject to further circumstances.

It is to be welcomed that the court considered not only the authorities so far, but also the current situation of pirates from the expert evidence and the Report of the European Committee of the House of Lords in respect of Somali piracy. Having insight into the trend of pirate activity, the Court can distinguish the peril of piracy from other forms of capture such as by terrorists or enemies.

Loss Proximately Caused by Piracy under ICC (A) Clauses, the Legality of Ransom Payments and their Recoverability as Sue and Labour Charges: *Masefield AG v Amlin Corporate Member Ltd (The Bunga Melati Dua)* [2011] EWCA Civ 24

Louise Lazarou

The Facts

The *Bunga Melati Dua*, a large oil tanker, was captured by Somali pirates whilst sailing through the Gulf of Aden on 19 August 2008 during a voyage from Malaysia to Rotterdam. The vessel was carrying two parcels of biodiesel fuel belonging to the appellant insured, Masefield AG, who brought a claim against the cargo insurers, Amlin Corporate Member Ltd, for the total loss of the cargos on the grounds of an actual total loss and alternatively a constructive total loss caused by the piratical seizure of the carrying vessel. Negotiations between the pirates and the shipowners, MISC, commenced promptly to ensure the release of the vessel, her crew and cargo. On 18 September 2008 the insured cargo owners served a notice of abandonment on the insurers claiming irretrievable deprivation of possession. The notice was rejected, but proceedings were by agreement deemed to have been commenced on that day. The vessel was released eleven days after the notice of abandonment was served on payment of a ransom of US $2 million by MISC.

The court considered a number of significant legal issues that spring from a piratical capture of a vessel. The Court of Appeal addressed whether the insured suffers any loss and the type of that loss, the legality of ransom payments in regards to public policy and their recoverability in the context of sue and labour expenses and, finally, the relationship between piracy and maritime theft in the law of marine insurance. The decision offers helpful guidance both to cargo owners and shipowners who may find themselves in the unfortunate predicament of their vessels and cargos being hijacked by pirates. This article looks at the Court of Appeal's consideration of the law of marine insurance in regards to claims arising from the capture of an insured vessel and her cargo by pirates.

The claims

The risk was written under the Institute Cargo Clauses (A), an all risks standard policy containing a war exclusion clause excluding “capture, seizure, arrest, restraint or detainment (piracy excepted)”. The insured cargo owner claimed deprivation of possession of the cargos, due to the capture of the carrying vessel by pirates, which according to the insured created an immediate actual total loss proximately caused by the insured peril of piracy. Additionally to the actual total loss claim the insured also contended that the law would not, or could not, take account of the payment of a ransom as a relevant, legitimate reason for calculating the possibilities of recovery. It should be noted that the dispute arose after the release of the vessel and the discharge of her cargo which, being of a non perishable nature, had not suffered any damage. The insured's claim amounted to the sum of US $7,608,845.30 as consequential financial damages caused by delay derived from the capture of the vessel. The delay amounted to loss of the relevant market due to biodiesel being a seasonal cargo and the sum claimed included warehousing costs and market losses.

Constructive total loss

In the Court of Appeal the insured ceased to rely on the doctrine of constructive total loss of its cargos and confined the claim to an actual total loss. The court, however, while examining the authorities did consider, obiter, whether a claim for a constructive total loss could arise in circumstances where a vessel was seized by pirates. The court upon construing cl 13 of the ICC (A) Clauses considered that even though cl 13 would permit a claim for a constructive total loss when the recovery of the subject matter was unlikely, the loss, on the facts of the case, did not satisfy the second requirement of cl 13 as it did not appear to be unavoidable. Piratical capture was a typical 'wait and see' situation and the assured's arguments founded on cl 13 ICC(A) failed. The Marine Insurance Act 1906 in s 60(2)(i) sets out two requirements for the doctrine of constructive total loss to operate. Under the Act the insured must suffer deprivation of possession of the insured subject matter and there must either be unlikelihood of recovery of the seized subject matter or the costs of recovering the subject matter must exceed the value of the ship or her cargo. . The court upon construing s 60(2)(i) considered that the loss on the facts of the case, did not satisfy the requirements of s 60(2)(i) as it did not appear to be unlikely. Piratical capture was a typical 'wait and see' situation and the assured's arguments founded on the doctrine of constructive total loss failed.

The insured was deprived of constructive possession of the cargo during the time the vessel was being held by pirates in Somalia, but possession was considered as being likely to be recoverable by payment of the agreed ransom by the shipowner. Having considered past precedent and expert witness statements the Court of Appeal held that the pirates' *modus operandi* has been well established over the years as being aimed at capturing vessels and claiming ransoms with the intent to release captured vessels upon receipt of substantial ransom payments. In regards to the second requirement under s 60(2)(i), deprivation of possession due to recovery costs exceeding the value of the insured subject matter, the court found that the ransom paid by the shipowner was considerably lower than the value of the ship and consequentially a claim for a constructive total loss could no longer stand.

Actual total loss

The court having considered the law on constructive total loss of the cargo went on to consider whether a piratical capture of the carrying vessel was the proximate cause of the insured's irretrievable deprivation of constructive possession of the two parcels of biodiesel cargos. For a loss to be ascertained as an actual total loss, s 57 of the 1906 Act must be satisfied. The section provides that there is an actual total loss where the subject matter insured is destroyed, or so damaged as to no longer be a thing of the kind insured, or the assured is irretrievably deprived of possession.

On the facts of the case it is noteworthy that on 31 August 2008 the shipowner, while briefing the families of captured crew members, stated that “the ordeal will be over in 30–40 days”. A series of updates followed on the status of the ongoing negotiations. On 2 September a press release was issued confirming that the shipowner was continuing negotiations which was closely followed by a Lloyd's List report containing a statement by the secretary of the Malaysian Security Council that negotiations with the pirates were going well. The rigorous negotiations and statements confirming the satisfactory progression of the mediation that could result in the timely release of the vessel were considered by the Court as indicators of the likelihood of recovery of the ship, cargo and her crew. Hence, the insured on 19 September when proceedings were deemed to have been commenced was not irretrievably deprived of possession as the prospects of recovering the captured vessel through successful negotiations was predicted as a very likely and feasible outcome. The vessel, crew and cargo were in fact released on 29 September, less than six weeks after her capture.

The Court considered relevant authorities in order to establish whether a claim for an actual total loss arose automatically by the capture of a vessel as was contended by the insured. The argument was founded on *Dean v. Hornby*, (1854) 3 El & Bl 179 in which it was held that

> in case of capture, because the intent is from the first to take dominion over a ship, there is an actual total loss straightaway, even though there later may be a recovery.

The Court of Appeal held that there is no rule of law that piratical capture constitutes an actual total loss per se. Such a loss was to be construed on the facts of each individual case. *Dean v Hornby* was distinguished as a case referring to the capture of a vessel as a prize ship, in which circumstance title passes lawfully, whereas in piracy there is an unlawful taking of possession of the vessel. On the facts there was no loss either in the form of a constructive total loss or an actual total loss. It was considered that an actual total loss may arise in the event that the captured vessel was intended to be used by the pirates in their operations as a mother ship regardless of whether ransom was demanded or not. In such an event there would indeed be no prospect of recovery. However, where there is a chance of recovering the captured vessel no actual total loss can be claimed, let alone an automatic actual total loss dating back to the time of seizure. The court held that the test for an actual total loss should be based on whether the assured is “permanently and irretrievably deprived not only of all present possession and control over it, but of all hope or possibility of ever ultimately recovering possession of, or further prosecuting the adventure upon it” and, thus, set aside the concept of an automatic actual total loss by re-establishing the criteria of the “wait and see” method.

Legality of ransom payments and their recoverability under s 78(1) of the 1906 Act

The majority of the court did not find any legislation that rendered payment of ransoms illegal or contrary to public policy and supported this finding by the repeal of the Ransom Act 1782, which formally

> outlawed the payment of ransom in respect of British ships taken by the King's enemies or persons committing hostilities against the King's subjects, and which was repealed by section 1 of the Naval Prize Acts Repeal Act 1864.[1]

Pill LJ, however, reserved his opinion on this point by stating that

> the underlying problem of reconciling ransom payments with public policy remains and is not in my view concluded by the repeal of the Ransom Acts enacted to deal with very different circumstances.[2]

The court also considered that the new Bribery Act 2010 would not be applicable to ransom payments to pirates. The lack of any statute in English law regarding the illegality of ransom payments was further supported by dicta found in *Royal Boskalis Westminster NV v Mountain* [1999] QB 674 in which the court held that the preservation of insured property from being lost was a sacrifice the financial consequences of which could be recovered as sue and labour charges. The case concerned the payment of ransom for the release of a dredging fleet and its 479 personnel that were used by the Iraqi government as a human shield after its invasion of Kuwait. Pill LJ, dissenting in *Royal Boskalis*, considered that payments made under duress by a threat of a total loss were repugnant to English notions of legality and that payment of such sums would only serve as an encouragement to such threats. Rix LJ supported the view taken by Pill LJ but concluded that despite the fact that ransom payments may encourage further hijackings, in practice, the only successful way of recovering the vessel and her crew was by payment of ransom. As further support of the legality of ransom payments the existence of a market for kidnap and ransom insurance was briefly considered as lending support to the argument that ransom payments are not contrary to public policy. The Court of Appeal arrived at the conclusion that

> the fact that there might be no duty to make a ransom payment did not turn a potential total loss which might be averted by the payment of ransom into an actual total loss.

The insured's second claim, therefore, failed. On the facts of the case this conclusion may be deemed to be satisfactory in regards to the potential of ransom payments being recoverable under sue and labour charges. However, the ratio raises a number of questions the most prominent of which is whether the failure of a shipowner to pay ransom would amount to a breach of s 78(4) of the 1906 Act to avert or minimise damage to or loss of the insured subject

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[1] *Masefield AG v. Amlin Corporate Member Ltd (The Bunga Melati Dua)* [2011] EWCA Civ 24 at [63]
[2] *Royal Boskalis Westminster NV v. Mountain* [1999] QB 674 at p 699.

matter. Whether such a failure would be considered as a break in the chain of causation sufficient to hold the shipowner liable for breach of suing and labouring duties is a question left unanswered. Parallel to this argument it is also unclear whether an insolvent one-ship company's failure to make a ransom payment would amount to a breach of suing and labouring duties by the insured company under s 78(4). In the event of non-payment by a shipowner it is questionable whether a solvent cargo owner would be under a duty to pay ransom under s 78(4), considering that the requested amount of ransom will usually exceed the value of the cargo carried on board the captured vessel and, hence, could be construed as an unreasonable expense not covered by s 78(1).

Whether capture of a vessel equates to theft by pirates

The appellant's legal counsel argued that the hijacking of a ship, the release of which would only be realised upon payment of the negotiated ransom fell within the ambit of s 6(1) of the 1968 Theft Act. Section 6(1) provides that a person appropriating property belonging to another without meaning the other permanently to lose the thing itself is nevertheless to be regarded as having the intention of permanently depriving the other of it, if his intention is to treat the thing as his own, to dispose of regardless of the other's rights. The court considered the section briefly and rejected its applicability under a claim for an actual total loss as the requirement of irretrievable deprivation of possession was, once more, not fulfilled.

The concept of piracy as equating theft has been rejected in a number of authorities under marine insurance law which does not offer a clear definition of piracy. It is noteworthy that in the *Athens Maritime Enterprises Corp v Hellenic Mutual War Risks Association (Bermuda) (The Andreas Lemos)* [1982] 2 Lloyd's Rep 483, piracy under the law of marine insurance was differentiated from the definition of piracy under art 101 of the United Nations Convention on the Law of the Sea 1982 (UNCLOS). Article 101 UNCLOS defines piracy as any illegal act of violence or detention, or any act of depredation, committed for private ends by the crew or the passengers of a private ship and directed on the high seas, against another ship or against persons or property on board such ship. In *The Andreas Lemos* the court did not limit such acts to the geographical area of the high seas as for the purposes of a marine insurance policy if a ship is at sea, or if the attack on her could be described as a maritime offence, then the ship is in a place where piracy could be committed, even if the ship is anchored in territorial waters. The ambit of piracy is thus wider under the English common law than in international law.

Unresolved matters

Masefield AG v Amlin Corporate Member Ltd clarified the law regarding losses under the insured peril of piracy. There is hardly any doubt that a number of subsequent cases will follow the Court of Appeal`s judgment considering the surge in piratical activity since 2008 when the facts of the case unfolded. The court set the starting point for the judicial construction of claims regarding total losses proximately caused by capture of vessels by pirates. The case inevitably raises unanswered questions that remain to be addressed by further litigation in this field of law. A brief consideration follows of some unresolved issues arising from piracy as an insured peril.

It is significant that the court on the facts of the case found that a piratical seizure of a vessel did not amount to a total loss either in the form of a constructive total loss or an actual total loss. It is doubtful whether an insured benefits from this finding; however, it is interesting that piracy as an insured peril, for which the insured will pay a considerably higher premium, does not seem to give rise to any loss proximately caused by the insured peril under an all risks policy. It may be speculated that a loss does not accrue under the peril of piracy when ransom is payable for the recovery of the vessel due to the requirements of irretrievable deprivation of possession and unlikelihood of recovery not being fulfilled. It should be noted that the *Bunga Melati Dua* was relatively swiftly released by her pirate captors and that the assessment of no total losses occurring pertained to the particular facts of the case where the pirates had in the past proven themselves willing to negotiate. It remains to be seen if different factual circumstances will cause the Court's decision to be reassessed.

On the facts of the case the cargo carried on the seized vessel was not of a perishable nature. It is uncertain whether an insured loss could, in fact, occur in circumstances where the cargo carried by a captured vessel is of a perishable nature and does perish whilst the vessel is under the control of pirates. Whether such a loss would be considered a total loss proximately caused by piracy or whether it will be assessed as an uninsured loss under s 55 in the form of either inherent vice or delay is unclear. The Court of Appeal's ruling that seizure of the carrying vessel by pirates does not give rise to an immediate total loss clarifies that the occurrence of an insured loss is ultimately a question of fact based on the circumstances of each individual case. By rejecting the possibility of an immediate total loss arising upon seizure of a vessel it is submitted that an insured would, most likely, fall foul of the delay and inherent vice exclusions and thus be barred from recovering under the insurance policy for the loss suffered.

As mentioned above, a prospective failure by a shipowner to make ransom payments and the consequences that such failure may have on the insured's duty to sue and labour under s 78(4) of the 1906 Act remains to be addressed. While there has never been a case on the breach of the duty imposed by s 78(4) on the insured since the enactment of the 1906 Act, it remains to be considered whether a shipowner's potential insolvency or a cargo owner's refusal to make ransom payments, could be considered as a break in the chain of causation and thus render an insured liable under s 78(4) for proximately causing its own loss.

In regards to the assessment of the legality of ransom payments and the compliance of such payments with public policy it is interesting to note that the United States of America have adopted a different approach to this issue. Under the US Presidential Order 2010 it could be rendered illegal for US shipowners to pay ransoms to Somali pirates in order to ensure the release of their vessels. The exact purpose and applicability of the Order in regards to payment of ransoms has been debated as the Order does not provide clear wording on this point. Nevertheless, the Order indicates that the US is differentiating its stance towards ransom payments and the ambiguous wording of the Order could give rise to interesting judicial constructions on the legality of ransom payments to pirates under US law.

Since 2008, which was the year during which the *Bunga Melati Dua* was captured, piracy has escalated into a more violent activity resulting in more vessels being captured and held for substantially longer periods whilst the sums of ransoms negotiated by pirates have increased considerably. The geographical area of piratical activity continues to grow outwards from the Gulf of Aden into the Arabian Sea and the Indian Ocean and the lack of international effectiveness in addressing piracy and bringing pirates before tribunals will only give rise to more vessels being captured and more claims under marine insurance policies coming to court. Piracy may be an ancient crime but the law of marine insurance is only now beginning to be shaped in this regard and time will tell how the law in this particular area will evolve.

Section 22 of the Marine Insurance Act 1906

Vidar Våge

Section 22 of the Marine Insurance Act 1906 provides that a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy. The apparent effect of the section is that a marine insurance contract is unenforceable until a policy has been issued. It will in this comment be discussed to what extent s 22 in the 1906 Act still provides a statement of applicable law. Pertinent to the discussion will be an examination of the status of the slip and its relationship to the policy, with consideration of the Court of Appeal's judgment in *HIH Casualty & General Insurance v New Hampshire*.[1]

Slip and policy

In the traditional course of concluding an insurance contract in the London market, a slip would be issued prior to the issue of a formal policy document.[2] The slip was prepared by the broker and set out the details of the intended insurance, including the subject matter to be insured and the proposed insurance contract clauses. In the case of *Ionides v Pacific Fire & Marine Insurance Co.*[3], the court held that the insurance contract was concluded by the underwriter's signature on the slip. This contractual effect of the slip was put into statutory form in s 21 of the 1906 Insurance Act, which provides that

> A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not

The contractual effect of signing the slip has been upheld in later case law and should be considered settled beyond doubt.

The legal position of an assured where a policy has not been issued

Having established that a contract of insurance may be concluded without a policy being issued, the next issue to address is the legal position of an assured in such a situation. As the insurance contract in this scenario has not been embodied in a policy, the question is in reality whether the assured may claim on the insurance solely on the slip. According to the apparent understanding of s 22, the starting point in this situation is that only the policy may be sued upon in court.

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[1] *HIH Casualty & General Insurance v New Hampshire* [2001] EWCA Civ 735

[2] Jonathan Gilman and others, *Arnould's Law of Marine Insurance and Average*, (17th ed, Sweet and Maxwell, London 2008), page 10

[3] *Ionides v Pacific Fire & Marine Insurance Co* (1871) LR 6 QB 674

It is, however, relevant to determine whether *HIH Casualty & General Insurance v New Hampshire*[4] may alter this starting point. In this case, concerning film finance insurance, the films did not generate sufficient financial income and the claimant direct insurer paid the assured film investor accordingly. The defendant reinsurers argued that the insurer was not liable to the insured and therefore refused to pay. One of the arguments of the defendant was that the term stipulating the number of films that would be made was not a term of the policy. This was a significant term of the insurance, as without it the insurer would not be liable to pay. The Court of Appeal held that the film number term was a term of both the slip and the policy wording. Interesting in the discussion of the relationship between the slip and the policy, however, is that the Court held *obiter* that even if the term was only in the slip, and not in the policy, the term in the slip could be considered so that the assured could claim on the insurance. This could suggest that the assured, in contrast to the apparent understanding of s 22, could claim on the insurance solely on the slip. This is, however, not how the *obiter dictum* should be read. The *obiter dictum*, more correctly read, concerns the issue of making use of the slip in the construction of the policy when the wording in the slip and the policy differs. In this respect the *obiter dictum* seems to go further in allowing use of the slip than previous case law. From this point of view, as the case does not concern the situation where a policy has not been issued, it does not alter the starting point which is that is only the policy may be sued upon in court.

A related question: Does an assured need to possess the policy?

It should be noted that, as s 22 solely provides that the insurance contract is inadmissible in evidence unless it is embodied in a marine policy, it does not assist in the related question of whether the policy document actually needs to be produced for the insurance to be enforced, i.e. in the situation where a policy has been issued, but the assured for some reason is unable to produce it. This issue was decided in *Swan and Cleland's Graving Dock and Slipway Co v Maritime Insurance Co and Croshaw*[5], a case concerning payment for a salvage loss. The cost of the salvage was paid by a third party, who subsequently had been paid by the insurer. The assured sued the insurer, arguing that the payment to the third party did not discharge the insurer from his obligation to pay under the insurance contract, and therefore was liable to be paid a second time. One of the arguments of the insurer in denying their liability was that the assured was not in possession of the policy. The court, however, held that as there was no doubt that the policy existed nor that somebody else had an interest in it, the claimants were able to succeed in their claim. It was stated that "The policy may be lost, but the action can be maintained just the same if the plaintiff can prove it."[6] The approach in *Swan* was upheld in the *Eide UK Ltd v Lowndes Lambert Group*[7] case. Based on

[4] *HIH Casualty & General Insurance v New Hampshire, supra.*
[5] *Swan and Cleland's Graving Dock and Slipway Co v Maritime Insurance Co and Croshaw* [1907] 1 KB 116
[6] Ibid at p 123.
[7] *Eide UK Ltd v Lowndes Lambert Group* [1999] QB 199

these cases, the law does not require the assured to actually possess the policy in order to claim on the insurance contract; it suffices to prove that a policy has been issued.

Market practice

In the discussion of the relationship between the slip and the policy it is necessary to make two remarks in regards to market practice. These remarks do not affect the law as it is presented above, but are nevertheless important in order to fully understand the slip and policy relationship. Firstly, if a loss occurs in the time before the insurer has yet issued a policy, it will be in accordance with market practice not to plead s 22 as a defence, but allowing the insured to enforce the insurance contract by issuing a policy[8]. From a business point of view, this is rational conduct, as pleading s 22 may make potential clients choose not to do business with this insurer. Secondly, it is not yet authoritatively decided whether the slip used in the market may also constitute a policy, i.e. whether the document used as a slip will also satisfy the requirements that the 1906 Act sets forth for policies, and that a distinction between these two documents, for that reason, is needless. The academic writers are divided on this question, and it will not be pursued in this comment.

Conclusion

In conclusion, s 22 in the Marine Insurance Act still provides a statement of applicable law: a contract of marine insurance is unenforceable until a policy has been issued. However, it is not required that the assured actually possesses the policy in order to claim on the insurance contract; it is sufficient that he can prove that a policy has been issued and that there is not somebody else having an interest in it.

[8] Merkin, Robert, *Marine Insurance Legislation* (4th ed, Lloyd's List Group, London 2010) p 36

Mending Holes: Slip and Policy

Vasiliki Digoni

The Marine Insurance Act 1906 carefully distinguishes between a 'slip' and a 'policy', the borderline of which can be found in s 22. The recent judgment of *HIH Casualty & General Insurance v New Hampshire* [1] on the other hand seems to have created a strong challenge to the statutory provision. But for now, this statement is just a hypothesis. What is true is that the decision of the Court of Appeal has muddled the long-held relationship between a slip and a policy. The following discussion will first examine the two concepts and will then move on to the relative judgment of *HIH* and its role in the issue. Subsequently, the status of s 22 and its impractical (or undesirable) effect will be self-evident.

The background of the distinction between a slip and a policy

Section 22 states that 'a contract of marine insurance is inadmissible in evidence unless embodied in a marine policy'. For the purposes of this provision, the contract of insurance is formed[2] when the insurers initial the *slip* which is a summary of the risk, while the *policy* is the formal expression of that contract with, if necessary, additional relevant material bearing on the risk.

The formality requirement as enforced was in line with the stamp duty legislation[3], which rendered an unstamped insurance policy 'null and void'.[4] In turn, s 89 of the 1906 Act allowed the court to look at the slip, only if there was a 'duly stamped policy'. However, following the abolition of the stamp duty in 1970, the distinction envisaged in the 1906 Act has become more conceptual than of legal effect. It can thus be argued that even if back then the legal distinction could be said to be clear, recent developments ring a bell for a radical review of the issue.

The judgment in *HIH*

In his judgment in *HIH*, Lord Justice Rix argues that there is no binding authority to preclude one from referring to the slip when construing a policy, and for this reason it is admissible to have regard to the slip as part of the 'factual matrix'[5] of the policy itself. In developing his argument further, he submits that the 'parol evidence rule', which rejects any (oral) supplementary

[1] [2001] EWCA Civ 735 [Hereinafter *HIH*]
[2] *General Reinsurance Corp v Forsakringsaktiebolaget Fennia Patria* [1982] QB 1022
[3] Stamp Act 1795 s 22; Stamp Act 1891 s 93
[4] Stamp Act 1795 s 11
[5] Per Rix LJ, at 1485

evidence to the written document, does not preclude prior *contracts* but only prior *negotiations* of the parties. Thus, the slip being a prior contract is admissible in evidence on its own merits.

The judgment above openly contradicts the widely accepted presumption that a slip is 'a (temporary) contract superseded by the marine policy[6]'. Indeed, as Rix LJ asserts, a slip is a separate contract that provides the 'circumstances' for the later contract i.e. the policy. In essence, he reasons that since he could not find any *rule of law* that the policy has to supersede the slip, it is acceptable to use the latter contract to construe the former. Therefore, what actually matters, as he submits, is the *weight* that should be given to the slip in construing the policy. If it is common ground that the slip was intended to be superseded, the court should focus on the policy and give - if at all - relatively little weight on the slip. On the contrary, where there is no such understanding, both documents are to be considered. The strongest example of the latter situation includes a policy that is *not self-contained*: in the present case, the slip was referred to as a 'slip policy' and the policy wording itself did not include fundamental issues (eg premium). Thus, following the above considerations, Rix LJ concluded that the slip was not superseded and inferred that both documents were to be read together. Arguably, since in cases of litigation there is always doubt as to intention of the parties, the Court is always required to look at the slip to assess whether the parties' intention was that it should be superseded.

Before *HIH*

In *Warwick v Slade*[7], the court strictly applied the requirement for a formal policy. In fact Lord Ellenborough said that since a policy had not been issued he was forbidden 'to look at what was the slip'. In the same line, in *Ionides*[8] the words of Blackburn J separate the slip which is 'the complete and final contract' between the insured and the insurers from what is 'clearly a policy' and conclude that it (a slip) is 'not enforceable either at law or in equity'. However, the original slip is admissible in evidence if 'even invalid, it is material' in demonstrating the parties' intentions when they enter into the contract.

After *Ionides*, *Youell*[9] takes the issue even further: a slip is admissible in evidence to rectify a policy in line with the slip, while at the same time it is inadmissible in evidence when the policy is being construed. The decision in *Youell* certainly does not provide a straightforward answer as to the status of the slip or its relationship with the policy.

[6] Gilman J et al (2008) *Arnould's Law of Insurance and Average*, 17th ed, London: Sweet & Maxwell; p 18

[7] *Warwick v Slade* (1811) 3 Camp 127; pp 128-129

[8] *Ionides v Pacific Fire & Marine Insurance Co* (1871) LR 6 QB 674

[9] *Youell v Bland Welch* [1992] 2 Lloyd's Rep 127

After *HIH*

The Court of Appeal in *HIH* tried to resolve this uncertainty by simply holding that a slip and a policy can be read together. The preliminary point in the judgment is that the presumption that a policy supersedes a slip is rebuttable. For instance, in the recent case of *Sugar Hut*[10] the risk improvement requirements which were set out in the slip requiring the burglar alarm to be upgraded did not appear in the formal policy. Nevertheless it was held that they survived as part of the contract. It is therefore clear that his was a case in which the slip was not intended by the parties to be superseded by the policy, and so the judge had to consider both documents.

In cases where the presumption is in fact rebutted, the slip retains its contractual effect and the policy becomes 'a mere mechanical act'. Thus, in *Dunlop Heywards*[11], in giving effect to the slip Rix LJ stated that

> although the policy is the final document, there was valid agreement that the parties had become bound as soon as the slip was scratched and the drawing of the policy itself was largely a matter of administration.

If that is the recent conception of the distinction between a slip and a policy, the judgment in *HIH* seems to challenge not only the applicability but also the existence of s 22 as a whole.

Can a slip be a policy?

Acknowledging the fact that a slip is nowadays treated as the main contractual document in an insurance contract, one could (re)argue more than ever that if the slip included the specifications of a policy as stated in s 23, then reasonably it ought also to be accepted as such. Even back in the 19th century, it was held in *Smith*[12] that there is no 'bar in principle to a slip being a policy under the 1891 Stamp Act'.[13] In reconsidering this decision, the term 'policy' was probably to have the same meaning in both the 1906 Act and the 1891 Act.

In the same line, Professor Bennett has argued that a slip 'can contain sufficient information to satisfy the formalities of the MIA'.[14] Interestingly, all these years the obstacle to such acceptance has been the recognition of the distinction as such in both the 1906 Act and case law. However, in *HIH*, Rix LJ turned to the 'slip policy' to find a number of fundamental issues that were left unmentioned in the policy itself. In doing so, he seems to blur the traditional idea that a policy is inclusive of the slip with additional information.

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[10] *Sugar Hut Group Ltd v Great Lakes Reinsurance (UK) Plc* [2010] EWHC 2636 (Comm)
[11] *Dunlop Heywards (DHL) Ltd v Erinaceous Insurance Services Ltd* [2008] EWCA Civ 354
[12] *Home Insurance Co v Smith* [1898] 2 QB 351
[13] Section 91 defines a policy of insurance as including 'every writing whereby any contract of insurance is made or agreed to be made or evidenced'. The definition can without doubt encompass the slip.
[14] Bennett, HN [1994] *The role of the slip in marine insurance law* [1994] Lloyd's Maritime and Commercial Law Quarterly 94

Market practice

In *Swan*[15], it was held that it is 'unusual for insurers to refuse to pay claims on the technical ground that a policy could not be produced'. Indeed, it is rather rare for an insurer to use the policy requirement as an excuse to avoid giving effect to the insurance contract. However, since s 22 is still in force and there is always the possibility of it being invoked, an insured is evidently left exposed to the risk of being unable to claim against their insurer. Such a situation seems impractical (or even unfair) while at the same time it demonstrates that commercial practice and the law are yet to coincide.

Section 22: is it needed?

In 2004 the Financial Services Authority proposed the 'Contract Certainty Code of Practice'. The project aimed at overcoming the technical requirements of s 22 by ensuring that all policy-terms are completely set out when a slip is scratched. Therefore, the slip will contain most, if not all, of the requirements of the 'traditional marine policy' and will (most probably) satisfy s 22, without the need to execute an 'actual' policy. In response, the Marine Insurance Market designed the Market Reform Contract (MRC) as a standard form contract, in line with the Contract Certainty Code. This initiative demonstrates the movement of the market towards the adoption of a single document that will include all the necessary policy terms and will ensure contractual certainty free of any formal technicalities. At this stage, s 22 has certainly nothing more to offer than an obsolete burden on business.

Conclusion

To sum up, neither the 1906 Act nor case law has ever clearly set out the role of the slip in an insurance contract. In turn, the judgment in *HIH* gives great significance to the slip as it is and rebuts the presumption that a policy supersedes the slip, as indeed there are cases where the two documents **must** be read together. Alongside this decision, the issue of whether a slip and a policy can actually be a single document has come back to light**.** The introduction of the standard form contract in the insurance market indicates a step in this direction and is likely to bring about even more change. One of them might be the repeal of s 22, which has proven all but useful. It is true that market-oriented laws which are simple, comprehensible and speed up execution prevail. Legislation must inevitably follow to mend holes.

[15] *Swan & Cleland's Graving Dock & Slipway v Maritime Ins Co* [1907] 1 KB 116

The Policy-Slip (Dis)connect

Karishma A. Galliara

Introduction

The recently proposed repeal of s 22 of the Marine Insurance Act 1906 (the 1906 Act) which provides for the existence of a formal marine policy, on grounds of being a '*technicality with potentially drastic consequences for the insured*', set out in the Law Commissions' Issues Paper 9,[1] immediately confirms the logical conflict created in one's mind when examining the provisions of the 1906 Act. The imminent question as to the status of the slip and its relationship to the policy presents one with several fascinating aspects. It is trite law that a slip, once scratched, concludes the contract of insurance between the assured and the insurer.[2] It is also common knowledge that, in the words of Professor Bennett, 'fiscal barriers'[3] to enforcement of marine insurance contracts exist no longer. Would then, the quintessential statutory requirement for the existence of a marine policy imply that a slip is a 'contract binding in honour' only? If that be so, then surely any attempt by either party to unilaterally alter its terms ought not to be prohibited in law.[4] Furthermore, what accelerates the need for a definitive answer to this question is the fact that actions have been brought on slips, albeit not in marine insurance;[5] the requirement in marine insurance of a 'marine policy' thus seems to remain a 'technical glitch'.

This article seeks to support the Law Commissions' proposal for reform in this aspect of marine insurance law by re-examining the 'then' and questioning the 'now' rationale of s 22 of the 1906 Act and considering the development of case law on the ever haunting question of the exact relationship between the slip and the policy.

[1] The Law Commission and Scottish Law Commission, *Issues Paper 9: The Requirement for a Formal Marine Policy: Should Section 22 Be Repealed?* available at http://www.lawcom.gov.uk/docs/IP9_web.pdf (last visited 14 November 2010).

[2] *General Reinsurance Corporation and Others v. Forsakringsaktiebolaget Fennia Patria* [1983] 2 Lloyd's Rep 287. *See also Ionides v. Pacific Fire and Marine Insurance Co* (1871) LR 6 QB 674; affirmed on appeal (1872) LR 7 QB 517; *Pindos Shipping Corporation v. Frederick Charles Raven (The "Mata Hari")* [1983] 2 Lloyd's Rep 449.

[3] Bennett, HN, *The Law of Marine Insurance* 2nd ed (Oxford, Oxford University Press, 2006) [3.68]

[4] But see *General Reinsurance Corporation and Others v. Forsakringsaktiebolaget Fennia Patria* [1983] 2 Lloyd's Rep 287, where the Court of Appeal confirmed that no party to a scratched slip has the unilateral right to alter its terms.

[5] *Thompson v. Adams* (1889)24 Q.B.D 361: signature of the slip led to a complete contract of insurance binding in law, on which action could be maintained even in the absence of a signed policy; *Burrows v. Jamaica Private Power Company Co Ltd* [2002] Lloyd's Rep IR 466.

The fiscal context

Section 22 of the 1906 Act states:

> Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act. ...

The milieu in which s 22 was worded consisted of a succession of revenue laws requiring marine insurance policies to be stamped in order to be valid and enforceable.[6] Under the 1906 Act, a contract of marine insurance, though valid, could not be admitted in evidence, if not embodied in a policy 'in accordance with this Act'.[7] Finally, the stamp duty on marine insurance contracts was abolished vide the Finance Act 1970.[8] However, s 22 continues to prevail in the marine insurance context.

Tracing the judicial history of the impact of the requirement of a duly stamped policy, one finds that the judicial approach shifted from an insistence on regarding nothing but the stamped policy as a contract of marine insurance[9] to considering the slip where the policy was in existence.[10] In *Ionides v. Pacific Fire and Marine Insurance Co*, the Exchequer Chamber observed that the slip could be used to show the intention of the parties in preparing the policy. The decision was later codified into s 89 and s 21 of the 1906 Act.[11] Subsequent decisions also recognised the distinction between the slip and the policy and provided that for a valid action to be maintained, a formal policy must exist.[12] The position can best be summarised in an excerpt from a Scottish case[13]:

> While it [the slip] undoubtedly reflects a concluded verbal contract of marine insurance made between the company as insurers and the broker as representing the assured, it is inadmissible as evidence under section 22 of that Act unless and until embodied in a written marine policy.

[6] Stamp Act 1795; s 14; Stamp Act 1814, ss 7 and 9, The Customs and Inland Revenue Act, 1867; Stamp Act, 1891, s 93.
[7] Bennett, HN, 2006.
[8] Schedule 1(2)(b), Finance Act 1970.
[9] *Warwick v. Slade* (1811) 3 Camp 127.
[10] *Ionides v. Pacific Fire and Marine Insurance Co* (1871) LR 6 QB 674; affirmed on appeal (1872) LR 7 QB 517.
[11] *Supra* n.1
[12] *Swan and Cleland's Graving Dock and Slipway Co v Maritime Insurance Co and Croshaw* [1907] 1 KB 116: the Court held that the assured could maintain a valid action so long as the policy was in existence; *Fisher v Liverpool Marine Insurance Co* (1872-73) LR 8 QB 469, *Genforsikrings Aktieselskabet (Skandinavia Reinsurance Co of Copenhagen) v Da Costa* [1911] 1 KB 137: In the latter two cases, the Courts refused to enforce the slip on the 'collateral contract' basis, since the revenue laws in force at that time clearly mandated the that actions be maintained on duly stamped policies.
[13] *Clyde Marine Insurance Co v Renwick & Co* 1924 SC 113.

Status of the slip

Prior to the 1906 Act, Blackburn J, in *Ionides v. Pacific Fire and Marine Insurance Co*,[14] whilst clarifying that the slip was <u>not</u> a policy, commented on its legal status in the following words.

> The slip is in practice ... the complete and final contract between the parties ... and neither party can, without the assent of the other, deviate from the terms thus agreed on ... .

In the subsequent decision of *Cory v Patton*,[15] Blackburn J, reinforcing the value of the slip in context of the assured's duty of disclosure observed that there was no duty to disclose material facts after the initialling of the slip. In more recent times, the Court of Appeal in *General Reinsurance Corporation and Others v. Forsakringsaktiebolaget Fennia Patria*[16] confirmed that scratching the slip gave rise to a binding contract between the assured and the insurer and that thus no party to a scratched slip could alter its terms unilaterally.

The status of the slip was further crystallised in *Allianz Insurance Co Egypt v Aigaion Insurance Co SA*,[17] wherein the Court of Appeal whilst holding that the contract between the parties was concluded on the terms of the slip nevertheless observed that the slip was 'a definitive reference point' of the terms of the parties.

The policy-slip relation

The principle was by now clearly embedded in law that for a slip, however commercially valuable, to be admissible in evidence, a formal policy must exist.[18] The issue that then captures interest is the role of the slip once a policy is executed. If a slip and the policy be inconsistent, which document shall take precedence? Can a slip be used to show the parties' intention? If a slip contains a warranty omitted in the policy, or worse still, if a policy contains a warranty which the slip never did,[19] what effect is a breach of warranty to have? The policy-slip relation that the slip was admissible to show parties' intention in preparing the policy was earliest considered in *Ionides v. Pacific Fire and*

[14] *Ionides v. Pacific Fire and Marine Insurance Co* (1871) LR 6 QB 674, at 684, 685.
[15] (1872) LR 7 QB 304.
[16] [1983] 2 Lloyd's Rep 287.
[17] [2008] EWCA Civ 1455.
[18] *See* ss 23 and 24, Marine Insurance Act 1906 which provide the statutory particulars of a marine policy.
[19] Policies, as a market practice, are issued after loss has occurred to enable the assured to make a claim. *See also Allianz Insurance Co Egypt v Aigaion Insurance Co SA* [2008] EWCA Civ 1455, where the parties during negotiations had agreed on an IACS warranty, which the slip erroneously omitted and the underwriter erroneously initialed the slip on such terms. The policy issued subsequently by the underwriter contained the warranty. Unfortunately, as the matter proceeded to the Court of Appeal, the assured abandoned the plea that the policy should take precedence over the slip and instead sought to maintain that there was no contract between the parties for want of *consensus ad idem*, which contention was rejected and the Court of Appeal held that the contract was entered into in terms of the slip. However, the policy-slip conflict that emerges in this case is nevertheless an interesting facet to look at.

Marine Insurance Co[20]. In *Youell v. Bland Welch*, Phillips J, at first instance observed that referring to the slip for construing the policy contradicted the object of replacing the slip with the policy.[21] In the Court of Appeal, though Staughton J accepted that a slip contained a "*concluded agreement between the parties*", Bedlam J, remarked that the slip was not admissible for the purpose of construing the policy.[22]

The Court of Appeal in *HIH v. New Hampshire*,[23] on being presented with this issue, observed that the earlier comments were obiter and distinguished the cases on the fact that the policies, in those cases, were clearly intended to supersede the slip. The Court laid down a thumb-rule that where the policy unequivocally superseded the slip, the latter could not be used as an aid for construing the former (though it could be used for rectification of the policy), but where such supersession was unclear,[24] the slip ought to be considered. Unfortunately, as is evident from Rix LJ's remark at the outset,[25] all these observations in this case were obiter.

However, these observations were applied in subsequent cases like *BG v. Nelson Group* [26] wherein the inclusive approach adopted in *HIH* was supported. In the most recent *Sugar Hut Group* case,[27] applying *HIH* in this regard, the court of first instance held that certain obligations[28] stipulated in the slip survived into the policy and that the policy did not supersede those obligations in the slip. Nevertheless, as a matter of principle on the policy-slip relation, *HIH* continues to be the most significant case in recent times, although observations of the Court on this issue were in fact obiter.

Is s 22 a statement of applicable law?

It must be reiterated that regardless of the legal and commercial value accorded to the slip, it remains that a slip is *not* a policy. The issuing of the policy is still a prerequisite to any action by the assured. It also remains that the value of the policy in statute law is quite removed from its value in commerce. Courts have in the past never been happy with insurers relying on the s 22 defence and have displayed their reluctance by not ordering the

[20] *Ionides v. Pacific Fire and Marine Insurance Co* (1871) LR 6 QB 674; affirmed on appeal (1872) L.R. 7 QB 517.

[21] *Youell v Bland Welch & Co Ltd* [1990] 2 Lloyd's Rep 423.

[22] *Youell v Bland Welch & Co Ltd* [1992] 2 Lloyd's Rep 127. *See also Punjab National Bank v de Boinville* [1992] 1 Lloyd's Rep 7; *St Paul Fire & Marine Insurance Co (UK) Ltd v McConnell Dowell Constructors Ltd* [1993] 2 Lloyd's Rep 503 which followed the same line of thought.

[23] *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co* [2001] EWCA Civ 735.

[24] In this case, the policy wording did not contain some of the most basic elements of detail one would expect in an insurance contract such as the premium payable and was silent on certain aspects dealt with in the slip.

[25] Rix LJ stated at the outset, "This is a most interesting question, but the decision on the previous question makes it unnecessary to determine it." *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co* [2001] EWCA Civ 735 at [69].

[26] *BG Plc v Nelson Group Services (Maintenance) Ltd* [2002] EWCA Civ 547.

[27] *Sugar Hut Group* Ltd & *Ors v Great Lakes Reinsurance* (UK) Plc & *Ors* [2010] EWHC 2636 (Comm).

[28] The slip set out certain risk improvement requirements which required the burglar alarm to be upgraded. Though these obligations were not a warranty, the Court considered them to be suspensory provisions i.e. they had the effect of suspending cover until fulfilled.

unsuccessful claimant to bear the costs.[29] There is no reason why this reluctance should not continue especially post the amendment by the 1970 Act. In light of the wearing down of statutory requisites of a marine policy,[30] a slip, in the form issued nowadays, seems to amply satisfy the statutory particulars. It has been submitted that in fact, a slip may be sued on.[31] In a nutshell, it may not be a very frequent occurrence for an insurer to not issue a policy and then proceed to reject a claim on basis of the claim not being made on a policy.[32] Similarly the approach of the courts in the past in allowing the assured to make a valid claim despite not being in possession of the policy, so long as a stamped policy was somewhere in existence,[33] shows that the statutory requirement for stamped policies was balanced with the commercial requirement of the assured to be able to sue on a valid binding contract of insurance, such that, as long as the fiscal conditions were met, the need for the assured to be in possession of the policy was not insisted upon. It follows, carrying this attitude to its logical end, that but for the statutory hiccup of s 22, there no longer exists any motive in law or commerce that would mandate the existence of a policy separate from the slip in order to enable the assured to bring an action under the contract of marine insurance. To that extent, s 22 remains, as a statement of applicable law, as described at the outset, a ‘technical glitch’.

Moreover, it is submitted that if an insurer were today to raise a s 22 defence to avoid liability under the contract of insurance, the courts would probably be more accepting of the ‘collateral contract’ argument such as that advanced in *Fisher v Liverpool Marine Insurance Co*,[34] given that the only reason for the Court’s reluctance to enforce the slip on this ground at that time was the fear of circumventing the then in force revenue laws. With the fiscal motive gone, there is now nothing left to circumvent. Thus, though s 22 may not be fatal to an assured seeking to claim under his insurance contract, the existence of the provision clearly raises anomalies, which if not eliminated through legislative amendment will pave way for further litigation and the consequent risk of an undesirable dictum furthering the ambiguity in the matter, looming large.

Ancillary issues raised by s 22

It is submitted that the requirement for a formal marine policy under s 22 of the 1906 Act possibly also creates scope for confusion in relation to contracts of P&I insurance and whether a ‘Certificate of Entry’ issued by a P&I Club could effectively be called a marine policy. Case law suggests that a P&I

[29] *Genforsikrings Aktieselskabet (Skandinavia Reinsurance Co of Copenhagen) v Da Costa* [1911] 1 KB 137.
[30] A policy now (post the Finance Act 1959 amendment) only needs to specify the name of the assured or the person who effects insurance on his behalf, signed by or on behalf of the insurer and designate the subject matter of insurance with reasonable certainty, ss. 23(1), 24(1) and 26(1), Marine Insurance Act 1906.
[31] Gilman, Merkin *et al*, *Arnould’s Law of Marine Insurance and Average* (UK, Sweet & Maxwell Ltd, 2008).
[32] *Nullus commodum capere potest de injuria sua* propria: No man can take advantage of his own wrong, a principle in equity.
[33] *Swan and Cleland’s Graving Dock and Slipway Co v Maritime Insurance Co and Croshaw* [1907] 1 KB 116.
[34] *Supra* n. 12.

insurer is in fact an insurer and that the rules of a P&I Club would have to be considered to ascertain the terms of the policy.[35] However, given that s 22 of the 1906 Act applies to contracts of P&I insurance,[36] the requirement of a marine policy does raise questions as to the status and enforceability of such Certificates of Entry. Considering the popularity of P&I insurance and the importance attached to Certificates of Entry across trading states, s 22 may not in fact even be a contentious issue in P&I. Nevertheless, certainty in law demands at least a contemplation of such supplementary aspects.

Another off-shoot of the statutory 'marine policy' requirement finds place in international trade law, particularly in shipment sale contracts such as CIF or FOB with additional terms as to insurance, which place the duty on the seller to insure the cargo for transit and tender to his buyer the 'policy of insurance'.[37] If the buyer, who is ultimately the party interested in the insurance policy, is unable to sue on the cover obtained for his cargo merely because the document tendered by his seller was not a 'marine policy' as envisaged under the 1906 Act, the seller would be in breach of his documentary duties under the sale contract and would risk consequent liabilities thereunder.

A final word

At a time when, in response to regulatory pressures, market initiatives towards greater contract certainty are being developed and trends of issuing 'slip-policies' are observed, the continued existence of s 22 seems to cloud not only the market initiative but the regulatory objectives that drove the insurance industry to develop initiatives like the Market Reform Contract in the first place. It is submitted that the absence of a rational explanation for retaining s 22 in modern day insurance law, would certainly be a deviation from the contract certainty roadmap. As stated earlier, the repeal of this provision has recently been proposed[38] and it may be a matter of time before there is an applicable law harmonised with current market practices.

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[35] *The Vainqueur Jose* [1979] 1 Lloyd's Rep 557; *The Allobrogia* [1979] 1 Lloyd's Rep190, the latter case determining that contracts between the assured and the P&I Club, were 'contracts of insurance' for the purpose of Third Parties (Rights against Insurers) Act, 1930.
[36] Marine Insurance Act 1906, s 85.
[37] *Diamond Alkali Export Corp. v. Bourgeois* [1921] 3 KB 443.
[38] *Supra* n. 1.

A statement of applicable law?
Section 22 of the Marine Insurance Act 1906

Serhan Handani

Introduction

This essay will consider s 22 of the Marine Insurance Act 1906 and, taking into account the decision in *HIH Casualty & General Insurance v New Hampshire*[1] and the Law Commissions' recent reports[2], will consider whether the section still provides a statement of applicable law. In order to fully consider this issue, the status of the slip and how it relates to the insurance policy as a whole will also be briefly examined.

Purpose and origins of s 22

The 1906 Act is the main UK statute regulating insurance policies. As the name suggests it applies particularly to policies of a marine nature but is also a key act for many other insurance policies. What makes this Act important, not just to English contracts but around the world, stems from the wide use of English law internationally in marine insurance matters. It is usual to see marine insurance contracts, between two international parties, stipulate that their agreement will use English law and arbitration. Despite this importance in global trade the Act itself has attracted more and more criticism and is currently under review by the Law Commissions to see how it can be improved to match the modern world of insurance. The majority of these criticisms stem from the age of the Act. The Act was passed into law over 100 years ago and many sections are not applicable in modern society[3]. However, an extensive discussion of all the flaws of the Act is not appropriate here and for the purposes of this discussion we will focus on the issues arising from s 22.

Section 22 of the 1906 Act reads as follows:

> Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act. The policy may be executed and issued either at the time when the contract is concluded, or afterwards.[4]

[1] [2001] EWCA Civ 735

[2] See The Law Commission, *The Requirement for a Formal Marine Policy: Should Section 22 Be Repealed?,* October 2010, Issue Paper 9

[3] For an interesting look at one of the biggest contradictions in the modern law when compared with the Act please see s 5 Marine Insurance Act, which deems gambling contracts unenforceable and compare with the relatively new Gambling Act 2006.

[4] Marine Insurance Act 1906 s 22

This section is a relatively straightforward provision but has wide ranging implications in the law and has caused several problems to the market. The provision states that any contract of marine insurance must be in a marine policy (in accordance with the Act), or it is inadmissible. If the written contract of insurance is inadmissible then an assured cannot prove that there was a contract and therefore will not have a claim. This section seems to impose a mere technicality on the relationship between the assured and insured, but one that could have disastrous effects for the assured.

Before we continue to examine the impact the section has had, let us first consider why the provision was considered necessary in the early 20th century. The section initially seemed to be a way to prevent tax evasion. The Stamp Act 1875 imposed a stamp duty on all marine insurance policies[5]. In order to prevent people evading the duty by not using a policy, the Act goes on to state that if the policy has not been stamped then it will be "*null and void to all Intents and Purposes whatever*."[6] Section 22 of the Marine Insurance Act seems to stem from these provision relating to a stamp duty on marine insurance policies. In 1970, this stamp duty was finally abolished in full by the Finance Act 1970. Despite this, s 22 Marine Insurance Act 1906 remains on the statute books, seemingly as a mere technicality.

Impact of section 22 on the Insurance Market

Let us now move on to consider how the market has been affected by the section and how it has adapted to accommodate this technicality. To understand the impact we must first briefly consider how the market works in practice, especially in relation to 'slips' and 'policies', both of which are mentioned in the Marine Insurance Act, yet are not defined.

The London market has traditionally had a practice of issuing an informal document detailing the main terms of the agreement between insurer and insured. These documents are known as 'slips' and precede the policy itself. The intention of the slip is to outline the terms of the insurance so both parties are clear on the contract, and their obligations and cover, before the formal policy is drawn up. The problem arises when no policy actually follows the slip. What then is the legal status of the slip and, indeed, the contract? If s 22 is to be followed strictly there is no insurance contract as the marine insurance was not contained in a policy and the slip cannot establish the contract in the absence of a policy. It should be noted that actions have been brought on the slip in other types of insurance, such as fire insurance[7].

Professor Bennett makes an interesting observation on the way the market works, stating:

> The market understanding has always been that the underwriter is bound from the moment he initials the slip, even in the absence of a policy. However, the law, driven principally by stamp duty legislation,

[5] Stamp Act 1875 s 1
[6] Stamp Act 1875 s 11
[7] See *Grover v Mathews* [1910] 2 K.B. 401; *American Airlines Inc v Hope* [1972] 2 Lloyd's Rep. 253

> and commercial practice, adhering obdurately to market tradition, have not always coincided.[8]

Here, Bennett points out that due to s 22, the legal framework has fallen out of sync with the commercial reality in the London market. Bennett's observation is an excellent observation in how the London market works and is key to understanding how the market deals with the requirements of s 22. As the Law Commissions state in their paper on the matter, s 22 seems to have little effect in practice.[9] The conclusions of the Law Commissions seem identical to those of many academics, Bennett included. In practice insurers will, and often do, pay out claims regardless of whether a written policy was present. The main problem the section now causes in the modern insurance market is the possibility that an insurer could refuse to pay out on a claim where no formal policy was issued and invoke s 22. If we follow the Act strictly, this would be a perfectly legal action and the insurer would be well within their legal rights to do so.

Decision in *HIH*

In the case of *HIH Casualty & General Insurance v New Hampshire,*[10] Lord Justice Rix examined the issue of whether the policy superseded the slip or whether they should be read together. This becomes of particular importance where there is inconsistency between the two documents, a not uncommon problem. Rix LJ stated that the distinguishing fact between this case and the previous precedents on the matter, *Youell v Bland Welch & Co Ltd*[11] and *Punjab National Bank v de Boinville*[12], was that in *HIH*, the issue was whether the policy was ever agreed to. In the above cases, it had been acknowledged that the parties had agreed to the policy and therefore that agreement was deemed to supersede the slip.

Rix LJ addressed this point quite concisely, and therefore we will examine his judgment closely. He held that:

> there is nothing in these citations which binds this court to rule that where a prior contract has been followed by a further contract, or where in an insurance context a slip contract has been followed by a policy...
>
> ...That is because all passages in prior cases in this court are only obiter dicta.[13]

Here Rix LJ points out that relevant statements in the previous cases were only *obiter dicta* and therefore, not binding on the Court of Appeal. However, he does give them the full consideration a judicial opinion deserves.

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[8] HN Bennett, *"The role of the slip in marine insurance law"* [1994] LMCLQ 94, at p 95.
[9] The Law Commission, The Requirement for a Formal Marine Policy: Should Section 22 Be Repealed?, October 2010, Issue Paper 9, at s.3
[10] [2001] EWCA Civ 735
[11] [1990] 2 Lloyd's Rep 423
[12] [1992] 1 Lloyd's Rep 7
[13] Lord Justice Rix, *HIH Casualty & General Insurance v New Hampshire* [2001] EWCA Civ 735 at [81]

> Moreover, in *Youell v Bland Welch and Punjab National Bank v de Boinville*, it was common ground that the policies in question were intended to supersede the slips. Where it is common ground that one contract has been intended to supersede an earlier contract, it must follow that the parties' contract must be found exclusively in the later contract. Thus the earlier contract cannot be used to add to, or modify, the later contract.[14]

Here Rix LJ explains why he agrees with the previous cases but disagrees in the extant scenario. The key part of the distinction, as mentioned above, is that the parties had agreed to the policy and therefore it seems logical that the policy was where they expected their contract to be found. He then goes on to discuss how the situation would work where there is no common ground that the original slip should be superseded by the policy.[15] He begins by stating that in this circumstance he

> do[es] not see how it can ever be permissible to exclude reference to the earlier contract. I do not see how the relationship of the two contracts can be decided without considering both of them.[16]

The problems with using the older case law are then discussed. The law relating to slips has evolved considerably since the turn of the 20th century and therefore any case law from this time would be of limited usefulness.[17]

How applicable is section 22 to modern law?

In light of the Law Commissions' criticisms of s 22, the current commercial reality and the decision in *HIH*, what legal effect, if any, does s 22 have? It is clear that the original justification for s 22 no longer exists since the stamp duty was abolished. Since then it seems that no other justification for keeping the section has been advanced.

The main argument for s 22 not having legal effect is the commercial reality of the market. In reality the London market often only issue slips and yet still pay out on the contracts even with the absence of a written policy. When this is considered alongside the decision in *HIH*, which essentially gives more legal authority to basing contracts on the slip, then s 22 becomes increasingly unnecessary.

The issue still remains than an insurer can technically refuse to pay out under a marine insurance contract due to the lack of written policy. The legal status of this has yet to be challenged but I suspect, based on the above, that a court will try to prevent this. It seems clear that s 22 still holds little effect and there is a strong case for its repeal.

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[14] *Ibid*
[15] Ibid, at [83]
[16] Ibid, at [84]
[17] An example of this is *Xenos v Wickham* (1867) LR 2 HL 296 where Lord Chelmsford said at p 321 that the slip is a mere proposal for insurance. This is clearly not the case now.

The Marine Insurance Slip and *HIH v New Hampshire*

Ayodeji Sasegbon

This article is in three parts. Firstly, brief consideration will be made of the contemporary status of the slip - that is to say how it is now no longer viewed as a mere proposal for insurance and is instead regarded as a binding contract. It will be proposed that this reconceptualisation left it open for the courts in *HIH Casualty & General Insurance v New Hampshire*[1] to limit the evidential restriction prohibiting the use of a slip in interpreting a policy. Subsequently, this article will examine the relationship of the slip to the policy, looking at how in a claim for rectification it is admissible in evidence, as well as how, after the Court of Appeal's judgment in *HIH*, it is now permissible to refer to the slip as an aid to construing the policy. Finally, a consideration will be made of the extent to which s 22 of the Marine Insurance Act 1906 provides a statement of applicable law. In this regard it will be necessary to make reference to two arguments which have been advanced in a bid to evade the policy requirement contained within the section.

The status of the slip

As late as 1867 it was the belief of the judges summoned to give their opinions to the House of Lords in *Xenos v Wickham*[2], that a slip was merely a proposal for insurance. Lord Chelmsford, for example, opined that:

> It is one thing to cancel a slip, *which is merely the inception of a contract*, and to change the terms of the proposal for an insurance; and an entirely different thing to release the underwriters from their liability upon a policy"[3] (my emphasis)

Some years later, however, in *Ionides v Pacific Fire & Marine*[4], Blackburn J explained that in the context of marine insurance

> the slip is, in practice, [customarily regarded as] the complete and final contract between the parties...[5]

He went on to describe the legal effect of the slip in no uncertain terms, commenting that, whilst

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[1] *HIH Casualty & General Insurance v New Hampshire* [2001] EWCA Civ 735
[2] (1867) LR 2 HL 296
[3] At p. 321
[4] (1871) LR 6 QB 674; LR 7 QB 517
[5] At 684-685

> the slip is clearly a contract for marine insurance, [it] is equally clearly not a policy[6]

This approach was eventually incorporated into the 1906 Act, s 21 of which provides that:

> A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not...

As will be seen, this reconceptualisation of the slip as a contract left it open for the courts to exclude the application of the parol evidence rule as an obstacle to the evidential admissibility of a slip in situations where the parties have not evinced an intention that the policy should supersede the slip.

Admissibility in evidence

Whilst it is beyond contention that the slip is admissible in evidence for some purposes – thus s 89 of the 1906 Act provides that reference may be made "as heretofor" to the slip or covering note in any legal proceeding – the extent to which this is the case is much less certain and the parol evidence rule has been applied in several cases as an obstacle to admissibility. Plainly stated, the rule provides that the courts are prohibited from admitting extrinsic evidence as an aid to the construction of a written policy.[7] One accepted exception to the parol evidence rule is where the slip reveals an error in the policy. In this situation the policy will be made conformable to the slip,[8] a process called 'rectification'[9]. Beyond rectification, however, the extent of a slip's admissibility has been less certain. In *Youell v Bland Welch*, Beldam LJ opined that although a slip was admissible in some circumstances (such as in a claim for rectification) it was not admissible as an aid to the interpretation of the policy. Considering the comments of CB Kelly in *Ionides*, he concluded that:

> If reinsurers had sought rectification because the policy omitted a term contained in the slip and intended to be incorporated into the subsequent policy, no doubt the Court would have looked at the slip as a document in which the parties had originally recorded their agreement. But that is not the case here and in my judgement the slip was not admissible as an aid to the construction of the reinsurance contract.[10]

This produced the somewhat anomalous situation whereby a slip was admissible as evidence where the court was considering whether to rectify the policy, but not if the court was simply interpreting policy wording. In *HIH*

[6] At 685; see also *Thompson v Adams* (1889) 23 QBD 361 in the context of non-marine insurance.
[7] *Youell v Bland Welch & Co Ltd* [1990] 2 Lloyd's Rep. 423 per Phillips
[8] *Youell v Bland Welch & Co Ltd* [1992] 2 Lloyd's Rep 127 per Beldam see also *Thor Navigation Inc v Ingosstrakh Insurance Company Ltd* [2005] ADR.L.R. 01/14
[9] For an explanation of the rationale behind 'rectification' see *Agip SpA v Navigatione Alta Italia SpA (The Nai Genova)* [1984] 1 Lloyd's Rep. 353 at 359 per Slade L.J.
[10] At p. 141

Casualty and General Insurance v New Hampshire Rix LJ, considering the validity of this conclusion, and noting from the post-1867 case law as well as the 1906 Act that the slip is a contract in its own right, reasoned that

> I do not see how the Parol Evidence rule can exclude prior *contracts*, as distinct from mere negotiations”[11].

He was quick, however, to issue the caveat that

> where the later contract is intended to supersede the prior contract...the later contract replaces the earlier one [and construction will not be permitted].[12]

In this way Rix LJ limited the evidential restriction to cases where the policy was intended to supersede the slip and it is now permissible for the courts to use a slip as an aid to policy construction.

To what extent does s 22 still provide a statement of applicable law?

Section 22 of the Marine Insurance Act 1906 provides that:

> ...a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act...

In situations where the insurer has failed to provide a policy, a strict application of s 22 will undoubtedly prevent the slip from being admitted in evidence, meaning that an insured is not permitted to bring a claim in the event of a loss.

Attempts to circumvent section 22: collateral contract

There have been several attempts made by insureds to circumvent the effects of s 22. Most notably, an argument has been advanced which, simply stated, postulates that there exists a collateral contract to provide a policy and, as the insurer has failed to do so, he should pay damages equivalent to the amount of the claim. The collateral contract argument was advanced unsuccessfully in *Fisher v Liverpool Marine Insurance Co*[13] and the finding was upheld on appeal. Lord Coleridge, giving the court’s conclusion, explained:

> ...in the present case there was only one contract. It is argued that there was a subsequent contract between the parties...[but] the whole transaction is one, an entire and indivisible contract...[14].

Further unsuccessful attempts to argue on the basis of a collateral contract occurred in *Clyde Marine Insurance Co v Renwick & Co.*[15] and *Genforsikrings*

[11] At p. 83
[12] At p. 83
[13] (1874) LR 9 QB 418
[14] At pp 424 to 425
[15] 1924 SC 113

Aktieselskabet v Da Costa[16]. In *Clyde Marine Insurance* an insurer had gone into liquidation having signed several slips, but without having issued policies on them.[17] Lord President Clyde dismissed the collateral contract argument advanced by the insureds on the basis that it was incompatible with several provisions of the Stamp Act 1891 and s 22.

Despite the unpromising case law, Professor Bennett suggests that in light of the abolition of the stamp duty regime, the path is now open for the courts to recognise and accept the collateral contract approach:

> Today, moreover, should the insurer refuse to execute a policy then, provided the premium has been paid or rendered, the assured may maintain an action for breach of a collateral contract to execute a policy... The abolition of stamp duty on marine insurance contracts... removes the fiscal barrier to recognition of such an action.[18]

However, as the Law Commissions point out in a recent report, this may prove not to be the case. They explain that:

> The various decisions which have rejected the collateral contract approach... have rarely been based on the stamp duty regime alone.[19]

Does a signed slip satisfy the requirement of a policy?

One other argument which has been advanced in an attempt to evade the requirement set out in s 22 is to claim that the slip itself satisfies the requirement that there be a policy. There is no definition of 'marine policy' in the 1906 Act and all that is certain is that a policy must be a document which complies with the formal requirements in the Act. Bennett is of the opinion that a signed slip will usually meet all of these requirements and, in light of the fact that the 'fiscal impediment' of the old Stamp Acts have been removed,

> ...a slip may contain sufficient information to satisfy the Marine Insurance Act".[20]

Furthermore, MacGillivray also seems to provide support for this view:

> Since the Finance Act 1970 repealed section 30(2) of the Finance Act 1958, it has not been necessary for such a policy to be stamped, and the longstanding question whether a slip issued by Lloyd's underwriters was a policy within the meaning of the Stamp Act is no longer relevant.[21]

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[16] [1911] 1 KB 137

[17] 1924 SC 113

[18] Bennett, H. Law of Marine Insurance, 2nd ed (Oxford: OUP, 2006) at para 3.68.

[19] Law Commissions of Scotland and England & Wales, Issues Paper 9 *The Requirement for a Formal Marine Policy*, October 2010 at para 3.28.

[20] Bennett, H., The Role of the Slip in Marine Insurance Law [1994] *Lloyd's Maritime and Commercial Law Quarterly* 94 at p 118.

[21] Legh-Jones, N, *MacGillivray on Insurance Law*, 11th ed, (London: Sweet & Maxwell, 2008) at para 3-005.

However, an obstacle to the acceptance by the courts of such an argument is the fact that both the case law and the 1906 Act recognise a distinction between policies and slips. In Colinvaux, Professor Merkin postulates that:

> A slip is probably not a policy of insurance, so that a policy must be issued before any action may be brought by the assured.[22]

Conclusion

In light of the unsuccessful attempts which have been made to evade s 22, it is submitted that the section still provides a statement of applicable law. This is not, however, a satisfactory state of affairs. The section is obsolete and has the potential to cause problems for insureds. Moreover it is difficult to justify the preservation of a rule which is so out-of-step with the contemporary marketplace especially at a time when there is a desire to reduce the burden of law and regulation on business.

[22] Merkin, R., *Colinvaux' Law of Insurance,* 9 ed, (London: Sweet & Maxwell, 2010) at para 1/33.

Insurable Interest in the Law of Marine Insurance

Meixian Song[1]

Insurable interest is a fundamental concept in insurance law. Until recently, it was not subject to doubt that the assured must obtain insurable interest when claiming a loss under indemnity insurance by virtue of statutes in English law. In the light of the Gambling Act 2005[2] and its repeal of s 18 of the Gaming Act 1845, indemnity insurance which includes most forms of property and liability insurance other than marine will not be rendered unenforceable due to the lack of an insurable interest. In contrast, marine insurance retains its own rules. Remaining unaffected by Gambling Act 2005, pursuant to s 4(2) of the Marine Insurance Act 1906, which is now the only piece of legislation requiring insurable interest among all forms of insurance. Where the assured neither has insurable interest nor the expectation of acquiring such interest, the insurance contract is void. Moreover, it constitutes a criminal offence by virtue of the Marine Insurance (Gambling Policies) Act 1909 if the assured is not in good faith.

Accordingly, the Law Commissions have published Issues Paper No.4 in 2008 addressing whether the law on insurable interest should be repealed. The Issues Paper is part of a programme to reform UK insurance law.[3] In respect of marine insurance, Issues Paper No. 4, recognises that the position remains subject to argument, but notes that an interest must be demonstrated at the time of loss. In principle, a gambling contract is not enforceable in insurance cases in spite of the accidental effect of the Gambling Act 2005.[4] Nevertheless, the enactment has triggered concern and a review of whether insurable interest is now redundant in marine and other insurance.

This article is attempting to address the legal nature of insurable interest based upon discussing the concept of insurable interest and its links to wager and the principle of indemnity. Moreover, the queries specific to marine insurance in the Issues Paper will be discussed from the perspectives of retrospective attachment and assignment. It will finally look at the fundamental issue concerning the balance of interest between assured and insurer in this respect. Both legal nature and consequential effects have to be taken into consideration in order to propose a suggestion that insurable

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[2] Section 335 Enforceability of gambling contracts
(1) The fact that a contract relates to gambling shall not prevent its enforcement.
(2) Subsection (1) is without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling).

[3] On the internet: *http://www.justice.gov.uk/lawcommission/areas/insurance-contract-law.htm* [Accessed June 14, 2011].

[4] Chris Nicoll, *Insurable interest: as intended?*, Journal of Business Law, 2008.

interest shall remain applicable and to answer the queries in respect to marine insurance which were pointed out in the Issues Paper.

Concept of insurable interest

Prior to the 1906 Act, it is recognized that the judgment of *Lucena v. Craufurd*[5] provided the classic definition of insurable interest which has been incorporated in the legislation of the 1906 Act. Per Lord Eldon, insurable interest resides in a right in the property or a contractual right on the property. The incidence of losing the property will affect the party's possession or enjoyment. The court also contemplated a broader view that the existing connection between the assured and the subject-matter insured by the constringency of the perils insured against is not necessarily in the form of a proprietary or contractual right.

The 1906 Act preferred the definition held by Lord Eldon in a narrow sense. The statutory definition of insurable interest is provided by s 5:

> (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 first part of the provision states the general proposition and the second part "in particular" specifies a prominent example of insurable interest which is treated by the courts as a non-exhaustive definition.[6] It refers to a legal or equitable relation, which is radically broader than a proprietary interest. It includes the rights conferred by law or in equity or even obligations may be incurred by the incidence of the insured perils on the subject-matter involved. Nevertheless, the legal rule fails to cover the whole scope of insurable interest.

It is unlikely that a thorough, concise and comprehensive definition can be provided for such an abstract concept as insurable interest. Besides s 4(2), from s 7 to s 14 in the 1906 Act, a variety of examples of interest acknowledged in the law of marine insurance are set out. However, current definitions of insurable interest are still not completely appropriate. They fail to cover all the types of insurable interest and it is also difficult to categorically distinguish interests which are not insurable. Consequently, the obscurity leads to the difficulty in its application before courts. Nevertheless, the essence of insurable interest is to determine the existence of an actual and legal link to the loss pertaining to the subject-matter insured. The ones merely of a remote nature or with no insurable interest must not satisfy the requirement of

[5] (1806) 2 Bosanquet and Puller (New Reports) 269,127 E.R. 630.

[6] Feasey v Sun Life Assurance Co of Canada [2003] Lloyd's Rep IR 693; O'Kane v Jones [[2004] 1 Lloyd's Rep 389, para. 145.

insurable interest. In addition, a distinction between property in general terms and subject-matters insured must be clarified, as they do not always refer to the same meaning and are easily confused.[7] The subject-matter insured may be the property involved, or it may be profit or income from the property. For instance, when a carrier places a cover on his earning of freight, the subject-matter insured in this case is the freight ad not the cargo or vessel. The insured carrier has an insurable interest in the freight, but not the cargo or vessel. In other words, insurable interest constitutes a direct legal connection between the assured party and the subject-matter lost. Thus, the insurable interest is best understood as being concerned with the assured's relationship with the subject-matter of the insurance.

Principle of indemnity and insurable interest

The principle of indemnity basically applies to all contracts of insurance. Per Brett LJ in *Castellain v. Preston*[8], the principle of indemnity is the foundation of every rule in indemnity insurance, such as a marine or fire policy. It entitles the assured to get a full indemnity against the loss that he suffered; however, the assured cannot retain compensation in excess of his loss caused by the insured perils. For instance, the prohibition of double insurance and the doctrine of subrogation typically reflect the indemnity principle for the purpose of avoiding moral hazard in making benefit by means of insurance. It requires the assured to have suffered from a loss as one of the conditions to get recovery or compensation in this respect. In other words, if there is no loss suffered by the assured, there is no liability of indemnity on the side of the insurer. Therefore, an interest is derived from the principle of indemnity purporting to establish and prove an actual link between the loss and the assured.

Notwithstanding the general principle, insurable interest is not a redundant concept which shall be removed from the statutes. The Issues Paper noted that a statutory insurable interest is distinct from interest necessary for the indemnity principle. The interest necessary for the indemnity principle is a general type of interest, while insurable interest emphasises a specific legal relation in insurance law which is introduced to avoid a wagering policy. It is suggested in the Issue Paper that despite the fact that a gambling contract is enforceable in compliance with s 355(1) of the Gambling Act 2005, the assured is still unable to get recovery in the absence of insurable interest under the indemnity insurance other than marine since the indemnity principle applies and requires an interest on the part of the assured. However, if for arguments sake the requirement of insurable interest had been removed from marine insurance law, the principle of indemnity cannot provide sufficient ground to prevent the assured from obtaining an indemnity where the policy is not wagering but a lack of insurable interest. In this event, although the assured satisfies the element of acquiring the interest necessary to the indemnity principle, the assured is not entitled to the recovery at least in a marine insurance claim. Therefore, it is unlikely that the indemnity principle will be able to substitute the requirement of insurable interest in insurance law.

[7] Supra, fn 2.
[8] (1882-83) L.R. 11 Q.B.D. 380.

Wager and Insurable Interest

A typical wagering contract was defined by Mr Justice Hawkins in *Carlill v Carbolic Smoke Ball Co*[9]:

> A wagering contract is ... neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties.

Wager is the abuse of the regime of insurance, which the insurers attempt to avoid by all means for a long history both in the commercial sense and for public benefits. Accordingly, insurable interest was introduced into the legislation of the Marine Insurance Act 1745 firstly for the purpose of preventing moral hazard in gambling on shipping transactions. By the same token, the Life Assurance Act 1774 stipulated the requirement of valid interest on lives. Therefore, insurable interest is an effective and familiar tool of the insurers to avoid wager which bars the assured from a valid claim. It is provided in s 4(2) that "a contract is deemed to be a gambling or wagering contract where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest" or an honour policy. It is certain that a wagering contract lacks insurable interest and the expectation of acquiring one; however, in reality the absence of insurable interest and the expectation does not inevitably imply that the policy is one of wagering and consequently provide the ground to void the policy. A reform is required that would describe the relationship between insurable interest and ascertaining a wagering contract in the 1906 Act.

In *Macaura v Northern Insurance*[10], an unsecured creditor mistakenly insured the property of the debtor company of which he was sole shareholder, but did not choose to insure against the loss of shareholder's profit or debtor default. The House of Lords held that as an unsecured creditor he did not have insurable interest in the property, for his relation was to the company not to its assets. The contract should nevertheless not be regarded as a wagering contract, since the repayment of the debt radically depended on safety of the assets insured. The case supports the notion that insurable interest entails greater legal significance besides the prevention of wagering contracts. The House of Lords also examined whether the assured had obtained cover on the right subject-matter insured. The consequence that the policy does not answer is due to the absence of a direct link with the subject-matter in spite of the existence of the interest necessary for the indemnity principle to operate.

Moreover, in *The Moonacre*[11], a businessman purchased a yacht but in the name of a company owned by him wholly for financial reasons. When he sought to claim for the loss on the yacht, the court held that the company was not the contractual party to the insurance contract and did not have an insurable interest. Conversely, the corporate veil merely disguised the

[9] [1892] 2 QB 484 at p 490.
[10] [1925] A.C. 619.
[11] Sharp v Sphere Drake Insurance (The Moonacre), [1992] 2 Lloyd's Rep. 501.

relationship between the yacht and the claimant businessman. Thus, it was held that the businessman had acquired an insurable interest. The logical relationship between wager and insurable interest is somewhat confused. Some negative comments arose on *The Moonacre* to the effect that it effectively held that because the policy was not one of wagering, there must be an insurable interest.[12] Indeed, the decision reflects a deviation from the traditional strict definition held in *Lucena v Craufurd* to a broader one. The judgment did not limit itself to the provision in s 4 when determining whether a policy is a wager or lacks insurable interest. It was noted by Lord Justice Waller in *Feasey v. Sun Life Assurance of Canada* that a relation less than a legal or equitable or even simply a pecuniary interest has been reckoned to be sufficient to amount to insurable interest in indemnity insurance. As long as the assured has suffered a substantial direct loss on the subject-matter insured, he is entitled to get recovery based upon his insurance. Nevertheless, it should be noted that insurable interest in a wider sense is relying upon the matter of fact. However, it does not imply that insurable interest is equal with the interest necessary to the indemnity principle.

In sum, it is implausible to remove rules of insurable interest from the 1906 Act. Reform to consider would instead be the redundant emphasis on the link between insurable interest and gambling policies in s 4. In present marine insurance disputes, it is not difficult to figure out whether a policy is a wager in the marine insurance context. The enforceability of gambling contract is of less importance and unaffected by marine insurance claims. The courts put more focus on whether there is some additional “concern” in the subject-matter insured in the form of a legal or equitable relation or even a pecuniary one. Such concerns are distinct from the general interest underlying the principle of indemnity, which requires the assured to possess both a direct and actual relation to the subject-matter. Accordingly, insurable interest remains an imperative requirement in the modern context without reference to s 335 of the Gambling Act 2005.

Examples of the effects of insurable interest in marine insurance

With respect to marine insurance, Issues Paper 4 considered three issues regarding insurable interest. In summary, the issues include the time when insurable interest must attach, the repeal of the Marine Insurance (Gambling Policies) Act 1909 Act as to criminal penalties and the repeal of the statutory requirement of identification of the party’s name in the policy under s 23 of the 1906 Act.[13] Each of these issues is closely connected to other rules in marine insurance.

Retrospective attachment

Pursuant to s 6(1) of the 1906 Act, the assured shall have an insurable interest at the time of the loss as has been affirmed by *The Moonacre*. However, this stipulation is distinct from other branches of insurance contracts where the insurable interest must attach at the inception of the policy. It is argued that

[12] H. Bennett, *The Law of Marine Insurance*, 2nd edition.
[13] *The Law Commissions Issues Paper*, Insurance Law Monthly, May 2008.

the Gambling Act 2005 will change the position in marine insurance contracts, although divergent views have been raised.[14]

The now disused SG form contained a "Lost or not lost" clause defined in Schedule 1 Rule 1 of the 1906 Act. Pursuant to that clause, the insurable interest is deemed to attach at the time of the loss before the policy is concluded, unless the assured knew of the loss and the insurer did not at the time of conclusion of the contract. That is to say, the assured is still able to recover even though no interest was acquired until the loss occurred. Two English cases can be referred to, namely *Sutherland v Pratt*[15] and *Reinhart v Joshua Hoyle and Sons*.[16] They are both concerned with the carriage of cotton, where the cotton had been damaged before the conclusion of the insurance contract. It was held that the buyers were covered under the policy for damage sustained before the cotton was loaded on board. This clause was contained in the SG form but no longer in the modern Institute Cargo Clauses. Nevertheless, the Institute Cargo Clauses now refer to retrospective attachment of risk under the condition that the assured had already acquired the insurable interest at the time of loss before the conclusion of the contract. Therefore, it demonstrates the persistent judicial focus on the acquisition of insurable interest at the time of loss instead of the time of the inception.

Assignment of policy

Another question raised in the Issue Paper is the suggestion of repealing the stipulation of s 23 which requires the policy to specify the name of the assured or of the person who effects the insurance on his behalf. It is strongly proposed that the failure to specify the name in the policy ought not to be available to the insurer to void the contract by law. A remedy is available where the name of the assured is material information which touches the issue of utmost good faith. Accordingly, the statutory regulation is no longer necessary and should be abolished.

Nonetheless, s 50(5) in the 1906 Act provides that an assignable policy can be assigned by indorsement on the policy or in any other customary manner. Assuming that the policy does not specify the name of the assured on the policy by law and the parties' agreement, it seems that a mere delivery of a policy is sufficient to assign the policy to a third party, since the assured is not obliged to set out his name on the policy. Moreover, the normal position as a matter of law is that a right, not an obligation, may be assigned without the consent of the obligor, unless of course the contract provides otherwise.[17] It is probably true in respect of the marine insurance contract, in the absence of contrary stipulation in the 1906 Act. It is likely that the insurer can receive a claim from an unidentified assignor on the policy, if the assignor is holding the policy.

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[14] R. Merkin, *The repeal of the prohibition on gambling*, Insurance Law Monthly, December 2005.
[15] 152 E.R. 1092.
[16] [1961] 1 Lloyd's Rep. 346.
[17] Chitty on Contracts (30th ed. 2008), para. 19-077 - 19-078.

Balancing the interests of insured and insurer

The balance of interests between insured and insurer is the major concern of the legislative reform project. Attention has been devoted to legal protection of the interest of the assured as the insurer is generally the party with greater commercial power. Unlike those rules, the insurers at an early stage adopted insurable interest to protect them from gambling policies. However, at a stage when good order has been established in the insurance market, in particular with marine insurance, such severe measures as criminal penalties for making a gambling policy without insurable interest in good faith is no longer of necessity and practical effect. A gambling policy is still unenforceable in compliance with s 4 of the 1906 Act in the absence of the criminal penalty. Therefore, it is strongly proposed in the Issues Paper that s 1(1) of the Marine Insurance (Gambling Policies) Act 1909 should be repealed.

Moreover, if the statutory requirement of insurable interest in the 1906 Act were to be repealed, it may be arguable that the indemnity principle can provide sufficient legal protection to the insurer as discussed above. The blank between insurable interest and the general interests necessary for the principle may give rise to insurer's liability in some exceptional occasions as a matter of fact. Therefore, it is suggested that the Law Commissions should carefully consider the equilibrium of interests prevailing between the parties before attempting to reform the law on insurable interest.

Conclusion

Just as gambling contracts are not insurance contracts and vice versa, the law governing gambling contract should not affect the law of insurance contracts as provided in s 335(2) of the Gambling Act 2005. In particular, the 1906 Act contains the statutory rules in respect of insurable interest. On the one hand, the gambling policy is a historical product deriving from the immature operation of insurance. Accordingly, insurable interest used to attach closely with identifying a gambling or wagering contract. However, along with a well-developed regime of insurance for over three centuries, insurable interest does not only purport to protect the insurer from indemnifying a loss upon a gambling contract, but also to guarantee the assured who actually and directly suffered from the loss of the subject-matter insured to be recovered. On the other hand, it can be inferred from *Macaura* v. *Northern Insurance* that the lack of insurable interest does not inevitably mean that the policy is a wager. The essence of insurable interest is to ensure that the assured acquires a more specific link with the subject-matter insured than the general interest necessary to the indemnity principle. Therefore, it seems superfluous to emphasize the relationship between insurable interest and gambling contracts; while it would be implausible to remove the concept of insurable interest notwithstanding the indemnity principle. Moreover, the Law Commissions' suggestions of repealing criminal penalties in the Marine Policies (Gambling Prevention) Act 1909 and s 23 of the 1906 Act requiring the naming of the party of insurable interest reflect modern, commercial and less severe attitudes towards gambling policies. In sum, the review of insurable interest in the law of marine insurance concludes that the time has come to detach the strict link between gambling contracts and insurable interests in the modern context, rather than removing the concept and statutory rules entirely from the 1906 Act. The courts need to grapple with the new challenges to get rid of the historical and strict confinements of insurable interest; instead, the nature of insurable interest should be always regarded as a fundamental basis of marine insurance law.