

MARINE INSURANCE FRAUD

BARIŞ SOYER

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MARINE INSURANCE FRAUD BARIŞ SOYER

This book provides a comprehensive and coherent legal analysis of the impact of fraud on the position of various parties to a marine insurance contract, as well as the cover provided by standard marine policies. The issues under discussion in this invaluable guide are also equally relevant in the context of non-marine insurance contracts.

Helpfully divided into two parts, **Part One** deals with the impact of fraud committed by parties to an insurance contract, such as the assured, insurer and brokers. **Part Two** analyses the extent to which standard marine policies cover the fraudulent and dishonest activity of third parties to an insurance contract.

This book will be of huge practical assistance to practitioners specialising in marine insurance as well as insurance generally, and to professionals, academics and post-graduate students.

Professor Barış Soyer is a Professor of Commercial and Maritime Law, head of the Postgraduate Legal Studies Department and the Director of the Institute of International Shipping and Trade Law at Swansea University School of Law.

This book is dedicated to my children: Özgür-James and Cherley-Jale

FOREWORD

Professor Soyer has written a valuable work, centred on marine insurance fraud, but of wider application in the context of insurance generally. The heart of it is its consideration of fraud at two critical stages of the relationship between insurer and insured, namely at the outset of their relationship when the doctrine of good faith disclosure requires a fair presentation of the risk, and after the insurance contract has inception when claims come to be presented.

Where fraud is concerned, the initial period presents fewer difficulties, because deliberate, dishonest concealment such as deserves the name of fraud overleaps many of the anxieties which currently hang about the doctrine of good faith in the presentation of the risk and the draconian remedy of avoidance. Indeed, Professor Soyer demonstrates how the most egregious frauds start life even before contract, in the conspiratorial planning of the loss of phantom cargoes.

It is in the second period, however, when claims are generated, that the issues that arise from fraud multiply. [Chapter 3](#) of this work provides its readers with a substantial and excellent analysis of the problems involved in finding a coherent and proportionate structure for dealing with the many different kinds of dishonesty which populate this period.

Thus Professor Soyer helpfully categorises the various ways in which claims are affected by lying, from the extreme cases of criminal conspiracies, to the over-ambitious exaggeration of values and the use of dishonest devices in the presentation of genuine claims. He goes on to demonstrate the analytical difficulties into which a judicial view that the statutory doctrine of good faith survives the inception of the contract has plunged modern jurisprudence. The courts have had to struggle with solutions for providing a fair response and proportionate remedies to the many different ways in which various forms of dishonesty may infect the presentation and pursuit of claims. Should avoidance *ab initio* be the consequence, with the undoing of previous settlements? Or should the instant claim be lost? Or should the insurance contract be lost for the future? Public policy and concepts of moral hazard also play their role.

[Chapter 4](#) concentrates on similar problems but from the point of view of a dishonest insurer, or at any rate one falling below the standards of good faith. It is rightly said that there are fewer case-reported examples of such conduct: but recent press coverage of wholesale compensation having to be provided in the consumer market makes one wonder where the balance is to be found. It is in this chapter that the author refers to such cases as *Drake Insurance plc v Provident Insurance plc* [2003]

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EWCA Civ 1834; [2004] 1 Lloyd's Rep 268 and *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep IR 111, the former raising questions of reform, the latter of the need for reform.

Law reform is indeed the subject matter of [Chapter 6](#), where the reader will find a helpful summary of the current proposals of the Law Commission. Professor Soyer analyses these proposals by and large favourably and looks forward to the time when, if the proposed reforms find Parliamentary enactment, he can write a second edition of his work to deal with a new legal framework operating in practice.

In his final [Chapter 7](#), the author considers what protection can be obtained by an insured against third party fraud. This is a substantial chapter which pulls together a series of problems concerning insurance coverage in a way which will be of real assistance to its readers. There is for instance extensive treatment of a peril which in the classical world gave Pompey his chance to be named Magnus ('the Great') and which still plagues the modern world, namely piracy.

In short, Professor Soyer has written a book on an important and fascinating theme which not only states the law in a clear and concise way, but also analyses it critically, insightfully and helpfully. I am confident that it will be used profitably by a wide range of readers. I too look forward to his second edition.

*Sir Bernard Rix
Formerly Lord Justice of Appeal
20 Essex Street
April 2014*

PREFACE

Fraud frequently occurs in every area of commerce, despite efforts of law enforcement agencies, regulators and executives of corporations. Commercial fraud is often the work of organised criminal syndicates; but it is also perpetrated by opportunist individuals taking advantage of other parties' lack of information about certain key data surrounding commercial transactions, or of their naivety. The position is not different in the context of marine insurance, although there are additional factors that make this area a fertile ground for fraudsters.

The main objective of this monograph is to provide a comprehensive and coherent legal analysis of both the impact of fraud on the position of various parties to a marine insurance contract, and the cover provided by standard marine policies. Accordingly, the book is divided into two parts. [Part 1 \(Chapters 1–6\)](#) analyses the impact of fraud committed by parties to the insurance contract, that is to say the assured, brokers and insurers, will be analysed. To this end, following a general introduction carried out in [Chapter 1](#), the impact of the assured's (and its employees') fraud at the pre-contractual stage on the contract and potential remedies available for the insurer are considered in [Chapter 2](#). [Chapter 3](#) discusses the position of the insurer when it is established that the assured has committed fraud at the post-contractual stage. This area of law is rather unsettled and has generated a considerable amount of litigation in the course of the last two decades. In [Chapter 4](#), the impact of insurer's fraud on the contract, both at pre- and post-contractual stages, is deliberated. The number of reported cases in this area is considerably lower than those dealing with the assured's fraud either at pre- or post-contractual stages. This partly reflects the nature of the insurance contracts and the fact that the information imbalance is very much in favour of the assured, who is in possession of the key information needed to assess the proposed risk or circumstances surrounding a loss. Independent intermediaries, such as insurance brokers and underwriting agents, play a significant role, particularly in the process of obtaining insurance cover, but this also puts them in a position where they could easily influence the decisions of their counterparts by acting deceitfully. Accordingly, [Chapter 5](#) is devoted to analysing the impact of fraud committed by independent intermediaries on their principal and the other party to an insurance contract. So far, the focus has been on the law as it currently exists. However, the English and Scottish Law Commissions are planning to put forward reform proposals and a draft Bill in 2014 that aspire to alter several fundamental principles of insurance law and certain provisions of the Marine Insurance Act (MIA) 1906. If and when such a statutory change occurs, a

new edition of this book is inevitable given that the current proposals will introduce significant changes to pre-contractual information duties of the parties, as well as of independent agents and legal principles concerning post-contractual duty of good faith. Therefore, I found it appropriate in [Chapter 6](#) to bring the proposed changes to the attention of the reader and discuss the shape that the law will take if such changes are implemented.

[Part 2](#) of the book ([Chapter 7](#)) analyses the extent to which fraudulent and dishonest activity of third parties to an insurance contract (such as crew, criminal syndicates and pirates) is covered by standard marine policies. It is believed that a monograph that is designed to offer a comprehensive analysis on fraud in marine insurance should also discuss such matters, especially considering that parties to a marine insurance contract often enter into this contractual relationship with the intention of providing protection for their interests against unexpected eventualities of this nature. Marine policies often provide cover against dishonesty of third parties, but the relationship between such insured risks and excluded perils can be difficult to ascertain, so it is critically analysed in this part.

I have no doubt that the readers will draw their own conclusions from the legal analysis carried out in this monograph on marine insurance fraud. However, two obvious observations are in order. First, the analysis carried out in [Part 1](#) clearly demonstrates that from a legal perspective, fraud in marine insurance requires a multifaceted approach. In addition to principles relating to utmost good faith enshrined in the MIA 1906, it is essential to take into account relevant sections of other statutes, for example the Misrepresentation Act 1967 and notions of contract/tort law, particularly in considering the remedies that might be available. It is highly probable that dishonest conduct of one of the parties to a marine insurance contract might trigger the application of remedies that can be found in other areas of law, in addition to allowing the innocent party to avoid the contract for breach of the good faith obligations crystallised in the 1906 Act. Second, it needs to be pointed out that the legal analysis carried out in [Part 1](#) is equally applicable in other areas of commercial insurance law. For example, when a fraudulent claim is advanced by an assured, the insurer will have the same common law and statutory remedies regardless of whether the contract is a contract of marine insurance or a facultative reinsurance agreement. Judged from this angle, it is fair to say that the book offers a bit more than its title might otherwise suggest.

I once heard from a colleague that it takes at least six editions for a legal book to get things right! There is an element of truth in that statement, although I hope this monograph provides a fairly accurate appraisal of the current state of law – highlighting its pitfalls and battlegrounds for the years to come, while offering plausible solutions to the unresolved legal problems. In the course of completing the research and writing this book, I have benefited from the wise counsel of several colleagues and practitioners; in particular I would like to thank Professor Andrew Tettenborn, who has always been willing to discuss any legal problem with me, anytime, anywhere! In my view, he is one of the phantoms of common law and I am honoured to be working closely with him. I am also indebted to my colleagues at the Institute of International Shipping and Trade Law at Swansea for creating such a fantastic working environment. I would like to extend my gratitude to Informa

PREFACE

Law for their patience, and in particular to Ms Faye Mousley and Mrs Fiona Biden for their support and kindness. Last but not least, I would like to thank my family (my partner, Jean; my son, Özgür-James; and my daughter, Cherley-Jale) for being so supportive and understanding, even when I spent weekends and holidays in my office working on this book and other projects. They mean everything to me, and this work would not have been completed without their emotional backing.

Needless to say, any infelicities remain my own.

The law stated is on the basis of materials available to me on 31 December 2013.

*Professor B Soyer
January 2014
Swansea, Wales*

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s 55(2)(a)	94, 226	r 48.7
s 56(1)	209	Pt 24
s 57(1)	209, 210	Pt 29, PD 29
s 60	212, 213	Financial Services and Markets Act
s 61	212	(Misleading Statements and Practices
s 62	212, 216	Order 2001 (SI 2001/3645)
s 66	218	Financial Services and Markets Act 2000
s 77	240	(Regulated Activities) Order 2001 (SI
s 78(4)	219	2001/544)
s 80	221	
s 84(1)	55	AUSTRALIA
s 88	213	Insurance (Agents and Brokers) Act 1984
Merchant Shipping Act 1995		s 9
s 281	204	Insurance Contracts Act 1984
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128–9, 134, 154, 158, 169, 171,	176, 273–4	Marine Insurance Act 1909
s 2(2)	64, 154	
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s 17(1)	7	Art 8
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1930	78	Safety of Life at Sea (SOLAS) Convention
Third Parties (Rights against Insurers) Act		1974
2010	78	UN Convention on the Law of the Sea
Unfair Contract Terms Act 1977		1982
s 11(1)	158	UN Salvage Convention 1989
Sched 2	158	UN Convention on the Suppression of
		Unlawful Acts against the Safety of
		Maritime Navigation 1988

PART 1

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CHAPTER 1

GENERAL OVERVIEW OF FRAUD IN MARINE INSURANCE

I FRAUD IN MARINE INSURANCE AND CONTRIBUTING FACTORS

1-1 It is estimated that the annual cost of insurance fraud for the sector is in the region of £2.1 billion.¹ Although this figure might seem frightening, the actual cost of fraud for the industry and society as a whole might well be much higher. It is not entirely clear whether the figures published are based on confirmed fraud cases or whether investigation and prosecution costs of suspicious cases have also been taken into account. It is also doubtful whether the cost of measures taken by the industry to prevent fraud is reflected in these figures. Furthermore, it is unquestionably the case that many forms of dishonest activity go undetected and on some occasions unreported, making it practically impossible to determine the actual cost of insurance fraud.

1-2 There is no reason to assume that the position is any different in the context of marine insurance. Although no data assessing the precise impact of fraud for the marine insurance industry is available, anecdotal evidence seems to indicate that the cost of fraud for the marine underwriting industry is immense. Fraud in the marine insurance context is frequently carried out by well-organised criminal syndicates capable of committing complex and expensive frauds. These syndicates usually concentrate their efforts on cargo insurance fraud, which requires substantial planning due to the number of parties that need to be involved to execute such a fraud. For example, generous insurance cover for cargo that never existed in the first place can be put in place by criminal elements with a view to making a claim for its mysterious disappearance during the transit. For a fraud of this nature to be successful, it is vital to secure the co-operation of a variety of individuals including warehouse personnel, drivers, shipping clerks and surveyors. However, it should not be assumed that marine insurance is immune to fraud perpetrated by opportunist individuals. Such individuals could be the owners of insured ships who decide to sink their ageing tonnage for insurance money, especially at a time of economic downturn,² or brokers who are prepared to stretch the truth or conceal material facts to secure a deal for their principals at a lower premium.

¹ The data has been obtained from the second Annual Fraud Indicator Report published by the National Fraud Office on 27 January 2011 (for more information, see <http://www.nfib.police.uk/index.html> (last accessed 1 December 2013)).

² In the first half of the twentieth century, English courts had to deal with a whole host of scuttling cases, which played a significant role in the development of law in this area.

1-3 It would not be an exaggeration to suggest that almost every maritime fraud perpetrated might bounce back to the marine insurance or reinsurance markets as a claim. Let us take the example of a fraudster who sets up a paper company involved in international trade with the intention of inducing people to enter into a carriage contract with him.³ When the fraudster disappears from the scene with the cargo of the innocent shippers or consignees, the only feasible option available to them will be to pursue the cargo insurers (assuming, of course, their policy provides cover against this kind of risk). In a similar fashion, in a case of indemnifying the assured for losses resulting from the dishonest conduct of third parties, a marine insurer will probably turn to its reinsurers. In that way, the reinsurers might find themselves liable for any kind of dishonest conduct affecting the maritime sector regardless of where the fraud has been perpetrated.⁴ These examples demonstrate clearly the relationship between maritime and marine insurance fraud. However, it is also possible that criminal gangs or opportunist individuals might target marine insurers specifically with an intention of obtaining monetary benefits from them by deceit. At this stage, it is appropriate to evaluate the various factors that make the marine insurance market a fertile stomping ground for fraudsters.

(1) Nature of Marine Business and Organisation of Insurance Companies

1-4 Marine insurance is an international business. Most marine risks are brought to the market from overseas. Marine underwriters know very little (or in most cases, nothing) about the risk or the assured in question. This makes it very difficult and costly for them to inspect the proposed risks at the underwriting stage with the objective of adopting proactive fraud prevention strategies. Put another way, in the context of marine insurance there is more room available to an assured determined to expose the information asymmetry, which is inherent in insurance transactions, to its full potential against marine underwriters, due to the fact that marine underwriters would normally lack familiarity with the business of potential assureds.

1-5 Naturally, marine underwriters fighting against fraud must rely heavily on their claim departments which are expected to employ reactive investigation strategies. However, in practice, this is not often the case. Claim departments are often undervalued and under-staffed within an insurance company, as opposed to the underwriting and investment departments which are regarded as the true generators of profit.⁵ This might lead claim departments to settle, especially small claims, with little investigation in an attempt to keep costs down. The claim departments might also be tempted to adopt a similar approach in cases where the loss has occurred in a remote part of the world and there are limited opportunities for investigation. On reaching the conclusion that investigating the circumstances of loss could be a costly exercise with no real financial benefit, the claims department might well decide to pay for a loss, even if there might be a suspicion of foul play.

³ This kind of fraud is commonly known as long-firm fraud.

⁴ Considering that a vast majority of marine insurers obtain their reinsurance cover from the London market, it is not fanciful to suggest that the cost of any dishonesty in the maritime world might ultimately need to be absorbed by the London market.

⁵ R Goldspink and J Cole (eds), *International Commercial Fraud* (Sweet & Maxwell, 2002), p. 772.

1-6 Another organisational difficulty stems from the fact that there is usually little interaction between the claims and underwriting departments of an insurance company. This might put a strain on the ability of claims departments to discover fraudulent misrepresentation and/or concealment on the part of the assured or his agents at the pre-contractual stage. In some reported cases, it has been observed that the communication might be less than efficient even within the same department of an insurance organisation.⁶

(2) Nature of Marine Policies

1-7 'A valued policy is a policy which specifies the agreed value of the subject matter insured.'⁷ It is a very common practice to insure marine risks by using valued policies. In case of a total loss, under a valued policy the assured is entitled to receive the value specified in the policy regardless of the market value of the subject matter of insurance. The use of valued policies has advantages for both parties to a marine insurance contract. From the assured's perspective, it removes the difficulty of proving the true market value of the insured property⁸ and satisfies the needs of financiers for foreseeability, ensuring that insurance proceeds will be adequate to finance the acquisition of a replacement asset or to discharge financial obligations attached to the acquisition of the insured property.⁹ For the insurer, a higher agreed value not only secures a higher premium income but might also, in some cases, reduce the possibility of liability arising.¹⁰

1-8 Despite its practical benefits, a valued policy could provide the necessary platform for a shipowner facing financial difficulties to perpetrate insurance fraud by obtaining a hull policy above the market value of an ageing ship before deliberately sinking her.¹¹ If the fraud succeeds, this will generate a cash flow which might be sufficient to rescue an insolvent or waning business. Of course, the valuation is

⁶ In *Malhi v Abbey Life Assurance Co Ltd* [1996] LRLR 237, for example, information obtained by the underwriting department of the same insurance company a few years previously in relation to the health of the assured was deemed not to be attributable to the company for the purposes of establishing waiver by election, as it was not received by a person authorised and able to appreciate its significance.

⁷ Section 27(2) of the Marine Insurance Act (MIA) 1906.

⁸ Establishing the actual market value of a ship might be difficult, as it depends on various factors such as size, type, age and speed of the ship, her class and other factors such as the freight market, the availability of a favourable charterparty that can run with the ship and the selling shipowner's reputation. For specialised or rare ships, there is the added difficulty of identifying a potential market.

⁹ See *Glafki Shipping Co SA v Pinos Shipping Co (The Maira) (No 2)* [1986] 2 Lloyd's Rep 12.

¹⁰ For example, under the International Hull Clauses 2003 (01/11/03) cl 21, the insured vessel could be declared a constructive total loss if the cost of recovery and/or repair of the vessel would exceed 80 per cent of her insured value. Accordingly, the likelihood of a casualty qualifying as such a loss will be reduced if a value higher than the market value of the vessel is agreed.

¹¹ From time to time, underwriters have been condemned by courts for their willingness to over-insure vessels. In *Compania Naviera Vascongada v British & Foreign Marine Insurance Co Ltd (The Gloria)* (1936) 54 LIL Rep 35, at 59, Branson J, said:

I should like before parting with this case to express my concurrence with the expressions of disapproval which have fallen from other Judges of the practice of underwriters of over-insuring ships against total loss. The practice is wholly bad. It turns what should be a contract of indemnity into a kind of lottery with a prize for the fortuitous loss of the ship. It must discourage even the most upright of shipmasters in the discharge of his duty to bring a damaged ship into port if he possibly can, and it tempts the dishonest to commit the crime of scuttling.

conclusive between the parties only in the absence of fraud,¹² and the insurer could possibly deny liability for misrepresentation if fraud on the part of the assured could be established;¹³ but the burden of proving that the assured's intention in overvaluing the subject matter of insurance is on the insurer and that is not always an easy task.¹⁴

(3) Absence of Successful Prosecutions/Convictions for Marine Fraud

1-9 It is often said that an effective use of criminal law could act as a deterrent against insurance fraud. Despite the soundness of the theoretical foundations of this view, in practice it is a rarity to witness convictions being secured for insurance fraud. This is not to suggest that the criminal law is not well equipped to deal with this type of fraud. Generally speaking, the introduction of a new 'offence of fraud' under the Fraud Act 2006 should provide the necessary framework for securing convictions for those individuals who take part in insurance fraud.

1-10 Section 2(1) of the Fraud Act 2006, for example, provides that a person is guilty of fraud if he dishonestly makes a false representation with the intention to make a gain for himself or another, to cause loss to another, or to expose another to a risk of loss.¹⁵ Although the Act does not attempt to describe the meaning of 'dishonesty', there is a vast amount of case law on the subject which indicates that for dishonesty the defendant's conduct must fail to conform: (a) to generally accepted standards of honest conduct (as they are and as the defendant believes them to be); and (b) to the limits of what he is legally entitled to do (at least as he believes those limits to be, and arguably also as they actually are).¹⁶ There can be no doubt that an assured who fraudulently misrepresents the attributes of the proposed risk at the outset could potentially be charged with a criminal offence under this section.¹⁷ The same is true of an assured who submits a fraudulent claim to an insurer, as it is invariably the case that submitting such a claim would involve a dishonest misrepresentation regarding the circumstances surrounding the loss. In a similar vein, s 3 of the Act makes it an offence when a person dishonestly fails to disclose

¹² Section 27(3) of the MIA 1906.

¹³ See e.g., *Eagle Star Insurance Co Ltd v Games Video Co SA (The Game Boy)* [2004] EWHC 15 (Comm); [2004] 1 Lloyd's Rep 238.

¹⁴ See [1-17].

¹⁵ For the purposes of this section, the terms 'gain' and 'loss' have been defined in s 5 of the Act:

(2) 'Gain' and 'loss'—

(a) extend only to gain or loss in money or other property;

(b) include any such gain or loss whether temporary or permanent;

and 'property' means any property whether real or personal (including things in action and other intangible property).

(3) 'Gain' includes a gain by keeping what one has, as well as a gain by getting what one does not have.

(4) 'Loss' includes a loss by not getting what one might get, as well as a loss by parting with what one has.

¹⁶ *R v Ghosh* [1982] QB 1053.

¹⁷ The meaning of false representation in criminal law is much wider than that of civil law. In criminal law, a representation need not be a statement at all. It is adequate that the defendant has led the victim to believe that something is true without in any real sense asserting it to be true, see *Scott v Brown, Doering, McNab & Co* [1892] 2 QB 724, at 734, per Smith LJ. Also, s 2(3) of the Fraud Act 2006 specifies that the proposition represented may be one of fact or law.

to another person information which he is under a legal duty to disclose, with the intention of making a gain for himself or another, to cause loss to another, or to expose another to a risk of loss. It is evident that the intention of the draftsman was to extend the application of this section to insurance contracts even though full disclosure is merely a condition precedent to the enforceability of the transaction and the retention of benefits conferred under it, and strictly speaking there is no legal duty to disclose.¹⁸ Accordingly, an assured who dishonestly conceals material facts at the pre-contractual stage is liable for conviction under s 3 of the Act.¹⁹ Needless to say, the position will be the same for an insurer who dishonestly makes material misrepresentations at the pre- or post-contractual stage with the intention of making a gain for himself or another, to cause loss to another, or to expose another to a risk of loss. Under the Act, it will be also possible to convict an independent agent of the assured or insurer who abuses his position dishonestly with the intention to make a gain for himself or another, to cause loss to another, or to expose another to a risk of loss, by virtue of s 4.²⁰

1-11 For the sake of completeness, it should be stressed that there is criminal legislation in force that can be utilised to secure convictions for those who are not parties to an insurance contract but, nevertheless, play a significant role in assisting the assured or his agents in perpetrating insurance fraud. For example, a surveyor who provides false survey reports to assist a criminal organisation in obtaining cargo insurance for goods that never existed in the first place could be charged under s 17(1) of the Theft Act 1968 which stipulates:

Where a person dishonestly, with a view to gain for himself or another or with intent to cause loss to another,—

- (a) destroys, defaces, conceals or falsifies any account or any record or document made or required for any accounting purpose; or
- (b) in furnishing information for any purpose produces or makes use of any account,

18 The Explanatory Notes to the Fraud Act 2006 [20] stipulates:

For example, the failure of a solicitor to share vital information with a client within the context of their work relationship, in order to perpetrate a fraud upon that client, would be covered by this section. Similarly, an offence could be committed under this section if a person intentionally failed to disclose information relating to his heart condition when making an application for life insurance.

Also, the Attorney-General explained in Parliament (*Hansard*, HL Vol 673, col. 1412, 19 July 2005):

There are many occasions in law where the duty is a duty of disclosure: in contracts of insurance, under certain market customs or certain contractual arrangements. In those circumstances, people may well be under a duty to make a disclosure and fail to make it. That will have consequences in law. . . for example, the ability to set aside contracts on the grounds of non-disclosure.

19 Interestingly, an assured who dishonestly conceals circumstances that might have a material bearing on the claim submitted might be charged under s 3 of the Fraud Act 2006 even though such a concealment would not amount to submission of a fraudulent claim for the purposes of recovery under the insurance contract.

20 Under s 1(3) of the Fraud Act 2006, a person who is guilty of the offence of fraud is liable:

- (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
- (b) on conviction on indictment, to imprisonment for a term not exceeding 10 years or to a fine (or to both).

It is worth noting that gain and loss are not part of the *actus reus* of the offence but only *means rea*. Therefore, fraud is an inchoate offence meaning that it includes attempted fraud.

or any such record or document as aforesaid, which to his knowledge is or may be misleading, false or deceptive in a material particular; he shall, on conviction on indictment, be liable to imprisonment for a term not exceeding seven years.²¹

In similar fashion, a shipping agent or a warehouse supervisor who falsifies various documents to assist the assured in bringing a claim for loss of cargo that never existed in the first place, or for short delivery when in fact the goods have been delivered in good condition and order, could be charged with the offence of forgery under s 1 of the Forgery and Counterfeiting Act 1981.²²

1-12 The crew of the insured vessel, if involved in scuttling on the instructions of the owners, could bear criminal responsibility for the offence of conspiracy under s 1(1) of the Criminal Law Act 1977 as substituted by s 5 of the Criminal Attempts Act 1981.²³ This is a crime that is committed immediately when an agreement is made between two or more persons to perform an unlawful act²⁴ or to perform a lawful act by unlawful means; there is no need to prove deception for a conviction to be secured. Likewise, the same charge could be brought against the crew operating on board a phantom ship on the premise that they conspired with the owners or fraudsters to steal someone's cargo.

1-13 Despite the backing of a robust criminal legal system, it is curious why prosecution and, ultimately, conviction for insurance fraud is not a common occurrence. This is mainly attributable to the international character of the business. Marine business is brought to the London market from all around the world (including emerging markets). If an assured located in a foreign jurisdiction, whether a company or an individual, acts dishonestly in obtaining an insurance product from the London market or when making a claim under such policy, that organisation or individual can technically be prosecuted by authorities in the UK for committing an

²¹ In *R v Mallett (Edward Arnold)* [1978] 1 WLR 820 a dealer was convicted under this section for furnishing false information in an application form to a hire a purchase company for financing. The false information was to the effect that the applicant had been a company director for eight years, which was not the case. It was held that the false information provided enabled a bad-risk customer to obtain hire purchase when this would not have happened had the truth been told. The reasoning could obviously be extended to a surveyor who assists an insurer to obtain cargo insurance in circumstances under which he would not have obtained it had the true state of affairs been disclosed to the insurer.

²² This section reads:

A person is guilty of forgery if he makes a false instrument, with the intention that he or another shall use it to induce somebody to accept it as genuine, and by reason of so accepting it to do or not to do some act to his own or any other person's prejudice.

Section 9 of the Act specifies eight ways in which a false document can be made or altered, but the essential requirement is that the document tells a lie about itself.

²³ This provision reads:

... if a person agrees with any other person or persons that a course of conduct shall be pursued which, if the agreement is carried out in accordance with their intentions, either—

- (a) will necessarily amount to or involve the commission of any offence or offences by one or more of the parties to the agreement, or
- (b) would do so but for the existence of facts which render the commission of the offence or any of the offences impossible,

he is guilty of conspiracy to commit the offence or offences in question.

²⁴ It is not necessary to prove that the conspirators intended to make a profit; it will be adequate to demonstrate that they conspired to cause a victim a loss.

offence in this jurisdiction. However, the reality is that if the person in question is not present in this jurisdiction, it is very likely that the enforcement authorities will lack the resources and also the legal standing²⁵ to bring a criminal action against such an individual. Similarly, in cases of cargo fraud, even if the enforcement agents in the UK bring the issue to the attention of their counterparts in the jurisdictions where a criminal gang is temporarily based, the chances are that upon the discovery of the fraud, such criminal elements would flee the jurisdiction immediately and the local police would normally be reluctant to investigate the actions of visiting foreigners who are no longer in the country.

1-14 Even in a case where the assured, alleged to have committed a criminal offence, turns out to be within the reach of the jurisdiction, there is no guarantee that insurance fraud investigation will be a priority for fraud squads. Over the years, both the number and size of fraud squads have diminished in the UK,²⁶ even though a steady increase in the number of fraud cases has been observed during the same period.²⁷ In the circumstances, it is no surprise that fraud squads prefer to investigate public-sector fraud²⁸ or serious commercial fraud (such as company fraud or fraudulent trading) because this type of fraud is more likely to affect a wide range of people. An insurance fraud that does not involve huge sums is likely to be pushed to the bottom of the pecking order, especially given the added jurisdictional difficulties caused by the international nature of the insurance business.

II SCARCITY OF FRAUD LITIGATION IN MARINE INSURANCE AND CONSEQUENCES

1-15 Considering the potential financial impact of fraud in the insurance sector, one would expect the courts to be inundated with litigation concerning fraud. This is not so. When fraud on the part of the assured is suspected, counsel tends to rely on a technical defence or attempts to defeat the indemnity claim put forward by the assured by using other defences. The reasons for this practice need first to be evaluated before any attempt is made to highlight its consequences on insurance practice and indeed, in the coverage of this book.

1-16 It is a procedural requirement that an allegation of fraud and the basis on which the same is alleged is pleaded expressly in the statement of case (pleading of the parties).²⁹ It has been emphasised that a general allegation of fraud is not adequate³⁰ and that fraud should be clearly and sufficiently particularised in the claim if it is to be relied on by any of the parties.³¹ In practice, it is the role of a barrister to write the statement of practice on behalf of his client. A barrister would be in breach

²⁵ If the authorities in the UK follow up the case by bringing the fraud to the attention of the enforcement agencies in the country in which the individual or the company is located, it is very unpredictable what sort of action authorities will take for an offence allegedly committed outside their jurisdiction.

²⁶ Doig, A, *Fraud* (2006, Willan Publishing), p 122.

²⁷ Credit card fraud seems to have contributed immensely in the increase.

²⁸ Doig, A, *Fraud* (Willan Publishing, 2006), p 56.

²⁹ Civil Procedure Rules 1998 (CPR), Pt 16, PD 16, para 8.2.

³⁰ *Wallingford v Mutual Society* (1880) LR 5 App Cas 685, at 697, 701, 705 and 709.

³¹ *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All ER 205, at 218, per Lord

of the Bar Standards Board (BSB) Handbook if he drafts any statement of case or other document containing an allegation of fraud unless he has clear instructions to make such allegation and has before him credible material which establishes a *prima facie* case of fraud.³² In *Medcalf v Weatherhill*,³³ Lord Bingham observed that to comply with his duty under the Bar Code of Conduct, counsel ‘is bound to exercise an objective professional judgment whether it is in all the circumstances proper to lend his name to the allegation . . . [and] counsel could not properly judge it proper to make such an allegation unless he had material before him which he judged to be reasonably credible and which appeared to justify the allegation’.³⁴ Likewise, at the hearing, counsel cannot properly make or persist in an allegation of fraud unless it is supported by admissible evidence. These professional requirements put counsel in a vulnerable position and make them reluctant to plead on the issue unless they have evidence that clearly amounts to a *prima facie* case for fraud. If it is proven later that a practitioner drafted an allegation of fraud without having *prima facie* evidence to that effect, he may be personally liable either to his own party or to the opposing party for wasted costs.³⁵

1-17 The position of legal representatives aside, there are several reasons associated with procedural matters that make parties involved in insurance litigation reluctant to plead fraud. A claim of fraud will generally increase the complexity of an action, requiring additional time to consider the evidence fully.³⁶ Courts will be reluctant to give summary judgment against a defendant on a claim of fraud³⁷ despite having wide powers under the Civil Procedure Rules to decide a claim or a particular issue without full trial.³⁸ Therefore, an increase in cost of litigation is an inescapable consequence of pleading fraud. It is a firmly established principle that a party who alleges fraud but fails to establish it will be normally responsible for those additional costs of the action. This will still be the case even if he is successful in

Wright. It is not necessary that the word ‘fraud’ is used in the claim if it is sufficiently clear and unambiguous that fraud is alleged: *Davy v Garrett* (1877–78) LR 7 Ch D 473, at 489, per Thesiger LJ.

³² Section 704 of the BSB Handbook (a copy can be found at: <https://www.barstandardsboard.org.uk/regulatory-requirements/the-old-code-of-conduct/> (last accessed 12 May 2014)).

³³ [2002] UKHL 27; [2003] 1 AC 120.

³⁴ *Ibid*, at [22].

³⁵ In *Medcalf v Weatherhill* [2002] UKHL 27; [2003] 1 AC 120, having reiterated the general principle, the House of Lords refused to be drawn to the conclusion that pleading fraud on the basis of documents subject to legal privilege amounted to improper conduct on the barrister even though such evidence was inadmissible in court. It should be noted that in cases where fraud is pleaded improperly, there might be a cause of action for wasted costs not only against barristers but also all other legal representatives (the Supreme Court Act 1981, substituted by the Courts and Legal Services Act 1990, s 4(1) and CPR, r 48.7).

³⁶ Where an allegation of fraud is made, the case will normally be heard in the High Court regardless of the value of the claim (CPR, Pt 29, PD 29, paras 2.2, 2.6(3)) and the court will normally hear the case on the multi-track procedure. The multi-track procedure is designed for flexibility during the period leading up to the final hearing and allows a great degree of judicial involvement in case management conferences and pre-trial checklists.

³⁷ See e.g., *Fashion Gossip Ltd v Esprit Telecoms UK Ltd* [2000] All ER (D) 1090 where the Court of Appeal refused summary judgment because there were allegations of fraud. Ward LJ said: ‘where . . . there are allegations of fraud, there must be a firm foundation of fact and all the facts, every nuance, needs exploration and needs to be firmly established.’

³⁸ CPR, Pt 24.

his claim for damages on alternative grounds.³⁹ The prospect of being responsible for additional costs of litigation is certainly a significant reason for the claimant to consider alternative causes of action in cases where fraud is suspected on the part of the other party.

1-18 However, the main difficulty facing a party pleading fraud in litigation is the high degree of burden of proof that needs to be discharged. The standard of proof in cases of fraud does not approach the criminal standard of proof, as is occasionally suggested.⁴⁰ It remains a civil law standard of proof (i.e. on the balance of probabilities).⁴¹ Where fraud is alleged, however, given the fact that it is a less-frequent type of misconduct compared to others, the strength or quality of the evidence required to sustain the allegation is higher, even though the degree of probability required to establish the allegation remains the same.⁴² In other words, the evidence required to prove fraud must be clear and persuasive, and naturally any court will consider the evidence in a more critical fashion before reaching the conclusion that the burden of proof on the part of the claimant has been discharged.⁴³ This is essentially to protect the presumption of innocence and the reputation of the defendant facing such charges.⁴⁴ The observations of Lord Nicholls on the matter are rather illuminating:⁴⁵

The balance of probability standard means that a court is satisfied an event occurred if the court considers that, on the evidence, the occurrence of the event was more likely than not. When assessing the probabilities the court will have in mind as a factor, to whatever extent

³⁹ *Anderson v Thornton* (1853) 8 Ex 425; *Parker v McKenna* (1874) LR 10 Ch App 96 and *Bellotti v Chequers Developments Ltd* [1936] 1 All ER 89.

⁴⁰ Atkin LJ in *Issaias (Elfie A) v Marine Insurance Co Ltd (The Elias Issaias)* (1923) 15 LIL Rep 186, at 192, went so far as to say that the insurer alleging fraud must discharge the burden of proof 'beyond reasonable doubt'.

⁴¹ In *Re B (Children)* [2008] UKHL 35; [2009] 1 AC 11, Lord Hoffmann, at [13], put it bluntly: 'I think that the time has come to say, once and for all, that there is only one civil standard of proof and that is proof that the fact in issue more probably occurred than not.'

⁴² Ungood-Thomas J in *In re Dellow's Will Trusts* [1964] 1 WLR 451, at 455, said: 'The more serious the allegation the more cogent is the evidence required to overcome the unlikelihood of what is alleged and thus to prove it.'

⁴³ In a similar context, Colman J in *Strive Shipping Corp and Another v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88, at 99, summed up the relevant principles in the following manner:

Where in a civil trial, such as one involving an allegation of scuttling, there is an allegation of criminal conduct, if there is to be a principle that the truth of the allegation must be proved by stronger evidence than if it were an allegation of non-criminal conduct, albeit on a balance of probabilities, one is in substance really doing no more than requiring that the evidence should be of sufficient strength to increase the tribunal's relative level of confidence in its conclusion, derived from that evidence, that the allegation is true beyond the level of confidence which it would have derived from such weaker evidence as might have sufficed in a civil case to prove the conduct had it not been criminal. The assertion that the defendant insurers can discharge the burden of proof in a scuttling case only by adducing evidence which is strong in the sense that it strongly connotes complicity and the requirement derived from the authorities in this field that, as I have already indicated, the Court must at least conclude on the whole of the evidence that it is highly improbable that the loss was caused without such complicity will, in my judgment, amount in both cases to the necessity that there be derived from the evidence of complicity a high level of confidence that the allegation is true. I therefore approach the evidence in this case on the basis that it must be strong and in particular of sufficient strength to induce a high level of confidence that the allegation of scuttling is true.

⁴⁴ *Hornal v Neuberger Products Ltd* [1957] 1 QB 247, at 266-7, per Morris LJ.

⁴⁵ In *Re H (Mimors)* [1996] AC 563, at 586.

is appropriate in the particular case, that the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability. Fraud is usually less likely than negligence . . . Built into the preponderance of probability standard is a generous degree of flexibility in respect of the seriousness of the allegation.

Although the result is much the same, this does not mean that where a serious allegation is in issue the standard of proof required is higher. It means only that the inherent probability or improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established.

An insurer claiming fraud on the part of the assured in an insurance litigation has a mountain to climb and is expected to bring to the court's attention clear, concise and convincing evidence to satisfy the burden of proof.⁴⁶

1-19 Faced with such practical and procedural difficulties, the natural reaction of an insurer suspecting fraud on the part of the assured is to search for alternative grounds to justify his rejection to indemnify the assured. When it comes to pre-contractual non-disclosure or misrepresentation on the part of the assured or his independent agent (i.e. broker), the insurer could simply allege material non-disclosure or misrepresentation without pleading fraud even though there might be strong indications that the assured or his agent dishonestly failed to disclose material circumstances or deliberately represented material circumstances inaccurately. The insurer could avoid the policy by proving material non-disclosure or misrepresentation under the MIA 1906⁴⁷ regardless of whether the assured acted fraudulently, negligently or even innocently. Similarly, in cases where the subject matter of insurance has been lost in suspicious circumstances, instead of alleging that the assured has wilfully caused the loss himself to make a claim under the insurance, the insurer could simply not admit the case alleged by the assured as the cause of the loss, and that way put the assured formally under the burden to prove his case. In a majority of such cases, the assured will fail to clear this hurdle. In a case where the insured vessel sank in calm weather, Lord Brandon emphasised that the assured's claim for indemnity could fail simply on the grounds of burden of proof without the need for the insurer to prove anything further:⁴⁸

. . . the judge is not bound always to make a finding one way or the other with regard to the facts averred by the parties. He has open to him the third alternative of saying that the party on whom the burden of proof lies in relation to any averment made by him has failed to discharge that burden. No judge likes to decide cases on burden of proof if he can legitimately avoid having to do so. There are cases, however, in which, owing to the unsatisfactory state of the evidence or otherwise, deciding on the burden of proof is the only just course for him to take.

1-20 A book attempting to offer a comprehensive analysis on the law relating to fraud in marine insurance should cast its net wider and consider these alternative grounds

⁴⁶ It should be noted that appellate courts are rather reluctant to disturb the findings of the trial judge on whether or not the defendant was fraudulent, especially when the defendant himself gave oral evidence at the trial and where the trial judge acquitted the defendant of fraud: *Armstrong v Strain* [1952] 1 KB 232, at 241, per Singleton LJ.

⁴⁷ See ss 18–20 of the MIA 1906.

⁴⁸ *Rhesa Shipping Co SA v Fenton Insurance Co Ltd (The Popi M)* [1985] 1 WLR 948, at 955–6.

that might be relied on in a case where fraud is suspected, but not formally pleaded. This is the approach adopted particularly in [Chapters 2, 3, 4 and 5](#), which essentially attempt to offer a critical analysis of the impact of fraud of the assured, insurer and their agents on the insurance contract. Where necessary, the analysis is extended to cover the areas of law that can be utilised by a party to the contract who suspects fraud but, for tactical reasons, prefers to plead his case in an alternative form. In this way it is intended to provide the complete legal picture for the reader.

III FRAUD – COMPETING VALUES

1-21 Fraud is often viewed as morally repugnant, especially in the context of insurance law, which is built upon the foundations of utmost good faith. It is, therefore, only natural that various policy considerations come to the fore when determining the legal consequences of fraud in insurance law. Very often, one observes judges subscribing to a view that the law should embody a disciplinary element to act as a deterrent against fraud in insurance law. For example, Sir Roger Parker in *Orakpo v Barclays Insurance Services Co Ltd*⁴⁹ remarked: ‘. . . there is an incentive to honesty if the assured knows that, if he is fraudulent, . . . he will recover nothing, even if his claim is in part good.’ In *AXA General Insurance Ltd v Gottlieb*,⁵⁰ Mance LJ, put it in a more uncompromising fashion when he said that the common law remedy against fraud was ‘deliberately designed to operate in a draconian and deterrent fashion’.⁵¹

1-22 Those in favour of law having a disciplinary role when dealing with cases of insurance fraud base their view on a value judgment that is formulated on the morality of this misconduct rather than on any statistical, economic or sociological grounds. A judge contemplating that the law should carry a disciplinary element is effectively saying that it is his view that dishonesty in the insurance context amounts to a ‘grave moral wrong’ which justifies the application of harsh legal remedies. In other words, the judge reflects his personal understanding of morality and equates it with the moral values of the society.⁵²

1-23 In most cases, there is merit in this approach. For example, it is understandable that the law should take a harsh stand against an assured who creates the loss in the first instance to make a claim under an insurance policy. In that case, dishonesty equates to a grave moral wrong when viewed not only from the personal perspective of a judge but also from the morality of the society built on philosophical, cultural and theological foundations. However, it is questionable whether the assured, who tells a lie to advance a valid claim, can be accused of committing a moral wrong of the same degree. Similarly, should an assured who dishonestly exaggerates a claim be treated the same as an assured who instructs the crew to scuttle the insured ship for insurance money?

1-24 The fundamental question is whether the insurance law should treat all lies

⁴⁹ [1995] LRLR 443, at 452.

⁵⁰ [2005] EWCA Civ 112; [2005] Lloyd’s Rep IR 369.

⁵¹ *Ibid*, at [31].

⁵² For a fascinating analysis on the subject of morality, see Devlin, P, *Enforcement of Morals* (1973, Oxford University Press).

in the same manner regardless of why they were told and their actual impact on the other party. The law of deceit as it applies in civil law does not make any distinction. It affords the same remedy in all cases as long as the misleading or wrong representation is made with the intention of committing the innocent party to a course of action that he would not have undertaken but for the deception.⁵³ Put another way, the law of deceit has been developed on the basis of a moral repugnance against all lies.⁵⁴ However, rather pleasingly in the context of insurance law, the judges have taken a more realistic and somehow liberal view of the matter recognising that while some lies are morally repugnant, some are justifiable, while others can cause damage or inconvenience only under certain circumstances.

1-25 Conscious of the fact that the remedy available to an insurer in cases involving submission of a fraudulent claim will be draconian, the courts have suggested that when a fraudulent device is used (i.e. when a lie is advanced) to support a valid insurance claim, this will be treated as a fraudulent claim only in certain circumstances. Mance LJ (as he then was) offered a comprehensive analysis in *Agapitos and another v Agnew and Others (The Aegeon)*:⁵⁵

... I would suggest that the courts should only apply the fraudulent claim rule to the use of fraudulent devices or means which would, if believed, have tended, objectively but prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects – whether they be prospects of obtaining a settlement, or a better settlement, or of winning at trial. Courts are used enough to considering prospects, e.g. when assessing damages for failure by a solicitor to issue a claim form within a limitation period.

Accordingly, a lie told to an insurer at the claims stage will convert the claim into a fraudulent one only if it is intended and capable of securing a bigger cheque for the assured or obtaining an insurance payment with less argument and struggle than might otherwise be the case. The law would not, therefore, take any action on an assured who advances a lie which is obviously irrelevant to the claim, that is to say, a lie that could not sensibly have had any significant impact on any insurer or judge.

1-26 One can observe a similar line taken by the judges when it comes to the exaggeration of insurance claims. In the eyes of law, exaggeration of an insurance claim, even dishonestly made, will not have any adverse consequences unless the exaggeration is deemed to be substantial.⁵⁶ This, according to judges, reflects the commercial reality that most assureds tend to exaggerate their insurance claims in anticipation of the fact that the claims put forward will be cut down by claim adjusters.⁵⁷ The position is different, of course, when the exaggeration is deemed to be substantial. In those cases, the predominant view is that a fraudulent intent to deceive the insurer can be inferred from the fact that a substantially exaggerated claim has been put forward.⁵⁸ The fact remains, though, that the judges are prepared

⁵³ *Derry v Peek* (1889) 14 App Cas 337.

⁵⁴ This has been the case even though there is an apparent recognition in some landmark tort of deceit cases such as *Attwood v Small* (1838) 6 Cl & F 232 that not all deceits are immoral.

⁵⁵ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [38].

⁵⁶ *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC); [2007] Lloyd's Rep IR 283, at [189], per HHJ Peter Coulson QC.

⁵⁷ See *Nsubuga v Commercial Union Assurance Co Plc* [1998] 2 Lloyd's Rep 682, at 686, per Thomas J.

⁵⁸ *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 451, per Hoffmann LJ.

to give the assured the benefit of the doubt even when he deliberately puts forward an exaggerated claim as long as the exaggeration is not substantial. In other words, judges are prepared not to view every dishonest act as 'morally repugnant' especially where commercial realities might dictate an opposite outcome.

1-27 Throughout this book, when it comes to identifying the scope of fraud in the insurance context and consequences of such misconduct, one will observe a notable difference in the moral values subscribed to by different judges. Undoubtedly, contradictory decisions will lead to a degree of uncertainty, particularly in the post-contractual context where one often sees legal authorities that seem to be at odds with previous authorities and established principles. As in any other area of common law, certain areas and concepts inevitably remain blurred; but it is fair to say that the judiciary has been largely successful in creating a sound and consistent legal framework dealing with fraud in insurance law. This will be apparent when we evaluate the impact of fraud on parties to an insurance contract in the succeeding chapters.

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CHAPTER 2

FRAUD COMMITTED BY THE ASSURED AT THE OUTSET

I INTRODUCTION

2-1 In marine insurance practice, the magnitude of the risk is a decisive factor in determining the level of the premium. If the possibility of loss is more likely, it is natural for the underwriter to require an additional premium. The most common form of fraud committed by the assured at the outset is leading the underwriter to believe that the risk he proposes to undertake is less than it actually is. This is achieved either by deliberately misrepresenting the proposed risk or concealing significant facts and circumstances pertaining to it.

2-2 Another form of fraud, albeit less common, is to obtain insurance cover for a property which the insurer does not own at the time the contract is formed. This is more common in cargo insurance practice. To facilitate a fraud of this nature, fraudsters usually obtain blank company invoices on which the details of the supposed cargo consignment are then listed.¹ The cargo is said to be located in a remote part of the world awaiting shipment and the possibility of conducting a survey is naturally very limited either due to logistics or shortage of time. After the insurance policy attaches, it is claimed that the insured cargo has been lost as a result of an unfortunate incident enabling the assured to seek indemnity under the policy for risks which he did not bear.

2-3 There is no doubt that in both scenarios outlined above, the misconduct of the assured is at odds with the utmost good faith principles which underpin marine insurance law. Furthermore, it is very likely that in cases where insurance is obtained for imaginary cargo, the court might conclude that no policy has ever existed.² The purpose of this chapter is to offer a legal analysis on the matter by taking into account the principles enshrined in the Marine Insurance Act (MIA) 1906. Given that, in most cases, the organisations seeking insurance cover in the marine sector will be corporate bodies, the fraud or misconduct of the assured's employees who are authorised to be involved in the process of obtaining insurance cover will be attributable to the assured company. Therefore, when reference is made to the assured in this chapter, this includes the employees of the assured company who

¹ Another method, which is used by fraudsters, is ordering goods and then cancelling them but keeping the invoice. The invoice is later presented to the underwriter while obtaining insurance cover for the supposed cargo.

² An additional defence for the insurer would be to argue that such a claim is fraudulent. The law relating to fraudulent claims is considered in [Chapter 3](#).

are authorised to be involved in obtaining insurance cover. The assured company might also be assisted by independent intermediaries at the formation stage, such as brokers, who will be also expected to comply with the good faith principles; their legal position is considered separately in [Chapter 5](#).

II PRE-CONTRACTUAL DUTY OF UTMOST GOOD FAITH

2-4 Marine insurance contracts are traditionally treated as contracts of utmost good faith.³ Accordingly, the assured and his agents effecting the insurance (usually brokers in marine insurance practice) are put under an obligation to refrain from making untrue statements when presenting the risk to the underwriter and to disclose all material facts relevant to the proposed risk. These pre-contractual duties are set out in ss 18 to 20 of the MIA 1906.⁴ The provisions of the MIA 1906 dealing with utmost good faith constitutes a partial codification of the common law which applies, by analogy, to all forms of insurance.⁵ The consequence of breach of these obligations is avoidance of the contract and it is now judicially confirmed that damages are not available for breach of utmost good faith obligations expressed in the MIA 1906.⁶ In parallel to the authorities decided prior to the enactment of the Act,⁷ the wording of the statute makes it abundantly clear that the policy can be avoided for breach of pre-contractual duty of good faith regardless of whether or

³ *Carter v Boehm* (1766) 3 Burr 1905.

4 Section 18: Disclosure by assured

(1) . . . , the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract . . .

Section 19: Disclosure by agent effecting insurance

. . . , where an insurance is effected for the assured by an agent, the agent must disclose to the insurer—
Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and
Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

Section 20: Representation pending negotiation of contract

Every material representation made by the assured or his agent to the insurer during negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract . . .

The combined effect of these provisions is that if the assured employs an agent to effect an insurance policy on his behalf, any misrepresentation or non-disclosure by the agent in effecting the insurance will give insurers the same entitlement to avoid the policy as if it had been that of the principal. Furthermore, by virtue of s 19(a), the assured will be held responsible for any failure by his agent to effect the insurance to disclose a material fact actually known to, or deemed to be known to the agent. The disclosure duty of the agent expressed in s 19(a) is an independent duty which is analysed in depth in [Chapter 5](#).

⁵ *Joel v Law Union & Crown Insurance Co* [1908] 2 KB 863, at 878; *Economides v Commercial Union Association Co plc* [1998] QB 587, at 598 and *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, at 518.

⁶ *Banque Financière de la Cité SA v Westgate Insurance Co Ltd* [1990] 1 QB 665 and *Bank of Nova Scotia v Hellenic Mutual Risks Association (Bermuda) Ltd (The Good Luck)* [1990] 1 QB 818.

⁷ *Carter v Boehm* (1766) 3 Burr 1905; *Macdowall v Fraser* (1779) 1 Dougl KB 260; *Buse v Turner* (1815) 6 Taunt 338 and *Lindenau v Desborough* (1828) 8 B & C 586.

not the assured has acted fraudulently. Put differently, the assured will not be able to rely on mistake or forgetfulness as a defence if he fails to make full disclosure or misrepresents certain facts to the insurer during negotiations.⁸ However, if the insurer proves that the assured has acted fraudulently whilst presenting the risk, this might not only yield procedural advantages for him but might also enable him to make use of additional remedies. He will be allowed to retain any premium paid under a marine insurance contract which has later been avoided.⁹

2-5 It is well established that pre-contractual duties of utmost good faith of the assured continue until the contract has been concluded.¹⁰ This essentially means that the assured is, up to the date of the making of the contract, under a duty to correct any false statements made in the course of his presentation of the risk¹¹ and to disclose any material facts which come to his attention.¹²

(1) Misrepresentation

2-6 In order to constitute an actionable misrepresentation under the MIA 1906, a statement should be either a false statement as to a fact, or as to a matter of expectation/belief. Furthermore, misrepresentation should be material as defined by the MIA 1906.¹³ It has recently been confirmed that material misrepresentation must also induce the underwriter to make the proposed contract.¹⁴ These elements are analysed in turn by making particular emphasis on the impact of fraud. As will be observed, dishonesty on the part of the assured, if pleaded and proved, will have a considerable impact on each of these elements.

(A) False Statement

2-7 A representation may be made to the assured at the pre-contractual stage either orally, in written format, or even by conduct. Such a representation creates an actionable misrepresentation if it intends to create in the mind of the insurer the existence of a state of affairs or facts which are fundamentally different than the true state of

⁸ *Pan Atlantic Insurance Co v Pine Top Insurance Co* [1995] 1 AC 501, at 518, per Lord Mustill. See also, *Economides v Commercial Union Assurance Association Co Plc* [1998] QB 587.

⁹ Section 84(3)(a) of the MIA 1906. It has been acknowledged by Morison J, in *Swiss Reinsurance Co v United India Insurance Co Ltd* [2005] EWHC 237 (Comm); [2005] Lloyd's Rep IR 341, at [52]–[53], that this section represents the law of non-marine insurance as well.

¹⁰ Section 21 of the MIA 1906 provides:

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; . . .

¹¹ *Canning v Farquhar* (1886) LR 16 QBD 727 and *Assicurazioni Generali Spa v Arab Insurance Group (BSC)* [2002] EWCA Civ 1642; [2003] Lloyd's Rep IR 131. Section 20(6) of the MIA 1906 allows the assured to withdraw or correct a false representation before the contract is concluded.

¹² *Ionides v Pacific Fire and Marine Insurance Co* (1871) LR 6 QB 674 and *Cory v Patton (Demurrer and Joinder)* (1872) LR 7 QB 304.

¹³ Section 20(2) of the MIA 1906 reads:

A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

¹⁴ *Pan Atlantic Insurance Co v Pine Top Insurance Co* [1995] 1 AC 501.

affairs or facts.¹⁵ Section 20(4) of the MIA 1906, following the approach developed by the common law, makes an allowance in terms of the degree of accuracy expected when a representation is a statement of fact. By virtue of this provision, a statement of fact is regarded as true if it is ‘substantially correct’, that is to say if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer.¹⁶ Put another way, the representation will not be substantially correct if the difference between the meaning of the representation and the truth is material, objectively tested by reference to the attitude of a prudent underwriter.¹⁷ In *Commonwealth Insurance Co of Vancouver v Groupe Sprinks SA*,¹⁸ the assured represented the gross loss ratio to be 85 per cent, whereas the actual gross loss ratio on the subject quota share reinsurance was 108 per cent. It was held that the difference was not substantial within the meaning of s 20(4) of the MIA 1906.¹⁹

2-8 A false statement, as described above, will be treated as a fraudulent statement in cases where the maker knows that what he says is false or makes the statement recklessly without caring whether it is true or false in accordance with the principles laid down in *Derry v Peek*.²⁰ A difficult question arises as to what happens in cases where the statement is substantially correct but a small part of it is tainted with dishonesty. Imagine a situation where the assured, while seeking cover for his cargo, tells the underwriter that the entire cargo was surveyed and found to be satisfactory by a surveyor even though he is aware that a few of the containers were not subject to the survey, as they had not been stuffed in time. Assuming that the consignment is made up of 1,000 containers, one can argue that the discrepancy between what is presented and the correct position is minimal and should be tolerated.²¹ It is an equally plausible argument to say that a representation made with the intent to deceive the other party should be regarded as substantially incorrect however trivial or immaterial it is to the nature of the risk. There is no direct legal authority on the subject but the former solution is seemingly at odds with the cardinal principle of law that dictates that a person should not be allowed to benefit from his own fraud.²² It

¹⁵ In cases where a misleading statement is made by a third party to the insurer, that statement might affect the assured’s contract with the insurer, especially if the assured actually and knowingly promotes or adopts the presentation. This is likely to be the case where an original assured or his broker makes a presentation with regard to the risk directly to the reinsurers. It has been held that in such circumstances, the reassured will be taken to have adopted the original assured’s or his broker’s presentation so that in the event of any falsity, the reinsurers will be entitled to avoid the reinsurance contract. On this point see *General Accident Fire and Life Assurance Corporation and Others v Peter William Tanter and Others (The Zephyr)* [1985] 2 Lloyd’s Rep 529, at 532, per Mustill LJ and more recently, *Bonner v Cox Dedicated Corporate Member Ltd* [2004] EWHC 2963 (Comm); [2005] Lloyd’s Rep IR 569, at [96], per Morison J.

¹⁶ *Macdowall v Fraser* (1779) 1 Dougl 260, at 261, per Lord Mansfield.

¹⁷ *Svenska Handelsbanken v Sun Alliance and London Insurance plc (No 2)* [1996] 1 Lloyd’s Rep 519, at 561, per Rix J.

¹⁸ [1983] 1 Lloyd’s Rep 67.

¹⁹ Similarly in *Sea Glory Maritime v Al Sagr National Insurance Co (The Nancy)* [2013] EWHC 2116 (Comm), it was held that a presentation to the effect that a particular management company was the technical and commercial manager of the insured vessel was substantially true even though another company had some involvement in the management of the insured vessel.

²⁰ (1889) 14 App Cas 337.

²¹ The current editors of *Arnould* suggest that a *de minimis* rule would be applied: Gilman, J, Merkin, RM, Blanchard, C and Templeman, M (eds), *Arnould’s Law of Marine Insurance and Average* (18th edn) (2013, Sweet & Maxwell), [17.91].

²² *Beresford v Royal Insurance Co Ltd* [1938] AC 586, at 598, per Atkin LJ.

can also be contended that disregarding the assured's fraud, no matter how trivial, would be against public policy.²³ In the post-contractual context, courts tend to make an allowance when an exaggerated claim is put forward as long as the exaggeration is not substantial.²⁴ By analogy, there is room to argue that a fraudulent misrepresentation at the pre-contractual stage gives rise to a right to avoid as long as it is not trivial.

2-9 Under common law, an incomplete statement is regarded as 'false' as it gives a misleading impression to the representee.²⁵ A similar problem could arise when presenting risks to the insurer.²⁶ When, for example, the assured is expressly asked for the claims made under the previous policy, he should express the position fully. Not mentioning one claim will amount not only to non-disclosure but also to misrepresentation²⁷ since the whole truth has not been told, although the impression given is that it has been.²⁸ It is probable that forgetfulness might be the cause of an incomplete answer given by the assured; however, in practice, it is likely that such omission will usually be associated with dishonesty, which might allow the underwriter to claim damages in addition to the remedy of avoidance.

2-10 In cases where there is an ambiguity in the question put to the assured, the fact that the assured has misunderstood or misinterpreted the question in giving what he believed to be a truthful answer will generally exonerate him.²⁹ When ascertaining whether there is a genuine ambiguity, courts need to approach the matter from the perspective of an objective and reasonable assured.³⁰ If the answer is true having regard to the construction which a reasonable man might put upon the question, the underwriter cannot rely upon the answer as a misrepresentation of fact. There is no need to enquire as to what the assured actually thought unless fraud is alleged.³¹ If it is demonstrated that the assured had understood the question correctly and deliberately gave a wrong answer, he will not be allowed to take advantage

²³ In fact this was the view taken in an earlier edition of *Arnould: Mustill, MJ and Gilman, J (eds), Arnould's Law of Marine Insurance and Average* (16th edn) (1981, Sweet & Maxwell), para 614. See also Cartwright, J, *Misrepresentation Mistake and Non-Disclosure* (3rd edn) (2012, Sweet & Maxwell), § 3.33, which makes a similar point.

²⁴ In *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 451, Staughton LJ said: '... I am not convinced that a claim which is knowingly exaggerated in some degree should, as a matter of law, disqualify the insured from any recovery. If the contract says so, well and good ... But I would not lend the authority of this Court to the doctrine that such a term is imposed by law.'

²⁵ *Oakes v Turquand* (1867) LR 2 HL 325; *Peek v Gurney* (1873) LR 6 HL 377; *Arkwright v Newbold* (1881) 17 Ch D 301 and *Jewson & Sons Ltd v Arcos Ltd* (1933) 39 Com Cas 59.

²⁶ *Krantz v Allan and Faber* (1921) 9 LIL Rep 410; *Candogianis v Guardian Association Co* [1921] 2 AC 125; *Dent v Blackmore* (1927) 29 LIL Rep 9 and *Rozanes v Bowen* (1928) 32 LIL Rep 98.

²⁷ Bearing in mind that the Misrepresentation Act 1967 applies only to misrepresentations, it is vital that partial non-disclosure is also regarded as a form of actual misrepresentation. This is later analysed when discussing remedies.

²⁸ *HIH Casualty & General Insurance Co v Chase Manhattan Bank* [2001] EWCA Civ 1250, at [48]; [2001] 2 Lloyd's Rep 483, at 494.

²⁹ *Yorke v Yorkshire Insurance Co Ltd* [1918] 1 KB 662; *Condogianis v Guardian Assurance* [1921] 2 AC 125; *Revell v London General Insurance Co Ltd* (1934) 50 LIL Rep 114 and *Taylor v Eagle Star and British Dominions Insurance Co* (1940) 67 LIL Rep 136. Cf *Glicksman v Lancashire and General Assurance Co Ltd* [1927] AC 139.

³⁰ *Roberts v Avon Insurance Co Ltd* [1956] 2 Lloyd's Rep 240, at 246-9, per Barry J and *Moore Large & Co Ltd v Hermes Credit and Guarantee Plc* [2003] EWHC 26 (Comm); [2003] Lloyd's Rep IR 315, at [53], per Colman J.

³¹ *R & R Developments Ltd v AXA Insurance UK Plc* [2009] EWHC 2429 (Ch); [2010] Lloyd's Rep IR 521 at [15]-[26], per HHJ Nicholas Strauss QC.

of the ambiguity in the question to avoid consequences of misrepresentation.³² This is yet another reflection of the celebrated maxim that ‘no one shall be permitted to profit by his own fraud’.

2-11 In general contract law, it is not possible to establish an actionable misrepresentation on the premise that the representor has chosen to remain silent on a particular issue.³³ However, in the context of insurance law, mere silence might in some cases be adequate to found a claim in misrepresentation. This is likely to be the case when the circumstances change after a representation is made but before the contract is concluded, so as to render the representation untrue, but the assured fails to inform the insurer of the change. In *St Paul Fire & Marine Insurance Co (UK) Ltd v McConnell Dowell Contractors Ltd*,³⁴ the insurers providing contractors’ liabilities insurance were told that piled foundations would be used in the project (the construction of the parliamentary and administrative buildings on the Marshall Islands), but subsequently and prior to the conclusion of the contract, the assureds decided to use spread foundations instead and failed to inform the insurers of the change. The Court of Appeal held that this was a statement as to the nature and design of the project and it amounted to material misrepresentation.³⁵ Likewise, a misleading representation made at the time when the contract is formed might be deemed to continue at the time of renewal if not corrected in the interim, giving rise to a right to avoid the renewal based on the original representation.³⁶ That said, it should not be readily assumed that the assured is under an obligation to correct his representation which turns out to be inaccurate in all instances. As pointed out by Longmore LJ, in *Limit No 2 Ltd v AXA Versicherung AG*,³⁷ it is possible that the representation relates to a state of affairs at a given point in time, or it may be that the presentation is one of intention which was ‘intended to be operative when the risk began and would continue up to that time’.

2-12 In similar fashion, due to the unique nature of insurance law – that is to say, that the assured is under a duty of disclosure at the pre-contractual stage – it might be possible that silence might constitute a false representation in cases where the assured deliberately withholds information from the insurer at the pre-contractual stage. By doing so, the assured gives the impression to the underwriter that he does not speak as he has nothing to say. This, itself, should be a misrepresentation, as the assured knows that the impression he gives is not accurate, but he insists on

³² *Beresford v Royal Insurance Co Ltd* [1938] AC 586.

³³ *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All ER 205, at 210–211, per Viscount Maugham.

³⁴ [1993] 2 Lloyd’s Rep 503; *aff’d* [1995] 2 Lloyd’s Rep 116.

³⁵ See also, *Svenska Handelsbanken v Sun Alliance and London Insurance plc (No 2)* [1996] 1 Lloyd’s Rep 519. *Cf Commonwealth Insurance Co of Vancouver v Groupe Sprinks SA* [1983] 1 Lloyd’s Rep 67.

³⁶ *Sharp v Sphere Drake Insurance (The Moonacre)* [1992] 2 Lloyd’s Rep 501 and *Glencore International AG v Alpina Insurance Co Ltd* [2003] EWHC 2792 (Comm); [2004] 1 Lloyd’s Rep 111.

³⁷ [2008] EWCA Civ 1231; [2009] Lloyd’s Rep IR 396, at [23]. The case was related to a series of reinsurance treaties protecting the energy accounts of various Lloyd’s syndicates. The reinsurers argued that the syndicates through their brokers had represented falsely that the syndicates intended to write risks with deductibles of at least £500,000 and their broker did not do anything to correct or qualify the statements at the renewal of the treaty in 1998. The Court of Appeal found that the representation as to the syndicates’ intention was not continuing at the time of the 1998 treaty. The Court refrained from identifying the exact point at which the misrepresentation made in July 1996 ceased to be operative, but it was convinced that it was well in advance of the 1998 treaty.

presenting this effective non-disclosure to the underwriter.³⁸ It is likely that the outcome will be different in cases where the assured remains silent due to his inability to appreciate the need to speak, but this is due to his negligence or ignorance rather than dishonesty.

2-13 An opinion is a statement as it appears, or should appear to the person to whom it is made, that the speaker does not have sufficient information to guarantee.³⁹ A statement of opinion creates an actionable misrepresentation if it can be demonstrated that the opinion was not in fact held.⁴⁰ The rationale behind this is that every opinion implies that the representor's view is genuine. If it is not, then there is a misrepresentation as to the state of a man's mind, which is a misstatement of fact.⁴¹ In *Anderson v Pacific Fire & Marine Insurance Co*,⁴² for example, a statement that an anchorage was 'good and safe', made by a party who professed not to have first-hand experience of it, did not create an actionable representation since it was regarded as an expression of opinion and was made in good faith.

2-14 Valuation of the subject matter insured is a matter of opinion, and in marine insurance practice this is an area which is prone to foul play.⁴³ If the insured property is deliberately overvalued by the assured and the underwriter is not aware of the overvaluation, this will amount to misrepresentation, as the assured in that case does not have a genuine belief in the opinion he presented.⁴⁴ Determining whether there is a material overvaluation or not is a question of fact. It is likely that courts would be willing to accept that the subject matter is overvalued in cases where it is so great as to make the risk speculative. For example, in *Ionides v Pender*,⁴⁵ a cargo of spirits worth £973 was insured under a valued policy for £2,800. The assured argued that the overvaluation was justified in that it took account of the assured's anticipated profits on resale. The judge, based on the evidence that an anticipated profit greater than 25–30 per cent was speculative, held that the assured had represented the value of goods so highly as to amount to a speculation. It is safe to assume that an overvaluation that can be explained as part of an ordinary business transaction will normally not be found to be excessive.⁴⁶ For instance, Colman J, in *Strive Shipping*

³⁸ *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665, at 773–4, 782–3, per Slade LJ and *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483, at [48]–[49], per Rix LJ.

³⁹ *Hubbard v Glover* (1812) 3 Camp 312, at 314–15; *Brine v Featherstone* (1813) 4 Taunt 869, at 873 and *Anderson v Pacific Fire & Marine* (1872) LR 7 CP 65, at 69.

⁴⁰ Section 20(5) of the MIA 1906. This section could be traced to the decision of Lord Mansfield in *Pawson v Watson* (1778) 2 Cowp 785, at 788. As stressed by Bowen LJ, in *Edgington v Fitzmaurice* (1885) 29 Ch D 459, at 483, a person saying that he expects or believes that a certain state of facts does or will exist, is, in fact, making an affirmative representation as to the present condition of his mind. Therefore, for that representation to be viewed as misleading it is necessary that the maker of the representation is conscious that the representation is false.

⁴¹ *Edgington v Fitzmaurice* (1885) 29 Ch D 459, at 483.

⁴² (1872) LR 7 CP 65.

⁴³ Most marine policies are valued policies and, by virtue of s 27(3) of the MIA 1906, the value fixed by the policy is, as between the insurer and assured, conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial, subject to the provisions of the MIA 1906 (see e.g., s 27(4) of the MIA 1906) and in the absence of fraud.

⁴⁴ See *Eagle Star Insurance Co Ltd v Games Video Co SA (The Game Boy)* [2004] EWHC 15; [2004] 1 Lloyd's Rep 238, where a vessel of a scrap value was insured for US\$1.8 million.

⁴⁵ (1874) LR 9 QB 531.

⁴⁶ *Mathie v Argonaut Marine* (1925) 21 LIL Rep 145. A similar point has been made by Waller LJ,

*Corp v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)*⁴⁷ concluded that the fact that the insured vessel was insured for about twice her true market value was not material as overvaluation was ‘consistent with reasonably prudent ship management’.⁴⁸

2-15 In general contract law, it might be possible that a statement that is presented as an opinion carries the implication of an assertion of a specific fact; often the implication is that the representor has reasonable grounds for holding the opinion or belief.⁴⁹ This could arise in cases where the representee has significantly less information than the representor about facts or other circumstances which are relevant to the opinion expressed.⁵⁰ In cases where such an implication could be inferred, falsity of the opinion expressed might create an actionable misrepresentation even if the representor is acting in good faith. It is possible, particularly in a reinsurance context, that certain matters mentioned in the slip as information with regard to the risk will be construed to be representation of facts by the reassured.⁵¹

2-16 A related question is whether a statement of opinion may give rise to an implied representation of facts accompanying it that the speaker possesses reasonable grounds for his opinion. The matter was deliberated scrupulously by the Court of Appeal in *Economides v Commercial Union Assurance Co Plc*.⁵² The assured, in the process of obtaining renewal of the insurance on the contents of his flat, represented that the value of the contents was £16,000. He also stressed that the worth of specific items of value did not exceed one-third of the total value. By the time of renewal, the assured’s parents had come to live with him and the figures given to underwriters included an element representing the value of his parent’s property, which the assured had been told by his father was no more than £4,000. The assured was aware that his parent’s property included some items of value, but he

in *North Star Shipping Ltd v Sphere Drake Insurance Plc* [2006] EWCA Civ 378; [2006] 1 Lloyd’s Rep 519, at [46].

⁴⁷ [2002] EWHC 203 (Comm); [2002] 2 Lloyd’s Rep 88, at [473]–[480].

⁴⁸ Similarly, Phillips J, in *Inversiones Manria SA v Sphere Drake Insurance Co Plc (The Dora)* [1989] 1 Lloyd’s Rep 69, at 92 expressed the view that a discrepancy between an insured value that is equivalent to the purchase price of a yacht and its open market value is not material.

⁴⁹ *Smith v Land and House Property Corporation* (1884) 28 Ch D 7 and *Brown v Raphael* [1958] Ch 636.

⁵⁰ *Smith v Land and House Property Corporation*, *ibid*, at 15, per Bowen LJ:

... if the facts are not equally known to both sides, then a statement of opinion by the one who knows the facts best involves very often a statement of a material facts, for he impliedly states that he knows facts which justify his opinion.

See *Bisset v Wilkinson* [1927] AC 177 and *Hummingbird Motors Ltd v Hobbs* [1986] RTR 276, where the representor had no real way of knowing whether or not his opinion was correct.

⁵¹ *Sirus International Insurance Corp v Oriental International Assurance Corp* [1999] 1 All ER (Comm) 699, at 708–9, per Longmore J. The knowledge of the assured’s agents (e.g. brokers) might also be relevant and give the impression to the insurer that the assured is well placed to know the facts in question; see e.g., *Crane v Hannover Ruckversicherungs AG* [2008] EWHC 3165 (Comm); [2010] Lloyd’s Rep IR 93, at [123]. See also, *Kamidian v Wareham Holt* [2008] EWHC 1483 (Comm); [2009] Lloyd’s Rep IR 242.

⁵² [1998] QB 587. It was suggested, *obiter dictum*, by Steyn J, in *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd’s Rep 109, at 112–13, that common law principles in this regard are also applicable to (marine) insurance law and accordingly, a representation of belief carries with it an implied representation that the person making it has reasonable grounds for his belief.

took no steps to verify that what he had been told was correct. Following a burglary, it became obvious that the true value of the flat's contents was in excess of £40,000, most of which was constituted by his parent's property. The main issue at stake was whether a statement as to the value of the contents of a flat which contained the assured's parents' belongings as well as his own (a statement of opinion), carried an implication that he had reasonable basis for the value stated. Relying on s 20(5) of the MIA 1906, the majority of the Court of Appeal held that the wording of the subsection excludes the possibility of implied representations of reasonable grounds for the belief. Peter Gibson LJ said:

... I find it impossible to see how consistently with section 20(5) an objective test of reasonableness can be imported by way of an implied representation. Once statute deems an honest representation as to a matter of belief to be true, I cannot see that there is scope for inquiry as to whether there were objectively reasonable grounds for that belief.⁵³

Based on this reasoning and given that the assured had answered the question honestly he was allowed to recover under the policy.

2-17 It is submitted that the view of the majority in the Court of Appeal is sound.⁵⁴ No insurance case decided before the enactment of the MIA 1906 suggested the existence of some element of objectivity to test the correctness of a subjective statement. On the contrary, Lord Mansfield⁵⁵ clearly proposed a subjective test when identifying in which instances an opinion could create an actionable misrepresentation and this has found its way into s 20(5) of the MIA 1906. Bearing in mind that the MIA 1906 was not intended to change the law but only to codify it, adopting an objective test to assess the correctness of an opinion would be contrary to the ethos behind the legislation. Therefore, it is sensible to treat a statement of opinion made under an insurance contract differently to one made under other contracts.

2-18 It should not, however, be assumed that objective elements have no role to play in this context. The absence of reasonable grounds for belief may point to the absence of good faith for that belief. It is also worth noting that the judgment of the Court of Appeal does not prevent courts from regarding a statement that initially appears to be a representation of opinion as an assertion of a specific fact, provided that the words used would have conveyed the impression to a prudent underwriter that the statement is a statement of fact.⁵⁶

2-19 There is a consistent line of authority suggesting that misstatements of law are not actionable as misrepresentations. The rationale behind this is commonly said

⁵³ *Ibid*, at 606. See also, the judgment of Simon Brown LJ, at 599. Sir Iain Glidewell, on the other hand, preferred to leave the matter open.

⁵⁴ The decision has been followed in *Eagle Star Insurance Co v Games Video Co (The Game Boy)* [2004] EWHC 15 (Comm); [2004] 1 Lloyd's Rep 238; *Rendall v Combined Insurance of America* [2005] EWHC 678 (Comm); [2006] Lloyd's Rep IR 732 and *Zeller v British Caymanian Insurance Co Ltd* [2008] UKPC 4; [2008] Lloyd's Rep IR 545.

⁵⁵ *Pawson v Watson* (1778) 2 Cowp 785, at 788.

⁵⁶ For example, in *Sirius International Insurance Corporation v Oriental Assurance Corporation* [1999] Lloyd's Rep IR 343, the reinsured's producing brokers sent a fax to the reinsured's placing brokers stating that 'we have been informed that' there were fire hydrants at the insured premises. This statement proved to be false. The reinsured argued that the information was no more than a statement of opinion and it was not false as it was made in good faith. It was held that the fax had to be construed as a statement of fact.

to lie in the general maxim *ignorantia iuris haud excusat*.⁵⁷ The distinction between a statement of fact and law is not always as clear-cut as one would hope.⁵⁸ However, it is fair to suggest that statements as to the interpretation of a statute⁵⁹ or the existence of insurable interest⁶⁰ are likely to be regarded as statements of law. There is a strong possibility that in cases where dishonesty is proven on the part of the assured, even a statement of law would create an actionable misrepresentation as: (i) a statement of law could be regarded as a statement of opinion⁶¹ and, as indicated by s 20(5) of the MIA 1906, such a statement is false if the representor is acting dishonestly; and (ii) there is judicial support for the proposition that fraud overrides whatever the policy grounds may be for the reluctance to grant remedies for misstatement of law.⁶² A similar outcome will follow when a representation concerns foreign law. In that case, even in the absence of dishonesty on the part of the assured, such a representation will be regarded as a representation of fact and, if false, will give rise to misrepresentation.⁶³ The difference between a representation concerning English law and foreign law stems from the fact that neither party is expected to have any knowledge of the foreign law, therefore the assured's representation is no longer a representation of opinion but instead can be viewed as a statement of fact.

2-20 A statement of intention/expectation does not create an actionable misrepresentation unless it is made dishonestly.⁶⁴ For example, in *Seismik Sukrurtig AG v Sphere Drake Insurance Co plc*,⁶⁵ a statement that the insured vessel was to be used for private pleasure and not for chartering was held not to have created a misrepresentation, as when the statement was made, the assured had genuinely intended this to be the case, even though he later changed his mind.⁶⁶ It has been occasionally held that in general contract law a statement of intention could contain an implication that it is made on reasonable grounds.⁶⁷ It has been suggested tentatively in some reinsurance cases that a similar outcome should follow. In *Simmer v New India Assurance Co Ltd*,⁶⁸ for example, estimates of future claims and premium income when applying

⁵⁷ 'Ignorance of law is no excuse.' *Bilbie v Lumley* (1802) 2 East 469, at 472, per Lord Ellenborough and *Cooper v Phibbs* (1867) LR 2 HL 149, at 170, per Lord Westbury.

⁵⁸ For a detailed analysis on this point, see Cartwright, J, *Misrepresentation Mistake and Non-Disclosure* (3rd edn) (2012, Sweet & Maxwell), §§ 3.22–3.27. It is also debateable whether any distinction between misrepresentations of fact and law can be maintained given that the House of Lords in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349 has extended restitutionary relief to causes of action based on mistakes of law.

⁵⁹ *Cross v Mutual Reserve Life Insurance Co* (1904) 21 TLR 15.

⁶⁰ *Tofts v Pearl Life Assurance Co Ltd* [1915] 1 KB 189.

⁶¹ *West London Commercial Bank v Kitson* (1884) 13 QBD 360, at 362–3; *Beattie v Lord Ebury* (1872) LR 7 Ch App 777, at 802 and *Solle v Butcher* [1950] 1 KB 671, at 703.

⁶² *British Workman's and General Assurance Co Ltd v Cunliffe* (1902) 18 TLR 425; *Hughes v Liverpool Victoria Legal Friendly Society* [1916] 2 KB 482 and *André & Cie SA v Ets Michel Blanc & Fils* [1979] 2 Lloyd's Rep 427.

⁶³ *Furness Withy (Australia) Pty Ltd v Metal Distributors (UK) Ltd (The Amazonia)* [1989] 1 Lloyd's Rep 403, at 408, per Gatehouse J. See also, *International Lottery Management v Dumas* [2002] EWHC 177 (Comm); [2002] Lloyd's Rep IR 237.

⁶⁴ *Bowden v Vaughan* (1809) 10 East 415; *Hubbard v Glover* (1812) 3 Camp 312 and *Anderson v Pacific Fire and Marine Insurance Co* (1872) LR 7 CP 65. See also, s 20(5) of the MIA 1906.

⁶⁵ [1997] CLY 3157.

⁶⁶ See also, *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] Lloyd's Rep IR 291, reversed on other grounds [2001] EWCA Civ 1047; [2001] Lloyd's Rep IR 667.

⁶⁷ *Bank Leumi Le Israel BM v British National Insurance Co Ltd* [1988] 1 Lloyd's Rep 79.

⁶⁸ [1995] LRLR Rep 240, at 259, per HHJ Diamond QC.

for reinsurance was construed as carrying with them an implied representation of fact that there exist reasonable grounds for making them. It is submitted that the reasoning adopted in *Simmer* does not survive the judgment of the Court of Appeal in *Economides*, especially in light of the fact that the possibility of adopting an objective test to determine the correctness of a statement of intention has been disregarded.⁶⁹

(B) *Materiality*

2-21 The MIA 1906 provides that ‘a representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk’.⁷⁰ Even though the origins of the test could be traced to the nineteenth century,⁷¹ it was not until the 1980s that the test was subjected to the scrutiny of the courts. In *Container Transport International Inc and Reliance Group Inc (CTI) v Oceanus Mutual Underwriting Association (Bermuda) Ltd*,⁷² Lloyd J argued that a circumstance or fact will be material if the underwriter could satisfy the court that a prudent insurer would have acted differently (ie would have either declined the risk altogether or charged a higher premium) had the information misrepresented or withheld been available to him.⁷³ In other words, under this test, the underwriter was required to demonstrate that a prudent underwriter had been decisively influenced as a result of the misrepresentation or non-disclosure.

2-22 Even though the Court of Appeal later rejected the decisive influence test,⁷⁴ the law in this area remained blurred until the judgment of the House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*.⁷⁵ The relevant facts of the case may be briefly stated. The reassured wished to obtain cover for the long-tail environmental liability business. The broker acting on their behalf presented the risk to the reinsurer in such a way as to distract attention from the more mature years of the loss record (which, of course, give a better indication of the true position in long-tail cases). Three weeks after the initial meeting between the parties, the reassured told the reinsurer that the losses for later years had not significantly increased since that meeting, when in fact the number of claims had doubled. The later misrepresentation was held to render the policy voidable. The earlier attempt to mislead the reinsurer was held to be irrelevant as a competent underwriter should have known that the earlier years were more reliable. Although their Lordships were unanimous in reaching this conclusion, there were differences in their approach to the question of materiality.

2-23 The majority view, endorsed by Lords Goff, Mustill and Slynn, was that the phrase ‘influence the judgment of a prudent insurer’, stipulated in ss 18(2) and 20(2) of the MIA 1906, meant no more than ‘an effect on the mind of the

⁶⁹ See *Economides v Commercial Union Assurance Co plc* [1998] QB 587.

⁷⁰ See s 20(2) of the MIA 1906. The same test applies in case of non-disclosure by virtue of s 18(2).

⁷¹ See *Rivaz v Gerussi* (1880) LR 6 QBD 622 and *Tate & Sons v Hyslop* (1885) LR 15 QBD 368.

⁷² [1982] 2 Lloyd’s Rep 178.

⁷³ *Ibid*, at 187.

⁷⁴ [1984] 1 Lloyd’s Rep 476.

⁷⁵ [1995] 1 AC 501.

insurer in weighting up the risk'. Accordingly, a concealment or misrepresentation would be regarded as material if a prudent insurer would have wanted to know the information in question and would not necessarily have acted any differently as regards the premium or the risk.⁷⁶

2-24 As the materiality test deals with the way a prudent insurer weighs up the risk, materiality of a false representation or a fact/circumstance concealed is a pure question of fact in each case. Therefore, the decided cases give no more than an indication of what conclusion a court would reach in any particular case.⁷⁷

2-25 Generally speaking, the burden of proving that a fact misrepresented or concealed is material rests upon the insurer. To this end, insurers invariably rely on expert evidence at the trial. Materiality can, however, be determined without evidence being called. The ultimate decision lies with the judge, who is expected to critically assess the evidence put forward. In cases where the materiality of misrepresented or concealed fact is obvious, it may be not be necessary to call any expert evidence to establish this point.⁷⁸ In similar vein, if a statement of fact is deemed not to be substantially correct, there is no need to prove materiality as the assessment of whether or not the fact is substantially correct inherently involves an assessment of this issue.⁷⁹ Furthermore, there is a presumption of materiality in respect of express questions put to the assured by the insurer, so that it would be difficult for an assured who has misrepresented the true position to deny the materiality of his answer.⁸⁰

2-26 The important question in this context is whether an insurer pleading fraud on the part of the assured would get any procedural advantage in terms of proving materiality if he succeeded in demonstrating that the representation was made dishonestly. There is a consistent line of authority in support of the proposition that fraud will dispense the requirement of materiality. In *Sibbald v Hill*,⁸¹ for instance, the House of Lords held that there was an actionable fraud in respect of an insurance contract 'not on the ground that the misrepresentation affected the nature of the risk, but because it induced a confidence, without which the party would not have acted'.⁸² In similar vein, Lord Mustill in *Pan Atlantic Insurance Co v Pine Top Insurance Co Ltd*⁸³ expressed the view that if the representation inducing a contract was fraudulent 'its falsehood would invariably give a right to avoid'. An innocent misrepresentation inducing the contract would, in contrast, 'give the underwriter a right to avoid only if it was material'.

2-27 With respect, it is submitted that considering legal authorities and the rationale for the materiality requirement, this is not a position that can be occupied with ease. First, s 20 of the MIA 1906 unequivocally states that avoidance is avail-

⁷⁶ Note that Lords Templeman and Lloyd, disregarding the new test, stressed that the 'decisive influence test' would have been a more appropriate test in this context.

⁷⁷ *Anderson v Fitzgerald* (1853) 4 HL Cas 484 and *Hoare v Bremridge* (1872) LR 8 Ch 22.

⁷⁸ *Glicksman v Lancashire and General Assurance Co Ltd* [1925] 2 KB 593, at 609, per Scrutton LJ.

⁷⁹ *Macdowall v Fraser* (1779) 1 Dougl 260, at 261, per Lord Mansfield.

⁸⁰ *Glicksman v Lancashire and General Assurance Co Ltd* [1927] AC 139, at 144, per Viscount Dunedin.

⁸¹ (1814) 3 ER 859, at 861, per Lord Eldon.

⁸² A similar view was echoed in *The Bedouin* [1894] P 1, at 12, per Lord Esher MR; *Smith v Kay* (1859) 7 HLC 750, at 759, per Lord Chelmsford LC and *Gordon v Street* [1899] 2 QB 641, at 646, per Smith LJ.

⁸³ [1995] 1 AC 501, at 533.

able only where the misrepresentation is material; there is nothing in the provision which supports the contention that the legal position is different in cases concerning fraudulent misrepresentation. Second, in the context of post-contractual duty of good faith, fraudulent conduct of the assured introduces the remedy of avoidance only in cases where fraud is material in the sense it has an impact on the ultimate liability of the insurer.⁸⁴ By analogy, it can be forcefully argued that dishonesty which does not have an impact on the decision of the underwriter in appraising the risk at the formation stage does not justify the application of the remedy of avoidance. Reaching a contrary solution would mean that an insurance contract can be avoided in circumstances where the fact misrepresented is utterly irrelevant to the risk which the insurer is insuring.⁸⁵

(C) *Inducement*

2-28 In general contract law, if the misrepresentation is to have legal effect it is essential that it should have been actively present to the mind of the representee.⁸⁶ However, there is no reference in the MIA 1906 to such a subjective element. Naturally, this might support the assumption that in the context of insurance law, the existence of a material misrepresentation or concealment would be adequate for an underwriter to avoid the policy. If this is the case, it is hardly an overstatement to suggest that the pendulum has swung too far in favour of the insurers, as it is relatively easy, as opposed to the ‘decisive influence test’, to fulfil the ‘mere influence’ test adopted for materiality to avoid the policy. Furthermore, given that the assured can be in breach of a pre-contractual duty of good faith if acting negligently, or even innocently, the assured has every reason to be apprehensive about the potential impact of the new materiality test.

2-29 Such concerns of the assured were, to a certain extent, laid to rest in the *Pan Atlantic* case. Having divided over the question of materiality, the House of Lords, unanimously ruled that ‘there is to be implied in the Act a qualification that a material misrepresentation will not entitle the underwriter to avoid the policy unless the misrepresentation induced the making of the contract’, a proposition which applied equally to non-disclosure. The reason why the MIA 1906 was silent on the requirement of inducement was explained by Lord Mustill on the ground that the Act did not seek to deal with ordinary principles of misrepresentation (which were left intact) but rather with the insurance aspects only (ie the definition of materiality).⁸⁷ Even though this seems to be judicial rewriting of the MIA 1906, this result is welcome, as it provides an opportunity to ease the harsh consequences that can emerge from the adoption of the new test of materiality.

⁸⁴ *K/S Merc-Skandia XXXXII v Certain Lloyd’s Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275; [2001] 2 Lloyd’s Rep 563.

⁸⁵ As debated later in this chapter, dishonest behaviour of the assured might nevertheless create moral hazard in some instances, but that is rather different than suggesting that dishonesty eliminates the need to prove materiality for avoidance.

⁸⁶ *Attwood v Small* (1838) 6 Cl & F 232; *Jennings v Broughton* (1853) 5 DE GM & G 126; *Smith v Chadwick* (1884) 9 App Cas 187 and *Edgington v Fitzmaurice* (1885) 29 Ch D 459.

⁸⁷ [1995] 1 AC 501, at 541–50.

2-30 Having introduced the ‘inducement’ test into insurance contracts, the majority of the members of the House of Lords did not feel the need to consider the relationship between these two tests. Lord Mustill, on the other hand, seems to have suggested in passing that once the materiality of the misrepresented or concealed fact/circumstance is proven, there is a ‘presumption of inducement’ in favour of the insurer and ‘the assured will have an uphill task in persuading the court that the withholding or misstatement of circumstances satisfying the test of materiality has made no difference’.⁸⁸

2-31 One could possibly construe the sentiments expressed by Lord Mustill as meaning that inducement can be inferred in law from proved materiality. If that is correct, as soon as the materiality of a misstated or concealed fact is established, it will be routinely presumed that the misrepresentation or non-disclosure would have had a decisive effect on the mind of the actual underwriter. The burden of proof is then reversed and the assured is expected to prove that the actual insurer would not have been induced.

2-32 Even though a literal reading of the judgment of Lord Mustill might support this contention, on close scrutiny it looks very unlikely that this was the outcome that Lord Mansfield had intended. On the point of inducement, Lord Mansfield clearly drew conclusions from general contract law; but, considering authorities in the field, it is very difficult to maintain that a presumption of inducement in law exists. Authorities, on the other hand, often indicate that the materiality of a statement might raise a presumption of inducement in fact. This point was put in an elegant fashion by Jessel MR in *Mathias v Yetts*:⁸⁹

... if a man has a material misstatement made to him which may, *from its nature*, induce him to enter into the contract, it is an inference that he is induced to enter into the contract by it.

2-33 It is, therefore, highly probable that Lord Mustill was referring to the possibility that the nature of a material misrepresentation or non-disclosure could create a presumption of inducement in fact.⁹⁰ A contrary outcome would certainly be at odds with established principles of common law and there is no reason to assume that his Lordship was proposing a deviation from common law principles in the context of insurance law.

2-34 The factual presumption of inducement is likely to be useful in cases where the misstated or concealed fact/circumstance is monstrous in its proportion, but the underwriter cannot be called to give evidence for good reasons.⁹¹ In *St Paul Fire & Marine Insurance Co (UK) Ltd v McConnell Dowell Contractors Ltd*,⁹² for instance, it was contended that a policy as to building risks subscribed by four underwriters was obtained following a material misrepresentation as to the foundations to be used

⁸⁸ *Ibid*, at 551.

⁸⁹ (1882) 46 LT 497, at 502 (emphasis added). See also, *Smith v Chadwick* (1884) 9 App Cas 187, at 196–7, per Lord Blackburn and *Smith v Land and House Property Corporation* (1884) 28 Ch D 7, at 16, per Bowen LJ.

⁹⁰ This is likely to arise in cases where the materiality is obvious or misrepresentation or concealment is calculated to induce. For a detailed discussion on this topic, see Clarke, M, *The Law of Insurance Contracts* (6th edn) (2009, Informa), para 23-2A1.

⁹¹ *Marc Rich & Co AG v Portman* [1996] 1 Lloyd’s Rep 430, at 442, per Longmore J.

⁹² [1995] 2 Lloyd’s Rep 116.

for the building. Three of the underwriters gave evidence to the effect that they had been induced by the false statement, but the fourth did not give evidence on this point. The Court of Appeal, nevertheless, held that proof of materiality gave rise to a presumption of inducement, no doubt a factual one, which the fourth insurer could rely upon even without adducing evidence of inducement.⁹³

2-35 It is, on the other hand, very unlikely that the presumption operates in cases where it could be demonstrated that the insurer acted other than prudently in the writing of the risk. In *Marc Rich & Co AG v Portman*,⁹⁴ in the process of obtaining cover for demurrage liability for various voyages in the Gulf, the assured failed to disclose that there had been previous heavy demurrage claims arising out of this business. The first instance judge found that the facts not disclosed were material and the policy was voidable, but the presumption of inducement was rebutted, as there was evidence to the effect that the underwriter who had accepted the risk was a junior who had little or no knowledge of the market.⁹⁵

2-36 At this juncture, it is imperative to debate whether establishing fraud would have any impact on the inducement requirement. By relying on the comments made by Lord Mustill in *Pan Atlantic Insurance Co v Pine Top Insurance Co*,⁹⁶ one might be tempted to argue that a fraudulent misrepresentation might create a factual presumption of inducement or perhaps even a variation in the degree of inducement required to the advantage of the insurer.⁹⁷ It is submitted that any such suggestion is misguided. It has been firmly established that the presumption of inducement has a very limited application in practice and can only be relevant where the relevant underwriter cannot be called to testify at the court for a legitimate reason.⁹⁸ More significantly, authorities leave no doubt that even in cases where damages are sought for deceit, courts have consistently applied the ‘but for’ test in determining whether the causation requirement has been satisfied.⁹⁹ Given that the inducement requirement in the context of insurance law has been traced to general contract law,¹⁰⁰ it would be difficult to justify that (in the context of insurance law) due to fraud the degree of inducement that the insurer needs to establish is considerably less. It

⁹³ Similarly, in *Toomey v Banco Vitalicio de Espana SA de Seguros y Reaseguros* [2004] EWCA Civ 622; [2005] Lloyd’s Rep IR 423, a reinsurer, who was not present to give evidence, was, nevertheless, held to be induced, as it was clear from other reinsurers’ evidence that the misrepresentation was sufficiently material to induce them to enter into the reinsurance contract.

⁹⁴ [1996] 1 Lloyd’s Rep 430.

⁹⁵ The findings of the first instance judge on this point was upheld by the Court of Appeal [1997] 1 Lloyd’s Rep 225, at 234–5.

⁹⁶ [1995] 1 AC 501, at 542, he said:

In the general law it is beyond doubt that even a fraudulent misrepresentation must be shown to have induced the contract before the promisor has a right to avoid, although the task of proof may be made more easy by a presumption of inducement.

⁹⁷ Beale, HG (ed), *Chitty on Contracts* (31st edn) (2012, London: Sweet & Maxwell), para 6-040.

⁹⁸ *Assicurazioni Generali SpA v Arab Insurance Group (BSC)* [2002] EWCA Civ 1642; [2003] Lloyd’s Rep IR 131 and *Laker Vent Engineering Ltd v Templeton Insurance Co Ltd* [2009] EWCA Civ 62; [2009] Lloyd’s Rep IR 704.

⁹⁹ *Smith New Court v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254, at 284, per Lord Steyn. See also, *Barings Plc (in liquidation) v Coopers & Lybrand (No 5)* [2002] EWHC 461; [2002] Lloyd’s Rep PN 395 (Ch).

¹⁰⁰ *Pan Atlantic Insurance Co v Pine Top Insurance Co Ltd* [1995] 1 AC 501, at 541–50, per Lord Mustill.

is sufficient for the insurer to show that misrepresentation would have only some impact on his thought process and does not need to be decisive.

2-37 An assured who is guilty of misrepresenting the risk fraudulently could still argue at a later stage that such misrepresentation did not, in fact, induce the underwriter to enter into the contract in question.¹⁰¹ A plea to that effect could succeed in a number of instances. It might be possible for the assured to prove that the underwriters, instead of relying on the false statement which was made to them, investigated the facts themselves and acted on the results of their investigations.¹⁰² Imagine a situation where the assured in the process of obtaining insurance cover for his vessel deliberately misrepresents the class and status of the vessel. If the underwriters, after acquiring a report from their surveyor contradicting the observations of the assured, decide to insure the vessel, it is possible for the assured to argue that his misrepresentation could not have induced the underwriters. The assured, however, must clearly demonstrate that the underwriters not only investigated the facts, but also relied on the results of their investigation.¹⁰³

2-38 There is also the possibility that the assured could argue that fraudulent misrepresentation did not induce the insurer, as he or his agents were aware of the true state of affairs.¹⁰⁴ This is likely to arise in a case where the insurer knows that the vessel does not have a sound structure even though the assured makes a representation to the contrary.¹⁰⁵ An insurer who decides to insure such a vessel is unlikely to be able to contend that he was induced as a result of the misrepresentation – provided of course that it could be proved that either he or his authorised agents were privy to the fact that the vessel was not sound.¹⁰⁶

2-39 The assured may be able to demonstrate, by the insurer's own admission or otherwise, that certain facts are of no account to him. In that case, the insurer cannot be allowed afterwards to rely on misrepresentation of such facts, even if committed fraudulently, to deny liability.¹⁰⁷

2-40 At this stage, it might be useful to summarise the impact of fraud on actionability for misrepresentation at the pre-contractual stage:

¹⁰¹ As indicated by Bowen LJ, in *Edgington v Fitzmaurice* (1885) 29 Ch D 459, at 483, it is vital to demonstrate that the misrepresentation was a contributing factor in the decision of the representee – in our case, the underwriter:

The real question is, what was the state of the [representee's] mind, and if his mind was disturbed by the misstatement of the [representor], and such disturbance was in part the cause of what he did, the mere fact of his also making a mistake himself could make no difference.

¹⁰² *Attwood v Small* (1838) 6 Cl & F 232; *Redgrave v Hurd* (1882) 20 Ch D 1.

¹⁰³ For a similar situation in a life insurance policy, see *Franklinlife v Champion Co* 350 F 2d 115 (6 Cir, 1965).

¹⁰⁴ *Bawden v London, Edinburgh and Glasgow Life Assurance Co* [1892] 2 QB 534 and *Holdsworth v Lancashire and Yorkshire Insurance Co* (1907) 23 TLR 521.

¹⁰⁵ In the context of disclosure, it was recently held in *Sea Glory Maritime Co v Al Sagr National Insurance Co (The Nancy)* [2013] EWHC 2116 (Comm) that an insurer would not be able to show inducement in a case where previous detentions of the insured vessel were not disclosed fully, as underwriters should expect that an elderly vessel was almost certain to have had detentions.

¹⁰⁶ There is authority to suggest that the rule does not apply in cases where the underwriter does not know about the inaccurate nature of the representations made, but has the means of discovering the truth and fails to do so, even if his conduct amounts to negligence; *Mackintosh v Marshall* (1843) 11 M & W 116 and *Scottish Equitable Assurance Co v Buist* (1876) 3 R 1078; (1878) 5 R (HL) 64.

¹⁰⁷ *Berger v Pollock* [1973] 2 Lloyd's Rep 442.

- (i) It is not clear whether a fraudulent representation of facts gives rise to a right to avoid in cases where the representation is trivial.
- (ii) If it is established that the assured has acted fraudulently, it is no longer possible for him to argue that the question put to him was ambiguous so that he can be excused for providing inaccurate information.
- (iii) There is powerful *dicta* to the effect that refraining deliberately from disclosure at the pre-contractual stage amounts to misrepresentation.
- (iv) A representation involving a statement of law creates an actionable misrepresentation if it is dishonestly made.
- (v) It is not likely that proving fraud would dispense with the requirement of materiality.
- (vi) Establishing fraud on the part of the assured does not have an impact on the degree of inducement that is required to avoid the policy.

(2) Non-disclosure

2-41 The MIA 1906 requires an assured to make full disclosure of all facts/circumstances material to an insurer's assessment of the proposed risk that are known (actual knowledge) or deemed to be known by the assured (constructive knowledge).¹⁰⁸ The general principle, expressed in s 18(1), is subject to certain qualifications which are spelt out in s 18(3). The purpose of this part is to analyse the scope of the pre-contractual disclosure duty of the assured with specific references to the impact of fraud. It is obvious that proving fraud is not essential for an insurer to rely on non-disclosure defence successfully, but proof of fraud might preclude the assured from arguing that some of the qualifications exist, as will be considered below.

(A) Facts Known by the Assured (Actual Knowledge of the Assured)

2-42 Assessing whether the assured is in possession of a material fact/circumstance is a question of fact.¹⁰⁹ It might involve a technical and procedural analysis but is often straightforward if the assured is a natural person. However, it will be a rare occasion for a natural person to seek insurance cover against marine risks.¹¹⁰ Parties involved in marine business are commonly corporate enterprises which are structured in a complex manner. It is, therefore, vital to determine which individual(s) knowledge within the structure of the assured's company will be attributable to the knowledge of the assured company itself. In line with the approach

¹⁰⁸ The assured is expected to disclose facts that are known or should be known to him. He cannot disclose what he does not know. Therefore, the scope of obligation to disclose depends on the knowledge the assured possesses or should possess: *Joel v Law Union and Crown Insurance Co* [1908] 2 KB 863, 884–5, per Fletcher Moulton LJ.

¹⁰⁹ *PCW Syndicates v PCW Reinsurers* [1996] 1 Lloyd's Rep 241, at 253, per Staughton LJ.

¹¹⁰ It might, of course, be possible that a natural person seeks cover for his pleasure yacht or an individual trader wishes to insure his consignment under a free on board (FOB) contract, but the volume of such transactions in marine business is rather negligible. It should be pointed out that as of 6 April 2013 in cases where an individual seeks insurance cover against marine risks for his pleasure yacht, his pre-contractual information duties will be regulated by the provisions of the Consumer Insurance (Disclosure and Representations) Act 2012. The regime set out in this Act is rather different than the regime stipulated by ss 18–20 of the MIA 1906.

adopted in *Meridian Global Funds Management Asia v Securities Commission*,¹¹¹ it is necessary to fashion a special (particular) rule of attribution to determine whose actual knowledge within the company is to count as the knowledge of the company for the purpose of the disclosure rule imposed upon all proposers for insurance in order to enable insurers to make an informed assessment of the risks presented to them. It is submitted that a special rule of attribution of this nature presumably requires the knowledge of those who represent the directing mind and will of the company and are placed in such authority to control what it does, to be taken as that of the assured. This class of persons usually consists of directors and officers¹¹² and non-directors to whom the exercise of the company's powers has been delegated by the board of directors¹¹³ or shareholders.¹¹⁴ Staughton LJ in *PCW Syndicates v PCW Reinsurers*,¹¹⁵ indicated that the knowledge of the company under s 18 can be extended to knowledge held by employees whose business is to arrange insurance. It is submitted that the comments of Staughton LJ, are within the spirit of the attribution of knowledge rule developed in *Meridian Global Funds* and there is no reason why knowledge of employees other than those who are regarded as the directing mind and will should not be considered as the knowledge of the assured company.¹¹⁶

2-43 It is a rather interesting question whether the assured or its directing mind and will is deemed to know facts/circumstances which they would have discovered on inquiry had they not deliberately chosen to ignore that the obvious signs of the relevant facts/circumstances existed. Imagine the position of a director in a ship-owning company who has firm suspicions that the manager of the insured ship is in the practice of operating the ship in contravention to international rules on safety. If that director shuts his eyes to this possibility and chooses to conceal his suspicions at the renewal of the hull policy, is it possible for the underwriter, who becomes aware of the true state of affairs at a later stage, to argue that the assured should be regarded as knowing whatever such inquiry would have revealed? There seems to be a consistent line of authority suggesting that in cases where the person in question wilfully shuts his eyes or closes his ears to any means of information he is deemed to have actual knowledge of those facts.¹¹⁷ Commenting on the scope of s 18(1) in *Economides v Commercial Union Assurance Co plc*,¹¹⁸ Simon Brown LJ said:

¹¹¹ [1995] 2 AC 500.

¹¹² *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] 1 Lloyd's Rep IR 151, at 156.

¹¹³ *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685. The relevant principles have been summarised in *Regina Fur Co v Bossom* [1957] 2 Lloyd's Rep 466, at 484, per Pearson J:

... in deciding whether in a particular case the knowledge of the agent is to be imputed to the company, or other principal, one should consider, mainly at any rate, (1) the position of the agent in relation to the principal and whether the agent had a wide or narrow sphere of operations, and (2) the position of the agent in relation to the relevant transaction and whether he represented the principal in respect of that transaction.

¹¹⁴ *Arab Bank v Zurich Insurance Co* [1999] 1 Lloyd's Rep 262, at 270.

¹¹⁵ [1996] 1 Lloyd's Rep 241, at 253.

¹¹⁶ See the flexible approach adopted by the Court of Appeal with regard to attribution of knowledge in *Moore Stephens v Stone & Rolls Ltd* [2008] EWCA Civ 644; [2008] 2 Lloyd's Rep 319.

¹¹⁷ See *Blackburn Low & Co v Vigors* (1887) 12 App Cas 531, at 543, per Lord Macnaghten; *Simner v New India Assurance Co Ltd* [1995] LRLR 240, at 253, per judge Diamond QC and also *Australia & New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd* [1960] 2 Lloyd's Rep 241, at 252, per McNair J.

¹¹⁸ [1998] QB 587, at 602.

... [it is required] that the assured does not wilfully shut his eyes to the truth. But that, sometimes called Nelsonian blindness – the deliberate putting of the telescope to the blind eye – is equivalent to knowledge.

There is a fundamental difference between the position of a person who wilfully shuts his eyes and one who fails to make enquiries. The former involves a degree of dishonesty.¹¹⁹

(B) Facts Deemed to Be Known by the Assured (Constructive Knowledge of the Assured)

2-44 Under s 18(1) of the MIA 1906, an assured is expected to disclose not only the circumstances within his actual knowledge, but also the circumstances which ‘ought to be known by him in the ordinary course of business’. The effect of this provision is that the assured is deemed to be aware of the information and is expected to disclose it to a potential underwriter (as long as such information is material) if the information has reached his office or his employee (agent) who is under an obligation to report it to the assured.¹²⁰

2-45 The first question is: Which employee’s (agent’s) knowledge will be treated as being the knowledge of the assured company? Put differently, the task here is to identify the employee (agent) on whom the assured company relies for information in the course of its business. It is likely that an employee who is entrusted with the management of the property to be insured (i.e. a ship manager)¹²¹ or a person employed by the owners of cargo whose duty is to keep their employers informed of all matters affecting the property which it is sought to insure (i.e. a trading agent)¹²² will fall into this category. To the contrary, the knowledge of a company’s entry clerk, who is neither under a duty to monitor and report on the efficiency of delivery system nor is in charge of goods in the assured’s warehouses with executive authority, could be treated as the knowledge of the insured company.¹²³

2-46 While assessing whether the assured company is in possession of information in the course of its business, it may be essential to ascertain its internal structure and reporting mechanisms. The position seems to be straightforward in cases where the assured company has adequate reporting facilities in place but there has been a breakdown in communication between the manager and the employee whose duty in the internal structure of the company is to keep him informed.¹²⁴ In *London General Insurance Co Ltd v General Marine Underwriters’ Association*,¹²⁵ for example, an insurance company, having insured a cargo on board a vessel called the *Vigo*, approached

¹¹⁹ *Economides v Commercial Union Assurance Co plc* [1998] QB 587, at 607, per Simon Brown LJ.

¹²⁰ See *Inversiones Manria SA v Sphere Drake Insurance Co Plc (The Dora)* [1989] 1 Lloyd’s Rep 69.

¹²¹ *Proudfoot v Montefiore* (1867) LR 2 QB 511 and *Blackburn Low & Co v Vigors* (1887) 12 App Cas 531.

¹²² In a different context, in *Lindsay v CIC Insurance Ltd* (1989) 16 NSWLR 673, the knowledge of an estate agent, which dealt with the day-to-day management of the insured premises, was treated as the knowledge of the assured.

¹²³ *Australia & New Zealand Bank v Colonial & Eagle Wharves Ltd* [1960] 2 Lloyd’s Rep 241.

¹²⁴ The breakdown in communication might be attributable to the negligence or incompetence of the employee.

¹²⁵ [1921] 1 KB 104.

the defendant reinsurers with a view to effect a reinsurance cover. On the night of 24 September, part of the cargo had been destroyed. A casualty slip detailing the partial loss was circulated to the underwriting department of the insurance company on the morning of 25 September. The underwriting department failed to circulate the casualty slip to the claims and reinsurance department, which would have been the norm. Unaware of the loss, the reinsurance department entered into a reinsurance agreement with the defendant reinsurers, who maintained that the reassured failed to disclose a material fact – partial loss of the cargo insured under the original policy. Affirming the judgment of the trial judge, the Court of Appeal held that the reassured company was deemed to know the fact in question because in the ordinary course of business it should have been known to those concerned in the reinsurance department.

2-47 Matters get a bit more complicated where the information possessed by an employee or unit of the assured company is not passed on to the relevant person, as the reporting structure of the company in question is far from being efficient compared to similar companies operating in the market. The gist of the matter is whether the test adopted by s 18(1) is objective or subjective. If it is an objective test, the assured company should be deemed to know what it ought to have known if the business was well run. Conversely, if a subjective test is preferred, the assured company is deemed to know only what it would be expected to know in the ordinary course of business, making allowances for its imperfect organisation. As recognised by Lord Sterndale MR,¹²⁶ this is a rather difficult question to answer. Arguments are strong on both sides. Support for the view that the test in s 18(1) is objective could be drawn from the fact that the wording of this sub-section makes no reference to the assured's business, but instead refers to the 'ordinary course of business'. If the intention of the draftsman was to make the test subjective, this could have been achieved by stating that the assured is presumed to know 'matters which an assured in the ordinary course of *his* business ought to know'¹²⁷ At first glance, this seems like a sound argument; but it might add a further burden on the assured by requiring him to run his business in a reasonable manner. Penalising the assured for running his business in a disorganised manner seems to conflict with the basic values of insurance law which intend to provide cover for the assured against loss caused by the perils insured against, including negligence and incompetence.¹²⁸

There is judicial support for the view that the test laid down by s 18(1) is subjective. In *Australia & New Zealand Bank Ltd v Colonial & Eagle Wharves Ltd*,¹²⁹ McNair J, said:

¹²⁶ *Ibid*, at 110:

... If it were a question of their having done their best, so far as the pressure of business would allow, to make themselves acquainted with the casualty slips, and of their not being able to do so in time to stop the broker's instructions, I think it might have been difficult to deal with such a case, but there is no such case before us.

¹²⁷ See s 18(3) of the MIA 1906.

¹²⁸ MacDonald Eggers, P, Foss, S and Picken, P, *Good Faith and Insurance Contracts* (3rd edn) (2010, Informa), para 7.122 and Birds, J, Lynch, B and Milnes, S, *MacGillivray on Insurance Law* (12th edn) (2012, Informa), 17-014.

¹²⁹ [1960] 2 Lloyd's Rep 241, at 252.

I have been referred to no authority to suggest that the board of a company proposing to insure owe any duty to carry out a detailed investigation as to the manner in which the company's operations are performed, and I know of no principle in law which leads to that result . . . To impose such an obligation upon the proposer is tantamount to holding that insurers only insure persons who conduct their business prudently, whereas it is a commonplace that one of the purposes of insurance is to cover yourself against your own negligence or the negligence of your servants.¹³⁰

2-48 A very interesting question which springs to mind in this context is what the impact of employee fraud in the assured's organisation will be on the assured's duty to disclose. Let us assume that the assured's employee commits fraud against the interest of the assured (e.g. he runs the assured's affairs in an illegitimate manner without the assured being aware of his employee's actions). Can the insurer in that case argue that by virtue of s 18 or s 19 of the MIA 1906, the assured should be deemed to have knowledge of such affairs and be expected to disclose them to the insurer? It has been settled since the end of the last century that if an employee (or agent) commits fraud on his principal, the knowledge of that fraud is not to be imputed to the principal.¹³¹ Whether this general agency principle holds true in the context of ss 18 and 19 of the MIA 1906, it was subjected to extensive deliberation by the Court of Appeal in *PCW Syndicates v PCW Reinsurers*¹³² and *Group Josi Reinsurance Co Ltd v Walbrook Insurance Co Ltd*.¹³³ The view that emerged was that the knowledge which ought to be imputed to the assured within the meaning of s 18 in the ordinary course of business does not include the knowledge of the agent (employee) acquired in fraud of his principal.¹³⁴ It was also held that s 19 did not change this outcome, as an agent (employee) who perpetrated fraud on his principal did so otherwise than in his capacity as agent; accordingly the agent was not obliged to disclose to the insurer any knowledge he obtained other than 'in the character of the agent for the assured'.¹³⁵ The outcome that the judiciary has arrived at is a sensible one given that it is impossible to conceive a situation where an employee in the ordinary course of business would disclose to his principal that he has perpetrated fraud against his interests.¹³⁶ A different outcome might follow if the employee's fraud was so transparent that the principal should have been aware of it. In that case,

¹³⁰ See also, *Sinner v New India Assurance Co* [1995] LRLR 240 where Justice Diamond QC held that the assured was not under a duty to disclose matters which he would have learned by making reasonable inquiries.

¹³¹ *Re Hampshire* [1896] 2 Ch 743.

¹³² [1996] 1 Lloyd's Rep 241.

¹³³ [1996] 1 Lloyd's Rep 345.

¹³⁴ This reasoning was later followed in *Arab Bank plc v Zurich Insurance Co* [1999] 1 Lloyd's Rep 262.

¹³⁵ *PCW Syndicates v PCW Reinsurer* [1996] 1 Lloyd's Rep 241, at 257, per Staughton LJ and *Group Josi Reinsurance Co Ltd v Walbrook Insurance Co Ltd* [1996] 1 Lloyd's Rep 345, at 367, per Saville LJ.

¹³⁶ Whether the reasoning adopted in *PCW Syndicates* and *Group Josi* applies in cases where the assured's agent (or employee) is acting against the interests of the assured but not in a fraudulent manner is open to debate. Put differently, it is debateable whether the assured can benefit from the *Re Hampshire* principle in cases where his employees (agents) are acting in breach of fiduciary duty or in gross negligence against him. In *Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd*, unreported (4/3/96), Colman J was prepared to accept that there were circumstances falling short of fraud, in which an employee (or agent) is not to be imputed to his principle. Proceeding on that basis, Colman J seemed to suggest that an employee (agent) will not, in the ordinary course of business, disclose its wrongdoing towards its principal. See also, *ERC Frankona Reinsurance v American National Insurance Co* [2005]

there is room to argue that the assured in the ordinary course of business should have been aware of his employee's fraud and should have disclosed it to the insurer.

2-49 However, if an employee (or agent) who is involved in the process of obtaining insurance cover perpetrates fraud against the insurer, for example by keeping back material information, his fraud will likely to be attributed to the assured. A good illustration of this principle can be seen in *Moore Stephens v Stone & Rolls Ltd*¹³⁷ where the company sought to advance a claim against its former auditors for failing to detect the fraud perpetrated by the directing mind and will of the company. The claim was struck out on the premise that the fraud of the directing mind and will of the company was attributable to the company and accordingly the company itself was fraudulent; its claim was banned by the operation of the principle of *ex turpi causa*.

(C) *Materiality and Inducement: Scope of the Duty of Disclosure*

2-50 The materiality test laid down by the House of Lords in the *Pan Atlantic* case is also applicable in the context of non-disclosure. As discussed earlier, materiality is ultimately a question of fact which will depend on the subject matter of insurance, nature of the risks insured against, the nature of the insurance product and also contemporary conditions. It is important to appreciate that the older authorities do not lay down rules of general application and in each instance, the opinion of express witnesses plays a significant role in assessing the materiality of a fact/circumstance not fully disclosed.¹³⁸ What might be a material fact with regard to one type of insurance policy might not be so for another. For instance, loss and claims experience of the assured will invariably be material in the context of a reinsurance agreement or a liability policy,¹³⁹ but perhaps not in the context of cargo insurance. Also, whether a fact/circumstance is material or not in the context of the same policy might depend on the nature and impact of the undisclosed circumstance. For instance, despite the existence of authority to the opposite effect,¹⁴⁰ it is now commonly acknowledged that the identity of the assured is of significance for the insurer and, therefore, if

EWHC 1381 (Comm); [2006] Lloyd's Rep IR 157 at [135]–[136] and [198], per Andrew Smith J. It should be noted that all authorities on this point are from courts of first instance.

¹³⁷ [2008] EWCA Civ 644; [2008] 2 Lloyd's Rep 319.

¹³⁸ It should not be readily assumed that in all instances the judge needs to rely on expert evidence to establish materiality. The matter is determined by the judge and in cases where an uncommunicated fact would obviously be relevant to a prudent insurer, it is entirely in his discretion to decide that non-disclosure is material without calling any expert evidence to establish this point. This point was made in an emphatic fashion by Scrutton LJ, in *Glicksman v Lancashire and General Assurance Co Ltd* [1925] 2 KB 593, at 609:

[It was argued] that you cannot find that a fact was material unless somebody gave evidence of the materiality. That is, in my view, and I agree with Mr Justice Roche, entirely contrary to the whole course of insurance litigation. It is so far contrary that it is frequently argued that you are not entitled to call other people to say what they think is material. That is a matter for the Court on the nature of the facts. I entirely agree with Mr Justice Roche that the nature of the facts may be such that you do not need anyone to come and say: 'This is material.' If a shipowner desiring to insure his ship for the month of January knew that in that month she was heavily damaged in a storm, it would with deference to counsel who has suggested the opposite, be ridiculous to call evidence of the materiality of that fact; the fact speaks for itself.

¹³⁹ *Marc Rich and Co AG v Portman* [1996] 1 Lloyd's Rep 430.

¹⁴⁰ *Glasgow Assurance Corp v Symondson* (1911) 16 Com Cas 109.

there is an involvement of an undisclosed principal that needs to be disclosed to the insurer.¹⁴¹ However, non-disclosure of an undisclosed principle will be treated to be material if it can be shown that a prudent insurer would like to know the true identity of the principal in question or his membership in a particular class.

2-51 The insurer is also expected to demonstrate that he was induced to enter into the contract as a result of a material concealment on the part of the assured.¹⁴² The insurer will find it difficult to prove inducement where he finds the business proposed to him so commercially attractive that he may well have accepted it on the same terms despite full disclosure.¹⁴³ Likewise, where an underwriter relied upon a favourable, *albeit* incorrect, interpretation of an exclusion clause in the policy and accordingly would not have attached importance to certain undisclosed material facts if made aware to him, he could not prove inducement.¹⁴⁴

2-52 In line with the authorities on misrepresentation discussed earlier, it is possible to argue that an obviously material non-disclosure might create a factual presumption of inducement in some instances. For instance, the Court of Appeal was adamant in *Laker Vent Engineering Ltd v Templeton Insurance Co Ltd*¹⁴⁵ that, in cases when the undisclosed fact is plainly material, it is at the discretion of the court to infer that the underwriter was induced even if he does not testify in the court.¹⁴⁶ However, on the facts, the Court of Appeal upheld the decision of the first instance judge¹⁴⁷ which held that the underwriter in question had failed to prove that he was induced by the non-disclosure, in light of the fact that he failed, for no good reason, to bring both the underwriting agent and the clerk to give evidence before the court.

(D) Moral Hazard and Impact of Fraud on the Scope of Disclosure Duty

2-53 The language used in s 18(5) of the MIA 1906 which provides that a fact which must be disclosed includes ‘any communication made to, or information received by, the assured’ is a clear indication that the duty of disclosure extends beyond facts or circumstances which might affect the risk insured in a physical or tangible manner (i.e. the matters that relate to physical conditions affecting the insured risk and surrounding geographical environment). Accordingly, the assured is expected to disclose allegations of dishonesty concerning himself published in the

¹⁴¹ *Talbot Underwriting Ltd v Nausch Hogan & Murray Inc (The Jascon 5)* [2006] EWCA Civ 889; [2006] 2 Lloyd’s Rep 195. Moore-Bick LJ said, at [43]: ‘The fact that the law generally recognises the right of an undisclosed principal to sue and be sued on a contract does not relieve the nominal insured from the duty to make full disclosure of all material circumstances in each case, including any which may relate to his undisclosed principal. That is essential to ensure a fair presentation of the risk to the insurer . . .’

¹⁴² *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, at 549–50, per Lord Mustill.

¹⁴³ *Kingscroft Insurance Co Ltd v Nissan Fire & Marine Insurance Co Ltd (No 2)* [1999] Lloyd’s Rep IR 603, at 631; *Glencore International AG v Alpina Insurance Co Ltd* [2003] EWHC 2792 (Comm); [2004] 1 All ER (Comm) 766, at [76] and *Crane v Hannover Ruckversicherungs AG* [2008] EWHC 3165 (Comm); [2010] Lloyd’s Rep IR 93, at [157] and [178].

¹⁴⁴ *Kusar v Eagle Star & British Dominions Insurance Co* [2000] Lloyd’s Rep IR 154.

¹⁴⁵ [2009] EWCA Civ 62; [2009] Lloyd’s Rep IR 704.

¹⁴⁶ *Ibid*, at [68].

¹⁴⁷ [2008] EWHC B6 (QB).

media¹⁴⁸ or reports concerning the risk to which he is privy¹⁴⁹ even if they ultimately turn out to be unfounded. The key issue here is not the reliability of such rumours or reports but the simple fact that they exist, which might influence the underwriting decision of a prudent insurer. The assured should also disclose rumours relating to himself or his insured property¹⁵⁰ unless, of course, the rumours are so improbable that no one knows how they have started.¹⁵¹

2-54 Building on the premise that the extent of disclosure duty is a broad one, the courts have been prepared over the years to expand the boundaries of the disclosure duty. It is now undisputed that apart from reports and intelligence, the assured is expected to disclose facts that relate to moral hazards. A moral hazard has been described as being circumstances or facts which may lead the insurer to take the view that the assured is an ‘undesirable person with whom to have contractual relations’.¹⁵² Such factors essentially relate to matters such as the character of the assured or his business integrity.

2-55 However, even if an undisclosed fact or circumstance relates to moral hazard, this does not automatically mean that the underwriter will have a right to avoid the policy. For avoidance, it is necessary to convince the court that the relevant fact or circumstance is material. For instance, not disclosing a previous conviction of the assured or one of those who will be in charge of the insured property or goods is likely to be a material fact, provided of course the conviction is of a serious nature, relevant to the insurance sought and that the gap between the conviction and the signing of the policy is not considerable.¹⁵³ This will be the case even if the assured believes that he was the victim of a miscarriage of justice and possesses the evidence to prove his innocence.¹⁵⁴ In *Regina Fur v Bossom*,¹⁵⁵ the assured company insured furs, which were its stock in trade. The managing director of the assured company had 12 years previously been convicted of receiving stolen furs, but this fact was not disclosed to the insurer. The trial judge, Pearson J, held that the non-disclosed fact amounted to moral hazard and afforded a defence to the insurer.¹⁵⁶ On the

¹⁴⁸ *Brotherton v Aseguradora Colseguros (No 2)* [2003] EWHC 335 (Comm); [2003] 1 All ER (Comm) 774, *aff'd* [2003] EWCA Civ 705; [2003] Lloyd’s Rep IR 746. At the Court of Appeal, Mance LJ, at [28], overruling the previous decision of Colman J in *The Grecia Express*, held that the relevant time for disclosure of relevant intelligence, rumours or allegation is when they were made. It was not open to the assured to disprove their truth at the trial.

¹⁴⁹ *De Costa v Scandret* (1723) 2 P Wms 170; *Shirley v Wilkinson* (1781) 3 Dougl KB 41 and *Stribley v Imperial Marine Insurance Co* (1876) 1 QBD 507.

¹⁵⁰ *The Grecia Express* [2002] EWHC 203 (Comm).

¹⁵¹ *Durrell v Bederley* (1816) Hort NP 283, at 285, per Gibbs CJ. Similarly Mance LJ in *Brotherton v Aseguradora Colseguros SA (No 2)* [2003] EWCA Civ 705; [2003] Lloyd’s Rep IR 746, at [28], noted that ‘loose or idle rumours’ were immaterial.

¹⁵² *Locker and Woolf Ltd v Western Australian Insurance Co* [1936] 1 KB 408, at 414, per Slessor LJ.

¹⁵³ As stressed by Mance J in *Insurance Corporation of the Channel Islands Ltd v Royal Hotel Ltd* [1998] Lloyd’s Rep IR 151, at 156–8, it is a question of degree as to which past wrongs should be disclosed.

¹⁵⁴ *March Cabaret Club and Casino Ltd v London Assurance* [1975] 1 Lloyd’s Rep 169, at 177, per May J and *Brotherton v Aseguradora Colseguros SA (No 2)* [2003] EWCA Civ 705; [2003] Lloyd’s Rep IR 746, at [23], per Mance LJ.

¹⁵⁵ [1957] 2 Lloyd’s Rep 466.

¹⁵⁶ Similarly, in *The Dora* [1989] 1 Lloyd’s Rep 69, not disclosing that the skipper of a yacht had been convicted seven times of drawing cheques against insufficient funds under a foreign law within a period of five years before the proposal was deemed to be material. See also, *March Cabaret Club and Casino Ltd v London Assurance* [1975] 1 Lloyd’s Rep 169; *Allden v Raven (The Kylie)* [1983] 2 Lloyd’s Rep

contrary, in *Roselodge Ltd v Castle*,¹⁵⁷ a conviction for bribing a policeman obtained against the principal director of the assured company involved in jewellery business some 20 years before the policy was held to be immaterial.¹⁵⁸ Similarly, if the assured had been charged with and committed to trial for a criminal offence this must be disclosed even if the trial had not taken place at the date of his application for insurance.¹⁵⁹ This applies even if the assured is subsequently acquitted. The fact that there was an ongoing investigation at the time of insurance is material and must be disclosed.¹⁶⁰ In *North Star Shipping Ltd v Sphere Drake Insurance Plc*,¹⁶¹ the Court of Appeal took one step further and held that the existence of civil proceedings in which fraud had been alleged against the assured were material and discloseable even though these proceedings were taking place in another jurisdiction and did not relate to the risk insured.

2-56 One last point on the issue of previous convictions is the impact of the Rehabilitation of Offenders Act 1974 on the disclosure duty. Under this Act, a conviction becomes 'spent' upon completion of the 'rehabilitation period'.¹⁶² Under s 4 of the Act, a spent conviction should be treated 'for all purposes in law' as though it had never happened; the person who has a spent conviction is to be treated as though he had not committed or been charged with the offence. As a result, the proposer for insurance is relieved of any duty to disclose not only a spent conviction but also events out of which it arose. Recently, in *Joseph Fielding Properties (Blackpool) Ltd v Aviva Insurance Ltd*,¹⁶³ a very interesting argument with regard to the effect of the Act was raised successfully by the insurer. There, the insurer facing a claim from the assured, to whom he provided property insurance cover, raised a non-disclosure defence, arguing that the assured had failed to disclose a previous conviction to his previous insurers and at the time insurance was sought, such a conviction was not spent under the Act. The conviction become spent under the Act by the time this policy was put in place, but the insurer's argument centred around the fact that not making full disclosure to the other insurers was a reflection of the character of the assured and created a moral hazard. The trial judge, HHJ Waksman QC, found the non-disclosure to be material. This was a smart argument which confirms the point

444 and *Jester-Barnes v Licences and General Insurance Co Ltd* (1934) 49 LIL Rep 231. It should be noted that at the time these cases were decided, the relevant materiality test was different than the one adopted by the House of Lords in the *Pan Atlantic* case. That said, it is submitted that this would not have made a difference to the outcome of these cases.

¹⁵⁷ [1966] 2 Lloyd's Rep 113.

¹⁵⁸ See also, *Reynolds v Phoenix Assurance Co Ltd* [1978] 2 Lloyd's Rep 440 and *Mackay v London General Insurance Co Ltd* (1935) 51 LIL Rep 201.

¹⁵⁹ See *Brotherton v Aseguradora Colseguros (No 2)* [2003] EWHC 335 (Comm); [2003] 1 All ER (Comm) 774, *aff'd* [2003] EWCA Civ 705; [2003] Lloyd's Rep IR 746 and *Strive Shipping Corporation v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88. See also, *March Cabaret Club and Casino Ltd v London Assurance* [1975] 1 Lloyd's Rep 169 and *The Dora* [1989] 1 Lloyd's Rep 69.

¹⁶⁰ *The Grecia Express* [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88 and *Brotherton v Aseguradora Colseguros (No 2)* [2003] EWHC 335 (Comm); [2003] 1 All ER 774, *aff'd* [2003] EWCA Civ 705; [2003] Lloyd's Rep IR 746.

¹⁶¹ [2006] EWCA Civ 378; [2006] 2 Lloyd's Rep 1.

¹⁶² The Act identifies different rehabilitation periods according to the length of the sentence. However, by virtue of s 5(1), a conviction for an offence punished by 'a sentence of imprisonment for a term exceeding 30 months' cannot become spent.

¹⁶³ [2010] EWHC 2192 (QB); [2011] Lloyd's Rep IR 238.

that the assured's previous breach of good faith principles can come back to haunt him when he seeks a new insurance product.

2-57 Given that not disclosing matters that might point towards a risk of moral hazard on the part of the assured could potentially bring the remedy of avoidance into play, an interesting debate concerns the impact of fraud in this context, especially if fraud is deemed not to have induced the insurer to enter into the contract, as discussed in the previous part,¹⁶⁴ or if the fraud was directed at third parties other than the insurer. If dishonesty that has nothing to do with the insurance policy in question, or that is not capable of influencing the judgment of a prudent insurer, is, nevertheless, deemed to be capable of creating moral hazard, a value judgment is passed on the assured and he is branded as an 'undesirable person' to contract with due to the fact he might be tempted to act in a fraudulent fashion after the contract is formed. The problem with this kind of reasoning is that no insurance policy would offer cover for a claim put forward by an assured if it is tainted by fraud. Therefore, it is difficult to see why such information with regard to the assured should be deemed material, given that the assured's propensity to act in a dishonest fashion (assuming that that is the case, of course) to the detriment of the insurer will not realistically result in a loss which the insurer is bound to indemnify under the relevant insurance policy.

2-58 Nevertheless, it seems that the preponderance of authority lends support to the proposition that non-disclosure of the fact that the assured has acted in a fraudulent manner in running his business affairs could itself be viewed as a moral hazard that gives rise to a right to avoid the policy. In *Insurance Corporation of Channel Islands v Royal Hotel Ltd*,¹⁶⁵ the assured obtained business interruption and material damage policies for his hotel from various underwriters in 1991. Before the inception of the policies, the owner of the hotel procured false invoices in respect of the occupancy of the hotel such that its apparent turnover was greatly increased. The intention was to persuade the assured's bankers that the hotel was operating at full capacity when, in fact, this was far from the truth. At a later stage, the insured property was damaged by fire and claims were made under both policies. As the invoices which were initially prepared to defraud the assured's bank were used in the presentation of the business interruption policy, the court dismissed that claim on the ground that it was fraudulent.¹⁶⁶ In similar fashion, the insurers under the material damage policy sought to avoid the policy on the ground that the assured had failed to disclose the fact that he had utilised fraudulent documents prepared with a view to defrauding his bankers, even though those documents had no connection with the material damage policy. Mance J (as he then was) upheld the insurer's defence concluding that preparing false invoices for use, if and when necessary, against the assured's bankers indicated a moral hazard in the manner in which the assured ran his business affairs and he was convinced that the non-disclosure was a material one. Evidently, here the assured's fraud was not directed at the insurer

¹⁶⁴ Imagine a situation where the assured could successfully show that fraudulent misrepresentation could not induce the insurer, either because the insurer relied on his investigation rather than the representation made, or because he was aware of the true state of affairs.

¹⁶⁵ [1998] Lloyd's Rep IR 151.

¹⁶⁶ *Insurance Corporation of the Channel Islands v McHugh* [1997] LRLR 94. This issue is linked to the post-contractual duty of good faith and is discussed in [Chapter 3](#).

as far as the material damage policy was concerned, but instead at a third party, namely his bankers. However, the fraudulent conduct of the assured was regarded as a material fact under the heading of moral hazard, as it demonstrated that the assured's character was such that he might attempt to defraud the insurer at a later date in the same manner as he attempted to defraud his bankers.

2-59 In *James v CGU Insurance Co plc*,¹⁶⁷ the insurer was allowed to avoid the motor trader's combined insurance policy for non-disclosure, on the basis that the assured had failed to disclose that he was in dispute with the Inland Revenue and Customs & Excise over allegations that he had withheld in each case sums of about £140,000. There were suspicions that he was dishonestly failing to account for the premium he was collecting for warranty cover for the second-hand cars he sold. There was no doubt in the mind of the trial judge, Moore-Bick J, that these facts created a moral hazard and were material as they demonstrated a trend of general dishonesty on the part of the assured.

2-60 Recently, a similar line of reasoning has been adopted in *Sharon's Bakery (Europe) Ltd v AXA Insurance UK Plc*,¹⁶⁸ where the co-owners of a bakery obtained an insurance policy for their property and upon occurrence of a loss caused by fire, their claim for indemnity was turned down by the insurers. One of the defences that the insurers decided to run related to the fact that the co-owners of the shop, when securing finance from a finance company, had presented a false invoice relating to the acquisition of equipment. This invoice was produced with a view to proving the value of the equipment in question. It was common ground that the invoice was fraudulent as the alleged transaction had never taken place. The insurers' argued that even if the fraudulent document was not used against them, the fact that it was forged and presented to the finance company was sufficient to demonstrate the assured's attitude towards others that they worked with and established a moral hazard for the purposes of the insurance policy. The trial judge, Blair J, held that it was insignificant that the forged document was not used against the insurers. The fact that it was produced by the assured and utilised to secure finance demonstrated general dishonesty and accordingly, keeping this information away from the insurers amounted to a material non-disclosure.¹⁶⁹

2-61 These authorities clearly indicate that the courts are receptive to an argument that the assured company's running of its affairs in a dishonest fashion could amount to a moral hazard. Making no reference to such practices, even if they are not associated with the contract of insurance, could potentially jeopardise their insurance cover for want of good faith. A more difficult question, which has not been considered in any of these authorities, is whether insurers could argue that the assured's dishonest behaviour which relates to a matter that is exempt from disclosure by virtue of s 18(3)(a), (b), (c) and (d) of the MIA 1906 could still amount to a moral hazard. The issue is deliberated below, but it is likely that dishonesty of the assured might still amount to moral hazard even in those circumstances.

¹⁶⁷ [2002] Lloyd's Rep IR 206.

¹⁶⁸ [2011] EWHC 210 (Comm); [2012] Lloyd's Rep IR 164.

¹⁶⁹ Blair J also opined that a similar outcome would have followed had the false invoice been produced at the request of the finance company rather than on the assured's initiative.

(E) Facts which Need Not Be Disclosed

2-62 Section 18(3) of the MIA 1906 restricts the scope of the disclosure duty on the part of the assured by listing circumstances which need not be disclosed. It is an interesting question whether establishing fraud on the part of the assured at the pre-contractual stage will have any impact on such exceptions. This matter will be subjected to a comprehensive analysis in this part.

(a) Circumstances which are actually known or presumed to be known to the insurer

2-63 By virtue of s 18(3)(b) of the MIA 1906, the assured bears no duty of disclosure to the insurer if the insurer already knows the relevant facts or circumstances. There are two issues that require clarification with regard to the scope of this provision: (i) given that an insurer is likely to be a corporate entity, whose knowledge in the insurance company will be imputed to the insurers, (ii) is it adequate that the relevant information be received by the insurers or should the information be also present to the insurer's mind at the time when the insurance contract is concluded? Applying the test laid down in *Meridian Global Funds Management Asia Ltd v Securities Commission*,¹⁷⁰ it can be safely said that the knowledge of the person authorised to take underwriting decisions within the company (i.e. deciding whether to accept the risk proposed or not) is the knowledge of the company for the purposes of s 18(3)(b). Given the huge volume of information an underwriting department receives on a daily basis, on point (ii), it is submitted that for any information to be deemed to be known by the insurer, it is necessary to show that that information must be present in the mind of the relevant individual in the insurer's organisation at the time the contract was concluded. It is unrealistic to expect any individual to remember all the information he has received. Accordingly, courts have been on their guard against any attempt to credit the insurers with a good memory of recent events. In *Bates v Hewitt*,¹⁷¹ it was not disclosed to the underwriter that the insured vessel had been in the service of the Confederate Navy during the American Civil War and was thus liable to be taken as a prize by the Union forces which won the war. Following the seizure of the ship, underwriters denied liability on the ground of non-disclosure of material facts. The assured, who was able to demonstrate that the insurer had at some time been aware of the ship's history, nevertheless did not defeat the insurer's defence, as he failed to show that the insurer at the time of underwriting the policy had any interest in past knowledge of the ship's history.¹⁷² It is also submitted that the knowledge in this context includes turning a blind eye.¹⁷³

2-64 The same provision stipulates that the assured is not obliged to disclose information which the underwriter is presumed to know. The underwriter is presumed to be aware of common notoriety and knowledge and matters which an

¹⁷⁰ [1995] 2 AC 500.

¹⁷¹ (1867) LR 2 QB 595.

¹⁷² See also *Winter v Irish Life Insurance plc* [1995] 2 Lloyd's Rep 274, at 280-1, per Sir Peter Webster. The same point has been made more recently in *Strive Shipping Corporation v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88.

¹⁷³ *Blackburn Low & Co v Vigors* (1887) LR 12 App Cas 531, at 543.

underwriter in the ordinary course of his business ought to know. This is discussed below.

(i) MATTERS OF COMMON NOTORIETY AND KNOWLEDGE

2-65 There is no obligation to disclose any matter which is in the public domain and known globally. Information under this category might relate to political or natural affairs. For example, in *Lean v Hall*,¹⁷⁴ there was no duty to disclose that the insured property was used as a prison to detain Sinn Fein rebels as this was well-known in the area. By the same token, it is likely that there is no need to disclose the fact that there is war in a certain part of the world¹⁷⁵ or that the war is imminent.¹⁷⁶ Equally, the fact that the infrastructure of a port has been adversely affected from a tsunami in the region is not something which needs to be disclosed to a marine underwriter.

(ii) MATTERS THAT OUGHT TO BE KNOWN TO THE UNDERWRITER IN THE ORDINARY COURSE OF HIS BUSINESS

2-66 It has long been recognised that each underwriter is presumed to be acquainted with the practice of the trade he insures.¹⁷⁷ A marine underwriter is, therefore, expected to be aware of the nature of the insured vessel¹⁷⁸ or cargo to be carried,¹⁷⁹ geographical properties of the ports of the world which are touched upon by the vessels or cargoes he insures,¹⁸⁰ claim records for a particular type of risk¹⁸¹ and commonly used clauses in carriage contracts.¹⁸² What an underwriter is expected to know should be judged according to the customs and usages of the class of insurance in question. Therefore, an underwriter who offers open cover to commodity traders is expected to be aware of the whole range of circumstances that might arise in the course of carrying on a business of that kind (e.g. the lack of methods for verifying the quantities of oil held in storage for the assured).¹⁸³

2-67 However, a distinction must be drawn between circumstances that may arise in the course of carrying on a business of that kind and matters that are specific to the risk insured against. The latter is unique to the proposed risk and unusual in the sense that they fall outside the contemplation of even a reasonable underwriter familiar with that particular trade. The assured is, therefore, expected to disclose such matters. In *Greenhill v Federal Insurance Co Ltd*,¹⁸⁴ it was held by

¹⁷⁴ (1923) 16 LIL Rep 100.

¹⁷⁵ *Bolivia v Indemnity Mutual Marine Assurance Co Ltd* [1909] 1 KB 785.

¹⁷⁶ *Planche v Fletcher* (1779) 1 Dougl KB 251.

¹⁷⁷ *Noble v Kennoway* (1780) 2 Dougl KB 510, at 512, per Lord Mansfield.

¹⁷⁸ *Cantière Meccanico Brindisino v Janson* [1912] 3 KB 452 and *George Cohen Sons & Co v Standard* (1925) 21 LIL Rep 30.

¹⁷⁹ *British and Foreign Marine Insurance Co Ltd v Sturge* (1897) 77 LT 208.

¹⁸⁰ *Stewart v Bell* (1821) 5 B & Ald 238; *Tate & Sons v Hyslop* (1885) 15 QBD 368; *Commercial Union Assurance Co Ltd v Niger Company Ltd* (1922) 13 LIL Rep 75; *Sharp v Sphere Drake Insurance (The Moonacre)* [1992] 2 Lloyd's Rep 501 and *Fraser Shipping Ltd v Colton (The Shakir III)* [1997] 1 Lloyd's Rep 586.

¹⁸¹ *Northern British Fishing Boat Insurance Co Ltd v Starr* (1922) 13 LIL Rep 206.

¹⁸² *The Bedouin* [1894] 7 Asp MLC 391.

¹⁸³ *Glencore International AG v Alpina Insurance Co Ltd* [2003] EWHC 2792; [2004] 1 Lloyd's Rep 111.

¹⁸⁴ [1927] 1 KB 65.

the Court of Appeal that an insurer insuring a particular type of cargo (celluloid) would be expected to know the general properties of that cargo, but any unusual circumstances affecting that cargo – such as damage sustained to the cargo during an earlier voyage and the manner of its carriage – should be disclosed, as such circumstances would not be within the contemplation of a prudent insurer.¹⁸⁵

2-68 It is beyond doubt that the test adopted here is subjective,¹⁸⁶ and the manner in which the insured company is organised needs to be analysed to determine whether matters ought to be known to that company in the ordinary course of business. Provided that a reporting facility within the insurer's company is in place, the insurer is deemed to know about matters that are brought to the attention of another department (e.g. the claims department, even if that department fails to report this to the underwriting department).¹⁸⁷ Similarly, if the internal organisation of the insurer's company allows various departments to correlate the data they receive into a central database, the insurer should be presumed to know this data for the purposes of a risk.

2-69 In today's world, as a result of the increased use of media services and the internet, underwriters are bombarded with information regularly. At this juncture, it is an interesting question whether an underwriter can be deemed to know matters which appear on a website or a newspaper (e.g. Lloyd's List) in the course of his business. In a number of cases decided in the nineteenth century, the courts expressed the view that information contained in the Lloyd's List need not be disclosed to insurers.¹⁸⁸ However, in an era where the internet provides a massive pot of knowledge and people get news updates on their tablets or mobiles, these authorities must be treated with caution. If any information appearing on the internet or Lloyd's List is treated as lying within the knowledge of an insurer, the scope of the disclosure duty will be reduced almost to nothing. It is submitted that such information could be presumed to be known by the insurer only if he has access to such information and also has an interest in it at the time when such information is received.¹⁸⁹

¹⁸⁵ See also, *Marc Rich & Co AG v Portman* [1996] 1 Lloyd's Rep 430; *aff'd* [1997] 1 Lloyd's Rep 225.

¹⁸⁶ Section 18(3)(b) reads (emphasis added):

... The insurer is presumed to know ... matters which an insurer in the ordinary course of *his* business, as such, ought to know.

See also, *Australia & New Zealand Bank Ltd v Colonial Eagle Wharves Ltd* [1960] 2 Lloyd's Rep 241.

¹⁸⁷ At first sight, the majority judgment of the Court of Appeal in *Malhi v Abbey Life Assurance Co* [1996] LRLR 237, where it was held that one department of the insurer's company having received information in respect of a risk did not mean that another department of the insurer could have knowledge of that fact, seems to contradict this proposition. It is, however, submitted that this judgment should be confined to the facts of that case where there was no procedure requiring various departments within the insurer's company to exchange information or store information in a central database for the use of other departments of the company. See also, *Gunns v Par Insurance Brokers* [1997] 1 Lloyd's Rep 173.

¹⁸⁸ *Friere v Woodhouse* (1817) Holt NP 572 and *Mackintosh v Marshall* (1843) 11 M & W 116.

¹⁸⁹ A similar point has been made by Colman J in *Strive Shipping Corp v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88, at 136:

The proposer for insurance is thus not entitled to assume that the underwriter will carry in his mind previous casualties of vessels not insured by him and be in a position to relate that information to the new risk proposed.

Recently, the issue has been deliberated again in passing in *Sea Glory Maritime Co v Al Sagr National*

2-70 As discussed above, an assured who innocently or negligently fails to disclose matters that are known or presumed to be known to the insurer is excused by virtue of s 18(3)(b). However, whether a different result should follow if the assured has acted fraudulently is a matter which requires further elaboration. Put another way, is it open to an assured, who has fraudulently concealed a matter known or ought to have been known to the insurer, to take advantage of this subsection? There is some support for the proposition that fraud should prevent the assured from arguing that any matter that is not disclosed is known or ought to have been known by the insurer. In *Harrower v Hutchinson*,¹⁹⁰ the assured insured a cargo of bone and ash for a voyage from a port or ports in the province of Buenos Aires to the UK. The plan, at the outset, was to load part of the cargo in Buenos Aires itself and complete at a port along the coast known as Laguna de los Padres. The latter was a place where a trade in hides, bone and bone ashes was carried on, but vessels could not clear from there to Europe and had to return to Buenos Aires to obtain a clearance. There was no artificial port but only a roadstead protected by natural headlands, forming a kind of bay. The assured, who was aware of the vessel's route, did not inform the underwriters that the vessel was to call at Laguna de los Padres. If the underwriters had known, they would have charged a higher premium. The vessel and part of the cargo was lost on the way back from Laguna de los Padres to Buenos Aires and the assured made a claim under the policy. Underwriters denied liability on the basis that the assured had failed to disclose a material fact. The assured argued that underwriters in the course of their business ought to have known the fact that Laguna de los Padres was not a natural port and vessels could not have obtained clearance from there to ports in Europe. The contention of the assured was rejected mainly on the ground that the nature of the port at Laguna de los Padres was not generally known in trade or known to underwriters in general. However, in passing, Cleasby J made the following observation:¹⁹¹

... I think that, in general, provided the terms of a policy include all ports of loading of every description within a certain district, the existence of these ports is a matter equally within the knowledge, or presumed knowledge, of both parties, and that if the underwriters are ignorant as to the ports within the district, or wish for information as to what port is the destination of the vessel, it was for them to ask such questions as they deemed material, and then they would have been entitled to true answers: *Haywood v Rogers* [4 East at p.597-8]. And it is of great importance not to break in upon this rule, otherwise the security of persons who had effected policies, would be much diminished, and vexatious defences set up when claims were made.

The rule would, however, I think, be subject to this qualification, that the assured had not by any contrivance in the wording of the proposal and policy, intentionally hid from the underwriters what was the real risk intended to be covered, and so misled them and given them no opportunity of ascertaining that risk. I think the quotation of Lord Mansfield, so often repeated, in the great case of *Carter v Boehm* [3 Burr. at p. 1910], peculiarly applicable to this

Insurance Co (The Nancy) [2013] EWHC 2116 (Comm). There, the issue was whether the underwriter in question was deemed to possess information that appears on databases, such as Lloyd's MIU and Seaweb. Blair J was convinced that the fact that information is available online does not necessarily give rise to a presumption of knowledge on the part of underwriters.

¹⁹⁰ (1870) LR 5 QB 584.

¹⁹¹ *Ibid.*, at 594-5.

case ‘aliud est celare, aliud tacere’, &c. Silence as to certain material particulars is one thing; but hiding and covering them up is another; and in such a contract as this, which is always said to be *uberrimae fidei*, avoids the policy.

2-71 The views expressed in *Harrower v Hutchinson* are obviously *obiter*, but in recent years we have witnessed a rapid expansion on the scope of the doctrine of moral hazard by English courts. There are several authorities indicating that dishonesty of the assured, although not directed at the insurer, could, nevertheless, amount to moral hazard.¹⁹² Drawing a parallel with these authorities, there is room to argue that although there is no duty to disclose a fact which the insurer knows, or is presumed to know, if it can be shown that the insurer has acted dishonestly by concealing such facts this paints a negative picture with regard to the character of the assured and ultimately might amount to moral hazard. It should be added that, as of yet, there is no judicial authority on this point.

(b) Circumstances which diminish the risk

2-72 There is no duty to disclose any circumstance which diminishes the proposed risk as indicated by Lord Mansfield in *Carter v Boehm*.¹⁹³ In any event, it is very unlikely that a circumstance which diminishes the risk would be found to be material, but the drafter of the Act found it necessary to reiterate this point in s 18(3)(a), possibly influenced by the decisions of Lord Mansfield on the subject.¹⁹⁴ The most modern authority on the matter is *Decorum Investments Ltd v Atkin (The Elena G)*,¹⁹⁵ where it was held that there was no need to disclose the fact that the insured yacht was kept in a secure mooring as the security precautions diminished the risk. In contemporary litigation practice, the assured willing to rely on this exception would, in all probability, need to rely on expert evidence to establish this point.

2-73 An interesting question is whether the insurer could still avoid the policy if the assured dishonestly conceals a material fact or circumstance that ultimately diminishes the risk. Although the matter concealed would be immaterial, the argument that can be advanced is that the assured’s dishonesty creates a moral hazard. This eventuality has not yet exercised the courts, but it is not without merit or legal backing.¹⁹⁶

¹⁹² See *Insurance Corporation of Channel Islands v Royal Hotel Ltd* [1998] Lloyd’s Rep IR 151; *James v CGU Insurance Co plc* [2002] Lloyd’s Rep IR 206 and *Sharon’s Bakery (Europe) Ltd v AXA Insurance UK Plc*; [2011] EWHC 210 (Comm); [2012] Lloyd’s Rep IR 164.

¹⁹³ (1766) 3 Burr 1905, at 1911:

... the underwriter needs not to be told what lessens the risque agreed and understood to be run by the express terms of the policy ... if he insures for three years he need not be told any circumstance to show it may be over in two; or if he insures a voyage, with liberty of deviation, he need not be told what tends to show there will be no deviation.

¹⁹⁴ See also, *Pawson v Watson* (1778) 2 Cowp 785.

¹⁹⁵ [2002] Lloyd’s Rep IR 450. See also, *The Dora* [1989] 1 Lloyd’s Rep 69 and *Zeus Tradition Marine Ltd v Bell (The Zeus V)* [2000] 2 Lloyd’s Rep 587.

¹⁹⁶ See *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] Lloyd’s Rep IR 151; *James v CGU Insurance Co plc* [2002] Lloyd’s Rep IR 206 and *Sharon’s Bakery (Europe) Ltd v AXA Insurance UK Plc* [2011] EWHC 210 (Comm); [2012] Lloyd’s Rep IR 164.

(c) Circumstances which are waived

2-74 The concept of waiver in common law has been regarded as ‘imprecise’¹⁹⁷ and ‘vague’¹⁹⁸ as it covers a variety of situations. In the context of insurance law, it can broadly be defined as the voluntary relinquishment of a right.¹⁹⁹ In a more precise manner, it is possible to classify a waiver that arises following a breach on the part of the assured in two categories: waiver by election and waiver by estoppel. The former, which is also known as affirmation, connotes an election on the part of the insurer to keep the contract alive despite a breach by the assured.²⁰⁰ Section 18(3)(c) deals with a species of waiver by estoppel which is founded on negligent passivity on the part of the underwriter.²⁰¹ This type of waiver is often referred to as ‘implied waiver’. For the sake of completeness, it should be stressed that the duty of disclosure can also be waived at the time of contracting by agreement. This is commonly known as ‘waiver by express agreement’. These different types of waivers are considered next with specific reference to the impact of fraud.

(i) WAIVER BY EXPRESS AGREEMENT

2-75 Despite not being so common in marine insurance practice,²⁰² it is conceptually possible to incorporate a clause into a contract of insurance whereby the parties agree that the duty of disclosure of the assured or his agent is waived.²⁰³ More commonly, insurance policies might contain a clause which purported to limit or exclude the rights of insurers to avoid a contract of insurance for breach of the duty of disclosure by the assured or his agent.²⁰⁴ There is a considerable difference between these two kinds of waiver agreements. While the former removes any duty of disclosure, the latter leaves the duty intact but simply removes possible remedies. The practical consequence of this is that if the duty of disclosure is removed, it would be immaterial that the assured or his agent had been guilty of fraud in withholding information.²⁰⁵ There is a limitation on a term which purports to remove the remedy for non-disclosure, leaving the main duty intact. Public policy would not

¹⁹⁷ *Commonwealth of Australia v Verwayen* (1990) 170 CLR 394, at 406, per Mason CJ.

¹⁹⁸ *Ross T Smyth & Co Ltd v Bailey Son & Co* (1940) 164 LT 102, at 106, per Wright LJ.

¹⁹⁹ *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] LRLR 151, at 162–3, per Mance J and *Baghdarani v Commercial Insurance Co plc* [2000] LRLR 94, at 122–3, per HJJ Gibbs QC.

²⁰⁰ This type of waiver is deliberated further later in the chapter under the section on remedies.

²⁰¹ Longmore J, in *Marc Rich & Co AG v Portman* [1996] 1 Lloyd’s Rep 430, at 442, reiterated the point that waiver in the context of s 18(3)(c) means something rather different from its meaning in other contexts where full knowledge and a clear and unequivocal representation are required.

²⁰² Such clauses appear frequently in professional indemnity policies.

²⁰³ A common example is a clause which provides that the assured will not have any duty to make any disclosure of any nature. See e.g., *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 2 Lloyd’s Rep 61.

²⁰⁴ For example, the clause might generally exclude rescission, in unequivocal terms: ‘The contract is neither cancellable nor voidable by either party.’ See *Toomey v Eagle Star Insurance Co Ltd (No 2)* [1995] 2 Lloyd’s Rep 88.

²⁰⁵ See the judgment of Aikens J in *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd’s Rep 30, at 43, where he said:

If there is no duty, then adding the epithet ‘fraudulent’ to the description of the deliberate non-disclosure of a material fact does not advance the argument. If there is no duty in the first place then the assured is entitled to keep quiet.

permit an assured to rely upon such a clause to exonerate him in the event of fraud on his part in the presentation of the risk.²⁰⁶

(ii) IMPLIED WAIVER BY ASKING LIMITED QUESTIONS

2-76 If the questions put forward by the insurer give the impression to a reasonable assured that the insurer is not interested in matters outside the scope of these questions, it could be inferred that the disclosure duty of the assured has been restricted. Naturally, here the important point is the nature of the questions asked and whether they are capable of conveying the message to the insurer that ‘this is all that the underwriter needs to know’ prior to making his decision about whether or not to provide cover. For example, in *Revell v London General Insurance Co Ltd*²⁰⁷ it was held that a question limited to motoring convictions implicitly waived information regarding other convictions. It has to be borne in mind that courts would only be prepared to infer waiver in those circumstances if, upon a true construction of questions put forward by the insurer, they are convinced that the insurer had intended to restrict his right to receive information on matters outside the scope of the question. This point has recently been considered in *O’Kane v Jones (The Martin P)*²⁰⁸ where it was argued by the insurer that late payment or failure to pay under a previous hull and machinery policy was a material fact which had to be disclosed. The thrust of the argument was that full disclosure on this point would have indicated to the insurer that the assured was impecunious and unable to maintain the vessel. Deputy High Court Judge Richard Siberry QC held that the concealed fact was not material as it was not a matter related to the risk insured and late payment is rather common in the marine market. He was, however, of the opinion that if this fact had been material since specific questions were asked by the insurer as to the maintenance and condition of the vessel, a reasonable proposer would have been justified in thinking that the insurer was only interested in the matters raised in the question and did not want to be told of other matters, such as late payment or failure to pay premiums.

2-77 Conversely, in *Noblebright Ltd v Sirius International Corporation Lloyd’s Syndicate 1200*,²⁰⁹ the assured, whilst obtaining insurance for his property, was asked in the proposal form about previous insurance claims which he truthfully answered. However, he failed to mention that he had been the victim of three armed robberies in the years immediately preceding the cover. It was held that the question could not give the impression to a reasonable assured that he had to disclose only claims put

²⁰⁶ *S Pearson & Son Ltd v Dublin Corporation* [1907] AC 351 and *Boyd & Forrest v Glasgow & South Western Railway Co* 1915 SC (HL) 20. It could, however, be argued that, as long as the assured is no way implicated the agent’s fraud, there is no reason of public policy why he should not be able to exclude his contractual liability for fraudulent non-disclosure (or misrepresentation) by his agent. By the same token, there is no reason of public policy why parties should be unable by contract to exclude a right of recession for fraudulent non-disclosure (or misrepresentation) by an agent. It is also worth noting that there is no judicial authority supporting an extension of the public policy rule to cover the fraudulent conduct of the assured’s agents. See the judgment of Rix LJ in *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] EWCA Civ 1250; [2001] 2 Lloyd’s Rep 483, at [104].

²⁰⁷ (1934) 50 LIL Rep 114. See also, *Taylor v Eagle Star Insurance Co Ltd* (1940) 67 LIL Rep 136 and *Schoolman v Hall* [1951] 1 Lloyd’s Rep 139.

²⁰⁸ [2003] EWHC 2158 (Comm); [2004] 1 Lloyd’s Rep 389.

²⁰⁹ [2007] EWHC 868 (QB); [2007] Lloyd’s Rep IR 584.

forward but not other losses which potentially would have been covered by a policy of similar nature.

(iii) IMPLIED WAIVER BY FAILING TO ASK FURTHER QUESTIONS

2-78 If the information provided by the assured either puts, or should put, the insurer on inquiry about related information and the insurer, nevertheless, chooses to make no further inquiry regarding the latter, it can be inferred that the insurer has waived the disclosure of further information. The key factor here is whether the information received by the insurer is sufficient to cast doubt in the mind of a reasonable and prudent insurer that there might be further attributes of the proposed risk. An insurer can be put on inquiry by various means. Usually, the nature of the risk proposed or facts surrounding the risk might raise questions regarding its extent. In *George Cohen v Standard Marine Insurance Co*,²¹⁰ the insurance was on an obsolete battleship which was to be towed across the North Sea and then broken up. During the voyage she became a constructive total loss. The insurers denied liability on the ground, *inter alia*, of failure to disclose the fact that the vessel had no steam power of her own. Roche J held that the insurers must be presumed to know that a dismantled warship which needed a tow was not likely to have her own sources of power available, and as they had abstained from asking any questions about the precise position on board, they had waived any further disclosure by the assured as to how she was going to be steered.

2-79 Recently, a similar point was made in *Garnat Trading & Shipping (Singapore) Pte Ltd v Baominh Insurance Corporation*.²¹¹ There, the assured insured a powerless floating dock for a towage operation from Vladivostock to Vung Tau (in Vietnam). When the dock was lost during the voyage, the insurers sought to deny liability on the premise that the assured had failed to disclose that sea towage was permissible only in conditions up to sea force 5 and up to a maximum permissible wave height of 3.5 m. The assured responded indicating that this information was incorporated in a document which formed part of the towage plan submitted to the underwriters. Christopher Clarke J held that the assured had fulfilled its obligation to make full disclosure. However, it was also considered whether waiver within the meaning of s 18(3)(c) could have been established had there been no actual disclosure. An affirmative answer was given to this hypothetical inquiry on the basis that the insurers were presented with the towage plan which contained limiting terms relating to the ocean towage. This would normally put a reasonable prudent insurer on inquiry as to the contents of the plan to make further inquiries on matters with regard to a limitation as to maximum wave height. It was the view of the trial judge that in the present case, the insurers had failed to act as a reasonable prudent insurer would have acted in the circumstances and that failure established a waiver of the information which such an inquiry would have yielded.²¹² Again, in *Mann MacNeal and Steeves v Capital and Countries Insurance Co*,²¹³ a hull underwriter, having been

²¹⁰ (1925) 21 LIL Rep 30.

²¹¹ [2010] EWHC 2578 (Comm); [2011] 1 Lloyd's Rep 589.

²¹² This point was not taken up before the Court of Appeal [2011] EWCA Civ 773; [2011] 2 Lloyd's Rep 492.

²¹³ [1921] 2 KB 300.

informed that the vessel was carrying a cargo, failed to ask further questions and issued a policy without ascertaining its nature. In fact, the cargo was petrol stored in iron drums. The Court of Appeal held that by not making further inquiries regarding the nature of the cargo, the insurer had waived the disclosure of such information.²¹⁴

2-80 As stressed by Kerr LJ, in *CTI v Oceanus*,²¹⁵ before any question of waiver can arise it is vital to consider whether the disclosed facts give a fair presentation of the risk.²¹⁶ If the risk is not fairly represented to the underwriter, he cannot sensibly be said to refrain from asking questions. What fair representation in this context amounts to is a question of fact, but it is highly unlikely that a plea for implied waiver will be successful in cases where the insurer fails to ask for additional information which he had no reason to believe existed. In *WISE (Underwriting Agency) Ltd and others v Grupo Nacional Provincial SA*,²¹⁷ during the presentation of the risk to the reinsurers, the reassured stated that the goods covered under the original policy included 'clocks' whereas, in fact, Rolex watches were also included. The reassured argued that disclosure had been waived by the underwriter's failure to ask any questions about the clocks, in particular given that the shipment was from Miami to a high-class resort with a duty-free area and that the slip presentation had been written by someone using English as a second language. Simon J held that the reinsurers were entitled to accept what they were told at face value and there was nothing in the presentation to raise suspicion that the transshipment contained valuable watches in addition to clocks.²¹⁸ In reaching this decision, the trial judge seemed to be influenced by the fact that from the manner in which the risk was presented, which could hardly be viewed as a fair representation, it would have been rather difficult to infer the conclusion that the shipment included high-value watches. The majority of the Court of Appeal approved this reasoning with Rix LJ dissenting.²¹⁹

2-81 It is also possible to put an insurer on inquiry by tendering relevant documentation. In *Pan Atlantic Insurance Co v Pine Top*, reinsurers sought to avoid the policy on the ground that the reassured had failed to disclose their full claims experience for the years 1977 to 1979. The evidence demonstrated that full documentary details of all losses had been made available by the reinsured's brokers but the agents of the insurer looked only at a document summarising the short record. Waller J held that the reinsurers were put on inquiry but they had waived disclosure by their conduct.²²⁰

²¹⁴ See also, *Court v Martineau* (1782) 3 Dougl 161; *Freeland v Glover* (1806) 7 East 457; *Asfar & Co v Blundell* [1896] 1 QB 123; *Becker v Marshall* (1922) 12 LIL Rep 413 and *George Cohen v Standard Marine Insurance Co* (1925) 25 LIL Rep 30.

²¹⁵ [1984] 1 Lloyd's Rep 476, at 496.

²¹⁶ See also, *Marc Rich & Co AG v Portman* [1996] 1 Lloyd's Rep 430, at 444, per Longmore J, *aff'd* [1997] 1 Lloyd's Rep 225. This must be associated with the fact this type of estoppel has its origins in the law of equity.

²¹⁷ [2003] EWHC 3038 (Comm); [2004] 1 All ER 495.

²¹⁸ See also, *New Hampshire Insurance Co v Oil Refineries Ltd* [2002] 2 Lloyd's Rep 462.

²¹⁹ [2004] EWCA Civ 962; [2004] 2 Lloyd's Rep 483. It should be, however, noted that the observations of the judges on this point were, strictly speaking, *obiter* as the case was decided on the affirmation point. See also, *Rendall v Combined Insurance Co of America* [2005] EWHC 678 (Comm); [2006] Lloyd's Rep IR 732, at [106]–[107].

²²⁰ [1992] 1 Lloyd's Rep 101. This analysis was approved by the Court of Appeal [1993] 1 Lloyd's Rep 496 and by a majority of the House of Lords [1995] 1 AC 501. The same is also true if the assured in a consumer insurance contract leaves incomplete a number of questions in the proposal form. In that

(iv) IMPACT OF FRAUD ON IMPLIED WAIVER

2-82 An interesting question arises as to the possible impact of the assured's fraud in this context. Imagine the position of an assured who dishonestly conceals material facts from the insurer during the presentation of the risk. Can he later argue that the facts disclosed were sufficient to put a prudent insurer on inquiry regarding additional attributes of the risk but that the insurer waived the disclosure of those issues by failing to ask for further clarification? It is submitted that due to the requirement that waiver can arise only if the risk is fairly represented in the first place and also taking into account the equitable foundations of the doctrine, no issue of waiver will arise if the facts are not submitted to the insurer in a truthful manner. Allowing an assured in this position to rely on waiver would be equivalent to allowing an assured to rely on his dishonesty, which is clearly contrary to public policy.²²¹

The outcome is likely to be the same in cases where the assured, faced with a limited question, provides false answers deliberately to that question. Even though the duty of disclosure has been restricted in such case, the misstatement on the part of the assured would certainly amount to actionable misrepresentation.²²²

(d) Circumstances which are covered by a warranty

2-83 There is no duty of disclosure on the part of the assured for matters that are covered by an insurance warranty as long as the warranty has been incorporated into the contract.²²³ The term 'warranty' has different meanings in various areas of contract law. A marine warranty is defined by s 33(1) of the MIA 1906 as a term of the contract by which the assured makes a promise to the underwriter. The promise which forms the subject matter of a marine warranty consists of an undertaking by the assured that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negates the existence of a particular state of facts.²²⁴ The philosophy behind this exclusion can be explained by the fact that a marine warranty, by putting the assured under an obligation to perform his promise, allows an insurer to assess the extent of the proposed risk, therefore disposing of the need to make further disclosure on points already covered

case, if it can be inferred that there remains further information to be communicated, then issue of a policy without further inquiry will support the assured's contention that disclosure was waived: *Roberts v Avon Insurance Co Ltd* [1956] 2 Lloyd's Rep 240. Cf *Stowers v GA Bonus plc* [2003] Lloyd's Rep IR 402.

²²¹ *Beresford v Royal Insurance Co Ltd* [1938] AC 586. See also, *New Hampshire Insurance Co v Oil Refineries Ltd* [2002] 2 Lloyd's Rep 462 in a similar context.

²²² *Moore Large and Co Ltd v Hermes Credit and Guarantee plc* [2003] EWHC 26 (Comm); [2003] 1 Lloyd's Rep IR 315.

²²³ It was deliberated in *Garnat Trading & Shipping (Singapore) Pte Ltd v Baominh Insurance Corporation* [2010] EWHC 2578 (Comm); [2011] 1 Lloyd's Rep 589 whether a warranty which appeared in the draft but was later dropped would render disclosure superfluous. The trial judge answered this hypothetical question in a negative fashion.

²²⁴ The legal effect of breach of a marine warranty has been spelt out in s 33(3) of the MIA 1906 in the following manner:

... the insurer is discharged from liability as from the date of the breach, but without prejudice to any liability incurred by him before that date.

For a detailed analysis on marine warranties, see Soyer B, *Warranties in Marine Insurance* (2nd edn) (2005, Routledge).

by a warranty. Accordingly, if the assured warrants that the insured vessel will only be used for pleasure purposes, his failure to disclose his intention to use the vessel as a demonstration model would preclude the insurer from bringing breach of disclosure duty as a defence.²²⁵ Conversely, in *O’Kane v Jones*,²²⁶ Mr Siberry QC, stated that the existence of a premium warranty, requiring the payment of premium in quarterly instalments, did not render disclosure of the assured’s record of paying premium to earlier insurers superfluous on the basis that the warranty did not afford protection to the insurer in all circumstances. Although the views expressed on this point were *obiter* due to the fact that the fact alleged as undisclosed was not deemed to be material,²²⁷ it clearly indicates that a careful analysis is needed to determine the scope of the warranty and what precisely the assured has undertaken with such a warranty before deciding whether disclosure of certain facts has been rendered superfluous by reason of the existence of the warranty.

2-84 The position is different if the insurer, during negotiations, makes an inquiry in relation to a matter covered by a marine warranty.²²⁸ In that case, disclosure of facts within the scope of the warranty does not become superfluous.²²⁹ The same is true in cases where the implied warranty of seaworthiness is waived by operation of a ‘seaworthiness admitted’ clause.²³⁰ Similarly, it is submitted that the duty to disclose material facts is not rendered superfluous within the meaning of s 18(3)(d) for matters covered by a provision akin to warranties (i.e. provisions dealing with change of voyage and deviation, exclusion clauses or clauses delimiting the risk) simply because in cases where these provisions become applicable, the insurer is exposed to risks which are much larger in scale than such provisions attempt to deal with.

2-85 Given that the duty to disclose matters that fall under the scope of a marine warranty has been removed completely, one might be tempted to argue that concealment of such facts, even in a dishonest fashion, will not have an impact on the position of the insurer. That said, as discussed above, it is possible that the insurer could argue that dishonesty on the part of the assured amounts to a moral hazard. There is no judicial authority on this point and the answer to this question will depend on how far the courts would be prepared to push the boundaries of the moral hazard doctrine.

(3) Remedies

2-86 The only remedy stipulated in the MIA 1906 for breach of pre-contractual duty of utmost good faith is the right to avoid the contract. This right is available if

²²⁵ See *Inversiones Manria SA v Sphere Drake Insurance Co Plc Malvern Insurance Co Ltd and Niagara Fire Insurance Co Inc, (The Dora)* [1989] 1 Lloyd’s Rep 69. See also, *Haywood v Rodgers* (1804) 4 East 590; *Kirkcaldy & Sons Ltd v Walker* [1999] Lloyd’s Rep IR 410 and *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] EWCA Civ 1047; [2001] Lloyd’s Rep IR 667.

²²⁶ [2003] EWHC 2158 (Comm); [2004] 1 Lloyd’s Rep 389.

²²⁷ This is so as s 53 of the MIA 1906 protected the insurer against the risk of a default in the payment of premium.

²²⁸ See the opening words of s 18(3) of the MIA 1906 which stipulates ‘In the absence of inquiry . . .’

²²⁹ *Haywood v Rodgers* (1804) 4 East 590, at 597–8 and, more recently, *Svenska Handelsbanken v Sun Alliance and London Insurance plc (No 2)* [1996] 1 Lloyd’s Rep 519, at 553–4, per Rix J.

²³⁰ *Cantiere Meccanico Brindisino v Janson* [1912] 3 KB 452. Such clauses are not incorporated into policies in contemporary marine insurance practice.

the assured fails to observe good faith dishonestly, negligently or even innocently. Until the right is exercised, the contract remains in force.²³¹ However, once the right is exercised, parties are discharged from all their obligations regardless of whether or not they have been performed. The MIA 1906 is silent on the subject of whether other remedies could be available for pre-contractual breaches of utmost good faith obligation. An unsuccessful attempt to claim damages on the basis that pre-contractual duty to make full disclosure in an insurance contract is based on an implied term of the contract²³² was made in *Banque Financière de la Cité SA v Westgate Insurance Co Ltd*.²³³ It is, however, possible that tort of deceit and other statutory provisions can be used as a platform to award damages, especially in cases of misrepresentation. The possibility of claiming damages for pre-contractual breach of utmost good faith is analysed in this part in addition to elaborating legal ramifications of the remedy of avoidance referred to in the MIA 1906.

(A) Avoidance

2-87 Being a self-help remedy, it is possible to elect to avoid an insurance contract simply by sending a notice to the assured to that effect. In that case, the rescission will date from the time of notice.²³⁴ Even though notice remains the most common form of communicating avoidance in practice, occasionally insurers go down the route of requesting the court to declare that they are entitled to avoid the contract.²³⁵ Although being an effective remedy, wrongful avoidance of an insurance contract, as in cases where the breach is not judged to be material by the court or if the insurer fails to demonstrate that he was induced to enter into the contract as a result of the breach, would amount to a repudiatory breach of the contract on the part of the insurer, entitling the assured to recover damages for loss he has suffered.²³⁶

2-88 The effect of avoidance is setting the contract aside for all purposes,²³⁷ so as to restore, as far as possible, the state which existed before the contract was entered into. In the context of insurance, the first step to be taken to restore the position which existed before the contract is to return the premium to the assured. However, the assured cannot recover the premium if he is guilty of fraud.²³⁸ It is

²³¹ *Mackender Hill & White v Feldia AG* [1966] 2 Lloyd's Rep 449, at 445, per Lord Denning MR.

²³² No doubt the *dictum* of Hamilton J in *William Pickersgill & Sons Ltd v London and Provincial Marine & General Insurance Co Ltd* [1912] 3 KB 614, at 621, was inspirational in this line of argument where he said:

The rule imposing an obligation to disclose upon the intending assured does not rest upon a general principle of common law, but arises out of an implied condition, contained in the contract itself, precedent to the liability of the underwriter to pay.

²³³ [1990] QB 665, *aff'd* on different grounds [1991] 2 AC 249 and *Bank of Nova Scotia v Hellenic Mutual Risks Association (Bermuda) Ltd (The Good Luck)* [1990] 1 QB 818. More recently, similar sentiments were echoed by the House of Lords in *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 2 Lloyd's Rep 61.

²³⁴ *Reese Silver Mining Co v Smith* (1869) LR 4 HL 64.

²³⁵ See e.g., *Insurance Corporation of the Channel Islands Ltd v McHugh* [1997] LRLR 94.

²³⁶ *Transthene Packaging v Royal Insurance (UK) Ltd* [1996] LRLR 32.

²³⁷ *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corporation of India (The Kanchenjunga)* [1990] 1 Lloyd's Rep 391, at 398.

²³⁸ Section 84(1) of the MIA 1906.

probable that an arbitration or jurisdiction clause will survive the avoidance on the basis that such an agreement is to be treated as a separate contract and is needed for the purpose of working out the consequences of avoidance.²³⁹

2-89 Generally speaking, if the insurer elects to avoid the policy, the avoidance takes effect totally; partial avoidance is not possible.²⁴⁰ There are, however, a few instances where, due to the nature of the contractual relationship, the remedy of avoidance is tailored. This usually arises where the assured is given a non-obligatory open cover. Under an agreement of this nature the insurer is not obliged to accept risks declared by the assured. The open cover in this case acts as a framework agreement which sets out the machinery for the making of individual contracts.²⁴¹ Each declaration made under the open cover, if accepted by the insurer, creates a binding contract.²⁴² If, therefore, the assured is in breach of utmost good faith obligation while making the declaration, the insurer is only entitled to avoid that declaration; other declarations, and the declaration policy itself, remain unaffected by the ability of an insurer to avoid any one declaration.²⁴³

2-90 A similar position arises in cases where an extension is made to the existing cover by activating a held-covered clause. A traditional held-covered clause gives an opportunity to an assured to extend the scope of cover automatically on giving notice to insurers and agreeing on additional premium and other terms imposed by insurers.²⁴⁴ Such a held-covered clause can be viewed as a mechanism for creating a distinct contract, thus requiring the assured to disclose material facts which are relevant only to the new part of the contract.²⁴⁵ It naturally flows from the distinct contract analysis that if the assured is in breach of the utmost good faith obligation while activating a held-covered clause, he will only be allowed to avoid the part of the contract as varied by the operation of the held-covered clause.²⁴⁶ The fact that the original agreement stays intact does not automatically mean that the assured

²³⁹ *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1992] 1 Lloyd's Rep 81 and *FAI General Insurance Co Ltd v Ocean Marine Mutual P & I Assurance* [1998] Lloyd's Rep IR 24.

²⁴⁰ *TSB Bank plc v Camfield* [1995] 1 WLR 430. Cf *Gladstone v King* (1813) 1 M & S 35 and *Stribley v Imperial Marine Insurance Co* (1876) 1 QBD 507.

²⁴¹ A non-obligatory open cover is a contract for insurance and accordingly does not attract the duty of utmost good faith: *Société Anonyme d'Intermédiaires Luxembourgeois v Farex Gie* [1995] LRLR 116. The position is different if the open cover is obligatory and the insurer is obliged to accept all risks declared under the cover. A contract of that nature attracts the duty of utmost good faith: *Property Insurance Co Ltd v National Protector Insurance Co Ltd* (1913) 18 Com Cas 119 and, more recently, *Glencore International AG v Alpina Insurance Co Ltd* [2003] EWHC 2792 (Comm); [2004] 1 Lloyd's Rep 111.

²⁴² *Citadel Insurance Co v Atlantic Union Insurance Co SA* [1982] 2 Lloyd's Rep 543.

²⁴³ *Société Anonyme d'Intermédiaires Luxembourgeois v Farex Gie* [1995] LRLR 116.

²⁴⁴ For a typical held-covered clause, see the Institute Time Clauses Hull (1995), cl 3.

²⁴⁵ See *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1988] 1 Lloyd's Rep 514, at 545-6, per Hobhouse J and *Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd & Le Réunion Européenne (The Star Sea)* [1997] 1 Lloyd's Rep 360, at 370.

²⁴⁶ Delivering the judgment for the Court of Appeal in *The Star Sea*, *ibid* at 370, Leggatt LJ, observed:

In relation to amendment a duty of disclosure of facts material to the amendment will exist but the law is not, we think, clear as to whether the remedy is avoidance of the whole contract or merely of the amendment. Since inducement of the actual underwriter is necessary, there seems much to be said for the point of view that avoidance of the amendment is all that should be permitted.

See also, *O'Kane v Jones (The Martin P)* [2003] EWHC 3470 (Comm); [2004] 1 Lloyd's Rep 389, at [229], per Mr Richard Siberry QC. More recently, the same point was made by Flaux, J in *AC Ward & Sons Ltd v Catlin (Five) Ltd & Others* [2009] EWHC 3122 (Comm); [2010] Lloyd's Rep IR 695 at [233].

will be able to recover for any loss arising. Let us assume that a held-covered clause is incorporated into the contract that provides the opportunity to the assured to remain covered when there is a change of destination, provided that immediate notice is given to the insurer and an additional premium is agreed. An assured intending to rely on this clause is expected to make full disclosure on matters material to the insurer's decision to agree to the variation in cover including the amount of premium.²⁴⁷ If the assured is in breach of this limited duty, the insurer's remedy will be to avoid the agreement by which the policy was amended but not the entire contract. Even so, the assured would still not be able to recover for any loss that arises after the change in destination occurs. Conversely, the assured would recover for any casualty that arises before the change of destination under the original agreement, as avoidance of the agreement to vary the policy would have no effect on the original policy.

2-91 Being an equitable remedy,²⁴⁸ avoidance should be exercised in a way that takes account of countervailing equitable considerations. To this end, an insurer's right to avoid may be barred in certain circumstances: most notably by affirmation of the contract. It is also possible that the right to avoid may be restricted by contractual clauses and, more recently, it has been suggested that breach of the continuing duty of utmost good faith of the insurer might act as a bar on the right of avoidance. These potential limitations of the right to avoid will be analysed in turn.

(a) Affirmation

2-92 Affirmation in this context arises when an insurer who is aware of the existence of facts which entitle him to avoid the policy elects to continue by making an unequivocal conduct to this end.²⁴⁹ The leading analysis of affirmation in the insurance context is that of Mance J in *Insurance Corporation of the Channel Islands v Royal Hotel Ltd*,²⁵⁰ where he summarised the essential elements of affirmation as follows:

- (1) The insurer must have knowledge that the duty of utmost good faith has been breached at the formation stage.
- (2) The insurer must also know that breach of utmost good faith duty creates a right to avoid.
- (3) There must be an unequivocal communication to the assured either by words or conduct that the insurer has made an informed choice to affirm the contract.

2-93 It is vital that an insurer who wishes to keep the insurance contract alive despite a breach of utmost good faith obligation on the part of the assured makes an

²⁴⁷ See *Fraser Shipping Ltd v Colton (The Shakir III)* [1997] 1 Lloyd's Rep 586 where in a similar context, Potter J framed the duty of disclosure by making reference to s 18 of the MIA 1906.

²⁴⁸ *Strive Shipping Corporation v Hellenic Mutual War Risks Association (The Grecia Express)* [2002] EWHC 2003 (Comm), at [217], per Colman J.

²⁴⁹ Once an informed election is made, it cannot be revoked: *Scarf v Jardine* (1882) 7 App Cas 345, at 360, per Lord Blackburn and *Continental Illinois National Bank & Trust Co of Chicago and Xenofon Maritime SA v Alliance Assurance Co Ltd (The Captain Panagos DP)* [1986] 2 Lloyd's Rep 470, at 512, per Evans J.

²⁵⁰ [1998] Lloyd's Rep IR 151, at 161. For a general account, see the judgment of Goff LJ in *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corporation of India (The Kanchenjunga)* [1990] 1 Lloyd's Rep 391, at 397-9.

informed decision. To this end, he must be shown to have been making his choice with actual knowledge of facts giving rise to the right.²⁵¹ The degree of knowledge required should not be equated with absolute certainty. Mance J, in *Insurance Corporation of the Channel Islands v Royal Hotel Ltd*,²⁵² described the degree of knowledge required in the following fashion:

For practical purposes, knowledge pre-supposes the truth of the matters known, and a firm belief in their truth, as well as sufficient justification for that belief in terms of experience, information and/or reasoning.

Knowledge that takes the form of ‘turning a blind eye’ is likely to be sufficient for the purposes of affirmation,²⁵³ while constructive knowledge is not.²⁵⁴

2-94 Another significant factor in this context is whose knowledge within the insurer’s organisation will be regarded as the knowledge of the company for the purposes of affirmation. Adopting a special rule of attribution,²⁵⁵ it can be suggested that the knowledge of the person who has been authorised to receive information from the assured on behalf of the insurer can be imputed to the insurer for this purpose. In each case it is a question of fact to identify which individual is authorised to receive such information. For this purpose, it would be essential to evaluate the structure of the company, making specific reference to functions of individuals concerned. The more central role the individual plays (e.g. a district manager²⁵⁶) in the process of underwriting or investigation of claims,²⁵⁷ the more likely that his knowledge will be imputed to the insurer. It should be borne in mind that agency principles have a role to play here. Therefore, the knowledge of a person who answers the phone and says that he would pass a message on an underwriting matter will be imputed to the insurance company as having an ostensible authority to take a message.²⁵⁸ Similarly, once the appropriate person has fixed the insurer with knowledge, a subsequent breakdown in communication will afford no defence to the insurer.²⁵⁹

2-95 Affirmation, in this context, is an election between two alternative routes: avoiding the contract *ab initio* or keeping it alive despite the breach. Therefore, an insurer can make an informed choice only if he is actually aware that the assured’s

²⁵¹ *McCormick v National Motor & Accident Insurance Union Ltd* (1934) 49 LIL Rep 361, at 365, per Scrutton LJ and *CTI v Oceanus* [1984] 1 Lloyd’s Rep 476, at 498, per Kerr LJ, at 530, per Stephenson LJ.

²⁵² [1998] Lloyd’s Rep IR 151, at 162.

²⁵³ If an insurer decides, knowingly and deliberately, not to investigate or confirm a matter about which he could acquire definite knowledge, he must be treated as having knowledge on that matter: *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] Lloyd’s Rep IR 151, at 172, per Mance J.

²⁵⁴ *Ibid*, at 163, per Mance J and *Callaghan & Hedges v Thomson* [2000] Lloyd’s Rep IR 125, at 133, per David Steel J. Cf an earlier version of Mustill, MJ and Gilman, J (eds), *Arnould’s Law of Marine Insurance and Average* (16th edn) (1981, Sweet & Maxwell), para 614, which seems to suggest that constructive knowledge on the part of the insurer would suffice to found waiver.

²⁵⁵ *Meridian Global Funds Management Asia v Securities Commission* [1995] 2 AC 500.

²⁵⁶ *Wing v Harvey* (1845) 5 De GM & G 265 and *Farquharson v Pearl Assurance Co Ltd* [1937] 3 All ER 124.

²⁵⁷ *Evans v Employers Mutual Insurance Association Ltd* [1936] 1 KB 505.

²⁵⁸ *Hadenfayre v British National Insurance Ltd* [1984] 2 Lloyd’s Rep 393.

²⁵⁹ *Ayrey v British Legal & United Provident Assurance Co Ltd* [1918] 1 KB 136 and *Evans v Employers Mutual Insurance Association Ltd* [1936] 1 KB 505.

pre-contractual breach of utmost good faith gives him a right to avoid the policy. This requirement, which has underpinned the general law of contract for some time,²⁶⁰ is now embodied in insurance law,²⁶¹ but realistically in contemporary practice it will be very difficult for any professional underwriter to argue that he is not aware of the right to avoid consequent material non-disclosure or misrepresentation.

2-96 It is straightforward to establish affirmation in cases where the insurer, in full possession of the relevant facts and being aware that he is entitled to avoid the contract, stresses expressly that he wishes to keep it intact.²⁶² This is, however, not so common. In practice, courts are usually required to evaluate the insurer's conduct to decide whether he has, in fact, demonstrated a will to keep the contract on foot.

2-97 Whether a particular conduct amounts to unequivocal presentation required to found affirmation is a question of fact in each case.²⁶³ The test seems to be: 'Does the conduct in question give the impression to a reasonable assured that the insurer, having been aware of the breach and his rights, has decided to keep the contract alive?' If the answer is affirmative, affirmation is potentially established. While applying the test, the court should look at whole series of communications and events collectively and should refrain from basing its decision on one single event or conduct.²⁶⁴ Probably the most apparent conduct amounting to affirmation is paying,²⁶⁵ or making a promise to pay,²⁶⁶ a claim under the policy. Similarly, accepting payment of a premium which becomes due after being aware of the breach is likely to amount to affirmation.²⁶⁷ The same applies if the insurer decides to reject a claim by reference to a policy defence (e.g. breach of warranty) without raising the issue of a breach of pre-contractual duty of good faith.²⁶⁸

2-98 There is some degree of uncertainty as to whether silence or inactivity of the insurer after being aware of a breach might constitute an affirmation. One can envisage circumstances where silence, particularly when accompanied by another

²⁶⁰ *Kendall v Hamilton* (1879) 4 App Cas 504; *Evans v Bartlam* [1937] AC 473 and *Leathley v John Fowler & Co Ltd* [1946] KB 579.

²⁶¹ *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] Lloyd's Rep IR 151; *Callaghan & Hedges v Thomson* [2000] Lloyd's Rep IR 125 and *Moore Large & Co v Hermes Credit & Guarantee plc* [2003] EWHC 26 (Comm); [2003] 1 Lloyd's Rep 163.

²⁶² *Wing v Harvey* (1854) De GM & G 265.

²⁶³ *Vitol SA v Esso Australia Ltd (The Wise)* [1989] 2 Lloyd's Rep 451, at 460, per Mustill LJ.

²⁶⁴ *Drake Insurance plc v Provident Insurance plc* [2003] EWCA Civ 1834; [2004] QB 601; [2004] Lloyd's Rep IR 277, at [96]–[103], per Rix LJ.

²⁶⁵ *CTI v Oceanus* [1984] 1 Lloyd's Rep 476, at 518, per Parker LJ and *Svenska Handelsbanken v Sun Alliance and London Insurance plc (No 2)* [1996] 1 Lloyd's Rep 519, at 569, per Rix J.

²⁶⁶ *Bhagbhadrani v Commercial Union Assurance Co plc* [2000] Lloyd's Rep IR 94, at 123, per HHJ Gibbs QC.

²⁶⁷ *Wing v Harvey* (1854) De GM & G 265; *Ayrey v British Legal & United Provident Assurance Co Ltd* [1918] 1 KB 136 and *Boag v Economic Insurance Co Ltd* [1954] 2 Lloyd's Rep 581. More recently, *Moore Large & Co Ltd v Hermes Credit & Guarantee plc* [2003] EWHC 26 (Comm); [2003] 1 Lloyd's Rep 163. It follows that receipt of the premium relating to a past period of cover might not amount to affirmation.

²⁶⁸ *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, at [14], per Longmore LJ. On the other hand, a cancellation agreement between the assured and insurer does not amount to waiver of the insurer's accrued right to avoid should the issue arise at a later stage: *O'Kane v Jones (The Martin P)* [2003] EWHC 3470 (Comm); [2004] 1 Lloyd's Rep 389.

unequivocal conduct on the part of the insurer, might amount to affirmation.²⁶⁹ However, it is very difficult to maintain that mere silence or inactivity on the part of the insurer constitutes unequivocal presentation, unless the lapse of time is great so that this could be treated as conclusive evidence that the insurer wishes to remain liable.²⁷⁰ Facts of each case need to be evaluated to determine whether a period of inactivity can be regarded as sufficient to found affirmation. In *Argo Systems FZE v Liberty Insurance plc Ltd*,²⁷¹ the Court of Appeal held that not raising a defence for a period of seven years would not be adequate to found unequivocal action on the part of the insurer.²⁷²

2-99 There is no legal principle preventing the insurer from affirming a contract even if the assured is fraudulently in breach of utmost good faith principles. However, the existence of fraud is likely to have an impact on affirmation in two respects. First, an assured who wishes to argue that the insurer has elected to affirm the contract despite the fraudulent behaviour of the former must demonstrate that the latter was aware not only of the breach but also of the fraud and did not intend to take any action in relation to it. This would mean that the burden of proof of the assured is a heavier one in cases of fraud.²⁷³ Second, an assured intending to argue that the insurer's silence or inactivity amounts to affirmation will not be allowed to do so if he has acted fraudulently. The reason behind this is that time does not run against a party (the insurer, in the present context) as long as he remains, without any fault on his part, in ignorance of fraud.²⁷⁴

2-100 In general contract law, when one person expressly or by his conduct indicates that he will not insist on his strict rights, the doctrine of promissory estoppel might prevent him from going back on his promise if the promise has influenced the conduct of the party it was made to and if it would be inequitable for the promisor to go back on the promise.²⁷⁵ As the doctrine steams from the law of equity, it does not require knowledge of the promise (the assured)²⁷⁶ but it will arise only when there is reliance on his part. The absence of the need to demonstrate the insurer had knowledge that the assured is in breach of utmost good faith obligations makes this form of estoppel very attractive in the insurance context for non-disclosure or misrepresentation.²⁷⁷ However, it should be borne in

²⁶⁹ *Vitol SA v Esso Australia Ltd (The Wise)* [1989] 2 Lloyd's Rep 451, at 460; *Glencore Grain Ltd v Flacker Shipping Ltd (The Happy Day)* [2002] EWCA Civ 1068; [2002] 2 Lloyd's Rep 487, at [66], per Potter LJ.

²⁷⁰ *Clough v London and North Western Rly* (1871) LR 7 Ex 26, at 35, per Mellor J. See also, *Morrison v Universal Marine Insurance Co* (1873) LR 8 Ex 197, at 204, per Honyman J.

²⁷¹ [2011] EWCA Civ 1572; [2012] 1 Lloyd's Rep 129.

²⁷² Aikens LJ, *ibid*, at [26] put it very forcefully: 'Saying nothing and "standing by", i.e. doing nothing, are, to my mind, equivocal actions.'

²⁷³ *Bhagbadrani v Commercial Union Assurance Co plc* [2000] Lloyd's Rep IR 94.

²⁷⁴ *Rolfé v Gregory* (1865) 4 DeG J & S 576 and *Armstrong v Jackson* (1917) 2 KB 822. See also, Mellor J's observations in *Clough v London and North Western Rly* (1871) LR 7 Ex 26, at 35.

²⁷⁵ *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130 and *The Kanchenjunga* [1990] 1 Lloyd's Rep 391.

²⁷⁶ *The Kanchenjunga*, *ibid*, at 399, per Lord Goff. This has been confirmed in an insurance context in *HIH Casualty & General Insurance Ltd v Axa Corporate Solutions* [2002] EWCA Civ 1253; [2003] Lloyd's Rep IR 1.

²⁷⁷ The doctrine was invoked in the insurance context in *Youell v Bland Welch & Co Ltd (The Superhulls Case) (No 2)* [1990] 2 Lloyd's Rep 431. It has been acknowledged by the Court of Appeal in

mind that the doctrine is one of equity law and can only be relied on a party who has himself acted equitably. That means that the option of relying on promissory estoppel will not be available for an assured who is in breach of utmost good faith principles fraudulently.²⁷⁸

(b) Express clauses

2-101 The remedy of avoidance can be limited with a carefully drafted contractual clause.²⁷⁹ It is potentially possible to exclude the remedy by expressly referring to innocent or negligent non-disclosure or misrepresentation. However, any clause attempting to exclude the remedy of avoidance in case of fraudulent non-disclosure or misrepresentation on the part of the assured would be ineffective for public policy reasons.²⁸⁰ If a clause is drafted so widely as to cover fraudulent, as well as non-fraudulent non-disclosure and misrepresentation, it is going to be construed *contra proferentem* and it will certainly be presumed that it did not apply to fraud.²⁸¹ When it comes to whether the assured can exclude the remedy of avoidance for fraud of its agents, the matter is slightly different. In *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank*,²⁸² the House of Lords declined to decide the matter, but indicated that for such an exclusion to be effective it needs to be expressed in clear and unmistakable terms on the face of the contract.²⁸³ It can hardly be contended that this is at odds with the public policy doctrine.

(c) Breach of insurer's continuing duty of utmost good faith

2-102 It has been suggested by Colman J, in *The Grecia Express*,²⁸⁴ that making the remedy of avoidance available to an insurer in cases where he has not acted in good faith would be unconscionable. In reaching this conclusion, Colman J traced the origins of the right of avoidance to the law of equity. When the matter was considered

Kosmar Villa Holidays plc v Trustees of Syndicate 1243 [2008] EWCA Civ 147; [2008] Lloyd's Rep IR 489 that a marine warranty can only be waived by estoppel, as breach of a warranty discharges the insurer from liability automatically.

²⁷⁸ *Bhagbhadrani v Commercial Insurance Co plc* [2000] LRLR 94.

²⁷⁹ See e.g., *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 2 Lloyd's Rep 61, where the following clauses were held to preclude avoidance of the policy by insurers on the grounds of innocent and negligent misrepresentation or non-disclosure by the agent of the assured:

The insured . . . shall have no liability of any nature to the insurers for any information provided by any other parties and any such information provided by or nondisclosure by other parties . . . shall not be a ground or grounds for avoidance of the insurers' obligations under the Policy or cancellation thereof.

²⁸⁰ *S Pearson & Son Ltd v Dublin Corporation* [1907] AC 351, at 353 and 362; *Boyd & Forrest v Glasgow & South Western Railway Co* 1915 SC (HL) 20, at 36; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd's Rep 496, at 502 and *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co* [2001] EWCA Civ 735; [2001] 2 Lloyd's Rep 161, at [128]. See also, *FoodCo LLP (t/a Muffin Break) v Henry Boot Developments Ltd* [2010] EWHC 358 (Ch), at [166].

²⁸¹ *Walker v Boyler* [1982] 1 WLR 495, at 503. As far as misrepresentation is concerned, this position has been supplemented by s 3 of the Misrepresentation Act 1967. This section provides that a term to which it applies is of no effect except insofar as it satisfies the requirement of reasonableness. A clause which is drafted widely to exclude all liability for misrepresentation might be held to be ineffective on the basis that it covered fraudulent misrepresentations.

²⁸² [2003] UKHL 6; [2003] 2 Lloyd's Rep 61.

²⁸³ *Ibid*, at [16], per Lord Bingham.

²⁸⁴ [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88, at 129.

by the Court of Appeal in *Brotherton v Aseguradora Colseguros SA (No 2)*,²⁸⁵ doubt was cast on the findings of Colman J on many grounds but essentially on the basis that: (i) it is doubtful whether avoidance is an equitable remedy; (ii) even if it is equitable in notion it is not conditional upon the exercising of good faith; and (iii) there is no room for the exercise of an equitable discretion to disallow avoidance, given that it becomes effective once declared to the assured and does not require a decree from the court. Conversely, the views expressed by Colman J found considerable support before a differently constituted Court of Appeal in *Drake Insurance plc v Provident Insurance Co*.²⁸⁶ There, even though there was a disagreement between the majority (Rix LJ and Clarke LJ) and Pill LJ on the scope of the continuing duty of the insurer, all their Lordships were sympathetic to the submission that good faith required the insurer to give the assured an opportunity to address the reason given for an intended avoidance. Pill LJ went slightly further to suggest that a continuing duty of good faith might prevent the insurer from avoiding in cases where he knows that he has no such right.²⁸⁷ These issues are discussed in [Chapter 4](#), but one should note at this stage that there is no binding precedent on the subject and all the views expressed are, strictly speaking, *obiter*. It is, therefore, open to the courts to extend the scope of the post-contractual duty of good faith to bar insurers from relying on the remedy of avoidance in certain cases.

(d) Statutory control

2-103 In cases where an insurer is induced to enter into a contract by misrepresentation on the part of the assured, it is likely that the provisions of the Misrepresentation Act 1967 might offer an alternative remedy to the insurer. Section 2(2) of the Act provides that the court has the discretion to award damages in lieu of rescission wherever it is of the opinion that it would be equitable to do so. It has been suggested that the court is not confined to a consideration of whether damages would be an adequate remedy to the representee in exercising its discretion. The court is also required to take into account the loss that the representor would suffer in case of recession.²⁸⁸ It has, however, been suggested that s 2(2) of the Act would not have application in insurance contracts mainly due to the policing function the utmost good faith duty plays at the formation stage.²⁸⁹ Furthermore, the subsection clearly stipulates that the discretion is not available if the misrepresentation is fraudulent. In light of this, it remains doubtful whether s 2(2) of the Act is capable of limiting the insurer's right to avoid an insurance contract.

(B) Damages

2-104 Even though it might be, in theory, possible to claim damages for pre-contractual breach of utmost good faith principles, no case has yet been reported of an insurer recovering damages for misrepresentation or non-disclosure against his

²⁸⁵ [2003] EWCA Civ 705; [2003] Lloyd's Rep IR 746.

²⁸⁶ [2003] EWCA Civ 1834; [2004] QB 601; [2004] 1 Lloyd's Rep 268.

²⁸⁷ *Ibid*, at [177].

²⁸⁸ Beale, HG (ed), *Chitty on Contracts* (31st edn) (2012, Sweet & Maxwell), para 6-101.

²⁸⁹ *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep 109, at 118, per Steyn J.

assured. However, one can contemplate the insurer in future bringing an action for damages to claim costs incurred while investigating whether the assured has been in breach of utmost good faith principles at the time of contracting. It is now beyond doubt that an action for damages cannot be based on the provisions of the MIA 1906.²⁹⁰ The door has also been shut to the possibility of importing a duty of care based on the utmost good faith principles. The Court of Appeal in *Banque Financière de la Cité v Westgate Insurance Co* rejected the submission that ‘the nature of the contract as one of good faith can be used as a platform to establish common law duty of care’, simply because the MIA 1906 did not provide any remedy for breach of the duty other than avoidance.

2-105 The inability of the utmost good faith principles enshrined in the MIA 1906 to create a cause of action for damages does not mean that a claim of that nature will necessarily fail in all instances. A fraudulent misrepresentation which induces the making of a contract constitutes the tort of deceit under common law. The essential elements of the tort of deceit, as an alternative cause of action for damages, are evaluated next. First, it must be demonstrated that a false representation has been made by the representor. The test for whether a misrepresentation has been made is in general terms the same as in other remedies for misrepresentation. It has recently been advocated by Rix LJ that a fraudulent non-disclosure in insurance context could amount to misrepresentation as the deliberate act of keeping quiet in cases where there is a duty to speak sends the wrong message to the insurer, representing the risk differently than it is.²⁹¹ It is submitted that there is force in this argument despite contrary views having been echoed over the years on the basis that mere omission is not sufficient to establish the tort of deceit.²⁹² It has to be borne in mind that it is not the mere act of omission, but deliberate omission with a view to presenting the risk differently, which converts a non-disclosure of this nature into a misstatement of fact.

2-106 The underlying factor of a claim in tort of deceit is the state of mind of the representor. The representee has to demonstrate that the representor made a false representation either knowing that it was false, without belief in its truth, or recklessly without caring whether the fact represented was true or untrue.²⁹³ The motive

²⁹⁰ *The Good Luck* [1988] 1 Lloyd’s Rep 514; [1990] 1 QB 818 and *Banque Financière de la Cité v Westgate Insurance Co (sub nom Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd)* [1989] 2 All ER 952; [1990] 2 QB 665. The main reason given for this is that the relief in case of a non-disclosure or misrepresentation stems from the equity which does not allow the recovery of damages: *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* [1990] 2 QB 665, at 780, per Slade LJ.

²⁹¹ *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] EWCA Civ 1250; [2001] 2 Lloyd’s Rep 483, at [48]–[49].

²⁹² *Peek v Gurney* (1873) LR 6 HL 377, at 403, per Lord Cairns; *Arkwright v Newbold* (1881) 17 Ch D 301, 318, at 320, per James LJ; *Society of Lloyd’s v Jaffray* [2002] EWCA Civ 1001, at [29] and *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 2 Lloyd’s Rep 61, at [75], per Hoffmann LJ. It should be noted that in earlier judgments, observations made on this point relate to contracts other than insurance. As there is no general duty of disclosure in English contract law, it would naturally not be possible for concealment, even of a dishonest nature, to found a misstatement of facts. It is highly possible that this point was overlooked by modern judges when suggesting that omission does not cause an action in tort of deceit.

²⁹³ *Derry v Peek* (1889) 14 App Cas 337. The only defence for a representor who makes a false representation knowing that it is not correct is to argue that the truth was not present to his mind when he

behind the deceit is not material.²⁹⁴ It must also be demonstrated that the representor must intend that the representation be acted upon by the representee in a way which resulted in damage to him.²⁹⁵ Finally, the representation must cause or induce the representee to enter into the contract or materially motivate the representee so to act.²⁹⁶ Therefore, a causal link is required between the representor's statement and the representee's decision to act in such a way as to cause the loss he claims. It is, however, not necessary to demonstrate that the representation is the only cause of the representee's decision. It is sufficient if the representation is a cause.²⁹⁷

2-107 The measure of damages for fraudulent misrepresentation is to put the innocent party in the position he would have been in if the misrepresentation had not been made.²⁹⁸ Therefore, the representee is entitled to damages for any such loss which flowed from the representor's fraud, even if the loss could not have been foreseen by the representor. The representee is entitled to recover consequential losses caused by the transaction,²⁹⁹ but must take all reasonable steps to mitigate his loss once he has discovered the fraud.³⁰⁰

2-108 It must be stressed that the insurer's right to claim damages for tort of deceit is not an alternative right to the right of avoidance.³⁰¹ Both courses of action exist independently. The corollary of this is that the right to claim damages will survive even if the insurer chooses not to rescind the contract.³⁰² Similarly, a contractual term that intends to limit or exclude the right of the insurer to avoid the policy for fraudulent misrepresentation of the assured's agent is not sufficient to prevent the insurer from claiming damages unless specific reference is made to the unavailability of damages in the clause.³⁰³

2-109 An alternative cause of action for the insurer is to claim damages from the assured under the Misrepresentation Act 1967.³⁰⁴ Obviously, the Act will be

made the statement or he did not realise the significance of the information he had at his disposal: *Derry v Peek* (1889) 14 App Cas 337, at 348, per Lord Bramwell.

²⁹⁴ *Foster v Charles* (1830) 7 Bing 105; *Peek v Gurney* (1873) LR 6 HL 377 and *Smith v Chadwick* (1884) 9 App Cas 187.

²⁹⁵ *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All ER 205 and *Barton v Country NatWest Ltd* [1999] Lloyd's Rep Bank 408.

²⁹⁶ *Briess v Woolley* [1954] AC 333.

²⁹⁷ *Attwood v Small* (1838) 6 Cl & F 232 and *Barton v Country NatWest Ltd* [1999] Lloyd's Rep Bank 408. For a comprehensive analysis on the essential elements of tort of deceit, see Eggers, PM, *Deceit: The Lie of the Law* (2009, Informa).

²⁹⁸ *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158.

²⁹⁹ *Esso Petroleum Co Ltd v Mardon* [1976] QB 801; *East v Maurer* [1991] 1 WLR 461 and *Roycott Trust Ltd v Rogerson* [1991] 2 QB 297.

³⁰⁰ *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254.

³⁰¹ *Adam v Newbigging* (1886) 34 Ch D 582, at 592, per Bowen LJ.

³⁰² *Urquhart v Macpherson* (1878) 3 App Cas 831, at 838, per Sir Montague Smith. Compare the observations made by HHJ Mackie QC in *Argo Systems FZE v Liberty Insurance (Pte)* [2011] EWHC 301 (Comm); [2011] 2 Lloyd's Rep 61, at [45] where he seems to indicate that damages under s 2(1) of the Misrepresentation Act 1967 would not be available to an insurer who decided to affirm the contract. This point was not taken up before the Court of Appeal [2011] EWCA Civ 1572; [2012] 1 Lloyd's Rep 1.

³⁰³ By the same token, an agreement to exclude the right of avoidance does not carry the implication that damages can be awarded in lieu of avoidance: *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30, at 54, per Aikens J.

³⁰⁴ It has been indicated in *Toomey v Eagle Star Insurance Co (No 2)* [1995] 2 Lloyd's Rep 88 and *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30 that the Misrepresentation Act 1967 will apply to insurance contracts.

applicable only in cases where the insurer has been induced to enter into a contract by reason of misrepresentation and the assured has no reasonable grounds for believing or does not believe prior to the contract that the facts as represented were true.³⁰⁵ Section 2(1) allows the claimant to recover damages in the same measure as if he were suing for deceit, so that he may recover his losses as damages, even if they were not foreseeable. Therefore, s 2(1) of the Act would enable the insurer to claim damages in cases of negligent and fraudulent misrepresentation made by the assured at the pre-contractual stage.³⁰⁶ However, the Act will not create a cause of action in damages against the agents of the assured. The liability of those will be based on tort of deceit or misrepresentation under common law.³⁰⁷

2-110 Apart from the right to claim damages for tort of deceit of the Misrepresentation Act 1967, it looks like there is no other possible way of creating a cause of action for damages even in cases of deliberate breach of pre-contractual good faith duties on the part of the assured. The possibility that s 47 of the Financial Services Act 1986 (now replaced by the Financial Services and Markets Act 2000) which makes it an offence to dishonestly conceal any material facts for the purpose of inducing another person to enter into a contract,³⁰⁸ could be used as a platform to create a right of action to recover damages, has been firmly rejected.³⁰⁹ There seems no reason to suggest that the new Act has altered the legal position.³¹⁰

(4) Miscellaneous

(A) *Impact of Misrepresentation/Non-disclosure on the Following Market*

2-111 It is a distinctive feature of the London market that commercial and marine risks are often subscribed to by a number of underwriters. Against that background, an interesting question arises as to what the legal position would be if an applicant induces an insurer by misrepresentation or non-disclosure to a policy and following insurers are subsequently drawn in to insure it. There is no doubt that the first-named underwriter could avoid the contract for misrepresentation and/or non-disclosure but would the following underwriters be able to do the same? An overwhelming majority of the old authorities seem to proceed on the basis that the following market should be able to avoid their contracts with the assured even though the misrepresentation was not repeated to them. Lord Mansfield in *Barber v Fletcher*³¹¹ expressed his view on the matter in the following manner: 'a representation to the first underwriter extends to the others'.³¹²

³⁰⁵ If fraudulent non-disclosure is viewed as a type of misrepresentation, the Act will again be applicable in those cases.

³⁰⁶ In *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30, at [90], the court proceeded on the assumption that damages is a remedy available for misrepresentation in insurance contracts.

³⁰⁷ *Hedley Byrne & Co v Heller & Partners* [1964] AC 465.

³⁰⁸ See s 397 of the Financial Services and Markets Act 2000.

³⁰⁹ *Norwich Union Life Insurance Sy v Qureshi* [1999] Lloyd's Rep IR 263, at 269, per Rix J.

³¹⁰ It is highly unlikely that the Fraud Act 2006 creates a cause of action for civil liability.

³¹¹ (1779) 1 Dougl 305, at 306.

³¹² In an earlier edition of Mustill, MJ and Gilman, J (eds), *Arnould's Law of Marine Insurance and Average* (16th edn) (1981, Sweet & Maxwell), [623] it is stipulated: 'Where there are several underwriters

2-112 The MIA 1906 treats each subscription as constituting a distinct contract with the assured unless the contrary is expressed.³¹³ Section 20(1) of the Act clearly stipulates that it is the assured and his agent who are expected to make the correct representation to the relevant insurer during the negotiations. Taking the combined effect of these provisions into account, it can be plausibly argued that it is inconsistent with these provisions to reach the conclusion that misrepresentation made to the first-named insurer extends to the following insurers. Furthermore, the Court of Appeal in *General Accident Fire and Life Assurance Corporation Ltd v Tanter (The Zephyr)*³¹⁴ was adamant that the signing indication given by the broker to the leading underwriter is not transmitted to all subsequent underwriters. By analogy, it can be argued that misrepresentation made to the leading underwriter cannot be deemed to be transmitted to following underwriters. In the same case, Mustill J,³¹⁵ in passing, doubted the existence of a rule that states otherwise.³¹⁶

2-113 It is relatively safe to assume that in the light of the wording of the statute, there is probably no such rule of law extending pre-contractual breaches made whilst negotiating with the first underwriter to the following underwriters. That said, it would be erroneous to assume that such breaches would have no impact on the contracts concluded with the following underwriters. In cases where the following market can show that the assured has given them, by his actions or statements, the impression that a fair representation had been made to those who previously scratched the slip, they can avoid the policy if this is not the case. This is likely to be the case when the following market places express reliance on the decisions made by previous underwriters in formulating their underwriting decisions. In *CTI v Oceanus*,³¹⁷ when seeking quotations from succeeding insurers, the assured indicated that a previous insurer covered the risk at a particular rate. The Court of Appeal held that this statement carried with it an implied representation that full disclosure was made to the prior insurer.³¹⁸ Also, one should not underestimate the potential of developing a moral hazard argument in cases where it is clear that the assured acted fraudulently in his pre-contractual dealings with the leading underwriter. If the following market could establish that the assured acted fraudulently when presenting the risk to the first-named underwriter, they could potentially argue that this is a reflection of the character of the assured and, assuming that the assured has not informed them that he obtained the cover from the first insurer by deceit, they should be allowed to avoid the contract on that basis.³¹⁹ Admittedly, the boundaries of the moral hazard doctrine have yet to be settled, but recent authorities

to the same slip or policy, a representation of a material fact to the underwriter whose name stands first extends to all the rest, so that each, when it proves false, may avail himself of the defence.'

³¹³ See s 24(2) of the MIA 1906.

³¹⁴ [1985] 2 Lloyd's Rep 529.

³¹⁵ *Ibid*, at 539.

³¹⁶ A similar view was expressed by Seville J in *Bank Leumi le Israel BM v British National Insurance Co Ltd* [1988] 1 Lloyd's Rep 71, at 77–8.

³¹⁷ [1984] 1 Lloyd's Rep 476.

³¹⁸ *Ibid*, at 522–3, per Stephenson LJ.

³¹⁹ See *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] Lloyd's Rep IR 151; *James v CGU Insurance Co plc* [2002] Lloyd's Rep IR 206 and *Sharon's Bakery (Europe) Ltd v AXA Insurance UK Plc* [2011] EWHC 210 (Comm); [2012] Lloyd's Rep IR 164 where the insurer successfully pleaded that assured's general dishonesty entitled them to avoid the contract.

on the matter indicate that there is room to argue that it might be relevant in this context.

(B) Scope of pre-contractual duties at the time of renewal

2-114 Renewal of an insurance contract leads to a new contract of insurance making the assured subject to the pre-contractual duties set out in ss 18–20 of the MIA 1906. This means that the assured is expected to correct any misleading representation made when the old contract was formed as long as they remain material to the new contract.³²⁰ Likewise, the assured is expected to disclose all material facts and circumstances that have come into existence since the conclusion of the original contract and any matters which he failed to disclose when the old insurance was concluded, as long as they remain relevant to the new one.

2-115 An interesting question is whether the assured is expected to disclose to the insurer his failure to act in good faith while procuring the old contract, especially in cases where the facts were once material to the expiring risk but no are longer. If it can be demonstrated by the insurer that the assured acted dishonestly at the time when he obtained the old contract, it is plausible to argue that his moral integrity is being impugned; this creates a moral hazard that needs to be disclosed at the time of the renewal.³²¹ However, for that kind of argument to succeed, it is vital to show that the assured's dishonesty was fundamental and relevant to an essential aspect of the old contract.³²² Needless to say, the moral hazard argument is unlikely to succeed in cases where the assured's failure to make a full disclosure or accurate representation under the old contract is attributed to his negligence or innocent omission.

(C) Criminal liability

2-116 As discussed in [Chapter 1](#), there is no shortage of legislation that can be utilised to prosecute those who fraudulently misrepresent or conceal material facts when obtaining insurance cover. For instance, s 2(1) of the Fraud Act 2006 stipulates that a person is guilty of fraud if he dishonestly makes a false representation with the intention to make a gain for himself or another, or to cause loss to another or to expose another to a risk of loss. Likewise, s 3 of the Act makes it an offence for a person dishonestly to fail to disclose to another person information which he is under a legal duty to disclose with the intention to make a gain for himself or another or to cause loss to another or to expose another to a risk of loss. There is little doubt that these sections can be relevant in this context. More specifically, s 397 of the Financial Services and Markets Act 2000 provides that a person who makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular; or dishonestly conceals any material facts whether

³²⁰ *The Moonacre* [1992] 2 Lloyd's Rep 501 and *Glencore International AG v Alpina Insurance Co Ltd* [2003] EWHC 2792 (Comm); [2004] 1 Lloyd's Rep 111.

³²¹ *Forrest & Sons Ltd v CGU Insurance Plc* [2006] Lloyd's Rep IR 113, at [37], per HHJ Kershaw QC.

³²² *CTI v Oceanus* [1982] 1 Lloyd's Rep 178, at 199, per Lloyd J.

in connection with a statement, promise or forecast made by him or otherwise; or recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular, is guilty of an offence if it is made to induce someone to enter or offer to enter a ‘relevant agreement’. There is no doubt that this section is relevant in the context of insurance contracts.³²³ That said, it is not a common occurrence to witness criminal prosecutions in the context of insurance contracts, for the reasons discussed in [Chapter 1](#).

III COVER NOT ATTACHING

2-117 As indicated at the outset, another form of fraud, which is less common, is insuring goods that did not exist in the first instance. In that case, the insurer can of course argue that the assured fraudulently misrepresented and/or concealed material facts that induced him to enter into the contract and this entitles him to avoid the contract. Furthermore, it is submitted that in such a case it is open to the insurer to contend that the insurance contract obtained for goods that did not exist is void. There is a remarkable difference between a void contract and a contract where one or more of its parties have the power to avoid legal relations created by the contract by means of an election. Generally speaking, a void contract does not produce any legal effects whatsoever. A contract which can be avoided is treated like a valid contract and produces legal results until the right of avoidance is exercised. From the insurer’s perspective, the main benefit of treating a contract as void is that the future conduct of the parties would not usually amount to affirmation of such a contract.³²⁴

2-118 In the insurance context, a contract is usually held void if the assured does not have insurable interest³²⁵ or if the insured marine voyage is illegal.³²⁶ There is also support for the contention that if the subject matter of the insurance is described radically differently than its original form, the cover does not attach at all. In *AF Watkinson & Co Ltd v Hullett*,³²⁷ for example, the proposal form completed by the assured and the policy issued indicated that the risk insured was that of a paper-board manufacturer, whereas the risk which the assured bore was that of a waste-paper merchant. Goddard J seems to suggest that the risk was misrepresented to such an extent that the actual risk was not covered by the terms of the policy. One can argue that in a case where insurance is obtained for an imaginary cargo, the legal position is similar to that of the assured in *AF Watkinson*. In that case, the non-disclosure and misrepresentation is of such magnitude that there is no cover at all. Accordingly, the insurer in such a case need not exercise the remedy of avoidance, as the policy can be declared void *ab initio*.³²⁸

³²³ See s 397(g) of the Act, and the Financial Services and Markets Act (Misleading Statements and Practices) Order 2001 (SI 2001/3645).

³²⁴ *Cf Tenant v Elliott* (1797) 1 B & P 3.

³²⁵ See ss 4(2) and 5 of the MIA 1906.

³²⁶ See s 41 of the MIA 1906.

³²⁷ (1938) 61 LILR 145.

³²⁸ A similar outcome should follow if the assured, who is after hull and machinery cover for his vessel, describes her as radically different than she actually was during the presentation of the risk.

CHAPTER 3

FRAUD COMMITTED BY THE ASSURED AT THE POST-CONTRACTUAL STAGE

I INTRODUCTION

3-1 Insurance contracts commonly contain provisions requiring the parties (particularly the assured) to supply information on matters that might have an impact on potential claims or to co-operate with each other, particularly at the claims stage. It could even be the case that the courts will, on certain occasions, imply a term creating an obligation on the part of the assured to provide assistance to the insurer for the sake of giving business efficacy to the relationship.¹ It is apparent that contractual remedies will be available to the insurer if the assured is in breach of such obligations regardless of his state of mind (i.e. whether or not he acted fraudulently). What requires further examination in this chapter is the relationship between the contractual regime and other legal regimes, statutory or otherwise, in cases where there is evidence of fraudulent conduct on the part of the assured during the performance of a post-contractual obligation. For example, in recent years the existence of a common law remedy of forfeiture, which might stand side-by-side with contractual remedies in the submission of a fraudulent claim by the assured has been confirmed by appellate courts in England and Wales.² The nature and scope of the common law remedy is considered in depth later in this chapter, but a more urgent and challenging task is to identify the role of the utmost good faith doctrine at the post-contractual stage, given that the remedy of avoidance afforded for breach of good faith obligations by the Marine Insurance Act (MIA) 1906, if available in this context, is capable of swinging the pendulum in favour of insurers.

3-2 Although it has been judicially acknowledged on several occasions that the duty of utmost good faith applies in its full rigour after an insurance contract is formed,³ the legal foundations of such a duty have remained opaque in judicial

¹ See e.g., *Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd* [1985] 2 Lloyd's Rep 599, at 613–14, where Hobhouse J concluded that the reinsurance contract then under consideration was subject to a term that gave the reinsurer an implied right to the reassured's records.

² See, particularly, the reasoning of the Court of Appeal in *Agapitos v Agnew (The Aegeon)* [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42 and *AXA General Insurance Ltd v Gottlieb* [2005] EWCA 112; [2005] Lloyd's Rep IR 369.

³ See e.g., *Britton v Royal Insurance Co* (1866) 4 F & F 905, at 909, where Wiles J, in his direction to the jury, seems to suggest that there is a continuing duty of good faith on both sides at the claims stage. In the same speech he also stresses the importance of maintaining such good faith during the currency of the policy. See also, the judgment of Hirst J in *Black King Shipping Corporation v Massie (The Litson Pride)* [1985] 1 Lloyd's Rep 437, at 510–11 (hereinafter referred to as *The Litson Pride*) which proceeds on the premise that there is a continuing duty on the assured throughout the voyage to disclose to the

circles for a considerable period of time. For instance, in *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd*,⁴ Slade LJ, in passing, stressed that on the particular facts, in some cases the post-contractual duty of good faith could be said to arise under the terms of the contract. Conversely, the origins of the post-contractual duty of utmost good faith could be traced to s 17 of the MIA 1906, keeping the law in line with the pre-contractual stage.⁵ The wording of this provision is very broad and imposes no time restriction on the duty of utmost good faith, making it plausible to argue that the duty must be observed at all times and certainly after the contract is formed.

3-3 However, it is equally an attractive proposition to argue that s 17 is intended to be a prologue to ss 18–20, dealing with specific aspects of pre-contractual duty of utmost good faith and, therefore, has no application in post-contractual stage.⁶ If one is to subscribe to this view, the role of s 17 can be viewed as signalling that the duty of utmost good faith extends beyond the specific ones placed on the assured in ss 18–20.⁷ Several convincing arguments can be put forward in support of such a stand.⁸ First, it is remarkable that Sir Mackenzie Chalmers, the drafter of the Act, in his *Digest of the Law of Marine Insurance*,⁹ on which the final Act was based, made no reference to the post-contractual dimension of the utmost good faith duty. There is, therefore, room to argue that the drafter of the Act did not envisage that the duty would have a post-contractual dimension. It very curious that Sir Chalmers, in the first edition of his work on the MIA 1906, published after the enactment of the Act, added a note to his commentary instancing the order of the court for ship's papers as the example of the operation of post-contractual good faith.¹⁰ Although the duty of good faith was associated with such orders in some cases,¹¹ the issuing of the order is a procedural matter for the court¹² which has nothing to do with the assured's

insurers any circumstance that, if known and believed, would influence him in any relevant decision he had to make (e.g. the fixing of [additional premium], or whether to pay, compromise, or resist a claim).

⁴ [1990] 1 QB 665, at 777.

⁵ It has been authoritatively determined that the legal basis of the duty of utmost good faith at the pre-contractual stage is a rule of law. This derives from Lord Mansfield's decision in *Pawson v Watson* (1778) 2 Cowp 785, at 786. A similar sentiment was echoed by the House of Lords both in *Banque Keyser Ullmann SA v Skandia (UK) Ins Co* [1991] 2 AC 249, at 280 and *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] UKHL 1; [2003] 1 AC 469, at [46] (hereinafter referred to as *The Star Sea*).

⁶ Writing extra-judicially, Sir Aikens expressed the opinion that the focus of s 17 is on the pre-contractual stage: 'Post-contractual Duty of Good Faith in Insurance Contracts: Is There a Problem that Needs a Solution?' [2010] JBL 379, at 389.

⁷ Parker LJ in *Container Transport International Incorporation & Reliance Group Inc v Oceanus Mutual Underwriting Association (Bermuda) Ltd* [1984] 1 Lloyd's Rep 476, at 512, illustrated an instance where s 17 could be relevant at the pre-contractual stage. If the assured or his broker realises in the course of negotiations that the insurer has made a serious arithmetic mistake or is proceeding upon a mistake of fact with regard to pact experience, he would, under s 17, be obliged to draw this to the attention of the insurer.

⁸ See Soyer, B, 'Continuing Duty of Utmost Good Faith in Insurance Contracts: Still Alive?' [2003] LMCLQ 39, at 41–2.

⁹ Chalmers, MD and Owen, D, *A Digest of the Law Relating to Marine Insurance* (2nd edn) (1903, London).

¹⁰ Chalmers, MD and Owen, D *The Marine Insurance Act 1906* (1907, London).

¹¹ *China Traders Insurance Co Ltd v Royal Exchange Association Corporation* [1898] 2 QB 187, at 193; *Boulton v Houlder Brothers & Co* [1904] 1 KB 784, at 791 and *Harding v Bussell* [1905] 2 KB 983, at 985.

¹² This is an exceptional discovery procedure open to insurers under the CPR, especially in alleged

post-contractual duty of good faith, as confirmed by Lord Hobhouse in *The Star Sea*.¹³ On that basis, the additional remarks made by Sir Chalmers on this subject in his later book cannot be used as a platform to launch a post-contractual dimension of the duty of utmost good faith. Also, it should be noted that s 17 is placed beneath the heading 'Disclosure and Representation' and above ss 18–20, which expressly relates to pre-contractual issues such as disclosure and representation. This can be taken as an indication that s 17 is intended to play a pre-contractual role only.

3-4 The uncertainty surrounding the scope of the good faith doctrine has been to a large extent eliminated through judicial intervention at the turn of the millennium. The House of Lords in *The Star Sea*, with some reluctance, confirmed that formation of the insurance contract does not bring the duty of good faith on both parties to an end.¹⁴ Despite identifying s 17 of the MIA 1906 as the main source of the duty of good faith at the post-contractual stage, their Lordships were also aware of the need to define the scope of this (relatively speaking) novel concept given the lack of any binding precedent on the subject and the potentially devastating and disproportionate consequences of the remedy of avoidance for a post-contractual breach of the duty. Accordingly, two limitations on the scope of the post-contractual duty of utmost good faith, as encapsulated by s 17 of the MIA 1906, were introduced. First, on the premise that there is no justification for requiring the same high degree of openness post-contractually as an assured is obliged to show pre-contractually, it was held that only fraudulent failure to act in good faith post-contract gives rise to the right to avoid.¹⁵ Second, it was confirmed that once the litigation had taken over, the duties of the parties were governed by the rules of court, not the general duties of good faith or contractual terms. Put another way, with the commencement of litigation any duty previously owed under s 17 of the MIA 1906 is superseded by the rules that govern the litigation.¹⁶

3-5 Undoubtedly, the decision of the House of Lords in *The Star Sea* was a

wilful misconduct of the assured cases. The scope of such an order, if granted, could be very wide. The assured may be ordered to produce the widest possible range of documents relating to any matter concerning the placing of the insurance on the ship and all documents relating to the sailing or alleged loss of the said ship, cargo or freight.

¹³ [2001] UKHL 1; [2003] 1 AC 469, at [60]. This conclusion is firmly in line with the decision of the House of Lords not to extend the continuing duty of good faith to the litigation stage. It is at the litigation stage that the order becomes relevant.

¹⁴ For instance, Lord Clyde noted that the solution of confining the duty of utmost good faith to the pre-contractual stage 'appears past praying for'.

¹⁵ This brought an end to the speculation fuelled by the dicta of Hirst J in *The Litson Pride* [1985] 1 Lloyd's Rep 437, at 512 that 'culpa' on the part of one of the parties might be sufficient to bring s 17 into play at the post-contractual stage.

¹⁶ Lord Hobhouse put this elegantly in his judgment ([2001] UKHL 1; [2003] 1 AC 469, at [75]):

When a writ is issued the rights of the parties are crystallised. The function of the litigation is to ascertain what those rights are and grant the appropriate remedy . . . It cannot be disputed that there are important changes in the parties' relationship that come about when the litigation starts. There is no longer a community of interest. The parties are in dispute and their interests are opposed. Their relationship and rights are now governed by the rules of procedure and the orders which the court makes on the application of one or other party. The battle lines have been drawn and new remedies are available to the parties. The disclosure of documents and facts are provided for with appropriate sanctions; the orders are discretionary within the parameters laid down by the procedural rules. Certain immunities from disclosure are conferred under the rules of privilege. If a party is not happy with his opponent's response to his requests he can seek an order from the court. If a judgment has been obtained by perjured evidence, remedies are

defining moment in the development of the post-contractual duty of good faith; but by no means does it shed light on all aspects of the doctrine. One issue not fully contemplated in the judgment is the relationship between s 17 of the MIA 1906 and the relevant contractual clause, which is the device used to introduce a continuing duty of good faith during the performance of the contract (i.e. a contractual obligation to provide information or co-operate in the post-contractual context). Stated otherwise, there is a need to align the remedy stipulated by s 17 with contractual remedies in cases where the relevant clause, which the continuing duty of performance derives from, is breached in a fraudulent fashion. An attempt to reconcile the remedy of avoidance with contractual remedies was made in the *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*.¹⁷ In his well-reasoned judgment, Longmore LJ stated that the insurer could not avoid the contract in every case of non-observance of post-contractual good faith by the assured. It was only appropriate to invoke the remedy of avoidance in a post-contractual context if the insurer would otherwise be justified in accepting the assured's conduct as a repudiatory breach of the policy. For this purpose: (i) the fraud must be material in the sense that the fraud would have an effect on the underwriter's ultimate liability; and (ii) the gravity of the fraud or its consequences must be such as would enable the underwriters, if they wished to do so, to terminate for breach of contract.¹⁸ It would be, therefore, accurate to say that under the analysis adopted by Longmore LJ, the right to avoid for breach of good faith at the post-contractual stage co-exists with the right to terminate for the breach of the contractual duty.¹⁹

3-6 Another matter that has not received thorough scrutiny before the House of Lords in *The Star Sea* is to determine in which instances the post-contractual duty of utmost good faith becomes relevant and binding on the parties. Although the matter was considered judicially in a number of cases prior²⁰ and after *The Star Sea*,²¹ a certain degree of ambiguity remains in certain instances (e.g. the relationship between s 17 and the fraudulent claims jurisdiction is far from clear). The rest of this chapter considers the contractual instances that are potentially capable of introducing a continuing duty of good faith and the impact of having an additional remedy in the shape of s 17 when such clauses are breached fraudulently. Judicial authorities, principles of contract law and policy considerations will form the basis of such analysis.

available to the aggrieved party. The situation therefore changes significantly. There is no longer the need for the remedy of avoidance under s 17; other more appropriate remedies are available . . .

¹⁷ [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563 (hereinafter referred to as *The Mercandian Continent*).

¹⁸ *Ibid*, at [35].

¹⁹ *Ibid*, at [36].

²⁰ See e.g., *Niger Co Ltd v Guardian Ass Co* (1922) 13 LILR 75 and *New Hampshire Ins Co v MGN Ltd* [1997] LRLR 24.

²¹ The matter has been deliberated in a detailed fashion in *The Mercandian Continent* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563.

II POST-CONTRACTUAL INSTANCES OF GOOD FAITH

(1) Clauses/Instances Requiring the Assured to Supply Information

3-7 In insurance contracts the assured is usually required to supply information to his insurer after the contract is formed, pursuant to the terms of the policy on matters that will have a significant bearing on the position of the insurer. Given that the function of a clause of this nature is to enable the insurer to take informed underwriting decisions during the currency of the policy on matters that might have an impact on his rights and liabilities by ensuring a regular flow of information from the assured, one would naturally expect clauses of this nature to attract notions of continuing duty of utmost good faith. The point was made forcefully by Hirst J in *The Litson Pride*,²² where the assured was required to inform the insurer that the insured vessel had entered an 'excluded area' identified by the policy's trading warranty. The purpose of the notice requirement was to enable the insurer to levy an additional premium so that the assured could benefit from cover extending to the excluded area. In the case, the insured vessel entered the excluded area without giving notice; after she was lost, an attempt was made by the assured to present to the insurers a fraudulent notice purported to have been tendered before the casualty. Hirst J was adamant that the duty of utmost good faith applied in its full rigour to the giving of information about the voyage under the warranty.

3-8 More recent authorities leave no doubt that in cases where the insurer is reliant on the information provided by the assured to make a decision, such clauses would attract the post-contractual duty of good faith.²³ However, one should not lose sight of the fact that the additional remedy of avoidance in such cases would only be available as long as the conditions set out in *The Mercandian Continent* are satisfied. Therefore, if the assured acts fraudulently when supplying information pursuant to a term of the contract apart from losing the right to benefit under the relevant provision, his breach might entitle the insurer to an additional remedy, namely avoidance of the contract if: (i) the quality or seriousness of breach is such that it would entitle the insurer to repudiate the contract; and (ii) the fraud would have an impact on the potential liability of the insurer under the insurance contract. The availability of avoidance as an additional remedy will be beneficiary for the underwriters, particularly when they wish to escape liability for other claims that might have arisen under the contract prior to the breach. Looking at *The Litson Pride* in this new light, it is evident that the underwriters in that case would not have acquired any benefit from the introduction of s 17 into the equation because the held covered clause in the contract afforded, rather bizarrely, coverage to the assured even in the absence of giving notice of entry to 'an excluded area'. Therefore, the intention of the assured by declaring false information fraudulently was essentially to ensure that his premium liability was less than it would otherwise be; and this would not have had an impact on the insurer's ultimate liability under the policy,

²² [1985] 1 Lloyd's Rep 437, at [507]–[512].

²³ See the judgment of Longmore LJ in *The Mercandian Continent* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, at [39]–[40].

making it not possible for the underwriters to rely on the remedy of avoidance under the *Mercandian Continent* test. The limitations imposed on the operation of the continuing duty of good faith might seem excessively restrictive, but there is no doubt that it was the intention of Longmore LJ to confine the insurers in most cases to contractual remedies rather than extra-contractual ones.²⁴

3-9 In a similar vein, the continuing duty of good faith should attach to clauses which require the assured to disclose to the insurer any information which increases the risk, or to seek the insurer's consent to an increase of risk. The matter received judicial attention in *Hussain v Brown (No 2)*²⁵ although, in attempting to draw conclusions from this case it is imperative that subsequent judicial developments are kept in mind. There, cl 5 of a fire policy on commercial premises provided as follows:

The Assured shall as soon as possible give notice in writing to the Underwriters of any alteration likely to increase the risk of or any damage to the insured or Underwriter's liability and shall pay such reasonable premium, if any, as may be required by the Underwriters

The judge found that the premise had ceased to be occupied, thus increasing the risk of loss, and this meant that the assured might have been in breach of cl 5 of the policy. The insurer argued that failure to provide information as required by the clause amounted to breach of the assured's continuing duty of utmost good faith. The assured's contention that the continuing duty of good faith was confined to clauses requiring the assured to notify material facts to the insurer, to enable the insurer to determine whether or not to extend the coverage, was rejected on the premise that such a view is inconsistent with the more expansive approach taken by Hirst J in *The Litson Pride*. However, the insurer's defence on this point still failed even though the existence of a continuing duty of good faith in this context was confirmed. Hegarty QC, sitting as a Deputy Judge of the High Court, held that a contractual obligation on the assured to notify of any circumstance which might increase the risk superseded the continuing duty of utmost good faith, so that the insurer's only remedy was breach of contract and damages.²⁶ To the extent that *Hussain v Brown (No 2)* suggests that the continuing duty of good faith could not operate alongside contractual obligations, the judgment does not survive the Court of Appeal's reasoning in *The Mercandian Continent*. One should, however, not lose sight of the fact that at the time the case was decided, there was a widespread belief fuelled by the judgment of Hirst J in *The Litson Pride* that the assured could be in breach of the continuing duty of utmost good faith even if he acted culpably and

²⁴ Speaking extra-judicially, Sir Andrew Longmore, in his Donald O'May lecture, 'Good Faith and Breach of Warranty: Are We Moving Forward or Backwards?' [2004] *Lloyd's Maritime and Commercial Law Quarterly* 158, at 170, summarised the impact of *The Mercandian Continent* in the following manner:

In the few cases where post-contractual the parties have to exercise good faith towards one another, there is no scope of avoidance as such but only for termination or resistance to the claim in accordance with ordinary contractual principles. . . Insofar as there is substantial content to the requirement of good faith post-contract, any breach of the requirement will be dealt with according to the contractual principles so again, no question of avoidance should arise.

²⁵ Unreported (1996).

²⁶ This analysis based on the assumption that if notice had been given by the assured in time, terms would have been imposed which would have reduced the likelihood of loss.

not fraudulently. It is possible that the Deputy Judge, faced with the predicament of extending the scope of continuing duty of good faith to the detriment of the assured, decided to adopt a solution that would contain the potentially devastating consequences of the remedy of avoidance. However, his finding to the effect that continuing duty of utmost good faith attaches to provisions requiring the assured to notify the insurer of any change that might increase the risk is sound and should still be regarded as good law. English insurance law takes a rather liberal approach to the prospect of the insured risk being altered during the currency of the policy.²⁷ In such cases, the assured does not lose his cover unless the policy contains express provisions to the contrary. Clauses requiring the assured to notify an alteration or increase in the extent of the risk during the policy period are invariably included in insurance contracts to protect the interests of the insurer; on that basis there is no conceptual difficulty if such a clause attracts the notion of good faith requiring the assured to act in good faith whilst giving notice of a potential increase in the insured risk. In the light of the Court of Appeal's decision in *The Mercandian Continent*, if the decision not to notify the underwriters of a potential increase in the risk is conscious and deliberate, the remedy of avoidance is likely to be available to the insurers as long as the breach of the increase of risk clause is capable of affording the insurer the right to repudiate the contract.²⁸

3-10 The assured's continuing duty to provide information plays a prominent role in the operation of 'blanket agreements' such as open covers. This form of cover is commonly used in cargo insurance and is developed out of what was termed a 'floating policy', which is essentially an agreement by the insurer to provide cover for all the subject matter of a given class and description for which the assured required insurance from time to time.²⁹ Open covers are often concluded between a

²⁷ Pollock, CB, in *Baxendale v Harvey* (1859) 4 H & N 445, at 452, put this emphatically: 'If a person who insures his life goes up in a balloon, that does not vitiate his policy . . . A person who insures may light as many candles as he pleases in his house, though each additional candle increases the danger of setting the house on fire.'

²⁸ There are, however, many illustrations of courts construing increase of risk clauses very narrowly and against the interest of the insurers: *Shanly v Allied Traders' Insurance Co Ltd* (1925) 21 LIL Rep 195; *Mint Security v Blair, Miller (Thomas R) & Son (Home)* [1982] 1 Lloyd's Rep 188 and *Exchange Theatre Ltd v Iron Traders Mutual Insurance Co Ltd* [1983] 1 Lloyd's Rep 674. In *Kausar v Eagle Star* [2000] Lloyd's Rep IR 154, the Court of Appeal went as far as holding that an increase of risk provision in the policy merely reflected the common law position, so that an assured who failed to inform the insurer of an increased risk was not in breach of a condition imposing that obligation, as the condition operated only where the risk was fundamentally altered.

²⁹ Although floating policies are not used in contemporary insurance practice, the MIA 1906 devotes a section to this type of agreement. Section 29 of the MIA 1906 stipulates:

- (1) A floating policy is a policy which describes the insurance in general terms, and leaves the name of the ship or ships and other particulars to be defined by subsequent declaration.
- (2) The subsequent declaration or declarations may be made by indorsement on the policy, or in other customary manner.
- (3) Unless the policy otherwise provides, the declarations must be made in the order of dispatch or shipment. They must, in the case of goods, comprise all consignments within the terms of the policy, and the value of the goods or other property must be honestly stated, but an omission or erroneous declaration may be rectified even after loss or arrival, provided the omission or declaration was made in good faith.
- (4) Unless the policy otherwise provides, where a declaration of value is not made until after notice of loss or arrival, the policy must be treated as an unvalued policy as regards the subject-matter of that declaration.

particular assured such as a trader or exporter and his cargo underwriters and allow the former to declare the risks falling within the cover for a special period of time, subject to a maximum limit per risk but no overall aggregate.³⁰ It is evident that declarations made by the assured under an open cover are critical for the operation of the contractual mechanism established. One would expect notions of good faith to be closely associated with declarations made under an open cover and with the information provided by the assured as part of such declarations.

3-11 The role that the doctrine of good faith might play in this context depends entirely on the nature of the open cover in question. Generally speaking, open covers given to the assureds take three forms. ‘Non-obligatory open cover’ does not require the assured to declare all risks; at the same time, there is no obligation on the insurer to accept any risk which is declared. ‘Obligatory open cover’ makes it obligatory for the assured to declare all risks of the agreed type; the insurer is bound to accept all risks declared to him. ‘Facultative and obligatory open cover’ is sometimes underwritten on the terms that entitle the assured to choose which shipments he will declare to the open cover; once declared, the insurer is under an obligation to accept those risks. The legal status of a non-obligatory open cover is different than the other two types. As the insurer is not obliged to accept any risk declared to him and retains the right to exercise the underwriting judgment for each risk declared, an open cover of this nature cannot be classified as a contract *of* insurance, but merely as a contract *for* insurance. It, therefore, does not attract the duty of utmost good faith.³¹ This does not, however, mean that good faith obligations are not relevant. The assured, whilst declaring each risk, must act in accordance with the principles of pre-contractual duty of good faith expressed particularly in ss 18–20 of the MIA 1906. Any breach, fraudulent or otherwise, will give the insurer a right to avoid the policy subject to the materiality and inducement requirements considered previously.

3-12 The position is more complex when dealing with an obligatory or facultative and obligatory open cover. It is highly unlikely that pre-contractual duty of good faith will be relevant in this context given that a contract of insurance comes into existence as soon as a declaration is made, without the insurer having the opportunity to rate and assess the risk presented. However, it is not fanciful to suggest that the continuing duty of good faith can apply here. Even though the courts have not yet grappled with this question, keeping abreast with recent judicial developments, it can be argued that there are remarkable similarities between: (i) the position of an assured who is expected to make declarations in line with the parameters set in the open cover so that the rate of the premium he will pay can be determined in accordance with such declarations; and (ii) the position of the assured who is required to inform the insurer that the insured vessel had entered into an excluded area so as to enable the insurer to levy additional premium. Assuming that the continuing duty of good faith applies in the later case,³² it is hard to argue that it has no role to play in the former case.

³⁰ Conversely, the facility granted under a floating policy would normally be for a fixed sum so the assured would run the risk of finding himself uninsured inadvertently exceeding the aggregate value.

³¹ *Société Anonyme d'Intermédiaires Luxembourgeois v Farex Cie* [1995] LRLR 116 and *Mander v Commercial Union Assurance Co Plc* [1998] 1 Lloyd's Rep IR 93.

³² *The Litson Pride* [1985] 1 Lloyd's Rep 437.

3-13 On the assumption that fraudulent behaviour of the assured when making a declaration under an obligatory or facultative obligatory open cover might constitute breach of the continuing duty of utmost good faith, the question that needs to be addressed is whether failure to make declarations in *bona fidei* amounts to a repudiatory breach of the open cover as a whole; as under the test laid down in *The Mercandian Continent*, avoidance in such a case will only be available as an additional remedy if the contractual breach is serious enough to enable the insurer to elect to terminate the contract. This is largely a matter of construction; in *Glencore International AG v Ryan (The Beursgracht)*,³³ however, breach of an obligation to make a timely declaration, though there was no evidence of fraud in the case, was held not to be adequate to allow the insurer to terminate an open cover as a whole, as the obligation was deemed to be an innominate one only.³⁴ In that case, Tuckey LJ in passing described the open cover as ‘more like a floating policy’,³⁵ opening the door for the application of s 29 of the MIA 1906 in instances of open cover. However, this does not necessarily enhance the position of the insurer. Section 29(3) of the MIA 1906 provides that an omission or erroneous declaration may be rectified after the loss or arrival, if made in good faith. This means that the insurer will be able to disregard a false or erroneous declaration made dishonestly by the assured, but it does not mean that he will be able to repudiate the open cover as a result.

(2) Notice of Loss and Co-operation Clauses

3-14 Logic suggests that clauses that attempt to regulate the behaviour of the assured after the occurrence of the event giving rise to the claim should also be capable of introducing the post-contractual duty of good faith into play, due to the fact that they are closely associated with the notion of fair dealing during the performance of an insurance contract. Such provisions would normally appear in liability policies and require the assured to report a claim brought against them by third parties promptly.³⁶ It is not uncommon to see clauses of this nature requiring the assured, apart from reporting claims brought against him, to keep the underwriters fully advised in relation to circumstances that might have an impact on the liability of the insurers.

3-15 The relationship between contractual remedies and the concept of continuing duty of good faith was the subject of an extensive judicial review in *The Mercandian Continent*. There, the assured was a ship repairer located in Trinidad who was insured against third-party liability by the defendant insurers under two

³³ [2001] EWCA Civ 2051; [2002] Lloyd’s Rep 574.

³⁴ It is worth noting, however, that in *Kuwait Rocks Co v AMN Bulcarriers Inc (The Astra)* [2013] EWHC 865 (Comm), it has been suggested by Flaux J that missing a payment of hire under a time charterparty can be treated as breach of a condition.

³⁵ *Ibid*, at [34].

³⁶ Such clauses often appear in other types of policies. For example, cl 43.1 of the International Hull Clauses (01/11/03) provides: ‘In the event of an accident or occurrence whereby loss, damage liability or expense may result in a claim under this insurance, notice must be given to the Leading Underwriter(s) as soon as possible after the date on which the Assured, Owners or Managers become aware of such loss, damage, liability or expense so that a surveyor may be appointed if the Leading Underwriter(s) so desire.’

policies framed in much the same terms. The policies contained a 'Notice of Claims' clause which provided that: 'In the event of an occurrence which may result in a claim . . . the assured shall give prompt written notice . . . and shall keep underwriters fully advised.' In April 1988, K/S arranged to have repairs to its vessel, the *Mercandian Continent*, carried out by the assured. The work was carried out in Trinidad in April and May of that year. However, the work was defective and, shortly after it was completed and the vessel had been repossessed by K/S, the engine exploded and she was severely damaged. On 1 July 1988, a claim against the assured was made by K/S. The assured denied liability, but took the precaution of informing their brokers of the possible claim by K/S. The dispute between K/S and the assured could not be resolved, and the parties agreed to refer it to the English High Court in May 1989. Soon afterwards, the defendant underwriters asserted their right to take over the assured's defence and instructed English solicitors. At this point, the underwriters received legal advice from a lawyer in Trinidad who expressed the view (which proved to be erroneous) that there was great advantage to the underwriters in the proceedings being heard in Trinidad, as local law operated to reduce the possible extent of damages by 90 per cent as compared to the measure available in England. Accordingly, the assured, through solicitors appointed by underwriters, challenged English jurisdiction. The challenge was supported by a letter produced by the assured on 1 July 1998 (immediately after the explosion) which purportedly had been sent to and countersigned by K/S indicating that only the assured's managing director and chairman had authority to discuss the claim. If the letter were genuine, then the jurisdiction agreement entered into by the assistant general manager was outside the scope of his authority. However, by the beginning of 1993, it had become clear that the letter was a forgery and had been manufactured by the assured in a desperate attempt to assist the solicitors appointed by liability underwriters. Once the fraud came to light, the underwriters purported to avoid the policies for breach by the assured of his continuing duty of good faith. The action brought by K/S against the assured proceeded in English courts and K/S was awarded damages caused by the defective repair work. The assured, which had not been presented at trial, was unable to pay the sums awarded and was wound up on 17 September 1997. K/S, having an unsatisfied judgment against an insolvent assured, commenced the present action against the assured's liability underwriters in accordance with the provisions of the Third Parties (Rights against Insurers) Act 1930.³⁷

The underwriters pleaded two defences: namely, that there was a breach of the claims co-operation clause and also that the assured was in breach of his continuing duty of good faith. The Court of Appeal, reversing the judgment of Aikens J³⁸ on this point, held that the assured was under a continuing duty to observe good faith whilst performing the post-contractual obligations set out by the claims co-operation clause. However, as discussed earlier, the Court of Appeal restricted the application of s 17 in this context to cases where the want of good faith would entitle the insurer

³⁷ It is worth noting that this Act was repealed and replaced by the Third Parties (Rights against Insurers) Act 2010 as from 25 March 2010. The 1930 Act continues to apply where both the assured's insolvency and the factual occurrence of liability to a third party took place prior to 25 March 2010.

³⁸ [2000] 2 Lloyd's Rep 357.

prospectively to terminate the contract for breach. This meant that the destiny of breach of s 17 defence was linked closely to the outcome of the contractual defence. In the view of Longmore LJ, even though the assured, by producing a forged letter, was in breach of the claims co-operation clause, this did not entitle underwriters to repudiate the contract.³⁹ This finding meant that the underwriter's s 17 defence also failed. The Court was also of the view that the fraud was not 'material' because it was not relevant ultimately or at all to the insurer's liability and in any event, the fraud was not directed at them. The only consequence of the fraud perpetrated was that the insurer's solicitors maintained their legal proceedings opposing English jurisdiction longer than would otherwise have been the case.

3-16 At this juncture, it may be useful to recap where the law currently stands as far as claim notification clauses are concerned. The decision of Longmore LJ in *The Mercandian Continent* leaves no doubt that such clauses could potentially bring s 17 into play where the assured acts fraudulently in breach of such a clause. However, it is also unambiguously clear that the materiality test introduced by Longmore LJ is a stringent one and as yet there has been no reported case in which it has been applied successfully to unleash the full potential of s 17. What makes the test very difficult to apply in practice is the fact that claim notifications clauses under general principles of contract law would normally be regarded as ancillary provisions, the breach of which would not entitle the innocent party (in this case the insurer) to elect to repudiate the contract⁴⁰ regardless of the nature of the breach (i.e. whether fraudulently or not).

3-17 An interesting feature of *The Mercandian Continent* is that fraud perpetrated by the assured in that case was not directed at the insurer. Instead, the assured was attempting to assist the solicitors appointed by the insurer by producing fraudulent documents to challenge the jurisdiction of Trinidad courts in the ongoing litigation with a third party. Put differently, the insurer was an unintended victim of a fraud directed at a third party. The question that deserves further scrutiny is whether the outcome would have been different in terms of the applicability of s 17, had the fraud been directed at the insurer. Let us suppose that in a liability policy, the assured is expected to give notice immediately after the occurrence of an event which may give rise to a claim and to keep the underwriters fully advised. Also assume that it is explicit in the relevant clause that the assured will lose his right to make a claim under the policy for the relevant loss if he fails to give notice in a timely manner, but the validity of the policy remains unaffected. Let us consider the position of an assured who alters the date on a letter sent to his broker outlining the occurrence of an event that might lead to a claim, believing that he failed to comply with the notice requirement, and who pretends that the notice was given earlier than it actually was. If the fraud is later discovered and successfully pleaded by the

³⁹ The court arrived at a similar conclusion when construing a similarly worded claim notification clause in *Alfred McAlpine Plc v BAI (Run-Off) Ltd* [2000] 1 Lloyd's Rep 437.

⁴⁰ See e.g., the decision of the Court of Appeal in *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corp* [2005] EWCA Civ 601; [2005] 2 Lloyd's Rep 517, where it was held that a claim notification clause was not, in fact, a severable innominate term which would entitle underwriters to reject the claim if the breach is serious. There are hints in the judgment of Mance LJ, suggesting that such ancillary provisions are mere conditions (contractual warranties) capable of sounding in damages.

underwriters, it is obvious that the assured will be deprived of the right to make a claim for the relevant loss. The effect of the breach of the notice clause will be to deprive the assured of the relevant claim; but it would not give the underwriter a right to repudiate the contract. In that case, one could argue that the insurer, as the innocent party, should be allowed to treat the breach as being repudiatory on the basis that the assured's fraudulent behaviour was directed at him. If the breach is treated as repudiatory, this will potentially open the door for the application of s 17 under the test laid out by *The Mercandian Continent*.

3-18 The proposition that fraud directed at the insurer can be justifiably treated as repudiatory conduct has an instinctive appeal and might find support both in judicial⁴¹ and academic⁴² circles. However, as is later analysed, courts are not always prepared to make remedies available at the disposal of underwriters in all instances of fraud, even in an insurance context. For example, not all dishonest behaviour of the assured in the presentation of a claim would give rise to a fraudulent claim.⁴³ By analogy, it is plausible to argue that dishonest behaviour directed at the insurer in the context of an ancillary contractual term should not be treated as a repudiatory breach of the contract. However, it should not be assumed that fraudulent behaviour of the assured in performing his obligation to give notice will not have any consequences other than contractual ones. If the assured subsequently advances a claim in respect of that loss and the material falsehood in the notice forms part of his claim, it is inevitable that the claim will be treated as fraudulent, potentially attracting other remedies.⁴⁴

3-19 It is not unusual in liability policies to find clauses that impose obligations on the assured to co-operate with the insurer following the occurrence of an event that might give rise to a claim against the assured by a third party. Typically, such clauses are framed in general terms that require the assured, for example, to provide information or evidence to the insurer to defend a claim against the assured and to render the insurer all reasonable assistance.⁴⁵ Although there is no authority on the subject in this jurisdiction,⁴⁶ it can be safely assumed that such clauses are capable of

⁴¹ In *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 451, Hoffmann LJ noted that 'any fraud in the making of the claim goes to the root of the contract, and entitles the insurer to be discharged'.

⁴² See e.g., Professor Malcolm Clarke, 'Fraud by the insured changes the nature of a relationship intended to be based in good faith: the insurer is entitled to say that the insured and the risk now appear in a different light, and claim to terminate the entire contract.': *The Law of Insurance Contracts* (6th edn) (2009, Informa), p 883.

⁴³ In *Agapitos v Agnew (The Aegeon)* [2002] EWCA Civ 247; [2003] QB 556, Mance LJ at [38], said:

In the context of use of a fraudulent device or means, one can contemplate the possibility of an obviously irrelevant lie—one which, whatever the insured may have thought, could not sensibly have had any significant impact on any insurer or judge. Tentatively, I would suggest that the courts should only apply the fraudulent claim rule to the use of fraudulent devices or means which would, if believed, have tended, objectively but prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects—whether they be prospects of obtaining a settlement, or a better settlement, or of winning at trial.

⁴⁴ See [3-67]–[3-93].

⁴⁵ In some cases, corporation clauses require the assured not to admit liability of settling a claim without the consent of the insurer.

⁴⁶ In the USA, such clauses were held to be capable of implying good faith. See e.g., *Vallado v Fireman's Fund Ind Co* 89 2 Pd 643 (1939), at 647.

attracting a continuing duty of utmost good faith, considering that they require the assured to work closely with his liability insurer at the post-contractual stage with the intention of protecting the interests of the latter. Obviously, the limitations set out by *The Mercandian Continent* will still be relevant and given that claim notification clauses would not normally afford the insurer a right to repudiate in case of breach, it is unlikely that the remedy of avoidance will be available for the insurer, even though the assured acts fraudulently whilst providing assistance to the insurer or refrains from providing such assistance deliberately.

(3) 'Follow the Settlement' Clauses in Reinsurance Agreements, and the Impact of Good Faith on Reinsurance Agreements

3-20 Reinsurance agreements, whether facultative or treaty, often contain 'follow the settlement' clauses, the effect of which is to bind the reinsurer to claims settled by the reassured provided certain conditions are satisfied. With such clauses, the reinsurer promises to surrender his discretion of investigating the loss and puts his faith in the decision of his primary insurer (reassured) in relation to the losses submitted by the assured under the primary insurance agreement. Follow the settlement clauses are, therefore, primary candidates for attracting continuing duty of good faith on the part of the reassured given that the reassured by virtue of such clause is expected to protect the interests of the reinsurer and the integrity of the reinsurers' bargain at the post-contractual stage. There are various hints coming from the judiciary that the notion of good faith might be relevant in this context. For example, in *Insurance Co of Africa v SCOR (UK) Reinsurance Co Ltd*, Lord Goff said:⁴⁷ '... I do consider that the [follow the settlement clause] presupposes that reinsurers are entitled to rely not merely upon the honesty, but also on the professionalism of insurers, and so is susceptible of an implication that the insurers must have acted both honestly and in a proper and business-like manner.'⁴⁸

3-21 That said, there is no reported case where the reinsurer has successfully relied on the good faith doctrine or s 17 to avoid the contract in cases where the reassured fails to settle a claim submitted to him in an honest fashion. Even assuming that continuing duty of good faith is relevant in this context if the reassured consciously and deliberately takes a decision to settle a claim for extraneous business reasons which were of no concern to the reinsurer, rather than on the merits of the claim, the restrictions imposed by *The Mercandian Continent* still apply. In that case, it is certain that the effect of good faith will be that the reinsurer will not be bound to follow the settlement; but it is doubtful whether the breach will entitle

⁴⁷ [1985] 1 Lloyd's Rep 312, at 330.

⁴⁸ See, also, the judgment of Scrutton LJ in *Gurney v Grimmer* (1932) 44 LIL Rep 189, at 193 (emphasis added):

The re-insurer . . . agrees 'to pay as may be paid thereon' (i.e. on the original policy). Independently of these words, he would be liable, on proof, for any loss suffered by the original assured and covered by the re-insurance policy. The addition of the words in question must be presumed to have been with the intention of giving a further advantage to the assured . . . What then is the additional obligation which the re-insurer assumes by these words? It would appear that *he forgoes the right to dispute any loss which has been settled in good faith by the original underwriters* and agrees to pay his proportion of the amount thereof, on being satisfied that payment has been made under the original policy.

the reinsurer to repudiate the contract,⁴⁹ which is essential under the test laid down by *The Mercandian Continent* to trigger the application of s 17. However, it should not be assumed that no other remedy apart from contractual remedies will be available to the reinsurers in cases where the reassured acts dishonestly in settling the underlying claim. It is very likely that the reinsurer will be able to argue that the resulting claim under the reinsurance constitutes a fraudulent claim (i.e. the reassured putting forward a claim knowing that the claim is not one allowed under the reinsurance agreement).

3-22 At this juncture, it is worth considering the instances where the good faith doctrine might still play a role in specifying the extent of contractual rights particularly in reinsurance agreements. In *Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd*,⁵⁰ when considering the reinsurer's rights in relation to the reinsurance contract under consideration, which was a reinsurance treaty, Hobhouse J held that the reinsurer had an implied right to the reassured's records in so far as they related to the covered business. Although this judgment has been viewed in some circles as suggesting that the continuing duty of good faith is capable of creating a free-standing legal right to information in re-insurance treaties,⁵¹ it is also apparent that Hobhouse J based his reasoning on a contractual basis and was merely suggesting that the continuing duty of good faith may be regarded as an additional reason for implying the relevant term.⁵² At no point in his judgment was reference made to the need to prove that the reassured has a particular state of mind to establish breach and there was no mention of avoidance as the only remedy. On the contrary, it has been recognised that the remedy could be enforced by granting discovery or inspection.

3-23 Whether the doctrine of good faith can be used as a means to justify the implication of a contractual term required for business efficacy is debateable, as such terms are usually implied into contracts to give effect to what is deemed by the courts to be the unexpressed intention of the parties.⁵³ Perhaps it could have been easier to justify the need to imply such a term by law,⁵⁴ had the judge been drawn on a general overarching principle of continuing duty of co-operation and good faith.⁵⁵

⁴⁹ It is possible that 'follow the settlement' clauses can be treated as condition precedents in the contingent sense rather than the promissory sense on the basis that the liability of the insurer under the contract is made subject to the occurrence of some future event (in this case the reassured settling the claim submitted by the assured in good faith).

⁵⁰ [1985] 2 Lloyd's Rep 599.

⁵¹ *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469, at [81], per Lord Scott.

⁵² Hobhouse J said, [1985] 2 Lloyd's Rep 599, at 614:

... The relevant terms have to be implied primarily so that the reassured shall conduct his business in a proper and business-like fashion, but, for present purpose, so that the reinsurer may also be able to find out what his rights are ... there is no ground for curtailing the obligation which would probably be imported anyway by the duty of good faith and which could also be enforced by way of discovery and inspection in any subsequent litigation. The relevant obligations must be regarded as continuing ones, just as the obligation of the utmost good faith.

⁵³ See the judgment of Bowen LJ in *The Moorcock* (1889) 14 PD 64.

⁵⁴ When a term is implied by law such a term is deemed essential due to the nature of the contract in question rather than the supposed intentions of the parties.

⁵⁵ For example, in a different context, a duty of corporation was incorporated into an employment contract as a term implied in law by the House of Lords in *Malik v Bank of Credit & Commerce International SA* [1998] AC 20.

Whichever proves to be the accurate legal analysis as to implication of the relevant term, it is clear that the judgment in *Phoenix* cannot be taken as authority for the proposition that s 17 has any role to play in this context, even if the reassured's failure to enable the reinsurer to inspect his records is motivated by his desire to default the reinsurer. The remedy in that case will be a contractual remedy and it may well be possible that the reinsurer may be allowed to elect to repudiate the contract if the breach is deemed to be serious.⁵⁶

(4) Subsequent Contractual Agreements Stemming from the Insurance Contract

3-24 It is not uncommon to see clauses, particularly in the context of indemnity policies, requiring the assured to protect the rights of the insurer against third parties, considering that the insurer will subrogate any such rights upon payment of the loss.⁵⁷ For example, cl 16.2 of the Institute Cargo Clauses 2009 requires the assured 'to ensure that all rights against carriers, bailees or other third parties are properly preserved and exercised'. What happens in practice is that on payment of a claim, the assured is asked to sign a subrogation form (sometimes known as a letter of subrogation). Under the standard Lloyd's market subrogation form, a new agreement between the parties is introduced, putting the assured under somewhat onerous contractual obligations. The second paragraph reads:

I/We also record that you have authority to use my/our name to the extent necessary effectively to exercise all or any such rights and remedies; that I/We will furnish you with assistance you may reasonably require of me/us when exercising such rights and remedies on the understanding that you will indemnify me/us against any liability for costs charges and expenses arising in connection with any proceedings which you may take in my/our name in the exercise of such rights and remedies.

Even though some sentiments were echoed suggesting that the doctrine of good faith may be relevant in this context,⁵⁸ it is highly unlikely that the new agreement, which originates from the terms of the insurance contract requiring the assured to co-operate and assist for the sake of protecting the insurer's rights in subrogation, attracts notions of good faith. It is one thing to say that in the absence of a

⁵⁶ Hobhouse J completed his analysis on this matter by saying, [1985] 2 Lloyd's Rep 599, at 614: 'The term or terms are all innominate and therefore the consequences of any breach for any particular cession or any individual claim or, indeed, for the contracts as a whole, must depend on the nature and gravity of the relevant breach or breaches.'

⁵⁷ Section 79 of the MIA 1906 reads:

- (1) Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss.
- (2) Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain, but he is thereupon subrogated to all rights and remedies of the assured in and in respect of the subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to this Act, by such payment for the loss.

⁵⁸ See particularly *Lord Napier and Ettrick v R F Kershaw* [1993] AC 713, at 736, per Lord Templeman.

contractual specification, the assured is expected to act in good faith in exercising his rights of action against third parties (what Lord Templeman was alluding to in *Napier v Kershaw*) and a completely different thing to suggest that once a separate agreement dealing with the rights of the insurer in cases of subrogation is established, the agreement imposes a continuing duty of utmost good faith on both parties. The subrogation agreement is like any commercial agreement; and if the assured acts fraudulently in breach of this agreement the remedy is to be found in the principles of the contract law.

3-25 The position is similar in cases where the parties enter into a compromise agreement following an insurance contract. A suggestion was once made to the effect that compromise agreements may attract a duty of good faith.⁵⁹ It is undeniable that compromise agreements are contracts whereby a degree of trust between the parties is needed, as both parties operate under the assumption that a genuine loss covered by the policy has occurred. However, this is not adequate to distinguish such agreements from other commercial contracts. For example, parties entering into a finance agreement also proceed on the basis that both parties will be able to meet the requirements of the contract. Therefore, it is difficult to see why compromise agreements should be treated differently to introduce a continuing duty of good faith on both parties.⁶⁰ This is not to say that any wrongdoing at the formation stage of a compromise agreement will not create legal consequences for the parties. A compromise agreement can certainly be set aside for material misrepresentation. It is debateable whether a compromise agreement can be declared void for common mistake in equity if, for example, an insurer entered into it under a mistaken impression that he was liable to the assured. Although this option seemed to be available at one point, it is unlikely that it still represents good law following the decision of the Court of Appeal in *Great Peace Shipping v Tsavlis*⁶¹ where it was concluded that ‘there is no jurisdiction to grant rescission of a contract on the ground of common law mistake where the contract is valid and enforceable on ordinary principles of contract law’.⁶²

(5) Claims Context

3-26 The main factor motivating the assureds in obtaining insurance cover is the need to safeguard their interests against the risk that the subject matter of insurance might suffer a loss due to a peril insured against during the period of insurance. When such a loss strikes, from the assured’s perspective, the priority is to be able to make a successful claim. This stage is also very important from the insurer’s

⁵⁹ *Royal Boskalis Westminster NV v Mountain* [1997] LRLR 523, at 600, per Rix J.

⁶⁰ See Foskett, D, *The Law and Practice of Compromise* (5th edn) (2002, Sweet & Maxwell), para 4.42–5, where the view was expressed that a settlement agreement was not a contract of *uberrimae fidei*. See also, *Turner v Green* [1895] 2 Ch 205, at 208, per Chitty J and *Piper v Royal Exchange Assurance* (1932) 44 LIL Rep 103, at 117, per Roche J. In *Direct Line Insurance Plc v Fox* [2009] EWHC 386 (QB); [2010] Lloyd’s Rep IR 324 the judge proceeded on the premise that a settlement agreement does not attract the notion of good faith.

⁶¹ [2002] EWCA Civ 1407; [2003] QB 679, at [157].

⁶² Such a mistake in common law is treated as a mistake as to the quality of the contract; there has never been a basis for saying that such contracts are void under common law.

perspective, as he is expected to make a decision as to whether he will provide indemnity from his own funds after investigating the claim put forward, regardless of the fact that the majority of facts surrounding the loss are not in his possession. There is an added difficulty, particularly in marine insurance, stemming from the fact that the majority of risks are insured in the market under valued policies enabling the assured to obtain a promise of indemnity at a rate higher than the market value of the subject matter of insurance.⁶³ As a result, the temptation to scuttle or cast away the subject matter of insurance becomes very difficult to resist, particularly when the sector faces economic difficulties.⁶⁴

3-27 Regardless of the underlying motivating factor, it is undeniable that fraudulent claims have always existed in the insurance market; this has created complex problems not only for the insurers, but also for the honest assureds who have often paid the price of other fraudulent behaviour by an increase in their premium payments. From a legal perspective, there can be no doubt that an assured who submits a fraudulent claim will not be able to recover in relation to that claim if the fraud is alleged and proved by the insurer. The rule which deprives the assured from recovery is founded upon public policy and is seen in accordance with justice.⁶⁵ The fundamental question in this context is whether a continuing duty of utmost good faith and s 17 have any role to play in the claims context. If the claims context is regarded as one of the instances where the continuing duty of good faith applies, this has, essentially, two drastic consequences: (i) Where the assured submits a fraudulent claim, the insurer will be potentially equipped with the remedy of avoidance, which will enable him to rescind the contract retrospectively. The remedy of avoidance *ab initio* might be viewed in this context as ‘severe and disproportionate’. For example, where a fully enforceable contract has been entered into insuring the assured, say, for a period of one year, the premium has been paid and an honest claim for a loss covered by the insurance has arisen and been paid, but then, towards the end of the period, the assured submits a fraudulent claim, the insurer is not only able to discharge himself from any further liability, but he can also undo all that has perfectly gone before. (ii) Introducing s 17 into the equation might also have the indirect effect of enhancing the scope of the fraudulent claims jurisdiction. Let us consider a hypothetical scenario where the assured submits a claim to the insurer in the knowledge that the claim is time-barred without taking any steps to mislead the insurer or hide the true facts. As the law currently stands, it is unlikely that this claim will be treated as fraudulent given that all the assured did was to bring a claim coming under the scope of the policy to measure the reaction of the underwriter (i.e. to see whether the underwriter would identify the presence of the time bar defence

⁶³ Section 27(3) of the MIA 1906 enables the parties to fix the value of the subject matter intended to be insured by the policy and indicates that such a valuation is conclusive between the parties in the absence of fraud.

⁶⁴ There is usually a correlation between the number of scuttling cases before the courts and a significant downfall in economic conditions.

⁶⁵ In *Britton v Royal Insurance Co* (1866) 4 F & F 905, at 909, per Willes J, while addressing the jury, said: ‘. . . The law is that a person who has made such a fraudulent claim could not be permitted to recover at all . . . It would be most dangerous to permit parties to practice such frauds and then, notwithstanding their falsehood and fraud, recover the real value of the goods consumed. And if there is wilful falsehood and fraud in the claim, the insured forfeits all claim whatever upon the policy.’

and choose to rely upon it or would take steps to affirm the contract). However, if s 17 is relevant in this context, this would mean that the assured is expected to disclose facts relevant to the claim when submitting such a claim. Accordingly, if he is aware that the claim submitted is time-barred but chooses to keep silent, this could well amount to misrepresentation, as it could be argued that the assured in that case deliberately conceals a significant attribute of the claim when he is, in fact, expected by law to disclose facts closely linked with the claim.⁶⁶

3-28 The judiciary seems to be divided on the issue whether s 17 has any role to play in the claims context. There is a fair degree of judicial support, particularly prior to the judgment of the House of Lords in *The Star Sea*, for the proposition that advancing a fraudulent claim should be treated as a breach of utmost good faith principles. In *The Litson Pride*, for example, Hirst J seems to proceed on the premise that s 17 and the remedy of avoidance are relevant when an assured advances a fraudulent claim.⁶⁷ In *The Star Sea*, their Lordships were very tentative on the matter and refrained from committing themselves to any particular view. It was, however, noticeable that the remedy of avoidance at the post-contract stage has been regarded as being ‘wholly one-sided’ and capable of creating ‘disproportionate benefit’ to the insurer.⁶⁸ Lord Scott regarded the question of whether the presentation of a fraudulent claim should be treated as breach of a continuing duty under s 17, thus entitling the insurer to avoid the policy with retrospective effect and also obliging the assured to repay the previous unimpeachable claims, as ‘more debateable’.⁶⁹

3-29 Given that the matter lacks judicial certainty, it is worth engaging in a more comprehensive analysis at this stage. Let us first consider the arguments that can be developed to lend support to the proposition that avoidance should stay as an applicable remedy in the event of submission of a fraudulent claim. First, it can be conceptually difficult to explain how, on the one hand, the scope of the good faith doctrine is extended through judicial intervention to the post-contractual phase but, on the other hand, its application in the claims process, which is probably the most significant post-contractual stage, is restricted. Such a dividing line has little to commend it and can be viewed as artificial.⁷⁰ Second, it can be argued that a continuing duty of good faith is required at the claims stage to ensure the flow of information between the parties – particularly from the assured to the insurer – at this critical stage, taking into account that circumstances of the casualty will rarely be within the knowledge of the insurance company. This was put cogently by Woolf MR in *Galloway v Guardian Royal Exchange (UK) Ltd*:⁷¹ ‘In the making of the

⁶⁶ See the statements made by Lord Bingham in *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, at [21].

⁶⁷ [1985] 1 Lloyd’s Rep 437, at 514–15. In a similar vein, Evans J, in *Continental Illinois National Bank & Trust Co of Chicago and Xenofon Maritime SA v Alliance Assurance Co Ltd (The Captain Panagos DP)* [1986] 2 Lloyd’s Rep 470; Rix J in *Royal Boskalis Westminster NV v Mountain* [1997] LRLR 523 and Aikens J in *The Mercandian Continent* [2000] 2 Lloyd’s Rep 357 seemed to be operating under the presumption that s 17 is available to the insurer if the assured advances a fraudulent claim.

⁶⁸ [2001] UKHL 1; [2003] 1 AC 469, at [57], per Lord Hobhouse.

⁶⁹ *Ibid*, at [110].

⁷⁰ Eggers, PM, ‘Utmost Good Faith and the Presentation and Handling of Claims’ in B Soyer (ed), *Reforming Marine and Commercial Insurance Law* (2008, Informa), p 242.

⁷¹ [1999] Lloyd’s Rep IR 209, at 212.

claim the facts are normally wholly within the insured's knowledge. The insurers are dependent on the insured exercising good faith in order to evaluate the claim.' Third, the continuing duty of good faith at the claims stage can be seen as vital for policy reasons. In line with this, it can be argued that there will be a deterrence effect which will be beneficial for the insurance industry, honest assureds and the society as a whole if severe remedies are made available in cases of fraudulent claims.

3-30 Equally, several coherent reasons can be put forward to justify why s 17 should be kept apart from the claims process. First, it should be noted that avoidance is a severe remedy and if it is readily available in the claims context, it can be unleashed on the assured regardless of the impact of the fraud. Put another way, the control mechanisms introduced by *The Mercandian Continent* to restrict the availability of the remedy of avoidance in the post-contractual scene will not provide any barrier for the insurer, who is minded to avoid the contract when a fraudulent claim is advanced, given that there is judicial support for the proposition that any fraud in making the claim goes to the root of the contract.⁷² Therefore, there is the danger that by extending s 17 into the claims stage, the insurer would be given an opportunity to use the good faith doctrine as an engine of oppression against the assured,⁷³ disregarding the fact that the doctrine has been originally designed to be an indispensable shield for the insurer. Second, in the majority of findings by legal authorities which are alleged to be advocating a link between good faith doctrine and fraudulent claims, there is no indication that the remedy will be the avoidance of the contract. For example, in *Britton v Royal Insurance Co*,⁷⁴ having stressed that good faith must be retained by both parties at the claims stage, Wiles J in his direction to the jury, identified 'forfeiture of all the claim under the policy' as the most severe consequence of advancing a fraudulent claim in the absence of an express contractual term dealing with the matter.⁷⁵ The absence of any binding authority makes it very difficult to argue that s 17 and the remedy of avoidance cannot be separated from the claims stage. Third, decoupling s 17 and the continuing duty of utmost good faith from the claims process does not necessarily mean that the law fails to recognise the significance of preventing fraud in the claims process. To the contrary, the common law rule is very unforgiving and embodies a disciplinary element. For example, an assured who is found to have exaggerated part of his claim will be deprived of the whole claim regardless of whether or not the rest is tainted with fraud. However, if the insurer is given an opportunity to use a defence to deprive the assured not only of the claim tainted with fraud but also of the benefit of the insurance policy, including previous claims made and paid in good faith, such

⁷² *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 451, per Hoffmann LJ.

⁷³ The expression was very famously used by Lord Sumner in *Niger Co Ltd v Guardian Assurance Co Ltd* (1922) 13 LILR 75, at 82.

⁷⁴ (1866) 4 F & F 905, at 909.

⁷⁵ See also, the judgment of Woolf MR in *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209. There was reference in the majority decision in *Orakpo v Barclays Insurance Services* [1995] LRLR 443 to the language of avoidance as a consequence of submitting a fraudulent claim; however, as stressed by Lord Hobhouse in *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469, at [66], that 'cannot be taken as fully authoritative in view of the contractual analysis there adopted'. Please note that in his dissenting judgment, Staughton LJ, in *Orakpo v Barclays Insurance Services*, is firmly of the view that there is no judicial basis or precedent justifying the introduction of avoidance as a remedy at the claims process.

an outcome might be viewed as going too far. There is no other instance in insurance law where the whole bargain is declared to have no effect in law for a failure of the assured during the performance of the contract, even where the failure is associated with illegality. For example, the failure of the assured to perform the insured adventure in a legal manner would amount to breach of the implied warranty of legality encapsulated in s 41 of the MIA 1906, but the insurer in that case will be discharged from the contract prospectively, leaving the rights that have arisen prior to the breach intact. Last, but not least, a well-reasoned analysis can be put forward to justify not extending the doctrine of good faith to the claims stage. The reasoning adopted by the legal authorities considered in depth in this chapter leaves no doubt that the duty of good faith is closely linked to the express or implied terms of the contract, such as claim co-operation clauses and that it stems from such contractual obligations. However, the position is different in the claims context. Here, the consequences of fraud stem originally from a rule of common law that prevents people from profiting from their own wrong.⁷⁶ It is, therefore, plausible to argue that there is no room for the continuing duty of good faith as long as common law remains the source of the duty rather than the contract itself. It has been consistently stressed by courts in recent years that any notion that the assured's duty of good faith continues post-contractually cannot be divorced from the terms of the policy. If that is the case and the duty to act in good faith stems from extra-contractual sources, there is no conceptual difficulty in contending that the post-contractual duty of utmost good faith cannot operate in the claims context.

3-31 In recent years, the view that advocates the removal of s 17 from the claims process seems to have gained currency in judicial circles. Longmore LJ in *The Mercandian Continent*,⁷⁷ cast considerable doubt on the application of s 17 in the claims process and indicated that it was not 'entirely clear' if the law relating to fraudulent claims can be regarded as an instance of post-contractual good faith. More forcefully, in *Agapitos and Another v Agnew and Others (The Aegeon)*, Mance LJ was adamant that s 17 should have no role to play in the claims process. He concluded by saying:⁷⁸

⁷⁶ Lord Hoffmann in *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469, at [62], put this very clearly:

Where an insured is found to have made a fraudulent claim upon the insurers, the insurer is obviously not liable for the fraudulent claim . . . This result is not dependent upon the inclusion in the contract of a term having that effect or the type of insurance; it is the consequence of a rule of law. Just as the law will not allow an insured to commit a crime and then use it as a basis for recovering an indemnity (*Beresford v Royal Insurance Co Ltd* [1937] 2 KB 197), so it will not allow an insured who has made a fraudulent claim to recover. The logic is simple. The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing.

Similar sentiments were echoed by Longmore LJ in *The Mercandian Continent* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, at [11]:

Although some judges have said that, in the absence of any express terms, such a term would be implied into the policy, . . . the better view now seems to be that both the obligation not to make a fraudulent claim and the inability to recover if a fraudulent claim is, in fact, made stem from a rule of law rather than any implied term . . .

⁷⁷ *Ibid*, at [11].

⁷⁸ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [45] (hereinafter referred to as *The Aegeon*).

In the present imperfect state of the law, fettered as it is by section 17, my tentative view of an acceptable solution would be . . . to treat the common law rules governing the making of a fraudulent claim (including the use of fraudulent device) as falling outside the scope of section 17 . . . On this basis no question of avoidance ab initio would arise.

3-32 A few years later, in another case before the Court of Appeal,⁷⁹ the insurer chose to rely on the common law rule relating to fraudulent claims and, interestingly, did not make any attempt to rest his case on s 17, even though avoidance, in that case, would have afforded him a defence to claims made prior to the fraudulent one. Although the debate is far from being settled, it can safely be suggested that the recent judicial trend is to exclude the application of s 17 from the claims process.⁸⁰ It is submitted that such a stand would not only achieve fairer results from the assured's perspective, but can also be defended on policy grounds as discussed above.

3-33 Even assuming that the claims stage does not attract notions of good faith, it is, nevertheless, a crucial stage in the insurance relationship and has constantly been a battleground between the parties given the number of fraudulent claims submitted to the insurers. Therefore, it is appropriate in the remaining part of this chapter to focus on the definition of fraudulent claims in the insurance context, the remedies that are available to the insurers and the relationship with fraudulent claims and other related defences that might be available to the insurers.

III FRAUDULENT CLAIMS

(1) Definition of Fraudulent Claim

3-34 The assured is in a position to advance a claim from the moment a cause of action is accrued on the policy.⁸¹ In indemnity policies, a cause of action is accrued when the subject matter of insurance suffers a physical or financial loss. Conversely, in liability policies, for a claim to be accrued it is vital that the assured's liability is ascertained and quantified by litigation, arbitration or binding settlement. Before embarking on a comprehensive analysis of the elements of insurance fraud, it would be useful to ascertain precisely when a claim is deemed to be put forward by the assured, because it is only after this point that relevant legal principles assume significance. In insurance practice, it is not uncommon for the assured or his intermediaries to make preliminary enquiries following a loss, or to inform the insurer provisionally that a loss has taken place. It is highly unlikely that such communication would amount to a claim. For a communication to amount to a claim it should

⁷⁹ *AXA General Insurance Ltd v Gottlieb* [2005] EWCA Civ 112; [2005] Lloyd's IR 369.

⁸⁰ Even though it was, strictly speaking, *obiter*, Mance LJ in *AXA General Insurance Ltd v Gottlieb* [2005] EWCA 112; [2005] Lloyd's Rep IR 369, at [22] put it very strongly that avoidance would not be an appropriate remedy in this context: 'To my mind, there is no basis or reason for giving the common law rule relating to fraudulent claims a retrospective effect on prior, separate claims which have already been settled under the same policy before any fraud occurs.'

⁸¹ *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 1 Lloyd's Rep 216.

probably represent the assured's concluded position and be an unequivocal assertion of entitlement to an indemnity under the policy.⁸²

3-35 A fraudulent claim in the context of insurance law has been described by Lord Trayner in *Reid & Co Ltd v Employers' Accident and Livestock Insurance Co Ltd*⁸³ as a 'fraudulent misrepresentation or misdescription of the circumstances under which the claim had arisen, or of the nature and extent of the damage done, for which the claim for indemnity was made'. Therefore, for an insurer to be able to rely on the fraudulent claim defence it is necessary to show that the assured's intention in putting forward the claim was to defraud the insurer by providing false evidence when in fact there was no loss, or claiming for a loss that is not within the policy, or describing the circumstances that led to the loss wrongly, or simply by exaggerating the extent of loss with an intention to get extra benefit from the insurer.

3-36 Various types of fraudulent claims are examined in the light of legal authorities later in this chapter; but at this juncture, it is vital to reiterate the point that for an insurer to be successful in alleging fraud, evidence should be furnished to establish subjective dishonest belief in the merits of the claim advanced by the assured.⁸⁴ This would mean that the claim would not be rendered fraudulent if the assured had an honest belief in its validity even though the claim is otherwise wrong⁸⁵ or the assured had access to information which, properly understood, would have revealed that the assured's belief about the honesty of the claim was baseless.⁸⁶ If

⁸² Thomas, DR, 'Fraudulent Insurance Claims: Definition, Consequences and Limitations' [2006] LMCLQ 485, at 488.

⁸³ (1899) 1 F 1031, at 1036-7.

⁸⁴ It has been conceded by the insurers in *Aviva Insurance Ltd v Roger George Brown* [2011] EWHC 362 (QB); [2012] Lloyd's Rep IR 211 that a combined test for dishonesty as described by Lord Hutton in *Twinsectra Ltd v Yardley* [2002] 2 AC 164, at 172, which combines an objective and subjective test requiring that before there can be a finding of dishonesty, the defendant's conduct should be regarded as dishonest by the ordinary standards of reasonable and honest people and that the defendant himself should realise by those standards that his conduct was dishonest. This might at first sight seem like a significant departure from the traditional standpoint (fraud test established in *Derry v Peek*), but on close scrutiny it is unlikely to lead to a significant alteration in the law. A person who knowingly or recklessly makes an untrue statement is likely to appreciate that, by the ordinary standards of reasonable and honest people, his conduct was dishonest. One should also not lose sight of the fact that the need for dishonesty (in the *Twinsectra* sense) was brought up in *Aviva Insurance v Roger George Brown* in the process of deliberating whether deliberate concealment could amount to a fraudulent claim. It has been stressed in *Versloot Dredging BV v HDI Gerling and others (The DC Merwestone)* [2013] EWHC 1666 (Comm), at [154], that in the circumstances where the fraudulent device consists of a representation, the appropriate test would be the test of fraud provided for in *Derry v Peek* and the combined test established in *Twinsectra* would not add much to the debate.

⁸⁵ In *Diggins v Sun Alliance and London Insurance plc (No 2)* [1994] CLC 1146 the assured, after receiving professional advice, advanced a claim for the repair of a damp problem affecting the squash court housed in the basement of his property. Apparently, such a claim was not within the scope of the policy and the insurers alleged that the assured had taken advantage of a subsidence claim to make a fraudulent claim. The Court of Appeal held that the claim for the repair work of the squash court was not fraudulent in the light of the professional advice the assured had received. The way the assured understood it, he had an honest belief in the truth of the claim and it was, on that basis, not open to the insurer to prove that a reasonable claimant would not have reached such a conclusion. See also, *Harris v Evans* (1924) 19 LIL Rep 303. In a similar vein, in the pre-contractual context it was held in *Economides v Commercial Union Assurance plc* [1998] QB 587, that the assured could not be held as making a dishonest misrepresentation if he had an honest belief in the opinion he held regardless of whether there were objective reasonable grounds for the opinion or not.

⁸⁶ Roskill LJ in *Piermay Shipping Co SA v Chester (The Michael)* [1979] 2 Lloyd's Rep 1, at 22, said: '[assureds] are not to be found guilty of fraud merely because, with the wisdom of hindsight, they had

a lie was told in relation to a claim at the presentation stage, the fact that it had been unravelled before the claim was rejected does not mean that the claim is no longer fraudulent.⁸⁷ Here, the lie has been told to deceive the insurer into making a payment in relation to the claim advanced, so the assured expects the insurer to act on the presentation at that point in time.⁸⁸

3-37 An issue that has remained unsolved and unconsidered until recently is the possibility of a fraudulent claimant retracting his claim before it is settled by the insurer. The question of retraction has been raised by an institutional author as a matter of legal policy and it has been advocated that retraction can be employed as an effective tool to encourage honesty.⁸⁹ The debate was carried into the judicial arena in *Direct Line Insurance Plc v Fox*,⁹⁰ where an attempt was made by the assured to rely on retraction as a possible defence. The assured suffered a fire at his house, and was paid about £32,000 in respect of damage to the contents and finding alternative accommodation pending rebuilding work. On 7 June 2007, the assured reached an agreement with the insurers under which he agreed to accept the sum of £46,524.50 in full settlement and discharge of all claims for the buildings: an initial payment of £42,412 was to be paid, followed by a final payment of £4,112.50 for VAT subject to the assured providing invoices demonstrating the outlay for the VAT. The assured subsequently submitted an invoice from a builder, which showed that VAT had been paid. It later transpired that the invoice had probably been forged and that the work had not been carried out by that builder. The insurers sought to recover all the sums paid to them under the policy in reliance on the fraudulent claims clause which stipulated: 'If any claim or part of a claim is made fraudulently or falsely, the policy shall become void and all the benefit under this policy shall be forfeited.' The Court held that the assured had not made a fraudulent claim under the insurance policy, as the claim made related to the settlement agreement made between the parties and not the insurance policy. There was no challenge to the validity of the settlement agreement. All that had happened was that the assured had failed to produce valid evidence that he had paid VAT, so the only consequence was that he could not recover the sum payable for VAT. The Court also considered the alternative defence put forward by the assured, which centred around the suggestion that the assured had retrieved the fraudulent element of the claim put forward by sending a letter to the insurer on 7 September 2007 where he withdrew his claim for the final payment of £4,122.50, indicating that the invoice had been sent by mistake. The invoice was sent to the insurers on 14 August 2007 and its authenticity was questioned in a letter dated 4 September 2007 sent to the assured. HHJ Richard

information which might, if appreciated at its true value, have led them to the truth at an earlier stage. A plaintiff in litigation is not maintaining a fraudulent claim merely because during the interlocutory proceedings he or his solicitors became aware of evidence which may militate against the correctness of the plaintiff's case and its likelihood of ultimate success.' A similar stance has been taken in the context of the tort of deceit: *Derry v Peek* (1889) 14 App Cas 337.

⁸⁷ This point was made forcefully by the Privy Council in *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30; [2006] Lloyd's Rep IR 852, at [34]–[36].

⁸⁸ The position is similar in the context of tort of deceit: *Briess v Woolley* [1954] AC 333, at 353–4, per Lord Tucker.

⁸⁹ Thomas, DR, 'Fraudulent Insurance Claims: Definition, Consequences and Limitations' [2006] LMCLQ 485, at 497.

⁹⁰ [2009] EWHC 386; [2010] Lloyd's Rep IR 324.

Seymour QC was inclined to reject the assured's defence that fraud can be retracted.⁹¹ He found no support in the legal authorities for such a stand. On the contrary, judicial opinion seems to be pointing in the direction of retraction being immaterial. Most noticeably, Mance LJ in *The Aegeon*⁹² said:

Does the fact that the lie happens to be detected or unravelled before a settlement or during a trial make it immaterial at the time when it was told? In my opinion, not. Materiality should take into account the different appreciation of the prospects, which a lie is usually intended to induce on insurer's side, and the different understanding of the facts which it is intended to induce on the part of a judge at trial.⁹³

3-38 It is submitted that the stand taken on the question of retraction in *Direct Line v Fox* can be justified on policy grounds. If retraction is readily made available to the assured, this might provide an incentive to some to put forward fraudulent claims safe in the knowledge that, depending of the progress of their claim, the option of retracting the fraudulent part of the claim is always there. Even if the law is minded to allow genuine retractions rather than a retraction for strategic reasons, drawing the line might not be as straightforward as it might initially appear. Viewed from this angle, one possible impact of allowing retraction is to encourage dishonesty rather than encouraging honesty. Also, one should not lose sight of the fact that an insurer who is the recipient of a fraudulent claim might invest heavily in investigating the claim put forward, wasting valuable resources in the process prior to retraction. If an assured holds a trump card which will allow him to walk free at a later stage despite the fact that he had no hesitation of putting forward a fraudulent claim in the first instance, this might have an impact on the transaction costs that the sector will have to bear. These costs will ultimately need to be passed on to honest assureds in the shape of increase in premium rates.

3-39 In line with the stand taken in the tort of deceit,⁹⁴ the definition of fraud appears to have been extended to cover recklessness of the assured at this stage. In *Lek v Matthews*,⁹⁵ Viscount Sumner, in describing the limits of the fraudulent claims clause, stipulated that 'a claim is false not only if it is deliberately invented but also if it is made recklessly, not caring whether it is true or false but only seeking to succeed in the claim'.⁹⁶ In *Bucks Printing Press v Prudential Assurance*,⁹⁷ the assured put a claim forward for the cargo, reconditioned printing machinery packed in a container, which was damaged beyond repair in transit. When a director from the assured's company was asked by the insurer's solicitors questions regarding the

⁹¹ He indicated that even if he was wrong on that ground, any retraction in the present case was after the fraud had been discovered; on that basis, the assured was not able to demonstrate retraction unprompted and sufficiently early in time to be able to benefit.

⁹² [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [37].

⁹³ See also, *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30; [2006] Lloyd's Rep IR 852, at [35], per Lord Mance.

⁹⁴ See *Derry v Peek* (1889) 14 App Cas 337, at 374.

⁹⁵ (1927) 29 LIL Rep 141, at 145.

⁹⁶ Similar sentiments were echoed by Rix J in *Royal Boskalis Westminster NV v Mountain* [1997] LRLR 523, at 592-3. More recently, Mance LJ in *Agapitos v Agnew (The Aegeon)* [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [30], defined a fraudulent claim to be one 'where the insured claims, knowing that he has suffered no loss, or only a lesser loss than that which he claims (or is reckless as to whether this is the case)'.

⁹⁷ (1994) 3 Re LR 219.

packaging of the cargo, he indicated that he had been the foreman in charge of packing and gave what purported to be a first-hand account of how the goods had been packed in the container. It transpired that he had not been the foreman and the process he described was materially and demonstrably inaccurate. Saville J was convinced that the misrepresentations made at the claims stage as to the sufficiency of the packaging were made recklessly, showing a total disregard for the truth. The director in question was described as ‘one of those people who give no real thought to what they are saying and who consequently . . . failed to distinguish between first-hand recollection of what really happened and what he believed must have happened’.⁹⁸ Although no detailed discussion on this point was carried out in *Bucks Printing Press v Prudential Assurance*, in the light of legal authorities on the subject it is highly likely that recklessness in this context requires the assured to have an actual awareness or appreciation that the claim is probably false, but nonetheless he is prepared to run the risk of this being the case.⁹⁹

(2) Types of Fraudulent Claim

3-40 The American politician, Benjamin Franklin, once famously said that ‘in this world nothing is certain but death and taxes’. It would be safe to add to that list ‘fraudulent claims in insurance law’. The law reports are packed with cases where the matter of what constitutes a fraudulent claim has been deliberated by phantoms of legal practice and judiciary. It emerges from these authorities that fraudulent claims, as recognised by law, can take different forms. An attempt is made below to identify the types of fraudulent claims. At the outset, it should be noted that the elements for certain types of fraudulent claim might be varied; hence an extensive analysis of certain types is carried out in this part.

3-41 One type of fraudulent claim occurs when the assured brings about the loss upon which the claim is based. To take the most obvious example: the assured deliberately sinks or sets fire to his vessel, most often when the shipping sector faces an economic downturn.¹⁰⁰ Needless to say, such a loss is also irrecoverable by virtue of a

⁹⁸ *Ibid*, at 223. Saville J continued:

Anxious to persuade Underwriters and their representatives that the container had been packed properly, he made the statements in question, careless of whether they were true or false, without bothering to consider whether or not they were accurate. It may well be the case that [the director] had convinced himself that the container must have been properly packed and that what he said resulted from this conviction, but this only goes towards rebutting an allegation of deliberate deceit. It does not excuse or rebut the fact that [the director] simply gave no thought to the truth or falsity of what he was saying.

⁹⁹ *Nugent v Michael Goss Aviation Ltd* [2000] 2 Lloyd’s Rep 222, at 227, per Auld LJ. Recently, in *Versloot Dredging BV v HDI Gerling and others (The DC Merwestone)* [2013] EWHC 1666 (Comm) Popplewell J treated the ship manager’s assertion that he had a word with the master to investigate why the sounding of the bilge alarm was not heard by the crew as being an untrue statement told in support of the claim. The trial judge was of the view that the manager did this to support a theory about the events surrounding the casualty which he genuinely believed to be a plausible explanation, but he was reckless in believing his version of the events and without grounds for belief as to its accuracy. Popplewell J, who clearly had sympathy for the manager, said, at [225]: ‘In a scale of culpability which may attach to fraudulent conduct relating to the making of claims, this was at the low end. It was a reckless untruth, not a carefully planned deceit.’

¹⁰⁰ See e.g., *Astrovlanis Compania Naviera SA v Linard (The Gold Sky)* [1972] 2 Lloyd’s Rep 187

policy exclusion relating to wilful misconduct encapsulated by s 55(2)(a) of the MIA 1906¹⁰¹ giving an insurer an option as to the choice of the defence he can rely on.¹⁰²

3-42 The relationship between wilful misconduct and a fraudulent claim defence requires closer examination. It is worth noting that the scope of fraudulent claims jurisdiction, as is considered below, is much wider than a wilful misconduct defence. Consequently, it might be easier to demonstrate that the assured has made a fraudulent statement when advancing his claim than to show that he wilfully destroyed his property. It is, therefore, possible that where the circumstances surrounding the loss of the insured property are suspicious, the insurer might defeat the claim by proving that the claim contained fraudulent misstatements, even though it might not be possible to convince the court that the loss was occasioned from a wilful misconduct of the assured.

3-43 Second, the assured might claim for a loss which, in effect, has not taken place. Such a state of affairs could arise in a case where the assured cargo owner, after selling the insured cargo, claims that his cargo was stolen from a warehouse. Again, this type of fraudulent claim is an obvious one and there are several authorities on the matter.¹⁰³

3-44 Third, the claim will still be treated as fraudulent if the assured who suffers a genuine loss advances a lie so fundamental as to transform the essential basis of his claim. Imagine the position of an assured who insures his yacht under a time policy against main marine perils including 'perils of the sea' and 'piracy'. The vessel is lost in moderate weather conditions due to the entry of seawater into her engine room. Conscious of the fact that the burden of proof facing the assured to be able to claim loss by a peril of the seas is a heavy one,¹⁰⁴ the assured convinces his employees to give statement to the effect that several armed men boarded the yacht and took control before disappearing with her. On that basis, the assured advances a claim based on loss by piracy. The fact that the assured has suffered a genuine loss, which might even be covered by the terms of the policy, does not mean that he has a valid claim simply because he has no honest belief in the truth of the statements made in the claim. Such an eventuality exercised the mind of Evans J in *Continental Illinois National Bank & Trust Co of Chicago and Xenofon Maritime SA v Alliance Assurance Co Ltd (The Captain Panagos DP)*¹⁰⁵ who has defined a fraudulent

and *National Justice Compania Naviera SA v Prudential Assurance Co Ltd (The Ikarian Reefer)* [1995] 1 Lloyd's Rep 455.

¹⁰¹ The essential elements of wilful misconduct are that 'the assured intended to achieve a loss or the damage or that he was recklessly indifferent whether such loss or damage was caused and that his immediate purpose was to claim on his insurers or that he subsequently advanced such a claim': per Colman J in *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582, at 622.

¹⁰² It has been noted that, in some cases, insurers chose to base their objection to a claim on a wilful misconduct defence rather than arguing that the assured has put forward a fraudulent claim having deliberately cast away his property: see e.g., *Brownsville Holdings Ltd v Adamjee Insurance Co Ltd (The Milasan)* [2000] 2 Lloyd's Rep 485. This is not to say that the burden of proof on the part of the assured is an easy one to satisfy in wilful misconduct cases. It might be that the insurers in those cases were trying to obtain a physiological advantage by not pleading fraud as part of their case.

¹⁰³ See e.g., *Britton v Royal Insurance Co* (1866) 4 F & F 905; *Cuppitman v Marshall* (1924) 18 LIL Rep 277 and *Herman v Phoenix Co Ltd* (1924) 18 LIL Rep 371. See also, *AXA Insurance UK Plc v Jensen*, unreported, Birmingham County Court (18 November 2008).

¹⁰⁴ See Soyer, B, 'Defences of A Marine Insurer' [2002] LMCLQ 199.

¹⁰⁵ [1986] 2 Lloyd's Rep 470, at 511.

claim as: 'one which is made on the basis that facts exist which constitute a loss by an insured peril, when to the knowledge of the assured those alleged facts are untrue'. A similar analysis must hold true in a case where the assured who suffers a genuine loss presents his claim in a way to suppress a defence which he knows to be open to insurers. The possibility was contemplated by the Court of Appeal in *The Aegeon*.¹⁰⁶ In that case, in an attempt to convince the underwriters that there was no breach of a 'hot works' warranty, the assured made inaccurate statements in relation to the date of commencement of such work. However, such statements were made after the commencement of litigation and, for that reason, had to be disregarded. Nevertheless, the Court was convinced that the intention of the assured in making such statements was to suppress a potential defence that would have been otherwise available to the underwriters and that would have rendered the claim fraudulent had they been made prior to the start of the litigation.¹⁰⁷

3-45 The common feature of the instances discussed above is that the dishonesty of the assured is so grave in that he either knowingly or recklessly puts forward a claim that is not covered by the policy or he knowingly or recklessly attempts to disregard the defences or objections that may be raised by the underwriters by furnishing palpable lies. In those circumstances, no question of materiality arises given that the assured is in a position to appreciate the dramatic consequences of his actions on the underwriter. Borrowing the words of Rix J in such cases there is no need for any further requirement of materiality because the notion of materiality is 'built into the concept of a fraudulent claim'.¹⁰⁸ However, the same cannot be said for the other two types of fraud which are considered next: namely fraud by exaggerating a loss, and using fraudulent devices to promote a valid claim. In the former case, it might be rather difficult to draw the dividing line between exaggerating the extent of the loss with an intention to defraud the insurer, as opposed to advancing a slightly exaggerated claim for bargaining purposes. The difficulty has been recognised by judges who have attempted to introduce various safety nets for the assured. When it comes to fraudulent devices, the courts have developed a materiality test with an intention of giving a lifeline to the assured who makes fraudulent statements or conceals information on matters that are not relevant to the claim when presenting a valid claim.

3-46 A fourth type of fraudulent claim arises where the assured suffers a genuine loss, which comes under the terms of the policy, but he knowingly (or with reckless indifference to the truth) exaggerates the claim either by inflating the quantum or by claiming for items which have not been lost or damaged. Exaggerating a claim is believed to be the main type of fraud in certain types of personal insurance, such as vehicle and household insurance where a large number of small-value claims are generated, making it very difficult for the insurers to detect which are genuine

¹⁰⁶ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42.

¹⁰⁷ Mance LJ in *The Aegeon* observed, *ibid*, at [18], 'a claim cannot be regarded as valid if there is a known defence to it which the insured deliberately suppresses'.

¹⁰⁸ *Royal Boskalis Westminster NV v Mountain* [1997] LRLR 523, at 599. Mance LJ seems to be in agreement on this point in *The Aegeon* [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [36]. The same must be the case as far as the inducement requirement is concerned. Requiring inducement in this context would lead to absurdity because it would mean that the only fraud that would be recognised is that which had been successfully carried out by the assured.

and which are not. However, this type of fraud is not a common phenomenon in marine insurance practice.¹⁰⁹ Generally speaking, claims associated with a marine policy are large enough to justify insurance companies seeking the expertise of loss adjusters and fraud investigators at the investigation stage. The availability of such experts would usually have a deterrent effect because their presence would make such a deceit more risky and difficult to perpetrate. Also, contemporary shipping practices leave little room for assureds minded of proceeding on such a slippery path. For example, in the context of hull insurance it would be rather difficult for a ship-owner making a claim for theft to allege that her ship had items of equipment which she never had, because the ship's documents would amount to a sort of inventory of all the pieces of equipment on board. Similarly, it would be very difficult for a shipowner to allege that repairs had been done which were not done because ship repairs are often carried out in respectable shipyards and such repairs are supervised by surveyors from the ship's classification society, meaning that the owner would require the collusion of shipyard and the surveyors to be able to put forward a fraudulently exaggerated claim.

3-47 Turning to legal analysis, it is fair to say that a degree of latitude seems to have been built in by the courts when assessing whether or not any exaggeration in the claim amounts to fraud. This is so because judges appreciate that most assureds have a tendency to inflate their insurance claims for bargaining purposes in anticipation that the claims put forward will be cut down by claim adjusters.¹¹⁰ It is also the case that in some instances it might be rather difficult to quantify the loss, particularly when assessing certain types of financial loss and, accordingly, an assured who fails to specify the amount of his claim with precision should not be penalised.

3-48 The proposition that only substantial exaggeration in the amount of the claim is sufficient to invoke the fraudulent claim rule has received firm judicial backing over the years.¹¹¹ Put another way, judges would be willing to tolerate to an insubstantial exaggeration in the amount of the claim even if dishonestly made.¹¹² What 'substantial' means in this context is a question of degree, but an interesting question arises: should one consider the amount of exaggeration itself, or should the amount of exaggeration be compared to the percentage of the whole claim in determining whether or not a claim has been substantially exaggerated? Favouring the former, Millet LJ in *Galloway v Guardian Royal Exchange (UK) Ltd*¹¹³ indicated that the latter solution 'would lead to the absurd conclusion that the greater the genuine loss, the larger the fraudulent claim which may be made at the same time without penalty'. The approach advocated by Millett LJ was subsequently endorsed by the Court of Appeal in *The Aegeon*, where Mance LJ observed: 'it is sufficient that

¹⁰⁹ In an attempt to reduce the number of small claims, most marine and commercial insurance policies would invariably contain a deductible clause. See e.g., cl 15 of the International Hull Clauses 2003 (01/11/03).

¹¹⁰ See *Nsubuga v Commercial Union Assurance Co Plc* [1998] 2 Lloyd's Rep 682, at 686, per Thomas J.

¹¹¹ This can be viewed as an application of the *de minimis* rule: *Lek v Mathews* (1927) 29 LIL Rep 141, at 145, per Viscount Sumner.

¹¹² *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC); [2007] Lloyd's Rep IR 283, at [189], per HHJ Peter Coulson QC.

¹¹³ [1999] Lloyd's Rep IR 209, at 214.

for the rule to apply that the fraud occurs in making a claim and relates to a part of the claim which, when viewed discretely, is not itself immaterial or unsubstantial.¹¹⁴

3-49 However, even if we proceed on the premise that the fraudulent excess will be considered in isolation when determining it is substantial or not, it is remarkable that different judgments have emerged from similar sets of facts over the years. For example, in *Galloway v Guardian Royal Exchange (UK) Ltd*,¹¹⁵ a claim for £18,000 which included a fraudulent claim for an item worth £2,000 (or 11 per cent of the whole) was viewed by all members of the Court of Appeal as a fraudulent claim. Conversely, in *Tonkin v UK Insurance Ltd*¹¹⁶ where the fraudulent component of the claim was worth £2,000, representing some 0.3 per cent of the entire claim, the trial judge did not consider that to be 'substantial'. It is therefore open to speculation that although the judges seem to consider the amount of exaggeration in isolation when assessing its magnitude, perhaps its proportion to the entirety of the whole claim should be given some weight, especially in borderline cases. Support for this can be drawn from *AXA General Insurance Ltd v Gottlieb*, where the assured submitted a genuine claim following flooding in the bathroom, but subsequently added an additional invoice for £1,200 submitted by an electrician. Whilst the total claim was for £14,250, a fraudulent element of £1,200 was adequate for the Court of Appeal to treat this as a fraudulent claim. The exaggerated amount was smaller than the amount in *Tonkin v UK Insurance Ltd*, but obviously it amounted to 8.4 per cent of the entire claim as opposed to 0.3 per cent!

3-50 A more challenging question, which has constantly exercised the minds of the judiciary, is the impact of any substantial exaggeration on the validity of a potential claim. In the absence of other indicators, it is debateable whether a fraudulent intent can be inferred merely from the fact that the assured has presented a substantially exaggerated claim. In *Central Bank of India Ltd v Guardian Assurance Co Ltd*,¹¹⁷ the Privy Council seemed to have no problem in drawing the inference of fraudulent intent on the part of the assured from the excessive level of exaggeration of the claim submitted. Naturally, it would be rather difficult for the assured to argue that a grossly exaggerated claim has been put forward for reasons, such as negotiation purposes, other than defrauding the insurer. The problem increases when the claim is exaggerated to a substantial extent, but not to the extent that it could be viewed as a grossly exaggerated claim. Contemporary judges seem to be more alert to the commercial reality that people have a tendency to put an exaggerated figure for bargaining purposes and it should not be immediately assumed that the assured's intention was to defraud the insurer. The problem is, of course, where the line can be drawn: is a substantial exaggeration in the claim made with the intention of defrauding the insurer or is it the result of a strategic decision of the assured taken for bargaining purposes?

3-51 Hoffmann LJ offered some useful guidelines as to how difficult questions of motive in this context can be addressed in *Orakpo v Barclays Insurance Services*.¹¹⁸

¹¹⁴ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [33].

¹¹⁵ [1999] Lloyd's Rep IR 209.

¹¹⁶ [2006] EWHC 1120 (TCC); [2007] Lloyd's Rep IR 283.

¹¹⁷ (1936) 54 LIL Rep 247.

¹¹⁸ [1995] LRLR 443.

In his view, a substantial exaggeration can be treated as being put forward as an initial bargaining position, ‘provided nothing is misrepresented or concealed, and the loss adjuster is in as good a position to form a view of the validity of the claim as the insured’.¹¹⁹ Clearly, his Lordship had in his mind instances where the value of the item lost is difficult to assess or is a matter of opinion, or where it is physically impossible to determine the number and value of the goods lost (e.g. when items are lost in a fire). This was, indeed, the case in *Dawson v Monarch Insurance Co of New Zealand*,¹²⁰ where the assured, a fairground proprietor, claimed under his insurance policy for the loss of an inflatable rabbit and the attachments thereto. The claim advanced was for NZD\$6,000. The insurer denied liability under a fraudulent claims clause on the ground that the claim was fraudulently exaggerated. Having noted that the subject matter of the insurance was a unique item and there was no ready market for inflatable rabbits, the trial judge, Somers J reached the conclusion that the claim was put honestly and no inference of fraud could be drawn, although he judged the value of the rabbit to be NZD\$3,500.¹²¹

3-52 It is beyond doubt that the approach advocated by Hoffmann LJ comes in handy when dealing with complex cases. However, it should not be assumed that it is capable of affording an assured, who is shown to have submitted a substantially exaggerated claim, a safe port of refuge. A development of that nature would be contrary to the policy concerns behind the fraudulent claim rule, as it would give a blank cheque to dishonest claimants to become very expansive as to the extent of the loss sustained. It is therefore inevitable that there will be a number of limitations, as is discussed below.

3-53 First, although contrary views have been occasionally expressed,¹²² it is obvious that under the test laid down by Hoffmann LJ the possibility of treating a substantial exaggeration in the claim as merely an initial bargaining position is not open in cases where it can be demonstrated that the claimant knows perfectly well that he is asking far too much. Making allowances for an assured who puts forward a claim that he knows he is not entitled to would be contrary to the general principles

¹¹⁹ *Ibid*, at 451.

¹²⁰ [1977] 1 NZLR 372.

¹²¹ Similar reasoning seems to have been adopted in *Ewer v National Employers’ Mutual General Assurance Association Ltd* [1937] 2 All ER 193, where the assured valued goods lost in an accidental fire on the basis of the price of new goods although they were second hand. McKinnon J was prepared to give the assured the benefit of the doubt. He said, at 203: ‘The plaintiff knew the claim would be discussed, and probably drastically criticised, by assessors; he had been asked for invoices, and he started the bargaining with them by putting down the cost of price to his articles as if they were new. Though I admit the resulting figure is preposterously extravagant, I do not think there was any fraud in putting forward.’ With respect, it is submitted that this goes too far. It is difficult to see on what basis the claim might not be regarded as fraudulent if the assured, knowing that the insured goods are second hand (and accordingly of a lesser value) proceeds to claim their full value from the insurer. Surely, it would be difficult for any assured in that position to argue that the exaggeration was carried out for bargaining purposes, especially if there is a huge difference between the value of new and second-hand goods.

¹²² In *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 451, Staughton LJ said: ‘... I am not convinced that a claim which is knowingly exaggerated in some degree should, as a matter of law, disqualify the insured from any recovery. If the contract says so, well and good ... But I would not lend the authority of this Court to the doctrine that such a term is imposed by law.’ Also, in *Nsubuga v Commercial Union Assurance Co Plc* [1998] 2 Lloyd’s Rep 682, at 686, Thomas J seems to be suggesting that ‘it would not be right to conclude that someone had behaved fraudulently merely because he put forward an amount greater than that which he reasonably believed he would recover’.

of English contract and tort law. This was, in fact, the stand taken in *Transthene Packing Co Ltd v Royal Insurance (UK) Ltd*,¹²³ where the assured made a claim for the full replacement cost of a machine lost in a fire. Once it was established that the machine was in a defective state before the fire, as to be likely to be a subject of litigation against the manufacturer or supplier, the trial judge had no hesitation in holding that the claim was fraudulent.

3-54 It is also obvious that the courts would not be accommodating to an assured who puts forward a substantially exaggerated claim and then contends that this figure marked his bargaining position, when he has all the facts and information at his disposal that would have enabled him to determine the extent of the claim accurately. This seemed to be the case in *Danepoint Ltd v Allied Underwriting Insurance Ltd*.¹²⁴ The property insured by the assured, which was divided into 13 flats for rental purposes, suffered a loss as a result of fire. The assured claimed loss of rent on the premise that all the flats had been vacated following the fire. The insurer's adjuster had attended on various occasions to find the flats occupied but the assured insisted that no rent was being received from those tenants. It was conceivable, therefore, that the assured had managed to collect some of the rental fees due, making his claim that he lost all of his rental income following the fire an exaggerated one. HHJ Coulson QC concluded that the evidence in favour of fraud was overwhelming as the exaggerated claim for loss of rent was excessive. He also noted that it is more difficult to excuse exaggeration in a case where the information which the claim is based upon is wholly within the control of the assured, as scrutinising and verifying that kind of information would be a very difficult task for the insurer.¹²⁵

3-55 Another area, which has proven to be controversial over the years, is the legal status of claims that are genuine in nature but are supported by a lie or fraudulent evidence (fraudulent device). In a controversial decision, Supreme Court of Australia in *GRE Insurance Ltd v Ormsby*¹²⁶ offered a legal analysis on the subject. In that case, the policy provided cover for the loss of stock on shop premises caused by a number of perils including theft consequent upon entry into the building by forcible and violent means. The lock of the assured's shop was forced, the shop was broken into and a number of items were stolen. The assured's claim was rejected by the insurer on the premise that he had attempted to bolster his claim by causing further damage to the door and lock at a later stage. The assured then sent photographs of the door in this heightened state of disrepair in support of the claim. On the assumption that the assured was responsible for tampering with the door and lock after the break in, the Supreme Court was, nevertheless, prepared to allow him

¹²³ [1996] LRLR 32.

¹²⁴ [2005] EWHC 2318 (TCC); [2006] Lloyd's Rep IR 429.

¹²⁵ It is interesting to note that the repair claim in the same case, which seemed to be higher than the value of the actual work carried out, was not regarded as fraudulent, essentially on the premise that the insurer's adjuster had always intended to visit the site to verify the work carried out, so they would not have made any difference in the final event. The trial judge was also influenced by the fact that the invoices rendered were for interim payments and were not final accounts. This finding did not have an impact on the outcome in the case, as part of the claim which related to the repair costs also failed once the claim for loss of rent was deemed to be fraudulent.

¹²⁶ (1982) 29 SASR 498.

recovery although it was observed that the assured may have been ‘morally wrong’ in bolstering the story to support the claim.¹²⁷ The Court was of the view that a distinction could be drawn between a valid claim supported by false evidence and a fraudulent claim. A fraudulent claim, it was asserted, involved situations where the assured had suffered no loss under the policy, or a claim where the assured attempts by deception to get money which he assured knows he is not entitled to. On the contrary, when the assured uses fraudulent devices to support a valid claim, he has no intention to defraud the insurer to receive money which he knows he is not entitled to.

3-56 Without doubt, the reasoning of the court is contentious and seems to reduce the debate to an elementary point: whether or not the assured, by putting the claim forward, has attempted to obtain a financial advantage. The court did not grapple with the issue as to whether an assured could still obtain an advantage by pursuing a genuine claim with fraudulent evidence. One can think of instances where the insurer might decide not to investigate the claim as rigorously as he would normally do in the light of very strong, but fraudulent, evidence put forward in support of the claim. The assured might benefit from a casual investigation, particularly if a more demanding one would have revealed other irregularities on the assured’s dealings with the insurer. Also, the logic of the court’s reasoning would lead ineluctably to the conclusion that it is possible to view the claim submitted in isolation from its surroundings. This is simply not correct. The insurers’ assessment of claims submitted to them is not a straightforward exercise and several factors, such as the possibility of further investigations, the cost of such investigations and even the conduct of the assured during the currency of the policy, are all taken into account. The assured’s conduct during the presentation of the claim can readily be added to the list. It is, therefore, not a correct assumption that the assured has no intention to defraud the insurer by furnishing false evidence in support of a valid claim. On the contrary, his intention by using fraudulent devices is to defraud the insurer to believe that the claim is a good one and there is no need to worry about the claim or the personal integrity of the assured.¹²⁸

3-57 It can be safely said that judges in this jurisdiction have not been as accommodating as the Australian Supreme Court, particularly in commercial cases.¹²⁹ It has been recognised on several occasions that the use of fraudulent devices in the presentation of a claim could taint a valid claim, although the issue has not arisen for

¹²⁷ Ibid, at 504, per Walters J.

¹²⁸ It should not be assumed that the decision of the Australian Supreme Court in *Ormsby* has been embraced in judicial circles. The decision has been widely criticised in *Vermeulen v SIMU Mutual Insurance Association* (1987) 4 ANZ Ins Cas 60-812 and *Bucks v National Insurance Co of New Zealand Ltd* [1996] 3 NZLR 363. The New Zealand Court of Appeal in *New Zealand Insurance Co Ltd v Forbes* (1988) 5 ANZ Ins Cas 60-871, at 75, 455, categorised *Ormsby* as an ‘exceptional case decided on its own facts’.

¹²⁹ It has to be stressed that in consumer cases, the Financial Ombudsman Service has taken a stand similar to the decision in *Ormsby*. In Case 42/3 (Financial Ombudsman Services, *Ombudsman News*, Issue 42, December 2005/January 2005), the policyholder, who had suffered a genuine loss, had a friend fake a receipt for him when the insurer required all original receipts to substantiate the claim. The Ombudsman stressed that the policy holder was not trying to obtain something to which he was not entitled. The decision was that ‘the fair and reasonable solution was for the insurer to reinstate the policy and pay the claim’.

decision.¹³⁰ It was not until the decision of Hirst J in *The Litson Pride*¹³¹ that the use of fraudulent devices to promote a valid claim was authoritatively equated with the fraudulent claims jurisdiction. There, the assured sent his vessel into an additional premium area without notifying the underwriters, in the anticipation that he could avoid paying an additional premium. After the vessel suffered a constructive total loss, the assured posted a fraudulently backdated letter of notification to the insurers as he, mistakenly, believed that the notification requirement was a condition precedent to the continuation of the cover. It turns out that this was not the case and the assured had a good claim as the vessel remained insured whilst in the additional premium area despite the failure to give prior notice. However, it is obvious that the claim was treated as fraudulent in the analysis of Hirst J. What clearly swayed his decision was the fact that a fraudulent device was employed by the assured in promoting his claim.¹³²

3-58 The legal position in relation to fraudulent devices attracted a more comprehensive analysis before the Court of Appeal in *The Aegeon*.¹³³ *The Aegeon*, which was insured by the defendant underwriters against hull and machinery port risks, caught fire on 19 February 1996 in the course of hot work being carried out on her in a Greek harbour. In their defence served on 21 April 1997, the underwriters alleged a number of breaches of warranty. One of the alleged breaches related to the acquirement of a certificate from the London Salvage Association prior to the commencement of hot work. The underwriters contended that hot work commenced on the insured vessel before such a certificate was acquired in breach of the warranty in question. It was common ground that no such certificate was issued prior to the casualty on 19 February 1996. In an attempt to demonstrate that no breach of warranty had taken place, the assured developed two main arguments. First, it was argued that an oxyacetylene tool had been used for a few hours on 24 January 1996 but this did not constitute ‘hot works’ within the meaning of the express warranty. Alternatively, the assured asserted that, even though the use of the oxyacetylene tool amounted to a breach of warranty, the underwriters waived their right to rely, or were estopped from relying, on such a breach. In disclosure, in early 2001, the assured disclosed sworn statements taken from two workmen immediately after the casualty, which attested that hot works of a substantial nature had been carried out from as early as 1 February 1996. In the light of this development, the underwriters sought to amend their defence to take account of allegations that, during the conduct of proceedings, the assured had been party to putting forward a knowingly false case about when the hot works began. It was their contention that the conduct

¹³⁰ In *Wisenthal v World Auxiliary Insurance Corp Ltd* (1930) 38 LIL Rep 54, at 62, Roche J said: ‘Fraud, [is] not mere lying. It [is] seeking to obtain an advantage, generally monetary, or to put someone else at a disadvantage by lies and deceit. It would be sufficient to come within the definition of fraud if the jury thought that in the investigation deceit had been used to secure easier or quicker payment of the money than would have been obtained if the truth had been told.’ See also, *Dome Mining Corp Ltd v Drysdale* (1931) 41 LIL Rep 109, at 122, per Branson J.

¹³¹ [1985] 1 Lloyd’s Rep 437.

¹³² Referring to the judgment of Hirst J, Lord Scott in *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469 made the following observation, at [106]: ‘Hirst J held that the falsely dated letter was a fraud directly connected to the claim. . . I do not think anyone would dissent from that conclusion.’

¹³³ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd’s Rep 42.

of the assured amounted to a fraudulent claim. The trial judge, Toulson J refused the underwriters leave to amend their defence so as to plead that they were entitled to refuse payment on the basis of fraud.¹³⁴ In his view, this was not, strictly speaking, a fraudulent claim situation, as telling lies to support a legitimate claim would not necessarily convert the claim into a fraudulent one. The underwriters appealed against the decision of Toulson J to the Court of Appeal. Their appeal was, however, rejected and the first instance judgment was upheld. On close scrutiny, it becomes apparent that the reasoning of the Court of Appeal on the matter is slightly different than the reasoning of Toulson J. The Court of Appeal regarded the underwriters' plea on the point of fraudulent claim as 'hopeless' not because the use of fraudulent devices could not convert a claim into a fraudulent one, but because the alleged fraudulent breach of the assured's duty not to make a fraudulent claim had occurred during the litigation stage. In drawing parallel with the duty of utmost good faith under s 17 of the MIA 1906,¹³⁵ and in the absence of any binding authority, the Court of Appeal held that the assured's duty to avoid submitting fraudulent claims ceased with the commencement of litigation.¹³⁶ However, on the impact of the use of fraudulent devices, Mance LJ offered the following analysis:

In the context of use of a fraudulent device or means, one can contemplate the possibility of an obviously irrelevant lie – one which, whatever the insured may have thought, could not sensibly have had any significant impact on any insurer or judge. Tentatively, I would suggest that the courts should only apply the fraudulent claim rule to the use of fraudulent devices or means which would, if believed, have tended, objectively but prior to any final determination at trial of the parties' rights, to yield a not insignificant improvement in the insured's prospects – whether they be prospects of obtaining a settlement, or a better settlement, or of winning at trial. Courts are used enough to considering prospects, e g when assessing damages for failure by a solicitor to issue a claim form within a limitation period.¹³⁷

¹³⁴ [2002] Lloyd's Rep IR 191.

¹³⁵ There is strong dicta in the judgment of the House of Lords in *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469 pointing towards the direction that good faith principles do not apply to conduct in the prosecution of litigation; see [77], per Lord Hobhouse and [110], per Lord Scott.

¹³⁶ An interesting question has arisen in *PT Buana Samudra Pratama v Maritime Mutual Insurance Association (NZ) Ltd* [2011] EWHC 2413; [2011] 1 Lloyd's Rep 655 as to whether the duty to avoid submitting fraudulent claims comes to an end after the leading underwriter agrees to settle the claim under a policy that contains a leading underwriter clause. In the case, the leading underwriter agreed to make a payment on 15 May 2006 but one of the following underwriters decided to reject liability, *inter alia*, on the basis that the assured made fraudulent misrepresentations when advancing the claim against them on 12 July 2006 and 20 April 2007. The assured sought a summary judgment against the relevant underwriter asserting that the latter was obliged to follow the settlement by the leader. The defendant underwriter submitted that the duty not to use a fraudulent device was an independent duty and did not come to an end once the leading underwriter decided to settle the claim. The summary judgment application was rejected due to the fact that the law on fraudulent devices was in the process of elucidation and development. Teare J at [49] considered that the defendant underwriter had a real prospect of succeeding on its defence and agreed with the underwriter that an agreement to put the claimant in the same position as if a writ had been issued does not give rise to the normal incidents of litigation which flow from the issue of the writ, so there is no need to bring the duty to an end. It is submitted that there is force in the trial judge's opinion. An agreement to follow the leading underwriter in respect of all decisions regarding claims within the terms of the policy does not take away the need for the assured to bring a claim against the following underwriter with regard to the part of the liability it has assumed. If so, when bringing such a claim against the relevant underwriter, one would expect the assured to avoid the use of any fraudulent device.

¹³⁷ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [38].

3-59 The observations of Mance LJ on this point are momentous to the extent that it is expressly recognised that the fraudulent claim rule might apply in some cases where a valid claim is perused by fraudulent devices. Despite being technically *obiter* in nature, the conclusion of Mance LJ to include fraudulent devices within the jurisdiction of fraudulent claims jurisdiction has found considerable support at the first instance¹³⁸ and more recently has been endorsed by the Supreme Court.¹³⁹ However, several issues arise out of the test laid down that might require further judicial airing at a future date. These are further analysed below.

3-60 The first point in need of clarification is the degree of causal link required between the fraudulent device used and the promotion of the claim against the insurer. Mance LJ has attempted to offer some guidance on this point by indicating that the fraudulent device, when objectively viewed, should be intended to provide a not insignificant improvement in the assured's prospects. In a further attempt to explain the degree of materiality required, he suggested that the materiality of the lie told or fraudulent device used should be judged at the time when it was told. A lie or fraudulent device will be material if it is intended to induce a different appreciation of the prospects in the mind of the insurer, or a different understanding of the facts which it is intended to induce on the part of a judge at trial.¹⁴⁰ This still does not provide clear guidance as to how great the improvement in the prospects of the assured on the mind of the insurer should be to convert a claim into a fraudulent one. It is highly probable that a fraudulent device used to remove any doubt in the mind of the insurer as to the legitimacy of the claim or the amount claimed will be deemed to have induced a different appreciation in the mind of the insurer as to the prospects of the assured. If, for example, the assured, when pursuing a valid claim, tells lies to the insurer in an attempt to disguise the fact that he attempted to sell the insured ship immediately before the loss, it can be argued that the assured's lie could potentially lead the insurer to believe that the possibility of scuttling is slim. If, therefore, the impact of the lie is that the insurer rules out a potential defence of wilful misconduct, it is plausible to consider the lie as improving the prospects of the assured to recover significantly.¹⁴¹ In a similar vein, the assured who puts forward a fraudulent invoice from the repairers to support a genuine claim will possibly be treated as advancing a fraudulent claim even though the invoice specifies the correct value of the repairs and was fabricated only because the original one was lost. However, it is less likely that a lie or

¹³⁸ *Eagle Star Insurance Co Ltd v Games Video (GVC) SA (The Game Boy)* [2004] EWHC 15 (Comm); [2004] Lloyd's Rep IR 867 and *Marc Rich Agriculture Trading SA v Fortis Corporate Insurance NV* [2004] EWHC 2632 (Comm); [2005] Lloyd's Rep IR 396. More recently, the claim was held to be fraudulent in *Joseph Fielding Properties (Blackpool) Ltd v Aviva Insurance Ltd* [2010] EWHC 2192 (QB); [2011] Lloyd's Rep IR 238, as the assured relied on an exaggerated and falsely annotated invoice in support of a property damage claim. Similarly, in *Sharon's Bakery (Europe) Ltd v AXA and Aviva Insurance* [2011] EWHC 210 (Comm), Blair J held that the claim was fraudulent as the assured relied on a false document of title in support of a genuine claim. A similar outcome followed in *Versloot Dredging BV v HDI Gerling and others (The DC Merwestone)* [2013] EWHC 1666 (Comm) where the judge held that the ship manager's reference to a meeting with the master of the ship, which never took place, was an untruth told in support of an otherwise genuine claim.

¹³⁹ *Fairclough Homes Ltd v Summers* [2012] UKSC 26, at [29].

¹⁴⁰ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [37].

¹⁴¹ See *Stemson v AMP General Insurance (NZ) Ltd* [2006] UKPC 30; [2006] Lloyd's Rep IR 852.

fraudulent device which forms part of the assured's presentation for the claim will be deemed adequate to establish a fraudulent claim, particularly if the fraud is not directed at the insurer. The issue has arisen for decision in *Interpart Comercio e Gestao SA v Lexington Insurance Co.*¹⁴² There, the cargo insurers sought summary judgment against the cargo interests, alleging that the assured, the owners of the cargo, submitted a certificate of inspection which contained false entries. Such false entries were inserted by the original seller to give the impression that the time limits laid down by the contract of sale had been met. The insurer's contention was that the claim submitted by the assured was fraudulent as the assured made use of this false document in substantiating its title to the goods. There is no doubt that the fraudulent device used here might have a marginal impact in the mind of the insurer as to the prospects of the assured's case, mainly because the false documentation was presented to the insurer although the fraud was not directed at him. However, it is rather debateable whether this degree of impact is adequate to convert the claim into a fraudulent one. Interestingly, HHJ Chambers QC refused to grant a summary judgment, stressing that the law on this point is currently regarded as insufficiently settled to permit the awarding of summary judgment. This is a clear manifestation that further clarification on the degree of nexus between the fraudulent device used and the claim is required. As forcefully argued by an institutional author, if the bar is set at a very low level, this would encourage an insurer, after the loss, to continually attempt to question its assured in the hope of obtaining misstatements.¹⁴³

3-61 At this juncture, it must be stressed that if the causal link between the fraudulent device and the claim is proven, it is not necessary for the underwriters to prove that the fraudulent device has induced underwriters into any course of action (e.g. to make payment).¹⁴⁴ It might seem like this is at odds with the indications given by Longmore LJ in *The Mercandian Continent*;¹⁴⁵ however, it should be noted that materiality and inducement in that case have been considered from the perspective of potential application of s 17 in the post-contractual context. When dealing with a fraudulent claim, a tougher stand is justifiable given that discouraging fraudulent behaviour, particularly at the claims stage, remains a very strong policy reason. If the law insists on proof of actual inducement, the effect will be that the use of fraudulent devices carries no sanction in many instances.

3-62 Another uncertainty relates to the availability of potential remedies when a claim is supported by a fraudulent device which is deemed to be relevant to the claim advanced. Mance LJ had no problem in treating the use of a fraudulent device as a sub-species of making a fraudulent claim, but he was more tentative when considering the remedies available to the insurer in that case. In his view, there is no difficulty in holding that the claim in relation to which the fraudulent device is used is forfeited. However, he left the question open as to whether the use of fraudulent devices would have any prospective impact on the future of the contract in the same

¹⁴² [2004] Lloyd's Rep IR 690.

¹⁴³ Clarke, MA, *The Law of Insurance Contracts* (6th edn) (2009, Informa), 27-2B4.

¹⁴⁴ *The Aegeon* [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [37], per Mance LJ.

¹⁴⁵ [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563.

manner the fraudulent claim rule might have.¹⁴⁶ The issue of remedies is deliberated later in this chapter, but suffice to say that submission of a fraudulent claim may well constitute a repudiatory breach of the contract so as to entitle the insurers to terminate the policy prospectively from the date of the breach. The reason for this is that, as emphasised forcefully by Lord Hobhouse, fraud is ‘fundamentally inconsistent with the bargain and the continuation of the contractual relationship between the insurer and the assured’.¹⁴⁷ Perhaps Mance LJ, by taking a tentative stand on the matter, was suggesting that the foundations of the contractual relationship between the assured and the insurer is not shaken enough to justify the repudiation of the contract in a case where a valid claim is pursued by a fraudulent device. If a parallel with the doctrine of innominate terms is to be drawn,¹⁴⁸ it can be argued that in this context, the fraud relates to the manner in which the claim is pursued and not to the substance of the claim; therefore, the breach is not serious enough to deprive the insurer from the whole benefit he expects under the insurance agreement.¹⁴⁹ A counter-argument would be that fraud in the claims context is a cardinal sin which is capable of breaking the trust that an insurance relationship is based upon. Accordingly, any fraud in this context, even though it might relate to the manner in which the claim is pursued rather than the substance of the claim, amounts to a serious breach justifying repudiation of the contract. What transpires from this discussion is that judicial guidance may well be sought in future to clarify the types of remedies available to an insurer when the assured makes use of a fraudulent device in pursuing a valid claim.

3-63 Last, but not least, it is vital to determine whether suppressing a relevant fact or matter at the claims stage deliberately with the intention of procuring an advantage will render the claim fraudulent. The issue arose in *Marc Rich Agriculture Trading SA v Fortis Corporate Insurance NV*,¹⁵⁰ where the assured claimed for the loss of cargo under a warehouse-to-warehouse cover. The cargo had been removed from the warehouse without the assured’s consent. The assured had come to an agreement with the party who had removed the cargo that it would pay for it. It was, however, alleged by the insurer that the assured had suppressed the fact that it had contacted an agent to see if he could ascertain what was happening with the cargo, but had then abandoned that effort in the hope that the removing party would agree to pay for the cargo. There was no plea of any deliberate misrepresentation or lies, only concealment. The case came before the court on a ‘strike-out’ application by the assured requesting the court to strike out a defence by the insurers who pleaded that there had been a fraudulent claim on the premise that the assured had failed to disclose material facts in the claims process. Cooke J refused to strike out the

¹⁴⁶ *The Aegeon* [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd’s Rep 42, at [45].

¹⁴⁷ [2001] UKHL 1; [2003] 1 AC 469, at [66].

¹⁴⁸ See *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26.

¹⁴⁹ Recently, in *Versloot Dredging BV v HDI Gerling and others (The DC Merwestone)* [2013] EWHC 1666 (Comm), Popplewell J expressed the view that the forfeiture of the claim in circumstances where the assured’s fraudulent conduct lay at the lower end of the culpability scale was ‘disproportionately harsh’. He went on to say, at [170]: ‘If the anomalous [fraudulent claim] rule is to be extended to fraudulent devices used in support of valid claims, it is to my mind important that it should not itself be allowed to be used as an instrument of injustice.’

¹⁵⁰ [2004] EWHC 2632 (Comm); [2005] Lloyd’s Rep IR 396.

defence, indicating that he could not decide that the assured was 'so clearly right that there [was] no possibility of other arguments succeeding'.¹⁵¹

3-64 Cooke J has a valid point in suggesting that this area of law is not yet settled given that the view expressed by Mance LJ in *The Aegeon* that restricting the fraudulent claim rule to the positive lies was, technically, *obiter*. One can instantly think of two arguments that can be advanced to lend support to the view that deliberate concealment at the claims stage can be treated as a facet of the rule on fraudulent claims. First, a parallel can be drawn with the instances where the assured is expected by law to correct a mistaken comprehension on the part of the insurer at the claims stage with regard to the loss claimed. On that basis, if a claim that had been honestly begun were dishonestly continued, that would be treated as fraudulent. In *The Aegeon*, Mance LJ gave the example of an assured who claims for a lost item and subsequently finds it in a drawer but maintains its claim. His Lordship said that 'it would be strange' if the assured in those circumstances did not risk the sanction of the fraudulent claim rule.¹⁵² In the same manner, it can be argued that the duty of the assured at the claims stage is not only to avoid deliberate lies but also to refrain from deceiving the insurer by knowingly concealing facts and circumstances relevant to the claim. Second, there is room to argue that suppression will often carry with it an implied representation by silence which is indistinguishable in character from a false positive representation. Ultimately, by concealing certain key circumstances relating to the claim, it can be argued that the assured makes a conscious attempt to mislead the underwriter so as to be able to present the claim in a particular fashion which is advantageous to his case. Although the issue was not explicitly deliberated in *Yeates v Aviva Insurance UK Ltd*,¹⁵³ the Court of Appeal's judgment contains hints that an implied representation by silence could result in a fraudulent claim in some cases. There, the assured in the aftermath of flooding of his insured home obtained an invoice from a company for repairs, but failed to reveal to the insurer the fact that the company which produced the invoice for the repair work was, in fact, owned by him and his wife. At the first instance, the insurer succeeded in obtaining a summary judgment against the assured on the ground that he had made a fraudulent claim or used fraudulent devices. The matter came before the Court of Appeal in the context of the assured's application for an extension of time in which to lodge his appeal. In advancing his application, which was refused, one of the arguments put forward by the assured was that he was not guilty of any positive misrepresentation and he was effectively branded a fraudster on a summary judgment application without being given the opportunity to give evidence on the critical question of whether he had intended to deceive the insurers. Longmore LJ who described the assured's arguments as being doubtful and difficult, said:¹⁵⁴

¹⁵¹ *Ibid*, at [33]. In his judgment, Cooke J treated this area of law as being 'undoubtedly difficult and developing'. If a deliberate concealment concerning the claim is capable of turning the claim into a fraudulent one, it will be interesting to see how the issue of materiality can be addressed in this context. Put another way, it is unclear at this stage what test will be applied in determining whether or not a deliberate concealment is relevant to the claim.

¹⁵² [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [15].

¹⁵³ [2012] EWCA Civ 634.

¹⁵⁴ *Ibid*, at [28].

... The starting point has to be that, as the [trial] judge found, [the assured] intended to and did give the false impression to insurers that [the management company] was wholly separate from himself and his wife.

3-65 The judgment leaves no doubt that knowing and deliberately withholding information may, in some circumstances, constitute fraud, especially if it can be shown that the concealment amounts to calculated deception on the part of the assured who allows the insurer to believe in his trustworthiness, while actively falsifying that belief by his inactivity.¹⁵⁵ Of course, the key question here is the context and it is necessary to evaluate the impact that concealment would have on the manner in which the insurer would perceive the claim. If concealment would help the assured to make an assertion with regard to the existence or otherwise of certain facts, it can well amount to fraud; this was the case in *Yeates v Aviva Insurance UK Ltd*.¹⁵⁶

3-66 To sum up, it is fair to say that the law on this point is far from settled; but in the light of recent judicial developments, one might be tempted to suggest that a deliberate concealment at the claims stage, as long as it is not immaterial or insignificant and is capable of influencing the way the insurer views the claim, is likely to convert a claim into a fraudulent one.

(3) Remedies

(A) Common Law Remedy of Forfeiture

3-67 It is well established at common law that a claim that is fraudulent in whole or part is forfeited and may be rejected by the insurer.¹⁵⁷ Policy considerations seem to have played an instrumental role in the development of this remedy. For instance, Lord Hobhouse in *The Star Sea*, referring to the justification of the common law rule of forfeiture, said: ‘The fraudulent insured must not be allowed to think: if the fraud is successful, then I will gain; if it is unsuccessful, I will lose nothing.’¹⁵⁸

¹⁵⁵ *Kensington International Ltd v Republic of Congo* [2007] EWCA Civ 1128; [2008] 1 Lloyd’s Rep 161, at [59], per Moore-Bick LJ.

¹⁵⁶ In *Aviva Insurance Ltd v Roger George Brown* [2011] EWHC 362 (QB); [2012] Lloyd’s Rep IR 211, it was argued that the assured acted fraudulently by not disclosing that an alternative accommodation was owned by a company of which the assured was both a director and a shareholder. The tenor of the judgment gives the impression that the judge would have prepared to treat this as a fraudulent claim had it been proven by the insurer that the concealment was fraudulent. Eder J was, however, not convinced that the assured had acted fraudulently, as he did not realise by the ordinary standards of reasonable and honest people that his conduct was dishonest (the test established in *Twinsectra Ltd v Yardley* [2002] 2 AC 164 was used in determining whether or not the assured acted fraudulently).

¹⁵⁷ *Levy v Baillie* (1831) 7 Bing 349. The same principle seems to have been recognised under Scots law: *Reid and Co v Employers’ Accident and Livestock Insurance Co Ltd* (1899) 1 F 1031, at 1036, per Lord Trayner.

¹⁵⁸ [2001] UKHL 1; [2003] 1 AC 469, at [62]. Similar policy considerations do not necessarily operate in other areas of law. In *Shah v Wasim Ul-Haq* [2009] EWCA Civ 542; [2010] Lloyd’s Rep IR 84, the wrongdoer negligently drove her car into the rear of a car driven by Wasim Ul-Haq with his wife and two children as passengers. A claim for personal injury was brought by Wasim Ul-Haq and his wife, and a claim was also made by Wasim Ul-Haq’s mother-in-law, who claimed that she had been in the car at the same time. The wrongdoer asserted that the mother-in-law had not been in the car and she had been encouraged by Wasim Ul-Haq to make a fraudulent claim; accordingly all three claims, including genuine ones, should be struck out because of their fraud in supporting the third person’s claim. The Court of Appeal refused to apply any analogy with fraudulent claims on insurance policies and held that there was

3-68 Even though the right of forfeiture at common law, as a remedy independent of contract, has been recognised since the early nineteenth century, remarkably few judicial attempts have been made over the years to demarcate its boundaries. From earlier authorities it is abundantly clear that the rule of forfeiture applies and the whole claim is forfeited even where the claim is fraudulent in part.¹⁵⁹ Viewed from this angle, the common law remedy embodies a disciplinary element, but this has been fully endorsed by contemporary judges.¹⁶⁰

3-69 An interesting question arises as to what the legal position will be in cases where interim payments are made to indemnify genuine losses suffered by the assured before the fraud was perpetrated. An opportunity to evaluate this point further has presented itself in *AXA General Insurance Ltd v Gottlieb*.¹⁶¹ There, Mr and Mrs Gottlieb, the co-assureds, made four separate claims on their building and contents policy. There was no suggestion that the first two claims were in any way tainted with fraud. However, a fictitious claim for alternative accommodation was added by the assureds to the third claim, which was genuine in part. In the case of the fourth claim, a forged invoice for some £1,200 had been used by the assureds in support of the claim. In both instances, interim payments had been made by the insurer before the relevant fraud occurred. Resting their case on the common law rule of forfeiture, the insurers argued that they were entitled to discharge themselves from liability entirely in relation to the third and fourth claims that were tainted with fraud. The main contention of the counsel for the assureds was that the severity of the common law rule should be reduced by excluding from its ambit payments made on the same claim prior to the fraud in respect of genuine loss in order not to disturb the settled expectations of the assureds. Approving the judgment of the trial judge on this point, the Court of Appeal dismissed the assureds' case and held that the proper scope of the common law rule was to forfeit the whole of the claim to which the fraud related. On that premise, the insurer was allowed to recover interim

no general rule of law that a claim which was in part fraudulent was lost in its entirety by reason of the fraud. See also, *Churchill Car Insurance v Kelly* [2006] EWHC 18 (QB). However, recently the Supreme Court in *Fairclough Homes Ltd v Summers* [2012] UKSC 26; [2012] 1 WLR 2004 stressed that when dealing with a grossly exaggerated and fraudulently maintained claim for personal injuries, courts have a jurisdiction to strike out such a claim, including the part of it which was good, as a sanction for the fraud in some extreme cases. Lord Clarke of Stone-cum-Ebony JSC said, at [49]:

The draconian step of striking a claim out is always a last resort, *a fortiori* where to do so would deprive the claimant of a substantive right to which the court had held that he was entitled after a fair trial. It is very difficult indeed to think of circumstances in which such a conclusion would be proportionate. Such circumstances might, however, include a case where there had been a massive attempt to deceive the court but the award of damages would be very small.

¹⁵⁹ *Galloway v Guardian Royal Exchange (UK) Ltd* [1999] Lloyd's Rep IR 209.

¹⁶⁰ Sir Roger Parker in *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 452, noted: '... there is an incentive to honesty, if the assured knows that, if he is fraudulent, at least to a substantial extent, he will recover nothing, even if his claim is in part good.' A degree of leniency has been introduced by legislative intervention in some common law jurisdictions in the field of non-marine insurance. Section 56(2) of the Australian Insurance Contracts Act 1984 permits the court to grant equitable relief in respect of minor frauds, that is, those where 'only a minimal or insignificant part of the claims [are] made fraudulently' and where 'non-payment of the claim would be harsh and unfair'. However, in deciding whether or not to grant the relief the courts are requested to take into account 'the need to deter fraudulent conduct in relation to insurance' and ensure that the relief does not serve as 'a source of encouragement' to assureds to exaggerate or pad claims.

¹⁶¹ [2005] EWCA 112; [2005] Lloyd's Rep IR 369.

payments made even though they might have been made prior to any fraudulent conduct. The legal reasoning underpinning this judgment has been summed up by Mance LJ who emphasised that the effect of submitting a fraudulent claim is ‘to remove or bar the insured’s pre-existing cause of action’.¹⁶² It is hard to disagree that this analysis holds true when a valid claim is promoted by using a fraudulent device (i.e. the use of a fraudulent device removes or bars the cause of action); arguably, this was the case when the assured forged an invoice in support of the fourth claim. A similar outcome follows in cases where the assured, who suffers a genuine loss, transforms the basis of his claim.¹⁶³ If the assured decides to present the claim honestly after the initial fraud comes to light, he will be precluded from doing so given that the initial fraud removes the assured’s cause of action in respect of the loss. However, in cases where the assured puts forward a claim to which he knows from the outset he is not entitled, it is plausible to argue that no cause of action could have accrued in the first instance because, in such a circumstance, there is an absence of an insured and indemnifiable loss.

3-70 The reasoning of the court is extremely useful in setting the limits of the common law rule of forfeiture in a clearer fashion. First, it is now beyond doubt that the insurer may recover any payment made by way of indemnity without knowledge of fraud,¹⁶⁴ regardless of the time that the payment was made, if the claim is somewhat tainted with fraud.¹⁶⁵ Second, the common law rule of forfeiture does not have an impact on the claims made beforehand under the same policy. As long as they are honestly made and paid, the insurer will not be able to recover such payments under the common law rule.¹⁶⁶ Lastly, it follows that separate claims which are still unpaid at the time of the fraud or have not yet arisen under the policy should remain unaffected and the common law rule relating to fraudulent claims should be confined to the particular claim to which any fraud relates. However, it has been acknowledged in Mance LJ’s judgment that general principles of contract law might act as a stumbling block against prospective claims. The possibility will be considered further when analysing contractual remedies in the succeeding part.

3-71 A point that has not been deliberated in *AXA General Insurance Ltd v Gottlieb* is the legal position when the same incident gives rise to more than one claim. Suppose that the insured vessel is grounded due to negligent navigation, making salvage services essential. In that case, the hull insurer might face two sets of claims: one for the cost of repairs to the hull and another for the vessel’s contribution to salvage charges. If there is fraud in relation to the claim for repairs, will the insurer be entitled to recover from the assured whatever amount they may have paid in respect of the claim relating to salvage expenses? Given that the effect of submitting a fraudulent claim is to remove or bar the insured’s pre-existing cause of action under the common law rule on forfeiture, the critical issue is whether in

¹⁶² Ibid, at [26].

¹⁶³ Cf *Piermay Shipping Co SA v Chester (The Michael)* [1979] 2 Lloyd’s Rep 1.

¹⁶⁴ See *Insurance Corp of the Channel Islands v McHugh* [1997] LRLR 94, at 135.

¹⁶⁵ *AXA General Insurance Ltd v Gottlieb* [2005] EWCA 112; [2005] Lloyd’s Rep IR 369 at [31].

¹⁶⁶ Whether fraud in the post-contractual context could be treated as a breach of s 17 of the MIA 1906 affording ‘avoidance of the contract’ as a potential remedy has not yet been authoritatively decided but, as discussed earlier, the recent judicial trend does not favour such a radical solution.

this case the assured can be deemed to have made a single claim with two separate aspects or two separate claims. If it is interpreted that the assured has made a single claim, then both aspects of the claim, repair costs and salvage contribution, are forfeited. However, if the proper interpretation is that two claims have been made, only the fraudulent claim in relation to repair costs is forfeited and the other claim in relation to the salvage charges survives (though this conclusion may be affected by the following discussion on potential contractual remedies). The courts seem to have adopted a non-technical and pragmatic approach in identifying what amounts to a single claim; usually claims that are similar in nature and stem from the same incident can be held as the constituent parts of a single claim even if they are submitted at different times. In *Danepoint Ltd v Allied Underwriting Insurance Ltd*,¹⁶⁷ for example, HHJ Peter Coulson QC had no difficulty in treating the claim as a single one, although the assured claimed not only for repair and reinstatement costs but also loss of rent following a fire on the insured property which was divided into flats for rental purposes. Similarly, in the context of household insurance where claims are made both for damage to the buildings and damage to the contents arising out of one incident, the individual claims under each head have usually been treated as forming part of a single claim.¹⁶⁸ However, it is submitted that a different outcome is possible in cases where completely different types of risks, such as physical loss suffered by the insured property and liability incurred to third parties, are insured under the same policy. In that case, the likelihood of treating such losses as two separate claims rather than one claim with two heads of loss is not insignificant.

(B) Contractual Remedies

(a) Fraudulent claims clauses

3-72 There is no conceptual difficulty if parties agree to incorporate a term into their agreement prescribing the consequences that are to result from the making of a fraudulent claim. Such terms have been used in insurance practice for centuries¹⁶⁹ and are commonly incorporated into contemporary marine insurance contracts.¹⁷⁰ A typical 'fraudulent claims clause' is expected to define what constitutes a fraudu-

¹⁶⁷ [2005] EWHC 2318 (TCC); [2006] Lloyd's Rep IR 429.

¹⁶⁸ *Yaganeh v Zurich Insurance* [2010] EWHC 1185 (QB); [2011] Lloyd's Rep IR 75 reversed by the Court of Appeal on different grounds and *Aviva Insurance Ltd v Roger George Brown* [2011] EWHC 362 (QB); [2012] Lloyd's Rep IR 211.

¹⁶⁹ In the most recent edition of *MacGillivray on Insurance Law* (12th edn) (2012, Sweet & Maxwell) edited by Birds J, Lynch, B and Milnes, S, an interesting fraudulent claims clause, commonly used in insurance policies in the eighteenth century, was identified, at [20-058]. The clause required the assured to procure a:

certificate under the hand of the minister and churchwardens, together with some other reputable inhabitants of the parish . . . importing that they were well acquainted with the character and the circumstances of the person . . . insured and do know or verily believe that he she or they really and by misfortune without any fraud or evil practice have sustained the claimed loss or damage by fire.

¹⁷⁰ The following clause appears in the most recent version of standard hull clauses (International Hull Clauses 2003 (01/11/03) cl 45.3):

It shall be a condition precedent to the liability of the Underwriters that the Assured shall not at any stage prior to the commencement of legal proceedings knowingly and recklessly 1) mislead or attempt to mislead the Underwriters in the proper consideration of a claim or the settlement thereof by relying on

lent claim for its purposes and prescribe the remedy available to the insurer should the assured present a fraudulent claim.

3-73 The wording of such clauses varies and has evolved over the years, but what would normally be expected of a contemporary ‘fraudulent claims clause’ is to broaden the substantive and remedial scope of the common law rule of forfeiture. For example, by virtue of cl 45(3) of the International Hull Clauses 2003, the assured, apart from deliberately and recklessly refraining from misleading the insurer in the proper consideration of the claim or the settlement, is also expected not to conceal any circumstance or matter (either deliberately or recklessly) from the insurers material to the proper consideration of a claim or a defence to such a claim.¹⁷¹ Similarly, in *Dome Mining Corporation Ltd v Drysdale*,¹⁷² extending the horizons of the remedial provision, the fraud clause stated: ‘If the assured shall make any claim knowing the same to be false or fraudulent, as regards amount or otherwise, this policy shall become void and all claim there-under shall be forfeited.’¹⁷³ At this juncture, a very interesting question springs to mind. What would be the impact of a ‘fraudulent claims clause’ on the common law remedy of forfeiture? Due to the broad nature of fraudulent claims clauses used in contemporary practice, it is very likely that the existence of a fraud clause would make it unnecessary for the underwriter to turn to alternative remedies, such as the common law remedy of forfeiture. However, this does not necessarily mean that the mere existence of the fraud clause would amount to waiver of alternative remedies. Given that the common law remedy of forfeiture stems from a rule of law rather than any term of the contract,¹⁷⁴ ordinary contract law principles suggest that ‘express, pertinent and apposite’ wording¹⁷⁵ would be required to found a waiver. Therefore, in the absence of ‘unequivocal wording’ indicating that remedies stemming from law are replaced by contractual remedies,¹⁷⁶ the common law remedy of forfeiture should exist side-by-side with the remedy stipulated by the fraudulent claims clause.

3-74 Obviously, the main purpose of incorporating a ‘fraudulent claims clause’ is the desire of the parties to provide a contractual, certain and effective solution where a fraudulent claim is presented by the assured. For this objective to be

any evidence which is false; 2) conceal any circumstance or matter from the Underwriters material to the proper consideration of a claim or a defence to such a claim.

Again in the marine context, the J and J(a) Schedules, which can be incorporated into Lloyd’s and Ins-sure policies, provide that: ‘If the Insured shall make any claim knowing the same to be false and fraudulent, as regards amount or otherwise, this Policy shall become void and all claim hereunder shall be forfeited.’

¹⁷¹ It is not clear how the test of materiality for the purposes of this clause will operate in practice. For more discussion on the subject, see Soyer, B, ‘A Survey of the New International Hull Clauses’ (2003) 9 JIML 256, p 263.

¹⁷² (1931) 41 LIL Rep 109.

¹⁷³ Precisely in what context the term ‘void’ has been used here is far from clear but the issue is debated further below.

¹⁷⁴ *The Mercandian Continent* [2001] EWCA Civ 1275; [2001] 2 Lloyd’s Rep 563, at [11] per Longmore LJ.

¹⁷⁵ *Québec Marine Insurance Co v Commercial Bank of Canada* (1870) LR 3 PC 234, at 243, per Lord Penzance.

¹⁷⁶ On the issue of waiver in the context of commercial contracts, see the judgment of the House of Lords in *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corporation of India (The Kanchenjunga)* [1990] 1 Lloyd’s Rep 391.

achieved, it is essential that the clause is drafted in clear, coherent language and with precision. However, a quick glance at the clauses commonly used in the market flashes the potential difficulties that may arise in the construction of these clauses. For instance, a considerable degree of ambiguity and controversy surrounds the words ‘all benefit under this clause shall be forfeited’. Potentially, these words may mean: (i) that the particular claim tainted with fraud will be forfeited; (ii) that all the benefit under the policy will be forfeited as from either (a) the date when the claim arose or (b) the date of fraud; (iii) that the liability of the insurer will be discharged automatically with prospective effect from the date of breach; or (iv) the liability of the insurer will be avoided *ab initio*.

3-75 Out of these alternatives, bearing in mind that in recent years, the harshness of ‘avoidance’ as a remedy has attracted considerable criticism from various judicial authorities,¹⁷⁷ it would not be fanciful to suggest that courts would take some convincing that both parties wanted the fraud clause to operate retrospectively.¹⁷⁸ Also, if it was the intention of the parties to confine ‘forfeiture’ to the relevant claim as suggested by (i), given that this adds nothing to the common law remedy of forfeiture, which already exists by operation of law, one might wonder why the parties went to the trouble of incorporating a ‘fraudulent claims clause’ into their contract.¹⁷⁹ This leaves us with (ii) and (iii). In *Insurance Corporation of the Channel Islands Ltd v McHugh*,¹⁸⁰ when construing the phrase ‘all benefit under this policy shall be forfeited’, Mance J in certain parts of his judgment seems to be suggesting that the effect of ‘forfeiture’ is prospective but this matter has not arisen for decision in the case.¹⁸¹ In other jurisdictions, for example in South Africa in *Lehmackers Earthmoving v Incorporated General Insurance Co*,¹⁸² when the court was required to determine whether a similarly worded clause applied retrospectively the decision was negative. However, applying the analogy of a condition subsequent, the clause was viewed as capable of meaning termination from the time of the breach represented by fraudulent claim. Although the weight of authority seems to support the contention that the effect of ‘forfeiture’ is prospective, uncertainty remains as to what point in time the remedy will bite, whether from the date of breach, or from the date the claim arose and whether or not it applies automatically.

3-76 The use of the term ‘void’, which is common in standard fraudulent claims clauses, can also be controversial in this context. In its most technical sense, a void contract describes a situation where no binding contract comes into being. This might arise for a variety of reasons, for example either because the parties were at cross purposes¹⁸³ or where parties made a mistake by concluding a contract where no subject matter existed.¹⁸⁴ In these circumstances no contract arises. The term is also sometimes used to describe a situation where deeds and other instruments

¹⁷⁷ See particularly, *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469, at [51], per Lord Hobhouse.

¹⁷⁸ *Ibid*, at [64] where Lord Hobhouse clearly stated that the remedy of ‘avoidance’ operates distinctly from the remedy of ‘forfeiture of all benefit’.

¹⁷⁹ *Cf* the decision of the Court of Session (Scotland) in *Fargnoli v G A Bonus plc* [1997] CLC 653.

¹⁸⁰ [1997] LRLR 94.

¹⁸¹ *Ibid*, at 135.

¹⁸² [1983] 3 SA 513 (App Div).

¹⁸³ *Falck v Williams* [1900] AC 176.

¹⁸⁴ *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377.

executed to transfer an interest in the property or money are of no force and effect. When used in this context, it usually means that the instrument is not effective to transfer whatever interest is sought to be conveyed or assigned, but it does not mean that the instrument fails to give rise to binding contractual obligations. Again, there are instances where the word ‘void’ has been used to describe loosely the effect of illegality arising during the performance of a contract.¹⁸⁵ Here, illegality usually makes the contract unenforceable but its effect is usually prospective. To complicate the matters further, the J and J(a) Schedules stipulate that the policy shall become void if a fraudulent claim is submitted which possibly carries an inference that the policy is valid until the fraud is perpetrated. In that case, parallels can be drawn with voidable contracts and it can plausibly be argued that the effect of submitting a fraudulent claim under the J and J(a) clause is avoidance of the contract *ab initio*.

3-77 The analysis carried out above demonstrates clearly that the word ‘void’ could carry potentially different meanings. It is highly unlikely that the word has been used here in its most technical sense, meaning that the contract has never come into existence. The fraud that arises during the performance of the contract can hardly be seen as having an impact on the foundations of the agreement between the parties. It is possible and certainly advantageous for the insurer to argue that the term entitles him to avoid the contract *ab initio* should a fraudulent claim be submitted. However, given the fact that the potential impact of such interpretation is devastating for one of the parties, it would probably be treated as an improbable term for them to agree on in the absence of unambiguous wording to that effect. Of course, on the premise that the parties were ambiguous as to the effect of this clause, it is always open to courts to construe it *contra preferentem* and resolve it against the party who benefits from the clause – in this case the insurer. If this solution is to be adopted, the court would be prepared to make the remedy available to the insurer in case of breach of such a clause only prospectively (*de futuro*).

(b) Implied term analysis

3-78 A great deal of discussion has taken place in judicial circles as to whether a promissory obligation restraining the assured from submitting a fraudulent claim can be implied into insurance contracts in the absence of any express term to that effect. Judicial dicta opposing the introduction of such an implied term can be found, particularly in older cases.¹⁸⁶ More recent judicial dicta, however, have been very supportive of a contractual analysis. For example, Lord Scott in *The Star Sea* expressed his view that the ‘presentation of a dishonest or fraudulent claim constitutes a breach of duty that entitles the insurer to repudiate any liability for the claim and, prospectively at least, to avoid any obligation under the policy’.¹⁸⁷ Similarly, in *Orakpo v Barclays Insurance Services Co Ltd*, Hoffmann LJ was prepared to base the remedy of the insurers when a fraudulent claim is submitted on an implied term which ‘it would be reasonable to regard as forming part of a contract of insurance’.¹⁸⁸

¹⁸⁵ *Napier v National Business Agency Ltd* [1951] 2 All ER 264.

¹⁸⁶ See *Reid & Co v Employers’ Accident and Livestock Co Ltd* (1899) 1 F 1031, at 1037, per Lord Traynor and *London Assurance Co v Clare* (1937) 57 LIL Rep 254, at 270, per Goddard J.

¹⁸⁷ *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469, at [110].

¹⁸⁸ [1997] LRLR 443, at 451. On this point Sir Roger Parker concurred, whilst Staughton LJ

3-79 Despite the seemingly obvious change in judicial stance, the implied term analysis has not yet formed the *ratio* of any judgment. This mainly results from the fact that in most cases, forfeiture of the claim tainted with fraud would be deemed to be adequate by insurers, who would accordingly prefer to base their defence exclusively on the common law remedy of forfeiture. However, implied term analysis is likely to enhance the remedial weaponry insurers have at their disposal in two respects. First, breach of this promissory obligation might give the insurer an opportunity to treat the assured's conduct as a repudiatory breach.¹⁸⁹ This would come in handy where the assured, during the currency of the policy, puts forward several claims but the fraud relates to the first claim or one of the earlier claims.¹⁹⁰ By electing to repudiate the contract prospectively, the insurer would be able to avoid payment of genuine claims arising after the submission of an earlier fraudulent claim. Some might see this development as excessively penal but there is no doubt that it is a defensible position from the perspective of public policy. Furthermore, the contractual analysis would also present the insurer with an opportunity to recover from the assured the wasted cost of investigating the fraudulent aspects of the claim as damages. This is a stance that insurers might be prepared to take with the intention to send a strong signal to the industry emphasising their determination to tackle fraudulent claims.

3-80 Without putting too much gloss on it, it should also be noted that the implied term analysis might prove troublesome in some respects. First, the basis on which it might be possible to imply an appropriate term is not free from difficulty. The necessity test that needs to be satisfied for a term to be implied by fact is very demanding – the question that needs to be considered in this context is whether the implication is necessary to make the contract work.¹⁹¹ Given the availability of other

dissented. Sir Roger Parker stressed that the existence of an implied term of this nature is 'in accordance with principle and sound authority'.

¹⁸⁹ It is highly likely that a promissory obligation not to make a fraudulent claim would be seen as a condition of the contract despite the evident ascendancy of innominate term analysis in recent years in contract law, given that submission of a fraudulent claim undermines the trust that lies at the foundation of the relationship between the assured and insurer. This seemed to be the preferred view of Hoffmann LJ in *Orakpo v Barclays Insurance Services Co Ltd* [1997] LRLR 443, at 451, who said 'Any fraud in making the claim goes to the root of the contract and entitles the insurer to be discharged.' However, in line with the discussion carried out at [3-63], it must be stressed that innominate term analysis has a particular attraction as it could afford a flexible remedy particularly when the fraud is exercised to support a genuine claim. For the sake of completeness, it should be mentioned that the language used in some judicial authorities could point to the direction in which the fraudulent claim rule could be classified as an insurance warranty. For example, Rix J, in *Royal Boskalis v Mountain* [1997] LRLR 523, at 592, suggested that the consequence of fraud was the 'automatic forfeiture of the whole policy'. However, the types of implied warranties have been specified in the MIA 1906 where no mention is made of such an implied warranty. If a factual basis for implying such a warranty had existed, it surely would have been recognised by now.

¹⁹⁰ See the facts of *AXA General Insurance Ltd v Gotlieb* [2005] EWCA 112; [2005] Lloyd's Rep IR 369.

¹⁹¹ *The Moorcock* (1889) 14 PD 64. In *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, Lord Steyn, at 459, stressed that a term could only be implied by fact as a matter of strict necessity: 'This principle is sparingly and cautiously used and may never be employed to imply a term in conflict with the express terms of the text. The legal test for the implication of such a term is a standard of strict necessity.' See also, *Mediterranean Salvage and Towage Ltd v Seamar Trading and Commerce Inc (The Reborn)* [2009] EWCA Civ 531; [2009] 2 Lloyd's Rep 639 and Lord Hoffmann's judgment in *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10; [2009] 2 All ER 127.

remedies, such as the common law remedy of forfeiture in cases where a fraudulent claim is submitted, it would be very difficult to argue that the contract could not function unless the term is implied.

3-81 However, the prospect of implying a term by law due to the nature of the insurance contract still remains a genuine possibility. Hoffmann LJ in *Orakpo v Barclays Insurance Services Co Ltd*, expressed the view that there ‘is sufficient authority for holding that such a term is implied by law as one which, in the absence of contrary agreement, it would be reasonable to regard as forming part of a contract of insurance’.¹⁹² Whilst the courts, from time to time, recite the test of necessity,¹⁹³ an overwhelming majority of the commentators are of the view that the courts are really applying a test akin to ‘reasonableness’ in determining whether or not a term can be implied by law.¹⁹⁴ Moving away from a strict test of ‘necessity’ to a more flexible concept of ‘reasonableness’ would inevitably require the courts to be concerned with questions such as ‘fairness and balancing of competing policy considerations’ in their assessment.¹⁹⁵

3-82 If the debate is reduced to the issue of policy considerations, a considerable support for the implication of such a term into insurance contracts can be drawn from various authorities. In the context of employment contracts, the decision of the House of Lords in *Malik v Bank of Credit and Commerce*¹⁹⁶ is an interesting one which can be relevant in insurance context by analogy. There, two employees of a bank sued their ex-employer for damages, arguing that their affiliation with the bank had placed them at a serious disadvantage in trying to find new jobs due to the fact that the bank operated a corrupt and dishonest business. Their contention was that the contract contained an implied term requiring the bank not to conduct itself in a manner likely to destroy or seriously damage the relationship of confidence and trust between employer and employee. The House of Lords saw such a term as a particular aspect of the general obligation of trust and confidence that was intended to facilitate the proper functioning of the contract.¹⁹⁷ A similar general obligation of trust and confidence underpins the relationship between parties in an insurance contract; and the concept of ‘utmost good faith’ is one of the main manifestations of this general duty in insurance law. It could, therefore, be argued that an implied term that essentially requires the assured to protect the interests of the insurer when the contract is being performed as well as the confidence and trust the parties enjoy, can derive from the overarching idea of ‘good faith’.

3-83 The effect of the term on the society and its fairness, particularly on parties of the contract are two other factors that seem to have a significant bearing on the decision of the courts whether or not to imply a term by law. There have been instances where courts have refused to imply certain terms into contracts on the

¹⁹² His Lordship made particular reference to the direction of the jury by Willes J in *Britton v Royal Insurance Co* (1866) 4 F & F 905.

¹⁹³ *Liverpool City Council v Irwin* [1997] AC 239, at 254, per Lord Wilberforce and *Scally v Southern Health and Social Services Board* [1992] 1 AC 294, at 307, per Lord Bridge.

¹⁹⁴ The point was made forcefully by Peden, E, ‘Policy Concerns behind Implication of Terms in Law’ [2001] 117 LQR 459, at 466–7.

¹⁹⁵ *Crossley v Faithful & Gould Holdings Ltd* [2004] EWCA Civ 293, at [36], per Dyson LJ.

¹⁹⁶ [1998] AC 20.

¹⁹⁷ *Ibid*, at 35, per Lord Nicholls.

premise that their implication might promote undesirable behaviour in society.¹⁹⁸ By the same token, there is room to develop a coherent argument to the effect that enabling the insurers to repudiate insurance contracts prospectively and potentially claim damages for breach where a fraud is perpetrated on them by the assured at the claims stage would signal to society that the law is determined (and equipped) to condemn such conduct with the harshness that it deserves. Also, it would be difficult to deny that the proposed implied term would promote fairness from the insurer's perspective by affording him a more resourceful remedy, given that the effect of submitting a fraudulent claim is to undermine the trust that lies at the heart of the relationship between the assured and insurer.¹⁹⁹ To sum up, it is submitted that the arguments for implying such a term by law are strong. In fact, Lord Hobhouse's judgment in *The Star Sea* can be viewed as an invitation to the judges to devise such terms:

Having a contractual obligation of good faith in the performance of the contract presents no conceptual difficulty in itself. Such an obligation can arise from an implied or inferred contractual term.²⁰⁰

3-84 The second difficulty associated with the implied term analysis stems from the nature of the contractual remedy available in such cases. Assuming that the implied term is to be treated as a condition in the traditional sense of the word, the insurer will be discharged from further performance of the contract prospectively from the time he elects to accept the repudiatory breach of the assured.²⁰¹ An interesting question is what happens to claims arising between the date of the fraud and the date of termination. In other words, if the assured suffers genuine losses after he has submitted a fraudulent claim but before the insurer has discovered the fraud, can he obtain indemnity with regard to such losses? Given that under the contractual analysis, termination will have effect only from the time when the assured has elected to terminate the contract,²⁰² valid claims in respect of separate events made subsequent to a fraudulent claim should be payable.

3-85 The contractual analysis might yield to a different result protecting the interests of the insurer only if it is possible to classify the implied obligation to refrain from submitting fraudulent claims as a promissory warranty within the meaning of s 33 of the MIA 1906. In that case, the insurer will automatically be discharged from liability under the policy as soon as the assured submits a fraudulent claim taking away his obligation to pay for claims in respect of separate events arising subsequent to a fraudulent claim. The difficulty is that, in the past, courts have been extremely reluctant to imply warranties into insurance contracts by making reference to those that appear in the MIA 1906.²⁰³

¹⁹⁸ *Johnstone v Bloomsbury Heath Authority* [1992] 1 QB 333 and *Harvela Ltd v Royal Trust Co of Canada (CI) Ltd* [1985] Ch 103.

¹⁹⁹ *Crossley v Faithful & Gould Holdings Ltd* [2004] EWCA Civ 293, at [36], per Dyson LJ. See also, the reasoning adopted in *Gloucestershire CC v Richardson* [1969] 1 AC 480.

²⁰⁰ *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469, at [50].

²⁰¹ See *Bunge Corp v Tradax Export SA* [1981] 1 WLR 711.

²⁰² *Hurst v Bryk* [2002] 1 AC 185.

²⁰³ See *Euro-Diam Ltd v Bathurst* [1987] 1 Lloyd's Rep 178 where Staughton J refused to imply a warranty of legality similar to the one in s 41 of the MIA 1906 into a motor insurance policy.

3-86 Last but not least, it can be debated whether damages that could normally be claimed by insurers in such circumstances would satisfy the remoteness test of modern contract law. The matter was considered several years ago in *London Assurance v Clare*,²⁰⁴ where Goddard J was of the view that the insurer could not recover damages for the cost of investigations into a fraudulent claim, on the basis that such damages were too remote. The striking feature of the case was that the insurer argued on the basis of breach of an implied term in the contract. With respect, it is submitted that the finding of Goddard J on the issue of remoteness is at odds with the test laid down in *Hadley v Baxendale*.²⁰⁵ In an insurance context, the wasted cost of investigating the fraudulent aspects of the claim submitted in breach of the contract could readily be viewed as arising according to the usual course of things. Besides, there is force in the argument that such damages may reasonably be supposed to have been in the contemplation of the parties, at the time when they made the contract, as a probable result of the breach. It is submitted that the outcome will be the same, even though one subscribes to the controversial view that Lord Hoffmann's intervention in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)*²⁰⁶ has led to a slight alteration in the remoteness test. The essence of Lord Hoffmann's reasoning in that case is that damages will be recoverable if they are the kind of damages that the breaker of the contract would assume responsibility for. If this view were to gain currency, courts would be inevitably required to view each contract and any breach stemming from it, within its commercial setting by considering surrounding circumstances and the general understanding in the relevant market. Thus, the application of the rule in *Hadley v Baxendale* may differ from market to market. Viewed from this perspective, it is still very likely that damages in the shape of wasted costs in investigating a fraudulent claim should be recoverable, as one would, within the context of the insurance market, expect an assured to assume responsibility for costs associated with his decision to submit a fraudulent claim.

(C) *Section 17 of the MIA 1906*

3-87 It is unquestionable that if s 17 is relevant in the claims context, the insurer would be able to invoke an additional remedy, avoidance of the contract *ab initio*, in most cases when a fraudulent claim is presented by the assured, even though the right of avoid in the post-contractual context has been restricted to a case where: (i) the fraud would have an effect upon the underwriter's ultimate liability; and (ii)

²⁰⁴ (1937) 57 LIL Rep 254, at 270.

²⁰⁵ (1854) 9 Ex 341.

²⁰⁶ [2008] UKHL 48; [2009] 1 AC 61, at [9]. It is very difficult to identify the *ratio* in the judgment. Lord Hope is in agreement with Lord Hoffmann. Lord Walker seems to endorse this view although he is not explicit. Lord Rodger's approach seems to be more traditional; he ends his judgment with a statement that although he has 'not found it necessary to explore . . . the issue of assumption of responsibility' he is otherwise in substantial agreement with Lord Hoffmann's reasons, at [63]. However, Baroness Hale's judgment is very unconventional and she offers more in the way of a critique of her colleague's reasons than an enumeration of her own. At the end of her judgment, she concludes by saying that 'if this appeal is to be allowed' – a result as to which she continues to have doubts – she would prefer it to be allowed on the basis of Lord Rodger's reasoning at [93].

the gravity of the fraud or its consequences would entitle the insurer, if he wished to do so, to terminate the contract for breach.²⁰⁷ Most types of fraudulent claim evaluated in this part, such as transformation of the basis of the claim, suppression of a defence and exaggeration of the claim, would pass both of these tests, but s 17 would not in all probability be available to the insurer when a genuine claim is promoted by using a fraudulent device, as this would not pass test (i).

3-88 Although there is some support for the proposition that s 17 should be relevant in the claims context,²⁰⁸ avoidance of the whole contract even for a fraudulent breach at the post-contractual stage is not viewed as a proportionate remedy. Also, in recent years, several appellate judges have expressed their preference to decouple fraudulent claims jurisdiction from s 17 of the MIA 1906.²⁰⁹ This will, undoubtedly, carry significant weight in the development of law. Against such powerful dicta it would take a very courageous court to bring s 17 back into the equation. Having said that, it should be stressed that the matter has not yet been resolved authoritatively.

(D) Other Remedies

3-89 Tort of deceit presents an alternative cause of action for the insurers aiming to recoup damages resulting from presentation of a fraudulent claim.²¹⁰ For the action to be successful, the insurer must be able to demonstrate that: (i) the assured has made a false statement to the insurer when putting his claim forward; (ii) the assured must know the statement to be false or was reckless as to the truth of the statement; (iii) the assured's intention must be to deceive the insurer who is acted upon; and (iv) a loss has been suffered by the insurer as a result.²¹¹ The main head of claim that an insurer can seek to recover under the tort of deceit is damages representing the time taken by an insurer to deal with and investigate the claim. Here, insurers could not only recover the cost of hiring external experts and consultants to unveil the fraud but also the costs of wasted staff time spent on the investigation of the fraud.²¹² If the assured has already received indemnity for the claim fraudulently presented, the insurer could seek to recover the sum paid as damages.

3-90 Whether insurers may be awarded exemplary damages by a court in addition to compensatory damages is a very controversial subject given that the purpose of such damage is not to compensate the claimant but to express the court's disap-

²⁰⁷ *The Mercandian Continent* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563.

²⁰⁸ See *MacGillivray on Insurance Law* (12th edn) (2012, Sweet & Maxwell), para 20-057 and Eggers, PM, 'Utmost Good Faith and the Presentation and Handling of Claims' in B Soyer (ed), *Reforming Marine and Commercial Insurance Law* (2008, Informa), pp 241-6.

²⁰⁹ See [3-32]-[3-33].

²¹⁰ The possibility of tort of deceit being available to the insurer in fraudulent claim cases was first pointed out by Goddard J in *London Assurance v Clare* (1937) 57 LIL Rep 254, at 270, where he suggested that the action before him for wasted costs might have been successful 'as damages for fraud'. Whilst actions of this nature are not common in the United Kingdom, in other common law jurisdictions damages based on tort of deceit are occasionally claimed from the assured submitting a fraudulent claim. See e.g., *Back v National* [1996] 3 NZLR 363.

²¹¹ *Derry v Peek* (1889) 14 App Cas 337.

²¹² *R + V Versicherung AG v Risk Insurance & Reinsurance Solutions SA (No 3)* [2006] EWCA 42 (Comm).

proval of the defendant's conduct. Although the judicial trend is in favour of awarding exemplary damages in an action in deceit, it is fair to say that the application of this head of damages in cases of deceit has not been fully worked through.²¹³ What transpires from the existing authorities is that, in determining the availability of exemplary damages, courts are primarily concerned with whether the defendant's conduct has been calculated by him to make a profit for himself that may well exceed the compensation payable to the claimant.²¹⁴ This approach would, inevitably, lead civil courts to consider the stand taken by criminal courts especially where the conduct of the defendant amounts to a crime.²¹⁵ The criminal courts are equipped with mechanisms enabling them to make compensation orders and to confiscate the proceeds of crime,²¹⁶ but these do not automatically preclude the making of an award of exemplary damages against the wrongdoer in a proper case.²¹⁷

3-91 It is, therefore, open to a civil court to consider whether the criminal law provides an adequate mechanism to deter wilful wrongdoing. In cases where the wrongdoer is subjected to criminal proceedings and receives an appropriate punishment for his criminal wrongdoing, the civil court might regard this as an adequate deterrent. However, in the insurance context, it is not uncommon for a fraudster to avoid criminal investigation altogether or to receive a light punishment not commensurate with the seriousness of the fraud perpetrated on the insurer. In that case, it should be, at least in theory, at the liberty of the court to award exemplary damages. The judgment of Mr Recorder Lochrane in *AXA Insurance UK Plc v Jensen*²¹⁸ might turn out to be a yardstick on the matter, and it certainly gives insurers encouragement when seeking to recover exemplary damages from assureds who present fraudulent insurance claims. The defendant sold her car but failed to receive the payment from the buyer. She then turned to the insurer, seeking indemnity on the basis that her caravan was stolen and received £8,100 for her loss. Shortly afterwards, the insurer discovered that the caravan had not been stolen. The assured was arrested by the police and given a caution. The insurer brought proceedings in the tort of deceit for the recovery of the £8,100 paid under the policy and also sought to recover exemplary damages in the sum of £8,103. Mr Recorder Lochrane was of the view that this was a case where the award of exemplary damages would be appropriate. Accordingly, an award of £4,000 was made, in addition to the basic claim, together with interest. The judgment seems to be based on three grounds. First, it has been stressed that it is in the discretion of the court to award exemplary damages where it is satisfied that the defendant has profited from fraud. This was obviously the case here. Second, reference is made to the need to preserve the relationship of utmost good faith between insurers and insured for the proper functioning of the financial services in this country. Establishing a link between the need to

²¹³ *Banks v Cox* [2002] EWHC 2166 (Ch), at [13] and [31], per Collins J.

²¹⁴ The position has been summarised by Peter Smith J in *Design Progression Ltd v Thurloe Properties Ltd* [2004] EWHC 324 (Ch); [2005] 1 WLR 1, at [141]. See also, *Archer v Brown* [1985] QB 401, at 423, per Peter Pain J.

²¹⁵ *Rookes v Barnard* [1964] AC 1129.

²¹⁶ See particularly, the Powers of Criminal Courts (Sentencing) Act 2000 and the Proceeds of Crime Act 2002.

²¹⁷ *Borders (UK) Ltd v Commissioner of Police of the Metropolis* [2005] EWCA Civ 197.

²¹⁸ Unreported, Birmingham County Court (18 November 2008).

promote good faith in insurance contracts and exemplary damages is an interesting development which can be justified on policy grounds. Third, it has been emphasised that when awarding exemplary damages, the courts are normally expected to ensure that the award does not add to the deterrent effect imposed by the criminal court. This would otherwise contradict the basic principle of law that ‘a man should not be punished twice for the same offence’. In the present case, exemplary damages were not viewed as amounting to double punishment as the assured was given only a caution for submitting a fraudulent claim to the insurer. At this juncture, Mr Recorder Lochrane distinguished the present case from the judgment of HHJ Derek in *AXA Insurance v Andrew Ernest Thwaites*,²¹⁹ where a claim for exemplary damages brought on the same ground (the assured submitting a fraudulent claim for damage to the car insured) was rejected. The essential difference was that Thwaites was prosecuted and given a suspended prison sentence for his criminal conduct. On that premise, HHJ Derek was of the view that awarding exemplary damages would effectively be adding to the criminal penalty.²²⁰

3-92 Given the standing of the court that delivered the judgment in *AXA Insurance UK Plc v Jensen* in the judicial hierarchy, it is too early to say whether this decision would set a precedent enabling insurers to seek such damages in future with a view to deterring assureds putting forward fraudulent claims. However, the wheels are in motion and conceptually, at least, there is no reason why exemplary damages should not have a role to play in this context, especially if the English law follows the footsteps of other common law jurisdictions²²¹ in extending the availability of such damages.²²²

3-93 Lastly, it should be noted that the insurer could pursue third parties, such as surveyors or adjusters under the tort of conspiracy if it can be demonstrated that they have conspired with the assured²²³ so that the latter could obtain insurance proceeds by deception.²²⁴ Although it has not yet been fully utilised, this might prove to

²¹⁹ Unreported, Norwich County Court (8/2/08).

²²⁰ Mr Recorder Lochrane summarised his view in the following manner: ‘... the obvious nature of the offence, the not insignificant amount of money involved in the fraud, the deliberate nature of that fraud and the general policy idea of providing a deterrent against such activities, both by the offender and others before the courts, [means] that the imposition of caution in this case really does not amount to punishment of any significant nature at all.’

²²¹ In other common law jurisdictions, courts have been prepared to award punitive damages in cases where the assured acts fraudulently. In *Andruisw v Aetna Life Insurance Co of Canada* (2001) 289 AR 1 (QB), the court awarded \$CAN20,000 in punitive damages against the assured who deliberately misrepresented facts to the insurer to continue to collect disability benefit. Murray J at [84]–[85] said: ‘If the only consequence of this behaviour is the forfeiture of his claim then in effect he is no worse off than if he had been truthful in the first place and deterrence which is one of the objects of granting punitive damages is given no effect.’

²²² In New Zealand, for example, exemplary damages can be awarded in cases of outrageously bad negligence; see *A v Bottrill* [2002] UKPC 44; [2003] 1 AC 449.

²²³ It is vital to demonstrate that relevant third parties and the assured combined with the purpose of striking at the insurer (i.e. defrauding the insurer to make payment for a fraudulent claim). It is not, however, necessary for the knowledge of an ‘accessory’ conspirator to be the same as that of the principal actor. It would be adequate if it can be demonstrated that the accessory shared a common objective with the primary actor and, in the achievement of that objective, intended to injure the claimant, in this case the insurer. For a discussion on this element of the tort of conspiracy, see *Bank of Tokyo–Mitsubishi UJF Ltd v Baskan Gida Sanayi v Pazarlama AS* [2008] EWHC 659 (Ch), at [847].

²²⁴ This possibility was alluded to in *Diggins v Sun Alliance & London Insurance plc (No 2)* [1994] CLC 1146.

be a valuable remedy, especially if there are jurisdictional difficulties associated with pursuing the assured who disappears after obtaining the insurance proceeds, or goes into liquidation or bankruptcy. If pleaded successfully, this tort might enable the insurer to recover other losses such as the cost of investigating losses;²²⁵ damages do not necessarily have to be restricted to the value of a pecuniary loss.²²⁶

²²⁵ See *British Motor Trade Association v Salvadori* [1949] Ch 556.

²²⁶ See *Lomrho Plc v Fayed (No 5)* [1993] 1 WLR 1489, at 1496.

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CHAPTER 4

FRAUD COMMITTED BY THE INSURER

I PRE-CONTRACTUAL STAGE

(1) Misrepresentation, Fraud and Remedies

4-1 Under general contract law principles, the assured will have the remedy of avoidance at his disposal if he is induced to enter into an insurance contract following any material misrepresentation on the part of the insurer at the formation stage. Prior to the enactment of the MIA 1906, on several occasions the assured managed to plead successfully insurer's misrepresentation as a defence under common law principles. For example, in *Duffell v Wilson*,¹ an insurance contract insuring the assured against the risk of him being drawn to military service by a specific date was avoided on the premise that the insurer made a material misrepresentation to the assured to the effect that the statute which regulated such conscription would cease to have effect after the expiry date of the insurance policy.² Recovering the premium paid might be a tempting proposition for the assured especially if the insured property suffers no loss during the currency of the policy. That said, the volume of case law on the matter is negligible. Perhaps this can be explained by the readiness of the assured to affirm any such breach occurring at the pre-contractual stage where the subject matter suffers a loss coming under the policy. In that case, running a misrepresentation defence might well secure the return of the premium for the assured but the cost will be losing right of recovery under the policy.

4-2 In the insurance context, the insurer's duty of good faith was analytically considered for the first time in *Banque Financière de la Cité v Westgate Insurance Co Ltd*,³ almost 80 years after the passing of the MIA 1906.⁴ The case has confirmed that the insurer owes a duty of utmost good faith to the assured. Given that ss 18–20 of the MIA 1906 devote their attention to specific pre-contractual duties of the

¹ (1808) 1 Camp 401. See also, *Hughes v Liverpool Victoria Legal Friendly Society* [1916] 2 KB 482.

² In cases where the insurer's misrepresentation was deemed to be fraudulent, the assured was also awarded damages. See e.g., *Refuge Assurance Company Ltd v Kettlewell* [1909] AC 243.

³ [1987] 1 Lloyd's Rep 69; [1990] 1 QB 665 (CA); [1991] 2 AC 249 (HL) (*sub nom Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd*).

⁴ In fact, it was Lord Mansfield who first alluded to the possibility that the doctrine of utmost good faith might have a role to play in this context without engaging in any thorough analysis. In *Carter v Boehm* (1766) 3 Burr 1905, his Lordship famously said: 'The policy would equally be void, against the underwriter if he concealed; as, if he insured a ship on her voyage, which he privately knew to be arrived, and an action would lie to recover the premium.'

assured and his intermediaries, the only provision in the Act that the insurer's duty could derive from is s 17 of the MIA 1906 which is worded in general terms: 'A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.'

4-3 Tracing the source of the insurer's duty of good faith to s 17 is, undoubtedly, a rational stand to take, but this does not necessarily provide a comprehensive legal framework in which the duty can flourish. The relevant statutory provision, in very general terms, stresses that insurance contracts are contracts of good faith and in case of breach of this duty, the other party, in this case the assured, can avoid the contract. However, a whole host of issues in relation to the scope of the duty remain unresolved. For example, would it be necessary that the misrepresentation is material? If so, how would the test of materiality operate given that the test specified in ss 18(2) and 20(2) is clearly not appropriate in this context? Also, would it be necessary that the assured is induced to enter into the contract as a result of misrepresentation? What would be the impact of fraud on materiality and inducement requirements?

4-4 In unpicking this conundrum, it might be useful to draw parallels with the assured's duty of utmost good faith, particularly at the pre-contractual level.⁵ Any misrepresentation is actionable in the context of the assured's duty of good faith, as long as it is material and induces the assured to enter into the contract or to enter into the contract on those terms. Logic would dictate that insurer's duty of utmost good faith should keep abreast with the doctrine that applies in the case of the assured's duty of good faith at the pre-contractual stage given that the mutuality of the duty has been echoed on several occasions by the highest court in this jurisdiction.⁶ This has been recognised by the Court of Appeal in *Banque Financière de la Cité v Westgate Insurance Co Ltd*,⁷ where a different materiality test, which seems to have found considerable support at the House of Lords, has been laid down. In the particular case, there was no need to be drawn into a comprehensive analysis of the finest details of the materiality test in this context, but the Court of Appeal's view was that a circumstance will be deemed material if it is relevant 'either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent assured would take into account in deciding whether or not to place the risk for which he seeks to cover with that insurer'.⁸ In similar fashion, neither the Court of Appeal nor the House of Lords had to consider the need for inducement in this context, but following the reasoning of Lord Mustill in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*,⁹ it can be safely assumed that 'inducement' being part of general law of contract pre-dating the MIA 1906,

⁵ See the House of Lords' decision in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501.

⁶ *Banque Financière de la Cité v Westgate Insurance Co Ltd (sub nom Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd)* [1991] 2 AC 249, at 281–2, per Lord Jauncey and *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, at 549, per Lord Mustill.

⁷ [1990] 1 QB 665.

⁸ *Ibid*, at 772.

⁹ [1995] 1 AC 501, at 541–50.

remains ‘intact’ in this context by virtue of s 91(2) of the MIA 1906.¹⁰ By adopting a similar type of reasoning there is room to argue that the requirement of materiality should be dispensed if it is demonstrated that the insurer acted fraudulently when presenting the risk,¹¹ although the opportunity to debate this issue further has not presented itself in the case of *Banque Financière de la Cité*.

4-5 Keeping up with the spirit of the general principles laid down by the Court of Appeal in *Banque Financière de la Cité*, in the absence of fraud, it is doubtful whether the assured will have an actionable misrepresentation if the insurer with misleading statements leads the assured to believe that there is no prospect for him to get a better deal from any other insurer in the market. That is because the test restricts the scope of materiality to circumstances that will have an impact on the nature of the cover or recoverability of a claim under the policy. Other considerations, such as the state of the market, would not be treated as relevant for this purpose. However, fraud on the part of the insurer might alter the whole equation. If it can be proven that the insurer is capable of putting forward misleading statements at the pre-contractual stage in the full knowledge that they are not accurate and with the intention of deceiving the assured, such statements could be treated as material regardless of whether they relate to any circumstance that will have an impact on the nature of the cover or recoverability of a claim under the policy. That is because an insurer who is tainted with fraud ceases to be the kind of party that a prudent reasonable assured would wish to have contractual relations with.¹²

4-6 However, if the rationale behind the materiality test is carried to its natural conclusion, it is very likely that an assured who is convinced to enter into an agreement which proves to be worthless as a result of misleading statements made by the insurer as to the scope of the coverage will have an actionable case against the insurer for misrepresentation. The prospect of bringing duty of utmost good faith into play would not necessarily put the assured in a more advantageous position in terms of remedies. That is because in *Banque Financière de la Cité* it has been held by the Court of Appeal,¹³ reversing the judgment of Steyn J, that the only remedy for breach of utmost good faith is avoidance and no damages could be made available for the innocent party. In the absence of damages as a remedy, it would be a rather pointless exercise for the assured to avoid the insurance contract, especially at a time when the insured property suffers a loss.

4-7 The stand taken by the Court of Appeal on the unavailability of damages for breach of good faith obligation seems to have been endorsed by the House of Lords.¹⁴ Whilst a more comprehensive analysis on the case will be carried out elsewhere in the chapter, it is useful at this stage to consider the reasons given by

¹⁰ This sub-section reads:

(2) The rules of the common law, including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts of marine insurance.

¹¹ See *Sibbald v Hill* (1814) 3 ER 859, at 861, per Lord Eldon. See also *The Bedouin* [1894] P 1, at 12, per Lord Esher MR; *Smith v Kay* (1859) 7 HLC 750, at 759, per Lord Chelmsford, LC and *Gordon v Street* [1899] 2 QB 641, at 646, per Smith LJ.

¹² In this context, fraud might be said to be capable of creating a moral hazard.

¹³ [1990] 1 QB 665.

¹⁴ [1991] 2 AC 249, at 980, per Lord Templeman. The parties in *Manifest Shipping Co Ltd v*

the judiciary to justify lack of damages in this context. Tracing the origins of the duty of good faith to the provisions of the MIA 1906 made it essential to carry out an analysis on the jurisdictional basis of such a statutory duty. Drawing a parallel with duress and undue influence, Slade LJ was convinced that in the context of insurance contracts, the duty of good faith stems from the jurisdiction originally exercised by the Courts of Equity. As the reasoning goes, since duress and undue influence as such give rise to no claim for damages, the same should hold true for pre-contractual breaches of good faith.¹⁵

4-8 It can be forcefully argued that the Court of Appeal's reasoning on this point does not stand up to scrutiny. First, it is conceptually, at least, doubtful whether good faith obligation in insurance contracts, which imposes positive obligations of candour and disclosure, can be treated in a similar fashion with concepts such as duress and undue influence that concern improper motives or vitiating factors that may affect the contract.¹⁶ Second, it would be very difficult to sustain the stance that the claimant is not entitled to compensation for breach of equitable obligations on the part of the defendant even if it is assumed that the duty of good faith is equitable in origin. Undoubtedly, it is the case that compensation for breach of equitable obligations is generally called 'indemnity' rather than 'damages' and fine distinctions between these concepts exist.¹⁷ However, there is no legal principle preventing the judges from awarding compensation in cases of breach of obligations emanating from equity; in several cases such remedies have been made available by courts.¹⁸ Lastly, but perhaps most significantly, tracing the origins of the duty of good faith in insurance contracts to the jurisdiction of the Court of Chancery is at odds with the historical setting. It is undisputable that equity exercised jurisdiction over insurance contracts vitiated by non-disclosure and misrepresentation.¹⁹ However, a careful analysis of case law leaves no doubt that the equity's jurisdiction on such matters was restricted to granting of orders for the policy to be delivered up and cancelled and proceedings on it at law to be restrained in cases where the policy was said to be vitiated by the assured's misrepresentation or non-disclosure.²⁰ In fact, for a considerable period of time and certainly until the judicature reforms, the Chancery's attitude in insurance cases concerning non-disclosure or misrepresentation was to refrain from exercising jurisdiction in cases where the matters alleged by the bill afforded a defence to a claim on the policy at common law. In those cases,

Uni-Polaris Insurance Co Ltd (The Star Sea) [2001] UKHL 1; [2003] 1 AC 469; [2001] 1 Lloyd's Rep 389 were prepared to proceed on the premise that good faith duties do not attract damages as a remedy.

¹⁵ [1990] 1 QB 665, at 780.

¹⁶ See Eggers, PM, Picken, S and Foss, P, *Good Faith and Insurance Contracts* (3rd edn) (2010, Lloyd's List), para 16.134.

¹⁷ See *Whittington v Seal-Hayne* (1900) 82 LT 49. For a comprehensive analysis on the subject, see McGhee, J (ed), *Snell's Equity* (32nd edn) (2010, Sweet & Maxwell).

¹⁸ See, in particular, *Nocton v Lord Ashburton* [1914] AC 932 in the context of breach of fiduciary obligations found in equity. Similarly, the court was prepared to allow an insurer to be awarded monetary compensation for the breach by the assured of his 'equitable duty' to preserve subrogation rights. The matter has been debated in a more comprehensive fashion by Professor Robert Grime in *Modern Law of Marine Insurance, Volume 2* (2002, LLP) edited by Professor DR Thomas; see 'Counterclaims by Marine Insurers' at pp 275-6.

¹⁹ Rather interestingly, in *Carter v Boehm* (1766) 3 Burr 1906, at 1909, Lord Mansfield commented that 'Both sides had long been in Chancery.' There is, however, no trace of case reports of the proceedings.

²⁰ *Barker v Walters* (1844) 8 Beav 92.

the Chancery would send an insurer's claim for relief to the common law courts for trial.²¹ It is, therefore, clear that the role of the equity in this context was viewed to be secondary, militating against the proposition that the origins of the duty in insurance law are founded in the law of equity.²² Most of the principles on the duty of good faith in insurance law emanate from the judgments of Lord Mansfield in the latter half of the eighteenth century. Lord Mansfield was a common law judge serving in common law courts and naturally applying common law principles. The fact that the Chancery had a secondary role to play in this context does not in any way lend support to the proposition that the concept of good faith in insurance law is equitable in origin.

4-9 The strength of these arguments does not change the fact that damages under the relevant provisions of the MIA 1906 will be unavailable unless, of course, the Supreme Court decides to reconsider its position or there is a statutory interference in this field.²³ However, it should not be assumed that lack of damages stemming from a breach of good faith obligation will have a huge impact on the assured's position particularly in cases of misrepresentation. It is, theoretically at least, open to an assured who is induced to enter into an agreement by the insurer's misrepresentation to seek damages by relying on alternative causes of action. If, for example, fraud is established on the part of the insurer, the assured will be able to bring a counter claim based on the tort of deceit. A fraudulent misrepresentation made by the insurer to induce the latter to enter into the contract is likely to satisfy ingredients of the tort of deceit.²⁴ When it comes to the measure of damages for the tort of deceit, the assured will be entitled to an award which would put him in the same position he would have been in had the tort not been committed. This would,

²¹ See *Wilson v Duckett* (1762) 3 Burr 1361 and *Duncan v Worrall* (1822) 10 Price 31.

²² The long-standing relationship between the equitable and common law jurisdictions in matters of insurance prior to the Judicature reforms was explained by Lord Selborne, LC in *Hoare v Brembridge* (1872) LR 8 Ch App 22, at 26-7:

... if there be a legal defence to a written instrument depending on facts not appearing upon the face of the instrument, the party charged on that instrument with some liability may come into a Court of Equity to get rid of it, notwithstanding the legal defence, because the evidence of those extrinsic facts upon which the defence depends might not be forthcoming at all times and under all circumstances. That would apply even perhaps to cases that were not strictly cases of fraud. But, independently of that, where a case of fraud is alleged, this Court has an original and unquestionable jurisdiction. We proceed, therefore, upon the ground that this Court would have jurisdiction to deal with such a case as this at the hearing. But it is to be observed that it is only in an imperfect sense that a case of this kind is one of concurrent jurisdiction. Each party, to be an actor and to bring forward his own case, is not at liberty to choose this Court or the Court of Law as he pleases, but each, if he would be Plaintiff, must come the one into equity and the other into a Court of Law. Each is *rectus in curia*. The assured cannot come into equity to sue on this policy; the office, the insurers, can come into equity only before they are sued, to have it delivered up to be cancelled. Each, therefore, is suing, of necessity, in the proper Court, and in the only Court in which he can sue, to have that which he claims as his right. But what the one claims as his right in equity would constitute his defence at law; what the other claims as his right at law would constitute his defence in equity. That is the true state of the case.

²³ English and Scottish Law Commissions are currently considering a potential law reform in this area. Their current proposals on this area of law are deliberated further in [Chapter 6](#).

²⁴ In line with the judgment in *Derry v Peek* (1889) 14 App Cas 337, it should be demonstrated in this context that the insurer made a false representation, which was known or believed by the insurer to be false, without belief in its truth, or at least made recklessly by the insurer without caring whether the fact represented was true or untrue, with the intention that the assured would rely upon such misrepresentation.

therefore, enable the assured who enters into an insurance contract as a result of the fraudulent misrepresentation of the insurer and finds out later that the policy has no practical use for him, to recover the cost of repair or cost of reinstatement in cases where the subject matter suffers a loss, on the premise that he has been deprived of the anticipated benefits from pursuing an alternative course of action (e.g. purchasing another insurance policy).²⁵ It should also be noted that the right to claim damages for tort of deceit is treated as a cumulative, not an alternative, right to claim avoidance of the contract tainted with fraudulent misrepresentation.²⁶ On that basis, it would be still open to the assured to claim damages (e.g. pre-litigation costs) even if he decides to affirm the contract despite the insurer's fraudulent misrepresentation at the formation stage.

4-10 The introduction of the Misrepresentation Act 1967 does not provide a significant change in the position of the assured in cases of fraudulent misrepresentation. The assured still has a right to sue for recession and damages if he can demonstrate that he has been induced to enter into a contract by reason of misrepresentation which resulted in him suffering a loss and the insurer did not have reasonable grounds for believing, or did not believe prior to the contract, that the facts, as represented, were untrue.²⁷ The Misrepresentation Act 1967, however, provides an opportunity to the assured to sustain a claim for damages where the misrepresentation is negligent without requiring the assured to demonstrate that the insurer was subject to a duty of care to represent the facts accurately. Put another way, the Act reverses the common law position²⁸ to the extent that there is no requirement that a special relationship that gives rise to a duty of care between the assured and insurer exists; it is adequate if misrepresentation is made negligently by one contracting party to the other. The Act also allows the assured to recover damages in the same measure as if he were suing for deceit,²⁹ so the measure of damages will be calculated more favourably from the assured's perspective.

4-11 For the sake of completeness, it should be stressed that courts have been granted discretion by virtue of s 2(2) of the Misrepresentation Act 1967 to award damages in lieu of recession for misrepresentation that was neither fraudulent nor negligent.³⁰ This provision might, on paper, afford an additional remedy to the assured in cases of innocent misrepresentation. However, whether any misrepresentation in the context of insurance law can be viewed to be related only to a minor matter is more debateable, especially considering that insurance contracts are contracts of good faith. Furthermore, Steyn J, in *Highlands Insurance Co v Continental Insurance Co*,³¹ was adamant that the remedy of avoidance, especially

²⁵ See *East v Maurer* [1991] 1 WLR 461 and *Dadourian Group International v Simms* [2006] EWHC 2973 (Ch); [2006] All ER 351.

²⁶ *Adam v Newbigging* (1887) LR 34 Ch D 582, at 592, per Bowen LJ.

²⁷ See s 2(1) of the Misrepresentation Act 1967.

²⁸ *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.

²⁹ See *Royscot Trust Ltd v Rogerson* [1991] 2 QB 297.

³⁰ The wording of the relevant provision is not confined to wholly innocent misrepresentation. Therefore, in cases of negligent misrepresentation it is open to the court to declare the contract subsisting and to award damages to the innocent party in lieu of recession. In practice, courts would use the discretion they have been awarded if the representation is related to a relatively minor matter (see e.g., *William Sindall plc v Cambridgeshire County Council* [1994] 1 WLR 1016).

³¹ [1987] 1 Lloyd's Rep 109, at 117–18.

in commercial contracts, carries a 'policing function' and for public policy reasons, it would be undesirable to grant relief from avoidance by virtue of s 2(2) of the Misrepresentation Act 1967. It is, therefore, possibly safe to assume that damages will not be available to the assured under the Misrepresentation Act 1967 in the absence of fraud or negligence on the part of the insurer.

(2) Non-disclosure, Fraud and Remedies

4-12 Potentially, the insurer's obligation of good faith at the pre-contractual stage could be invaluable for the assured where he suffers a loss, but contrary to his belief, it transpires that the loss does not fall under the scope of the policy. In those circumstances it is conceivable that the assured puts the insurer into his sight as a potential defendant for failing to disclose certain attributes in relation to the risk to the assured prior to the conclusion of the contract, which would have had an impact on his decision to enter into the contractual relationship or not. Surprisingly, there was a lack of legal engagement with this type of eventuality until *Banque Financière de la Cité v Westgate Insurance Co Ltd*.³² The relevant facts of this rather complex case can be summarised as follows. A fraudster named Ballestero persuaded a consortium of Swiss banks to make loans of 26.25 million Swiss francs to four companies controlled by him. The primary security for the loan was a parcel of gemstones which was independently valued at 95 million Swiss francs. In fact, the parcel of gemstones later proved to be worthless. As secondary security, a credit insurance policy for 37 million Swiss francs was put forward which had specifically been written to cover default by Ballestero's companies or if the gemstones proved to be inadequate security. The banks instructed an insurance broker to arrange the credit insurance policy. The task of securing the policy was delegated to one of the employees of the broker's firm, Mr Lee. In the process of setting up the credit policies with various insurers Mr Lee engaged in several fraudulent activities. In particular, he issued cover notes on behalf of some of the insurers undertaking second and third layers of the insurance several months prior to these policies being, in fact, obtained. By June 1980, the full amount of insurance had been obtained. In May 1980, however, an employee of one of the underwriters providing cover for the primary level became aware of Mr Lee's fraud but did not report this to the banks. Under the assumption that the loans were firmly secured, the banks continued making advances of up to 80 million Swiss francs to the companies of Ballestero between August 1980 and March 1981. Mr Lee was asked to extend the current layers of credit insurance and arrange a fourth layer. The fourth layer had never been arranged, although continuing with his earlier practice, Mr Lee issued a cover note for the banks. Before Mr Lee's wrongdoings were discovered, the extent of the fraud perpetrated by Ballestero became apparent when his companies defaulted on repayment of the loans. In 1983, the banks brought actions against the insurance brokers and Mr Lee for negligence and fraud respectively. The claim was settled by the insurance brokers to the extent of their liability insurance. When the banks turned to the credit insurers, to the extent that

³² [1990] 1 QB 665; [1987] Lloyd's Rep 69; [1990] 1 QB 665 (CA); [1991] 2 AC 249 (HL) (*sub nom Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd*).

such policies were in place, the underwriters refused payment on the ground of Ballestero's fraud by virtue of a clause that appeared in the credit policies:

The insurers shall not be liable hereunder for . . . any claim or claims arising directly or indirectly out of or caused directly or indirectly by fraud attempted fraud misdescription or deception by any person, firm or, company.

Running out of options, the banks then turned to the insurers on the premise that they had failed to inform them of other frauds committed by Mr Lee about which they were aware. It was contended that, had there been full disclosure, the banks would have gone elsewhere for the additional insurance and would not have used the relevant brokerage firm, particularly Mr Lee. The damages sought from the insurers represented the advances made between August 1980 and March 1981.

4-13 The first instance judge and the Court of Appeal attempted to resolve the dispute by engaging in an analysis of the insurer's pre-contractual duty of disclosure and remedies available. The main difficulty with this approach is that the insurers became aware of Mr Lee's fraud only after the primary layer of insurance had been put in place. It is, therefore, plausible to suggest that the fraud was discovered by the insurer only at a time when an attempt to make a variation in the existing policy (i.e. by adding second and third layers of cover to the existing primary cover) was made by the assured, therefore the alleged misbehaviour of the insurer related only to the post-contractual stage.³³ Perhaps, it was for that reason that the argument proceeded along rather different lines before the House of Lords. Their Lordships, viewing the matter in a different light, came to the conclusion that the case could be disposed of without considering whether the insurer was under a duty to disclose Mr Lee's fraud by reason of the obligations of an insurer to deal with the proposer of the insurance with the utmost good faith.³⁴ The House of Lords found in favour of the insurers by employing a straightforward causation analysis. It was held that the losses suffered by the banks did not stem from the fraudulent activities of Mr Lee carried forward by the brokerage firm's failure to inform them. Mr Lee's fraud did not cause a claim under the policy to arise. It was the fraud of the borrower, Ballestero, which caused the loss under the policy in the present case; but that kind of loss was excluded from the policy anyway, by express provision of the contract.³⁵

4-14 Even though the matter did not receive the full attention of the House of Lords, the courts below engaged in a painstaking analysis of the insurer's duty of disclosure at the pre-contractual stage. In particular, the opinions expressed by the Court of Appeal can be viewed as providing insightful guidance on the matter. The first issue that needed to be settled was the nature of the materiality test in this context. On that matter, the first instance judge, Steyn J, took a very liberal stand. He was disposed to accept that the duty of the insurer at the pre-contractual stage

³³ The nature and scope of disclosure that should accompany variations to an insurance contract has not yet been settled by authorities.

³⁴ [1991] 2 AC 249, at 280, per Lord Templeman.

³⁵ Another argument put forward by the banks was that the insurers owed them a common law duty of care under which the true state of facts ought to have been disclosed to them. This was also rejected by the courts in the present case.

should be viewed as an example of his general duty of ‘good faith and fair dealing’ and, accordingly, the insurer should be expected to disclose every circumstance and fact which, if not disclosed, would influence the assessment process of the assured as to whether or not to conclude the contract.³⁶ Applying this test, Steyn J reached the conclusion that the leading underwriter was in breach of his pre-contractual disclosure obligation by not revealing the fraud of Mr Lee because he was a key figure in setting up the second and third layers of cover and the banks heavily relied on him for their information concerning the transactions.³⁷

4-15 The fundamental problem in Steyn J’s analysis is the fact that the scope of materiality is so far-reaching that if adopted, good faith and fair dealing would possibly require the insurers to disclose not only circumstances pertinent to the nature of the risk but also possibly provide advice as to the terms of the contract that the assured is about to enter, or even guidance as to the state of the market on a particular product. Naturally, these are the duties that one would expect an independent agent (i.e. a broker) to perform at the formation stage, but perhaps not an insurer. Also, defining ‘materiality’ in this fashion would put the concept out of line with its counterpart that applies to the assured at the pre-contractual stage. In that context, the disclosure duty would not require the assured to give guidance to the insurer as to the nature of their business or the state of the market.³⁸

4-16 Pleasingly, the Court of Appeal has taken a more sober stand on the matter. Whilst concurring with Steyn J that there had been a breach by the insurers of the duty of disclosure, the Court of Appeal has subscribed to a rather different and more precise materiality test. In the Court’s view, the insurer is expected to disclose at the pre-contractual stage all facts known to the insurer as long as such facts relate to ‘the nature of the risk sought to be covered or the recoverability of a claim under the policy which a prudent insured would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer’.³⁹ Tying the materiality requirement to factors that are relevant to the decision-making process of the assured, such as attributes of the risk and recoverability under the policy, the Court of Appeal has marked its boundaries in a clearer fashion compared to Steyn J’s test.⁴⁰ Under this test it is likely that the insurer will be expected to disclose: the existence of fraud in connection with the risk undertaken; any defence of which he

³⁶ [1987] 1 Lloyd’s Rep 69, at 95.

³⁷ The driving force behind the judgment of Steyn J was a desire to find a suitable remedy in all circumstances (*ubi jus ubi remedium*). His ruling seems to have been based on his appreciation of ‘justice and policy considerations’. See, in particular, [1990] 1 QB 665, at 706.

³⁸ Courts have repeatedly held that the disclosure duty of the insurers at the pre-contractual stage is not extended to giving advice as to the state of the insurance market, in particular the losses facing the insurers on a particular type of product. Rix J, in *Norwich Union Life Insurance Society v Qureshi* [1999] Lloyd’s Rep IR 263, at 272, expressed the view that the imposition of a duty of good disclosure on insurers in relation to the investments to be made by the assured would convert them into financial advisers. The Court of Appeal decided in a similar fashion in joint cases *Aldrich v Norwich Union Life* and *Norwich Union Life v Qureshi* [2000] Lloyd’s Rep IR 1.

³⁹ [1990] 1 QB 665, at 772.

⁴⁰ It should be stressed that the Court of Appeal’s approach to materiality found considerable support at the House of Lords, even though it was not necessary to apply it to solve the case. Lord Templeman, [1991] 2 AC 249, at 280, who gave the only substantial speech in the House, described the reasons given by the Court as ‘cogent’.

is aware and may rely on at a later stage;⁴¹ information in relation to the state of the subject matter insured that the insurer is privy to;⁴² and even foreign illegality⁴³ or any proposed change in law that might have an impact on recovery under the policy.⁴⁴

4-17 The decision of the Court of Appeal, however, still left a sour taste in the mouths of the banks, despite the victory on the point of materiality, as they failed in their quest to recover damages for the insurer's breach of good faith. As discussed above,⁴⁵ the Court of Appeal took the stand that the relevant provisions of the MIA 1906 do not give rise to damages. It was deliberated in the case whether damages can be founded on alternative causes of action other than the statutory provisions of the MIA 1906. One possibility contemplated was whether damages could be recoverable for breach of contract. For this to work, it would be essential to show that the pre-contractual duty of good faith takes effect as an implied term of the contract. This is a very tall order indeed, as it is conceptually rather difficult to reconcile the contractual analysis with the fact that the duty of good faith in this context relates to a pre-contractual stage. Put another way, how is it that the existence of a duty, which is relevant to the pre-contractual stage, can be traced to a contract which was not in place at the relevant time? The contractual analysis did not advance the banks' case in *Banque Financière de la Cité*, but this point was stressed forcefully in other judicial decisions.⁴⁶

4-18 In similar fashion, the banks did not have much joy in demonstrating that the insurer's non-disclosure gave rise to a tort action. The Court of Appeal found no authority of any common law to support the existence of such a tort and was rather reluctant to create a novel tort of this nature. At the end of the day, what the court was requested to do was to offer a policy decision as to whether or not a new tort of this nature should be created. It offered four reasons for answering this question in a negative fashion, placing particular emphasis on the fact that creating a new tort might well work against the assured as it would allow the insurers to pursue assureds for damages even in cases of innocent non-disclosure.⁴⁷ Admittedly, some of the

⁴¹ This would have been the case in *Banque Financière de la Cité v Westgate Insurance Co Ltd* if the insurer had been aware of the fact that Ballestero was a fraudster. This would have invalidated any claim made under the credit insurance policy due to the exclusion clause in the contract.

⁴² *Carter v Boehm* (1766) 3 Burr 1905.

⁴³ An example would be where the kidnap and ransom insurer providing cover for a ship registered in a foreign country fails to disclose to the assured that a ransom payment would be illegal under the law of that state.

⁴⁴ For a similar situation, see *Duffell v Wilson* (1808) 1 Camp 401.

⁴⁵ See [4-6] to [4-9].

⁴⁶ See particularly, the decision of the Court of Appeal in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1990] 1 QB 818. Previously non-disclosure had not been viewed as a breach of contract that could engender an award of damages; see *Glasgow Assurance Corp Ltd v William Symondson & Co* (1911) 16 Com Cas 109, at 121, per Scrutton J.

⁴⁷ Slade LJ put this point emphatically, [1990] 1 QB 665, at 780, when he said:

An insured who had in complete innocence failed to disclose a material fact when making an insurance proposal might find himself subsequently faced with a claim by the insurer for a substantially increased premium by way of damages before any event had occurred which gave rise to a claim. . . . In our judgment, it would not be right for this court by way of judicial legislation to create a new tort, effectively of absolute liability, which could expose either party to an insurance contract to a claim for substantial damages in the absence of any blameworthy conduct.

reasons put forward were far from convincing. For example, it does not take the argument further to say that there is no suggestion in the relevant sections (particularly ss 17–20) of the MIA 1906 that a breach of the obligation of good faith will give rise to a claim for damages. That is undoubtedly correct, but given that a majority of the provisions of the MIA 1906 are not obligatory in nature, it is certainly open to the judiciary to develop additional legal remedies as it deems necessary.

4-19 Perhaps the Court of Appeal was also wary of the fact that the extent of damages would be more generous than those for breach of contract if a new tort is to be created. For example, if an assured is allowed to recover damages from the insurer for failing to disclose a material fact, the availability of damages will be dependent upon the foreseeability of such losses at the time of the tort. The foreseeability test is inherently vague, allowing the courts room for manoeuvre. Whether or not the foreseeability test is satisfied would depend a great deal on how the kind of loss suffered by the innocent party is described.⁴⁸ It is, therefore, possible that the assured could claim losses well beyond the value insured under the insurance policy. This, potentially at least, can lead to an unrestricted increase in the insurer's liability. An institutional author is also of the opinion that the stand taken by the Court of Appeal in *Banque Financière* on the matter could be the consequence of the higher courts attempting to cut back on the availability of tortious remedies at the time.⁴⁹

4-20 Over the years, doubts have been cast on the reasoning adopted in *Banque Financière* case⁵⁰ and the court has often been criticised for being overcautious in not creating a new tort whilst that has not been the case in other areas of law.⁵¹ The truth of the matter is that a policy decision has been made which has since found considerable support in the judiciary.⁵² The position is unlikely to change but for the intervention of the Supreme Court or the legislator.⁵³

4-21 The courts have also turned their face away from any attempts made by assureds to seek damages for breach of a pre-contractual duty of good faith on the

⁴⁸ See e.g., the difference in the outcomes of *Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound)* [1961] AC 388 and *Overseas Tankship (UK) Ltd v Miller Steamship Co Pty (The Wagon Mound (No 2))* [1967] 1 AC 617. The facts of both cases were identical with opposite outcomes due to the fact that in the latter case additional scientific information was provided to demonstrate that the kind of loss claimed was foreseeable.

⁴⁹ Birds, J, *Birds' Modern Insurance Law* (8th edn) (2010, Sweet and Maxwell), p 155.

⁵⁰ See, in particular, Grime, R, 'Counter Claims by Marine Insurers' in *Modern Law of Marine Insurance, Volume 2* (2002, LLP) edited by Professor DR Thomas, at 274–6 and Eggers, PM, 'Remedies for the Failure to Observe the Utmost Good Faith' (2003) *Lloyd's Maritime and Commercial Law Quarterly* 249, p 175.

⁵¹ For example, a new tort of 'breach of confidence' has been introduced in *Fraser v Thames Television* [1984] QB 44; [1998] 2 All ER 101.

⁵² See, in particular, *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483, at [68], per Rix LJ.

⁵³ It should also be borne in mind that the Court of Appeal in *Banque Financière* was adamant that the duty of utmost good faith does not import a duty of care on the parties. The common law courts would normally regard the existence of a contractual relationship as a major obstacle for creating a common law duty of care: see particularly the remarks of Lord Scarman in *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd (No 1)* [1986] AC 80, at 106–7. The Court of Appeal took the view that recognising the existence of a duty of care in this context would amount to creating legal liability from an act of pure omission. This was also regarded as undesirable. The House of Lords seems to be in agreement with the Court of Appeal on this point.

part of the insurer by forcing the boundaries of relevant statutes. In the joint cases of *Aldrich v Norwich Union Life* and *Norwich Union Life v Qureshi*,⁵⁴ one of the arguments put forward by the assured was that s 47 of the Financial Services Act 1986⁵⁵ could give rise to damages. The relevant provision made it a criminal offence for any person to make a false, misleading or deceptive statement, or dishonestly to conceal any material fact. The Court of Appeal did not agree. It was emphasised that the section did not expressly give rise to civil rights, whereas the Act in a number of other contexts created civil rights. It was also evident that the court was not prepared to intervene with the established doctrines of the common law and stressed that the section did not create a duty of disclosure wider than that recognised at common law. There is no reason to subscribe to the view that the equivalent provision, s 397 in the Financial Services and Markets Act 2000 has intended to create a change in the legal position.

4-22 Lastly, it should be noted that proving the fraud of the insurer would not advance the legal position of an assured seeking to recover damages where the insurer fails to disclose material facts at the pre-contractual stage. It is unlikely that an insurer's intentional decision to remain silent will render his conduct equivalent to making a false statement, which is the essential ingredient of the tort of deceit.⁵⁶ In similar fashion, the relevant provisions of the Misrepresentation Act 1967 will not be applicable in this context given that the insurer's concealment does not amount to an actionable wrong within the scope of the Act.

II POST-CONTRACTUAL STAGE

4-23 Extending the scope of s 17 to the post-contractual stage⁵⁷ would lead inevitably to the conclusion that the duty applies equally to the insurer subsequent to the conclusion of the insurance contract. That being the case, in the light of leading authorities on the matter, it would be natural to assume that s 17 at the post-contractual stage would be restricted to circumstances where the insurer's act is fraudulent. This was, in fact, the line taken by Mance J in *The Standard Steamship Owners' Protection and Indemnity Association (Bermuda) Ltd v Oceanfast Shipping Ltd (The Aimikolas)*⁵⁸ several years prior to the decision of the House of Lords in *The Star Sea*. There, the assured contended that the insurer was in breach of his post-contractual duty of good faith by claiming a payment of interest from the assured after the conclusion of the contract when no such claim was justified by the terms. The assured's contention failed on the ground that a mere mistake in the interpretation of facts was not adequate to warrant avoidance, especially where the mistake had been made after the conclusion of the contract. Mance J was adamant that the

⁵⁴ [2000] Lloyd's Rep IR 1.

⁵⁵ The Act was later repealed. A similar provision now appears in s 397 of the Financial Services and Markets Act 2000.

⁵⁶ Viscount Maugham in *Bradford Third Equitable v Borders* [1941] 2 All ER 205, at 211, noted that 'mere silence, however morally wrong, will not support an action for deceit'.

⁵⁷ *The Star Sea* [2001] UKHL 1; [2003] 1 AC 469.

⁵⁸ Unreported, QBD (Comm Ct) (7/3/96).

assured needed to demonstrate that the insurer had acted either intentionally or recklessly.

4-24 However, it would be presumptuous to conclude that s 17 will apply in all circumstances where the insurer acts with a fraudulent intent towards the assured at the post-contractual phase. Logic suggests that the materiality test laid down by Longmore LJ in *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*⁵⁹ should be relevant in this context, as well as restricting the scope of s 17 further to circumstances of repudiatory breach. Put another way, it should be a prerequisite for the application of s 17 that the insurer acts fraudulently at the post-contractual stage and the gravity of fraud or its consequences must be such as would enable the assured, if he wished to do so, to terminate for breach of contract.⁶⁰

4-25 Apart from the restrictions imposed on the scope of the duty at the post-contractual stage, it should also be borne in mind that the effectiveness of the doctrine at the post-contractual stage has been minimised significantly due to its association with s 17. The only remedy afforded by this section is avoidance of the contract, which would be of limited value to the assured in most cases where the insurer intentionally and recklessly behaves in a manner at odds with the spirit of good faith, after the conclusion of the insurance contract. The factual background of a well-known case, *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)*,⁶¹ may be borrowed to illustrate this point. There, the owners of the insured vessel obtained war risk cover on the condition that the vessel would not enter into an additional premium area without prompt notice being given to the underwriter. As mortgagee of the vessel, the proceeds of the policy were assigned to the claimant bank under an agreement to which the insurer was itself a party. The assured was in the practice of sending the insured vessel into the additional premium area without giving prior notice. This became known to the insurer's London agent but not to the bank. When the insured vessel was destroyed as a result of a missile fired from Iraqi helicopters, the insured's claim for indemnity was turned down by the insurer. Subsequently, the bank brought an action against the insurer asserting that the continuing duty of good faith obliged the insurer to disclose to the bank the fact that the insured vessel was trading in the additional premium area, risking the validity of the cover. The Court of Appeal was prepared to accept that the insurer owed a continuing duty of good faith to the assured to disclose such circumstances but the insurer's duty did not extend to the bank, which was only the assignee of the proceeds of the policy and not the policy itself. If the position of the bank is considered in the light of authorities considered above, it is apparent that the outcome of the case would have been the same even though the bank had been assigned the policy and the insurer withheld such information fraudulently. In those circumstances, insurer's breach of continuing duty of good faith would have

⁵⁹ [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563.

⁶⁰ Needless to say, it is open to judicial authorities to introduce a different kind of materiality test; but the test developed by Longmore LJ in *The Mercandian Continent*, *ibid*, has an appeal given that it successfully blends the contractual remedies with the remedy of avoidance stipulated in s 17.

⁶¹ [1988] 1 Lloyd's Rep 514; *rev'd* [1989] 2 Lloyd's Rep 238; [1990] 1 QB 818 (CA); *rev'd* [1991] 2 Lloyd's Rep 191; [1992] 1 AC 233 (HL).

possibly brought s 17 into play,⁶² but given that the only remedy stipulated in that section is avoidance, the bank would have recovered nothing by way of damages for the breach. Needless to say, the prospect of recovering damages in this case would have been available, had the continuing duty of good faith taken effect as an implied term and not been traced to a principle of law manifested in s 17.⁶³ However, in light of the stand taken by the House of Lords in *The Star Sea*,⁶⁴ and the fact that both counsels accepted that the only remedy for breach of continuing duty of good faith of the assured is avoidance in line with s 17, without the intervention of the Supreme Court it is very unlikely that a right to damages can be introduced for breach of the insurer's continuing duty of good faith.

4-26 This analysis leaves no doubt that the insurer's duty of good faith in the post-contractual context might well be alive and kicking, but in practice, it is unlikely to yield any significant gain for the assured even if the insurer's fraudulent intent is proven.⁶⁵ That said, one comes across references to the insurer's post-contractual duty of good faith in judicial opinions which does not achieve much apart from adding confusion and creating turmoil in terms of the scope of the duty. For a better understanding of the current legal position, it is vital to consider not only the development of case law but also the relationship between related concepts and the continuing duty of good faith which emerges from s 17 of the MIA 1906. The continuing duty of the insurer has often been said to be arising in the following contexts:

- insurers exercising their discretionary contractual rights;
- restricting the insurers' right of avoidance;
- handling claims; and
- agreeing a settlement.

These are analysed in turn.

(1) Exercising Discretionary Contractual Rights

4-27 Liability policies will frequently contain provisions giving the insurer the right to take over and control the defence of proceedings brought against the assured. Similarly, in certain types of reinsurance policies the contract may give the reinsurer a right to inspect the relevant documents held by the assured. It is vital that limitations are imposed on the insurer exercising such contractual rights. In *Gan v Tai*

⁶² This is assuming that the insurer's failure to disclose to the assured or assignee of the policy the existence of circumstances that will jeopardise the validity of the policy would amount to a repudiatory breach of the contract. The existence of a notification clause in the contract can arguably be viewed as the reason why such a breach is repudiatory.

⁶³ It is worth noting that at the first instance in *The Good Luck* [1988] 1 Lloyd's Rep 514, at 546, Hobhouse J stressed that his preferred choice would be to view the good faith obligation arising after the formation of the contract as a facet of the implied term analysis.

⁶⁴ Lord Hobhouse overruled the reasoning of Hirst J in *Black King Shipping Corp v Massie (The Litson Pride)* [1985] 1 Lloyd's Rep 437, which seems to divorce the requirement of good faith from the remedy of avoidance at [71]. See also, Lord Scott at [102] and Longmore LJ in *The Mercandian Continent* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, at [11].

⁶⁵ The existence of fraud might bring other remedies into play, as is considered in the following part.

*Ping (Nos 2 and 3)*⁶⁶ it was held that an insurer acting under a claims control clause should exercise his rights in ‘good faith and in the common interest on the basis of facts giving rise to a particular claim and not arbitrarily or with reference to considerations wholly extraneous to the subject matter of the particular claim’.⁶⁷

4-28 At first sight, one might be tempted to argue along the lines that the decision in *Gan v Tai Ping* is an illustration of how the continuing duty of good faith might have a role to play in shaping the scope of contractual obligations that fall on the insurer at the post-contractual phase. However, on closer scrutiny, it transpires that this is not what is suggested in the case. The reasoning seemed to be based on basic contract law principles rather than the special nature of the relationship between the insurer and the assured. In other words, the judges were simply suggesting that due to the nature and purpose of the co-operation clause, a term could be implied requiring the insurer to act in good faith to protect the interests of the assured as well as his own when exercising control over the proceedings. No attempt has been made in the judgment to define the scope of the implied obligation of acting in good faith except that it is highly unlikely that the degree of co-operation expected of the insurer will be reduced to the level of acting reasonably in an objective fashion when exercising the discretion afforded to him.

4-29 However, this analysis should not be taken as suggesting that the continuing duty of good faith has no role to play in this context. It is conceivable that an insurer will be in breach of the duty of utmost good faith if he acts fraudulently in exercising control over the proceedings⁶⁸ (e.g. by deliberately running up costs and exceeding the policy limit to the detriment of the assured if the limit of indemnity includes sums awarded by way of damages, interest and costs). However, it should be recognised that avoidance of the contract in those circumstances would scarcely be an appropriate remedy. The most appropriate course of action for the assured would be to seek damages from the insurer for breach of contract under the precedent set in *Gan v Tai Ping*.⁶⁹

4-30 Although the judgment in *Gan v Tai Ping* can be elucidated by employing a contractual analysis, the question still remains as to whether the continuing duty of good faith can be used as a platform to create contractual obligations on the part of the insurer. Undoubtedly, considerable benefits will emerge for the assured if it proves possible to integrate a continuing duty of good faith with the contractual analysis. Most significantly, the assured will be able to rely on conventional contractual remedies such as damages, specific performance and also injunctions in every circumstance without the need to demonstrate that business efficacy necessitates the implication of such a term into the contract. A degree of judicial support for

⁶⁶ [2001] Lloyd’s Rep IR 667, at [54].

⁶⁷ Similar sentiments were echoed in *Groom v Crocker* [1939] 1 KB 194 where it was held that the insurer’s right to control the litigation was subject to the requirement that ‘they do so in what they *bona fidei* consider to be the common interest of themselves and their assured’, at 203, per Sir Wilfred Greene MR.

⁶⁸ See the observations made by Longmore LJ in *The Mercandian Continent* [2001] 2 Lloyd’s Rep 563, at 572.

⁶⁹ See the judgment of Sir Thomas Bingham MR in *Cox v Bankside* [1995] 2 Lloyd’s Rep 437, at 462, where he said forcefully that he could not ‘for one instant accept . . . [the] suggestion that a breach of this duty, by an insurer, once a policy is in force, gives the assured no right other than rescission’.

development of law in that direction has been expressed in *Phoenix General Insurance Co of Greece SA v Halvanon Insurance Co Ltd*,⁷⁰ where Hobhouse J, *obiter dictum*, said that in a facultative reinsurance treaty a reinsurer's contractual right of inspection of the reassured's records would 'probably be imported by the duty of good faith.'⁷¹ As attractive as it may seem, it is submitted that it will be very difficult to reconcile such a step with the evolution that the doctrine of good faith has undergone over the last few decades. Having cut the connections of the utmost good faith doctrine with contractual devices, it will be a rather questionable contention to suggest that the doctrine, which has origins in a special rule of insurance law encapsulated in s 17 of the MIA 1906, can now be used as the foundation for creating contractual obligations. This is not to say that s 17 cannot stand side-by-side with contractual clauses. It certainly can and the availability of the remedy of avoidance stipulated in s 17 seems to have been associated with repudiatory breach of the contract.⁷² However, given that the origin of the doctrine is traced to a statutory rule, it will be very difficult and logically contradictory to argue that the same statutory provision is capable of creating contractual obligations, the breach of which brings into action contractual remedies, whilst the same statutory provision identifies avoidance specifically as the only remedy for its breach.

4-31 It is submitted that continuing duty of good faith might, on paper, be relevant where the insurer has a contractual right to exercise discretion but, in practice, it is rather questionable whether this would provide any tangible benefit for the assured, save for the possibility of other contractual remedies being brought into operation by virtue of implying terms into the contract.

(2) Restricting the Right of Avoidance

4-32 Perhaps as a result of the momentum generated from the development of the continuing duty of good faith by the appellate courts in the course of the last decade, we have witnessed the attempts made in certain judicial quarters to attribute a more extensive role to the doctrine. Although there have been hints in some previous authorities that the right to avoid may be fettered by a requirement of good faith,⁷³ it was Colman J in *Strive Shipping Corporation v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)*⁷⁴ who first brought this debate into the limelight by suggesting that the continuing duty of good faith might place constraints on the insurer's right to avoid an insurance policy due to the assured's pre-contractual breaches of utmost good faith. In that case, insurers sought to avoid a marine policy on the ground that at the time of renewal the assured failed to disclose the fact that there were suspicious circumstances which connected the assured

⁷⁰ [1985] 2 Lloyd's Rep 599.

⁷¹ *Ibid*, at 614. Hobhouse J held that such a contractual right had been implied into the contract to give business efficacy to the relationship.

⁷² See *The Mercandian Continent* [2001] 2 Lloyd's Rep 563.

⁷³ Most emphatically in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, at 555, Lord Lloyd stipulated: '... the obligation of good faith [is not] limited to one of disclosure. As Lord Mansfield said in *Carter v Boehm*, at p. 1908, there may be circumstances in which an insurer, by asserting a right to avoid for non-disclosure, would himself be guilty of want of good faith.'

⁷⁴ [2002] EWHC 203 (Comm); [2002] 2 Lloyd's Rep 88.

with previous marine casualties. Colman J held that the previous losses were not, in fact, suspicious and thus were not material. However, his additional observations on the matter were very interesting. He went on to say, *obiter dictum*, that even though the suspicious circumstances may have been material facts at the inception of the policy requiring their disclosure, it would be unconscionable and contrary to the insurer's continuing duty of good faith if the insurer were to be allowed to avoid the policy based on those facts which had not been disclosed and which had been proved at the date of the purported avoidance not to have been true.⁷⁵ If it proves to be possible to make an inroad into the equitable concept of 'unconscionability', the corollary of such a development is that the courts might be given the discretion to overturn a purported avoidance at a trial stage.⁷⁶ That said, the exact relationship between continuing duty of good faith and unconscionability is not at all clear in the judgment of Colman J. Both seem to be identified as reasons for restricting the insurer's right of avoidance, but there is a notable lack of detailed analysis as to how these concepts would operate in practice.

4-33 Soon afterwards, the opportunity to engage in a more comprehensive analysis of the matter presented itself in *Brotherton v Aseguradora Colseguros SA (No 2)*.⁷⁷ Here, the reinsurers attempted to avoid a policy on the premise that the insurers, who provided professional indemnity cover to a Colombian bank, had failed to disclose the reinsurers' allegations against senior officials of the bank in the Colombian press, even though the insurers were aware of such allegations. The defendant insurers argued that such allegations were unsubstantiated so the reinsurers should be prevented from avoiding the policy if it could be ascertained at trial that such allegations were, in fact, incorrect. It was, therefore, the contention of the defendant insurers that the materiality of certain facts, such as allegations, should be determined at the time of the trial rather than at the time the contract was formed. This argument was rejected both by Moore-Bick J and the Court of Appeal and was enough to dispose the case without engaging in a debate as to whether the insurer's right of avoidance could be fettered with the duty of good faith. However, Mance LJ who delivered the main judgment of the Court of Appeal, expressed his views on the observations made by Colman J in *The Grecia Express*. On the issue of unconscionability, his Lordship was uncompromising. He was adamant that the mere fact that a right to rescind has an equitable origin does not mean that its exercise is only possible if that is consistent with good faith or with a court's view of what is conscionable.⁷⁸ He also commented unfavourably on the potential impact of the doctrine of good faith, indicating that even if there might be some support for the idea this was impossible in the present case as the reinsurers did not at the time of avoidance accept, or know for certain of, that the intelligence constituting the basis of their avoidance was incorrect. He issued a reminder that the scope of the post-contractual duty of good faith had been limited to circumstances of repudiatory breach or fraudulent intent.

⁷⁵ *Ibid*, at [129], [133] and [154].

⁷⁶ It was passionately argued that avoidance should be treated as a discretionary remedy: Eggers, PM, 'Remedies for the Failure to Observe the Utmost Good Faith' [2003] LMCLQ 249.

⁷⁷ [2003] EWHC 335 (Comm); [2003] EWCA Civ 705; [2003] Lloyd's Rep IR 746 (CA).

⁷⁸ [2003] EWCA Civ 705; [2003] Lloyd's Rep IR 746, at [34].

4-34 Although one would naturally assume that the observations of Mance LJ are intended to put a significant constraint on the potential development of the continuing duty of good faith in this context, an attempt to move the debate to a slightly different path was made by at least one of the judges in *Drake Insurance plc v Provident Insurance plc*.⁷⁹ The primary focus of the case was a contribution action for double insurance between two insurers; to determine the outcome of that action it was vital to identify whether one of the insurers, namely Provident, was entitled to avoid the motor insurance policy for non-disclosure of the assured, Dr Singh. When renewing his insurance policy, Dr Singh informed his brokers of the fact that his wife, who was a named driver on the policy, had been involved in an accident. This was a no-fault incident, but it had been recorded as a fault incident on the broker's computer system until the claim was settled in her favour. However, Dr Singh forgot to inform his brokers that his wife's claim had now been settled in her favour and that he had received an SP30 speeding conviction. Under the ranking system operated by Provident, the conviction of Dr Singh would not have affected his quote if his wife's accident had been reclassified as no-fault. At a later stage, Provident became aware of the speeding conviction and sought to avoid the policy for non-disclosure, but the Court of Appeal held that it could not. Had Provident made further investigations prior to avoiding the policy, it would have become apparent to them that the earlier accident had not been the fault of Dr Singh's wife and ought to have been left out in fixing the premium, thereby rendering the conviction alone incapable of affecting the premium.

4-35 Few would disagree with the outcome of the case, but what makes the judgment rather interesting is the fact that there are fundamental differences in the reasoning adopted by the judges. Rix and Clarke LJ based their decision on the finding that the insurer had not been induced by the non-disclosure of the speeding conviction to enter into the contract given that Dr Singh's wife was involved in a no-fault accident. Its non-disclosure could not have had any impact on Provident's quote under their grading system. This is a rational stand to take and was adequate to dispose the case before them. However, their Lordships went on to make observations on the impact of the insurer's continuing duty of good faith in this context. Their view was that this would prevent the insurer from avoiding the contract if the insurer, with the knowledge (including knowledge in the shape of turning a blind eye) of the no-fault accident, nevertheless, attempted to avoid the policy.⁸⁰ Adopting this test, their Lordships were satisfied that avoidance in the present case had not been made in bad faith. Pill LJ, however, took a rather different stance on the matter. He was prepared to base his decision in favour of the assured on breach of the continuing duty of good faith of the insurer. Dramatically expanding the scope of the insurer's duty of good faith, Pill LJ reached the conclusion that Provident had not acted in good faith when avoiding the policy by treating the accident which Dr Singh's wife was involved in as a 'fault-accident'. In his view, the continuing duty of good faith required the insurer, at least, to make an enquiry

⁷⁹ [2003] EWCA Civ 1834; [2004] 1 Lloyd's Rep 268.

⁸⁰ *Ibid*, at [91], per Rix LJ and at [177], per Clarke LJ. Interestingly, both of their Lordships indicated that their observations on the role of good faith should not be regarded as part of their judgment.

of the assured, offering him an opportunity to update the insurer on the accident. He continued:⁸¹

All that was required was a simple enquiry as to what had happened in relation to that accident. If more than lip service is to be paid to the principle that an insurer shall show the utmost good faith, the principle in my judgment required that enquiry to be made before the ‘wholly one-sided’ remedy of avoidance was exercised.

The majority was sympathetic to the sentiments expressed in the judgment of Pill LJ, but felt that that was a bridge too far. Clarke LJ stressed the fact that there was no authority for the proposition that an insurer owes a duty of care to the assured to take reasonable care to make proper inquiries before avoiding the policy.⁸²

4-36 The variance in the judicial opinions expressed is staggering and, it should be noted, none form a binding precedent on the matter. The following tentative conclusions can be drawn. First, it is very doubtful whether the solution lies in the exercise of the court’s equitable jurisdiction as contemplated by Colman J. The authorities are divided as to the origins of the right to avoid for pre-contractual breach of good faith: some proceeding on the basis that this is a common law right⁸³ whilst others view the doctrine as having an equitable origin.⁸⁴ As discussed above,⁸⁵ it is undeniable that equity played a role in this context but, Chancery’s role was very much secondary before the judicature reforms, restricting its jurisdiction to providing procedural assistance to common law actions by way of bills for discovery and, where appropriate, protecting an insurer by degrees for injunction and cancellation. Against this historical background, it would be very difficult to argue that the insurer’s right to avoid can be fettered by the discretion of the court. The right of avoidance, originating from common law, is exercisable at the election of the injured party and does not require the intervention of the court. It should also be noted that in the context of commercial contracts, courts have usually set their face against the use of equitable relief to soften the blow for one of the parties of the contract. In *The Scaptrade*,⁸⁶ for example, the court refused to grant an injunction restraining ship-owners from exercising their right of withdrawal from a time charter-party arising out of the charterer’s breach of making hire payments in time.⁸⁷ It is likely that a similar approach is adopted in the context of insurance contracts. It is also worth noting that the unconscionability point was not taken up by any of the judges in *Drake Insurance plc v Provident Insurance plc*, having been categorically rejected by Mance LJ in *Brotherton v Aseguradora Colseguros SA*.

⁸¹ Ibid, at [177].

⁸² Ibid, at [145].

⁸³ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd’s Rep 496 (CA) 503 (Steyn LJ) and *Svenska Handelsbanken v Sun Alliance and London Insurance plc (No 2)* [1996] 1 Lloyd’s Rep 519, at 552, per Rix J.

⁸⁴ *Banque Financière de la Cité v Westgate Insurance Co Ltd* [1990] 1 QB 665, at 779, per Slade LJ and *Strive Shipping Corporation v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)* [2002] EWHC 203 (Comm); [2002] 2 Lloyd’s Rep 88, at 129.

⁸⁵ See [4-8].

⁸⁶ [1983] 2 Lloyd’s Rep 253.

⁸⁷ Equitable relief may be given under a demise charter-party due to the fact that such a contract transfers to the charterers an interest in or right to possession of the ship, but courts tend to use such relief very rarely: *The Jotunheim* [2004] EWHC 671 (Comm); [2005] 1 Lloyd’s Rep 181.

4-37 Moving on to the role of the continuing duty of good faith in confining the right of avoidance of the insurer, it is clear that there is no consensus either on the scope of such duty or its origins. All of the judges in *Drake Insurance plc v Provident Insurance plc* were receptive to such a possibility but, curiously, no attempt was made to tie in the continuing duty with s 17 of the MIA 1906 and the subsequent case law restricted the scope of duty to fraudulent acts and imposed an inducement requirement. To the extent that Pill LJ, suggests that the continuing duty of the insurer could be breached by a conduct other than fraud, it is out of tune with the authorities such as *The Star Sea*, assuming, of course, the obligation emanates from s 17 of the MIA 1906. By the same token, if s 17 is not the origin of the continuing duty of good faith as applied in this context, it is curious, to say the least, why Rix and Clarke LJ were determined to specify that the duty can be breached only by deliberate misconduct of the insurer at this stage.

4-38 Even if, disregarding Pill LJ's stand on the matter, one subscribes to the view that the duty in this context is traceable to s 17 of the MIA 1906, a further difficulty arises. There are several authorities which seem to suggest that avoidance of the contract is the only remedy stipulated by this section.⁸⁸ If that is the case, it will be conceptually rather difficult to justify how, on this occasion, the insurer will be prevented from avoiding the policy for breach of s 17 rather than simply having a right to avoid the policy for breach of the insurer's continuing duty of good faith.

4-39 It is submitted that there might be a possibility of reconciling various judicial views expressed on the matter with established principles and authorities if the debate is moved away from the continuing duty of utmost good faith. Let us consider the position of an insurer who attempts to avoid the policy for non-disclosure of the assured in the knowledge that facts that are deemed to be material have, in fact, been disclosed, or they do not give rise to a right of avoidance (e.g. due to waiver by the insurer). The general principles of common law would naturally prevent the insurer in those circumstances from avoiding the contract given that it is one of the fundamental principles of common law that everyone must act honestly towards others. That principle is of universal application in the common law and does not depend on the existence of a relationship between parties based on good faith. Admittedly, this would not provide any relief to an assured if the insurer's action is negligent. However, in that case, it will be possible to offer protection to the assured by preventing the insurer from avoiding the contract on the premise that one of the essential ingredients of the right to avoid (i.e. inducement) has not been satisfied as was the case in *Drake Insurance plc v Provident Insurance*. To sum up, it can forcefully be argued that s 17 and a continuing duty of good faith offer nothing but confusion in this context. The common law is well equipped to deal with a situation where an insurer in contravention of the principle of fair dealing attempts to avoid an insurance contract in the knowledge that no right of avoidance arises in the circumstances. It is, therefore, questionable whether s 17 has any role to play here, which might explain the reluctance of Mance LJ to be drawn into this debate in *Brotherton v Aseguradora*. This would also be consonant with the views of the majority expressed in *Drake Insurance plc v Provident Insurance*. If views expressed by

⁸⁸ See, in particular, *Banque Financière de la Cité v Westgate Insurance Co Ltd* [1991] 2 AC 249 (HL).

Pill LJ in this case were to gain currency, it would mark a vast expansion of the good faith doctrine and, ultimately, the development of a general principle of fair dealing governing the insurer's affairs with the policyholder. It is submitted that there is no judicial basis or justification for such a development.

(3) Handling of Claims

4-40 The tension between the assured and the insurer reaches boiling point when a claim is put forward by the assured and the insurer takes its time in assessing the claim or decides to take up minor points in an attempt to prolong the decision-making process, perhaps in the hope that this will encourage the assured to agree a settlement in favour of the insurer. At first sight, one might assume that the continuing duty of good faith might come in handy, especially in this context, particularly if it is possible to prove that the insurer has deliberately delayed the assured's claim. However, even if the insurer is expected to observe good faith when handling a claim presented by the assured, in the light of the established precedent⁸⁹ the only remedy that will be available for the assured for breach of the continuing duty of good faith will be avoidance, has no practical value for the assured.

4-41 Being able to seek damages from the insurer, particularly for late payment of an insurance claim, would yield a considerable benefit for the assured who might suffer from the actions (or inactivity) of the insurer at the claims handling stage. Regrettably, as it currently stands, this is not a viable proposition under English law as the insurer's liability to pay under an insurance contract is not deemed to be one in debt.⁹⁰ The theoretical foundation of this lies in the assumption that, with an insurance contract, the insurer promises to keep the assured unharmed; consequently, the insurer is deemed to be in breach of contract upon occurrence of a loss from an insured peril, making him liable to the assured for breach of the insurance contract for unliquidated damages.⁹¹ Due to the fact that payment under an insurance contract is deemed to be payment of damages, in the event of those damages not being paid within a reasonable time, or in accordance with the contractual terms, the assured will only be entitled to statutory interest given that damages for non-payment or late payment of damages are not available.⁹²

4-42 The stand taken by the courts remains controversial⁹³ and strict

⁸⁹ *Banque Financière de la Cité v Westgate Insurance Co Ltd* [1990] 1 QB 665 (CA); [1991] 2 AC 249 (HL) and *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1992] 1 AC 233 (HL); [1991] 2 Lloyd's Rep 191; [1990] 1 QB 818 (CA).

⁹⁰ *Israelson v Dawson (Port of Manchester Insurance Co)* [1933] 1 KB 301, at 304 and 306, per Scrutton LJ and Greer LJ, respectively.

⁹¹ *Grant v Royal Exchange Assurance Co* (1816) 5 M & S 439, at 442, per Lord Ellenborough CJ. This is the same for any kind of indemnity and liability policy.

⁹² See, in particular, the judgment of Lord Brandon in *President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395; [1987] 2 Lloyd's Rep 311. The same principle was reiterated in the context of a marine policy in *Ventouris v Mountain (The Italia Express) No 2* [1992] 2 Lloyd's Rep 281.

⁹³ The principle and the judgment of the House of Lords in *The Lips* was severely criticised by Clarke, M, 'Compensation for Failure to Pay Money Due: A Bolt on English Common Law Jurisprudence' (2008) *Journal of Business Law* 291. In a similar vein, in *Sempra Metals Ltd v Her Majesty's Commissioner of Inland Revenue* [2008] 1 AC 561; [2007] UKHL 34, Lord Nicholls, at [92], was of the view that the time had come to do away with the common law restriction on the recovery of interest for late payment of money. Lord Hope, at [16]–[17], and Lord Walker, at [165], were prepared to endorse this suggestion.

application of this principle has occasionally led to catastrophic consequences for the assureds. The case of *Sprung v Royal Insurance (UK) Ltd*⁹⁴ illustrates the difficulties that assureds might face under the current legal regime. There, the assured was a small businessman who purchased two insurance policies to protect his factory which processed animal waste. The first policy covered him against theft and the second provided plant and machinery cover against 'sudden and unforeseen damage that necessitates immediate repair of the plant before it can resume normal working'. Condition 6 of the second policy permitted the assured to carry out minor repairs 'without prejudice to the liability of the insurers' provided they were given notice together with a schedule of repairs'. Conversely, it was stipulated in the policy that major repairs required the prior sanction of the insurers. In April 1986, vandals badly damaged both the factory and the plant. The assured's claim was rejected on the grounds that the first policy did not apply as no theft had occurred and there was no cover for 'wilful damage' under the second policy. The assured lacked the financial resources to repair the machinery himself pending the resolution of the dispute with the insurers, failed to secure credit to finance the repair work and was forced out of business six months later. The insurers continued to deny liability for almost four years but in March 1990, abandoning their defence under the second policy, they indemnified the assured for his lost plant and machinery plus interest and costs. The assured then brought an action against the insurers seeking consequential damages in the sum of £75,000 calculated by reference to the value of the lost opportunity to sell his business. The assured's claim was rejected both at first instance and in the Court of Appeal. It was evident that the Court of Appeal reached this decision with reluctance but felt that it was bound by earlier authorities, particularly by the principle that there could be no award of damages for the late payment of damages.⁹⁵

4-43 Claim handling is, undoubtedly, an area in which the insurer's continuing duty of good faith could have a prominent role to play. Removing the prospect of seeking damages under s 17 of the MIA 1906 means that the assured will not receive any practical advantage even though the insurer acts in bad faith (i.e. by deliberately delaying the payment or assessment of the claim). It is worth, however, considering whether damages could be sought by the assured by establishing a separate breach of a primary obligation by the insurer. For example, there could be instances where the assured might be able to rely on the tort of deceit if his claim is improperly dealt with by their insurer; or statutory provisions (i.e. provisions of the Fraud Act 2006) might help the assured to receive compensation. Also, it is not beyond the bounds of possibility that the courts would imply certain terms into the contract. If a contractual solution could be adopted, this might assist the assured even with the lack of fraud on the part of the insurer. These potential causes of action are considered next.

As is evaluated in [Chapter 6](#), the Law Commission is proposing to alter this position by imposing a contractual duty that will require the assured to pay valid claims within a reasonable time.

⁹⁴ [1999] 1 Lloyd's Rep IR 111.

⁹⁵ See also, *Normhurst Ltd v Dornoch Ltd* [2004] EWHC 567 (Comm); [2005] Lloyd's Rep IR 27 and *Tonkin v UK Insurance Ltd* [2006] EWHC 1120 (TCC); [2007] Lloyd's Rep IR 283.

(A) Tort of Deceit

4-44 When handling the assured's claim, it is inevitable that the insurer will be in close contact with the assured or his agents to determine his course of action. There is, therefore, the possibility that the insurer, or its representatives, might mislead the assured as to their prospects of recovery or other attributes of the claim. For an extreme example, let us consider the position of an insurer who indicates to the assured that his claim for partial loss will be rejected for a reason it knows to be fabricated, forcing the assured to sell his vessel for much lower than its market value. If the assured could demonstrate, as stipulated in *Derry v Peek*,⁹⁶ that the insurer or his agents, knowingly or recklessly misled the assured about the prospect of recovery under the policy and that the assured had relied on the representation to his detriment, the insurer may be liable for the financial loss suffered. As an intentional wrongdoer, the insurer would be liable for all the losses directly flowing from the action, regardless of whether these were foreseeable under the test that would normally be applicable in the tort of deceit.⁹⁷

4-45 However, it should be noted that this course of action would not have helped the assured in a case like *Sprung v Royal Insurance (UK) Ltd*. For an action of this nature to succeed, it is essential for the insurer to prove that the insurer knowingly or recklessly made a false representation. Mere inaction on the part of the insurer would not suffice.

(B) Criminal Remedies

4-46 There is a possibility that the Fraud Act 2006,⁹⁸ coupled with the continuing duty of good faith, might open the door for the assured to seek monetary compensation even where the insurer at the claim handling stage fails to disclose to the assured matters that might enhance the prospect of recovery in relation to his claim. Section 3 of the Act makes it an offence for a person to fail to disclose to another person information which they are under a legal duty to disclose, intending thereby to make a gain or cause loss to another.⁹⁹ By virtue of s 5 of the Fraud Act 2006, the concepts of 'gain' and 'loss' are broadly defined as including 'a gain by keeping what one has' and 'a loss by not getting what one might get'.

4-47 Under the assumption that the continuing duty of good faith requires the insurer to refrain from fraudulent non-disclosure at the claims handling stage, it is

⁹⁶ (1889) 14 App Cas 337.

⁹⁷ For a similar situation see *Clef Aquitaine SARL v Laporte Materials (Barrow) Ltd* [2001] QB 488, at 498–500. Although there is no case law on the subject in this context, it is highly probable that the courts would have the discretion of awarding exemplary damages in this case. Peter Smith J in *Design Progression Ltd v Thurloe Properties Ltd* [2004] EWHC 324 (Ch); [2005] 1 WLR 1, at [141], said: 'An award of exemplary damages is available where there is unacceptable behaviour on the part of the defendant, and that behaviour displays features which merits punishment, where the defendant acts in a way calculated to make a profit for himself which might well exceed the compensation payable to a claimant.'

⁹⁸ The Act intends to simplify the criminal law on fraud by creating a number of broad offences.

⁹⁹ For the sake of completeness, it should be mentioned that s 2 of the Act also makes it an offence if a person dishonestly makes a false representation intending either to make a gain or to cause a loss to another (or expose another to a risk of loss). In those circumstances, it is possible that the assured could make out a case for tort of deceit without necessarily relying on this section of the Fraud Act 2006.

possible that an insurer who intentionally attempted to obtain a gain by keeping money it would otherwise have to pay out will be guilty of an offence under s 3 of the Fraud Act 2006. If this analysis hold true, the victim of the fraud might be entitled to a compensation order under s 130(1) of the Powers of Criminal Courts (Sentencing) Act 2000.¹⁰⁰

(C) Contractual Analysis

4-48 The assured might be able to rely on an additional cause of action for damages even in the absence of fraud on the part of the insurer if it is possible to show that the insurer's conduct at the claims handling stage amounts to some other and separate breach of the contract. One possibility is that a term could be implied into insurance contracts requiring the parties to handle claims under the policy reasonably and efficiently. This was, in fact, argued but rejected, by the trial judge in *Insurance Corporation of the Channel Islands Ltd v McHugh*.¹⁰¹ There, the assured was the proprietor of a hotel which suffered three arson attacks. When submitting a claim under his business interruption policy, the assured manipulated the hotel's monthly and annual occupancy figures with a view to increasing the quantum of turnover lost because of the fires. For this purpose, the assured produced fraudulent invoices. The trial judge reached the conclusion that the claim was fraudulent. He went on to consider counterclaims by the assured, which depended on the breach by the insurer of an implied term to negotiate and pay insurance money with reasonable diligence and due expedition. Mance J was not prepared to imply a term of this nature into the policy before him. On this point, he held accordingly:¹⁰²

It is necessary to give the contract business efficacy or represent the obvious, although unexpressed, intention of the parties. Mere reasonableness or convenience is not sufficient. The implied term suggested by [the assured] fails to satisfy the prerequisites of an implied term. If any such term existed at all, it would, presumably, have to be mutual. In other words, there would be a duty on the insured to present and progress the claim with reasonable speed and efficiency. Just as the insurers would be obliged not to refuse or delay indemnity, so, presumably the assured would be under a duty not unreasonably to delay, mistake or overstate his case. The reasonableness of each party's conduct would, if necessary, be susceptible of review at each point. I think both parties would have hesitated before agreeing any such mutual obligations, and that they are certainly not to be implied.

4-49 It is submitted that this judgment does not signal the end of the road for the implied term analysis. In the present case, the arguments were raised by the assured very late in the proceedings and were not fully developed. Most significantly, it is possible that the assured's contention on this point was not reviewed in a favourable light by the trial judge given that the assured himself had put forward a fraudulent claim. Turning to the legal analysis employed by the trial judge to dispose the implied term analysis, one quickly notices that the judgment is given in the vacuum of any relevant legal authority. Reference to the need to satisfy the

¹⁰⁰ Compensation orders are limited to £5,000 on magistrates' courts.

¹⁰¹ [1997] LRLR 94.

¹⁰² *Ibid.*, at 136-7.

'business efficacy' test before a term could be implied¹⁰³ is a clear indication that the judge considered whether a term of that nature could be implied 'in fact' and had reached the conclusion that such a term is not necessary to make the agreement work, which is undoubtedly an accurate finding. However, courts could also imply terms into contracts by making reference, not only to the parties' intentions but also to wider considerations pertinent to contracts of the type in question.¹⁰⁴ It, therefore, remains plausible that a term could be implied in an insurance contract requiring the co-operation of the parties at the claims stage; as part of this, the insurer could be expected to process and pay the claims presented to them with reasonable diligence and in a timely manner. A term of this nature could be implied by law for policy reasons;¹⁰⁵ it can be argued that lack of any practical remedy for the assured at the claims stage can be used as a catalyst for the implication of such a term. It is obvious that this eventuality was not considered in this case, possibly because of the limited nature of the assured's submissions. However, there is every possibility that the matter might be taken up later by the courts. It is encouraging to see that in appropriate circumstances, courts have been eager to consider implying terms in insurance contracts (e.g. in *The Mercandian Continent*,¹⁰⁶ it was held that there was an express term to the effect that in the event of the assured making a knowingly false claim, the claim would be forfeited). However, Longmore LJ went on to say that even if that had not been the case, such a term would have been implied.

4-50 In other common law jurisdictions, courts have not been adverse to the prospect of implying terms into insurance contracts requiring the insurers to deal with claims in both a reasonable fashion and a timely manner. Recently, for example, the Supreme Court of New South Wales in *Brescia Furniture Pty Ltd v OBE Insurance (Australia) Ltd*¹⁰⁷ allowed damages for breach of an implied term requiring payment to be made to the assured within a reasonable time. In this case, the assured held a policy providing cover for loss by fire and for business interruption up to a maximum period of 12 months. When the assured's property was damaged following a fire, the insurer delayed the processing of the claim and refused to pay. The assured sued for the loss to its property and clean-up costs, business interruption for a period that exceeded 12 months and various types of consequential loss. The Court was of the firm view that the failure to pay within a reasonable time or an unreasonable delay in payment or admission of liability without payment amounted to breach of contract, and losses, including consequential losses, are recoverable as long as they are not remote and a causal link between the loss and breach can be established.¹⁰⁸

4-51 Taking the implied term analysis a step further, the Canadian Supreme Court was prepared to imply such an obligation as an incident of the continuing duty of utmost good faith between the assured and the insurer. In *Whitten v Pilot*

¹⁰³ *Liverpool City Council v Irwin* [1977] AC 239.

¹⁰⁴ *Malik v Bank of Credit and Commerce International SA (in liquidation)* [1998] AC 20, at 45, per Lord Steyn.

¹⁰⁵ *Scally v Southern Health and Social Services Board* [1992] 1 AC 294.

¹⁰⁶ [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563, at [10].

¹⁰⁷ [2007] NSWSC 598.

¹⁰⁸ See also, *Stuart v Guardian Royal Exchange Assurance of New Zealand Ltd (No 2)* (1988) 5 ANZ Insurance Cases 60-844 and *Moss v Sun Alliance Australia Ltd* (1990) 55 SASR 145.

Insurance,¹⁰⁹ Mr and Mrs Whiten claimed the cost of reinstating their family home following a fire at their home in January 1994. The insurers denied indemnity alleging that the family had torched its own home, although the local fire chief, the insurance company's own expert investigator and its initial expert maintained that there was no evidence of arson. The insurers continued to allege arson throughout the trial. Their position was wholly discredited at trial and they were forced to concede that the allegation was unfounded. At the trial before the Ontario court, the jury awarded the assured \$CAN318,252.32 in compensatory damages and \$CAN1 million in punitive damages. On appeal, the punitive damages were reduced by the Ontario Court of Appeal to \$CAN100,000. The assured appealed to the Supreme Court, which was bound by the decision in *Vorvis v Insurance Corporation of British Columbia*¹¹⁰ that in an instance of breach of a contract, punitive damages are only available if, apart from the breach sued upon, the defendant has committed an independent actionable wrong. The assured's claim for punitive damages was, therefore, dependent upon the Court finding the insurer to be in breach of a duty to the assured, in addition to breach of contract. The majority view was that this was the case and the punitive damages at \$CAN1 million were reinstated on the premise that the continuing duty of good faith created an independent contractual obligation on the part of the insurer to act in a reasonable fashion when dealing with a claim.

4-52 As appealing as it may seem at first sight, on closer scrutiny it becomes apparent that reconciling this decision with the principles embodied in the MIA 1906 would be a very tall order. As far as English law is concerned, the source of the continuing duty of good faith is s 17 itself. It would be contrary to logic to trace the source of the duty to a statutory provision and then to use the same provision as the basis for creating a contractual duty. Also, it should be borne in mind that the ambit of the duty of continuing duty of good faith has been restricted judicially to refraining from dishonest behaviour. It would be conceptually difficult to justify how fraud is needed to activate s 17 in the first instance, but once it is activated, it can be used to imply a contractual term into the contract which can be breached by the insurer negligently or even innocently. Of course, had the case been considered under the MIA 1906 (or its Canadian equivalent),¹¹¹ there would have been no need for the judges to adopt such an artificial reasoning to be able to award punitive damages. They would have been able to demonstrate that the insurer's breach of s 17 had constituted an 'actionable wrong' within the *Vorvis* rule. To sum up, it is probably not wrong to suggest that the chances of English law developing in the way contemplated by the Canadian Supreme Court in *Whitten v Pilot Insurance* is rather slim.

4-53 Even if we proceed under the assumption that a term could be implied into the contract for policy reasons through the contractual route requiring the insurer to act reasonably when assessing the claim, one difficulty that might arise is the scope of such an implied term. How far would such an implied term require the insurer to co-operate? Would, for example, the insurer be required to disclose the contents of

¹⁰⁹ [2002] 1 SCR 595.

¹¹⁰ [1989] 1 SCR 1085.

¹¹¹ The MIA 1906 has been incorporated into Canadian law by the Marine Insurance Act 1993 (SC 1993, c 22).

the expert reports in his possession in relation to the claim? It is very likely that the scope of the implied obligation will depend on the type of the contract in question rather than the individual circumstances of the parties. Another point to note is that in breach of such an implied term, the damages that an assured might seek will be subject to the remoteness test as applied in contract law and will need to be foreseeable at the time the contract is made.¹¹²

4-54 Last but not least, it should be mentioned that opinions have been expressed to the effect that deliberate breach of the contract on the part of the insurer at the claims stage might amount to a repudiatory breach. In a Scottish case, *Fargnoli v GA Bonus plc*,¹¹³ Lord Penrose expressed the view that the insurer will be held to be in repudiatory breach of the contract if, acting in bad faith, he delays admission of liability, advances spurious defences to a claim, puts the assured to proof of what the insurer knows is true, or delays settlement of claims which he would, objectively, be obliged to admit to be valid before a court.¹¹⁴ Similar sentiments have also been echoed in *Transthene Packaging Co Ltd v Royal Insurance (UK) Ltd*¹¹⁵ by HHJ Kershaw, QC. There are authorities in different contexts where intentional breach of the contract by one of the parties was held to allow the innocent party to repudiate the contract.¹¹⁶ However, this arises only if the party in breach violates an obligation, either express or implied, under the contract intentionally. If an insurance contract contains an express or implied term requiring the insurer to deal with the claims presented to him in a reasonable manner, it follows that the insurer is in repudiatory breach of the contract if he intentionally fails to fulfil this obligation. This will enable the assured to claim damages and the fact that the contract will be discharged prospectively, means that the assured's claim under the policy for indemnity will remain intact.

(4) Settlement of Claims

4-55 Although there are no reported insurance cases on the matter, one might envisage a situation where the assured could claim that he was pressured to settle by the insurer or by parties acting on his behalf, such as assessors or loss adjusters.¹¹⁷ In light of the analysis carried out so far in this chapter, there is little doubt that the insurer would be expected to observe good faith at this stage, and he might be found to be in breach of this obligation if he acted fraudulently in applying pressure on the assured to accept the settlement put forward. However, the remedy stipulated in s 17 would provide little, if any, relief to the assured who accepts a settlement offer

¹¹² It is evident in the light of the decision of the House of Lords in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] UKHL 48; [2009] 1 AC 61, the commercial context of the contract will be decisive in determining for which losses a contract breaker is liable.

¹¹³ [1997] CLC 653.

¹¹⁴ *Ibid*, at 670–1.

¹¹⁵ [1996] LRLR 32, at 39.

¹¹⁶ In *Cohin Refineries v Triton Shipping* [1978] AMC 444, for example, the court expressed the view that if failure to pay in accordance with the terms of a time charter-party was either intentional or enforced by financial difficulties and repeated, such failure may well amount to a repudiation of the charter, which would entitle the owner to terminate the charter and/or claim damages.

¹¹⁷ Insurers will often find it an attractive proposition to be able to close the file and predict their losses.

under duress or as a result of deliberate confusion created by the insurer. That said, general contract law remedies could come to the rescue. It is certainly open for the assured to cast doubt on the validity of a settlement agreement on the premise that he was induced to enter into it as a result of misleading statements made by the insurer as to the nature of the settlement agreement or circumstances surrounding it.¹¹⁸ The assured would not be required to prove that the misstatements were made in bad faith. Alternatively, it might be possible for the assured to question the validity of the settlement agreement relying on the general principle of unconscionability. Under English contract law, relief has been granted to claimants who have been pressurised to agree to quick settlements due to need for quick payment.¹¹⁹ There is no reason why the same cannot be the case in this context, especially if an assured is forced to agree unfair terms.¹²⁰ However, it should be noted that proving undue influence might be difficult in practice, especially in a commercial context.

¹¹⁸ Damages might also be available to the assured in those circumstances.

¹¹⁹ See, in particular, *D & C Builders Ltd v Rees* [1966] 2 QB 617 (CA). Also, see Lord Denning's statements in *Arrale v Costain Civil Engineering Ltd* [1976] 1 Lloyd's Rep 98, at 102.

¹²⁰ In other common law jurisdictions, such as Canada and the USA, relief has been granted to assureds who have been unduly influenced to accept detrimental settlements: *Pridmore v Calvertetall* 54 DLR (3d) 133 (BC) and *Elkwein v Hartford* 15 P 3d 640 (Wash 2001).

CHAPTER 5

FRAUD COMMITTED BY INDEPENDENT AGENTS OF THE PARTIES

I INTRODUCTION

5-1 Insurance intermediaries play a primary role both at the formation stage of insurance contracts and during the currency of the policy.¹ The term ‘intermediary’ has been used rather loosely in practice and covers, *inter alia*, independent agents of the assured (commonly known as brokers) and insurer (i.e. selling agents and underwriting agents)² and also employees of the insurance companies. The thrust of this chapter is to analyse the impact of fraud committed by independent agents³ of the parties on insurance contracts.⁴ For the sake of completeness, legal issues, particularly liability arising out of the engagements of the agent with his principal and third parties are also evaluated briefly. It is inevitable that the legal relationship between a principal and an independent agent will be governed to a large extent by the principles of agency law. That said, when it comes to assessing the liability of an agent involved in fraudulent activities against his principal and third parties, tort law plays a significant role and needs to be taken into account as well. However, rules embodied in the MIA 1906 and common law principles will be instrumental when determining the validity of insurance contracts where the independent agents act fraudulently while performing their duties.

¹ In fact, their role continues until claims arising out of an insurance policy are settled, even though this might take place after the expiry of the policy period.

² Selling agents play a central role in non-marine insurance practice. Nowadays, most banks and building societies act as selling agents for various insurance companies. Their function is to obtain proposals for consideration by the insurer. In marine insurance practice, the function performed by selling agents is usually discharged by brokers who operate under non-obligatory (limited) binding authority.

³ It should be noted that insurance is a regulated activity under the Financial Services Act 2000 and the conduct of insurance intermediaries is now regulated by the Financial Services Authority (FSA). The FSA’s Handbook also stipulates that a broker’s business has to be conducted with integrity, skill, care and diligence, maintaining adequate financial resources, avoiding conflicts of interest and giving adequate financial resources, avoiding conflicts of interest and giving suitable advice. The FSA has drawn up more specific rules of guidance: the Insurance Conduct of Business Sourcebook (ICOBS), which applies to general insurance and the Conduct of Business Sourcebook (COBS), which applies to long-term insurance, are the main relevant guidelines.

⁴ The impact of fraud committed by the employees of the insurer (and assured) is considered in Chapter 2.

II PRE-CONTRACTUAL STAGE

(1) Insurance Brokers and Fraud

5-2 In insurance practice, new business in the market is invariably placed on behalf of the assured by independent agents commonly known as ‘brokers’.⁵ It is trite law that a broker, being instructed by the assured, acts as his exclusive agent.⁶ However, it is not uncommon in the market to see an insurance broker performing functions on behalf of both the assured and insurer for the same transaction.⁷ The dual agency is acceptable as long as the assured is made aware of the position and gives consent.⁸

(A) Broker’s Duty of Utmost Good Faith and Fraud

5-3 A broker instructed to effect an insurance policy on behalf of the assured is under an obligation to disclose material facts⁹ which the assured himself is bound to disclose¹⁰ and refrain from making material misrepresentations while presenting the risk.¹¹ If this obligation is breached, the insurer is entitled to avoid the policy even if the assured was not privy to the breach, or if the statements were made without his knowledge or against his express instructions.¹² The position will be the same if the broker in the process of procuring a reinsurance contract before the direct insurance is concluded makes a material misrepresentation to the insurer. In such a case, the reinsurer will be entitled to avoid the reinsurance contract on the premise that the reassured is to be taken as having adopted the broker’s presentation.¹³

⁵ Until recently, the title ‘broker’ could only be used by people who satisfied the requirements under the Insurance Brokers (Registration) Act (IBRA) 1977 and registered with the Insurance Brokers Registration Council (IBRC). It was a criminal offence for an unregistered individual or a corporate body to use the description ‘insurance broker’ or any other description falsely implying registration or enrolment under ss 22–24 of the IBRA 1977. The repeal of the IBRA 1977 and the abolishment of the IBRC by the FSA 2000 means that anybody now can use the title ‘broker’. However, brokers who can operate in the Lloyd’s market are those accredited by Lloyd’s under the Lloyd’s Act 1982.

⁶ *Rozanes v Bowen* (1928) 32 LlL Rep 98, at 101, per Scrutton LJ and *Deeny v Gooda Walker Ltd* [1996] LRLR 276, at 282, per Gatehouse J.

⁷ See *Forsikringsaktieselskapet Vesta v Butcher* [1989] 1 All ER 402 where this market practice was condemned by the court.

⁸ *Excess Life Assurance Co Ltd v Fireman’s Insurance Co of Newark* [1982] 2 Lloyd’s Rep 599, at 619, per Webster J.

⁹ As to the meaning of the term ‘material’ in this context, see [Chapter 2](#), [2-21] and [2-27].

¹⁰ See s 19(b) of the MIA 1906.

¹¹ *Ibid*, s 20.

¹² *Russell v Thornton* (1860) 6 H & N 140 and *Lloyd v Grace Smith & Co* [1912] AC 716. Essentially, both the assured and insurer are innocent parties, but in the eyes of the law, the assured, as the employer of the agent broker, is expected to bear the loss. This was stressed in an emphatic fashion by Cockburn CJ, in *Proudfoot v Montefiore* (1867) LR 2 QB 511, at 522: ‘Where loss must fall on one of two innocent parties through the fraud or negligence of a third, it ought to be borne by the party by whom the person guilty of the fraud or negligence has been trusted or employed.’

¹³ *Bonner v Cox Dedicated Corporate Member Ltd* [2004] EWHC 2963 (Comm); [2005] Lloyd’s Rep IR 569, at [96], per Morison J. See also, *Aneco Reinsurance Underwriting Ltd (in Liquidation) v Johnson & Higgins Ltd* [1998] 1 Lloyd’s Rep 565; *aff’d* in part [2000] Lloyd’s Rep IR 12 (CA); *aff’d* [2001] UKHL 51; [2002] 1 Lloyd’s Rep 157 (HL).

5-4 Even if the broker is found to be acting dishonestly in breach of the pre-contractual duties of utmost good faith imposed on him by the MIA 1906, this will not make a difference as far as the insurer's entitlement to avoid the policy is concerned, as under the MIA 1906, the remedy is the same regardless of whether there is an innocent, negligent or fraudulent misrepresentation or non-disclosure. However, in those cases, it is open to the assured to bring a recourse action against the broker for breach of the agency agreement or in tort. Proving the dishonesty of the broker is unlikely to make a significant change in the assessment of damages. The assured's loss will presumably be measured by the sum that he would have been able to claim under the policy coupled with any costs that he may have incurred in pursuing the insurer unsuccessfully.¹⁴

5-5 Facing a claim of this nature, the only defence that the broker could rely on is to prove an independent ground for the insurer disclaiming liability.¹⁵ If, for example, the insurer is entitled to reject the assured's claim both on the ground of the broker's pre-contractual breach of utmost good faith and on another ground wholly independent of the broker's misconduct (i.e. contractual breach or other misconduct of the assured) the broker may argue by way of defence that his misconduct was immaterial, as the insurer would have refused to pay had he been aware of the existence of the other ground.¹⁶ Put differently, this defence is a natural extension of the celebrated maxim *novus actus intervenes* and what the broker attempts to prove is the existence of another plausible defence that cuts the chain of causation between his pre-contractual breach and the assured losing his insurance cover. The court is invited to exercise its own commercial judgment as to the likelihood of success of the other defence. If it is likely that the policy defence would have succeeded, the broker's defence also succeeds. Admittedly, in all the authorities in which this defence was raised, the broker in question acted negligently rather than dishonestly. It could, therefore, be questioned whether the defence would be available where the broker acts dishonestly in breach of his statutory or contractual duties. It is submitted that this should not make a difference. The question the court needs to answer is: 'What are the prospects that a reputable insurer would in the circumstances such

¹⁴ *Ramco Ltd v Weller Russell & Laws Insurance Brokers Ltd* [2009] Lloyd's Rep IR 27. An assured who is deprived of his insurance cover could possibly claim consequential losses from the broker. This is, for example, possible if it can be demonstrated that the broker accepted responsibility in preserving the assured from the type of loss that he had actually suffered: *South Australia Asset Management Corporation Respondents v York Montague Ltd (SAAMCO)* [1997] AC 191 (HL). Where the subject matter of insurance concerns a property, it is debateable whether the broker can be held out as assuming that kind of responsibility. However, drawing analogy from the solution adopted for tort of deceit (see, in particular, *Hornal v Neuberger Products Ltd* [1957] 1 QB 247) there is room to argue that a more expansive remoteness test should be adopted if the dishonesty of the broker is proven.

¹⁵ Although contributory negligence is a defence to most torts, the House of Lords confirmed that it was not available as a defence to deceit under common law and the Law Reform (Contributory Negligence) Act 1945 made no change in this respect: *Standard Chartered Bank v Pakistan National Shipping Corp and Others (Nos 2 and 4)* [2002] UKHL 43; [2003] 1 AC 959; [2003] 1 Lloyd's Rep 227.

¹⁶ *Fraser v BN Furman (Productions) Ltd* [1967] 1 Lloyd's Rep 1. In this case the Court of Appeal rejected the defence of a broker who negligently forgot to renew the assured's employer's liability policy, as on the facts of the case, the assured was not found to be in breach of a condition alleged to be contravened. See also, *Everett v Hogg, Robinson and Gardner Mountain (Insurance) Ltd* [1973] 2 Lloyd's Rep 217. More recently, see *Nicholas G Jones v Environcom Ltd and MS PLC t/a Miles Smith Insurance Brokers* [2010] EWHC 759 (Comm); [2010] Lloyd's Rep IR 676.

as the present have relied on the breach of the policy?¹⁷ It is not expected that the court would be drawn into an enquiry as to whether the broker has acted honestly or otherwise.^{17a}

5-6 An interesting question in this context is whether the assured, as the principal of the broker, could be held vicariously liable and sued for damages where the risk has been misrepresented by the broker at the formation stage. The answer is likely to be negative in the absence of fraud on the part of the broker. The Court of Appeal in *Banque Financière de la Cité v Westgate Insurance Co*¹⁸ was firmly against the suggestion that the provisions of the MIA 1906 could be used as a platform to establish an action for damages in tort. By the same token, it can safely be assumed that courts are unlikely to allow an action against the principal of the broker in tort on the premise that s 19(b) or s 20 of the MIA 1906 create an independent duty of pre-contractual duty of good faith on the part of the broker. Accordingly, in *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank*,¹⁹ the members of the Court of Appeal set their face against the suggestion that the broker's independent duty of disclosure expressed in s 19 of the MIA 1906 itself could serve as the basis of an action for damages. There is also judicial support for the contention that an agent (i.e. broker) cannot be held liable for a representation made on behalf of his agent under s 2(1) of the Misrepresentation Act 1967.²⁰ The analysis might, however, differ if the broker is sued successfully for damages in tort of deceit²¹ on the premise that he made a false representation fraudulently and it is within the scope of his actual or apparent authority or within the course of his employment to make such a representation.²² In that case, the principal will be vicariously liable for the broker's deceit.²³

5-7 The nature of the insurance market is such that an insurance broker is well placed to obtain information from various sources in relation to risks which potential assureds will intend to offer to the market. An insurance broker is, therefore, in some cases expected to have more information as to the proposed risk than the insurer. For this reason, s 19(a) of the MIA 1906 places an independent duty of disclosure upon the broker so that all that is known or ought to be known to the broker, as opposed to the assured, must be revealed to the insurer. Of course, the broker is expected to disclose only material information, but it is not a requirement that the assured should be privy to that information. It is beyond doubt that the broker will be in breach of s 19(a) if he intentionally conceals the facts omitted.²⁴ Furthermore,

¹⁷ *Phillips & Co v Whatley* [2007] UKPC 28; [2008] Lloyd's Rep IR 111, at [31], per Lord Mance.

^{17a} It is submitted that this should be the case even though contributory negligence defence is not available for the tort of deceit in common law.

¹⁸ [1990] 1 QB 665.

¹⁹ [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483.

²⁰ *Resolute Maritime Inc and Another v Nippon Kaiji Kyokai and Others (The Skopas)* [1983] 1 Lloyd's Rep 431, at 432-3, per Mustill J.

²¹ *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483, [48], per Rix LJ. For the elements of tort of deceit, see [Chapter 2](#), [2-106].

²² *Barwick v English Joint Stock Bank* (1876) LR 2 Ex 259 and *Briess v Woolley* [1954] AC 333.

²³ *Uxbridge Permanent Benefit Building Society v Pickard* [1939] 2 KB 248 and *Armagas Ltd v Mundogas Ltd (The Ocean Frost)* [1986] AC 717. Where principal and agent are both liable for a wrongful act committed by the agent they are joint tortfeasors: *Jones v Manchester Corp* [1952] 2 QB 852, at 869, per Denning LJ.

²⁴ *Biggar v Rock Life Assurance Co* [1902] 1 KB 516.

if the broker has actual knowledge of the facts omitted, the insurer will still have a right to avoid the policy whether the broker merely forgot to mention them or thought, *bona fide*, that it did not matter.²⁵

5-8 Widening the scope of the independent disclosure duty of the broker, s 19(a) also requires the disclosure of matters which the broker is deemed to know, even though he may not, in fact, have actual knowledge. The broker is deemed to know every circumstance which, in the ordinary course of business, ought to be known by, or to have been communicated to him. Without doubt, this formulation will create difficulties if the broker (as will invariably be the case) is a corporate organisation and information received by one department within that organisation is not passed on to the unit that presents the risk to the insurer.²⁶ The case law seems to suggest that the broker is still expected to disclose material information even if he acquires it from a source other than the assured²⁷ or, indeed, if he acquires information in a capacity other than that of the assured's agent (i.e. in the course of other broking activities for different parties).²⁸ This is in line with the wording of s 19(a) which does not seem to put any restriction on the source and nature of the knowledge that needs to be disclosed. This section is designed to ensure that the risk in question is presented fairly to the insurer by parties who possess more information in relation to that risk than the insurer himself. Although there is no authority on the point, by considering the ethos behind s 19(a), it can forcefully be argued that information obtained by the broker in a private capacity does not qualify as information that needs to be disclosed.

5-9 However, in line with the discussion in Chapter 2,²⁹ the dishonest conduct of the employees of the broker's organisation against the interest of the broker is not knowledge to be imputed to the 'directing mind and will' of the broker's organisation.³⁰ It follows that the broker is not deemed to know those circumstances in the ordinary course of his business and, therefore, no disclosure is required under s 19(a) of the MIA 1906. Similarly, the broker's awareness that his organisation is defrauding the assured (e.g. by making false declarations as to the amount of the premium received) is not information that should be disclosed (even assuming that it is material) because such information is not gained in the regular performance of his agency.³¹ By the same token, this is not information which the assured is expected to disclose, as the agent's fraud is not something which the assured is deemed to know under s 18 of the MIA 1906. As a subsidiary point, it must be borne in mind that a principal who fails to recover under the policy due to breach of his broker's independent duty of utmost good faith can bring an action against his agent either in contract or tort for his loss.³²

²⁵ *Krantz v Allan and Faber* (1921) 9 LILR 410.

²⁶ See a similar discussion in Chapter 2, [2-47].

²⁷ *Société Anonyme d'Intermédiaires Luxembourgeois v Farex Gie* [1995] LRLR 116, at 157, per Saville LJ.

²⁸ *El Ajou v Dollar Land Holdings plc (No 1)* [1994] 2 All ER 685, at 702, per Hoffmann LJ.

²⁹ See Chapter 2, [2-48].

³⁰ *Re Hampshire Land Co* [1896] 2 Ch 743.

³¹ *PWC Syndicates v PWC Reinsurers* [1996] 1 Lloyd's Rep 241.

³² It will rarely matter whether the assured's action is contractual or tortious as the measure of damages is likely to be the same.

5-10 It is theoretically possible that a marine insurance contract might contain a clause waiving the duty of disclosure on the part of the broker.³³ Such a term might also be drafted more widely to waive the independent disclosure duty of the broker under s 19(a) of the MIA 1906. It is a question of fact in each case to determine the scope of a clause of this nature and it is possible that, if not drafted clearly, litigation as to its construction might follow. It is likely that if the meaning of the clause is ambiguous, it will be construed *contra proferentem* by the courts (i.e. against the party for whose benefit was inserted or who is seeking to rely on it to his advantage)³⁴ which will be the assured in this case. Where the duty of disclosure on the part of the broker is successfully removed by a contractual clause, it would be immaterial that the broker had been guilty of fraud in withholding information.

5-11 Even though it is not commonly used in marine insurance practice, it is permissible to incorporate a clause into the contract limiting the right of the broker to make representations to the insurer on the assured's behalf when placing the risk.³⁵ The function of such a clause is to remove the authority of the broker to make binding representations in relation to the risk. If such a clause is successfully incorporated into the agreement, even if there is a representation which has been relied on by the insurer, it is not a statement which binds the assured. The outcome will be the same even in the case of fraud of the broker, as the clause has the effect of negating the agent's actual or apparent authority to make representations on behalf of his principal.³⁶

5-12 It is also possible that a clause excluding a particular liability or all liability of the assured for breach of the broker's pre-contractual duty of utmost good faith can be incorporated into the contract.³⁷ Such a clause would normally purport to exclude the right of the insurer to avoid the contract for breach of pre-contractual duties of utmost good faith by the broker. It has to be noted that, here, the duty of utmost good faith is left untouched, but instead the principal remedy available in case of its breach has been removed. In principle, these clauses are valid as long as they are clearly drafted and do not attempt to exclude the remedy in cases where the assured has acted fraudulently in breach of the utmost good faith obligations.³⁸

³³ It should be noted that clauses of this nature do not often appear in marine insurance contracts. See *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30; *rev'd* on a different ground [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483; *rev'd* on a different ground [2003] UKHL 6; [2003] 2 Lloyd's Rep 61, where a clause of similar nature was incorporated into a time-variable contingency insurance policy.

³⁴ For a comprehensive analysis of the *contra proferentem* rule, see McMeel, G, *The Construction of Contracts* (2011, OUP), pp 287–90.

³⁵ See *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483, at [103], per Rix LJ.

³⁶ *Overbrooke Estates Ltd v Glencombe Properties Ltd* [1974] 1 WLR 1335.

³⁷ It has been established by authorities that the MIA 1906 does not itself create an action for damages (*Banque Financière de la Cité v Westgate Insurance Co (sub nom Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd*) [1989] 2 All ER 952; [1990] 2 QB 665) but there is the possibility of claiming damages for the fraudulent misrepresentation of the assured's broker under the principles of tort law.

³⁸ *S Pearson & Sons Ltd v Dublin Corporation* [1907] AC 351 and *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30; *rev'd* on a different ground [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483; *rev'd* on a different ground [2003] UKHL 6; [2003] 2 Lloyd's Rep 61; *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co* [2001] 1 Lloyd's Rep 378.

Public policy has been identified as the reason why the assured cannot be allowed benefit from his own fraud.³⁹

5-13 It is not, however, clear whether the position is different if the clause seeks to exclude the liability of the assured for the consequences of fraudulent breach of utmost good faith by the assured's agent in presenting the risk to the insurers. In *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank*,⁴⁰ where the court was asked to determine whether a 'truth of statement clause'⁴¹ was drafted sufficiently wide enough to exclude the remedy of avoidance in cases where the broker failed fraudulently to perform his disclose duty, it was the view of the trial judge and the Court of Appeal that there is no legal principle preventing an assured from excluding liability for fraudulent conduct of his agents provided that a suitably worded clause is used. The issue, however, did not arise for decision at the House of Lords, as the majority (Lord Scott of Foscote dissenting) held that the clause, upon its true construction, was not sufficient to relieve the assured from liability to avoidance of the contract or damages where the misrepresentation by its agents has been fraudulent or avoidance in cases in which the non-disclosure has been dishonest. The majority of the House of Lords⁴² refrained from making a conclusive ruling as to whether it is legally possible for the assured to contract that he should not be liable for his agent's fraud. Lord Hobhouse,⁴³ in passing, was sympathetic to the suggestion that public policy could operate to invalidate a clause of this nature. Lord Scott,⁴⁴ on the other hand, expressed the view that public policy had no role to play in this context.⁴⁵

5-14 When the role public policy plays in contract law is considered, one tends to favour the view of Lord Scott on this point. There is no doubt that the term 'public policy' does not admit of definition and it is not easily explained.⁴⁶ However, the case law seems to suggest that the doctrine finds application in contract law if the harmful tendency of the agreement is clear (i.e. if the injury to the public is a

³⁹ *Boyd & Forrest v Glasgow & South Western Railway Co* 1915 SC (HL) 20.

⁴⁰ [2001] 1 Lloyd's Rep 30; *rev'd* on a different ground [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483; *rev'd* on a different ground [2003] UKHL 6; [2003] 2 Lloyd's Rep 61;

⁴¹ The clause was worded:

The insured . . . shall have no liability of any nature to the insurers for any information provided by any other parties and . . . any such information provided by or nondisclosure by other parties . . . shall not be a ground or grounds for avoidance of the insurers' obligations under the Policy or cancellation thereof.

⁴² Lords Bingham, Steyn and Hoffmann stated that the point should be decided when it arose and refused to be drawn.

⁴³ [2003] UKHL 6; [2003] 2 Lloyd's Rep 61, at [98].

⁴⁴ *Ibid*, at [122]. See also, the judgment of Rix LJ, in the Court of Appeal to the same effect [2001] EWCA Civ 1250; [2001] 2 Lloyd's Rep 483, at [103].

⁴⁵ Even in *S Pearson & Son Ltd v Dublin Corporation* [1907] AC 351, which is often cited as authority for the proposition that public policy prevents parties from excluding liability for fraud, Lord Loreburn LC, at 353-4, seems to contemplate as a possibility a different rule for the exclusion of one's own fraud from the rule for the exclusion of an agent's fraud:

Now it seems clear that no one can escape liability for his own fraudulent statements by inserting in a contract a clause that the other party shall not rely upon them. I will not say that a man, himself innocent, may not under any circumstances, however peculiar, guard himself by apt and express clauses from liability for the fraud of his own agents.

⁴⁶ *Davies v Davies* (1887) 36 Ch D 359, at 364, per Kekewich J.

serious probability). This is apparent when a contract is entered into to interfere with the course of justice,⁴⁷ to deceive public authorities⁴⁸ or to commit a tort.⁴⁹ One can easily appreciate that the position is rather different if an assured attempts to exclude his liability arising out of the fraudulent activities of his agents. Here, the purpose of such a clause is to shift the risk arising out of the fraud of agents of the assured to the other contracting party, which is ultimately a decision based on risk allocation. The parties' intention is not to cause a public aggravation. There is no evidence of judges invoking public policy doctrine in the context of contract law to defeat the principle of freedom of contract, when the objective of the agreement is simply to allocate risks under the contract.⁵⁰

5-15 Even though it is legally permissible for the assured to protect himself against the fraud of his agents, courts will generally adopt an approach to construction which presumes that a clause is not, in the absence of clear words, intended to apply to exclude or limit liability fraud. HHJ Jack QC, in *Government of Zanzibar v British Aerospace (Lancaster House) Ltd* indicated:⁵¹

... even in the contracts of today it surely has the ring of common sense that clauses dealing with representations are not intended by the parties to apply where a representation has been fraudulently made.

5-16 Perhaps a more difficult legal question is whether a clause which excludes the right of the insurer to rely on various remedies for pre-contractual misrepresentation by the agent of the assured would survive s 3 of the Misrepresentation Act 1967. This clearly states that any contractual term which excludes or restricts any remedy available to another party to the contract by reason of a pre-contractual misrepresentation is of no effect unless it is shown by the party relying thereon to satisfy the requirement of reasonableness stated in s 11(1) of the Unfair Contract Terms Act 1977. In assessing the reasonableness of an exclusion clause, the key is to determine whether the term is a 'fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in contemplation of the parties when the contract was made'. There is no authority on the matter in this context, but the strength of the bargaining position of the parties relative to each other will obviously be the key consideration and it will be very surprising indeed if a commercial judge knocks out such an exclusion clause in a commercial policy on the ground of unreasonableness.⁵²

(B) *Signing Indication and Fraud*

5-17 Due to the unique nature of the London insurance market and unconventional methods used at the formation stage of insurance contracts, it is essential for

⁴⁷ *R v Panayiotou* [1973] 3 All ER 112.

⁴⁸ *Miller v Karlinski* [1945] 62 TLR 85.

⁴⁹ *Apthorp v Neville* (1907) 23 TLR 575.

⁵⁰ *Fender v St John Mildmay* [1938] AC 1.

⁵¹ [2000] 1 WLR 2333, at 2346–7.

⁵² Sched 2 to the Unfair Terms Act 1977 contains guidelines which could be taken into account in assessing the reasonableness of the relevant exclusion clause.

brokers and underwriters to develop a close working relationship.⁵³ Consequently, it is very common for a broker to be asked to provide a ‘signing indication’ (i.e. his assessment of the likely subscription level to be obtained for the slip). A signing indication provides valuable information for the underwriter concerned, as there is always the possibility that the subscription of each underwriter may be reduced to an uncertain extent by means of signing down.⁵⁴ A misleading signing indication might, therefore, have serious financial consequences for the underwriter in question. For example, if the degree of over-subscription is less than indicated by the broker, the underwriter may face a greater proportion of the risk than he may have judged prudent. Conversely, if the degree of over-subscription is greater than indicated, the underwriter will receive proportionately less of the risk than he had hoped for. The question which requires careful consideration in this context is whether a wrong signing indication given by the broker intentionally will have any impact on the insurance contracts. A related question is, of course, the availability of other legal remedies against the broker when a misleading signing indication is given.

5-18 The leading authority on this point is *General Accident Fire and Life Assurance Corporation Ltd v Tanter (The Zephyr)*.⁵⁵ Here, a Lloyd’s broker, in the process of placing reinsurance cover before original insurance on a vessel was obtained,⁵⁶ indicated to the leading reinsurance underwriter that the slip would sign for 300 per cent so that he could expect to receive only one-third of the proportion for which he scratched the slip. On the basis of the signing indication given, the leading underwriter scratched the slip for a proportion greater than he actually believed he would receive. The slip was later presented to two further underwriters, who were not given signing indications by the broker. However, relying on the apparent over-subscription of the leading underwriter, they came to the conclusion that a signing indication was given and they initialled the slip for an increased proportion. As a result of the broker’s negligence, not enough offers of reinsurance cover were collected so all three underwriters were left with an aggregate liability of some 88.48 per cent – almost three times more than they were prepared to take.

5-19 At first instance, the underwriters argued that they were entitled to deny liability because of the misleading signing indication. Their case was based primarily on the ground that the signing indication had been incorporated into the slip and thus formed a part of the contract. Hobhouse J rejected this argument, stating that the market practice indicated that the slip was the record of contract between parties⁵⁷ and that it was not open to either party to contend that part of the contract was to be found elsewhere. It should be noted that even if the signing indication

⁵³ The process of obtaining insurance cover in the London market has been outlined by Diplock LJ in the House of Lords in *American Airlines v Hope* [1974] 2 Lloyd’s Rep 301, at 304–5.

⁵⁴ If the broker obtains more than 100 per cent subscription on a slip, the subscription of each underwriter will later be reduced proportionately until the amount insured equals 100 per cent. This practice is known as signing down and has received legal backing in *General Reinsurance Corp v Forsakringsaktiebolaget Fennia Patria* [1983] 2 Lloyd’s Rep 287.

⁵⁵ [1984] 1 Lloyd’s Rep 58; *rev’d* in part [1985] 2 Lloyd’s Rep 529.

⁵⁶ This is, in fact, a regular practice in the London market. Once a binding reinsurance offer is received from a reinsurer, the broker can offer potential underwriters a package consisting of the opportunity to take a line on the primary cover and at the same time to place an order for reinsurance.

⁵⁷ See also, *Thompson v Adams* (1889) 23 QBD 361 and *General Reinsurance Corp v Forsakringsaktiebolaget Fennia Patria* [1983] 2 Lloyd’s Rep 287.

was found to be contractual, the underwriters had to establish that its legal status was either a condition precedent or promissory warranty so that its breach allowed underwriters to be discharged from liability. Another argument put forward by underwriters was that the broker's misleading signing indication amounted to a misrepresentation, which allowed them to avoid the policy *ab initio*. The trial judge held that the signing indication was made in good faith therefore it did not amount to misrepresentation.⁵⁸ Having decided that reinsuring underwriters were bound by the subscription, Hobhouse J went on to consider if the broker faced any liability to the underwriters by reason of making the signing indication. On the facts of the case, he held that the signing indication did not have a contractual force but that it was capable of giving rise to liability in tort because, once given, it imposed on the broker a duty to take reasonable care to achieve the indicated signing down. On this basis, the trial judge held that the broker was liable both to the leading underwriter and the other two underwriters. The broker conceded its liability to the leading underwriter but appealed against its liability to the following underwriters.

5-20 The Court of Appeal's analysis differed from the trial judge in two respects. First, the Court of Appeal seems to have proposed that questions of this nature ought to be analysed in terms of contract rather than in terms of tort.⁵⁹ In this respect, the Court of Appeal was of the view that the signing indication given to the leading underwriter was binding on the broker as a contractual warranty; the obligation arising from such an indication was not strict but only an obligation to use his best endeavours to ensure that there would be a subscription rate expressed in the indication. Second, unlike Hobhouse J, the Court of Appeal was not prepared to impose liability in favour of the following underwriters, on the basis that the signing indication had only been made to the leading underwriter and not repeated to them. The outcome is in line with the decision of the Court of Appeal to deal with the matter purely on a contractual basis. The broker, by giving signing indication to the underwriter, undoubtedly creates a contractual relationship between the two, but there is no contractual relationship between him and the following market unless the signing indication given to the leading underwriter is transmitted to all subsequent underwriters. The Court of Appeal categorically rejected the existence of a market practice to this effect. Consequently, it was held that the broker was not liable to following underwriters.

5-21 It was not essential for either the High Court or the Court of Appeal in *The Zephyr* to consider the implications of a broker giving a wrong signing indication to underwriters deliberately or recklessly. However, by considering the judicial views expressed in *The Zephyr* and taking into account contract and insurance law principles, it is obvious that giving a misleading signing indication fraudulently or recklessly might have an impact on the validity of the insurance contracts. By its

⁵⁸ Another argument was that the broker had no authority to bind the underwriters to take more than their agreed proportion of the risk, as he had acted as the agent of the reinsuring underwriters and not as the agent of the operation. This view was also rejected. It has recently been confirmed in *Bonner v Cox Dedicated Corporate Member Ltd* [2005] EWCA Civ 1512; [2006] 2 Lloyd's Rep 152 that the broker acts as the agents of the operation.

⁵⁹ The decision of the Court of Appeal could be explained by reference to the principle that a person who could reasonably be expected to protect his economic interest by contract should not be allowed recourse to the law of tort to make good a failure to do so.

nature, a signing indication is a representation but it is not a representation of the existing facts. Instead, it is a representation of expectation or belief.⁶⁰ By virtue of s 20(5) of the MIA 1906, a representation as to a matter of expectation or belief is true if it is made in good faith. Therefore, a broker who is aware that he will not achieve a degree of subscription to the slip but nevertheless tells the underwriter that he will, or he is reckless to the extent that he does not care whether or not he will achieve that degree of subscription, makes a misrepresentation. The next question is whether the misrepresentation is material, which can induce an underwriter to enter into the agreement. The test of inducement is a rather subjective one and requires careful deliberation as to the state of mind of the relevant underwriter. That aside, it is submitted that any representation which affects the size of the risk taken by an underwriter should be material within s 20(2) of the MIA 1906.⁶¹ It is highly likely that a prudent insurer would like to know the extent of the risk he has undertaken.⁶² If, for example, as a result of a representation he was led to believe that his maximum exposure would be 20 per cent but, in reality, he ended up taking 60 per cent of the risk, there is no doubt this kind of misrepresentation would have had an impact on his decision whether or not to take the risk.⁶³

5-22 Even though an underwriter manages to avoid the contract on the basis of misrepresentation, if a misleading signing indication is given to him by the broker it is open to the underwriter to pursue an action in tort of *deceit* against the broker for damages he might suffer (i.e. investigation costs).⁶⁴ For the sake of completeness, it must be stressed that the broker might be sued by the assured, either in tort or contract, if the broker, by giving misleading signing indication, costs the assured his insurance cover and accordingly the assured's indemnity claim remains unanswered.

5-23 The next question is whether an underwriter who has not been given a misleading signing indication by the broker directly can still rely on s 20(5) of the MIA 1906 to avoid the insurance contract, on the basis of fraudulent representation made to the leading underwriter. The answer depends on whether a representation as to the expected/intended subscription rate is transmitted to all subsequent underwriters. This issue was not considered directly in *The Zephyr*, but the reasoning seems to suggest that the answer should not be affirmative. Since there is a different insurance contract between the assured and each underwriter who subscribes to a portion of the risk,⁶⁵ a representation made to the leading underwriter can only be transmitted to the following market if it is incorporated into the slip. As the Court of Appeal in *The Zephyr* rejected the existence of a market practice to this end, it is hard to see why the outcome should be different where there is dishonesty on the part of the broker.

⁶⁰ *The Zephyr* [1984] 1 Lloyd's Rep 58, at 81, per Hobhouse J.

⁶¹ This sub-section reads: 'A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.'

⁶² See Chapter 2, [2-27] where it was argued that existence of fraud would dispense the requirement of materiality.

⁶³ See *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501.

⁶⁴ It should be noted that the assured will also be vicariously liable for the torts of the broker committed in the course of performing his contractual obligations.

⁶⁵ See s 24(2) of the MIA 1906.

(C) Sub-brokers and Fraud

5-24 The natural consequence of an agency contract being a confidential contract is that an agent is expected to perform the contract in person.⁶⁶ An agent may delegate his authority only if the principal has given consent to such delegation expressly or impliedly.⁶⁷ Implied consent may be inferred if, in a particular trade, the use of sub-agents is a common practice. For centuries, the use of sub-agents has been a regular feature of insurance practice in the London market.⁶⁸ The existence of this practice, therefore, amounts to an implied consent on the part of the principal and delegation is possible (unless, of course, the contract between the assured and broker expressly prohibits such delegation).

5-25 It is safe to assume that the relationship between the producing broker and placing broker is based on a contract. In *Prentis Donegan & Partners Ltd v Leeds & Leeds Co Incorporation*,⁶⁹ New York brokers approached the Lloyd's brokers for a renewal quotation for hull and machinery risks in respect of three ship-owning companies managed by Offshore Oil Services UK Ltd. The Lloyd's brokers provided a quotation and the New York brokers placed a firm order. The slip was written 'Account: Offshore Services UK Ltd'. Following the attachment of the risk, the Lloyd's brokers paid the premium to the underwriters but they were not reimbursed by the New York brokers, who argued that there was no contractual relationship between themselves and the Lloyd's brokers. Rix J categorically rejected this argument.

5-26 However, the contractual analysis proves problematic when it comes to the relationship between the assured and the placing broker. In the absence of extraordinary circumstances, it is hard to see how privity of contract between a principal and a sub-agent (placing broker) can be established simply because the delegation was effected with the authority of the principal. It will, of course, be a different matter if it can be shown that the parties intended to create a direct relationship between the principal and the placing broker (e.g. by effecting a complete substitution of the producing brokers by the placing brokers) but the burden is on the shoulders of the producing broker and is not an easy one to satisfy.⁷⁰ The lack of a contractual relationship between the assured and the placing broker does not prevent the latter from being liable to the former in tort if the placing broker assumes responsibility to perform the functions in question.⁷¹ It was held in *BP Plc v Aon*⁷² that on the facts of the case, the placing broker assumed responsibility to the assured by entering into an agreement between the assured and the producing broker, which required the

⁶⁶ This is based on the maxim '*delegatus non potest delegare*' which is an established rule of the law of agency.

⁶⁷ *De Bussche v Alt* (1878) 8 Ch D 286.

⁶⁸ There might be various reasons why a broker (producing broker) might wish to use the services of a sub-broker (placing broker). This might be necessary if the producing broker does not have expertise in the type of cover sought. It might also be the case that the producing broker is located in another jurisdiction, therefore is prevented from operating in the market from which the cover is sought.

⁶⁹ [1998] 2 Lloyd's Rep 326.

⁷⁰ *Ibid*, at 334, per Rix J. See also, *Heath Lambert Ltd v Sociedad de Corretaje de Seguros* [2003] EWHC 2269 (Comm); [2004] 1 Lloyd's Rep 495, at [11]–[15], per Deputy High Court Judge Jonathan Hirst QC.

⁷¹ In a similar context, see *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.

⁷² [2006] Lloyd's Rep IR 577.

producing broker to declare risks to the London Market underwriters. However, this does not reflect the ordinary practice in the market. Normally, there will be minimal or no contact between the placing broker and the assured and the assured will rely solely on the producing broker. In that scenario, it will be very difficult to argue that a duty of care has been imposed on the placing broker. An interesting question is whether the placing broker could still be sued by the assured even in the absence of assumption of responsibility. A course of action could possibly be established if the placing broker is deemed to be effecting a collateral contract for the benefit of the assured, which makes him directly responsible to the assured.⁷³ It should, however, be noted that there is no English authority that lends support to this proposition.⁷⁴

5-27 As evaluated above, it is well-established under the law of agency that a principal is liable for fraud, concealment, misrepresentation or wrong of his agent where the agent is acting, or purporting to act, in the course of business transactions such as he was authorised, or held out as authorised, to conduct on behalf of his principal.⁷⁵ Therefore, if the producing broker dishonestly withholds material information from the placing broker or misguides the placing broker on material issues so that the latter ends up making material misrepresentations regarding the risk, the assured will be in breach of the utmost good faith obligation, considered above, even though the placing broker is acting *bona fide*.⁷⁶ *Blackburn v Haslam*⁷⁷ provides a good illustration of this principle. There the Glasgow insurers, who provided insurance cover for an overdue vessel, instructed their brokers in Glasgow to obtain reinsurance. The Glasgow brokers employed a broker based in London to effect the reinsurance. They had received information which indicated that the insured ship had been lost, but they did not disclose this either to the assured or to the London broker. It was held that the reinsurers were entitled to avoid the policy. There is no doubt that a producing broker in that case will be personally liable to a third party in deceit for misleading statements made by him. As the principal of the producing agent, it is also certain that the assured will be vicariously liable to the third party in that event.

5-28 The insurer will be entitled to avoid the contract if the placing broker deceitfully conceals material information, or is involved in making material representations relating to the risk even in the absence of any wrong-doing on the part of the producing broker or the assured, on the basis that a placing agent is authorised to negotiate the insurance contract on behalf of the assured.⁷⁸ The existence of a

⁷³ Seavey, WA, 'Subagents and Subservants' (1955) 68 *Harvard Law Review* 658, at 666-7.

⁷⁴ However, it is clear that any benefit a placing agent might acquire (i.e. commission or bribe, could be claimed by the assured on the premise that the placing broker owes fiduciary duties to the assured). See *Powell & Thomas v Euan Jones & Co* [1905] 1 KB 11.

⁷⁵ *Barwick v English Joint Stock Bank* (1867) LR 2 Ex 259; *Lloyd v Grace Smith & Co* [1912] AC 716 and *Briess v Woolley* [1954] AC 333.

⁷⁶ The principle has been encapsulated in s 19(a) of the MIA 1906, which requires the agent effecting the insurance to disclose material circumstances that in the ordinary course of business ought to be known by or to have been communicated to him. The producing broker's knowledge on matters relating to the risk could be classified as information that in the ordinary course of business ought to have been communicated to the placing broker.

⁷⁷ (1888) 21 QBD 144. The origins of s 19(a) of the MIA 1906 could be traced to this decision.

⁷⁸ Needless to say, that breach of pre-contractual duties of good faith on the part of the placing broker will give the insurer a right to avoid the policy, even in the absence of fraud.

contractual relationship between the producing and placing broker means that the producing broker will be vicariously liable to third parties in deceit for the fraudulent statements made by his agent in the course of discharging his obligation of obtaining insurance cover. This may be a relevant consideration, particularly if the placing broker becomes insolvent. Even though there is normally no privity of contract between the assured and a placing broker, the former might find himself vicariously liable on the basis that he is responsible for the torts of his agent (that includes the torts of a sub-agent who has been given authority by the agent to perform a specific duty). If the producing broker or the assured faces some form of vicarious liability towards the third parties on the basis of the placing broker's fraudulent misrepresentation, both will have the right to seek indemnification from the placing broker. Similarly, the insurer will be able to pursue an action in deceit against the producing broker where the placing broker makes a misleading representation to the insurer in reliance on the wrong information knowingly provided by the producing broker about the proposed risk. Here, the intention of the producing broker is to induce the insurer to rely on what he says; he is also in a position to appreciate that in the absence of some unforeseen intervention, the insurer will actually do so.⁷⁹

(D) Binding Authorities and Fraud

5-29 Given the sheer volume of transactions conducted in the London market, it is not surprising to see syndicates at Lloyd's and other insurance companies delegating underwriting authority to various agents in an attempt to reach more clients and ultimately grow their business. A common practice in this regard is the use of binding authorities (or binder). A binding authority is a contract between insurers and a cover-holder (in practice this is usually a broker)⁸⁰ authorising the cover-holder to accept risks on behalf of the insurer on conditions set out in the contract without specific prior approval of those insurers.⁸¹ This is, in fact, an agency agreement where the insurer commits the power of his pen to the cover-holder. It is for this reason that a binding authority of this nature is also known as an obligatory binder.⁸²

5-30 There is another type of binding authority used in practice which is commonly known as limited (or sometimes non-obligatory) binding authority. This is an agreement which sets out a mechanism allowing the cover-holder to submit various risks to the insurers in order to seek their confirmation of acceptance. Under this agreement, the cover-holder can normally issue insurance documents evidencing that a risk has been accepted on behalf of the insurers only after the insurers have

⁷⁹ *Shinhan Bank Ltd v Sea Containers Ltd* [2000] 2 Lloyd's Rep 406.

⁸⁰ Any person holding a binding authority will have to be authorised and regulated by the FSA by virtue of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).

⁸¹ The grant and operation of binding authorities are regulated at the Lloyd's by byelaws made by the Council of Lloyd's. The most relevant byelaws concerning binding authorities are: Underwriting Byelaw (No 2 of 2003) and Intermediaries Byelaw (No 3 of 2007). As stipulated in Part XIX of the FSMA 2000, the FSA has the role of overseeing the Council of Lloyd's and these byelaws may become subject to intervention by the FSA at some future date.

⁸² Under a binding authority, any business underwritten by the cover-holder is the underwriter's business, and accordingly, all records relating to insurance contracts bound under the binding agreement remain the property of the underwriter. See *Hiscox Underwriting Ltd and Another v Dickson Manchester & Co Ltd* [2004] EWCH 479 (Comm); [2004] 2 Lloyd's Rep 438.

rated and accepted the risk. No underwriting authority is delegated to the cover-holder and the insurer is not under an obligation to accept any of the risks declared.

5-31 It is beyond doubt that a broker operating under an obligatory binding agreement acts as the agent of the insurer for certain purposes (i.e. underwriting). It is, therefore, vital that when considering the fate of insurance contracts formed under a binding agreement, the precise legal position that a broker occupies in this relationship is carefully identified. The rest of this part deals with legal issues arising under binding agreements especially the impact of dishonest behaviour on the part of the broker.⁸³

5-32 It is inevitable that the broker will find himself in a very delicate position in legal terms if he chooses to place insurance for his clients under the binding agreement. The dual agency role he plays is likely to give rise to more complex issues.⁸⁴ In that case, the broker will owe fiduciary duties to the assured by reason of the trust and confidence placed upon him to the effect that he is expected to protect the interests of the assured by avoiding bringing about a conflict of interest.⁸⁵ The assured will be able to make a claim for damages in case of breach of these fiduciary duties.⁸⁶ At the same time, under the binding agreement, the broker will owe fiduciary duties to the insurer, which will be compromised if he puts his own interest in obtaining commission above making a genuine assessment of the business presented to him by the assured.⁸⁷ A serious breach of these duties entitles the insurers to terminate the agency relationship and seek damages.⁸⁸ In the absence of express provisions in

⁸³ As indicated earlier, usually, in practice, a binding authority is granted to a broker. The reason behind this is the desire of the insurer to expand his client base by using the contacts of an insurance broker. There is, however, a slim possibility that an independent agent other than a broker might be granted a binding authority. Taking this possibility into account, the rest of this part uses the more general term 'cover-holder' when referring to the party who has been delegated a binding authority by the insurer.

⁸⁴ In the discussion paper, *Transparency, Disclosure and Conflict of Interest in the Commercial Insurance Market*, (FSA Discussion Paper 08/2, March 2008), p 17, binding authorities have been highlighted as arrangements where 'the risk of conflict of interest is almost certain to become more pronounced'.

⁸⁵ *Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep 602. Millet LJ in *Bristol & West BS v Mathew* [1998] Ch 1, at 18, has defined in a categorical fashion what a fiduciary relationship entails:

The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of the fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or for the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list . . . They are the defining characteristics of the fiduciary.

⁸⁶ For breach of fiduciary duty, dishonesty is not required, but it is essential that a fiduciary's conduct is intentional and involves some element of disloyalty.

⁸⁷ Recognising the potential conflict of interest, ss 8.2 and 8.3 of the Code of Practice for Lloyd's Brokers provide:

Where a Lloyd's broker accepts his own client's risk on behalf of insurers under a binding authority granted to him, he should disclose this to his client. Where the client so requests, a Lloyd's broker should inform him of all financial advantages to the Lloyd's broker of the use of the binding authority.

At the time of accepting a binding authority a Lloyd's broker should remind the insurers who are granting that authority that the Lloyd's broker's first duty will be to his existing and future clients rather than to the insurers granting the authority.

It is debateable, to say the least, whether these principles apply following the deregulation of Lloyd's brokers.

⁸⁸ Even in cases where the cover-holder broker is acting for the insurer only, the cover-holder still

the binding contract, English law does not seem to require the broker to observe a duty of care to the insurer in determining which risks to be declared to the binder.⁸⁹ However, the circumstances of each case might justify the implication of a term of this nature into the binding agreement. It is beyond the scope of this book to consider various conflicts that can arise and how the principles of agency, contract and tort law can be used to deal with complex legal problems. The rest of this part will devote attention to the consequences of broker's fraud on the insurance policies issued under a binding authority.

5-33 An interesting question arises as to whether an insurance contract effected by the cover-holder exceeding the scope of his authority delegated under an obligatory binder is valid as far as the assured is concerned. The answer to this question will turn on whether and, if so, to what extent the insurer is bound by the actions of his agent. The crucial point will, therefore, be whether the cover-holder will have apparent or ostensible authority.⁹⁰ This authority arises where the principal, by words or conduct, represents to a third party that another has authority to act on his behalf. In that case, the principal may be bound by the acts of that other as if he had in fact authorised him.⁹¹

5-34 The case law suggests that, by placing an agent in a specific position carrying with it a usual authority, a principal might make a presentation of a general nature that the agent has authority to act on his behalf. For example, it was held that by appointing a person as managing director,⁹² company secretary⁹³ or using the ser-

owes fiduciary duties to his principal; this duty is also extended to the employees of the cover-holder; see *Markel International v Surety Guarantee Consultants and Others* [2008] EWHC 1135 (Comm); [2009] Lloyd's Rep IR 77.

⁸⁹ See *Aneco Reinsurance Underwriting Ltd (In Liquidation) v Johnson & Higgins Ltd* [2001] UKHL 51; [2002] 1 Lloyd's Rep 157; *Sphere Drake Insurance Ltd v Euro International Underwriting Ltd et al.* [2003] EWHC 1636 (Comm); [2003] Lloyd's Rep IR 525 and *Bonner v Cox Dedicated Corporate Member Ltd* [2005] EWCA Civ 1512; [2006] 2 Lloyd's Rep 152. To the contrary, in Australia, under the Insurance (Agents and Brokers) Act 1984, the broker under a binder is deemed to be the agent of the insurer for all matters falling within the scope of his authority from the insurer (s 9).

⁹⁰ It is trite law that the doctrine of apparent authority applies even though the agent acts in his own interests and in fraud of his principal provided that the act in the course of which the forgery occurred is within the apparent or ostensible authority of the agent: *Uxbridge Permanent Benefit Building Society v Pickard* [1939] 2 KB 248; *Navarro v Moregrand* [1951] 2 TLR 674; *Briess v Woolley* [1954] AC 233 and *Lloyd v Grace Smith & Co* [1912] AC 716.

⁹¹ *Pickering v Busk* (1812) 15 East 38 and *Smith v M'Guire* (1858) 3 H & N 554. In *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, at 503, Diplock LJ said:

An 'apparent' or 'ostensible' authority . . . is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority, so as to render the principal liable to perform any obligations imposed upon him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract.

It should be borne in mind that a representation made by the agent as to his authority cannot of itself create apparent or ostensible authority: *Attorney-General for Ceylon v Silva* [1953] AC 461, at 479.

⁹² *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549 and *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.

⁹³ *Panorama Developments (Guildford) Ltd v Fielis Furnishing Fabrics Ltd* [1971] 2 QB 711.

vices of a professional agent (someone whose occupation normally gives him a usual authority to do things of a certain type (e.g. a solicitor))⁹⁴ a principal would make a general presentation to the effect that the agent was authorised to act on his behalf. It is submitted that the position of a broker with a binding authority is similar to the position of a solicitor, in that both are professionals who are authorised to enter transactions to bind their principals. There is, therefore, room to argue that a broker with a binding authority has an apparent or ostensible authority due to the impression given to the outside world as a result of this appointment. Accordingly, if the broker acts fraudulently while performing his apparent authority, his principal will be responsible for his actions, therefore insurance contracts effected by the broker should stand even if he has deceitfully exceeded the authority given under the binder.⁹⁵ The only remedy available to the insurer in that case will be to bring a claim against his agent (broker/cover-holder) for breach of the agency agreement or even in tort.⁹⁶

5-35 The doctrine of apparent or ostensible authority has been developed with a view to providing protection to third parties, who are given the impression by the representation of the principal that the agent dealing with them is authorised to put the principal into a contractual relationship with third parties. Naturally, the doctrine will not provide any assistance to a third party if the insurer has brought to the attention of the third parties any limits on the usual powers of the agent which are inconsistent with the agent's assertion of authority.⁹⁷ A similar outcome will follow if the third party has notice from the nature of the transaction that he is dealing with an agent who is exceeding his authority.⁹⁸ Admittedly, acquiring this kind of constructive knowledge from the surrounding circumstances is possible only in some extreme circumstances (i.e. if the agent's acts are manifestly for his own benefit).⁹⁹ Therefore, a principal is not bound by an insurance contract where the assured has actual or constructive knowledge that the cover-holder has exceeded his authority. In that case, if the principal refuses to ratify the agreement, the assured can bring an action against the cover-holder for breach of warranty of authority.¹⁰⁰ It is not clear whether an action for breach of warranty of authority is grounded in contract or tort, but it is settled that the proper measure of damages is contractual.¹⁰¹ Based on this, the assured can claim the amount he could have claimed under the policy and also the expenses he incurred in pursuing the insurer unsuccessfully.

⁹⁴ *Waugh v HB Clifford & Sons Ltd* [1982] Ch 374.

⁹⁵ Even though this issue was not at the centre of the discussion in *Pryke v Gibbs Hartley Cooper Ltd* [1991] 1 Lloyd's Rep 602, by settling the claims under policies which were issued by a cover-holder by exceeding the scope of his authority, the insurers seemed to have conceded the point that the cover-holder had apparent authority due to the fact that he was given an obligatory binder.

⁹⁶ Determining the quantum in such an action might prove problematic, as the outcome of risks underwritten may not be known for many years.

⁹⁷ *Acey v Fernie* (1840) 7 M & W 151 and *Baines v Ewing* (1866) LR 1 Ex 320.

⁹⁸ *John v Dodwell and Co Ltd* [1918] AC 563. By virtue of Intermediaries Byelaw (No 3 of 2007), unrestricted binding authorities at Lloyd's must be registered on the Lloyd's binding authority registration website (the BAR) and can only be issued to an 'approved cover-holder'. A restricted binding authority does not require registration on the BAR and can be issued to both approved cover-holders and restricted cover-holders.

⁹⁹ *Midland Bank Ltd v Reckitt* [1933] AC 1.

¹⁰⁰ *Albion Fire v Mills* (1828) 3 Wills & S 218 and *Collen v Wright and Others* (1857) 7 E & B 647; (1857) 120 ER 241.

¹⁰¹ *V/O Rasnoimport v Guthrie & Co Ltd* [1966] 1 Lloyd's Rep 1.

5-36 It is a curious question whether a binding authority attracts a duty of good faith at the pre-contractual stage. Waller J, in *Pryke v Gibbs Hartley Cooper Ltd*,¹⁰² answered this question in the negative, essentially on the premise that a binding agreement is nothing more than a contract of agency. There is merit in this view. A binding authority gives the cover-holder the authority to enter into insurance agreements on behalf of the insurer but is not a contract of insurance itself; it is rather a contract for insurance. Furthermore, the common view is that the types of contract that can be categorised as giving rise in law to an obligation of utmost good faith are closed.¹⁰³ However, Waller J in *Pryke v Gibbs* expressed the view that the broker who is negotiating the binding authority for the cover-holder would possibly be under a duty of disclosure, at least concerning any 'unexpected features' of the proposed cover-holder. In so stating, the judge drew a parallel with contracts of suretyship.¹⁰⁴ With respect, it is submitted that drawing any analogy between a contract of suretyship and a binding authority is a curious reasoning. In a contract of surety, the creditor, who is expected to make a disclosure to a would-be surety, is already in a contractual or similar relationship with the debtor, hence is expected to know the material facts which the surety would bear if he enters into the contract. That is not true for a broker who negotiates an agency contract on behalf on his principal (cover-holder). Furthermore, as indicated, it is firmly established that any duty of disclosure before the contract is concluded is limited to certain classes of contract; it is unlikely that courts would be accommodating if an attempt is made to expand the number of such contracts.

5-37 Even though the cover-holder or his broker is not required to disclose material facts when negotiating the binding authority, there is always the possibility that the contract might be vitiated due to other factors. A material misrepresentation, whether fraudulent or not, made by the broker or the cover-holder himself that induces the insurer to agree to give a binding authority to the cover-holder, is one of those factors which springs to mind. In discovering the misrepresentation, the insurer will have an option to rescind or affirm the binding agreement. The critical question is what happens to insurance contracts entered into by the cover-holder if the insurer decides to rescind the binding authority. If the insurer chooses to rescind the contract, it becomes avoided *ab initio* and parties should be brought to the position they occupied before the formation of the contract.¹⁰⁵ A strict application of this principle in this context would mean that insurance contracts issued under a binder should fall with the binder. However, this would mean that an innocent third party who has nothing to do with the misconduct of the cover-holder is penalised for the misconduct of the latter. There are two possible ways of addressing this problem. First, there is authority to the effect that recession may be barred if it would prejudice

¹⁰² [1991] 1 Lloyd's Rep 602, at 616.

¹⁰³ *Bell v Lever Brothers Ltd* [1932] AC 161, at 227, per Atkin LJ and, at 231–2, per Thankerton LJ. See also, comments made by Rix J in *L'Alsacienne Première Société Alsacienne et Lorraine D'Assurances Contre L'Indendie les Accidents et les Risques Divers v Unistorebrand International Insurance AS and Kansa Reinsurance Co Ltd* [1995] LRLR 333, at 348–9.

¹⁰⁴ [1991] 1 Lloyd's Rep 602, at 616.

¹⁰⁵ *Refuge Assurance Co Ltd v Kettlewell* [1908] 1 KB 545, at 551, per Sir Gorell Barnes and *Dawsons v Bonnin Ltd* [1922] 2 AC 413, at 437, per Lord Wrenbury.

the rights of third parties.¹⁰⁶ This is precisely the position here. In similar circumstances, it was held that a contract between a Lloyd's Name and certain Lloyd's companies authorising the companies to enter into settlements on behalf of the Name could not be rescinded for fraudulent misrepresentation because rescission would affect third parties with whom settlements had been entered into.¹⁰⁷ Second, s 2(2) of the Misrepresentation Act 1967 gives the courts a statutory discretion to refuse rescission and to award damages instead. This sub-section reads:

Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.

It can be argued that allowing rescission for the misrepresentation of the cover-holder will have inequitable consequences for the parties dependant on the binding authority. It has to be noted that no discretion is available if the misrepresentation is fraudulent.¹⁰⁸

5-38 A case which is likely to arise in practice is that the assured or his broker makes full disclosure to the cover-holder but the cover-holder, mindful of the commission he would earn, chooses deliberately to ignore material facts and issues an insurance policy. In those circumstances, the policy issued should stand, as the cover-holder's knowledge is imputed to the insurer due to the fact that he is authorised to conclude insurance contracts on behalf of the insurer.¹⁰⁹ It follows that the insurer, through his agent, is deemed to have received the relevant information and has decided to ignore it. The only remedy open to the insurer in that case is to bring an action against the cover-holder, either in contract or tort for his loss. The position would be, undoubtedly, different if the cover-holder had no authority to make a decision on the insurer's behalf. In that case, the knowledge of the cover-holder of the true facts would not be imputed to the insurer even if the cover-holder's fraud on the insurers is established.¹¹⁰

5-39 It is another very interesting question as to what happens to the insurance contract issued if there is a conspiracy between the cover-holder and the assured or his agent to defraud the insurer. If, for example, the cover-holder, under a secret agreement between the assured or the assured's agent, accepts risks that are not

¹⁰⁶ *Thomas Witter Ltd v TBP Industries* [1996] 2 All ER 573.

¹⁰⁷ *Society of Lloyd's v Leighs and Co* [1997] CLC 1398; [1997] 6 Re LR 289.

¹⁰⁸ It has been suggested by Steyn J in *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep 109, at 118, that s 2(2) did not apply to insurance contracts due to the policing function utmost good faith principles perform in these contracts. Even if this view proves to be accurate, it has no impact in the present case, as a binding agreement is a contract for insurance and not a contract of insurance.

¹⁰⁹ The knowledge of the agent is to be imputed to the company if the agent had a wide sphere of operations and where he represented the principal in respect of that transaction: *Regina Fur Co v Bossom* [1957] 2 Lloyd's Rep 466, at 484, per Pearson J.

¹¹⁰ See *Newsholme Bros v Road Transport and General Insurance Co* [1929] 2 KB 356 and *Dunn v Ocean Accident and Guarantee Corp Ltd* (1933) 47 LIL Rep 129.

commercially viable, would those policies stand despite the conspiracy and fraud surrounding the transactions? It is readily appreciated that the situation is slightly different, as here the assured or his agent is actively involved in the act of defrauding the principal. It is submitted, therefore, that the active participation of the assured or his agent in the fraud would mean that they are in breach of the utmost good faith obligation they owe to the insurer. It is one thing to say that the cover-holder is authorised to receive information on behalf of the insurer in relation to the risk so that his knowledge is imputed to the principal. It is a completely different thing to suggest that he is entitled to waive the utmost good faith obligation of the other party by conspiring to defraud his principal. Apart from avoiding the policy, the insurer could potentially bring an action for damages against the cover-holder in contract or against the assured or his agent. The legal basis of such action against the assured or his agent will be conspiracy to defraud the underwriter.

5-40 As a final point, the impact of fraud of the broker operating under a limited binder should be given some consideration. What happens, for example, if the cover-holder broker while presenting the risk to the insurer wilfully puts a positive spin to it so as to make the risk more attractive for the insurer?¹¹¹ In this case, it is essential to identify whose agent the cover-holder broker is for the purposes of presenting this risk to the insurer. If the cover-holder broker does not have any relationship with the assured or his agent and the risk has been accurately presented to the cover-holder by the assured and/or his agent, it is highly unlikely that the misconduct of the cover-holder broker will have any impact on the validity of the insurance policy. The cover-holder is not acting as the agent of the assured when presenting the risk to the insurer under the binding agreement; he is not acting as the agent of the insurer when it comes to assessment of the risk put forward. What actually happens here is an internal mishap within the insurer's organisation, which should not have any impact on the position of third parties. No doubt, there will be legal consequences for the cover-holder broker, especially if the insurer insists on treating this as a repudiatory breach of the binding agreement.¹¹²

5-41 If, however, the cover-holder broker presents his own client's risk to the insurer under a limited binding authority, a different outcome should follow. There, the cover-holder broker, as the agent of the assured seeking insurance cover, is under pre-contractual obligation of utmost good faith¹¹³ and is expected to disclose matters he is deemed to know in the course of his business.¹¹⁴ Therefore, if the act of putting a positive spin to the risk presented is viewed as a material misrepresentation or non-disclosure, the insurer will be able to avoid the insurance contract. The issue of attribution of the cover-holder's knowledge to the insurer will not be at stake here, as the cover-holder has a limited authority and is not entrusted with the task of evaluating the risk presented on behalf of the insurer.¹¹⁵

¹¹¹ The motive here for the cover-holder is the prospect of earning commission.

¹¹² Repudiation will be allowed if 'performance of the stipulation went to the very root' of the binding agreement: *Glaholm v Hays* (1841) 2 Man & G 257, at 268, per Tindal CJ.

¹¹³ See ss 19(b) and 20 of the MIA 1906.

¹¹⁴ *Ibid*, s 19(a).

¹¹⁵ See *Newsholme Bros v Road Transport and General Insurance Co* [1929] 2 KB 356. *Cf Stone v Reliance Mutual Insurance Sy Ltd* [1972] 1 Lloyd's Rep 469.

(2) Underwriting Agents

5-42 Underwriting agents are central to the activities of companies operating in the London market and also syndicates at Lloyd's.¹¹⁶ An underwriting agent, by an agreement, is delegated authority to accept risks on behalf of insurers, to determine the terms of the agreement, to prepare necessary documentation and also to execute the insurance contracts issued on behalf of the insurer.¹¹⁷ It is also common practice to delegate authority to an underwriting agent to arrange reinsurance on behalf of the insurer. An underwriting agent is normally integrated to the insurer's organisation to the extent that it might, to the outside world, give the impression that it is a branch of the insurer. However, the legal relationship between an underwriting agent and an insurer is regulated by a management agreement, which is not a contract of insurance. Therefore, it does not attract the duty of utmost good faith stipulated in the MIA 1906.¹¹⁸

5-43 Previous chapters establish that the duty of utmost good faith is bilateral;¹¹⁹ that the insurer is under an obligation to observe utmost good faith towards the assured.¹²⁰ As the duty of the insurer is a reflection of the assured's pre-contractual duty of utmost good faith, the agents of the insurer involved in the placing of the risk are also expected to make full disclosure and avoid material misrepresentations, even though this has not been expressly indicated in s 17. An underwriting agent is normally delegated authority to enter into insurance agreements binding his principal. Therefore, he is bound by the pre-contractual duty of utmost good faith expressed in s 17. Any material non-disclosure or misrepresentation on his part will give the assured an opportunity to avoid the contract,¹²¹ but the provisions of the MIA 1906 do not give rise to an action for damages.¹²² It will, of course, be a different matter if the underwriting agent misrepresents certain facts/circumstances with the intention of inducing the assured to enter into the contract. In that case, the assured will have a claim for damages under the Misrepresentation Act 1967 and/or for tort of deceit.

5-44 A more difficult question is whether it is open to the insurer to contend that information received from an assured (or his agent) could not be imputed to him on the basis that his managing director has been operating fraudulently against his principal's interest. There is authority to the effect that knowledge possessed by

¹¹⁶ Lloyd's members, both corporate and individual, conduct their insurance business in syndicates and each syndicate is run by a managing agent. Currently, there are over 80 syndicates operating at the Lloyd's market.

¹¹⁷ An agent may be an individual, a partnership or a company.

¹¹⁸ Under the FSMA 2000, persons assisting in the administration and performance of a contract of insurance must be authorised. Accordingly, underwriting agents have to be authorised and must seek permission to carry on the regulated activity of intermediary: Ch 3 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).

¹¹⁹ Section 17 of the MIA 1906 reads: 'A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.'

¹²⁰ Of course, question marks remain as to the scope of the insurer's duty at the pre-contractual stage, (i.e. what the right test of materiality is). For a detailed examination of these issues see [Chapter 4](#).

¹²¹ *Pontifex v Bignold* (1841) 3 Man & G 63; 133 ER 1058 and *Refuge Assurance Company Ltd v Kettlewell* [1908] 1 KB 545; *aff'd* [1909] AC 243.

¹²² *Banque Financière de la Cité v Westgate Insurance Co* [1990] 1 QB 665.

an insurance agent is imputed to the insurers so that they could not rely on a non-disclosure defence.¹²³ However, the key issue is whether the judgment of Vaughan Williams J in *Re Hampshire Land Co*,¹²⁴ could alter the equation and strengthen the hands of an insured who has been defrauded by his managing agent. There, two companies, Hampshire Land and Portsea, occupied offices in the same building and had four common directors and a common secretary. The directors of Hampshire Land were allowed by the articles of association to borrow a sum up to the amount of its paid capital. Borrowing above this sum would have required authorisation by the shareholders in general meeting. Both companies ended up going into liquidation. The liquidators of Portsea sought to recover from Hampshire Land the sum of £30,000. It was clear that the resolution authorising the extent of borrowing had, in fact, been passed at a meeting of shareholders, but the resolution was invalid due to technical reasons. It was held that Portsea could recover the sum of £30,000 and the knowledge of Portsea's company secretary that Hampshire Land had exceeded its borrowing capacity was not to be imputed to Portsea. The decision is generally viewed as authority for the proposition that in a case where the agent commits a fraud on his principal, the knowledge of that fraud is not to be imputed to the principal and the principal can, accordingly, assert rights which, with the requisite knowledge, would have been lost. *Re Hampshire Land Co* has been followed on the rationale that an agent cannot be expected to disclose his own fraud against the principal and, accordingly, it would not be appropriate to impute knowledge of such fraud to the principal.¹²⁵

5-45 Despite noticeable similarities, it is submitted that the position of the insurer in the above mentioned scenario is rather different to the position of the principal in *Re Hampshire*. In *Re Hampshire*, the agent was aware of the fact that a third party was acting in an inappropriate fashion in its dealings with the principal but chose not to inform his principal, attempting to defraud him so that he entered into a contractual relationship with a third party. In the present context, the agent, who has been put into a position of authority in terms of collecting information and making underwriting decisions on the principal's behalf, is provided the requisite information required by the assured (or his agent to insure). As far as the assured is concerned, that information is received by the insurer by his authorised agent; if the agent is defrauding the principal (e.g. by not making underwriting decisions in an appropriate fashion) that concerns the insurer and his agent and should be handled within the context of the agency agreement. This is, essentially, a case of the agent acting in breach of his authority and it is certainly true that both the insurer and assured are innocent parties. That said, when it comes to choosing which innocent party should bear the consequences of a third-party's fraud, the tendency would be to require the party who is in a better position to avoid the risk to foot the bill.¹²⁶ On

¹²³ *Bowden v London, Edinburgh & Glasgow Assurance Co* [1892] 2 QB 534 and *Tate & Sons v Hyslop* (1885) LR 15 QBD 368.

¹²⁴ [1896] 2 Ch 743.

¹²⁵ *Kwei Tek Chao v British Traders and Shippers Ltd (No 1)* [1954] 1 Lloyd's Rep 16.

¹²⁶ The position here is similar to the position of a ship-owner who delivers the goods to the wrong person against a forged bill of lading. Even though he is unlikely to be able to detect the forgery, as the producer of the bill of lading he is deemed to be in a better position to avoid the loss. See e.g., *Motis Exports Ltd v Dampskibsselskabet* [2000] 1 Lloyd's Rep 211.

that premise, given that the insurer has chosen to delegate authority of this nature to his managing agent, it is only fair that he, rather than the assured, bears the consequences of his agent's actions.¹²⁷

5-46 Determining the legal standing of an underwriting agent is more difficult when he is appointed to manage underwriting for a group of insurers, collectively referred to as a 'pool'. The relationship between the pool members and the underwriting agent is regulated by a management agreement¹²⁸ and could give the agent a varying degree of autonomy in managing the affairs of the pool members. In most cases, the underwriting agent, apart from having authority to accept business on behalf of the members in the pool, also has authority to arrange reinsurance cover for the members of insurers in the pool. When the underwriting agent is assessing the risk presented by potential assureds or their brokers on behalf of the members of the pool, as discussed above, any information passed to the underwriting agent will be treated as information passed to the insurers that he is representing. Any misconduct of the underwriting agent, including dishonesty against the pool members, will not have an adverse impact on the insurance contract put in place.¹²⁹

5-47 Conversely, the legal position of the underwriting agent will be different where he is involved in arranging a reinsurance agreement on behalf of the members of the pool and reinsurers outside the pool. For the purposes of that transaction, the underwriting agent is acting as the agent of pool members (reassureds) and failure by him to disclose a material fact of which he was aware, whether dishonestly or otherwise, might give the reinsurers the right to avoid the reinsurance agreement. A more difficult legal question is whether the underwriting agent in the process of obtaining reinsurance is expected to disclose to reinsurers a fact known to him but not to pool members. If the underwriting agent in this context is viewed as an agent to insure, then he is under an independent duty of disclosure under s 19 of the MIA 1906. Although views have been expressed in some cases that only a placing agent can be treated as an agent to insure,¹³⁰ it is submitted that such an outcome is at odds with the Court of Appeal's judgment in *Blackburn Low & Co v Haslam*,¹³¹ where the reinsurer in question was allowed to avoid the contract for non-disclosure

¹²⁷ There are a number of non-marine insurance cases where the view has been taken that the knowledge of an agent as to the true state of affairs could not be imputed to the insurers: see, in particular, *Newsholme Bros v Road Transport & General Insurance Co* [1929] 2 KB 356. However, it should be noted that in *Newsholme*, for the purpose of filing the proposal form, the agent was held to be acting as the agent of the assured and could, therefore, be easily distinguished in that regard. With the introduction of the Consumer Insurance (Disclosure and Representations) Act 2012, the rule expressed in *Newsholme* is reversed, as an agent collecting information from the assured will now be regarded at all times as the agent of the insurer by virtue of Sched 2, para 2 to that legislation.

¹²⁸ The agreement is not a contract that attracts notions of utmost good faith, but there is nothing preventing the parties from imposing a duty of good faith on the agent by agreement (i.e. a duty requiring disclosure of the activities undertaken in previous years on renewal). See e.g., *Pryke v Gibbs Hartley Cooper* [1991] 2 Lloyd's Rep 602.

¹²⁹ The pool member will obviously be in a position to bring a claim against the underwriting agent in that case for breach of the management agreement or even in tort.

¹³⁰ In two cases heard concurrently by the Court of Appeal, *PWC Syndicates v PWC Reinsurers* [1996] 1 Lloyd's Rep 241 and *Group Josi Reinsurance Co SA v Wallbroke Insurance Co Ltd* [1996] 1 Lloyd's Rep 345, Saville LJ and Rose LJ seemed to suggest that an underwriting agent acting on behalf of a Lloyd's Syndicate was not an agent to insure.

¹³¹ (1888) 21 QBD 144.

of material facts known to the reassured's Glasgow producing brokers but not to his London placing brokers. Given that s 19 is an attempt to codify the law as it stood before the enactment of the MIA 1906, it is evident that any agent involved in the process of procuring insurance is under a duty to disclose. In this context, an underwriting agent entrusted with the task of running the affairs of the pool is expected to disclose facts that he knows even if the pool members might not.¹³²

III FRAUD AT POST-CONTRACTUAL STAGE

5-48 It is not uncommon for independent agents of the assured and insurer to carry out certain functions beyond the formation stage of an insurance contract (e.g. brokers are often involved in presenting insurance claims to the insurer). Similarly, notification requirements under the policy (i.e. giving notice of an event that might give rise to a claim) are usually delivered by brokers. Insurers, however, occasionally employ loss adjusters to investigate and settle claims. The principal of such an independent agent is fixed with the misdeeds of his agent if the agent has sufficient authority to take that particular action on behalf of the assured or insurer.¹³³

5-49 It is a question of fact based on evidence whether the agent in question possesses such degree of authority.¹³⁴ A broker who has been given authority to put forward a claim to the insurer under the policy will likely have the power or influence to determine how the claim should be presented. Accordingly, a deceitful answer given to the insurer in response to a question in relation to the claim is likely to be attributed to the assured, making him responsible for the consequences of advancing a fraudulent claim. In a similar vein, any fraud committed by the broker in relation to the nature of the notice (e.g. changing date of the notice)¹³⁵ will be attributed to the assured, amounting to a breach of the contract on his part. It might even enable the insurer to avoid the contract for breach of s 17 of the MIA 1906.¹³⁶

5-50 Needless to say, an independent agent might face a claim for indemnity from his principal if he suffers a financial loss as a result of the agent's fraud. Such a claim is likely to be founded either on breach of contract or tort. Likewise, the independent agent might be targeted by the other party for tort of deceit if it can be demonstrated that the deceitful representation of the independent agent has led to a loss.¹³⁷

¹³² In *L'Alsacienne Première Société Alsacienne et Lorraine D'Assurances Contre L'Indendie les Accidents et les Risques Divers v Unistorebrand International Insurance AS and Kansa Reinsurance Co Ltd* [1995] LRLR 333, Rix J proceeded on the premise that knowledge in the possession of an intermediate agent had to be disclosed.

¹³³ This is also known as 'attribution of conduct'.

¹³⁴ See *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] UKPC 5; [1995] 2 AC 500.

¹³⁵ For a similar incident, see *Black King Shipping Corporation v Massie (The Litson Pride)* [1985] 1 Lloyd's Rep 437.

¹³⁶ *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] EWCA Civ 1275; [2001] 2 Lloyd's Rep 563.

¹³⁷ This does not mean that independent agents would naturally owe a duty of care to the other party. In *South Pacific Manufacturing v New Zealand Consultants* [1992] 2 NZLR 282, it was held that loss adjusters appointed by the insurer did not owe a duty of care to the assured.

CHAPTER 6

POTENTIAL IMPACT OF LAW REFORM

I THE CURRENT REFORM INITIATIVE

6-1 Reforming insurance law has been on the agenda for some time.¹ The most recent reform initiative is led by the English and Scottish Law Commission (the Law Commissions) and commenced in 2006 with a scoping exercise. In July 2007, the Law Commissions published their first Consultation Paper (CP1)² which proposed significant changes to the legal regime dealing with pre-contractual information duties and insurance warranties. Following the publication of CP1, it emerged that there was a wide-ranging consensus for the reform of consumer insurance law; this has led to the enactment of the Consumer Insurance (Disclosure and Representations) Act 2012,³ which has fundamentally overhauled the pre-contractual duty of utmost good faith as it had previously applied to consumer insurance contracts. As far as marine and insurance contracts are concerned, although there was general support for the reform agenda, the proposals put forward were not deemed fit for the purpose.⁴ The Law Commissions altered their position substantially and, in June 2012, published their third Consultation Paper (CP3)⁵ principally dealing with the duty of disclosure (and also misrepresentation) as it applied to commercial insurance contracts and

¹ In 1980, the Law Commission prepared a report advocating a reform of the pre-contractual duty of good faith and warranty regimes: Law Commission Report No 104, *Insurance Law – Non-Disclosure and Breach of Warranty*, Cmnd 8064 (1980). The striking feature of this report is the fact that marine, aviation and transport insurance has been excluded from the scope of a possible reform. Although a draft Bill was introduced to Parliament for reform in the field of non-marine insurance, it was withdrawn after the Government reached an agreement with the Association of British Insurers (ABI) that it would take up the Law Commission's recommendations on a self-regulatory basis. Extending the debate to marine and commercial insurance, the Australian Law Reform Commission (ALRC) in 2001 proposed substantial amendments to the Australian Marine Insurance Act 1909 (the equivalent of the MIA 1906), including the regime regulating marine insurance warranties; see Australian Law Reform Commission, *Review of the Marine Insurance Act 1909* (Report 91, 2001). At the time of writing, no action has been taken with regard to the proposals made in this Report.

² Law Commission and Scottish Law Commission, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured* (LCCP No 182, SLCDP No 134 (2007)).

³ The Act came into force on 6 April 2013 (SI 405/2013).

⁴ For a comprehensive analysis of the proposals, see Merkin, R and Lowry, J, 'Reconstructing Insurance Law: The Law Commissions' Consultation Paper' (2008) MLR 95; Soyer, B, 'Reforming Pre-Contractual Information Duties in Business Insurance Contracts: One Reform too Many?' [2009] JBL 15. For general reading on the subject, see Soyer, B (ed), *Reforming Marine and Commercial Insurance Law* (2008, Informa).

⁵ Law Commission and Scottish Law Commission, *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties* (LCCP No 204, SLCDP 155 (2012)).

warranties. In between CP1 and CP3, the Law Commission published their second Consultation Paper (CP2) in December 2011,⁶ which fundamentally focused on the post-contractual duty of good faith of the assured and the insurer.⁷

6-2 At the time of writing, the consultation has already been completed and the Law Commissions are working on their Final Report, which is expected to be available in 2014.^{7a} It is expected that the Final Report of the Law Commissions will draw upon the proposals made in CP2 and CP3, especially given the enthusiastic response received as part of the consultation process.⁸ Assuming that these proposals are adopted, they will alter the law considered in previous chapters significantly. It is, therefore, appropriate to draw attention to the main proposals put forward and to comment on them with a view to assessing their potential impact on current law if they were to find their way into the statute book.

(1) Pre-contract Information Duties

(A) Proposed Change on Remedies

6-3 Perhaps the most sweeping reform proposal put forward relates to the remedy of avoidance, which is currently available for a breach of the duty of utmost good faith at the pre-contractual stage. The main criticism directed at this remedy is that it adopts an all-or-nothing approach, which may extract a penalty way out of proportion to the breach, disregarding the state of mind of the assured (i.e. whether he acted innocently, negligently or deliberately) at the time the breach occurred.⁹ To make matters worse, the courts have set their face against allowing any other substantive remedy, such as damages, in cases where the pre-contractual good faith obligation is breached.¹⁰ To address these concerns and balance the interests of both parties, it is proposed to introduce proportionate remedies.¹¹

6-4 The Law Commissions see no difficulty in maintaining the current position in cases where the assured acts dishonestly at the pre-contractual stage (deliberate or reckless non-disclosure or misrepresentation). In such cases, the insurer may avoid

⁶ Law Commission and Scottish Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (LCCP No 201, SLCDP No 152 (2011)).

⁷ Other issues considered in the CP2 are: insurable interest and policies and premiums in marine insurance.

^{7a} The Law Commissions are working on a draft Bill and it is expected that a limited consultation will be carried out in the [first part](#) of 2014 aiming to obtain feedback on the wording of the proposed changes to the relevant sections of the MIA 1906.

⁸ The responses to the CP2 and CP3 can be found at: http://lawcommission.justice.gov.uk/consultations/business_disclosure.htm and http://lawcommission.justice.gov.uk/consultations/post_contract_duties.htm (last accessed 1 September 2013).

⁹ See Longmore, Sir A, 'An Insurance Contracts Act for a New Century' [2001] LMCLQ 249 and Eggers, PM, 'Remedies for the Failure to Observe the Utmost Good Faith' [2004] LMCLQ 249.

¹⁰ *Banque Financière de la Cité SA v Westgate Insurance Co* [1990] 1 QB 665; [1988] 2 Lloyd's Rep 513 and *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1990] 1 QB 818; [1989] 2 Lloyd's Rep 238. Although s 2(2) of the Misrepresentation Act 1967 confers upon the court the ability to deny the remedy of avoidance to a claimant and, in its place, to substitute an award of damages, views were expressed in *Highlands Insurance Co v Continental Insurance Co* [1987] 1 Lloyd's Rep 109 to the effect that this provision cannot be invoked in the context of commercial insurance policies.

¹¹ See CP3, para 9.40.

the contract and retain the premium. In other cases, for example if the assured is in breach of pre-contract information duties innocently or negligently, the available remedy will depend on a hypothetical assessment of what action the insurer would have taken had he been aware of the true state of affairs at the time of contracting. If, as a result of this assessment, it transpires that the insurer would not have entered into the contract, the remedy of avoidance will still be available. If, however, the view is that the insurer would have entered into the contract on different terms (e.g. with exclusions or warranties) the contract will be treated as if it included those terms. Lastly, if it is concluded that the insurer would have charged a higher premium, the insurer may reduce proportionately the amount to be paid on a claim.

6-5 Although an overwhelming majority of the responses received by the Law Commissions were in favour of introducing proportionate remedies,¹² one should not quickly dismiss the theoretical and practical problems associated with the concept of proportionality. The fundamental problem with the proportionality principle is that it is based on the assumption that re-rating of the insured risk is possible 'after the fact' in the light of the information not disclosed or misrepresented at the pre-contractual stage. However, re-rating is extremely difficult in certain types of business insurance contracts, as it requires re-examination of several variable factors, such as the business affairs of the assured's company, market trends and actions of the assured's employees.¹³ In the context of marine insurance, for example, it has been pointed out that moral risk can never be re-rated on a standard basis 'after the fact' (i.e. once it has emerged that there has been appreciably less than innocent non-disclosure).¹⁴ Furthermore, allowing a proportionate recovery for the assured, particularly where he has acted negligently in presenting the risk at the pre-contractual stage, is likely to have an impact on the level of the premium. This is inevitable, as the natural reaction of the insurers to such a rule would be to invest heavily in the claims/litigation stage in the hope that they can convince the judge that they would not have accepted such a risk, or would have charged a significantly higher premium had the risk properly been presented to them. Given the international character of most business insurance contracts, which might make it more troublesome and costly to investigate pre-contractual negotiations between parties, one can foresee that the level of increase in premiums is likely to be higher in this sector. One consequence of the proposed reform is, therefore, cross-subsidization (i.e. higher premiums for more diligent corporations to compensate for the sloppy behaviour of others). Undoubtedly this will have undesirable effects in terms of redistributing wealth. It is often argued that using individual bodies of law, such as

¹² It should be stressed that proportionality in terms of remedies has been welcomed by some of the commentators; see Eggers, PM, 'The Past and Future of English Insurance Law: Good Faith and Warranties' [2012] *UCL Journal of Law and Jurisprudence* 211, at 236. See, however, the criticisms made by Blackwood, G, 'The Pre-contractual Duty of (Utmost) Good Faith: The Past and the Future' (2013) *Lloyd's Maritime and Commercial Law Quarterly* 311, at 318–21.

¹³ Conversely, re-rating is more straightforward in consumer contracts, as these do not involve a great number of unusual risks. That possibly explains why the principle has found application in statutes dealing with general insurance law. See s 2 of the Norwegian Insurance Contracts Act 1989, Ch 4, s 2 para 2 of the Swedish Insurance Contracts Act 2005, s 19 of the German Insurance Contracts Act 2007 and, most recently, s 4 of and Sched 1 to the Consumer Insurance (Disclosure and Representations) Act 2012.

¹⁴ Staring, GS and Waddell, GL, 'Marine Insurance' (1999) 73 *Tulane Law Review* 1619, at 1661.

tort, contract, or insurance law, to redistribute wealth is inefficient, undemocratic and inequitable.¹⁵ It is inefficient because there are likely to be cheaper ways of transferring wealth and because the transfers tend to be in kind and, therefore, do not necessarily reflect the uses that would be preferred by recipients if they were entitled to choose how to spend their redistributed wealth.¹⁶ Such distribution is said to be undemocratic because it is fashioned by unelected institutions;¹⁷ it is thought to be inequitable because it mainly burdens participants in the tort, contract and insurance systems and, therefore, does not systematically allocate burdens in accordance with the ability to pay.¹⁸ Last, but not least, the proportionality principle could also be criticised on the ground that it may fuel a degree of uncertainty. Attempting to find out what an insurer would or would not have done involves a particularly high level of artificiality and it is inevitable that the courts' decisions would contain an element of arbitrariness. In the words of a legal scholar, if the proportionality principle is adopted, '[R]isk would be determined not by the free market but by judges exercising after-the-fact highly discretionary (and arbitrary) judgments.'¹⁹

6-6 Leaving these well-founded concerns aside, if the proposed change finds its way into the statute book, it is undeniable that it could potentially alter the manner in which insurers approach the claim assessment exercise. Under the current law, to avoid the contract proving material misrepresentation and/or non-disclosure is adequate as long as inducement can be demonstrated. The insurer does not need to prove what state of mind of the assured had when he committed the breach. However, following the implementation of the proposed changes, to be able to avoid the policy for non-disclosure or misrepresentation, the insurer needs either to prove that the assured acted fraudulently or that he would not have entered into the contract at all, had he known the true state of affairs. This would fundamentally change the claim assessment and litigation strategy adopted by the insurers in the future and one should not be surprised to see fraud being alleged more often than it has traditionally been by the insurers. The proposed change leaves common law rules intact. That would mean that upon proving fraud on the part of the assured, insurers might be tempted to claim damages from the assured under tort of deceit.

(B) Proposed Change on the Substance of the Duty

(a) Change-in-materiality test

6-7 Under the current test, a fact must be disclosed if it 'would influence the judgment of a prudent underwriter in fixing the premium or determining whether

¹⁵ The validity of distributive justice as a social goal is a much-debated issue. Controversy stems both from the difficulty of defining the concept of a 'fair division of wealth' and also of agreeing on merits of the approaches to be used to achieve that goal. See generally, Kornman, AT, 'Contract Law and Distributive Justice' (1980) 89 *Yale Law Journal* 472.

¹⁶ Abraham, KS, *Distributing Risk: Insurance, Legal Theory and Public Policy* (1986, Yale University Press), p 213.

¹⁷ See generally, Schwartz, A, 'Product Liability and Judicial Wealth Redistribution' (1976) 51 *Indiana Law Journal* 558. See also, Dworkin, R, *Taking Rights Seriously* (1977, Duckworth), pp 84-6.

¹⁸ Abraham, KS, *Distributing Risk: Insurance, Legal Theory and Public Policy* (1986, Yale University Press), p 213.

¹⁹ Schoenbaum, TJ, *Key Divergences between English and American Law of Marine Insurance: A Comparative Study* (1999, Cornell Maritime Press), p 127.

he will take the risk'.²⁰ It is not essential that the insurer's judgment is decisively influenced; to establish materiality it is sufficient to demonstrate that the circumstance would denote an effect on the mind of the prudent insurer in weighing the risk.²¹ The same test applies in deciding whether or not a misrepresentation is actionable.²² It has to be noted that materiality of a circumstance or representation alone is not sufficient to confer on the insurer the right to avoid the contract. To be able to avoid the contract, the insurer is expected to show that he was actually induced to enter into the contract on the relevant terms as a result of non-disclosure or misrepresentation.

6-8 The prudent-insurer test has often been criticised on the basis that it is very difficult for the assured to know what a prudent insurer would want to consider in evaluating the risk.²³ It is also believed that the current regime encourages insurers to play an unduly passive role in the underwriting process in the knowledge that the threshold for satisfying the test is a low one. This, according to the Law Commissions, encourages insurers in a soft market to accept premiums on the basis of inadequate information and then re-open the issue should a claim arise.²⁴

6-9 As a solution, the Law Commissions are proposing to change the yardstick for materiality, anticipating that this will encourage the insurers to be fully engaged with the underwriting process. Under the new test, a material circumstance is 'a circumstance required to provide a fair presentation of the risk'. More specifically, a fair presentation should include the disclosure of '(a) any unusual or special circumstances which increase the risk; (b) any particular concerns about the risk which led the assured seek insurance; and (c) standard information which market participants generally understand should be disclosed'.²⁵

6-10 The change in the test is a fundamental one, as it would require judges to evaluate materiality not only from the perspective of a reasonable insurer but also from a wider perspective, taking into consideration the standpoint of the assured and other market participants. It is anticipated that a few changes will arise as a result of the adoption of the new test. First, given the fact that the proposed test attempts to define materiality by a general abstraction and is very open-ended, an increase in the use of expert evidence will be inevitable. For example, in assessing whether a circumstance/fact is one that market participants generally understand should be disclosed would require assessment as to the standard of disclosure that: (i) insurers and brokers operating in that market; and (ii) purchasers of this type of insurance would expect. More significantly, the vagueness of the test will enable the judges to be more flexible in determining materiality on the surrounding circumstances and

²⁰ See s 18(2) of the MIA 1906.

²¹ *Pan Atlantic Insurance Corporation v Pine Top Insurance Corporation* [1995] 1 AC 501.

²² See s 20(2) of the MIA 1906.

²³ *Joel v Law Union & Crown Insurance Co* [1908] 2 KB 863, at 884–5, per Fletcher Moulton LJ. See also, Diamond, A, 'The Law of Marine Insurance-Insurance – Has it a Future?' [1986] LMCLQ 25, at 30–1. This theme has been further developed in CP3. It has been suggested that buyers of insurance have little understanding as to what the scope of the disclosure duty is. This might be a correct observation with respect to some types of business insurance contracts, particularly those concerning small and medium-sized businesses.

²⁴ CP3, para 5.59.

²⁵ CP3, para 5.79.

facts of each case. Perhaps this might lead to more equitable results, but one could legitimately argue that the price to pay will be a reduction in certainty.

6-11 When it comes to the impact of the change-in-materiality test in cases of fraudulent non-disclosure or misrepresentation, it is not an overstatement to say that no significant change in the position should be expected. Currently, establishing fraud on the part of the assured at the pre-contractual stage would not remove the requirement of materiality. However, unless fraud is utterly irrelevant to the risk that the insurer is insuring, it is likely that this will be treated as a material non-disclosure or misrepresentation. Under the new test, it will be very difficult for an assured who either deliberately conceals facts related to the risk, or knowingly misleads the insurer on issues relevant to the risk, to be able to claim later that the risk was presented fairly. Similarly, no change in the terms of moral hazard cases is expected under the new test. Concealing the general dishonesty of the assured is currently treated as a material non-disclosure;²⁶ it is anticipated that this will be the case under the new test, as it would be very difficult for the assured to argue successfully that dishonesty of the assured in his business affairs is not part of the standard information that market participants generally understand should be disclosed.

(b) Redefining the scope of the duty to make fair representation

6-12 Under s 20(3) of the MIA 1906, a representation may either be ‘a matter of fact’, or ‘a matter of expectation or belief’. If it is a matter of fact, it must be true.²⁷ If it is a matter of expectation or belief, it must be ‘made in good faith’.²⁸ On the premise that the dividing line between a representation of fact and one of belief is, usually a matter of construction and in most cases a narrow one, the Law Commissions are tentatively suggesting approaching the matter from a different perspective. Their recommendation is that: (i) where the representation is one which the assured knew, or ought to know about, it must be true; (ii) where the representation is not one which the assured knew, or ought to know about, it must be made in good faith.²⁹

6-13 The proposal has the potential to fundamentally alter the current position. Let us consider the valuation of the subject matter insured. This is currently regarded as a matter of opinion and excessive overvaluation amounts to misrepresentation only where the assured has acted in bad faith (i.e. when he does not have a genuine belief in the opinion he has presented).³⁰ If the proposed change were to be adopted, it is possible to treat the assured’s presentation as being untrue, even where he has not acted in bad faith. The proposals make clear that in determining what circumstances an assured ‘ought to know’, an inquiry will need to be carried out as to whether the assured’s directing mind will have made reasonable enquiries to find out such matters. Applying this in the present context, it can plausibly be suggested

²⁶ *Insurance Corporation of the Channel Islands v Royal Hotel Ltd* [1998] Lloyd’s Rep IR 151; *James v CGU Insurance Co plc* [2002] Lloyd’s Rep IR 206 and *Sharon’s Bakery (Europe) Ltd v AXA Insurance UK Plc* [2011] EWHC 210 (Comm); [2012] Lloyd’s Rep IR 164.

²⁷ See s 20(4) of the MIA 1906.

²⁸ *Ibid*, s 20(5).

²⁹ CP3, para 6.95.

³⁰ See e.g., *Eagle Star Insurance Co Ltd v Games Video Co SA (The Game Boy)* [2004] EWHC 15; [2004] 1 Lloyd’s Rep 238.

that a ship manager is expected to find out the correct value of the ship insured; it might not be a defence for the assured to contend that inaccurate information with regard to the value of the insured ship was provided as a result of his negligence in failing to make reasonable enquiries. Of course, the assured could, potentially, argue that valuation of the insured vessel is not something which he ‘knows or ought to know about’, so any representation made in that regard is accurate as long as the assured has acted in good faith. However, this will be at odds with the spirit of the proposed changes. The Law Commissions are clearly attempting to redefine the concept of ‘constructive knowledge’ and they are firmly of the view that the assured should be under a positive duty to make enquiries.³¹

6-14 A similar outcome is likely to follow in cases such as *Economides v Commercial Union Assurance Co Plc*,³² where it has been held that, under the current regime, a statement of opinion does not carry with it an implied representation of fact to the effect that the speaker possesses reasonable grounds for his opinion. Under the proposed amendment, given that the assured will now be expected to make reasonable enquiries to find out facts and circumstances, in cases where he fails to do so, it might be possible to conclude that he ought to have known that his opinion was not based on reasonable grounds, especially if it turns out that this was, indeed, the case.

6-15 As illustrated above, the tentative recommendation made by the Law Commissions could potentially put the assured in a more vulnerable position than under the current legal regime. One gets the impression that the potential impact of the changes has not been fully appreciated by the Law Commissions.

(C) Broker’s Duty of Disclosure

6-16 Section 19(a) of the MIA 1906 imposes an independent duty on the part of an agent to insure (broker) to volunteer material information even if such information is not known by the assured. As discussed in [Chapter 5](#), where a sub-broker is used, the obligation extends to all agents of the assured involved in the transaction.³³ The case law seems to suggest that the broker is still expected to disclose material information, even if he acquires it from a source other than the assured³⁴ or, indeed, if he acquires it in a capacity other than of being the assured’s agent (e.g. during broking activities for another party).³⁵

6-17 The proposal of the Law Commissions is not revolutionary and attempts to clarify the common law position. It is proposed that it is clearly expressed in the legislation that the duty of disclosure, currently encapsulated in s 19(a), should

³¹ CP3, para 6.78 stipulates:

A business policyholder should be under a duty to disclose information that would have been discovered by reasonable enquiries, which are proportionate to the type of insurance and to the size, nature and complexity of the business.

³² [1998] QB 587.

³³ *Blackburn v Haslam* (1888) 21 QBD 144

³⁴ *Société Anonyme d’Intermédiaires Luxembourgeois v Farex Gie* [1995] LRLR 116, at 157, per Saville LJ.

³⁵ *El Ajou v Dollar Land Holdings plc (No 1)* [1994] 2 All ER 685, at 702, per Hoffmann LJ.

include producing, placing and intermediate brokers within its scope.³⁶ This was the position in common law, so the proposed change is just a clarification. Furthermore, it is proposed that the relevant statute should clarify that the duty of disclosure only applies to information received or held by that agent in its capacity as agent for the policyholder; it should not include information given to the broker by other clients in relation to other insurers.³⁷ This will alter the current position slightly and is designed to reverse the effect of *El Ajou v Dollar Land Holdings plc (No 1)*. If implemented in its current format, it would amount to a restriction in the scope of the broker's independent disclosure duty, which is regarded as too expansive by many, but this would hardly be regarded as a radical reform of law.

(2) Post-Contractual Duty of Good Faith – Fraudulent Claims

6-18 The starting point for the Law Commissions is that the law on remedies for fraudulent claims is convoluted and a source of uncertainty for all the parties concerned.³⁸ What is essentially recommended is the introduction of a series of statutory provisions that specify the insurers' remedies when a fraudulent claim is submitted by the assured. Their first recommendation is that the assured should be deprived of the claim tainted with fraud. This proposal does not envisage any change to the existing common law rule of forfeiture, save to clarify that that it is a free-standing statutory rule that relates solely to the claim to which the fraud relates. It needs to be stressed that the Law Commissions are not also planning to introduce a description of fraud in this context.³⁹ This is a sensible approach which means that the case law on the subject will still be relevant following the introduction of any statutory change.

6-19 The second proposal is designed to address uncertainty caused by the potential role that s 17 of the MIA 1906 could play in this context. As evaluated in [Chapter 3](#), it is a moot point as to whether the insurer could argue that submitting a fraudulent claim amounts to breach of s 17. If s 17 is relevant in this context, the remedy of avoidance will naturally be available to the insurer each time a fraudulent claim is submitted, potentially undoing all valid claims paid prior to the fraudulent claim. Recently, Mance LJ has joined the ranks of commentators⁴⁰ who have persistently argued against extending the scope of s 17 to fraudulent claims jurisdiction. He put it elegantly in *Agapitos and Another v Agnew and Others (The Aegeon)*:⁴¹

In the present imperfect state of the law, fettered as it is by section 17, my tentative view of an acceptable solution would be . . . to treat the common law rules governing the making of a fraudulent claim (including the use of fraudulent device) as falling outside the scope of section 17 . . . On this basis no question of avoidance *ab initio* would arise.

³⁶ CP3, para 7.73.

³⁷ *Ibid*, at para 7.74.

³⁸ CP2, para 7.1.

³⁹ Paragraph 3.62 of the Law Commissions 'Issues Paper 7: The Insured's Post-Contract Duty of Good Faith' (July 2010) states: 'Our view is that [what amounts to a fraudulent claim] is best left to the courts to develop, and that it does not require statutory reform.'

⁴⁰ See e.g., Soyer, B, 'The Star Sea – A Lode Star?' [2001] LMCLQ 428, at 436.

⁴¹ [2002] EWCA Civ 247; [2003] QB 556; [2002] 2 Lloyd's Rep 42, at [45].

6-20 The Law Commissions are proposing to give statutory effect to the view expressed by Mance LJ, by stating that the fraud at the claims stage does not affect any claim where the loss arises before the fraud takes place, whether or not it has been paid.⁴² This is a welcome development and it makes perfect sense. A contrary solution would have meant that a disciplinary element is introduced into insurance law, which should have no place in the context of commercial law.

6-21 It is one thing to say that the law should not have a retrospective effect to deprive the assured from valid claims paid prior to the fraudulent claim; it is entirely another to deliberate whether submitting a fraudulent claim amounts to a contractual breach, thus enabling the insurer to treat the contract as terminated. Both the commentators⁴³ and judges⁴⁴ seem to suggest that submission of a fraudulent claim might possibly give the insurer a right to terminate the contract with prospective effect on claims made subsequent to the fraud. Mance LJ, in *AXA General Insurance Ltd v Gottlieb*,⁴⁵ left this point open by saying:

... there seems to me some force in the argument that the common law rule relating to fraudulent claims should be confined to the particular claim to which any fraud relates, while the potential scope and operation of more general contractual principles might in some circumstances also require consideration.

6-22 It is argued in [Chapter 3](#) that a term could be implied into the insurance contract enabling the insurer to discharge himself from the further performance of the contract. The Law Commissions' third proposal relates to this point and it is proposed that on discovery of fraud the insurer should be entitled to terminate the contract with retrospective effect on any claim made after the fraud.⁴⁶ There is not much detail with regard to the mechanics of this proposal, but it seems the Law Commissions are proposing that a condition, as traditionally understood, is implied into insurance contracts by law enabling the insurer to elect to terminate the insurance cover prospectively on discovery of the fraud. The termination will, however, be effective from the date of fraud, not on the day when the insurer elects to terminate the contract. Naturally, if an insurer has evidence of fraud and takes no action, it will be taken to have waived its defence to a subsequent claim.⁴⁷ The proposal is not a radical one and conforms with the legal thinking advanced in the last decade on the subject.

6-23 The final recommendation made by the Law Commissions on the subject is also its most novel. This intends to give the insurer an entitlement to claim damages for losses and expenses incurred by the insurance company as a result of the fraudulent claim. Under the current law, damages are recoverable, in theory, if it is possible to establish a cause of action against the assured for tort of deceit.

⁴² CP2, para 7.56.

⁴³ See e.g., Soyer, B, 'Continuing Duty of Utmost Good Faith in Insurance Contracts: Still Alive?' [2003] LMCLQ 39, at 59 and Thomas, DR, 'Fraudulent Insurance Claims: Definition, Consequences and Limitations' [2006] LMCLQ 485, at 511.

⁴⁴ In *Orakpo v Barclays Insurance Services* [1995] LRLR 443, at 451, Hoffmann LJ noted that 'any fraud in the making of the claim goes to the root of the contract, and entitles the insurer to be discharged'.

⁴⁵ [2005] EWCA 112; [2005] Lloyd's Rep IR 369, at [22].

⁴⁶ CP2, para 8.12.

⁴⁷ *Ibid*, at para 8.13.

However, the proposals go further and indicate that damages will be allowed by the statute for the costs actually incurred by the insurer in investigating the fraud as long as the costs are reasonable and proportionate in the circumstances.⁴⁸ In an attempt to ensure that insurers do not unjustly benefit from the new statutory rule, it is proposed to put a cap on the sum recoverable by reducing from the damages sought the savings made by the insurer as a result of avoiding the legitimate element of the claim tainted with fraud.⁴⁹ A few examples will help to understand what is proposed here. If, for example, in the course of claiming £1,000 of genuine loss, the assured seeks to recover £1,200, the whole claim of £1,200 will be forfeited. Assuming that the insurer incurs £500 of investigation costs, he will not be able to claim any damages, as he has made a saving of £1,200 by avoiding payment for the fraudulent claim and this sum is higher than the damages claimed. Conversely, if a fraudulent claim of £5,000 is put forward and the insurer incurs £6,000 in investigating the claim, he will be able to claim £1,000 as damages (the sum over the amount of the fraudulent claim forfeited).

6-24 It is submitted that the proposal on the recoverability of damages is controversial. An institutional commentator questions whether there is any need to introduce damages, in light of the fact that insurers have not greatly utilised the existing tort of deceit under the current regime. He also finds it difficult to understand the justification for introducing a concept of ‘savings’ in respect of claims for which the insurer has no liability by reason of fraud.⁵⁰ On a more practical level, the proposed rule gives rise to two sources of uncertainty. First, it will be difficult to distinguish between costs associated with the investigation of the claim generally and additional costs incurred in investigating the fraud. Similarly, it will not be a straightforward task to determine whether investigation costs are reasonable and proportionate in the circumstances. It can be safely predicted that the proposal, if implemented in its current format, will encourage parties to battle on these points at the litigation stage. This will increase costs without providing any tangible benefit to the insurers due to the introduction of the concept of ‘savings’.

6-25 Another potential difficulty that has not been aired in the CP2 is what the relationship will be between the statutory rule affording damages in cases where a fraudulent claim has been submitted and other causes of action, such as tort of deceit. If the statute does not expressly forbid an insurer from pursuing alternative causes of action, this might be a way for the insurers to bypass the artificial restriction on damages imposed by the concept of ‘savings’. It should be noted that, increasingly, insurers are successful in claiming exemplary damages from the courts in cases of fraudulent claims.⁵¹ That will provide an additional incentive for the insurers to pursue alternative causes of action. In summary, it is fair to say that there is an urgent need for the Law Commissions to refine their thinking on their proposal on damages.⁵²

⁴⁸ *Ibid*, at para 8.22.

⁴⁹ *Ibid*, at para 8.20.

⁵⁰ Rainey, S, ‘The Law Commission’s Proposals for the Law Reform of An Insurer’s Remedies for Fraudulent Claims Made under Business Insurance Contracts’ (2013) LMCLQ 357, at 381–2.

⁵¹ *AXA Insurance UK Plc v Jensen*, unreported, Birmingham County Court (18/11/08).

⁵² At the time of writing (December 2013) the author has been informed of the Law Commissions’

(3) Post-Contractual Duty of Good Faith – Late Payment of Damages

6-26 As evaluated in [Chapter 4](#), it is a colossal failing of English law that the assured has no viable remedy against the insurer, other than claiming statutory interest where there is an unjustifiable delay in paying legitimate claims.⁵³ It has been advocated that the way forward would be to imply a term into the contract requiring the insurer to pay the assured within a reasonable amount of time. This is, in fact, the preferred solution of the Law Commissions. It has been proposed in the CP2 that a statutorily imposed contractual duty is created requiring the assured to pay valid claims within a reasonable time. Failure to do so, entitles the assured to claim their foreseeable losses from the insurer.⁵⁴

6-27 Without doubt, a key consideration will be how ‘reasonable time’ will be determined for the purposes of this contractual obligation. To this end, the Law Commissions have provided extensive guidelines.⁵⁵ When it comes to identifying what kind of losses will be recoverable, it is envisaged that ordinary contractual principles on remoteness will come into play. This would mean that the commercial context behind the relevant insurance contract will be a decisive factor⁵⁶ in determining which losses an insurer is responsible for. For example, if the insurer delays a payment under an insurance policy that covers physical losses, the financial losses associated with the assured being deprived of the use of the insured property are likely to be found to be foreseeable, applying the ‘assumption-of-responsibility’ test developed by Lord Hoffmann in *The Achilles*.

6-28 As a matter of principle, allowing damages for late payment of claims is a positive development, although a number of difficulties should be expected. For example, where there are multiple insurers and all but one pays for their proportions promptly, would the non-paying insurer be liable for the full range of the assured’s losses? It is an interesting question. It is anticipated that he would, as long as it is possible to establish a causal link between the breach and any consequential losses arising.⁵⁷

6-29 In recognising the significance of party autonomy in the context of commercial insurance law, the Law Commissions are minded to allow the insurer to limit or exclude his liability to pay damages for late payment of claims through a term of the insurance contract.⁵⁸ However, there is an interesting twist. The Law

intention to drop the proposal to allow recovery of investigation costs from the final bill. It is submitted that this will be a very positive development, especially in light of the criticisms made above.

⁵³ See *President of India v Lips Maritime Corporation (The Lips)* [1988] AC 395 and *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd’s Rep IR 111.

⁵⁴ CP2, para 5.9.

⁵⁵ In identifying whether the insurer has dealt with the claim in a reasonable time frame, it is necessary to assess: (i) whether the assured has provided the insurer with all the material information requested in respect of the claim; (ii) whether the insurer has been permitted sufficient time to carry out a full investigation, including time to seek information from third parties; (iii) whether the insurer has been given enough time to assess the claim and arrive at and communicate his decision to the assured; as well as market practice, the type of insurance and the size, location and complexity of the claim. See CP2, para 5.3.

⁵⁶ *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] UKHL 48; [2009] 1 AC 61.

⁵⁷ These kinds of difficulties can be avoided by using leading underwriting clauses.

⁵⁸ Contracting out of the statutory regime is not possible in the consumer insurance context. See CP2, para 5.25.

Commissions are proposing to use the concept of ‘good faith’ as a shield to protect policyholders from an insurer seeking to rely on an exclusion clause. Accordingly, it has been suggested that to be able to revoke an exclusion clause of that nature, the insurer must convince the court that he was acting in good faith at the time of the decision.⁵⁹ Accordingly, the insurer should be able to rely on an exclusion clause where he makes a genuine mistake in deciding that a claim is outside the scope of the policy, or where it is possible to show that the delay was caused by circumstances beyond his control (e.g. delay in assessing the claim due to natural disasters). Even though the subject has not attracted much deliberation in the CP2, it is clear that the burden of proof lies with the insurer to show that he has acted in good faith in assessing the claim put forward.

6-30 To use the doctrine of ‘good faith’ as a shield is a novel concept, but it is in line with recent judicial thinking which seems to suggest that a continuing duty of good faith should play a role in curbing the harshness of existing legal principles.⁶⁰ On policy grounds, it is a sensible move, as not imposing any restriction on the freedom of contract in this instance would have undermined the ethos of the proposed reform.⁶¹

II THE WAY FORWARD

6-31 In the context of commercial law, the merit of any reform proposal can best be judged against several key considerations, such as whether the proposal is designed to: (i) protect party autonomy; (ii) promote certainty; (iii) introduce more balanced remedies; (iv) reduce legal and transaction costs; and (v) promote confidence in the respective area of law. It is inevitable that whilst attempting to satisfy some of these objectives, tensions will arise with others. For example, for the sake of introducing more proportional remedies, certain sacrifices become unavoidable. This trade-off is inherent in the present proposals as well. The key question here is whether the market participants will feel that this is a fair price to pay for a more balanced legal regime.

6-32 How effective will the proposals be in reducing both transaction and legal costs? This is not an easy question to answer. It is anticipated, as discussed above, that some of the proposals could fuel litigation. For example, one can foresee disputes arising in the context of applying proportionate remedies for breach of pre-information duties. However, it is undeniable that the proposed changes will clarify the legal principles and help to make the law clearer and more certain, particularly when it comes to remedies for submitting a fraudulent claim. On another positive note, it is encouraging to see that party autonomy has been preserved by allowing the contracting-out of almost all of the proposed changes, with the exception of excluding liability for late payment of claims where the insurer has not acted in good faith.

⁵⁹ CP2, para 5.32.

⁶⁰ See, in particular, the judgment of the Court of Appeal in *Drake Insurance plc v Provident Insurance plc* [2003] EWCA Civ 1834; [2004] 1 Lloyd’s Rep 268.

⁶¹ That said, it remains to be seen whether a bold proposal of this nature would make it to the final Bill.

6-33 It is unrealistic to expect any law reform agenda to be carried out without some glitches. Although a number of problems are fleshed out in this chapter, the majority of the proposals are sound and have been designed to create a more balanced and certain legal regime. It is too early to say whether law reform will, eventually, be successfully completed, but if it does come about, we need to go back to the drawing board as far as fraud in the insurance law context is concerned. It will require some time until the effects of such reform are fully appreciated in insurance practice.

6-34 It needs to be stressed, however, that the analysis carried out in this chapter is based on the information coming out of the Law Commissions at the beginning of December 2013. It is possible that they might re-consider their position on some of these matters and make slight alterations to their proposals before the draft Bill comes out later in 2014.

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PART 2

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CHAPTER 7

IMPACT OF FRAUD AND OTHER DISHONEST ACTIVITY ON INSURANCE COVERAGE

7-1 So far, the impact of dishonesty of relevant parties, namely the assured, insurer and their independent agents, on an insurance contract has been subjected to a rigorous analysis. Changing the focus slightly, this chapter delineates the impact of fraud and dishonesty of third parties on insurance coverage. Put another way, the chapter considers to what extent contemporary marine insurance clauses offer protection to an assured who finds himself to be the victim of fraud or dishonesty perpetrated by those who are outsiders to the insurance relationship.

7-2 Fraud and dishonesty could affect an assured in different ways. The subject matter of insurance could be lost or damaged as a result of theft, conversion, scuttling, pirate attack or barratry committed by the crew and master against the interests of the owners. In the case of cargo insurance, the assured also could load his cargo on a phantom ship which ends up disappearing to an unknown destination. Phantom ship fraud is the product of organised crime syndicates and used to happen frequently in certain parts of the world, particularly in the 1970s and 1980s.¹

7-3 From a technical perspective, there is a difference between phantom ship fraud and other types of dishonest activity, such as theft and piracy, which could affect the interest of the assured. A phantom ship fraud involves an element of deception where a phantom ship operator poses as a legitimate ship-owner with a view to convincing the innocent cargo interest to load his cargo on the fraudster's vessel. No such deception occurs in a case where the assured loses the whole or a substantial part of his cargo due to misappropriation. Here, the assured is simply the victim of dishonest conduct on the part of a third party who might later be involved in deception when disposing of the stolen goods. For the purposes of this chapter, no differentiation is made between phantom ship fraud and other types of dishonest conduct. The common feature in all types of conduct that are considered in this chapter is the fact that, as a result of such activity, a third party acquires a benefit unfairly. Needless to say, such conduct also has consequences in terms of criminal law despite the fact that there might be difficulties in securing criminal convictions.²

¹ For more information as to how fraud of this nature was executed in those days, see Ellen, E and Campbell, D, *International Maritime Fraud* (1981, Sweet & Maxwell), pp 30-1 and 52-60.

² For a discussion on this point, see [Chapter 1](#), [1-9]-[1-14].

I THEFT

7-4 Despite the fact that there are only a handful of reported cases contemplating the extent of ‘theft’ as an insured peril in hull policies, this peril is significant in the context of insuring smaller vessels such as yachts and fishing vessels, as these crafts are in some cases left unattended or unsupervised for a considerable period of time.

7-5 An attempt has been made to offer guidance on the definition of ‘theft’ as one of the traditional perils in marine insurance, by Rule 9 of the Rules of Construction of the MIA 1906, which stipulates that ‘the term “thieves” does not cover clandestine theft or theft committed by any one of the ship’s company, whether crew or passengers’. It has to be stressed that Rule 9 does not provide a complete answer (e.g. no direct assistance is provided as to when the act of theft is deemed to be completed). Fortunately, there is a fair amount of case law surrounding the subject, which might prove to be useful in providing answers to some of the demarcation issues.

(1) ‘Theft’ in Contemporary Marine Policies

7-6 The rationale for excluding theft committed in a clandestine fashion from the scope of coverage is that a theft of this nature has been considered to be entirely the result of negligence or carelessness on the part of the master; thus it lacks the element of fortuity.³ Therefore, in the context of marine insurance, the word ‘thieves’ has been historically construed as referring to theft committed by persons other than ship’s crew or passengers and using violence to achieve their end⁴ unless, of course, the policy provides otherwise.⁵ It is not, however, essential that the violence is used or threatened against persons. In *La Fabrique de Produits Chimiques SA v Large*,⁶ it was held that the property was stolen by ‘thieves’, although no one was assaulted; the thieves used violence to break into the warehouse in which the insured property was kept.⁷ In similar fashion, in *Re Calf and the Sun Insurance Office*,⁸ the Court of Appeal reached the conclusion that the sliding of a latch in the fashion of picking a lock with an instrument was sufficient to satisfy the violence requirement to establish theft.

7-7 In contemporary practice, most standard clauses, following the traditional line, expressly stipulate that the cover provided is against ‘violent theft’.⁹ However, in the context of the Institute Yacht Clauses,¹⁰ the meaning of the term ‘theft’ seems to

³ Gow, W, *Sea Insurance* (1914, Macmillan), p 113.

⁴ It is doubtful that any difference of meaning is intended whether the peril is defined as ‘theft’ or ‘thieves’.

⁵ See cl 9 of the Institute Yacht Clauses (1/11/85).

⁶ [1923] 1 KB 203.

⁷ The decision in *La Fabrique* was applied in the USA in *Swift v American Universal Insurance Co* [1966] AMC 269 where force was used to gain entry into a cabin from which the property was stolen.

⁸ [1920] 2 KB 366.

⁹ See cl 6.1.3 of the Institute Time Clauses – Hulls (1/10/83) and (1/11/95); cl 2.1.3 of the International Hull Clauses (1/11/03) and cl 6.1.3 of the Institute Fishing Vessels Clauses (20/07/87).

¹⁰ (1/11/85).

have acquired a different meaning. By virtue of cl 9 of the Institute Yacht Clauses,¹¹ loss of or damage to the subject matter insured is covered if it is caused by ‘theft of the entire vessel, or her boat(s), or outboard motor(s) provided it is securely locked to the vessel or her boat(s) by an anti-theft device in addition to its normal method of attachment, or, following upon forcible entry into the vessel or place of storage or repair, theft of machinery including outboard motor(s), gear or equipment’. The clause is designed to qualify the traditional meaning of the term ‘theft’ and also to avoid any confusion that could be caused when trying to distinguish between violent and clandestine theft. Accordingly, to bring himself under the policy, an assured is expected to demonstrate that machinery, outboard motor(s), gear or equipment were stolen following a forcible entry into the insured vessel or place of storage or repair. The policy covers theft of the entire vessel, her boat(s) or any outboard motor(s) as long as it is securely locked to the vessel or one of her boats by an anti-theft device in addition to its normal method of attachment. In these cases, however, recovery is not dependent upon proof of violence inflicted either upon the insured vessel or her place of storage.

7-8 When it comes to cargo insurance, ‘theft’ is not a peril that comes into the limelight instantaneously, because it is not insured against in most standard clauses.¹² However, in all-risk policies (Institute Cargo Clauses (A)), loss caused by ‘theft’ will be covered. The only problem in an all-risk cargo policy is identifying whether the loss has arisen after the attachment of the policy or not. Evidential problems might become acute, especially when goods are stolen from containers at some uncertain point after leaving the place of production.¹³ In an all-risk policy, cover would normally attach when the goods leave the warehouse or place of storage named in the policy.¹⁴ Therefore, where the goods are stolen after they have been loaded onto the lorry but whilst still in the warehouse, there will be no cover under an all-risk cargo policy even though the goods might be in the custody of the carriers at that point in time.¹⁵ The position would be different under the most recent version of the Institute Cargo Clauses (A)¹⁶ given that the insurance under those clauses would attach when the goods are first moved in the warehouse or at the place of storage for the purpose of the immediate loading into or onto the carrying vehicle or other conveyance for the commencement of transit. However, even under the revised version of the cargo policies, there will be no coverage for theft in cases where the goods are stolen en route to the warehouse or place of storage specified in the policy.¹⁷

¹¹ Under this clause, the cover against theft is available as long as loss or damage has not resulted from want of due diligence by the assured, owners or managers.

¹² See e.g., Institute Cargo Clauses (B) and (C) (both (1/1/82) and also (1/1/09) versions).

¹³ In such a case, debate will centre around issues such as which insurance cover (i.e. marine cargo insurance cover or manufacturer’s general marine cover against theft) is relevant. Normally, the latter will provide cover for loss arising if the theft occurs while the goods are being transported in containers to a warehouse or place of storage.

¹⁴ See cl 8.1 of the Institute Cargo Clauses (A) (1/1/82).

¹⁵ *Kessler Export Corporation v Reliance Insurance Co of Philadelphia and American Insurance Co of Newark* [1962] AMC 2429.

¹⁶ See cl 8.1 (1/1/09).

¹⁷ For coverage problems that can arise as a result of the use of standard cargo clauses in multimodal context, see Soyer, B, ‘Cargo Insurance in the Multimodal Context: Full and Complete Cover?’ in

7-9 At this juncture, it is appropriate to say a few words about the Institute Theft, Pilferage and Non-Delivery Clause, which reads:¹⁸

In consideration of an additional premium, it is hereby agreed that this insurance covers loss of or damage to the subject-matter insured caused by theft or pilferage, or by non-delivery of an entire package, subject always to the exclusions contained in this insurance.

This clause can be incorporated into cargo policies where the coverage is not against all risks (this is the case in the Institute Cargo Clauses (B) and (C)).¹⁹ Its effect is to extend the coverage to all kinds of theft of the insured cargo, including clandestine theft by persons on board the vessel. Pilferage can be regarded as a species of theft indicating clandestine theft of a small proportion of the insured goods rather than of the whole.²⁰

7-10 The latter part of the clause provides cover for losses caused by the non-delivery of an entire package. There is judicial authority indicating that the term 'non-delivery' cannot be treated as intended to denominate an entirely new risk but instead affects the burden of proof in that the assured need not prove loss by theft or pilferage. It is enough if he proves non-delivery and gives *prima facie* proof that the goods were not lost in any other way than by theft or pilferage.²¹ With respect, it is submitted that this line of reasoning is at odds with basic principles of literal construction. It is worth noting that the title of the clause makes reference specifically to 'non-delivery' in addition to 'theft and pilferage'. Furthermore, in the main text, it has been deemed necessary to repeat the words 'or by' before the term 'non-delivery' and after the words 'theft or pilferage'. Seen in this light, it can justifiably be argued that in the eyes of the draftsman, 'non-delivery' has been viewed as a separate risk in addition to 'theft' and 'pilferage'. One can envisage circumstances where a loss could be attributed to non-delivery to trigger the application of the clause, for example where one package is short-delivered and investigation reveals that the package may have been delivered to another consignee by mistake.²²

7-11 Although the insured peril of 'violent theft' relates to theft committed by persons from outside the vessel, there is no restriction that the act of taking should occur when the vessel is at sea. Therefore, as long as the policy remains in force, recovery for theft is possible in a case where the insured vessel is laid up out of commission and stolen from a warehouse or place of storage. The motive of the thieves also seems to be an irrelevant consideration in the light of the case law. It is not open, for example, to the underwriter to argue that the thieves were pursuing a political agenda and not motivated by personal gain. The intention to deprive the assured from the insured property permanently would suffice.

7-12 Whilst it is not an ambitious statement to suggest that the key elements in

Carriage of Goods by Sea, Land and Air: Unimodal and Multimodal Transport in the 21st Century (Informa, 2013), pp 286–307.

¹⁸ (1/12/82).

¹⁹ Both (1/1/82) and also (1/1/09) versions.

²⁰ *Nishina Trading Co Ltd v Chiyoda Fire & Marine Insurance Co Ltd (The Mandarin Star)* [1968] 1 WLR 1325, at 1334, per Donaldson J.

²¹ See *Middows Ltd v Robertson* (1940) 67 LIL Rep 484, at 507, per Hilbery J.

²² It should be noted that the decision of Hilbery J was reversed on other grounds by the appellate courts: [1941] 1 KB 225 (CA) and [1942] AC 50 (HL).

the definition of ‘theft’ as an insured peril are clearly set out by legal authorities, a number of grey areas still remain which might potentially engender interesting legal debates in years to come. In particular there are two issues that deserve further consideration.

7-13 The first question is to what extent assistance could be drawn from other branches of law, such as criminal law, in determining the precise meaning of ‘theft’ in the context of insurance law. There is something to be said for the view that terms such as ‘theft’, ‘thieves’ and ‘pilferage’ have all required special meanings in marine insurance through custom and usage; it would be desirable to construe them in their commercial context. In fact, this was the line taken by the majority in *Nishina Trading Co Ltd v Chiyoda Fire & Marine Insurance Co Ltd (The Mandarin Star)*.²³ There, the shipowners claimed that the charterer failed to pay the charter hire and refused to deliver the goods, which did not belong to the charterer, at their port of destination, Kobe, but instead sailed to Hong Kong. At Hong Kong, the cargo was placed in a warehouse and the shipowners in co-operation with the charterers attempted to mortgage the cargo as security for a loan. Having managed to recover the cargo and forward it to Kobe, the cargo owners claimed reasonable legal and other expenses they incurred for the purpose of averting or diminishing a loss caused by a peril insured against. The cargo policy provided cover for ‘theft and/or pilferage’. The majority concluded that the loss was not attributable to ‘theft’ as it was possible to infer from the agreed facts that the shipowners might have thought that they had some kind of lien on the cargo for the unpaid charter hire. Lord Denning MR was adamant that the intrusion of the criminal law in the arena of commercial and maritime documents should be resisted. He said:²⁴

The word ‘theft’ is not used here in the strict sense of the criminal law. It does not bring in all the eccentricities of the law of larceny. It means only what an ordinary commercial man would consider to be theft: and before finding theft, the court should be satisfied that it is an appropriate description of what took place. The court need not be satisfied beyond reasonable doubt (as in the criminal law) but it should find on balance that there is sufficient to warrant the serious imputation of ‘theft’ . . . For myself, I would hesitate to describe the act of the master as theft. You must remember that the owners were claiming their charter hire. They had not been paid the two months’ hire that was due to them and they did not sell the goods. They only raised money on mortgage. They may have thought that they had some sort of lien on the goods for their charter hire.

7-14 Dissenting on this point, Edmund Davies LJ suggested that the meaning of the word ‘theft’ in insurance law should be more closely aligned with the terminology used in criminal law.²⁵ In support of his view, he was prepared to endorse the dictum of Lord Sumner in *Lake v Simmons*:²⁶

. . . reliance has been placed on arguments that in a commercial document no legal technicality of the criminal law should be taken into account . . . I dissent from the view that criminal law should be treated as irrelevant merely because a document is commercial. After all, criminal law is still law and so are its definitions and rules.

²³ [1969] 2 QB 449; [1969] 1 Lloyd’s Rep 293.

²⁴ [1969] 2 QB 449, at 462.

²⁵ *Ibid*, at 463–5.

²⁶ [1927] AC 487, at 509.

7-15 The interaction between insurance and criminal law when defining the meaning of the word 'theft' was at the centre of the debate in *Athens Maritime Enterprises Corporation v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Andreas Lemos)*.²⁷ There, a group of six or seven armed men boarded the insured vessel while she was at anchor within the territorial waters of Bangladesh. The raiders were discovered throwing mooring lines into the sea by the deck watchmen who raised the alarm. Once the raiders were confronted by the Master, officers and crew, who were armed, they drew their knives; but in the face of weaponry confronting them and with rockets being fired in their direction, the raiders retreated and dived into the sea, finally making off in their boats. One of the issues under consideration was whether the loss was caused by theft and/or piracy. It was beyond doubt that equipment from the insured vessel had been stolen and also that the raiders had used violence or at least threatened violence. However, the key issue was at what point the theft was completed (i.e. either when property was thrown into the sea by raiders from the insured vessel, or when the raiders left the insured vessel together with the property taken from the insured vessel). Adopting the former approach would mean that the theft was conducted in a clandestine fashion and hence was not covered (violence or threat of violence was only used by the rioters to make good the escape). However, endorsing the second approach would mean that theft was not completed until the raiders had left the insured vessel together with the stolen equipment; the loss would be covered because violence was used or threatened by the raiders to enable them to commit theft.

7-16 In reaching the conclusion that the act was one of clandestine theft, Staughton J drew support from the Theft Act 1968, which indicates that a thief is 'a person who dishonestly appropriates property belonging to another with the intention of permanently depriving the other of it'.²⁸ Section 8(1) of the Theft Act 1968 also stresses that 'a person is guilty of robbery if he steals, and immediately before and at the time of doing so, he uses force on any person or puts or seeks to put any person in fear of being there and then subjected to force'. Accordingly, it was held that no theft or robbery had taken place, as no force or threat of force was used until after the appropriation was complete. The author acknowledges that aligning insurance law-related issues with criminal law might not be appropriate in all cases. However, it is submitted that the solution adopted here is not out of line with the commercial sense of the matter. For the purposes of criminal law it is adequate that the raiders intended to deprive the assured of his property permanently at the time when they threw the equipment overboard. Whether the raiders managed to pick up the equipment from the sea later on so as to take it with them has no bearing on their criminal liability. Seen from the insurance angle, the purpose of obtaining insurance cover against theft is to protect the assured against the risk of third parties depriving him of his property permanently. Therefore, it can be suggested that the risk materialises the moment when the assured is deprived of the possession of his property by persons with such intention.²⁹

²⁷ [1982] 2 Lloyd's Rep 483.

²⁸ See s 1(1) of the Theft Act 1968.

²⁹ In several non-marine cases 'theft' has been given the same meaning as in the criminal law: *Grundy (Teddington) Ltd v Fulton* [1981] 2 Lloyd's Rep 666; [1983] 1 Lloyd's Rep 16 (CA) and *Dobson v General*

7-17 Second, there is no indication either in the relevant part of the Rules of Construction or in decided cases as what extent damage to the insured property can be recovered under the peril of theft. For example, would it be possible to recover damage caused to the insured property by an unsuccessful attempt at theft? Similarly, if thieves break down the door of an insured vessel to gain access to the ship, would it be possible to recover the damage to the door in gaining entry? It is submitted that these types of damages should be recoverable, as they are closely connected with the act of thieving. The solution advocated here can be further supported by legal authority. The Privy Council, in responding to a question referred under the Judicial Committee Act 1833, indicated that success is not an essential element in piracy.³⁰ Given that there are marked similarities between piracy and theft, in that both require the use or threat of violence for personal gain, it can be argued, by analogy, that a similar outcome should be adopted in cases of theft.

7-18 A similar question was raised in an American case,³¹ where the decision of the US Court of Appeals (Fifth Circuit) on the matter was based on the premise that the phrase ‘assailing thieves’ used in the policy did not cover theft of the entire vessel, but provided cover only against ‘theft by force or violence of personal property on vessels’. It is hard to find any justification, historical or practical, for restricting the scope of theft as an insured peril to cases of partial loss. Besides, the standard clauses on yachts indicate unequivocally that the loss of the entire yacht caused by theft is covered. Perhaps a better view would be to confine the decision of the Fifth Circuit to its contractual setting.

(2) Relationship between ‘Theft’ and Perils Excluded from Coverage

(A) Theft, Conversion and Seizure

7-19 A common occurrence, especially in some ports of the world, is that the goods are misappropriated by customs officers or others in a position of authority. In such a case, it is very unlikely that indemnity will be available for the assured even if the policy expressly provides coverage against the risk of ‘theft’ as it will be rather difficult to satisfy the requirement of ‘violence’. In a technical sense, the actions of customs officers or authorities at the harbour can be treated as ‘conversion’.³²

7-20 Under an all-risk policy, the assured will be able to recover for loss occasioned by such unlawful acts of customs officers and others in position of authority. However, at this juncture, an interesting question arises. Given that in contemporary practice, ‘seizure’ has been excluded from the ambit of marine cargo policies,³³ one can justifiably argue that the actions of customs officers and other authorities

Accident Fire & Life Assurance Corporation [1990] 1 QB 274. In the context of marine insurance, see *Shell International Petroleum Co Ltd v Caryl Antony Vaughan Gibbs (The Salemi)* [1982] QB 946 where there seems to be a consensus that that *The Mandarin Star* was wrongly decided.

³⁰ *Re Piracy Jure Gentium* [1934] AC 586.

³¹ *S Felicione & Sons Fish Co v Citizens Casualty* 450 F 2d 136 (5th Cir 1970).

³² See e.g., *Tinkler v Poole* (1770) 5 Burr 2657 and *Burton v Hughes* (1824) 2 Bing 173.

³³ See e.g., cl 6.2 of the Institute Cargo Clauses (A), (B) and (C) (1/1/82). Coverage against this risk is normally provided as part of the war-risk cover.

amount to 'seizure' rather than conversion.³⁴ Some support for this contention could arise from the fact that, in some cases, the definition of the peril of seizure has been extended to cover taking of insured property by revenue or sanitary officers of a foreign state regardless of whether this is legal or not,³⁵ by pirates,³⁶ and even by those on board³⁷ but not by the master or crew to whom it has been entrusted. In a similar vein, in *Cory & Sons v Burr*,³⁸ seizure has been described by Lord Fitzgerald as a peril which 'embraces every act of taking forcible possession [of the insured property], either by lawful authority or by overpowering force'.

7-21 However, the likelihood of disposition of the insured property by customs officers and other authorities being regarded as seizure should not be overstated. There is a line of authority stressing the point that misappropriation of the insured property by those in possession does not amount to seizure. Put another way, there is no seizure in a case where only the character of possession changes. In *Shell International Petroleum Co Ltd v Gibbs (The Salem)*³⁹ it was held that no seizure took place when the owner's vessel unlawfully discharged the cargo left in its custody to person(s) other than the legal owners. Similarly, in *Bayview Motors Ltd v Mitsui Marine and Fire Insurance*,⁴⁰ two shipments of cars were taken by customs officers from a compound at the port of transshipment. At the time of appropriation, the cars were in the possession of customs and all that happened was that some of the officers decided to distribute the cars to other officers, their friends and relatives. The fact that being customs officers gave them the opportunity to behave in this way was not deemed material. Accordingly, the Court of Appeal, approving the judgment of the trial judge on this point,⁴¹ concluded that there was no dispossession of the kind needed to establish seizure.

(B) Theft and Mysterious Disappearance Clauses

7-22 Many cargo policies written in the London market and elsewhere commonly incorporate clauses excluding liability for 'mysterious disappearance of the cargo and stocktaking losses'. It has been contended that the impact of such a clause in an all-risk policy is to alter the burden of proof by requiring the assured to prove on the balance of probabilities that the disappearance was caused by theft or another similar peril. This contention can be based on the decision in *Widefree Ltd v Brit Insurance Ltd*.⁴² In this case, the assured jewellery retailer obtained an all-risk policy which included an 'Unexplained Loss Exclusion'. This exclusion stated that any insured items which are found to be missing during stocktaking,

³⁴ It is important not to lose sight of the fact that cl 6 of the Institute Cargo Clauses (A) provides that the exclusion of 'seizure' from the marine cover does not apply to piracy but no such saving provision is made with regard to 'violent theft' or 'conversion'.

³⁵ *Miller v Law Accident Insurance* [1903] 1 KB 712.

³⁶ *Dean v Hornby* 118 Eng Rep 1108.

³⁷ *Kleinwort v Shephard* (1859) 1 El & El 447.

³⁸ (1883) 8 App Cas 393, at 405.

³⁹ [1983] 2 AC 375.

⁴⁰ [2002] EWCA Civ 1605; [2003] 1 Lloyd's Rep 131.

⁴¹ [2002] EWHC 21 (Comm); [2002] 1 Lloyd's Rep 652.

⁴² [2009] EWHC 3671 (QB).

where the assured is unable to prove the date and circumstances of the loss, will not be covered by the policy. In considering the effect of this clause, Mr Peter Leaver QC expressed the view that the assured was expected to prove the facts and circumstances of his loss.

7-23 In *AXL Resources Ltd v Antares Underwriting Services Ltd*,⁴³ the assured was the owner of a consignment of cobalt which went missing sometime between 21 October 2008 and 27 January 2009 from a warehouse in Antwerp. The cobalt was insured by the defendant underwriters under an all-risk policy which excluded 'mysterious disappearance and stocktaking losses'. The assured adduced evidence pointing towards the conclusion that the insured cobalt had been stolen by a group of criminals operating in the port. The counsel for the assured relied on the policy evidence produced by their Belgian lawyers following an inspection of the police files. Reference was made to various newspaper reports of 11/12 September 2010 reporting that the Belgian police had arrested a gang which had been engaged in various criminal activities including 'the theft of 20 tons of cobalt in early 2009 at a company in the port of Antwerp'. The assured's counsel was also allowed to present further evidence subsequent to the hearing which included Belgium police reports demonstrating that a number of criminals confessed to stealing the cobalt in question from the warehouse on 23 December 2008. Accordingly, the assured requested a summary judgment in their favour on the premise that, the policy being an all-risk policy, all they were required to prove was that there was an accidental loss, which they did. Conversely, the underwriters relying on the decision in *Widefree Ltd v Brit Insurance Ltd* argued that the effect of the mysterious disappearance exclusion in an all-risk policy is to undermine the basic cover of the policy and require the assured to prove his loss. Taking this to its natural conclusion, their contention was that a summary judgment could not be issued where a 'mysterious circumstances' exclusion has been incorporated into an insurance contract unless the assured proves, on the balance of probability, that the disappearance was caused by theft; this burden was not discharged in the present case.

7-24 The trial judge, Gloster J, reached the conclusion that the wording of the 'mysterious disappearance' clause used in the present case (and in marine policies) differed from that used in *Widefree v Brit Insurance*, which explicitly required the assured to prove the date and circumstances of any loss of insured property alleged to have taken place during stocktaking. Conversely, the 'mysterious disappearance' clause in the present case did not require the assured to adduce evidence explaining the nature of the loss. It simply excluded from coverage any loss attributable to mysterious circumstances. Applying the general principles of causation, the burden of proving that the cause of the loss was a peril excluded from coverage was held to rest on the insurer.⁴⁴ The insurer in the present case could not discharge the burden on him as there was strong evidence pointing towards theft, especially in light of

⁴³ [2010] EWHC 3244 (Comm); [2011] Lloyd's Rep IR 598.

⁴⁴ The trial judge went on to consider the meaning of 'mysterious disappearance' for the purposes of marine policies. It was acknowledged that the meaning of the phrase would depend on the context, the nature of the property in question and the circumstances of the particular loss. Such a loss arises when the cause of the loss cannot be identified or the circumstances in which the property has been lost arouse suspicion or are hard to explain.

the fact that removing tons of cobalt required the use of a fork lift truck or similar vehicle.

7-25 In light of this judgment, it is worth questioning whether the ‘mysterious disappearance’ clause as used in marine policies will have an enormous impact in practice. In an all-risk policy (Institute Cargo Clauses (A)), given that the existence of such a clause would have no impact on the burden of proof, the assured will be *prima facie* covered as soon as a loss arises unless the insurer puts forward convincing evidence indicating that the cause of the loss is attributable to ‘mysterious circumstances’ or ‘associated with stocktaking’. In a named risk policy (Institute Cargo Clauses (B) and (C)), which incorporates the Institute Theft, Pilferage and Non-Delivery Clause, it is unlikely that the ‘mysterious disappearance’ clause will have a significant impact in practice. In such a policy, to bring himself under the coverage, the assured is expected to prove that the loss was proximately caused by a peril insured against (e.g. theft). An assured who is able to do so will, by definition, defeat the mysterious disappearance exclusion, because the disappearance has been shown not to be unexplained. Conversely, an assured who is unable to identify which insured peril has caused the loss will not be able to recover anyway. Therefore, it is not fanciful to suggest that the mysterious disappearance clause does not add much to the insurer’s rights either in all-risk or named-risk marine policies.

II PIRACY

7-26 It would be a grave mistake to assume that piracy is an antiquated peril. Piracy is very much alive and kicking and still poses a serious threat to commercial shipping in the twenty-first century. Apart from causing commercial inconvenience, it also creates dangerous working conditions for seafarers.⁴⁵ Limited capability of the seafarers to protect themselves against pirates, who are readily prepared to exert violence on the crew, is certainly an encouraging factor for groups engaged in this organised criminal activity.⁴⁶

7-27 Over the years, the insurance sector has responded to this global threat to the shipping sector by offering insurance coverage against piracy. Under the Lloyd’s Ships and Goods Policy (commonly known as the SG Policy), piracy appeared as a named risk and remained so despite the introduction of the Free of Capture and Seizure (FC & S) clause in the nineteenth century, designed to exclude war risks from the marine cover.⁴⁷ During the late 1930s, in several cases arising out of the Spanish Civil War, the distinction between piracy and perils excluded under the

⁴⁵ Much has been written on the subject, but for a firsthand account of a survivor (Captain Ken Blyth) of a modern piracy attack, see Corris, P, *Petro Pirates: The Hijacking of the Petro Ranger* (2000, Allen & Unwin).

⁴⁶ An increasing number of commercial ships are carrying armed guards on board for certain voyages even though the legitimacy of such action in international law is questionable. At the end of March 2012, the Baltic and International Maritime Council (BIMCO) announced the publication of the GUARDCON, a standard contract for the employment of security guards on vessels.

⁴⁷ At a general meeting of Lloyd’s on 15 June 1898, it was agreed to insure marine and war risks separately. For a comprehensive coverage of the historical developments in this area, see Miller, MD *Marine War Risks* (3rd edn) (2005, LLP), pp 1–9.

FC & S clause became blurred as it was very difficult to determine whether the acts were prompted by personal greed or revenge, or whether they had any political dimension. In 1937, it was felt that difficulties of demarcation could be avoided by including piracy in the FC & S clause. The consequence of this contractual adjustment was to align piracy with war risks. This remained the position until new clauses were introduced for marine and war perils in the early 1980s. Incorporating piracy into the war-risk policies solved the problem of demarcation between this peril and other war risks; but as a result of the adjustment new demarcation problems had arisen, particularly in terms of distinguishing between piracy and theft, a peril traditionally insured by marine policies. The general feeling was that the problem would be resolved if both perils were covered under the same policy. On that basis, it was decided to transfer piracy back to the marine risks cover.⁴⁸

7-28 In recent years, the increase in the frequency of piratical activity has led the market to reconsider its position as to which market, marine or war, should bear the risk of loss caused by piracy. On 17 October 2005, the Joint Hull Committee released the Violent Theft, Piracy and Barratry Exclusion Clause,⁴⁹ which can be used in conjunction with the standard hull marine and war-risk policies. The effect of this clause, if incorporated into the contract, is to exclude piracy and other related perils – violent theft and barratry – from the coverage of marine policies and to reinstate them as war risks. Surprisingly, there is no sign that this clause has met with general acceptance in the market, which indicates a hesitation on the part of war-risk insurers in the current climate to extend their cover to include piracy.

(1) Piracy in Contemporary Marine Policies

7-29 The main characteristics of ‘piracy’ as an insured peril have been identified in Rule 8 of the Rules for Construction of Policy. This stresses that ‘the term “pirates” includes passengers who mutiny and rioters who attack the ship from the shore’. It is evident that Rule 8 does not intend to provide a complete definition of the term but rather acts as a reminder that piracy can be committed by passengers⁵⁰ as well as outsiders. Interesting causation debates might arise in a case where an unrest, initially started by the passengers for personal gain, leads to the seizure and carrying away of the ship by the crew who decide to join forces with the passengers.⁵¹ As far as English law is concerned, the debate is largely academic given that both the potential causes of loss in this case, piracy and barratry, are insured against in contemporary marine policies.

7-30 In the light of the authorities, one of the distinguishing features of piracy

⁴⁸ Today, most standard clauses nominate ‘piracy’ as a peril insured against: cl 6.1.5 of the Institute Time Clauses – Hulls (1/11/95); cl 2.1.5 of the International Hull Clauses (1/11/03); cl 7.1.5 of the Institute Time Clauses Freight (1/11/95); cl 6.1.5 of the Institute Fishing Vessels Clauses (20/7/87); cl 9.1.4 of the Institute Yacht Clauses (1/11/85). Piracy is also covered under the Institute Cargo Clauses (A) as this policy is an all-risk policy. However, piracy is not a named peril in (B) or (C) of the Institute Cargo Clauses (both (1/1/82) and also (1/1/09) versions).

⁴⁹ JH 2005/046.

⁵⁰ *Palmer v Naylor* (1854) 10 Ex 382. It should be noted that theft committed by the insiders is not a peril insured against.

⁵¹ *Brown v Smith* (1813) 1 Dow 349.

is that attacks on ships and their cargo are carried out by people who pursue their own personal gain.⁵² The motivating factor for most pirates is financial private gain and the indication is that collecting the ransom payment is the driving force for pirates currently operating in the Gulf of Aden. However, one must bear in mind that ‘personal end’ is a concept much wider than that of financial gain. In *Palmer v Naylor*,⁵³ the insurance was effected to cover advances, outfit and provisions with respect to transportation of Chinese emigrants from China to Peru, who were possibly put on ship against their will. The policy included cover against loss by ‘pirates, rovers, thieves, etc’. During the voyage, the emigrants murdered the captain and some of the crew and took possession of the ship for the purpose of being put ashore at the nearest point of land, after which the ship was returned to the mate and the remaining crew. The assured claimed for a total loss of expenses sustained as a result of the emigrants’ ‘piratical murdering of the captain and part of the crew, and feloniously stealing and carrying away the ship’. The court ruled that the actions of the emigrants amounted to piracy since they acted with the intention of obtaining a personal gain to facilitate their escape. In a similar vein, it is possible that attacks on ships and cargo motivated by revenge can also be viewed as acts of piracy, as personal satisfaction of pirates might well be the main motive behind such acts.⁵⁴

7-31 It hardly needs saying that in times of revolution or in the disturbances which often follow the breakdown of constituted authority, determining the motive behind an attack on a ship and her cargo – whether it is carried out by people pursuing personal ends or whether it has a political dimension – is not an easy task. The complexities in determining the motive behind such an attack were evident in *Banque Monetecca & Carystuiaki v Motor Union Insurance Co Ltd*.⁵⁵ The insured vessel, *The Filia*, was bound to Batum when she encountered some engine trouble and anchored off the Turkish coast. The vessel carried a Greek flag and was insured against ‘capture, seizure, or arrest and the consequences thereof, or warlike operations, whether before or after declaration of war’, but no coverage was provided against piracy. The *Filia* was boarded by a group of armed men under the command of Osman Agha. She was never recovered and it appears that the Master, crew and the passengers were murdered. At the time the incident took place, there was great political upheaval in the region following the First World War. The central Ottoman Government was weak and the Kemalists were preparing to take control of the country and resist the Greek army, which was on the verge of invading Anatolia. Osman Agha was the president of the local National Defence Association, a body affiliated with the Kemalists, whose main aim was to provide resistance to the Peace

⁵² *Republic of Bolivia v Indemnity Mutual Marine Assurance Co Ltd* [1909] 1 KB 785.

⁵³ (1854) 10 Ex 382.

⁵⁴ Following the deaths of three Somali pirates in an operation involving the US Special Forces, a leader of the pirate group based in the town of Eyl vowed to take revenge, telling reporters that ‘this matter will lead to retaliation and we will hunt down particularly American citizens travelling our waters. Next time we get American citizens they [should] expect no mercy from us’. A few days later, an attack on the US-flagged vessel *MV Liberty Sun* appeared to be an attempt by pirates to make good on that threat. A pirate leader told reporters after the *Liberty Sun* attack: ‘We were not after a ransom. We also assigned a team with special equipment to chase and destroy any ship flying American flag in retaliation for the brutal killing of our friends.’ Source: Agence France Press, ‘Pirates Stage Rocket Attack on US Freighter’, 14 April 2009.

⁵⁵ (1923) 14 LIL Rep 48.

Treaty signed by the Ottoman Empire. Osman Agha was part nationalist leader and part feudal baron who was reputed to be involved in looting and robbing around the region. Although, Roche J reached the conclusion that the *Filia's* loss was attributable to seizure, not piracy, his observations on the matter point towards the difficulty in distinguishing between two perils:

I am satisfied that Osman Agha was on the side of the Turks, and was in real alliance with the Kemalists in Asia, and I am satisfied and find that he did capture and seize this Greek vessel under cover of and largely upon motives of a political character. That is to say he desired to effect a stroke against the Greeks. It may be, and I dare say it was, the case that personal gain was also a motive, but the action in my view was dominantly political and military.⁵⁶

The reasoning in the case leaves the impression that piracy could have been identified as the cause of loss had the insured vessel carried the flag of another state not associated with the turbulence affecting the region. It is interesting to note that Somalia currently seems to be in a similar state. Several groups, including the Al Shebbab, are engaged in an insurgency against the Transitional Federal Government. Al Shebbab is considered to be a Sunni fundamentalist group and an affiliate of Al-Qaida. There is speculation that pirates operating in Somalia are associated with Al Shebbab, which receives funds generated by the ransom stream. If proven, that would certainly indicate a strong political motive, but there is no solid evidence confirming the existence of any link between Somali pirates and Al Shebbab.⁵⁷

7-32 In order to elevate theft to piracy in the context of a marine insurance policy, it is essential that force is either used or threatened before the act of appropriation is completed.⁵⁸ However, with piracy, unlike violent theft, it is not sufficient that violence is simply directed against the property; the use of force against the crew or master is an essential element of piracy. On that basis, if in the *Andreas Lemos*⁵⁹ the boarders had forcefully broken into the paint locker and stolen equipment, they would have been probably regarded as 'thieves' and the loss would have been recoverable even though they boarded the ship in a clandestine fashion. However, their action would not amount to piracy.

7-33 A problematic aspect in the definition of piracy is whether there are any geographical limits in respect to this peril. The matter received judicial airing in the *Andreas Lemos*,⁶⁰ where an assault on the insured vessel had taken place within the territorial waters of Bangladesh. The precise location of the vessel was 2.8 miles from the land and the evidence showed that this location was within the port limits of Chittagong, Bangladesh's busiest seaport. The assured's contention was that piracy can be committed anywhere within the common law jurisdiction of the Court of Admiralty. However, the underwriters argued that piracy in the context of

⁵⁶ Ibid, at 50.

⁵⁷ The *International Herald Tribune* on 25 November 2009 reported that the head of US military operations in Africa had indicated that he had no evidence that Somali pirates were connected to Al-Qaida.

⁵⁸ Staughton J in *The Andreas Lemos* [1982] 2 Lloyd's Rep 483, at 491, indicated: 'It is not necessary that the thieves must raise the pirate flag and fire a shot across the victim's bows before they can be called pirates. But piracy is not committed by stealth.'

⁵⁹ [1982] 2 Lloyd's Rep 483.

⁶⁰ Ibid.

a marine insurance policy should be construed consistently with the international law definition of piracy⁶¹ and accordingly it can only be committed on the high seas, outside the territorial waters of any state. Relying on the dicta in *Republic of Bolivia v Indemnity Mutual Marine Insurance Co Ltd*,⁶² Staughton J held that there was no reason to limit piracy under a policy of insurance to acts outside the territorial waters of a state. It was held that the ship is in a place where piracy can be committed, if she is 'at sea' or if the attack can be described as a 'maritime offence'.

7-34 The decision of Staughton J in the *Andreas Lemos* leaves no doubt that piracy can be committed in ports⁶³ and possibly harbours⁶⁴ as well as within the territorial waters of a state. However, the matter is still surrounded by a degree of uncertainty and ambiguity. The difficult question is whether inland waters are included in the area within which piracy can be committed. Put another way, would an attack on a ship navigating in the inland waters be considered as a 'maritime offence' as described in the *Andreas Lemos*? It is not so uncommon to see that the application of certain maritime law concepts are extended to estuaries and some inland rivers. For instance, it was confirmed by the House of Lords in *The Goring*⁶⁵ that common law rules apply to salvage services rendered in tidal waters and rivers.⁶⁶

7-35 At the appeal stage in *Republic of Bolivia v Indemnity Mutual Marine Insurance Co Ltd*, contradictory views were put forward by different judges, which might be useful in resolving the current debate. The facts of this case can be summarised in the following fashion. In 1867, by a treaty, the Bolivian Government acted to assert its rights to a remote area between Bolivia and Brazil named Colonias, situated some 1,000 miles up the Amazon river. In that area, Brazilian insurgents had established an illegal independent republic. The Bolivian Government sent an expedition to the region to suppress the insurgents. To support its army based in the region, the Bolivian Government, with the consent of the Brazilian Government, began to send stores transported by steamers up the Amazon. The vessels used for this purpose were regularly stopped by the insurgents and checked as to whether they were carrying stores for the Bolivian Government. One such vessel, *the Labrea*, was insured under a marine policy including piracy as a risk for a voyage from Para, at the mouth of the Amazon, to Puerto Alonzo and

⁶¹ This can be found in Art 101 of the UN Convention on the Law of the Sea 1982.

⁶² [1909] 1 KB 785.

⁶³ In fact, piracy is a named risk in the Institute Time Clauses – Hulls Port Risks (20/7/87), cl 4.1.5.

⁶⁴ There is old authority to the effect that piracy could not be committed in harbours. In *Britannia Shipping Co v Rutgers* (1792) 4 TR 783, the loss of a tug moored alongside a pier was held not to be recoverable as a loss by piracy because the tug was in a harbour. It is difficult to reconcile this with the reasoning adopted in *The Andreas Lemos*. Staughton J was adamant that piracy can be committed at any location where a maritime offence can be committed. When it comes to maritime offences, no distinction is made in law between ports and harbours. For example, s 281 of the Merchant Shipping Act (MSA) 1995 confers jurisdiction over a British subject who commits an offence, *inter alia*, in a foreign port or harbour.

⁶⁵ [1988] 1 AC 831.

⁶⁶ The common law position persevered when the UK decided to exercise its right of reservation in relation to inland navigation contained in Art 30 of the Salvage Convention 1989. Part II, para 2(1) of Sched 11 to the MSA 1995 excludes the provisions of the Convention regarding both: (a) any 'salvage operation which takes place in inland waters of the United Kingdom and in which all the vessels involved are of inland navigation'; and (b) any 'salvage operation which takes place in inland waters of the United Kingdom and in which no vessel is involved'.

other places on the Acre River or in that district. The River Acre is a tributary of the Parsus which, in turn, is a tributary of the Amazon. Having travelled a considerable distance from Para, *the Labrea* was stopped by insurgents, who then seized the vessel after discovering that there were stores on board belonging to the Bolivian Government. The Bolivian Government's claim under the marine policy was rejected on the ground that the insurgents were acting for a public purpose and were not motivated by private gain.

7-36 Having reached the conclusion that the taking was not occasioned by piracy, their Lordships went on to discuss the geographical limits of this peril. Vaughan Williams LJ was of the opinion that piracy was essentially a maritime offence and the location where the vessel was taken, a branch river running into another branch river of the Amazon far up the country, was not a place where piracy could be committed on the premise that the particular location had no connection with the ocean at all. However, he appears to concede that had the vessel been attacked at the mouth of the Amazon, it could have amounted to piracy. Kennedy LJ on the other hand, took a different view, suggesting that on construction of the policy in question, the parties could not have intended 'piracy' to be confined to the open sea because it would be inapplicable to the specific voyage – a voyage that would be carried out entirely on a river miles away from the ocean.

7-37 What emanates from this debate is that the question of locality has not yet been solved. Whilst it is possible that an attack on a ship at a navigable river not far from the sea or ocean could be regarded as piracy, it is doubtful, to say the least, whether an attack carried out in a non-tidal river or lake would be treated in a similar fashion. The same difficulty arises if the vessel is tied up in a port that is in a lagoon and can only be approached by a narrow channel.⁶⁷ It is submitted that the approach taken by Kennedy LJ is not only pragmatic, but also in line with the commercial common sense. If no restriction is imposed on the insured vessel's ability to navigate in a river, tidal or not, or to proceed to a port that can be reached through a narrow channel, and the policy expressly provides coverage against piracy, one can argue that it would be against the intention of the parties to deprive the assured from coverage on the basis that the vessel is not 'at sea' or the event does not amount to a 'maritime offence'. One would be hard-pressed to find any difference between piracy on the open sea and piracy on a navigable river.

(2) Relationship between Piracy and Perils Excluded from Coverage

(A) Piracy, Seizure and Capture

7-38 There is precedent to the effect that forcible taking of the insured property by pirates amounts to seizure or capture at the same time. In *Kleinwort v Shephard*,⁶⁸ a vessel was insured against piracy for a voyage from Macao to Havana under a hull and machinery policy including the exclusion: 'Warranted free from capture

⁶⁷ Port of Santos in Brazil is a port which is a few feet above sea level and can only be approached by a tidal channel.

⁶⁸ (1859) 1 E & E 447.

and seizure and the consequences of any attempt thereat . . .’ The vessel was carrying Chinese immigrants who rose up against the officers and crew and seized the vessel. Lord Campbell CJ held that although the loss of the vessel resulted from an act of piracy which was an insured peril, there had also been a loss by seizure. Notwithstanding the fact that the claimed loss had its origins in an act of piracy, a seizure had occurred sufficiently to fall within the exclusion to deny assured recovery.⁶⁹ To avoid an outcome of this nature, modern marine policies stress clearly that the exclusion of seizure from marine cover does not apply to piracy.⁷⁰ The effect of this qualification is that the loss caused by piracy is not excluded from the coverage provided by marine policies, even though the act of taking the ship might amount to seizure in the context of marine insurance law.

(B) *Piracy and Riot*

7-39 At this juncture, further attention should be devoted to the relationship between piracy and riot – a peril that is traditionally insured against by war policies and accordingly excluded from the coverage of marine policies.⁷¹ Riot is a statutory offence under the Public Order Act 1986. By virtue of s 1 of the 1986 Act, the essential elements of riot are that 12 or more persons use or threaten violence for a common purpose, such as would cause a person of reasonable firmness present at the scene to fear for his personal safety. Section 10(2) of the 1986 Act provides: ‘In Schedule 1 to the Marine Insurance Act 1906 . . . “rioters” in rule 8 and “riot” in rule 10 shall, in the application of the rules to any policy taking effect on or after the commencement of this Act, be construed in accordance with s. 1 above unless a different intention appears.’ When read together, the impact of these provisions is that the statutory definition of the term ‘riot’ shall be applied in construing marine insurance policies. It is, therefore, possible that in a case where 12 or more pirates attack the insured ship with a common purpose (e.g. personal gain) and use or threaten violence, this might be treated as riot for the purposes of marine insurance policies. Considering that in none of the contemporary standard clauses is there a provision indicating that the exclusion of riots from the marine cover does not apply to piracy, the inevitable conclusion will be that in cases where the number of pirates is 12 or more, piracy is likely to be excluded from the marine cover and to be insured, if at all, under the war and strikes clauses. It is quite obvious that a distinction of this nature is very artificial and difficult to apply in practice. It is unfortunate to end up with an arbitrary

⁶⁹ More recently, it has been acknowledged by David Steel J in *Masefield AG v Amlin Corporate Member Ltd* [2010] EWHC 280 (Comm), at [49] that capture of the insured property by pirates could amount to actual total loss in some instances. This will be the case if one can infer from the circumstances that there was a clear intention at the time of disposition to deprive the owner of possession and ownership permanently: this was deemed to be the case in *Kuwait Airways Corporation v Kuwait Insurance Co* [1996] 1 Lloyd’s Rep 664.

⁷⁰ See e.g., cl 29. 2 of the International Hull Clauses (01/11/03): ‘In no case shall this insurance cover loss, damage, liability or expense caused by . . . capture, seizure, restraint or detention (barratry and piracy excepted) and the consequences thereof or any attempt thereat.’

⁷¹ See e.g., cl 25.1 of the Institute Time Clauses – Hulls (1/11/95). See, however, cl 1.4 of the Institute War and Strikes Clauses Hulls Time, which provides cover for riots.

dividing line between these perils, but this is an inevitable consequence of the statutory intervention.

(C) *Piracy and Malicious Acts Exception*

7-40 The relationship between piracy and the malicious acts exception is also an interesting one which deserves thorough consideration in the light of recent judicial developments. Most standard marine policies incorporate ‘a malicious acts exclusion’ which intends to shift the loss occasioned from this peril to the ‘war and strikes risks’ underwriters. Disregarding the broad criminal law definition of the term,⁷² it was held in a series of marine insurance cases that malice required personal spite or ill will.⁷³ Whilst he was prepared to proceed on that basis, Mustill J in *Shell International Petroleum Co Ltd v Gibbs (The Salem)*,⁷⁴ raised the possibility that it might still be possible to consider an act as malicious where the property is damaged by wanton violence, the malice being directed at the goods rather than their owner. This view seemed to form the reasoning of Colman J’s judgment in *Strive Shipping Corp v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)*,⁷⁵ where the mooring lines of the insured car ferry were cut and she was then scuttled by unknown persons. The claimant relied on the peril ‘persons acting maliciously’ in the defendant association’s rules which were in similar terms to the Institute War and Strikes Clauses. After considering judgments in previous cases and drawing an analogy with the Malicious Damage Act 1861, Colman J came to the conclusion that the words ‘malicious damage’ cover casual wanton vandalism and do not require proof that the person concerned had the purpose of injuring the assured or even knew his identity.⁷⁶

7-41 Assuming that the approach taken by Colman J in the interpretation of ‘malicious acts’ is adopted as the proper approach,⁷⁷ a potential overlap with piracy appears to be inevitable where the pirates choose to destroy the ship or its cargo by using explosives or weapons of war.⁷⁸ In that case, it can be justifiably argued that the loss should be excluded from the marine cover. However, it is obvious that such

⁷² Section 58 of the Malicious Damage Act 1861 provides that it is irrelevant for the purposes of crimes involving malice under that Act ‘whether the offence shall be committed from malice conceived against the owner of the property in respect of which it shall be committed, or otherwise’.

⁷³ See, particularly, the Court of Appeal’s decision in *Nishina Trading Co Ltd v Chiyoda Fire & Marine Insurance Co Ltd (The Mandarin Star)* [1969] 2 QB 449.

⁷⁴ [1982] QB 946, at 966.

⁷⁵ [2002] EWHC 203 (Comm); [2002] 2 Lloyd’s Rep 88.

⁷⁶ In the context of non-marine insurance, there is a strong indication that the word ‘malice’ is construed to be a wide one in cases where the clause treats the acts of malicious persons as an independent risk not coloured by its context. However, in cases where the exclusion for malicious acts is set out in the context of specific risks targeted at the assured, it is very likely that the word ‘malicious’ is to be construed in the same fashion. See particularly, *Tektrol Ltd v International Insurance Co of Hanover Ltd* [2005] EWCA Civ 845; [2005] 2 Lloyd’s Rep 701 (CA).

⁷⁷ A similar reasoning seems to have been adopted in *North Star Shipping Ltd v Sphere Drake Insurance Plc (The North Star)* [2005] EWHC 665 (Comm); [2005] 2 Lloyd’s Rep 76. The issue was not raised at the Court of Appeal level [2006] EWCA Civ 378; [2006] 2 Lloyd’s Rep 183.

⁷⁸ Clause 25 of the Institute Time Clauses – Hulls (1/10/83), for example, stipulates: ‘In no case shall this insurance cover loss damage liability or expense arising from (1) the detonation of an explosive (2) any weapon of war and caused by any person acting maliciously or from a political motive.’

an interpretation is capable of robbing the cover provided for piracy in modern policies of force – an outcome which might be at odds with the intention of the parties. However, it is equally plausible to suggest that piracy can still be viewed as the *proximate* cause of the loss by courts because explosives or weapons of war would not have caused the loss had the insured property not been in the hands of the pirates. A degree of flexibility is certainly inherent in the proximate cause doctrine,⁷⁹ which requires the courts to seek for the efficient cause of any loss. Furthermore, doubts can be raised as to whether the reasoning in *The Grecia Express* can be extended in construing the meaning of ‘malicious damage’ appearing in an exclusion clause. It should be borne in mind that Colman J was dealing with the term ‘malicious damage’ in the context of construing the scope of an insured peril. However, there is room to argue that the same words should be construed narrowly when they appear in an exclusion clause. As it currently stands, it is fair to say that the matter is far from being resolved and that both of these approaches are equally plausible.

7-42 Difficulties of a similar nature are likely to arise in the context of cargo insurance. Standard Institute Cargo Clauses (B) and (C) exclude deliberate damage to or deliberate destruction of the subject matter insured or any part thereof by the wrongful act of any person or persons.⁸⁰ It is possible that cover for such losses could be reinstated by incorporating the Institute Malicious Damage Clause⁸¹ which reads:

In consideration of an additional premium, it is hereby agreed that the exclusion ‘deliberate damage to or deliberate destruction of the subject-matter insured or any part thereof by the wrongful act of any person or persons’ is deemed to be deleted and further that this insurance covers loss of or damage to the subject-matter insured caused by malicious acts, vandalism or sabotage, subject always to the other exceptions contained in this insurance.

In a case where the cargo on board of a ship seized by pirates is destroyed maliciously or vandalised by pirates, the key question is whether recovery is possible under the Institute Malicious Damage Clause even though piracy is not a peril specifically insured against in the policy. One could argue that the clause introduces insurance cover back only for perils originally insured against, such as fire in Institute Cargo Clauses (B), when such loss is caused by malicious acts, vandalism or sabotage. Put differently, the effect of the Institute Malicious Damage Clause is to reinstate the cover caused by perils originally insured against, even in cases where such perils occur as a result of malicious acts, vandalism or sabotage committed by third parties. Equally, it can be argued that the effect of the Institute Malicious Damage Clause is to provide indemnity to the assured for losses proximately caused by malicious acts, vandalism or sabotage.⁸² It is submitted that this solution is in accord with commercial realities. A reasonable assured who pays an additional premium to protect his cargo against malicious damage caused by third parties does not expect the cover not to be available if the cargo is damaged or vandalised by pirates. Also, the wording of the clause lends considerable support

⁷⁹ *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350.

⁸⁰ Clause 4.7 of the Institute Cargo Clauses (B) and (C) (both 1982 and 2009 versions).

⁸¹ (1/8/82).

⁸² This is also the stand adopted in Dunt, J, *Marine Cargo Insurance* (2009, Informa), pp 184–5.

to this conclusion. There is nothing in the clause suggesting that indemnity should be restricted to instances where the loss or damage is caused by a peril insured against when such peril comes about by malicious acts of third parties. The only restriction imposed on the additional cover provided for malicious acts, vandalism or sabotage is that such additional cover is subject to the other exclusions contained in the policy. Therefore, cover should be available for loss or damage sustained by the insured property as a result of deliberate and malicious actions of the pirates.

(3) Piracy in Action – A Legal Analysis

(A) Making a Claim for Piracy – Actual and Constructive Total Loss Caused by Piracy

7-43 In a case where the insured property is taken by pirates at sea and nothing is ever heard of her destiny, it is very likely that the owner of such property will be able to make a claim for actual total loss of such property.⁸³ Section 57(1) of the MIA 1906 stipulates that there is an actual total loss ‘where the subject-matter is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof’. In the light of authorities on the subject,⁸⁴ it is clear that for the property to be regarded as ‘irretrievably deprived’ for this purpose, it should be placed in such a position that it is totally out of the power of the assured or the underwriter to procure its retrieval. Similarly, if the ship or cargo is partly destroyed following a piratical attack, there is no doubt that the assured will be able to make a claim for partial loss⁸⁵ under the policy.⁸⁶

7-44 The position becomes more complicated in cases where the insured property remains in the hands of pirates without suffering any physical loss.⁸⁷ The question then is whether the assured could make a claim under the policy on the premise that the subject matter insured becomes an actual total loss the moment it is captured by pirates. This matter was raised and debated extensively in *Masefield AG v Amlin Corporate Member Ltd (The Bunga Melati Dua)*.⁸⁸ *The Bunga Melati Dua*, a chemical/palm oil tanker, laden with two parcels of bio-diesel owned by the assured, was seized by Somali pirates on 19 August 2008 in the Gulf of Aden and was taken to Somali waters. The cargo of bio-diesel parcels was insured by insurers under an open cover, incorporating the Institute Cargo Clauses (A). There was no dispute that seizure by pirates was an insured risk under the policy of insurance. Immediately

⁸³ Stealing the ship and cargo seems to be the intention of pirates operating in some parts of the world. Some of the ships taken by pirates later appear as phantom ships in the hands of phantom traders intending to load and steal further cargoes whilst the cargo on board are usually sold to innocent third parties.

⁸⁴ *Cossmann v West* (1887) 13 App Cas 160 and *Panamanian Oriental Steamship Corp v Wright (The Amia)* [1970] 2 Lloyd’s Rep 365.

⁸⁵ By virtue of s 56(1) of the MIA 1906, any loss that does not satisfy the criteria for a total loss is partial.

⁸⁶ It has been acknowledged that marine policies provide cover for loss or damage caused by a failed piracy attempt. See *Re Piracy Jure Gentium* [1934] AC 586.

⁸⁷ Reports suggest that pirates operating on the Gulf of Aden keep most of the vessels they capture for months whilst the negotiations for ransom continue.

⁸⁸ [2010] EWHC 280 (Comm) [2010] 1 Lloyd’s Rep 509; *aff’d* [2011] EWCA Civ 24; [2011] 1 Lloyd’s Rep 630.

after seizure, the pirates made contact with the owners with a view to negotiating a ransom for release of the vessel, crew and cargo. During the course of negotiations between hull interests and the Somali pirates, on 18 September 2008, the assured tendered a notice of abandonment to the defendant insurers, which they rejected. Eleven days later, on 29 September (around six weeks after her seizure), the vessel was released following the payment of the agreed ransom between the owners of the vessel and the Somali pirates. The vessel arrived at the intended destination of Rotterdam on 26 October 2008 with no damage to the cargoes. Despite having their cargo restored to them in apparently good condition, the assured claimed indemnity from their cargo insurer, essentially due to the fact that the market value of the bio-diesel had declined considerably due to its late arrival, arguing that the capture of the vessel by the pirates and its subsequent removal into Somali waters rendered the cargo an actual total loss pursuant to s 57(1) of the MIA 1906 in that they had been irretrievably deprived of the cargo.

7-45 The submission of the counsel for the assured was that piracy is similar to capture in the sense that it operates immediately, depriving the assured of the subject matter of insurance unless there is recovery before the date of commencement of proceedings. Having been rejected by the trial judge, David Steel J, the argument was raised again before the Court of Appeal. In building his case, counsel for the assured relied on a number of capture cases, most notably *Dean v Hornby*.⁸⁹ In a nutshell, the facts of this case could be summarised as follows. The insured vessel was captured by pirates in December 1851. In January 1852, she was recaptured by an English warship and was sailed to Valparaiso under the command of a prize master. In April 1852, her owners, under the misapprehension that the vessel had been condemned as a prize at Valparaiso, gave a notice of abandonment. From Valparaiso, the insured vessel was sent to Liverpool under the command of a prize master but encountered bad weather on route and put into Fayal. There she was sold by the prize master in August 1852 on a surveyor's erroneous advice that she was unfit for repair. Her new owners repaired her for a small sum and took her to England, where her old owner, the assured, and his underwriter, by agreement took proceedings in early 1853 to regain possession of her, without prejudice to their rights *inter se*. The admiralty court awarded possession to her old owner and after she was sold, her price was deposited to await the outcome of the issue between the assured and his underwriter. The assured's contention was that he was entitled to be paid for total loss as he had lost possession of the vessel when she was captured by the pirates and did not recover possession up to the time of the commencement of the action. The counsel for the underwriter argued that the assured's entitlement was for partial loss only on the premise that the notice of abandonment was given when the vessel was in the possession of the Queen as a result of recapture. The counsel conceded that the vessel could have been declared a total loss had the notice been given while the vessel was in the hands of the pirates. The judgment was given in favour of the assured. On the issue, Lord Campbell CJ said:⁹⁰

⁸⁹ 118 Eng Rep 1108.

⁹⁰ *Ibid*, at 1112.

... In December 1851, she is taken by pirates. Then, in fact, a total loss has occurred. After that, she never is restored to her owners; nor have they had an opportunity of regaining possession. They have lost the possession by events over which they have no control, and therefore are entitled to indemnity for which they have paid.

From this judgment, the counsel for the assured in the present case attempted to argue the existence of a principle of general applicability that capture by pirates amounts to an actual total loss. It was doubted at the first instance whether the decision in *Dean v Hornby* was, in fact, an authority for actual total loss. Rix LJ, who delivered the leading judgment of the Court of Appeal, also expressed similar doubts. The truth is that in *Dean v Hornby*, the assured was deprived of the possession of his ship in December 1851 and recapture of the vessel by a prize master in January 1852 did not mean that possession was automatically restored to the assured. The assured remained deprived of possession of the vessel and when he finally gave the notice of abandonment in April 1852, it is plausible that he was trying to rely on constructive total loss on that premise, with recovery unlikely. The emphasis on the giving of notice of abandonment in the leading judgments in *Dean v Hornby* lends further support to the contention that the judges treated the case as an instance of constructive total loss rather than actual total loss.

7-46 Furthermore, there is no authority suggesting that capture of the insured property automatically amounts to an actual total loss. It has been acknowledged on a number of occasions that, on the facts of particular cases, an actual total loss might be justified in cases of capture, especially if one can infer from the circumstances that there was a clear intention at the time of the dispossession to deprive the owner of possession and ownership permanently. This was deemed to be the case in *Kuwait Airways Corporation v Kuwait Insurance Co*,⁹¹ where the insured Kuwaiti planes were deemed to have suffered an actual total loss when the Iraqi army occupied Kuwait. However, in *Scott v Copenhagen Reinsurance Co (UK) Ltd*,⁹² the Court of Appeal distinguished the case of the British Airways (BA) jet caught at Kuwait airport at the time of the Iraqi invasion from the position of Kuwaiti planes, holding that there was only an actual total loss when the BA jet was destroyed by allied bombing where it had been parked. The main difference was the fact that in *Scott v Copenhagen*, it was not possible to infer the intention that the Iraqi army was determined to deprive BA of the ownership of their property simply by occupying Kuwait and the airport where it had been parked. For a foreign company such as BA, this was a typical 'wait and see' situation. The fate of Kuwaiti planes was different, as the Iraqi army had invaded their country, making it easier to infer the conclusion that the Iraqi military intended to take dominion over the insured property from the outset. In the present case, drawing a parallel with *Scott v Copenhagen*, the Court of Appeal reached the conclusion that it cannot be inferred from the actions of the Somali pirates that they intended to deprive the assured from the possession of the insured property permanently. In light of the facts, the chance of recapture remained a strong possibility pending the payment of the ransom.

7-47 The judgment of the Court of Appeal in *The Bunga Melati Dua* leaves no

⁹¹ [1996] 1 Lloyd's Rep 664.

⁹² [2003] EWCA Civ 688; [2003] Lloyd's Rep IR 696.

doubt that in the context of Somali piracy, it is not a realistic prospect to claim actual total loss where the ship or goods are kept in the hands of pirates for the purposes of negotiating a ransom payment. However, in those circumstances it might still be possible for the owner of a property kept in the hands of pirates to approach his underwriter seeking indemnity under his insurance policy for constructive total loss. Constructive total loss is unique to marine insurance law and can be described as a type of loss whereby 'the subject matter insured is effectively lost to the assured, but is not actually destroyed'.⁹³

7-48 The issue will be deliberated first from the perspective of hull policies. The MIA 1906 permits an assured who is 'deprived of the possession of his ship by a peril insured against and it is unlikely that he can recover the ship'⁹⁴ to make a claim for constructive total loss.⁹⁵ It is a prerequisite of a claim for a constructive total loss of a ship that the assured gives notice of abandonment.⁹⁶ The notice of abandonment, in this context, means the voluntary cession by the assured to the insurer of all that remains of the subject matter insured and it is a procedural requirement that must be satisfied before a claim for total loss can be made. Several difficult issues may arise if the assured decides to treat the loss as total by giving notice of abandonment in a case where the insured vessel is detained by pirates but not destroyed.

7-49 The first question is, can the assured give notice of abandonment as soon as his vessel is detained by pirates? It has been submitted that capture, *prima facie*, gives the assured an immediate right to give notice of abandonment.⁹⁷ The justification given for this stand is that capture is an action conducted by a belligerent power, usually in wartime, with the intent to deprive the owner of all dominion or property right over the thing taken. It is rather doubtful whether the same justification applies when a vessel is seized by pirates, considering that collecting the ransom money is the main motivation for the majority of piracy attacks.⁹⁸ Even though pirates operating in a particular region are known not to be after the ransom payment but instead prefer to steal the ship and her cargo, there is a world of difference between capture by a belligerent power, who under the prize law, can seek a regular sentence of condemnation from a prize court and seizure by pirates who are criminals and can be caught at any time by authorities.

7-50 Proceeding on the premise that seizure of insured property by pirates in all probability may not justify an immediate notice of abandonment, the next question is, what is meant by 'unlikelihood of recovery' and how long must the assured be deprived of the possession of his ship⁹⁹ before he can give notice of abandonment?

⁹³ Hodges, S, *Cases and Materials on Marine Insurance Law* (1999, Cavendish Publishing), p 623.

⁹⁴ See s 60(2)(i) of the MIA 1906.

⁹⁵ Section 61 of the MIA 1906 gives a right of election in those circumstances to the assured either to treat the loss as partial loss or to abandon the subject matter insured to the insurer and treat the loss as total.

⁹⁶ Section 62(1) of the MIA 1906 provides: 'Subject to the provisions of this section, where the assured elects to abandon the subject matter insured to the insurer he must give notice of abandonment.'

⁹⁷ See *Pohurian SS Co Ltd v Young* [1915] 1 KB 922.

⁹⁸ The recoverability of the ransom payment under the insurance contracts is debated further in the following part.

⁹⁹ The fact that the crew might still be on board is not determinative. The owner may be said to be 'deprived of possession' if he is not in a position to continue with the active performance of contractual

7-51 It is worth noting that the MIA 1906 is silent as to the ‘degree of unlikelihood’ that is required. Prior to the enactment of the MIA 1906, the test was one of uncertainty of recovery. However, it is generally accepted that the draftsman, by making use of the word ‘unlikely’ in s 60(2)(i)(a), took a conscious decision to qualify the pre-Act test of uncertainty of recovery.¹⁰⁰ The main difference between these two tests is that under the former (uncertainty test) no one can say that the release of the vessel will happen. In the latter case, however, there is some balance against the event not happening.¹⁰¹ In the absence of policy provision to the contrary,¹⁰² it is established that the words ‘within a reasonable time’ are to be implied in s 60(2)(i)(a) of the Act.¹⁰³ Therefore, the courts will have to assess whether it is unlikely that the insured property can be recovered within a reasonable time. What constitutes a reasonable time is a question of fact.¹⁰⁴ It is obvious that the courts will have put themselves in the position of a reasonable person with knowledge of the true facts and the process will inevitably require a degree of ‘speculation as to what is likely to be the outcome of possible contingencies’.¹⁰⁵ If there is a time gap between the date of detention and the date of notice (and inevitably there will be), the courts will take into account any period for which the vessel had already been detained prior to the notice being given.¹⁰⁶ However, the requirements for a constructive total loss are required to be present both when the notice of abandonment is served and also at the date, if different, when the legal proceedings are commenced or are deemed to have commenced by the issuing of a claim form.

7-52 It is evident from the analysis conducted so far that claiming constructive total loss on this ground is not as straightforward as it might seem at first sight. However, in a situation where negotiations for the release of the vessel collapse, or no further communication is received from the pirates, there is a good chance of advancing a constructive total loss claim, particularly if the vessel is detained for a considerable period of time. In that case, there is every chance that the courts will consider the likelihood of recovery within a reasonable time as a remote possibility.

7-53 Further complications could arise in cases where the policy expires after the seizure of the insured property by pirates but before the assured advances a

commitments while the vessel is being detained. See *The Bamburi* [1982] 1 Lloyd’s Rep 312, where it was held that there was a constructive total loss when, at the outbreak of the Iran–Iraq war, the Iraqi port authorities at Umm Qasr denied the insured vessel permission to leave. It is likely that the insured finds himself in a similar position when his vessel, together with her crew, are detained by a group of armed pirates.

¹⁰⁰ *Polurrian Steamship Co Ltd v Young* (1913) 19 Com Cas 143, at 155, per Pickford J.

¹⁰¹ See the judgment of Lord Wright in *Rickards v Forestal Land, Timber & Railways Co Ltd (The Minden)* [1942] AC 50, at 87.

¹⁰² Clause 3 of the Institute War and Strikes Clauses Hulls Time (1/10/83 and 1/11/95) incorporates a detention clause which reads: ‘In the event the Vessel shall have been the subject of capture seizure arrest restraint detainment [confiscation or expropriation], and the Assured shall thereby have lost the free use and disposal of the Vessel for a continuous period of 12 months then for the purpose of ascertaining whether the Vessel is a constructive total loss the Assured shall be deemed to have been deprived of the possession of the Vessel without any likelihood of recovery.’

¹⁰³ *Roura & Forgas v Townend* [1919] 1 KB 189.

¹⁰⁴ Section 88 of the MIA 1906.

¹⁰⁵ *Polurrian Steamship Co Ltd v Young* [1915] 1 KB 922, at 937 (CA).

¹⁰⁶ See *Panamanian Oriental SS Corp v Wright (The Anita)* [1970] 1 Lloyd’s Rep 365, at 381, per Mocatta J.

claim. Let us assume that the insured vessel falls into the hands of pirates a few days before the expiry of the policy. Whilst the negotiations for her release continue, the policy expires before the assured gives a notice of abandonment.¹⁰⁷ There is legal authority pointing towards the direction that if the insured property falls into the grip of an insured peril (in this case piracy) during the currency of the policy and the loss develops afterwards (as a result of a sequence of events following in the ordinary course upon the peril insured against) into one which is constructively total, the underwriter is still liable.¹⁰⁸ Stated otherwise, the lack of notice of abandonment before the expiry of the policy does not act as a bar to recovery in this case. In fact, this outcome is a natural extension of the 'death blow' doctrine, which allows the assured recovery for total loss where he is deprived of possession or control of the insured property prior to the expiry of the risk by a peril insured against. The loss develops into an actual total loss only after the expiry of the policy as a result of the natural progression of the events.¹⁰⁹ The doctrine received its clearest exposition in *London & Provincial Leather Processes Ltd v Hudson*.¹¹⁰ There, a liquidator of an insolvent company to which the assured entrusted goods for processing refused to return them to the assured and instead sold them unlawfully. The detainment of the insured property occurred during the insurance period, although it was unclear whether the sale occurred before or after the expiry of the policy. In the view of the court, the time of the sale did not matter.¹¹¹

7-54 However, recovery for losses becoming ripe after the expiry of the policy is not possible if the ultimate loss is not the result of a sequence of events following in the ordinary course upon the peril insured against, but is the result of some supervening cause.¹¹² Whilst the accuracy of this principle is not in dispute, identifying the cause of the loss is a matter ultimately left to the discretion of the courts. Therefore, it is possible that in a case where the assured is deprived of possession of the insured ship by the actions of the pirates and the property is destroyed by another peril when it is in the hands of pirates, the proximate cause of loss can be regarded as the piracy, not the subsequent casualty.¹¹³ Accordingly, if the insured ship captured by pirates is attacked and destroyed by a rival gang whilst she is in the hands of the pirates, it is possible that piracy will remain the cause of the loss, as the vessel would not have been within the reach of such people acting maliciously had she not been captured by pirates in the first instance.¹¹⁴

7-55 When it comes to cargo insurance, the prospect of claiming constructive

¹⁰⁷ If notice had been given before the policy expired, it was likely that it would have been rejected, as at that point in time it was not possible to suggest that recovery of the insured property was unlikely.

¹⁰⁸ See *The Anita* [1970] 2 Lloyd's Rep 365. The point did not arise on appeal [1971] 1 Lloyd's Rep 487.

¹⁰⁹ *Mullet v Shelden* (1811) 13 East 304 and *Stringel v English and Scottish Marine Insurance Co* (1870) LR 5 QB 599.

¹¹⁰ [1939] 2 KB 724.

¹¹¹ See also the judgment of David Steel J in *Bayview Motors Ltd v Mitsui Marine and Fire Insurance Co Ltd* [2002] EWHC 21 (Comm); [2002] 1 Lloyd's Rep 652, where he has stressed that indemnity is available for total loss occurring after the expiry of the policy as long as partial loss is sustained during the currency of the policy.

¹¹² See *Fooks v Smith* [1924] 2 KB 508.

¹¹³ *Anderson v Marten* [1908] AC 334.

¹¹⁴ See *Lawrence v Aberdeen* (1821) 5 B & Ald 107.

total loss in a case where the cargo is on board a ship detained by Somali pirates for ransom is rather bleak. Standard Institute Cargo Clauses, modifying the provisions of the MIA 1906, restrict the number of instances that could give rise to constructive total loss in cargo policies. It is, for example, not possible under a policy that incorporates Institute Cargo Clauses to claim constructive total loss on the premise that the cargo owner has been deprived of the possession of his cargo by a peril insured against and it is unlikely that he can recover it. Under cl 13 of the Institute Cargo Clauses A, B and C (both 1982 and 2009 versions), it is open to the assured to declare constructive total loss only in two instances – if the subject matter insured is reasonably abandoned: (i) either on account of its actual total loss appearing unavoidable; or (ii) because the cost of recovering, reconditioning and forwarding the subject matter to the destination to which it is insured would exceed its value on arrival. In the context of Somali piracy, the relevant heading would be (i); but whether it will be possible to establish constructive total loss on this ground is rather doubtful. For an assured to be able to rely on this heading, it is essential that he demonstrates that the insured cargo has physically been abandoned with no hope of recovery. The meaning of the word ‘abandonment’ as used in this clause has been elaborated by Scott LJ in *Court Line v R* in the following manner:¹¹⁵

When the ship is spoken of as ‘abandoned on account of its actual total loss appearing to be unavoidable’, the word is used in nearly the same sense as when according to the law of salvage the ship is left by master and crew in such a way as to make it a ‘derelict’ . . .

It will be an uphill task to convince the court to infer such intention of abandonment in a case where a ship-owner is in negotiations with the pirates with the intention of securing the release of the ship and her cargo. This was, in fact, the view of David Steel J in *The Bunga Melati Dua*,¹¹⁶ and interestingly the constructive total loss point was not taken up by the assured in the appeal.

(B) Ransom Payment – Insurance Implications

7-56 Obtaining ransom seems to be the main motivation for pirates operating around the Gulf of Aden. To date, a single sum has been sought for each vessel, cargo and crew seized by the pirates and, according to various press reports, the burden of ransom payment seems to have been absorbed, at least for now, by the owners of the vessels. Not much data is available regarding the involvement of underwriters in the negotiations for ransom payments, and it is a matter of speculation as to what extent such payments are currently paid, if any, by insurance policies of the interested parties. Considering the sensitivity surrounding the matter, lack of information comes as no surprise,¹¹⁷ but a number of observations are in order.

7-57 When it comes to recovery of the ransom payment made to the pirates to secure the release of the insured vessel and her cargo (if any), two alternative routes seem to be open to the owner. The first possibility is that the owner might turn to his

¹¹⁵ (1945) 78 LIL Rep 390, at 395.

¹¹⁶ [2010] EWHC 280 (Comm); [2010] 1 Lloyd’s Rep 509.

¹¹⁷ There is a concern that releasing information about the insurance position might encourage pirates to intensify their attacks on commercial ships.

hull underwriters, claiming the ransom payment as part of sue and labour expenses. Sue and labour clauses, which are invariably incorporated into hull policies,¹¹⁸ require the underwriters to pay for expenses reasonably incurred by the assured in an attempt to avert or diminish loss covered by the policy. Support can be drawn for the proposition that ransom payments can be regarded as sue and labour expenses from *Royal Boskalis Westminster NV v Mountain*.¹¹⁹ In that case, the assured owned a fleet of dredgers which were involved in a dredging project in Iraq. Following the invasion of Kuwait, the United Nations imposed sanctions on Iraq. In retaliation, the Iraqi authorities seized property owned by foreigners, including the dredgers. In order to secure the release of the dredgers, the assured entered into a 'finalisation agreement' with the Iraqi authorities, under which they agreed to relinquish all claims under the dredging contract and to return a sum held in the Netherlands by way of security for payments due under the contract. The fleet was allowed to leave Iraq upon the implementation of the 'finalisation agreement'. The assured then claimed the value of the relinquished claims as sue and labour expenses. The Court of Appeal reached the conclusion that expenditure to obtain the release of the insured property can be recovered, in principle, under a 'sue and labour' clause.¹²⁰ The assured's claim nevertheless failed because the finalisation agreement was unenforceable (having been obtained under duress), hence no loss could be proved. It is submitted that the general principles emerging equally apply to the payment of ransom money to pirates in order to obtain the release of insured property.

7-58 Assuming that this analysis holds true, there is a strong case to argue that negotiation costs are also recoverable as sue and labour expenses in addition to ransom payment.¹²¹ Given that negotiation costs are ongoing expenses, it is essential to specify the duration of the right to sue in cases where the insured property is detained by pirates and the assured gives a notice of abandonment to claim constructive total loss on the basis that the likelihood of its recovery is slim. To put it more precisely, the question is, from which point onwards do ongoing expenses cease to be recoverable as sue and labour expenses? If the notice of abandonment is to be accepted by the underwriter, the day of acceptance is likely to be the cut-off date for the recoverability of such expenses. Section 62(6) of the MIA 1906, which indicates that the underwriter admits liability conclusively by accepting the notice of abandonment, lends support to this conclusion. The position might be different where the notice of abandonment is not accepted by the underwriter. In that case, the date at which the writ is issued or deemed to have been issued (e.g. the issuing date of the claim form) is likely to be the cut-off date for sue and labour expenses on the basis that the rights of the parties with respect to a total claim become crystallised with the issuing of the writ.¹²² The matter becomes more complicated if total

¹¹⁸ See cl 13.2 of the Institute Time Clauses – Hulls (1/10/83), cl 11. 2 of the Institute Time Clauses – Hulls (1/11/95) and cl 9.2 of the International Hull Clauses (1/11/03).

¹¹⁹ [1999] QB 674.

¹²⁰ In reaching this conclusion, the Court of Appeal rejected the argument put forward by the underwriters that such an expense had to be capable of assessment on a *quantum meruit* basis.

¹²¹ However, crew's salaries during the period of detention, as well as running expenses of the ship, are not recoverable as sue and labour expenses, as they fall outside the coverage provided by hull policies. See *Field SS Co v Burr* [1898] 1 QB 821; [1899] 1 QB 579 (CA).

¹²² See *Polurrian SS Co Ltd v Young* [1915] 1 KB 922, 927–8; *Rickards v Forestal Land, Timber &*

loss is ultimately conceded or established with the notice of abandonment having been declined at the first instance. Although there is no case law on the subject, it is possible that expenditure made between the time of the issuing of the writ and the time of loss can be recovered from the underwriter on a restitutionary basis.

7-59 At this juncture, the relationship between the hull underwriter and other underwriters needs to be clarified. If the assured manages to recover the ransom payment from his underwriter as a sue and labour expense, the hull underwriter would possibly be in a position to seek contribution from cargo underwriters, assuming that there is cargo on board, under the corresponding obligation of cargo underwriters to make good on an expense paid in these circumstances.¹²³ By the same token, it is possible that the hull underwriters can turn to the liability insurer of the ship-owner (P & I Club) for a contribution, considering that clubs are responsible for any injury or death to crew members. It is currently the practice of pirates to seek a single sum for the vessel, her cargo and crew. Although what goes behind the closed doors whilst negotiating with pirates holding the insured vessel is not made public, it is highly probable that, in practice, the owners in such a case liaise with hull, cargo and liability insurers and any decision as to the payment of ransom is jointly taken. However, it needs to be stressed that so far, the public stance taken by the P & I Clubs on the matter is that they do not regard themselves as having any responsibility to contribute to ransom payments.

7-60 The second alternative of the owner of a vessel seized by pirates is to try to recover the ransom money paid in general average from other property interests pro rata to values. Obviously, this option is open only in cases where the vessel seized was carrying cargo at the time of seizure. There is little doubt that any ransom payment made to rescue a ship and her cargo from pirates ranks as general average expense, as it is incurred for the purpose of preserving the property involved in a common maritime adventure from peril.¹²⁴

7-61 It must be stressed that the owner might face a number of legal and practical difficulties if he chooses to follow this route. The first difficulty is that the cargo interests can raise an objection to the general average claim on the ground that the peril which gave rise to the general average act (piracy) was caused by the fault of the person claiming contribution (owner) (e.g. it can be claimed that the ship-owner has failed to exercise due diligence to provide a seaworthy vessel).¹²⁵ The other difficulty arises in the case that the owner, following the release of the vessel, should attempt to collect general average security from all the cargo interest prior to the discharge of

Railways Co Ltd (The Minden) [1942] AC 50, at 84–5 and *Kuwait Airways Corp v Kuwait Insurance Co SAK (No 1)* [1996] 1 Lloyd's Rep 664, at 696–7, per Rix J.

¹²³ A sue and labour clause is normally incorporated into cargo policies. See e.g., cl 16 of the Institute Cargo Clauses 1982 (A, B and C) (1/1/82). The matter is complicated as far as freight insurance is concerned, as the Institute Freight Clauses (both time and voyage) do not include this clause. However, it is possible that an entitlement to reimbursement might be implied. See *Netherlands Insurance Co Est 1845 Ltd v Karl Ljungberg and Co AB (The Mammoth Pine)* [1986] 2 Lloyd's Rep 19 (PC).

¹²⁴ See Rule A of York-Antwerp Rules 2004.

¹²⁵ See Rule D of York-Antwerp Rules 2004. A defence of this nature would require the examination of various factors, such as: (i) whether the voyage plan was sufficiently safe given knowledge of high-risk areas; (ii) whether the vessel was adequately protected by security systems suitable to prevent easy access by pirates; and (iii) whether the ship's crew had adequate training and could take reasonable measures to prevent the pirates from attacking the ship.

the cargo at the destination. This would not be necessary if the hull policy contains an absorption clause, whereby the hull underwriter agrees to indemnify the assured (owner) for the general average expenditure, not merely the assured's proportion.¹²⁶ The main objective of absorption clauses is to avoid the expense of obtaining security from various cargo interests for small general averages; they have proven to be very useful in box trade.¹²⁷ However, in the absence of an absorption clause, each underwriter will be liable for the proportion of the general average expenditure for which their assured is responsible.

7-62 There is one final point which calls for further scrutiny. The prospect of the assured claiming the ransom money and costs of negotiations from the underwriters as sue and labour expenses is subject to the condition that the measures taken by the assured to avert or minimise loss are neither illegal nor contrary to public policy. If they are, the assured will not be able to recover in respect of such measures. In a similar vein, the underwriters will not be expected to cover the general average expenditure if the expenditure stems from conduct which is illegal or contrary to public policy. It is, therefore, essential to engage in a discussion on the legality of paying ransom.

7-63 There does not seem to be any positive law making ransom payments to pirates illegal under the English law¹²⁸ unless an association between a terrorist organisation and pirates can be established. By virtue of s 15(3) of the Terrorism Act 2000 it is an offence to provide funds if the provider knows, or has reasonable cause to suspect, that such funds may be used for the purposes of terrorism.¹²⁹ Similarly, the Proceeds of Crime Act 2002, which aims to deal with money-laundering offences, is not relevant in this context as the Act is not designed to deal with the payers of a ransom demand and paying a ransom does not, of itself, constitute a crime under this legislation. Although international law deals with piracy and allows states to take action against such criminal acts,¹³⁰ the payment of a ransom has not been made illegal under that legal framework.

7-64 However, illegality, as a matter of general principle, extends to conduct which, though not prohibited by a specific rule of law, is nevertheless prohibited as contrary to public policy. Public policy has been identified as 'a method which the courts use where there is conduct which the public disavow'.¹³¹ Dealing with issues

¹²⁶ Section 66(4) of the MIA 1906 provides: 'Subject to any express provision in the policy, where the assured has incurred a general average expenditure, he may recover from the insurer in respect of the proportion of the loss which falls upon him; . . .'

¹²⁷ Clause 40 of the International Hull Clauses 2003 (1/11/03) incorporates a general absorption clause.

¹²⁸ Although this has not been the case throughout history. Making ransom payments was illegal under the Ransom Act 1782 (now repealed).

¹²⁹ The definition of terrorism under the Act (s 1) extends to acts outside the UK and covers not only violent actions but actions which might have devastating impact on the society, such as interference or disturbance of an electronic system. The Act also recognises that terrorism may have religious, ideological or political motives.

¹³⁰ The main conventions dealing with the matter are: the United Nations Convention on the Law of the Seas 1982 and the Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation 1988. The United Nations, in the context of Somalia, allowed the possibility of states undertaking measures not only for the purposes of suppressing acts of piracy but also armed robbery at sea (UNSC1851, 16 December 2008, para 6).

¹³¹ *Gray v Barr* [1971] 2 QB 554, at 561.

of public policy is far from easy because it would require the court in question to strike a delicate balance between the conflicting duties of safeguarding individual rights and freedoms and that of protecting social institutions and society. Therefore, it is essential to assess the harm inflicted on the society by allowing the owners to make ransom payments in an attempt to save their property. No one can doubt that the payment of a ransom sends the wrong signal to pirates and, therefore, might have an undesired effect in encouraging crime. However, one should not lose sight of the fact that payment of the ransom money might ensure that no harm is done to the crew who are being held hostage. Also, it can be argued that paying a ransom avoids the destruction of property, which would usually have a higher value than the sum paid, thus reducing the extent of social harm. On balance, it is submitted that making a ransom payment, despite its potential negative impact in the encouragement of crime, does not inflict a substantially incontestable harm to the public; thus it is not an act contrary to public policy.

7-65 It is reassuring to see that the courts have adopted a similar approach on the matter. David Steel J in *The Bunga Melati Dua*¹³² held that payment of ransoms to pirates to secure the release of the insured vessel, crew and cargo should not be treated as being against public policy. The matter was raised again by the insurers before the Court of Appeal by linking the debate with the assured's duty to avoid and minimise loss which is to be found in s 78(4) of the MIA 1906. Accordingly, it was submitted before the Court of Appeal that the assured's duty to minimise or avert the loss under s 78(4) of the MIA 1906 did not require him to make a ransom payment to the pirates. To lend support to this submission, counsel for the insurers sought to draw an analogy between payment of ransom and the release of prisoners in response to a hostage situation or payment of bribe, arguing that the court should not take payment of ransom into account as one of the factors in determining the likelihood of the insured ship's release for the purpose of identifying whether an actual total loss has taken place or not.

7-66 This submission is open to criticism on several accounts. First, it seems to be at odds with the decision of the Court of Appeal in *Royal Boskalis Westminster NV v Mountain*,¹³³ where it was held that payment of a ransom could be recovered as a sue and labour expense. Second, even if it is assumed that there is no duty to make a ransom payment, it is difficult to see how this turns from a potential loss which may be avoided by the payment of ransom into an actual total loss. It must still remain a question of fact whether the assured has lost possession of his vessel indefinitely or whether it is likely that he will recover the vessel at a later stage. Finally, as acknowledged by Rix LJ,¹³⁴ the analogies that the appellant's counsel attempted to draw are not sound. Release of prisoners is an act which can only be undertaken by public authorities acting within the limits of law, so this has no connection with ransom payments by the owners of the insured property to secure its release. Similarly, there is no connection between bribery and ransom payments, given that the former constitutes an illegal act whilst it is common ground that the latter is not illegal

¹³² [2010] EWHC 280 (Comm); [2010] 1 Lloyd's Rep 509.

¹³³ [1999] QB 674.

¹³⁴ [2011] EWCA Civ 24; [2011] 1 Lloyd's Rep 630, at [74].

(although this might have once been the case under the Ransom Act 1782, which has long been repealed). Another fallacy inherent in the insurers' submission is the fact that in the present case, we are not concerned with the consequence of a failure to pay a ransom demand. In fact, the ransom payment had already been negotiated and made by the shipowners, making it irrelevant, at least for the assured of the cargo, to consider how he could avert or minimise the loss under s 78(4) of the MIA 1906. Accordingly, the public policy defence, which was dressed up as matter relating to the assured's duty to minimise or avoid loss, was appropriately rejected.

7-67 The discussion so far has concentrated on the legality of ransom payments from the perspective of English law, under the assumption that it is the law applicable to the contract.¹³⁵ Difficult conflict of law questions may arise if payment of a ransom constitutes an offence under other legal regimes that are closely connected to the contract (i.e. under the legal regime where the insured property is detained). It is evident that the court will not give its blessing to an action that is illegal at its place of performance due to public policy considerations.¹³⁶ However, in the context of Somalia, this does not seem to be a relevant consideration. A more difficult question arises if ransom payments constitute an offence under the law of another country which is closely associated with the property in question, such as the flag state country or the country where the owners of the property are resident.¹³⁷ The weight of authority is such that English courts would enforce agreements in cases where no issue of legality arises under the proper law of the contract and agreement was not made with the object of breaching the law of the place of performance.¹³⁸

(C) Double Insurance

7-68 Given the number of policies ship operators obtain in contemporary practice to protect themselves against various eventualities that can arise in the course of a marine adventure, the possibility of double insurance cannot be discounted. Double insurance occurs when the assured enters into two or more insurance contracts on the same subject, the same risk and the same interest.¹³⁹

7-69 In some cases, double insurance is purely coincidental as piracy might appear as an insured peril in different types of policy obtained from different markets. For instance, hull war-risk insurance written under the Norwegian Marine

¹³⁵ See Arts 8 and 10 of the Rome Convention on the Law Applicable to Contractual Obligations, as implemented in the UK by the Contracts (Applicable Law) Act 1990.

¹³⁶ *Regazzoni v Sethia* [1958] AC 301.

¹³⁷ On 13 April 2010, President Obama released Executive Order 13536, which makes a ransom payment unlawful when a US person knowingly pays it for the benefit of a Specially Designated National (SDN). The term 'US person' for the purposes of this Order means any US citizen, permanent resident alien, entity organised under the laws of the USA or any jurisdiction within the USA (including foreign branches), or any person in the USA. The SDN list is frequently updated and as such seems exhaustive. This does not mean that all ransom payments are deemed illegal under US law, but the matter gets very complicated when under an insurance policy obtained from the London market, a ransom payment is made by an English insurer to secure the release of a vessel owned by a US person, especially if the payment is made to a SDN.

¹³⁸ *Kahler v Midland Bank* [1950] AC 24 (HL). See also, *Kleinworth v Ungarische Baumwolle Industries AG* [1939] 2 KB 678.

¹³⁹ The law does not prohibit double insurances unless it has been made fraudulently. However, the assured is not entitled to receive any sum in excess of the loss he suffers (MIA 1906, s 32(2)(a)).

Insurance Plan 1996 provides cover against ‘piracy’. This means that in cases where the assured obtains hull policy against marine risks from the London market incorporating standard hull clauses and hull war-risk insurance from the Norwegian market, he will have double insurance unless piracy is excluded from one of the policies. However, double insurance could also occur as a result of the owners’ tendency to purchase policies against kidnap and ransom (K&R).¹⁴⁰ Although this is, relatively speaking, a new insurance product, there are reports suggesting that the K&R insurance sector has grown significantly over the last few years. A significant feature of the K&R insurance cover is assistance by crisis response teams helping with investigations, negotiations and delivery of the funds. Despite claims made by some British underwriters that many international corporations are their clients, there is not much data in relation to the size of the market. It is also not known how common this type of insurance is amongst ship-owners. However, if a ship-owner obtains this type of specialist cover even though ‘piracy’ appears as an insured risk in his marine or war policy, the issue of double insurance will inevitably arise where he makes a ransom payment to ensure the release of his ship.

7-70 In case of double insurance, the issue of contribution amongst the underwriters might arise. By virtue of s 80(2) of the MIA 1906, if any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution from other insurers. Practical and legal difficulties can be expected if insurers are from different jurisdictions. Furthermore, legal difficulties are inevitable in a case where the assured chooses to approach one of the underwriters for the full indemnity while failing to satisfy a procedural requirement under the agreement, with the second underwriter believing that following the procedure is pointless from his perspective. In that case, the second underwriter can attempt to resist a claim for contribution from the first underwriter on the ground that breach of the procedural requirement means that he could not now be called upon to pay the assured so there is no liability to a common demand. This potential problem seems to have been avoided as a result of the judicial stand taken, which confirms that the right of contribution in the case of double insurance is accrued at the time of the loss and is not affected by procedural breaches on the part of the assured.¹⁴¹

III BARRATRY

(1) Definition and Scope of the Peril

7-71 Barratry has traditionally been an insured risk in marine policies.¹⁴² Rule 11 of the Rules of Construction defines barratry as ‘every wrongful act wilfully

¹⁴⁰ The future of this insurance sector would have been in serious doubt, had payment of ransom been treated as against public policy. The K&R insurers could breathe a sigh of relief following the decision of the Court of Appeal in *The Bunga Melati Dua* [2010] EWHC 280 (Comm); [2010] 1 Lloyd’s Rep 509.

¹⁴¹ See the Court of Appeal’s majority judgment in *Legal & General Assurance Society Ltd v Drake Insurance Co Ltd* [1992] QB 887. See also, *O’Kane v Jones (Martin P)* [2003] EWHC 3470 (Comm); [2004] 1 Lloyd’s Rep 389.

¹⁴² Sceptical views have been occasionally expressed by judges as to why coverage should be afforded

committed by the master or crew to the prejudice of the owner, or, as the case may be, the charterer'.¹⁴³ The first point which needs to be clarified at the outset is the degree of culpability required on the part of the master and/or crew. Where the act of alleged barratry is in itself criminal, it is not necessary to demonstrate that the master or crew acted with a fraudulent intent to injure the owners. In that case, the law assumes that the required degree of culpability exists essentially because the crew's contractual duties to the ship-owner include a duty to obey the law. This type of barratry is commonly associated with smuggling carried out by the master or crew without the knowledge of the assured; but in certain circumstances the actions of the master or crew can lead to the seizure of the vessel, particularly if the insured vessel is used in illegal trading or leaves a port in breach of an embargo.¹⁴⁴ Similarly, sailing out of a port without paying port dues, whereby the ship and goods are subjected to forfeiture, is an act of barratry.¹⁴⁵ It should be stressed that in cases where the acts of the master or crew are criminal, it is immaterial whether their motive was to protect the interest of the assured. The act will be treated as barratry if it ultimately operates against the interests of the assured. This was the case in *Earle v Rowcroft*,¹⁴⁶ where the vessel was insured for a slaving voyage from Liverpool to the African coast, there to stay and trade, and proceeding thence to a port of sale in the West Indies. The master, failing to find a good market for trading on the African coast, entered D'Elmina, a Dutch port, fully aware that it was illegal for him to enter that port as England was at war with Holland. His objective for entering D'Elmina was to further the assured's interest by exchanging his cargo for slaves cheaply and expeditiously. In consequence of entering a Dutch port, the insured vessel was later seized by a British cruiser and condemned. Lord Ellenborough had no hesitation in holding that this was a loss by barratry.

7-72 However, it gets more complicated in cases where the crew and/or master, who commits a barratrous act, has no capacity in criminal law to be accountable for his actions. Let us assume an extreme case where a crew member, acting under the pressure of mental illness, murders the rest of the crew and the master and then sinks the insured vessel. In that case, if the crew member can rely on the defence of insanity if he were to be charged with a criminal offence, this should have an impact on determining whether or not a barratrous act for the purposes of insurance law

for this peril in marine policies. Lord Ellenborough CJ in *Earle v Rowcroft* (1806) 8 East 126, at 134, observed:

It is extraordinary that this species of loss, occasioned by the misconduct of the master, selected and appointed as he is by the owners themselves, and liable to be dismissed by them only, should ever been made the subject of insurance: and it is the more so, as it has an impolitic tendency to enable the master and owners, by a fraudulent and secret contrivance and understanding between themselves, to throw the ill success of an illegal adventure, of which the benefit, if successful, would have belonged solely to themselves, upon the underwriters.

¹⁴³ Before the enactment of the MIA 1906, barratry has been defined by Willes J in *Lockyer v Offley* (1786) 1 TR 252 as: 'every species of fraud or knavery in the Master by which the freighters or owners are injured'.

¹⁴⁴ *Robertson v Ewer* (1788) 1 TR 127.

¹⁴⁵ *Knight v Cambridge* (1724), cited (1743) 2 Str 1173.

¹⁴⁶ (1806) 8 East 126.

has been committed. It is submitted that an action that has no consequences from the perspective of criminal law could not amount to barratry, as it cannot be sustained that the person in question had intended to commit the action against the interests of the owners.¹⁴⁷

7-73 Conversely, where the act is not, on the face of it, criminal, to judge it as barratrous it is essential to establish that the master or crew acted fraudulently, either with the intention of acquiring a personal benefit or injuring the owner. Undoubtedly, if the question of barratry turns merely upon fraud, then the subjective motive of the master or crew will be relevant. The standard of proof required here would be a civil standard of proof. Accordingly, if the vessel is seized for breach of an embargo as a result of the master deviating from the normal route, the act of deviation will not amount to barratry even though the master is judged to be acting in ignorance or even grossly negligent.¹⁴⁸ In similar fashion, there is no barratry in cases where the insured vessel is driven into a blockade zone against the will of her master by force of weather where she is seized.¹⁴⁹ However, deviation will amount to barratry in cases where it is undertaken by the crew to collect goods for smuggling purposes on their account¹⁵⁰ or to deliver a passenger under a private agreement unknown to the owners.¹⁵¹

7-74 The second significant aspect in the definition of this peril is against whom barratry can be committed. The party whose interest is targeted by the barratrous act is essentially the owner of the vessel or the charterer as long as he acquires such an interest in the vessel under the terms of the charterparty.¹⁵² If the master is also part-owner, there is precedent to the effect that his acts can be regarded as barratrous against his co-owners and, equally, against the mortgagee of his interest in the ship.¹⁵³ Accordingly, the cause of loss was held to be barratry of the master in *Jones v Nicholson*¹⁵⁴ where the master, who was a part owner of the insured vessel, sold the ship and cargo and appropriated the proceeds to his own use. Naturally, there is no act of barratry if the assured is complicit. Put another way, the acts of the master or crew would not rank as barratry if they are sanctioned or authorised by her owners.¹⁵⁵

¹⁴⁷ Support for this could be drawn from an American case, *Isbell Enterprises v Citizens Casualty Co of NY* 303 F Supp 549 (1969). In that case, the view was expressed that the assured could not recover the loss caused by the actions of a mentally ill crew member on the count of barratry, but could instead recover his loss under the general clause as the action was similar to barratry. The observations were *obiter* as the US District Court SD Texas held that on the facts, insanity in the criminal law sense was not established.

¹⁴⁸ *Rhyn v Royal Exchange Assurance Co* (1789) 7 TR 565.

¹⁴⁹ *Everth v Hannam* (1815) 6 Taunt 375.

¹⁵⁰ *Vallejo v Wheeler* [1774] 1 Cowp 143.

¹⁵¹ *Mentz, Decker & Co v Maritime Insurance Co Ltd* [1910] 1 KB 132.

¹⁵² In contemporary practice, demise (bareboat) charterparties make the charterer temporary owner of the ship.

¹⁵³ *Small v United Kingdom Marine Mutual Insurance Co Association* [1897] 2 QB 311.

¹⁵⁴ (1854) 10 Ex 28.

¹⁵⁵ This was clearly expressed by Lord Mansfield in *Nutt v Bourdieu* (1786) 1 TR 323 in the following manner: 'Barratry is something to the contrary to the duty of the master and mariners in relation in which they stand to the owners of the ship. An owner cannot commit barratry; he may make himself liable by his fraudulent conduct to the owner of the goods, but not as for barratry; and besides barratry cannot be committed as against the owner with his consent.'

(2) Barratry in Contemporary Marine Policies and Burden of Proof Issues

7-75 In contemporary insurance practice, a cargo owner can recover under the Institute Cargo Clauses (A) for loss of or damage caused by a barratrous act of the master or crew, even where the owner of the ship is complicit, since the cover is not confined to a list of specific perils including barratry and no relevant exclusion exists. However, no coverage has been provided against barratry in Institute Cargo Clauses (B) and (C).

7-76 Standard hull policies identify barratry as an insured peril under the Inchmaree clause.¹⁵⁶ Considering that barratry was a traditional marine peril under the SG Policy, it is evident that the change in its status is not the result of a coincidence. In fact, it can be viewed as a reaction of the market to the increased use of cheap crew agencies in the 1970s by ship-owners, which resulted in the appointment of crew members without checking their previous records.¹⁵⁷ The change means that barratry is now made subject to the due diligence proviso, and thus cover for barratry is available only if the loss or damage has ‘not resulted from want of due diligence by the Assured, Owners, Managers’.¹⁵⁸

7-77 The precise legal impact of this change has not yet been aired by the courts. However, given the practical reasons behind the change, it would not be improper to suggest that the proviso is most likely to apply to decisions and inquiries made by the assured or his agents at the manning stage of the vessel.¹⁵⁹ Taking this to its natural conclusion, the assured will not be able to recover for a loss caused by the barratrous act of the crew in cases where the relevant crew had a record of similar conduct in the past which should have alerted the assured or his agents at the appointment stage that he could be involved in a similar misconduct.

7-78 Even if one subscribes to the restricted view as to the scope of the due diligence proviso, a question still remains unanswered. It is not clear which party has to bear the burden of proof of the requirement of the proviso that the ‘loss or damage has not resulted from the want of due diligence by the Assured, Owners or Managers’. If the proviso is seen as providing an exclusion from the cover, naturally the burden of proof should fall on the underwriters. Conversely, if the proviso is regarded as part of the definition of barratry, the onus will fall on the assured to demonstrate that the loss on the balance of probabilities did not result from the

¹⁵⁶ See e.g., cl 6.2.5 of the Institute Time Clauses – Hulls (1/10/83) and cl 2.2.5 of the International Hull Clauses (1/11/03).

¹⁵⁷ See *Piermay Shipping Co SA v Chester (The Michael)* [1979] 2 Lloyd’s Rep 55 in which the assured managed to recover for the loss of the insured ship that had been scuttled by one of her engineers who had been accused of scuttling another vessel previously.

¹⁵⁸ In the 1995 version of the clauses, the range of persons whose lack of due diligence would provide a defence was extended to include superintendents and onshore management. This was a controversial move which did not survive the most recent version of the hull clauses. It has recently been confirmed by the Court of Appeal in *Sealion Shipping Ltd Toisa Horizon Inc v Valiant Insurance Co (The Toisa Pisces)* [2012] EWCA 1625; [2013] 1 Lloyd’s Rep 108 that it is not the higher threshold of recklessness that is required on the part of the assured, his managers or owners to contravene the due diligence proviso in this context. Therefore, the assured will not be able to recover under the policy if the loss stipulated in the Inchmaree clause results from his (or his manager’s) negligence.

¹⁵⁹ This seems to be the meaning attributed to the Inchmaree clause in the USA.

failure of due diligence on the part of any relevant person. The proviso seems to be an addition to the Inchmaree clause, which provides cover for a range of risks including barratry; there is no indication that the draftsman intended to modify the traditional meaning of these perils. If modifying the meaning of these perils was an intended outcome, this should have been done with a clear wording. As this is not the case here, there is room to argue that the clause should be construed *contra proferentem* and, accordingly, treated as an exclusion clause, leaving the onus of proof on the shoulders of the underwriter.¹⁶⁰

7-79 Leaving the due diligence proviso aside, the issue of the burden of proof in barratry cases creates further controversy and ambiguity. It is beyond doubt that the initial burden is on the assured to demonstrate that the loss was occasioned from the criminal or fraudulent conduct of the master or crew.¹⁶¹ However, as barratry requires the absence of complicity on the part of the assured, an interesting question arises as to who bears the burden of proof in respect of demonstrating the complicity or otherwise of the assured. Stated otherwise, would the assured be expected to adduce evidence that the conduct was carried out without any knowledge or occurrence on his part, or is the burden on the shoulders of the underwriter to prove that the assured was complicit? Contradictory judicial views have been expressed on the matter, but it is fair to say that the weight of authority lends support to the latter view.¹⁶² A contrary solution would require the assured to prove the negative, that is to say lack of his complicity, so as to bring himself under the cover in a case where it is evident that damage is done on his property by his master or crew against his interest. Proving the negative is rather difficult and it can be contemplated only if there is clearly an indication in the case law to the effect that ‘lack of complicity on the part of the assured’ has been made an essential element of a claim for barratry. There is no case law supporting this approach. Furthermore, as the effect of alleging the complicity of the assured is to implicate him in criminal behaviour, *albeit* in a civil context, it is only fair that the assured benefits from the presumption of innocence and that the underwriter is put under the burden of demonstrating the assured’s complicity.

7-80 It is fair to say that, in the absence of a judicial intervention from the Supreme Court, it is trite law that in barratry cases when the loss is caused by the criminal or wrongful acts of the crew, the onus of proving absence of consent or connivance of the owner rests on the insurers. The current legal position has recently been summarised by Colman J, in *The Grecia Express*:¹⁶³

¹⁶⁰ However, note that in *The Brentwood* (1971) 23 DLR (3d) 226 (Supreme Court of British Columbia) a different outcome was advocated although no basis for it was articulated. There, a claim under the Inchmaree clause for loss caused by negligent loading on the part of the master was unsuccessful because the assured failed to provide adequate loading instructions regarding the stability of the vessel.

¹⁶¹ *Compania Naviera Martiaru v Royal Exchange Assurance Corp* [1923] 1 KB 650. More recently, *Strive Shipping Corp v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Grecia Express)* [2002] EWHC 203 (Comm); [2002] Lloyd’s Rep IR 669.

¹⁶² See in particular, the Court of Appeal’s decision in *Issaias (Elfie A) v Marine Insurance Co Ltd* (1923) 15 LIL Rep 186. See also, *Houghton (RA) & Mancon Ltd v Sunderland Marine Mutual Insurance Co Ltd (The Ny-Eeasteyr)* [1988] 1 Lloyd’s Rep 60. Cf *Michalos v Prudential Assurance Co Ltd (The Zinovia)* [1984] 2 Lloyd’s Rep 264, at 272, per Bingham J.

¹⁶³ [2002] EWHC 203 (Comm); [2002] 2 Lloyd’s Rep 88, at 97.

... as the law now stands, where it is proved that there has been a deliberate sinking by the master or crew, the hull and machinery underwriters will be liable for a loss by barratry, since it is presumed that the sinking was both wrongful and to the prejudice of the owner or charterer, unless the underwriters prove that the loss was 'attributable to the wilful misconduct' of the assured within s. 55(2)(a) of the Marine Insurance Act.

(3) Relationship between Barratry and Other Perils

7-81 The insured vessel might face seizure, arrest or detainment by authorities in cases where the misconduct of the master and crew is criminal in nature (e.g. smuggling). In such a case, it is very likely that in the light of the modern approach to proximity of causation, a peril excluded from marine coverage, such as seizure, arrest or detainment, can be viewed at least as one of the proximate causes. This was, in fact, the case in *Cory & Sons v Burr*.¹⁶⁴ There, the master had hovered off the Spanish coast, proceeding at 'dead slow' in order to rendezvous with another vessel to which he wished to transfer tobacco for smuggling ashore. While he was so proceeding, his ship was hailed and boarded by Spanish revenue officers, who discovered the contraband tobacco and seized the ship. The assured sought to recover expenses incurred in obtaining the release of the vessel. The policy provided cover for marine risks, including barratry, but also contained an FC & S clause excluding losses caused by seizure. The majority of the House of Lords regarded 'seizure' as the cause of loss, whilst Lord Blackburn held that both barratry and seizure were proximate causes.¹⁶⁵

7-82 By placing reliance on these authorities, it has been suggested that in cases where barratry leads to capture or seizure (a peril normally excluded from marine policies), the proximate cause doctrine is applied in a less stringent manner and there will be no recovery under a marine policy even if barratry is listed as an insured peril.¹⁶⁶ It is submitted that the cases in question do not lend support to such a general principle of law. The majority's finding in *Cory v Burr* on seizure being the only proximate cause of loss could be explained with the fact that at the time of the judgment the proximate cause doctrine had not been settled and the last-in-time doctrine was in predominant use.¹⁶⁷ Subscribing to that doctrine of causation, it is understandable why seizure, as being the last in the chain, was viewed as the proximate cause of loss. In the light of the House of Lords' decision

¹⁶⁴ (1883) 8 App Cas 393.

¹⁶⁵ See the decision of the Court of Appeal in *Panamanian Oriental SS Corp v Wright* [1971] 2 All ER 1028 to the same effect.

¹⁶⁶ See O'May, D and Hill, J, *O'May on Marine Insurance* (1993, Sweet & Maxwell), p 155. One author goes further to suggest that the courts have, in fact, redefined barratry through manipulating the language of proximate causation, see Pitts, GP, 'Barratry as A Covered Risk in Marine Insurance: Problems & Perspectives' (1983) *Journal of Maritime Law and Commerce* 131, at 134.

¹⁶⁷ This doctrine had been endorsed by the Court of Appeal in *Pink v Fleming* (1890) 25 QBD 396. There, following a collision the insured cargo of fruit was discharged into the lighters in order to effect repairs to the vessel. The goods were reshipped after the repairs were carried out and the vessel continued to her port of destination. Upon arrival, it was discovered that some of the fruit had gone bad as a result of poor handling and delay. The proximate cause of loss was deemed to be delay. Lord Esher MR, at 398, said: 'According to the English law of marine insurance only the last cause can be regarded . . . To connect the loss with any mentioned in the policy, the plaintiffs must go back two steps and that, according to English law, they are not entitled to do.'

in *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd*¹⁶⁸ and more recent developments, it is very likely that both barratry and seizure will be treated as proximate causes of the loss.¹⁶⁹ It is worth noting that the outcome would have been the same on the facts case, as the policy in question contained an FC & S clause excluding seizure from cover; in a case where the cause of loss is attributable to a peril expressly excluded from cover, no recovery is possible even if the other proximate cause of loss is expressly insured against.¹⁷⁰ The current state of law has been succinctly summarised by Chief Judge Thomsen in *The Hai Hsuane*:¹⁷¹

I conclude that where barratry is one of the causes of the loss, if the ultimate cause (such as stranding or capture) is not excluded from coverage by a warranty or an exclusion clause, recovery may be had on the grounds of barratry, whether or not the ultimate cause of loss was or was not a peril insured against . . . But where the ultimate cause of the loss is excluded from coverage by a warranty or an exclusion clause, recovery may not be had on the grounds of barratry.

7-83 Conscious of this potential overlap, standard marine clauses on hulls, whilst listing the perils excluded from cover, such as capture, seizure, arrest, restrain or detainment, expressly indicate that ‘barratry is exempted’.¹⁷² The effect of this qualification is to enable the assured to recover for his loss caused by barratry even though such an act can result in the capture, seizure, arrest, restrain or detainment of the insured vessel, as long as, of course, barratry is regarded as one of the proximate causes of the loss.

7-84 Another potential overlap with a peril excluded from marine coverage could arise in cases where the barratrous act of the master or crew is treated as an act committed by malicious persons. In standard marine policies on hulls, ‘loss, damage, liability or expense arising from the use of any weapon or the detonation of an explosive by any person acting maliciously’ is excluded.¹⁷³ It is plausible, therefore, to argue that in a case where a barratrous act qualifies as malicious, the resulting loss should be excluded from the marine coverage and fall instead with the war-risks cover. There is no doubt that demarcation problems might arise between marine and war-risk policies in such a case. However, one feels that under the modern proximate cause test, it is possible to view ‘barratry’ as the proximate cause of a loss in a case where the master employs a weapon or an explosive to destroy the insured vessel to the prejudice of the assured. There is room to argue that regardless of the device used to achieve the result, the reason for loss is the decision of the master to destroy the vessel in order to harm the owner.

7-85 Last, but not least, one needs to consider the impact of the reports alleging

¹⁶⁸ [1918] AC 350.

¹⁶⁹ It is now settled that in search of proximate cause courts must identify the ‘efficient’ and ‘pre-dominant’ cause. Disregarding the last-in-time approach means that it is now open to courts to identify two or more causes as proximate causes of the loss; see e.g., *ff Lloyd Instruments Ltd v Northern Star Insurance Co Ltd (The Miss Jay Jay)* [1987] 1 Lloyd’s Rep 32.

¹⁷⁰ See *Board of Trade v Hain SS Co Ltd* [1929] AC 554.

¹⁷¹ [1957] 1 Lloyd’s Rep 428, at 443 (District Court of Maryland, USA).

¹⁷² See e.g., cl 23.2 of the Institute Time Clauses – Hulls (1/10/83) and cl 29.2 of the International Hull Clauses (01/11/03).

¹⁷³ See cl 25 of the Institute Time Clauses – Hulls (1/10/83) and cl 30.3 of the International Hull Clauses (01/11/03).

that in some instances the pirates obtain the co-ordinates of the ship they attack through the crew. Assuming that the crew engaged in such a conspiracy against the owner in pursuit of a financial gain and the vessel is ultimately taken away by pirates, identifying the cause of loss might pose a challenging task. It is submitted that, in such a case, barratry should be regarded at least as a proximate cause of the loss.¹⁷⁴ If that proves to be the correct analysis, the assured can recover under a standard hull marine policy, as both of these perils are insured against. There will still be cover in a case where the barratry is an insured peril whilst piracy is not. It is an established insurance law principle that in cases where there are two proximate causes of the loss of equal, or nearly equal, efficiency, indemnity is available where one of the causes comes within the terms of the policy and the other is not expressly excluded.¹⁷⁵

IV SCUTTLING FRAUDS

7-86 Under this heading, the position of cargo interest who is not associated with scuttling of the vessel carrying his cargo will be considered. Experts stipulate that on rare occasions owners who instruct their crew to have their vessels scuttled during the course of the voyage at the same time make the cargo interests aware of their intention.¹⁷⁶ Advance knowledge gives cargo interests an opportunity to defraud their insurers by obtaining an overvalued insurance policy for the goods or by arranging their cargo to be landed secretly before scuttling. If the insurer could establish that the cargo interest has been somehow complicit in the act of scuttling, this will enable the insurer to rely on remedies considered in previous chapters (i.e. avoidance of the insurance contract for pre-contractual misrepresentation, non-disclosure¹⁷⁷ or denial of claim for fraud).¹⁷⁸

7-87 However, the legal position of the cargo interest whose cargo is lost as a result of scuttling of the carrying vessel by the owners or other third parties acting towards their own ends, depends entirely on the coverage provided by the policy (i.e. whether or not the cause of loss is specifically insured against). Under the old SG Policy, before the introduction of the Institute Cargo Clauses in 1980, in case of a loss caused by scuttling, recovery would be possible only if the loss could be attributed to a peril listed in the SG Policy rather than scuttling itself. The celebrated case of *Shell International Petroleum Co Ltd v Caryl Antony Vaughan Gibbs (The Salem)*¹⁷⁹ provides a striking illustration of the matter.

7-88 The extraordinary facts of this case are as follows. In November 1979, the fraudsters by using a company they control, the American Polomax International (API), agreed to sell about 1.5 million barrels of Saudi Arabian light crude oil or

¹⁷⁴ There is ample amount of case law pointing towards this direction. See in particular, *Elton v Brogden* (1747) 2 Str 1264; *Toulmin v Inglis* (1808) 1 Camp 421 and *Hucks v Thornton* (1815) Holt 29.

¹⁷⁵ See the reasoning of the Court of Appeal in *Jiff Lloyd Instruments v Northern Star Insurance Co (The Miss Jay Jay)* [1987] 1 Lloyd's Rep 32.

¹⁷⁶ See Ellen, E and Campbell, D, *International Maritime Fraud* (1981, Sweet & Maxwell), pp 29–30.

¹⁷⁷ See Chapter 2.

¹⁷⁸ See Chapter 3.

¹⁷⁹ [1982] 1 All ER 225; [1982] QB 946 (CA) and [1983] 2 AC 375 (HL).

equivalent crude oil to the South African Strategic Fuel Fund (SFF) for US\$50 million to be delivered to Durban in December 1979. It was also agreed that payment was to be made by letter of credit and it was a condition of the sale that finance should be arranged for the purchase of a suitably situated tanker. To this end, the SFF paid fraudsters US\$12.3 million in advance on account of the US\$50 million they would have to pay for the oil when it arrived at Durban.

7-89 The fraudsters acquired the vessel, *The South Sun*, a super-tanker of 200,000 tonnes deadweight and had her re-registered as *The Salem* on 3 December 1979 in the name of Oxford Shipping Co Inc, a Liberian company controlled by fraudsters. They then offered her on the market for a voyage to carry crude oil from the Persian Gulf to the usual European and Caribbean discharge options. The offer was taken up by a very respectable company, Pontoil SA of Lausanne, which had nothing to do with the crooks and was absolutely innocent of any wrongdoing. Pontoil had already made a contract with a very respectable Kuwait Oil Co to buy about 200,000 tonnes of oil Free on Board (FOB) Kuwait. To carry out this contract of purchase, Pontoil chartered *The Salem* for a voyage from Kuwait to Europe. She was to go to Kuwait, load the oil and proceed via the Cape to Europe. The freight was to be paid to Swiss banks in favour of a company called Shipomex SA in Switzerland. This company was also fraudulent but had an accommodation address in Zurich.

7-90 Having been directed to Kuwait by the charterers, *The Salem* arrived at the port of loading in Mina al Ahmadi where a new crew, consisting of Greek officers and Tunisian crewmen, were put on board. They were the crooks' men. The Kuwait Oil Co, in complete innocence, loaded 195,000 tonnes of oil onto *The Salem* to be carried to Italy. The master issued bills of lading for 195,000 tonnes to be delivered to Italy to the order of Pontoil SA, Lausanne. In the meantime, Pontoil obtained insurance cover for the cargo from the defendant and fellow underwriters. In the policy, which was based on the Lloyd's SG Policy together with the Institute Cargo Clauses (Free of Particular Average (FPA)) and the Institute Strikes, Riots and Civil Commotions Clauses, the voyage was described as one from Mina al Ahmadi to Italy. Some of the perils insured against were perils of the seas, takings at sea, barratry of the master and mariners and loss or damage caused by persons acting maliciously.

7-91 Soon after *The Salem* sailed, Pontoil sold the cargo to Shell on Cost Insurance Freight (CIF) terms. Thus, Shell became the owners of the oil and the assignee of the insurance policy. *The Salem* went straight down the coast of Africa to Durban where she discharged 180,000 tonnes of oil in accordance with the sale contract between API and SFF. During the course of the journey, the vessel changed her name from *The Salem* to *The Lema*. The South African importers paid for the oil through their bank into numbered accounts in Switzerland belonging to the fraudsters. The vessel sailed from Durban on 2 January 1980 with about 15,840 tonnes of crude oil still on board. The tanks were filled with seawater to give the impression as if she had still a full cargo of oil. In a calm sea off Dekar and Senegal, the vessel was deliberately flooded and abandoned by her master and crew acting upon the instructions of the fraudsters.

7-92 Underwriters denied liability when Shell claimed under the policy. At first

instance, subscribing to the stance adopted in *The Mandarin Star*¹⁸⁰ to the effect that ‘takings at sea’ included the risk of a ship-owner misappropriating the goods, Mustill J found for the assured. Lord Denning MR’s admission that he had erred in his understanding of earlier cases in *The Mandarin Star* removed a significant hurdle from the path of the Court of Appeal,¹⁸¹ which reached the conclusion that the cargo was lost in two batches. The first batch of 180,000 tonnes was lost at Mina al Admadi or Durban and the remainder of 15,840 tonnes when the ship was scuttled off Dekar. On that premise, it was held that the loss of 180,000 tonnes was not covered by the policy. There had been no ‘takings at sea’ as the loss occurred in port, either at Mina al Ahmadi during loading or at Durban during discharge.¹⁸² It was also common ground that there was no ‘theft’ as the property was already in the possession of the fraudsters therefore, no violence had to be used to misappropriate the cargo. Conversely, the assured was allowed recovery in respect of 15,840 tonnes of oil, which went down with the vessel following scuttling, as this loss was held to be attributable to ‘perils of the sea’ which was an insured risk under the policy. At first sight, the outcome might come as a bit of surprise given that ‘fraud’ or ‘fraudulent conspiracy’ are also serious contenders to be at least a proximate cause of the loss in this case. However, taking the reasoning of the Court of Appeal that the loss for this batch of cargo took place at a later date at sea to its natural conclusion, it makes sense to perceive scuttling, which was motivated by the intention of concealing the fraudulent act of selling a huge part of the assured’s cargo at Durban, to be the proximate cause of the loss. There is commanding authority to the effect that the scuttling of a ship by the owner is not a peril of the sea in the context of hull insurance.¹⁸³ This is not at odds with the finding here. The reason why, in that case, scuttling cannot be viewed as a ‘peril of the sea’ is that the loss is not the result of any fortuity. However, for a cargo owner who places his goods on board a vessel, scuttling of the carrying vessel by the owner or his crew, for whatever reason, amounts to a fortuitous casualty occurring at sea.¹⁸⁴ It is also worth mentioning that both the Court of Appeal and the House of Lords reached the conclusion that scuttling could not be regarded as ‘barratry’ as it would be contrary to the very essence of the

¹⁸⁰ [1969] 2 QB 449; [1969] 1 Lloyd’s Rep 293.

¹⁸¹ The decision of the Court of Appeal in *The Mandarin Star* was later overruled by the House of Lords [1983] 2 AC 375.

¹⁸² Kerr LJ, *ibid*, at 990–1, offered another explanation as to why the peril of ‘takings at sea’ could not be extended to cover the ship-owner’s wrongful actions against the cargo owners. He said:

... there is another and more fundamental reason why I do not think that ‘takings at sea’ could ever have comprised a ‘taking’ by the shipowners as against the cargo owners, ... but which is bedevilled by the confusing fact that the wording of the SG policy (which evidently originally meant ‘ship and goods’) is used for hull and cargo insurance alike. This is that the policy was never intended to insure any of the three possible parties to the marine adventure, i.e., ship, cargo and freight, against wrongful action by any of them against any other party to the adventure, but only against action by outsiders to the prejudice of the parties’ common interest in the adventure. Thus, the cover against ‘thieves’ can only apply to what have become known as ‘assailing thieves’; this was recognised by the plaintiffs in the present case when they accepted that they could not rely on this cover, which would otherwise have precluded any answer to their claim, since this cargo of oil was clearly stolen by the shipowners. This is also the reason why there is a need for separate cover against ‘theft and/or pilferage’ in many cargo policies ...

¹⁸³ *P Samuel & Co Ltd v Dumas* [1924] AC 431.

¹⁸⁴ The Court of Appeal’s decision on this point was affirmed later by the House of Lords [1983] 2 AC 375.

peril to conclude that it can be committed by a ship-owner against the interest of the cargo owners.¹⁸⁵

7-93 Fortunately, the legal position of the assured is more certain following the introduction of standard Institute Cargo Clauses. If the cargo insured by using Institute Cargo Clauses (A)¹⁸⁶ is lost as a result of scuttling, the assured is likely to recover from the underwriters given that such a policy provides cover against all risks and scuttling is not a peril excluded from the policy. Similarly, the position is crystal clear when Institute Cargo Clauses (C) forms the basis of the cover. In that case, there will be no recovery as loss caused by scuttling is not a peril expressly insured against. Institute Cargo Clauses (B), however, provides cover against the risk of ‘entry of sea, lake water into vessel craft hold conveyance container liftvan or place of storage’.¹⁸⁷ Although the clause has yet to receive judicial airing, the common view is that it is an extension of the traditional risk of ‘perils of the seas’ to landward risks of river and lake water, to which a conveyance, container, or even place of storage may be exposed.¹⁸⁸ Given that the new clause puts the element of ‘fortuity’ at its heart, there is force in the argument that loss caused by scuttling should come under its ambit, as was the case in *The Salem*. Although there is mileage in this line of reasoning, there is another problem. Institute Cargo Clauses (B) and (C) contain an exclusion in cl 4.7 stipulating that no loss caused by ‘deliberate damage to or deliberate destruction of the subject-matter insured or any part thereof by the wrongful act of any person or persons’ will be recoverable under this insurance.¹⁸⁹ It is very likely that loss of cargo due to the ship being sunk by scuttling would be excluded from coverage by virtue of the deliberate damage exclusion.

V PHANTOM SHIP FRAUDS

(1) *Modus Operandi* and Current State of Play

7-94 Phantom ship fraud is an organised and sophisticated type of maritime fraud where a ship is used as an instrument of fraud to steal an entire shipload of cargo belonging to shipper or consignee. At its most basic level, phantom ship fraud works within a simple framework. After the fraudsters have received the order from a third party, which usually is not associated with the fraud, they scan the markets for a likely target. The ideal target will be a legitimate shipper of the targeted cargo, which may be having difficulty in finding a suitable vessel and may be close to the expiry time for his letter of credit. Such factors are significant, as shippers in those circumstances are pressed for time and might be prepared to enter into a contract of affreightment without reviewing the vessel’s documentation and background thoroughly. Vessels used by fraudsters are usually old SD-14 or tween-decked general

¹⁸⁵ [1982] QB 946, at 997, per Kerr LJ and [1983] 2 AC 375, at 391–2, per Lord Roskill.

¹⁸⁶ Both 1982 and 2009 versions.

¹⁸⁷ Clause 1.2.3 of both 1982 and 2009 versions although the word ‘liftvan’ does not appear in the 2009 version of the clauses.

¹⁸⁸ Dunt, J, *Marine Cargo Insurance* (2009, Informa), p 179.

¹⁸⁹ Institute Cargo Clauses (A) (both the 1982 and 2009 versions) do not contain a similar exclusion.

cargo ships, which can be bought from scrapyards for a few hundred thousand dollars. If things go according to plan, the fraudsters will earn their money's worth from a single voyage. Typically, the phantom ship will have arrived at anchor around the time that the shipper is urgently looking for a suitable contract of affreightment. The agent for the vessel, a bogus company established in a different jurisdiction, presents full documentation, class certificates and insurance coverage; in fact all the documents that you would expect from a good operator. In most cases, the freight rate is very competitive. After the loading of the cargo, payment of the advance freight and issue of bills of lading, the phantom vessel sails for her destination. To the prejudice of all legitimate parties involved, from shipper and receiver to cargo underwriter, the destination of the cargo is not what is stated on the bill of lading. To ensure that any attempt to trace the vessel remains unsuccessful, the phantom ship will probably change her identity once or twice during the voyage, accompanied by fresh documents to perpetuate the charade. It is also usual for the vessel to have been repainted either in part, or from stem to stern. To buy some time for the fraudsters, the cargo receiver will usually receive a communication from the agents for the vessel advising that the estimated time of arrival will slip two or three days. A regular trick is to state that the vessel has suffered some engine trouble and also has encountered heavy weather along the way. This will probably be the last time any communication is received regarding the vessel. Weeks will pass and the vessel will not arrive at the intended port of discharge. By the time the consignee and other legitimate parties become aware of the fraud, the fraudsters will have already sold the cargo to an innocent third party under a contract previously agreed. The phantom ship, depending on her state, is either scuttled or changes her name ready to be used in another venture.

7-95 In the 1980s and 1990s, phantom ship fraud was a regular occurrence in the Far East, usually around Indonesia, Malaysia, Thailand, the Philippines and China. There has been a considerable decline in the number of reported phantom ship frauds since the turn of the millennium, essentially because of various international developments. In 2002, the Assembly of the International Maritime Organisation (IMO) adopted a resolution urging governments to review their ship registration procedures to ensure that adequate safeguards were in place to prevent the registration of phantom ships.¹⁹⁰ There is anecdotal evidence to the effect that most ship registers now insist on seeing evidence that the previous registration of the ship has been deleted or consent from the previous register has been obtained before they will transfer the ship's registration. Similarly, several changes to the Safety of Life at Sea (SOLAS) Convention 1974 have been made in recent years with a view to enhancing maritime security. A new Chapter XI-1 to the Convention requires: (i) the installation of an Automatic Information System (AIS) in most vessels;¹⁹¹ and (ii) vessels to be marked with their IMO Identification number in a permanent manner.¹⁹² Although these measures were originally implemented to provide assistance in identifying, tracking and apprehending vessels that were the subject of

¹⁹⁰ Resolution A 923(22).

¹⁹¹ Regulation 19 of Chapter XI-1.

¹⁹² Regulation 3 of Chapter XI-1. The IMO ship identification number scheme was introduced in 1987 (Resolution A. 600(15)). Under the scheme, each ship is assigned a permanent number. This

hijacking or acts of piracy, it is evident that they also make it very difficult for crime syndicates to use any random ship in a phantom ship fraud.

7-96 However, it is premature to suggest that phantom ship fraud has been eliminated entirely from the shipping sector. Provisional registration in respect of a ship can still be obtained from some flag states with relative ease. Also, the revival of piracy not only in Somalia but in other parts of the world in recent years means that hijacked vessels could end up in the hands of organised crime syndicates to be used in other kinds of criminal activities, including phantom ship fraud. It should not be assumed that port security applies with the same intensity throughout the world. There are ports which take a rather relaxed view of maritime security and favourable treatment can be secured from the officers through bribery. Such ports provide fruitful hunting grounds for organised crime syndicates.

(2) Impact of Fraud on Cargo Policies

7-97 If the cargo is insured against all risks, the assured would understandably expect to be indemnified in a case where his cargo, put on board a phantom ship without his knowledge, disappears in a mysterious fashion. However, over the years underwriters have refused to bear the risk for such frauds and have relied on contractual defences to deny liability, on the premise that the impact of the fraud is such that they are expected to provide indemnity for a risk which is radically different than they once believed they were providing cover for. The truth of the matter is that judges in those cases are forced to make a choice between the owner of the cargo and underwriters, both of whom are innocent victims of the fraud perpetrated. Apart from policy considerations, the moral considerations must be taken into account when assessing where the loss should lie. The purpose of this section is to analyse the relevant principles enshrined in the MIA 1906, along with the reasoning of the judges when applying those principles; and also to discuss to what extent contractual provisions might be relevant in this context.

(A) Section 44 of the MIA 1906 – Does the Risk Attach at All?

7-98 As described above, phantom ship frauds operate in such a way that the cargo, which as far as the shipper, consigner and underwriter understand, sails for a destination stated in the bill of lading and insurance policy, in fact sails for a completely different destination chosen by fraudsters. This brings to mind the possible application of s 44 of the MIA 1906, which reads:

Where the destination is specified in the policy, and the ship, instead of sailing for that destination, sails for any other destination, the risk does not attach.

7-99 The possibility that this section might have a role to play in this context was first echoed in the *The Salem*¹⁹³ both by the first instance judge, Mustill J and several members of the Court of Appeal; even though the case, in the end, was decided

number remains unchanged upon transfer of the ship to other flag(s) and is inserted in the ship's certificates.

¹⁹³ [1982] 1 All ER 225; [1982] QB 946 (CA) and [1983] 2 AC 375 (HL).

on completely different grounds. The assignee, Shell, did not want to concede that the vessel sailed for Durban, otherwise they sensed that their claim for indemnity could have been defeated by s 44 of the MIA 1906. Similarly, the underwriters did not wish to rely on s 44 either, perhaps appreciating that a difficult question could arise on the meaning of ‘sailing for’ in the context of the purposes of this section; especially because the shippers and charterers intended the vessel to sail for Europe whilst the crew intended her to sail for Durban. Lord Denning, however, referring to s 44, took the opportunity to make the following observation:

... the parties made various concessions for tactical reasons. I am sorry they were made: for if they had not been made, I should have thought that the claim of Shell would have failed altogether: for the simple reason that the risk never attached.¹⁹⁴

7-100 In two more recent cases, however, the underwriters did not shy away from a defence built around s 44 of the MIA 1906 when they were presented with a claim under a cargo policy due to phantom ship fraud. Before embarking on an analysis of recent judicial developments, it is appropriate to provide a brief analysis of the origins and nature of this section of the MIA.

(B) Background and Function of s 44 of the MIA 1906

7-101 Most insurance policies contain express provisions, usually in the shape of warranties, to protect the insurer against the alteration of risk. In cases where, for example, a policy is warranted to cover the subject matter of a particular description and the subject matter has never met that description, the risk simply fails to attach and the policy is void.¹⁹⁵

7-102 Additionally, at common law, there might be instances where the cover is vitiated even in the absence of an express provision due to a substantial increase in the risk. This is likely to arise in cases where the alteration is such that the risk no longer corresponds with that defined in the policy. It fell to Lord Mansfield in *Woolridge v Boydell*¹⁹⁶ to lay down the legal foundations of this principle. There, a vessel was insured from Maryland to Cadiz. Having sailed from Maryland to Falmouth, she was captured in Chesapeake Bay. Underwriters denied liability on the ground that the risk never attached. Lord Mansfield concurred:¹⁹⁷

The policy, on the face of it, is from Maryland to Cadiz, and therefore purports to be a direct voyage to Cadiz . . . Here, was the voyage ever intended for Cadiz? There is not sufficient evidence of the design to go to Boston, for the Court to go upon. But some of the papers say to Falmouth and a market, some to Falmouth only. None mention Cadiz, nor was there any person in the ship, who ever heard any intention to go to that port . . . In short, that was never the voyage intended, and consequently is not what the underwriters meant to insure.

¹⁹⁴ [1982] QB 946, at 985. See also, the judgment of Kerr LJ, at 994. Similar remarks were also made by Mustill J in the first instance [1982] 1 All ER 225, at 232–3.

¹⁹⁵ In *New Castle Fire v Macmorran* (1815) 3 Dow 255, for example, the assured warranted that the insured building did not possess more than two feet of stoving; the fact that the building had more than that amount prevented the risk from attaching, and any dispute as to the significance of the deviation was rendered unnecessary by the fact that the description had been warranted. See also, *Watkinson & Co v Hullett* (1938) 61 LILR 145 and *Sillem v Thornton* (1854) 3 E & B 868 to the same effect.

¹⁹⁶ (1778) 1 Dougl 16.

¹⁹⁷ *Ibid*, at 17–18.

7-103 This principle has been further articulated on a number of occasions since the judgment of Lord Mansfield,¹⁹⁸ most notably by the Court of Appeal in *Simon Israel & Co v Sedgwick*¹⁹⁹ just a few years before the principles of marine insurance were codified by Lord Chalmers. In this case, the assured, merchants at Bradford, effected an insurance policy on merchandise exported. Although the goods were carried from Bradford to Liverpool by inland conveyance, the cover afforded by the policy was from Liverpool to Seville (west of Gibraltar) and thence to Madrid by rail. In fact, the vessel, on which the goods were loaded, did not intend to call at Seville, but to Carthage (east of Gibraltar). When the bill of lading came to hand it was discovered that the goods were due to be discharged at Carthage and then forwarded to Madrid by rail. The vessel was lost during the sea leg of the voyage and the assured claimed under the policy. Affirming the decision of the first instance judge, Wright J,²⁰⁰ the Court of Appeal held that the risk had never attached because the voyage to Carthage was not one of the voyages covered by the policy and accordingly, the underwriters were not liable.

7-104 There is no doubt that the origins of s 44 of the MIA 1906 could be traced to these authorities.²⁰¹ More precisely, this section could be seen as one of the specific attempts of the draftsman to protect the underwriters against unexpected alterations of the risk during the currency of a marine policy in the absence of any express provision.²⁰²

7-105 That being the case, it becomes necessary to consider the impact of s 44 on phantom ship frauds. As highlighted above, crew on board the phantom ship, who operate under the instructions of the fraudsters, after taking the goods into their possession, sail for a destination other than the one expressed in the carriage contract and insurance policy. In *The Salem*, the view was expressed to the effect that s 44 could come into operation in such a case. However, it should be borne in mind that the views expressed in *The Salem* were, strictly speaking, *obiter* and no lengthy discussions were carried out on this point. Furthermore, one could argue that there is some difficulty in reconciling this view with the terms of the

¹⁹⁸ *Way v Modigliani* (1787) 2 TR 30; *Sellar v McVicar* (1804) 1 B & P (NR) 22; *Spitta v Woodmans* (1810) 2 Taunt 416 and *Mellish v Allnut* (1813) 2 M & S 106.

¹⁹⁹ (1893) 1 QB 303.

²⁰⁰ (1892) 62 LTMS 352.

²⁰¹ Again the Privy Council in *Kallis (Manufacturers) Ltd v Success Insce* [1985] 2 Lloyd's Rep 8, at 11, proceeded on the premise that the principle that is encapsulated in s 44 of the Act stems from the decision of the Court of Appeal in *Simon Israel & Co v Sedgwick*. In that case, a quantity of denim was intended to be shipped from Hong Kong to Limassol, Cyprus. On the date the goods were alleged to have been loaded, they were still in the shipping agent's warehouse. In fact, they were shipped on another vessel to Keelung in Taiwan, where they remained for three months after being discharged, before being loaded on a further vessel for carriage to Cyprus. When that vessel caught fire, the denim was so damaged that it was regarded as total loss. However, the underwriters maintained that the insured venture was the carriage of goods from Hong Kong to Limassol on the named vessel and since the voyage never took place, the risk did not attach and, accordingly, the goods were not on risk when actually lost. Lord Roskill, delivering the judgment of the court, held that this was another situation where the goods had not been appropriated by a contract of carriage to the insured voyage. Therefore, their Lordships were of the opinion that it was impossible to assert that the risk had ever attached when the denim left the suppliers' warehouse in Hong Kong.

²⁰² Section 43 of the MIA 1906 intends to achieve a similar objective by stipulating that the risk does not attach in cases where the assured under a marine policy specifies the port of the vessel's departure but the vessel commences its voyage from another port.

warehouse-to-warehouse clause in standard Institute Cargo Clauses, which allows an extension to the marine cover so as to protect the assured against losses on any land risk which may be incidental to any sea voyage.²⁰³ It is difficult to comprehend how a policy, which is attached once the goods leave the warehouse, can later be unattached on sailing to a different destination.

7-106 It can plausibly be argued that s 44 should be confined to a policy ‘from’ a named port and is not applicable to an ‘at and from’ policy (i.e. a policy that provides cover ‘from warehouse to warehouse’). Tentative support for this contention can be drawn from the fact that, in none of the cases forming the basis of this section, was the impact of the warehouse-to-warehouse clause taken into account,²⁰⁴ pointing to the conclusion that the section was intended to be relevant only in cases where the cover attaches from a named port. It might, however, be very difficult to sustain this argument in the light of the fact that s 25 of the MIA 1906 defines a voyage policy as a policy which insures the subject matter ‘at and from’ or ‘from one place to another or others’. Clearly, the Act treats both types of voyage policies in the same manner; therefore, it is hard to justify why s 44, which intends to apply to all voyage policies, should only be applicable to a certain type of voyage policy, namely a policy from a named port.

7-107 However, it could equally be contended that there is nothing, either statutory or contractually, which prevents the application of s 44 to phantom ship frauds. Even though cover is extended to land risks in modern cargo policies by virtue of warehouse-to-warehouse clauses, the substance of the policy is the maritime risk; the character of the preliminary conveyance before the ship is reached must be determined by that of the voyage on which the goods are actually shipped and the goods must, until shipment, be taken to have started for the voyage for which they are afterwards, in fact, shipped.²⁰⁵ The effect of this would be that sailing for a destination other than the one specified in the policy would trigger s 44, and both the sea leg and the land leg incidental to the sea leg would fail. This argument pre-supposes that the land part of the voyage cannot have a life of its own and is dependent on the sea leg, which forms the main part of a marine policy. Support for this contention could be drawn from the fact that in marine policies where the risk is extended to cover land risks, such a risk is regarded as incidental to the sea voyage by s 2 of the MIA 1906. One should not lose sight of the fact that adopting this view would

²⁰³ See cl 8 of Institute Cargo Clauses (Type A, B and C) (1/1/82) which reads: ‘This insurance attaches from the time the goods leave the warehouse or place of storage at the place named herein for the commencement of the transit, continues during the ordinary course of transit and terminates . . .’

Clause 8 of the Institute Cargo Clauses (Type A, B and C) (1/1/09) also provides cover in a similar fashion.

²⁰⁴ The warehouse-to-warehouse clauses were not in use during the times of Lord Mansfield. *Simon Israel & Co v Sedgwick*, even though the policy contained a warehouse-to-warehouse clause, was decided on a completely different ground: that the insured goods were never specifically appropriated to the insured voyage because the person who had the control of the goods fixed the voyage outside the policy. Therefore, the goods were on a different voyage from the moment they left the warehouse in Liverpool. It was, in that case, not essential to evaluate the potential implications of the warehouse-to-warehouse clause on the policy. However, in phantom ship frauds, the goods are usually on the right voyage when leaving the warehouse, but the destination changes at a later stage upon the commencement of the sea leg.

²⁰⁵ *Simeon Israel & Co v Sedgwick* [1892] 62 LTMS 352, at 353–4.

pose a problem in cases where the goods are lost or stolen en route between the warehouse and the ship's rail. It is an interesting question whether such loss would be recoverable, especially if it is assumed that the land leg fails together with the sea leg upon sailing of the vessel to a different destination.²⁰⁶

(C) *Recent Judicial Developments*

7-108 At the turn of the millennium, the opportunity presented itself in two cases to offer the much-needed analysis on the subject at issue here. In *Nam Kwong Medicines & Health Products Co Ltd v China Insurance Co Ltd*,²⁰⁷ the Hong Kong High Court was drawn into the discussion on the impact of s 44 of the MIA 1906 in case of a loss caused as a result of a phantom ship fraud. There, the assured, Nam Kwong, obtained insurance cover from China Insurance Co Ltd on Institute Cargo Clauses (A) for 15,788 drums of refined, bleached and deodorised palm olein valued at US\$2,442,000. The cargo was bought from Pao Sang on CIF terms and was shipped on board the vessel *Pacifica* on 1 June 1998 at Pasir Gudang, Malaysia destined for Beihei, Guangxi China. The voyage to Beihei should have taken eight to ten days, but the *Pacifica* never arrived. Ship-to-shore cables purporting to be from the vessel were received indicating distress said to be caused by bad weather, culminating on 19 July 1998, when Guangxi Radio received a message indicating that the ship had been abandoned. It was the general feeling that *Pacifica* was a phantom ship. The defendant underwriters denied liability arguing, *inter alia*, that the risk never attached by virtue of s 44 of the MIA 1906. Stone J, harking back to *Simeon Israel v Sedgwick*, held in favour of the underwriters. He said:²⁰⁸

A voyage policy is no more than insurance on a particular risk. It is evident that if in actuality the voyage performed is not the voyage described in the policy, then equally clearly it is not the risk that the insurer has bargained to cover. In other words, the scope of the cover from shipment is defined by reference to the voyage so specified, and it is not easy to see why cl 8 of the ICC (A) should circumvent, or be regarded as circumventing, that situation. The fact that 'all risks' are to be held covered from the time of leaving the warehouse in itself cannot be determinative of insurance cover if the ocean leg of the transit is not that specified in the policy. All risks are held to be covered if in actuality the transit, of which the specified ocean leg is the major part, takes place as contemplated, and I am unable to see any residual inequity if cover is regarded as lapsing if in fact the vessel promptly sails for somewhere else.

7-109 The judgment clearly indicates that a cargo policy, even though it is extended to cover the land leg of the voyage by virtue of the warehouse-to-warehouse clause, is essentially, a policy controlled by the sea leg; if the sea leg falls for any reason, the rest falls with it. Clause 8 of the Institute Cargo Clauses and the fact that the attachment of the risk has been equated with the act of insured goods leaving the warehouse does not have any impact on this outcome. In reaching this decision, the judge made no attempt to discuss the position of the assured who might lose his goods before they arrive at the ship's rail. In that case, there is no

²⁰⁶ Note that this was identified as a potential problem by Bowen LJ in *Simeon Israel & Co v Sedgwick* [1893] 1 QB 303, at 308, but was left unresolved.

²⁰⁷ [2002] 2 Lloyd's Rep 591.

²⁰⁸ *Ibid*, at 600.

doubt that the goods are on the insured voyage at the time of the loss. Interestingly, when determining whether the vessel sailed for the contemplated voyage, the judge took into account the state of mind of fraudsters instead of the assured. In the minds of the assured (and underwriters as well) the *Pacifica* had sailed for Beihei, which was the voyage stipulated in the insurance policy.

7-110 In the same year, almost a month after the judgment of the Hong Kong High Court, it was the turn of the English Court of Appeal to offer an illuminating analysis on the matter in *Nima SARL v Deves Insurance Public Company Ltd (The Prestrioka)*.²⁰⁹ The claimants, Nima SARL, a company incorporated and resident in Mali, purchased a cargo of some 5,500 tonnes of rice valued at about €1.5 million from Central Rice Co Ltd of Thailand under a CIF contract to be delivered at Dakar in Senegal. In accordance with the sale agreement, a vessel, *Prestrioka*, was chartered by the sellers of the cargo. The cargo was shipped in Kongsichang, Thailand on *The Prestrioka* in early March, after having been inspected, but the vessel did not, in fact, sail until 28 March 1999 as she was undergoing engine repairs. In the meantime, insurance was arranged for the cargo from an insurance company based in Thailand under Institute Cargo Clauses (A). The policy was then assigned to Nima SARL. The vessel should have arrived at Dakar at the beginning of May 1999. Faxed communications concerning the progress of the vessel were received by the agents on paper bearing the letterhead of 'Prestrioka Maritime Ltd (Penang) Representative Office' and signed by 'Eddy' of that office who stated that the owners were in touch with the vessel on a daily basis. On 22 April, they advised she had been delayed owing to her speed and on 24 April gave an estimated arrival time at Dakar of 20–21 May. On 13 May, the owners advised that the vessel would be in Dakar within 15–17 days, her engine problem having resulted in an unfavourable speed. On 20 May, the owners advised that the vessel had not been heard from for seven days. The last message from the owners was received on 24 May reporting the vessel's position as of 22 May and stating that the main engines had failed, that she was drifting southward about 44 miles a day due to strong winds and rough to very rough seas and that she was also rolling/pitching heavily at times. The vessel never arrived in Dakar and no trace of her or her cargo has been found. All that is known with certainty is that the cargo was loaded on the vessel at the loading port, but did not arrive at the discharge port. On the face of it, therefore, the cargo was totally lost in circumstances, *prima facie*, covered by the all-risk policy.

7-111 The insurers denied liability on the ground that the cargo had been stolen by persons purporting to be the owners of *MV Prestrioka*, who had planned their crime prior to the voyage. It was contended that the risk under the policy had never attached by virtue of s 44 of the MIA 1906. The Court of Appeal concurred. Their reasoning is, somehow, similar to the reasoning of the Hong Kong High Court. In the view of the Court of Appeal, the existence of a warehouse-to-warehouse clause, which allows an extension to the marine cover so as to protect the assured against losses on any land risk incidental to any sea voyage, does not alter the fundamental nature of the marine policy as being a policy covering the interests of the assured in a marine adventure, which is defined in the case of a voyage policy by its two marine

²⁰⁹ [2002] EWCA Civ 1132; [2003] 2 Lloyd's Rep 327.

termini. If that adventure is never, in fact, embarked upon, the insurer will not be liable.²¹⁰ Following the *ratio* of *Simeon Israel v Sedgwick*, the Court of Appeal rejected the assured's argument that, if the goods have been appropriated by the hand and act of an innocent seller or shipper to the carriage in the vessel named in the policy which he believes and intends will occur, that is sufficient to avoid the effect of s 44 if the vessel, in fact, sails on a different voyage. To the contrary, in cases where the s 44 defence is invoked, the court will conduct an *ex post facto* exercise to determine not simply the contractual, but the actual, destination of the ship at the time of sailing, which exercise depends upon the acts and intention of the owners and/or master at the time of her departure.

7-112 Therefore, it has now been confirmed by the Court of Appeal that s 44 has a significant role to play to the prejudice of the assured in phantom ship frauds. It should not, however, be readily assumed that this is a defence which can be invoked by underwriters where there are suspicions that the owners or master had no intention to sail for the contractual voyage. The success of the defence lies with whether the court is satisfied that the criminal intent to divert the vessel for the purpose of stealing the cargo was formed from the outset or only subsequently in the course of the voyage. In the latter scenario, the risk attaches given that the vessel sails for the destination specified in the policy.

7-113 In order to prove that the criminal intent to divert the vessel existed at the outset, the insurer is expected to demonstrate on the balance of probability that it is fanciful to suppose that the loss occurred in any way other than a pre-conceived plan to proceed to a port other than the port expressed in the policy to discharge the cargo.²¹¹ The degree of proof required here seems to be the usual civil burden of proof. Given that no trace of the vessel or her cargo is likely to be found in most phantom ship cases, it is highly unlikely that the underwriters would be assisted by any direct evidence in their quest to discharge the burden on them. In all probability, evidence would need to be drawn from the surrounding facts and circumstances. Not finding any record regarding the registration of the vessel or the company purporting to be the owners would inevitably raise suspicions that the cargo was in the hands of people who had no intention of acting in an honest fashion. It might, however, be necessary to provide further evidence pointing towards the conclusion that the disappearing of the ship with the cargo was part of a well-executed crime planned before the cargo was put on board. In *The Prestrioka*, the Court of Appeal relied upon two statements that were not available when the case was heard in the first instance.²¹² First, was the statement of a crew member, Mr Aung, who sailed with *Prestrioka* on 28 March. Soon after sailing, Mr Aung learned from other crew members, who were mostly officers, that the vessel was to go to India to unload. The vessel, after a number of breakdowns

²¹⁰ *Ibid*, at [53]–[54], per Potter LJ.

²¹¹ *Ibid*, at [58], per Potter LJ.

²¹² The underwriters sought permission to allow the new evidence to be admitted for the first time in the Court of Appeal. Permission was granted, applying the well-established principle in *Ladd v Marshall* [1954] 1 WLR 1489 that additional evidence was to be allowed on appeal if it could not reasonably have been obtained by the time of the original trial, was credible and would have had an important influence on the outcome of the trial.

and repairs during her onward journey, reached India and berthed about 50 miles from Bombay port, where the captain was replaced and the vessel subsequently sailed to Dubai. At that time, Mr Aung learned from Indian crew members that there was no consignee for the goods in India so the vessel must have been traveling somewhere else. The engine again failed and the vessel was towed to Dubai, arriving on 19 July where it unloaded alongside the MV *Mariner* which had already berthed there. Mr Aung also stated that the *Prestrioka* changed her name en route in the Indian Ocean and he was informed by the captain that the vessel was going to be destroyed following unloading. He also said that the voyage conditions were reasonably good throughout and there had been no storms. The fact that Mr Aung was informed that the vessel was proceeding to India to discharge strongly pointed towards the existence of a preconceived plan by the owners of an unregistered vessel operating from a bogus address. Furthermore, the report of the weather expert, Professor Motte, demonstrated that the messages reported to have been sent by the vessel and relayed by Mr Eddy on behalf of the owners were also bogus. Professor Motte's evidence as to the weather off South Africa, the area where the vessel was reported by the owners to be during the relevant period (between 12 and 22 May), was to the effect that the vessel would have been in the middle of an area of high pressure with light southerly winds and slight seas, the winds being of a direction appropriate to cause her to drift north, rather than south as stated in the owners' final telex.²¹³

7-114 Having decided in favour of the insurers, Potter LJ who delivered the judgment of the Court of Appeal, made an attempt to rationalise the relationship between cl 8 of the Institute Cargo Clauses and s 44 of the MIA 1906. His view is that both provisions could coexist and cl 8 provides indemnity to the assured where the cargo leaves the warehouse, destined for a phantom ship, but becomes a total loss en route or in the course of loading. Section 44 comes into the equation only when the vessel sails for an entirely different destination than the one expressed in the policy. In that case, the cover, which attaches when the goods leave the warehouse, is invalidated retroactively (*ex post facto*).²¹⁴ This is a pragmatic solution and could possibly be explained by arguing that the policy contains an implied term giving the underwriter a right to invalidate the policy, attached originally when leaving the warehouse, retroactively if the ship sails to a different destination than the one stated in the policy. Taking this analysis to its natural conclusion, it is clear that an assured will not be able to recover for his loss if he suffers a partial loss during the land leg of the transit, which has not been repaired or otherwise made good, in a case where the cargo sails to a different destination on board a phantom ship. Section 77 of the MIA 1906 allows recovery only in respect of the total loss in a case where a partial loss, which has not been repaired or otherwise made good, is followed by a total loss. In this example, the total loss arises only after the policy is retrospectively invalidated.

²¹³ Similarly, in *Nam Kwong Medicines & Health Products Co Ltd v China Insurance Co Ltd* [2002] 2 Lloyd's Rep 591, Stone J attributed the lack of any third-party records of distress calls or rescue reports relating to the casualty of the vessel, which allegedly had perished at sea, to a well-conceived plan to steal the cargo.

²¹⁴ [2002] EWCA Civ 1132; [2003] 2 Lloyd's Rep 327, at [56].

(D) Contractual Solution – The Way Forward

7-115 The decision in *The Prestrioka* leaves the innocent assured unprotected in cases where his goods are loaded on a phantom ship without his knowledge at the loading port. Although this outcome can be defended from a technical point of view, it disregards the realities of contemporary shipping practice by presupposing that the assured could determine which vessel his cargo will be loaded onto. More significantly, it undermines the conscious decision taken to extend the cover beyond the commencement of the sea leg by incorporating warehouse-to-warehouse clauses into modern cargo policies. The 2009 version of Institute Cargo Clauses attempts to offer a solution to this problem. Clause 10.2 of the Institute Cargo Clauses 2009 (A), (B) and (C) reads:²¹⁵

Where the subject-matter insured commences the transit contemplated by this insurance (in accordance with Clause 8.1), but, without the knowledge of the Assured or their employees the ship sails for another destination, this insurance will nevertheless be deemed to have attached at commencement of such transit.

7-116 The effect of this clause is to reverse the impact of the decision in *The Prestrioka* by giving precedence to the warehouse-to-warehouse clause in the contract over s 44 of the MIA 1906 where the cargo is put on board a phantom ship, as long as the assured or his employees are not privy to the fact that the vessel has sailed to a destination other than the one stipulated in the policy. This is a positive development which will offer further protection to assureds who have fallen victim to phantom ship frauds.

²¹⁵ It is not clear why there is a need to incorporate this clause into Institute Cargo Clauses (B) and (C) given that loss caused by phantom ship frauds would not be covered under those policies anyway.

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APPENDICES

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APPENDIX 1



Marine Insurance Act 1906

1906 CHAPTER 41 6 Edw 7

An Act to codify the Law relating to Marine Insurance.

[21st December 1906]

MARINE INSURANCE

1 Marine insurance defined.

A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure.

2 Mixed sea and land risks.

- (1) A contract of marine insurance may, by its express terms, or by usage of trade, be extended so as to protect the assured against losses on inland waters or on any land risk which may be incidental to any sea voyage.
- (2) Where a ship in course of building, or the launch of a ship, or any adventure analogous to a marine adventure, is covered by a policy in the form of a marine policy, the provisions of this Act, in so far as applicable, shall apply thereto; but, except as by this section provided, nothing in this Act shall alter or affect any rule of law applicable to any contract of insurance other than a contract of marine insurance as by this Act defined.

3 Marine adventure and maritime perils defined.

- (1) Subject to the provisions of this Act, every lawful marine adventure may be the subject of a contract of marine insurance.

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- (2) In particular there is a marine adventure where—
- (a) Any ship goods or other moveables are exposed to maritime perils. Such property is in this Act referred to as “insurable property”;
 - (b) The earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan, or disbursements, is endangered by the exposure of insurable property to maritime perils;
 - (c) Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.

“Maritime perils” means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints, and detentions of princes and peoples, jettisons, barratry, and any other perils, either of the like kind or which may be designated by the policy.

INSURABLE INTEREST

4 **Avoidance of wagering or gaming contracts.**

- (1) Every contract of marine insurance by way of gaming or wagering is void.
- (2) A contract of marine insurance is deemed to be a gaming or wagering contract—
- (a) 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
 - (b) Where the policy is made “interest or no interest,” or “without further proof of interest than the policy itself,” or “without benefit of salvage to the insurer,” or subject to any other like term:

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer.

5 **Insurable interest defined.**

- (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.

6 **When interest must attach.**

- (1) The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected:
Provided that where the subject-matter is insured “lost or not lost,” the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.

- (2) Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss.

7 Defeasible or contingent interest.

- (1) A defeasible interest is insurable, as also is a contingent interest.
- (2) In particular, where the buyer of goods has insured them, he has an insurable interest, notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller's risk, by reason of the latter's delay in making delivery or otherwise.

8 Partial interest.

A partial interest of any nature is insurable.

9 Re-insurance.

- (1) The insurer under a contract of marine insurance has an insurable interest in his risk, and may re-insure in respect of it.
- (2) Unless the policy otherwise provides, the original assured has no right or interest in respect of such re-insurance.

10 Bottomry.

The lender of money on bottomry or respondentia has an insurable interest in respect of the loan.

11 Master's and seamen's wages.

The master or any member of the crew of a ship has an insurable interest in respect of his wages.

12 Advance freight.

In the case of advance freight, the person advancing the freight has an insurable interest, in so far as such freight is not repayable in case of loss.

13 Charges of insurance.

The assured has an insurable interest in the charges of any insurance which he may effect.

14 Quantum of interest.

- (1) Where the subject-matter insured is mortgaged, the mortgagor has an insurable interest in the full value thereof, and the mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage.

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- (2) A mortgagee, consignee, or other person having an interest in the subject-matter insured may insure on behalf and for the benefit of other persons interested as well as for his own benefit.
- (3) The owner of insurable property has an insurable interest in respect of the full value thereof, notwithstanding that some third person may have agreed, or be liable, to indemnify him in case of loss.

15 Assignment of interest.

Where the assured assigns or otherwise parts with his interest in the subject-matter insured, he does not thereby transfer to the assignee his rights under the contract of insurance, unless there be an express or implied agreement with the assignee to that effect.

But the provisions of this section do not affect a transmission of interest by operation of law.

INSURABLE VALUE

16 Measure of insurable value.

Subject to any express provision or valuation in the policy, the insurable value of the subject-matter insured must be ascertained as follows:—

- (1) In insurance on ship, the insurable value is the value, at the commencement of the risk, of the ship, including her outfit, provisions and stores for the officers and crew, money advanced for seamen's wages, and other disbursements (if any) incurred to make the ship fit for the voyage or adventure contemplated by the policy, plus the charges of insurance upon the whole: The insurable value, in the case of a steamship, includes also the machinery, boilers, and coals and engine stores if owned by the assured, and, in the case of a ship engaged in a special trade, the ordinary fittings requisite for that trade:
- (2) In insurance on freight, whether paid in advance or otherwise, the insurable value is the gross amount of the freight at the risk of the assured, plus the charges of insurance:
- (3) In insurance on goods or merchandise, the insurable value is the prime cost of the property insured, plus the expenses of and incidental to shipping and the charges of insurance upon the whole:
- (4) In insurance on any other subject-matter, the insurable value is the amount at the risk of the assured when the policy attaches, plus the charges of insurance.

DISCLOSURE AND REPRESENTATIONS

17 Insurance is uberrimæ fidei.

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

18 Disclosure by assured.

- (1) Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.
- (2) Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.
- (3) In the absence of inquiry the following circumstances need not be disclosed, namely:
 - (a) Any circumstance which diminishes the risk;
 - (b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;
 - (c) Any circumstance as to which information is waived by the insurer;
 - (d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.
- (4) Whether any particular circumstance, which is not disclosed, be material or not is, in each case, a question of fact.
- (5) The term "circumstance" includes any communication made to, or information received by, the assured.

19 Disclosure by agent effecting insurance.

Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer—

- (a) Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and
- (b) Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

20 Representations pending negotiation of contract.

- (1) Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract.
- (2) A representation is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.
- (3) A representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief.
- (4) A representation as to a matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer.

- (5) A representation as to a matter of expectation or belief is true if it be made in good faith.
- (6) A representation may be withdrawn or corrected before the contract is concluded.
- (7) Whether a particular representation be material or not is, in each case, a question of fact.

21 When contract is deemed to be concluded.

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; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract . . . ^{F1}

Annotations:

Amendments (Textual)

F1 Words repealed as to instruments made or executed after 1.8.1959 by Finance Act 1959 (c. 58), Sch. 8 Pt. II

THE POLICY

22 Contract must be embodied in policy.

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.

23 What policy must specify.

A marine policy must specify—

- (1) The name of the assured, or of some person who effects the insurance on his behalf:
- (2) ^{F2}

Annotations:

Amendments (Textual)

F2 S. 23(2)–(5) repealed as to instruments made or executed after 1.8.1959 by Finance Act 1959 (c. 58), Sch. 8 Pt. II

24 Signature of insurer.

- (1) A marine policy must be signed by or on behalf of the insurer, provided that in the case of a corporation the corporate seal may be sufficient, but nothing in this section shall be construed as requiring the subscription of a corporation to be under seal.
- (2) Where a policy is subscribed by or on behalf of two or more insurers, each subscription, unless the contrary be expressed, constitutes a distinct contract with the assured.

25 Voyage and time policies.

- (1) Where the contract is to insure the subject-matter “at and from,” or from one place to another or others, the policy is called a “voyage policy,” and where the contract is to insure the subject-matter for a definite period of time the policy is called a “time policy.” A contract for both voyage and time may be included in the same policy.
- (2)^{F3}

<p>Annotations:</p> <hr/> <p>Amendments (Textual)</p> <p>F3 S. 25(2) repealed as to instruments made or executed after 1.8.1959 by Finance Act 1959 (c. 58), Sch. 8 Pt. II</p>

26 Designation of subject-matter.

- (1) The subject-matter insured must be designated in a marine policy with reasonable certainty.
- (2) The nature and extent of the interest of the assured in the subject-matter insured need not be specified in the policy.
- (3) Where the policy designates the subject-matter insured in general terms, it shall be construed to apply to the interest intended by the assured to be covered.
- (4) In the application of this section regard shall be had to any usage regulating the designation of the subject-matter insured.

27 Valued policy.

- (1) A policy may be either valued or unvalued.
- (2) A valued policy is a policy which specifies the agreed value of the subject-matter insured.
- (3) Subject to the provisions of this Act, and in the absence of fraud, the value fixed by the policy is, as between the insurer and assured, conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial.
- (4) Unless the policy otherwise provides, the value fixed by the policy is not conclusive for the purpose of determining whether there has been a constructive total loss.

28 Unvalued policy.

An unvalued policy is a policy which does not specify the value of the subject-matter insured, but, subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained, in the manner herein-before specified.

29 Floating policy by ship or ships.

- (1) A floating policy is a policy which describes the insurance in general terms, and leaves the name of the ship or ships and other particulars to be defined by subsequent declaration.
- (2) The subsequent declaration or declarations may be made by indorsement on the policy, or in other customary manner.
- (3) Unless the policy otherwise provides, the declarations must be made in the order of dispatch or shipment. They must, in the case of goods, comprise all consignments within the terms of the policy, and the value of the goods or other property must be honestly stated, but an omission or erroneous declaration may be rectified even after loss or arrival, provided the omission or declaration was made in good faith.
- (4) Unless the policy otherwise provides, where a declaration of value is not made until after notice of loss or arrival, the policy must be treated as an unvalued policy as regards the subject-matter of that declaration.

30 Construction of terms in policy.

- (1) A policy may be in the form in the First Schedule to this Act.
- (2) Subject to the provisions of this Act, and unless the context of the policy otherwise requires, the terms and expressions mentioned in the First Schedule to this Act shall be construed as having the scope and meaning in that schedule assigned to them.

31 Premium to be arranged.

- (1) Where an insurance is effected at a premium to be arranged, and no arrangement is made, a reasonable premium is payable.
- (2) Where an insurance is effected on the terms that an additional premium is to be arranged in a given event, and that event happens but no arrangement is made, then a reasonable additional premium is payable.

DOUBLE INSURANCE

32 Double insurance.

- (1) Where two or more policies are effected by or on behalf of the assured on the same adventure and interest or any part thereof, and the sums insured exceed the indemnity allowed by this Act, the assured is said to be over-insured by double insurance.
- (2) Where the assured is over-insured by double insurance—
 - (a) The assured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may think fit, provided that he is not entitled to receive any sum in excess of the indemnity allowed by this Act;

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- (b) Where the policy under which the assured claims is a valued policy, the assured must give credit as against the valuation for any sum received by him under any other policy without regard to the actual value of the subject-matter insured;
- (c) Where the policy under which the assured claims is an unvalued policy he must give credit, as against the full insurable value, for any sum received by him under any other policy;
- (d) Where the assured receives any sum in excess of the indemnity allowed by this Act, he is deemed to hold such sum in trust for the insurers, according to their right of contribution among themselves.

WARRANTIES, &C.

33 Nature of warranty.

- (1) A warranty, in the following sections relating to warranties, means a promissory warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.
- (2) A warranty may be express or implied.
- (3) A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

34 When breach of warranty excused.

- (1) Non-compliance with a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract, or when compliance with the warranty is rendered unlawful by any subsequent law.
- (2) Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss.
- (3) A breach of warranty may be waived by the insurer.

35 Express warranties.

- (1) An express warranty may be in any form of words from which the intention to warrant is to be inferred.
- (2) An express warranty must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy.
- (3) An express warranty does not exclude an implied warranty, unless it be inconsistent therewith.

36 Warranty of neutrality.

- (1) Where insurable property, whether ship or goods, is expressly warranted neutral, there is an implied condition that the property shall have a neutral character at the commencement of the risk, and that, so far as the assured can control the matter, its neutral character shall be preserved during the risk.
- (2) Where a ship is expressly warranted “neutral” there is also an implied condition that, so far as the assured can control the matter, she shall be properly documented, that is to say, that she shall carry the necessary papers to establish her neutrality, and that she shall not falsify or suppress her papers, or use simulated papers. If any loss occurs through breach of this condition, the insurer may avoid the contract.

37 No implied warranty of nationality.

There is no implied warranty as to the nationality of a ship, or that her nationality shall not be changed during the risk.

38 Warranty of good safety.

Where the subject-matter insured is warranted “well” or “in good safety” on a particular day, it is sufficient if it be safe at any time during that day.

39 Warranty of seaworthiness of ship.

- (1) In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured.
- (2) Where the policy attaches while the ship is in port, there is also an implied warranty that she shall, at the commencement of the risk, be reasonably fit to encounter the ordinary perils of the port.
- (3) Where the policy relates to a voyage which is performed in different stages, during which the ship requires different kinds of or further preparation or equipment, there is an implied warranty that at the commencement of each stage the ship is seaworthy in respect of such preparation or equipment for the purposes of that stage.
- (4) A ship is deemed to be seaworthy when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure insured.
- (5) In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness.

40 No implied warranty that goods are seaworthy.

- (1) In a policy on goods or other moveables there is no implied warranty that the goods or moveables are seaworthy.
- (2) In a voyage policy on goods or other moveables there is an implied warranty that at the commencement of the voyage the ship is not only seaworthy as a ship, but also that she is reasonably fit to carry the goods or other moveables to the destination contemplated by the policy.

41 Warranty of legality.

There is an implied warranty that the adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

THE VOYAGE

42 Implied condition as to commencement of risk.

- (1) Where the subject-matter is insured by a voyage policy “at and from” or “from” a particular place, it is not necessary that the ship should be at that place when the contract is concluded, but there is an implied condition that the adventure shall be commenced within a reasonable time, and that if the adventure be not so commenced the insurer may avoid the contract.
- (2) The implied condition may be negated by showing that the delay was caused by circumstances known to the insurer before the contract was concluded, or by showing that he waived the condition.

43 Alteration of port of departure.

Where the place of departure is specified by the policy, and the ship instead of sailing from that place sails from any other place, the risk does not attach.

44 Sailing for different destination.

Where the destination is specified in the policy, and the ship, instead of sailing for that destination, sails for any other destination, the risk does not attach.

45 Change of voyage.

- (1) Where, after the commencement of the risk, the destination of the ship is voluntarily changed from the destination contemplated by the policy, there is said to be a change of voyage.
- (2) Unless the policy otherwise provides, where there is a change of voyage, the insurer is discharged from liability as from the time of change, that is to say, as from the time when the determination to change it is manifested; and it is immaterial that the ship may not in fact have left the course of voyage contemplated by the policy when the loss occurs.

46 Deviation.

- (1) Where a ship, without lawful excuse, deviates from the voyage contemplated by the policy, the insurer is discharged from liability as from the time of deviation, and it is immaterial that the ship may have regained her route before any loss occurs.
- (2) There is a deviation from the voyage contemplated by the policy—
 - (a) Where the course of the voyage is specifically designated by the policy, and that course is departed from; or
 - (b) Where the course of the voyage is not specifically designated by the policy, but the usual and customary course is departed from.

- (3) The intention to deviate is immaterial; there must be a deviation in fact to discharge the insurer from his liability under the contract.

47 Several ports of discharge.

- (1) Where several ports of discharge are specified by the policy, the ship may proceed to all or any of them, but, in the absence of any usage or sufficient cause to the contrary, she must proceed to them, or such of them as she goes to, in the order designated by the policy. If she does not there is a deviation.
- (2) Where the policy is to “ports of discharge,” within a given area, which are not named, the ship must, in the absence of any usage or sufficient cause to the contrary, proceed to them, or such of them as she goes to, in their geographical order. If she does not there is a deviation.

48 Delay in voyage.

In the case of a voyage policy, the adventure insured must be prosecuted throughout its course with reasonable dispatch, and, if without lawful excuse it is not so prosecuted, the insurer is discharged from liability as from the time when the delay became unreasonable.

49 Excuses for deviation or delay.

- (1) Deviation or delay in prosecuting the voyage contemplated by the policy is excused—
- (a) Where authorised by any special term in the policy; or
 - (b) Where caused by circumstances beyond the control of the master and his employer; or
 - (c) Where reasonably necessary in order to comply with an express or implied warranty; or
 - (d) Where reasonably necessary for the safety of the ship or subject-matter insured; or
 - (e) For the purpose of saving human life, or aiding a ship in distress where human life may be in danger; or
 - (f) Where reasonably necessary for the purpose of obtaining medical or surgical aid for any person on board the ship; or
 - (g) Where caused by the barratrous conduct of the master or crew, if barratry be one of the perils insured against.
- (2) When the cause excusing the deviation or delay ceases to operate, the ship must resume her course, and prosecute her voyage, with reasonable dispatch.

ASSIGNMENT OF POLICY

50 When and how policy is assignable.

- (1) A marine policy is assignable unless it contains terms expressly prohibiting assignment. It may be assigned either before or after loss.
- (2) Where a marine policy has been assigned so as to pass the beneficial interest in such policy, the assignee of the policy is entitled to sue thereon in his own name; and the

defendant is entitled to make any defence arising out of the contract which he would have been entitled to make if the action had been brought in the name of the person by or on behalf of whom the policy was effected.

- (3) A marine policy may be assigned by indorsement thereon or in other customary manner.

51 Assured who has no interest cannot assign.

Where the assured has parted with or lost his interest in the subject-matter insured, and has not, before or at the time of so doing, expressly or impliedly agreed to assign the policy, any subsequent assignment of the policy is inoperative: Provided that nothing in this section affects the assignment of a policy after loss.

THE PREMIUM

52 When premium payable.

Unless otherwise agreed, the duty of the assured or his agent to pay the premium, and the duty of the insurer to issue the policy to the assured or his agent, are concurrent conditions, and the insurer is not bound to issue the policy until payment or tender of the premium.

53 Policy effected through broker.

- (1) Unless otherwise agreed, where a marine policy is effected on behalf of the assured by a broker, the broker is directly responsible to the insurer for the premium, and the insurer is directly responsible to the assured for the amount which may be payable in respect of losses, or in respect of returnable premium.
- (2) Unless otherwise agreed, the broker has, as against the assured, a lien upon the policy for the amount of the premium and his charges in respect of effecting the policy; and, where he has dealt with the person who employs him as a principal, he has also a lien on the policy in respect of any balance on any insurance account which may be due to him from such person, unless when the debt was incurred he had reason to believe that such person was only an agent.

54 Effect of receipt on policy.

Where a marine policy effected on behalf of the assured by a broker acknowledges the receipt of the premium, such acknowledgement is, in the absence of fraud, conclusive as between the insurer and the assured, but not as between the insurer and broker.

LOSS AND ABANDONMENT

55 Included and excluded losses.

- (1) Subject to the provisions of this Act, and unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against.
- (2) In particular—

- (a) The insurer is not liable for any loss attributable to the wilful misconduct of the assured, but, unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew;
- (b) Unless the policy otherwise provides, the insurer on ship or goods is not liable for any loss proximately caused by delay, although the delay be caused by a peril insured against;
- (c) Unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or nature of the subject-matter insured, or for any loss proximately caused by rats or vermin, or for any injury to machinery not proximately caused by maritime perils.

56 Partial and total loss.

- (1) A loss may be either total or partial. Any loss other than a total loss, as hereinafter defined, is a partial loss.
- (2) A total loss may be either an actual total loss, or a constructive total loss.
- (3) Unless a different intention appears from the terms of the policy, an insurance against total loss includes a constructive, as well as an actual, total loss.
- (4) Where the assured brings an action for a total loss and the evidence proves only a partial loss, he may, unless the policy otherwise provides, recover for a partial loss.
- (5) Where goods reach their destination in specie, but by reason of obliteration of marks, or otherwise, they are incapable of identification, the loss, if any, is partial, and not total.

57 Actual total loss.

- (1) Where the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, there is an actual total loss.
- (2) In the case of an actual total loss no notice of abandonment need be given.

58 Missing ship.

Where the ship concerned in the adventure is missing, and after the lapse of a reasonable time no news of her has been received, an actual total loss may be presumed.

59 Effect of transshipment, &c.

Where, by a peril insured against, the voyage is interrupted at an intermediate port or place, under such circumstances as, apart from any special stipulation in the contract of affreightment, to justify the master in landing and reshipping the goods or other moveables, or in transshipping them, and sending them on to their destination, the liability of the insurer continues, notwithstanding the landing or transshipment.

60 Constructive total loss defined.

- (1) Subject to any express provision in the policy, there is a constructive total loss where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred.
- (2) In particular, there is a constructive total loss—
 - (i) Where the assured is deprived of the possession of his ship or goods by a peril insured against, and (a) it is unlikely that he can recover the ship or goods, as the case may be, or (b) the cost of recovering the ship or goods, as the case may be, would exceed their value when recovered; or
 - (ii) In the case of damage to a ship, where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired.

In estimating the cost of repairs, no deduction is to be made in respect of general average contributions to those repairs payable by other interests, but account is to be taken of the expense of future salvage operations and of any future general average contributions to which the ship would be liable if repaired; or

- (iii) In the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival.

61 Effect of constructive total loss.

Where there is a constructive total loss the assured may either treat the loss as a partial loss, or abandon the subject-matter insured to the insurer and treat the loss as if it were an actual total loss.

62 Notice of abandonment.

- (1) Subject to the provisions of this section, where the assured elects to abandon the subject-matter insured to the insurer, he must give notice of abandonment. If he fails to do so the loss can only be treated as a partial loss.
- (2) Notice of abandonment may be given in writing, or by word of mouth, or partly in writing and partly by word of mouth, and may be given in any terms which indicate the intention of the assured to abandon his insured interest in the subject-matter insured unconditionally to the insurer.
- (3) Notice of abandonment must be given with reasonable diligence after the receipt of reliable information of the loss, but where the information is of a doubtful character the assured is entitled to a reasonable time to make inquiry.
- (4) Where notice of abandonment is properly given, the rights of the assured are not prejudiced by the fact that the insurer refuses to accept the abandonment.
- (5) The acceptance of an abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer after notice is not an acceptance.
- (6) Where notice of abandonment is accepted the abandonment is irrevocable. The acceptance of the notice conclusively admits liability for the loss and the sufficiency of the notice.

- (7) Notice of abandonment is unnecessary where, at the time when the assured receives information of the loss, there would be no possibility of benefit to the insurer if notice were given to him.
- (8) Notice of abandonment may be waived by the insurer.
- (9) Where an insurer has re-insured his risk, no notice of abandonment need be given by him.

63 Effect of abandonment.

- (1) Where there is a valid abandonment the insurer is entitled to take over the interest of the assured in whatever may remain of the subject-matter insured, and all proprietary rights incidental thereto.
- (2) Upon the abandonment of a ship, the insurer thereof is entitled to any freight in course of being earned, and which is earned by her subsequent to the casualty causing the loss, less the expenses of earning it incurred after the casualty; and, where the ship is carrying the owner's goods, the insurer is entitled to a reasonable remuneration for the carriage of them subsequent to the casualty causing the loss.

PARTIAL LOSSES (INCLUDING SALVAGE AND
GENERAL AVERAGE AND PARTICULAR CHARGES)

64 Particular average loss.

- (1) A particular average loss is a partial loss of the subject-matter insured, caused by a peril insured against, and which is not a general average loss.
- (2) Expenses incurred by or on behalf of the assured for the safety or preservation of the subject-matter insured, other than general average and salvage charges, are called particular charges. Particular charges are not included in particular average.

65 Salvage charges.

- (1) Subject to any express provision in the policy, salvage charges incurred in preventing a loss by perils insured against may be recovered as a loss by those perils.
- (2) "Salvage charges" means the charges recoverable under maritime law by a salvor independently of contract. They do not include the expenses of services in the nature of salvage rendered by the assured or his agents, or any person employed for hire by them, for the purpose of averting a peril insured against. Such expenses, where properly incurred, may be recovered as particular charges or as a general average loss, according to the circumstances under which they were incurred.

66 General average loss.

- (1) A general average loss is a loss caused by or directly consequential on a general average act. It includes a general average expenditure as well as a general average sacrifice.

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- (2) There is a general average act where any extraordinary sacrifice or expenditure is voluntarily and reasonably made or incurred in time of peril for the purpose of preserving the property imperilled in the common adventure.
- (3) Where there is a general average loss, the party on whom it falls is entitled, subject to the conditions imposed by maritime law, to a rateable contribution from the other parties interested, and such contribution is called a general average contribution.
- (4) Subject to any express provision in the policy, where the assured has incurred a general average expenditure, he may recover from the insurer in respect of the proportion of the loss which falls upon him; and, in the case of a general average sacrifice, he may recover from the insurer in respect of the whole loss without having enforced his right of contribution from the other parties liable to contribute.
- (5) Subject to any express provision in the policy, where the assured has paid, or is liable to pay, a general average contribution in respect of the subject insured, he may recover therefor from the insurer.
- (6) In the absence of express stipulation, the insurer is not liable for any general average loss or contribution where the loss was not incurred for the purpose of avoiding, or in connexion with the avoidance of, a peril insured against.
- (7) Where ship, freight, and cargo, or any two of those interests, are owned by the same assured, the liability of the insurer in respect of general average losses or contributions is to be determined as if those subjects were owned by different persons.

MEASURE OF INDEMNITY

67 Extent of liability of insurer for loss.

- (1) The sum which the assured can recover in respect of a loss on a policy by which he is insured, in the case of an unvalued policy to the full extent of the insurable value, or, in the case of a valued policy to the full extent of the value fixed by the policy is called the measure of indemnity.
- (2) Where there is a loss recoverable under the policy, the insurer, or each insurer if there be more than one, is liable for such proportion of the measure of indemnity as the amount of his subscription bears to the value fixed by the policy in the case of a valued policy, or to the insurable value in the case of an unvalued policy.

68 Total loss.

Subject to the provisions of this Act and to any express provision in the policy, where there is a total loss of the subject-matter insured,—

- (1) If the policy be a valued policy, the measure of indemnity is the sum fixed by the policy:
- (2) If the policy be an unvalued policy, the measure of indemnity is the insurable value of the subject-matter insured.

69 Partial loss of ship.

Where a ship is damaged, but is not totally lost, the measure of indemnity, subject to any express provision in the policy, is as follows:—

- (1) Where the ship has been repaired, the assured is entitled to the reasonable cost of the repairs, less the customary deductions, but not exceeding the sum insured in respect of any one casualty:
- (2) Where the ship has been only partially repaired, the assured is entitled to the reasonable cost of such repairs, computed as above, and also to be indemnified for the reasonable depreciation, if any, arising from the unrepaired damage, provided that the aggregate amount shall not exceed the cost of repairing the whole damage, computed as above:
- (3) Where the ship has not been repaired, and has not been sold in her damaged state during the risk, the assured is entitled to be indemnified for the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage, computed as above.

70 Partial loss of freight.

Subject to any express provision in the policy, where there is a partial loss of freight, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the proportion of freight lost by the assured bears to the whole freight at the risk of the assured under the policy.

71 Partial loss of goods, merchandise, &c.

Where there is a partial loss of goods, merchandise, or other moveables, the measure of indemnity, subject to any express provision in the policy, is as follows:—

- (1) Where part of the goods, merchandise or other moveables insured by a valued policy is totally lost, the measure of indemnity is such proportion of the sum fixed by the policy as the insurable value of the part lost bears to the insurable value of the whole, ascertained as in the case of an unvalued policy:
- (2) Where part of the goods, merchandise, or other moveables insured by an unvalued policy is totally lost, the measure of indemnity is the insurable value of the part lost, ascertained as in case of total loss:
- (3) Where the whole or any part of the goods or merchandise insured has been delivered damaged at its destination, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the difference between the gross sound and damaged values at the place of arrival bears to the gross sound value:
- (4) “Gross value” means the wholesale price, or, if there be no such price, the estimated value, with, in either case, freight, landing charges, and duty paid beforehand; provided that, in the case of goods or merchandise customarily sold in bond, the bonded price is deemed to be the gross value. “Gross proceeds” means the actual price obtained at a sale where all charges on sale are paid by the sellers.

72 Apportionment of valuation.

- (1) Where different species of property are insured under a single valuation, the valuation must be apportioned over the different species in proportion to their respective insurable values, as in the case of an unvalued policy. The insured value of any part of a species is such proportion of the total insured value of the same as the insurable value of the part bears to the insurable value of the whole, ascertained in both cases as provided by this Act.
- (2) Where a valuation has to be apportioned, and particulars of the prime cost of each separate species, quality, or description of goods cannot be ascertained, the division of the valuation may be made over the net arrived sound values of the different species, qualities, or descriptions of goods.

73 General average contributions and salvage charges.

- (1) Subject to any express provision in the policy, where the assured has paid, or is liable for, any general average contribution, the measure of indemnity is the full amount of such contribution, if the subject-matter liable to contribution is insured for its full contributory value; but, if such subject-matter be not insured for its full contributory value, or if only part of it be insured, the indemnity payable by the insurer must be reduced in proportion to the under insurance, and where there has been a particular average loss which constitutes a deduction from the contributory value, and for which the insurer is liable, that amount must be deducted from the insured value in order to ascertain what the insurer is liable to contribute.
- (2) Where the insurer is liable for salvage charges the extent of his liability must be determined on the like principle.

74 Liabilities to third parties.

Where the assured has effected an insurance in express terms against any liability to a third party, the measure of indemnity, subject to any express provision in the policy, is the amount paid or payable by him to such third party in respect of such liability.

75 General provisions as to measure of indemnity.

- (1) Where there has been a loss in respect of any subject-matter not expressly provided for in the foregoing provisions of this Act, the measure of indemnity shall be ascertained, as nearly as may be, in accordance with those provisions, in so far as applicable to the particular case.
- (2) Nothing in the provisions of this Act relating to the measure of indemnity shall affect the rules relating to double insurance, or prohibit the insurer from disproving interest wholly or in part, or from showing that at the time of the loss the whole or any part of the subject-matter insured was not at risk under the policy.

76 Particular average warranties.

- (1) Where the subject-matter insured is warranted free from particular average, the assured cannot recover for a loss of part, other than a loss incurred by a general average sacrifice, unless the contract contained in the policy be apportionable; but, if the

contract be apportionable, the assured may recover for a total loss of any apportionable part.

- (2) Where the subject-matter insured is warranted free from particular average, either wholly or under a certain percentage, the insurer is nevertheless liable for salvage charges, and for particular charges and other expenses properly incurred pursuant to the provisions of the suing and labouring clause in order to avert a loss insured against.
- (3) Unless the policy otherwise provides, where the subject-matter insured is warranted free from particular average under a specified percentage, a general average loss cannot be added to a particular average loss to make up the specified percentage.
- (4) For the purpose of ascertaining whether the specified percentage has been reached, regard shall be had only to the actual loss suffered by the subject-matter insured. Particular charges and the expenses of and incidental to ascertaining and proving the loss must be excluded.

77 Successive losses.

- (1) Unless the policy otherwise provides, and subject to the provisions of this Act, the insurer is liable for successive losses, even though the total amount of such losses may exceed the sum insured.
- (2) Where, under the same policy, a partial loss, which has not been repaired or otherwise made good, is followed by a total loss, the assured can only recover in respect of the total loss:
Provided that nothing in this section shall affect the liability of the insurer under the suing and labouring clause.

78 Suing and labouring clause.

- (1) Where the policy contains a suing and labouring clause, the engagement thereby entered into is deemed to be supplementary to the contract of insurance, and the assured may recover from the insurer any expenses properly incurred pursuant to the clause, notwithstanding that the insurer may have paid for a total loss, or that the subject-matter may have been warranted free from particular average, either wholly or under a certain percentage.
- (2) General average losses and contributions and salvage charges, as defined by this Act, are not recoverable under the suing and labouring clause.
- (3) Expenses incurred for the purpose of averting or diminishing any loss not covered by the policy are not recoverable under the suing and labouring clause.
- (4) It is the duty of the assured and his agents, in all cases, to take such measures as may be reasonable for the purpose of averting or minimising a loss.

RIGHTS OF INSURER ON PAYMENT

79 Right of subrogation.

- (1) Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter

so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss.

- (2) Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain, but he is thereupon subrogated to all rights and remedies of the assured in and in respect of the subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to this Act, by such payment for the loss.

80 Right of contribution.

- (1) Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract.
- (2) If any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution against the other insurers, and is entitled to the like remedies as a surety who has paid more than his proportion of the debt.

81 Effect of under insurance.

Where the assured is insured for an amount less than the insurable value or, in the case of a valued policy, for an amount less than the policy valuation, he is deemed to be his own insurer in respect of the uninsured balance.

RETURN OF PREMIUM

82 Enforcement of return.

Where the premium or a proportionate part thereof is, by this Act, declared to be returnable,—

- (a) If already paid, it may be recovered by the assured from the insurer; and
(b) If unpaid, it may be retained by the assured or his agent.

83 Return by agreement.

Where the policy contains a stipulation for the return of the premium, or a proportionate part thereof, on the happening of a certain event, and that event happens, the premium, or, as the case may be, the proportionate part thereof, is thereupon returnable to the assured.

84 Return for failure of consideration.

- (1) Where the consideration for the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured.
- (2) Where the consideration for the payment of the premium is apportionable and there is a total failure of any apportionable part of the consideration, a proportionate part of the premium is, under the like conditions, thereupon returnable to the assured.
- (3) In particular—

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- (a) Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable, and has once attached, the premium is not returnable:
- (b) Where the subject-matter insured, or part thereof, has never been imperilled, the premium, or, as the case may be, a proportionate part thereof, is returnable:

Provided that where the subject-matter has been insured "lost or not lost" and has arrived in safety at the time when the contract is concluded, the premium is not returnable unless, at such time, the insurer knew of the safe arrival.

- (c) Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable, provided that this rule does not apply to a policy effected by way of gaming or wagering;
- (d) Where the assured has a defeasible interest which is terminated during the currency of the risk, the premium is not returnable;
- (e) Where the assured has over-insured under an unvalued policy, a proportionate part of the premium is returnable;
- (f) Subject to the foregoing provisions, where the assured has over-insured by double insurance, a proportionate part of the several premiums is returnable:

Provided that, if the policies are effected at different times, and any earlier policy has at any time borne the entire risk, or if a claim has been paid on the policy in respect of the full sum insured thereby, no premium is returnable in respect of that policy, and when the double insurance is effected knowingly by the assured no premium is returnable.

MUTUAL INSURANCE

85 Modification of Act in case of mutual insurance.

- (1) Where two or more persons mutually agree to insure each other against marine losses there is said to be a mutual insurance.
- (2) The provisions of this Act relating to the premium do not apply to mutual insurance, but a guarantee, or such other arrangement as may be agreed upon, may be substituted for the premium.
- (3) The provisions of this Act, in so far as they may be modified by the agreement of the parties, may in the case of mutual insurance be modified by the terms of the policies issued by the association, or by the rules and regulations of the association.
- (4) Subject to the exceptions mentioned in this section, the provisions of this Act apply to a mutual insurance.

SUPPLEMENTAL

86 Ratification by assured.

Where a contract of marine insurance is in good faith effected by one person on behalf of another, the person on whose behalf it is effected may ratify the contract even after he is aware of a loss.

87 Implied obligations varied by agreement or usage.

- (1) Where any right, duty, or liability would arise under a contract of marine insurance by implication of law, it may be negatived or varied by express agreement, or by usage, if the usage be such as to bind both parties to the contract.
- (2) The provisions of this section extend to any right, duty, or liability declared by this Act which may be lawfully modified by agreement.

88 Reasonable time, &c. a question of fact.

Where by this Act any reference is made to reasonable time, reasonable premium, or reasonable diligence, the question what is reasonable is a question of fact.

89 Slip as evidence.

Where there is a duly stamped policy, reference may be made, as heretofore, to the slip or covering note, in any legal proceeding.

90 Interpretation of terms.

In this Act, unless the context or subject-matter otherwise requires,—

“Action” includes counter-claim and set off:

“Freight” includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money:

“Moveables” means any moveable tangible property, other than the ship, and includes money, valuable securities, and other documents:

“Policy” means a marine policy.

91 Savings.

- (1) Nothing in this Act, or in any repeal effected thereby, shall affect—
 - (a) The provisions of the Stamp Act 1891, or any enactment for the time being in force relating to the revenue;
 - (b) The provisions of the Companies Act 1862, or any enactment amending or substituted for the same;
 - (c) The provisions of any statute not expressly repealed by this Act.
- (2) The rules of the common law including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts of marine insurance.

92, 93. F4

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Annotations:

Amendments (Textual)

F4 Ss. 92, 93, Sch. 2 repealed by Statute Law Revision Act 1927 (c. 42)

94 Short title.

This Act may be cited as the Marine Insurance Act 1906.

SCHEDULES

FIRST SCHEDULE

Section 30.

FORM OF POLICY

Lloyd's S.G. policy

Be it known that as well in own name as for and in the name and names of all and every other person or persons to whom the same doth, may, or shall appertain, in part or in all doth make assurance and cause and them, and every of them, to be insured lost or not lost, at and from

Upon any kind of goods and merchandises, and also upon the body, tackle, apparel, ordnance, munition, artillery, boat, and other furniture, of and in the good ship or vessel called the whereof is master under God, for this present voyage, or whosoever else shall go for master in the said ship, or by whatsoever other name or names the said ship, or the master thereof, is or shall be named or called; beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship.

upon the said ship, &c.

and so shall continue and endure, during her abode there, upon the said ship, &c. And further, until the said ship, with all her ordnance, tackle, apparel, &c., and goods and merchandises whatsoever shall be arrived at

upon the said ship, &c., until she hath moored at anchor twenty-four hours in good safety; and upon the goods and merchandises, until the same be there discharged and safely landed. And it shall be lawful for the said ship, &c., in this voyage, to proceed and sail to and touch and stay at any ports or places whatsoever

without prejudice to this insurance. The said ship, &c., goods and merchandises, &c., for so much as concerns the assured by agreement between the assured and assurers in this policy, are and shall be valued at

Touching the adventures and perils which we the assurers are contented to bear and do take upon us in this voyage: they are of the seas, men of war, fire, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, surprisals, takings at sea, arrests, restraints, and detainerments of all kings, princes, and people, of what nation, condition, or quality soever, barratry of the master and mariners, and of all other perils, losses, and misfortunes, that have or shall come to the hurt, detriment, or damage of the said goods and merchandises, and ship, &c., or any part thereof. And in case of any loss or misfortune it shall be lawful to the assured, their factors, servants and assigns, to sue, labour, and travel for, in and about the defence, safeguards, and recovery of the said goods and merchandises, and ship, &c., or any part thereof, without prejudice to this insurance; to the charges whereof we, the assurers, will contribute each one according to the rate and quantity of his sum herein assured. And it is especially declared and agreed that no acts of the insurer or insured in recovering, saving, or preserving the property insured shall be considered as a waiver, or acceptance of abandonment. And it is agreed by us, the insurers, that this writing or policy of assurance shall be of as much force and effect as the surest writing or policy of assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London. And so we, the assurers, are contented, and do hereby promise and bind ourselves, each one for his own part, our heirs, executors, and goods to the assured, their executors,

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administrators, and assigns, for the true performance of the premises, confessing ourselves paid the consideration due unto us for this assurance by the assured, at and after the rate of

In Witness whereof we, the assurers, have subscribed our names and sums assured in London.

N.B.—Corn, fish, salt, fruit, flour, and seed are warranted free from average, unless general, or the ship be stranded—sugar, tobacco, hemp, flax, hides and skins are warranted free from average, under five pounds per cent., and all other goods, also the ship and freight, are warranted free from average, under three pounds per cent. unless general, or the ship be stranded.

RULES FOR CONSTRUCTION OF POLICY

The following are the rules referred to by this Act for the construction of a policy in the above or other like form, where the context does not otherwise require:—

Lost or not lost.

- 1 Where the subject-matter is insured “lost or not lost,” and the loss has occurred before the contract is concluded, the risk attaches unless, at such time the assured was aware of the loss, and the insurer was not.

From.

- 2 Where the subject-matter is insured “from” a particular place, the risk does not attach until the ship starts on the voyage insured.

At and from.

- 3
 - (a) Where a ship is insured “at and from” a particular place, and she is at that place in good safety when the contract is concluded, the risk attaches immediately.
 - (b) If she be not at that place when the contract is concluded, the risk attaches as soon as she arrives there in good safety, and, unless the policy otherwise provides, it is immaterial that she is covered by another policy for a specified time after arrival.
 - (c) Where chartered freight is insured “at and from” a particular place, and the ship is at that place in good safety when the contract is concluded the risk attaches immediately. If she be not there when the contract is concluded, the risk attaches as soon as she arrives there in good safety.
 - (d) Where freight, other than chartered freight, is payable without special conditions and is insured “at and from” a particular place, the risk attaches pro rata as the goods or merchandise are shipped; provided that if there be cargo in readiness which belongs to the shipowner, or which some other person has contracted with him to ship, the risk attaches as soon as the ship is ready to receive such cargo.

From the loading thereof

- 4 Where goods or other moveables are insured “from the loading thereof,” the risk does not attach until such goods or moveables are actually on board, and the insurer is not liable for them while in transit from the shore to the ship.

Safely landed.

- 5 Where the risk on goods or other moveables continues until they are “safely landed,” they must be landed in the customary manner and within a reasonable time after arrival at the port of discharge, and if they are not so landed the risk ceases.

Touch and stay.

- 6 In the absence of any further licence or usage, the liberty to touch and stay “at any port or place whatsoever” does not authorise the ship to depart from the course of her voyage from the port of departure to the port of destination.

Perils of the seas.

- 7 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.

Pirates.

- 8 The term “pirates” includes passengers who mutiny and rioters who attack the ship from the shore.

Thieves.

- 9 The term “thieves” does not cover clandestine theft or a theft committed by any one of the ship’s company, whether crew or passengers.

Restraint of princes.

- 10 The term “arrests, &c., of kings, princes, and people” refers to political or executive acts, and does not include a loss caused by riot or by ordinary judicial process.

Barratry.

- 11 The term “barratry” includes every wrongful act wilfully committed by the master or crew to the prejudice of the owner, or, as the case may be, the charterer.

All other perils.

- 12 The term “all other perils” includes only perils similar in kind to the perils specifically mentioned in the policy.

TABLE OF LEGISLATION

Average unless general.

- 13 The term “average unless general” means a partial loss of the subject-matter insured other than a general average loss, and does not include “particular charges.”

Stranded.

- 14 Where the ship has stranded, the insurer is liable for the excepted losses, although the loss is not attributable to the stranding, provided that when the stranding takes place the risk has attached and, if the policy be on goods, that the damaged goods are on board.

Ship.

- 15 The term “ship” includes the hull, materials and outfit, stores and provisions for the officers and crew, and, in the case of vessels engaged in a special trade, the ordinary fittings requisite for the trade, and also, in the case of a steamship, the machinery, boilers, and coals and engine stores, if owned by the assured.

Freight.

- 16 The term “freight” includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money.

Goods.

- 17 The term “goods” means goods in the nature of merchandise, and does not include personal effects or provisions and stores for use on board.

In the absence of any usage to the contrary, deck cargo and living animals must be insured specifically, and not under the general denomination of goods.

F5

SECOND SCHEDULE

Annotations:

Amendments (Textual)

F5 Ss. 92, 93, Sch. 2 repealed by Statute Law Revision Act 1927 (c. 42)

APPENDIX 2



Misrepresentation Act 1967

1967 CHAPTER 7

An Act to amend the law relating to innocent misrepresentations and to amend sections 11 and 35 of the Sale of Goods Act 1893. [22nd March 1967]

1 Removal of certain bars to rescission for innocent misrepresentation.

Where a person has entered into a contract after a misrepresentation has been made to him, and—

- (a) the misrepresentation has become a term of the contract; or
- (b) the contract has been performed;

or both, then, if otherwise he would be entitled to rescind the contract without alleging fraud, he shall be so entitled, subject to the provisions of this Act, notwithstanding the matters mentioned in paragraphs (a) and (b) of this section.

2 Damages for misrepresentation.

- (1) Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made the facts represented were true.
- (2) Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.
- (3) Damages may be awarded against a person under subsection (2) of this section whether or not he is liable to damages under subsection (1) thereof, but where he is so liable

any award under the said subsection (2) shall be taken into account in assessing his liability under the said subsection (1).

[F13 Avoidance of provision excluding liability for misrepresentation.

If a contract contains a term which would exclude or restrict—

- (a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or
- (b) any remedy available to another party to the contract by reason of such a misrepresentation,

that term shall be of no effect except in so far as it satisfies the requirement of reasonableness as stated in section 11(1) of the Unfair Contract Terms Act 1977; and it is for those claiming that the term satisfies that requirement to show that it does.]

Annotations:

Amendments (Textual)

F1 S. 3 substituted by Unfair Contract Terms Act 1977 (c. 50), s. 8(1)

4 **F2**

Annotations:

Amendments (Textual)

F2 s. 4 repealed by Sale of Goods Act 1979 (c. 54, SIF 109:1), ss. 62, 63, Sch. 3

5 Saving for past transactions.

Nothing in this Act shall apply in relation to any misrepresentation or contract of sale which is made before the commencement of this Act.

6 Short title, commencement and extent.

- (1) This Act may be cited as the Misrepresentation Act 1967.
- (2) This Act shall come into operation at the expiration of the period of one month beginning with the date on which it is passed.
- (3) This Act . . . ^{F3} does not extend to Scotland.
- (4) This Act does not extend to Northern Ireland.

Annotations:

Amendments (Textual)

F3 Words repealed by Sale of Goods Act 1979 (c. 54, SIF 109:1), ss. 62, 63, Sch. 3

APPENDIX 3



Fraud Act 2006

2006 CHAPTER 35

An Act to make provision for, and in connection with, criminal liability for fraud and obtaining services dishonestly. [8th November 2006]

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

Fraud

1 Fraud

- (1) A person is guilty of fraud if he is in breach of any of the sections listed in subsection (2) (which provide for different ways of committing the offence).
- (2) The sections are—
 - (a) section 2 (fraud by false representation),
 - (b) section 3 (fraud by failing to disclose information), and
 - (c) section 4 (fraud by abuse of position).
- (3) A person who is guilty of fraud is liable—
 - (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
 - (b) on conviction on indictment, to imprisonment for a term not exceeding 10 years or to a fine (or to both).
- (4) Subsection (3)(a) applies in relation to Northern Ireland as if the reference to 12 months were a reference to 6 months.

2 Fraud by false representation

- (1) A person is in breach of this section if he—
 - (a) dishonestly makes a false representation, and

FRAUD ACT 2006

- (b) intends, by making the representation—
 - (i) to make a gain for himself or another, or
 - (ii) to cause loss to another or to expose another to a risk of loss.
- (2) A representation is false if—
 - (a) it is untrue or misleading, and
 - (b) the person making it knows that it is, or might be, untrue or misleading.
- (3) “Representation” means any representation as to fact or law, including a representation as to the state of mind of—
 - (a) the person making the representation, or
 - (b) any other person.
- (4) A representation may be express or implied.
- (5) For the purposes of this section a representation may be regarded as made if it (or anything implying it) is submitted in any form to any system or device designed to receive, convey or respond to communications (with or without human intervention).

3 Fraud by failing to disclose information

A person is in breach of this section if he—

- (a) dishonestly fails to disclose to another person information which he is under a legal duty to disclose, and
- (b) intends, by failing to disclose the information—
 - (i) to make a gain for himself or another, or
 - (ii) to cause loss to another or to expose another to a risk of loss.

4 Fraud by abuse of position

- (1) A person is in breach of this section if he—
 - (a) occupies a position in which he is expected to safeguard, or not to act against, the financial interests of another person,
 - (b) dishonestly abuses that position, and
 - (c) intends, by means of the abuse of that position—
 - (i) to make a gain for himself or another, or
 - (ii) to cause loss to another or to expose another to a risk of loss.
- (2) A person may be regarded as having abused his position even though his conduct consisted of an omission rather than an act.

5 “Gain” and “loss”

- (1) The references to gain and loss in sections 2 to 4 are to be read in accordance with this section.
- (2) “Gain” and “loss”—
 - (a) extend only to gain or loss in money or other property;
 - (b) include any such gain or loss whether temporary or permanent;and “property” means any property whether real or personal (including things in action and other intangible property).

- (3) “Gain” includes a gain by keeping what one has, as well as a gain by getting what one does not have.
- (4) “Loss” includes a loss by not getting what one might get, as well as a loss by parting with what one has.

6 Possession etc. of articles for use in frauds

- (1) A person is guilty of an offence if he has in his possession or under his control any article for use in the course of or in connection with any fraud.
- (2) A person guilty of an offence under this section is liable—
 - (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
 - (b) on conviction on indictment, to imprisonment for a term not exceeding 5 years or to a fine (or to both).
- (3) Subsection (2)(a) applies in relation to Northern Ireland as if the reference to 12 months were a reference to 6 months.

7 Making or supplying articles for use in frauds

- (1) A person is guilty of an offence if he makes, adapts, supplies or offers to supply any article—
 - (a) knowing that it is designed or adapted for use in the course of or in connection with fraud, or
 - (b) intending it to be used to commit, or assist in the commission of, fraud.
- (2) A person guilty of an offence under this section is liable—
 - (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
 - (b) on conviction on indictment, to imprisonment for a term not exceeding 10 years or to a fine (or to both).
- (3) Subsection (2)(a) applies in relation to Northern Ireland as if the reference to 12 months were a reference to 6 months.

8 “Article”

- (1) For the purposes of—
 - (a) sections 6 and 7, and
 - (b) the provisions listed in subsection (2), so far as they relate to articles for use in the course of or in connection with fraud,“article” includes any program or data held in electronic form.
- (2) The provisions are—
 - (a) section 1(7)(b) of the Police and Criminal Evidence Act 1984 (c. 60),
 - (b) section 2(8)(b) of the Armed Forces Act 2001 (c. 19), and
 - (c) Article 3(7)(b) of the Police and Criminal Evidence (Northern Ireland) Order 1989 (S.I. 1989/1341 (N.I. 12));(meaning of “prohibited articles” for the purposes of stop and search powers).

9 Participating in fraudulent business carried on by sole trader etc.

- (1) A person is guilty of an offence if he is knowingly a party to the carrying on of a business to which this section applies.
- (2) This section applies to a business which is carried on—
- (a) by a person who is outside the reach of [^{F1}section 993 of the Companies Act 2006](offence of fraudulent trading) , and
 - (b) with intent to defraud creditors of any person or for any other fraudulent purpose.
- (3) The following are within the reach of [^{F2}that section]—
- (a) a company (within the meaning of [^{F3}the Companies Act 1985 or the Companies (Northern Ireland) Order 1986]);
 - (b) a person to whom that section applies (with or without adaptations or modifications) as if the person were a company;
 - (c) a person exempted from the application of that section.
- (4) ^{F4}.....
- (5) “Fraudulent purpose” has the same meaning as in [^{F5}that section].
- (6) A person guilty of an offence under this section is liable—
- (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
 - (b) on conviction on indictment, to imprisonment for a term not exceeding 10 years or to a fine (or to both).
- (7) Subsection (6)(a) applies in relation to Northern Ireland as if the reference to 12 months were a reference to 6 months.

Annotations:

Amendments (Textual)

- F1** Words in s. 9(2)(a) substituted (1.10.2007 with application as mentioned in Sch. 4 para. 111(6) of the amending S.I.) by virtue of The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (S.I. 2007/2194), arts. 1(3)(a), 10(1), Sch. 4 para. 111(2) (with art. 12)
- F2** Words in s. 9(3) substituted (1.10.2007 with application as mentioned in Sch. 4 para. 111(6) of the amending S.I.) by The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (S.I. 2007/2194), arts. 1(3)(a), 10(1), Sch. 4 para. 111(3)(a) (with art. 12)
- F3** Words in s. 9(3)(a) substituted (1.10.2007 with application as mentioned in Sch. 4 para. 111(6) of the amending S.I.) by The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (S.I. 2007/2194), arts. 1(3)(a), 10(1), Sch. 4 para. 111(3)(b) (with art. 12)
- F4** S. 9(4) repealed (1.10.2007 with application as mentioned in Sch. 4 para. 111(6) of the amending S.I.) by The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (S.I. 2007/2194), arts. 1(3)(a), 10(1)(3), Sch. 4 para. 111(4), Sch. 5 (with art. 12)
- F5** Words in s. 9(5) substituted (1.10.2007 with application as mentioned in Sch. 4 para. 111(6) of the amending S.I.) by The Companies Act 2006 (Commencement No. 3, Consequential Amendments,

Transitional Provisions and Savings) Order 2007 (S.I. 2007/2194), arts. 1(3)(a), 10(1), Sch. 4 para. 111(5) (with art. 12)

10 Participating in fraudulent business carried on by company etc.: penalty

- (1) In Schedule 24 to the Companies Act 1985 (punishment of offences), in column 4 of the entry relating to section 458 of that Act, for “7 years” substitute “ 10 years ”.
- (2) In Schedule 23 to the Companies (Northern Ireland) Order 1986 (punishment of offences), in column 4 of the entry relating to Article 451 of that Order, for “7 years” substitute “ 10 years ”.

Obtaining services dishonestly

11 Obtaining services dishonestly

- (1) A person is guilty of an offence under this section if he obtains services for himself or another—
 - (a) by a dishonest act, and
 - (b) in breach of subsection (2).
- (2) A person obtains services in breach of this subsection if—
 - (a) they are made available on the basis that payment has been, is being or will be made for or in respect of them,
 - (b) he obtains them without any payment having been made for or in respect of them or without payment having been made in full, and
 - (c) when he obtains them, he knows—
 - (i) that they are being made available on the basis described in paragraph (a), or
 - (ii) that they might be,but intends that payment will not be made, or will not be made in full.
- (3) A person guilty of an offence under this section is liable—
 - (a) on summary conviction, to imprisonment for a term not exceeding 12 months or to a fine not exceeding the statutory maximum (or to both);
 - (b) on conviction on indictment, to imprisonment for a term not exceeding 5 years or to a fine (or to both).
- (4) Subsection (3)(a) applies in relation to Northern Ireland as if the reference to 12 months were a reference to 6 months.

Supplementary

12 Liability of company officers for offences by company

- (1) Subsection (2) applies if an offence under this Act is committed by a body corporate.
- (2) If the offence is proved to have been committed with the consent or connivance of—
 - (a) a director, manager, secretary or other similar officer of the body corporate, or
 - (b) a person who was purporting to act in any such capacity,

he (as well as the body corporate) is guilty of the offence and liable to be proceeded against and punished accordingly.

- (3) If the affairs of a body corporate are managed by its members, subsection (2) applies in relation to the acts and defaults of a member in connection with his functions of management as if he were a director of the body corporate.

13 Evidence

- (1) A person is not to be excused from—
- (a) answering any question put to him in proceedings relating to property, or
 - (b) complying with any order made in proceedings relating to property,
- on the ground that doing so may incriminate him or his spouse or civil partner of an offence under this Act or a related offence.
- (2) But, in proceedings for an offence under this Act or a related offence, a statement or admission made by the person in—
- (a) answering such a question, or
 - (b) complying with such an order,
- is not admissible in evidence against him or (unless they married or became civil partners after the making of the statement or admission) his spouse or civil partner.
- (3) “Proceedings relating to property” means any proceedings for—
- (a) the recovery or administration of any property,
 - (b) the execution of a trust, or
 - (c) an account of any property or dealings with property,
- and “property” means money or other property whether real or personal (including things in action and other intangible property).
- (4) “Related offence” means—
- (a) conspiracy to defraud;
 - (b) any other offence involving any form of fraudulent conduct or purpose.

14 Minor and consequential amendments etc.

- (1) Schedule 1 contains minor and consequential amendments.
- (2) Schedule 2 contains transitional provisions and savings.
- (3) Schedule 3 contains repeals and revocations.

15 Commencement and extent

- (1) This Act (except this section and section 16) comes into force on such day as the Secretary of State may appoint by an order made by statutory instrument; and different days may be appointed for different purposes.
- (2) Subject to subsection (3), sections 1 to 9 and 11 to 13 extend to England and Wales and Northern Ireland only.
- (3) Section 8, so far as it relates to the Armed Forces Act 2001 (c. 19), extends to any place to which that Act extends.

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- (4) Any amendment in section 10 or Schedule 1, and any related provision in section 14 or Schedule 2 or 3, extends to any place to which the provision which is the subject of the amendment extends.

16 Short title

This Act may be cited as the Fraud Act 2006.

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SCHEDULES

SCHEDULE 1

Section 14(1)

MINOR AND CONSEQUENTIAL AMENDMENTS

Abolition of various deception offences

- 1 Omit the following provisions—
- (a) in the Theft Act 1968 (c. 60)—
 - (i) section 15 (obtaining property by deception);
 - (ii) section 15A (obtaining a money transfer by deception);
 - (iii) section 16 (obtaining pecuniary advantage by deception);
 - (iv) section 20(2) (procuring the execution of a valuable security by deception);
 - (b) in the Theft Act 1978 (c. 31)—
 - (i) section 1 (obtaining services by deception);
 - (ii) section 2 (evasion of liability by deception);
 - (c) in the Theft Act (Northern Ireland) 1969 (c. 16 (N.I.))—
 - (i) section 15 (obtaining property by deception);
 - (ii) section 15A (obtaining a money transfer by deception);
 - (iii) section 16 (obtaining pecuniary advantage by deception);
 - (iv) section 19(2) (procuring the execution of a valuable security by deception);
 - (d) in the Theft (Northern Ireland) Order 1978 (S.I. 1978/1407 (N.I. 23))—
 - (i) Article 3 (obtaining services by deception);
 - (ii) Article 4 (evasion of liability by deception).

Visiting Forces Act 1952 (c. 67)

- 2 In the Schedule (offences referred to in section 3 of the 1952 Act), in paragraph 3 (meaning of “offence against property”), after sub-paragraph (l) insert—
- “(m) the Fraud Act 2006.”

Theft Act 1968 (c. 60)

- 3 Omit section 15B (section 15A: supplementary).
- 4 In section 18(1) (liability of company officers for offences by company under section 15, 16 or 17), omit “ 15, 16 or ”.
- 5 In section 20(3) (suppression etc. of documents—interpretation), omit “deception” has the same meaning as in section 15 of this Act, and ”.

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- 6 (1) In section 24(4) (meaning of “stolen goods”) for “in the circumstances described in section 15(1) of this Act” substitute “, subject to subsection (5) below, by fraud (within the meaning of the Fraud Act 2006) ”.
- (2) After section 24(4) insert—
- “(5) Subsection (1) above applies in relation to goods obtained by fraud as if—
- (a) the reference to the commencement of this Act were a reference to the commencement of the Fraud Act 2006, and
 - (b) the reference to an offence under this Act were a reference to an offence under section 1 of that Act.”
- 7 (1) In section 24A (dishonestly retaining a wrongful credit), omit subsections (3) and (4) and after subsection (2) insert—
- “(2A) A credit to an account is wrongful to the extent that it derives from—
- (a) theft;
 - (b) blackmail;
 - (c) fraud (contrary to section 1 of the Fraud Act 2006); or
 - (d) stolen goods.”
- (2) In subsection (7), for “subsection (4)” substitute “ subsection (2A) ”.
- (3) For subsection (9) substitute—
- “(9) “Account” means an account kept with—
- (a) a bank;
 - (b) a person carrying on a business which falls within subsection (10) below; or
 - (c) an issuer of electronic money (as defined for the purposes of Part 2 of the Financial Services and Markets Act 2000).
- (10) A business falls within this subsection if—
- (a) in the course of the business money received by way of deposit is lent to others; or
 - (b) any other activity of the business is financed, wholly or to any material extent, out of the capital of or the interest on money received by way of deposit.
- (11) References in subsection (10) above to a deposit must be read with—
- (a) section 22 of the Financial Services and Markets Act 2000;
 - (b) any relevant order under that section; and
 - (c) Schedule 2 to that Act;
- but any restriction on the meaning of deposit which arises from the identity of the person making it is to be disregarded.
- (12) For the purposes of subsection (10) above—
- (a) all the activities which a person carries on by way of business shall be regarded as a single business carried on by him; and
 - (b) “money” includes money expressed in a currency other than sterling.”
- 8 In section 25 (going equipped for burglary, theft or cheat)—

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- (a) in subsections (1) and (3) for “burglary, theft or cheat” substitute “ burglary or theft ”, and
- (b) in subsection (5) omit “ , and “cheat” means an offence under section 15 of this Act ”.

Theft Act (Northern Ireland) 1969 (c. 16 (N.I.))

- 9 Omit section 15B (section 15A: supplementary).
- 10 In section 19(3) (suppression etc. of documents—interpretation), omit “deception” has the same meaning as in section 15, and”.
- 11 (1) In section 23(5) (meaning of “stolen goods”) for “in the circumstances described in section 15(1)” substitute “ , subject to subsection (6), by fraud (within the meaning of the Fraud Act 2006) ”.
- (2) After section 23(5) insert—
- “(6) Subsection (1) applies in relation to goods obtained by fraud as if—
- (a) the reference to the commencement of this Act were a reference to the commencement of the Fraud Act 2006, and
 - (b) the reference to an offence under this Act were a reference to an offence under section 1 of that Act.”
- 12 (1) In section 23A (dishonestly retaining a wrongful credit), omit subsections (3) and (4) and after subsection (2) insert—
- “(2A) A credit to an account is wrongful to the extent that it derives from—
- (a) theft;
 - (b) blackmail;
 - (c) fraud (contrary to section 1 of the Fraud Act 2006); or
 - (d) stolen goods.”
- (2) In subsection (7), for “subsection (4)” substitute “ subsection (2A) ”.
- (3) For subsection (9) substitute—
- “(9) “Account” means an account kept with—
- (a) a bank;
 - (b) a person carrying on a business which falls within subsection (10); or
 - (c) an issuer of electronic money (as defined for the purposes of Part 2 of the Financial Services and Markets Act 2000).
- (10) A business falls within this subsection if—
- (a) in the course of the business money received by way of deposit is lent to others; or
 - (b) any other activity of the business is financed, wholly or to any material extent, out of the capital of or the interest on money received by way of deposit.
- (11) References in subsection (10) to a deposit must be read with—
- (a) section 22 of the Financial Services and Markets Act 2000;
 - (b) any relevant order under that section; and
 - (c) Schedule 2 to that Act;

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but any restriction on the meaning of deposit which arises from the identity of the person making it is to be disregarded.

(12) For the purposes of subsection (10)—

- (a) all the activities which a person carries on by way of business shall be regarded as a single business carried on by him; and
- (b) “money” includes money expressed in a currency other than sterling.”

13 In section 24 (going equipped for burglary, theft or cheat)—

- (a) in subsections (1) and (3), for “burglary, theft or cheat” substitute “burglary or theft”, and
- (b) in subsection (5), omit “, and “cheat” means an offence under section 15”.

Theft Act 1978 (c. 31)

14 In section 4 (punishments), omit subsection (2)(a).

15 In section 5 (supplementary), omit subsection (1).

Theft (Northern Ireland) Order 1978 (S.I. 1978/1407 (N.I. 23))

16 In Article 6 (punishments), omit paragraph (2)(a).

17 In Article 7 (supplementary), omit paragraph (1).

Limitation Act 1980 (c. 58)

18 In section 4 (special time limit in case of theft), for subsection (5)(b) substitute—

- “(b) obtaining any chattel (in England and Wales or elsewhere) by—
 - (i) blackmail (within the meaning of section 21 of the Theft Act 1968), or
 - (ii) fraud (within the meaning of the Fraud Act 2006);”.

Finance Act 1982 (c. 39)

19 In section 11(1) (powers of Commissioners with respect to agricultural levies), for “or the Theft (Northern Ireland) Order 1978,” substitute “, the Theft (Northern Ireland) Order 1978 or the Fraud Act 2006”.

Nuclear Material (Offences) Act 1983 (c. 18)

20 In section 1 (extended scope of certain offences), in subsection (1)(d), omit “ 15 or ” (in both places).

Police and Criminal Evidence Act 1984 (c. 60)

21 In section 1 (power of constable to stop and search persons, vehicles etc.), in subsection (8), for paragraph (d) substitute—

- “(d) fraud (contrary to section 1 of the Fraud Act 2006).”

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Limitation (Northern Ireland) Order 1989 (S.I. 1989/1339 (N.I. 11))

- 22 In Article 18 (special time limit in case of theft), for paragraph (5)(b) substitute—
“(b) obtaining any chattel (in Northern Ireland or elsewhere) by—
(i) blackmail (within the meaning of section 20 of the Theft Act (Northern Ireland) 1969), or
(ii) fraud (within the meaning of the Fraud Act 2006);”.

Police and Criminal Evidence (Northern Ireland) Order 1989 (S.I. 1989/1341 (N.I. 12))

- 23 In Article 3 (power of constable to stop and search persons, vehicles etc.), in paragraph (8), for sub-paragraph (d) substitute—
“(d) fraud (contrary to section 1 of the Fraud Act 2006).”

Criminal Justice Act 1993 (c. 36)

- 24 (1) In section 1(2) (Group A offences), omit the entries in paragraph (a) relating to sections 15, 15A, 16 and 20(2) of the Theft Act 1968.
(2) Omit section 1(2)(b).
(3) Before section 1(2)(c) insert—
“(bb) an offence under any of the following provisions of the Fraud Act 2006—
(i) section 1 (fraud);
(ii) section 6 (possession etc. of articles for use in frauds);
(iii) section 7 (making or supplying articles for use in frauds);
(iv) section 9 (participating in fraudulent business carried on by sole trader etc.);
(v) section 11 (obtaining services dishonestly).”

- 25 (1) Amend section 2 (jurisdiction in respect of Group A offences) as follows.
(2) In subsection (1), after “means” insert “ (subject to subsection (1A)) ”.
(3) After subsection (1) insert—
“(1A) In relation to an offence under section 1 of the Fraud Act 2006 (fraud), “relevant event” includes—
(a) if the fraud involved an intention to make a gain and the gain occurred, that occurrence;
(b) if the fraud involved an intention to cause a loss or to expose another to a risk of loss and the loss occurred, that occurrence.”

Criminal Justice (Northern Ireland) Order 1994 (S.I. 1994/2795 (N.I. 15))

- 26 In Article 14 (compensation orders), in paragraphs (3) and (4)(a) for “or Article 172 of the Road Traffic (Northern Ireland) Order 1981” substitute “, Article 172 of the Road Traffic (Northern Ireland) Order 1981 or the Fraud Act 2006 ”.

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Criminal Justice (Northern Ireland) Order 1996 (S.I. 1996/3160 (N.I. 24))

- 27 (1) In Article 38(2) (Group A offences), omit the entries in sub-paragraph (a) relating to sections 15, 15A, 16 and 19(2) of the Theft Act (Northern Ireland) 1969.
- (2) Omit Article 38(2)(b).
- (3) Before Article 38(2)(c) insert—
- “(bb) an offence under any of the following provisions of the Fraud Act 2006—
- (i) section 1 (fraud);
- (ii) section 6 (possession etc. of articles for use in frauds);
- (iii) section 7 (making or supplying articles for use in frauds);
- (iv) section 9 (participating in fraudulent business carried on by sole trader etc.);
- (v) section 11 (obtaining services dishonestly).”

- 28 (1) Amend Article 39 (jurisdiction in respect of Group A offences) as follows.
- (2) In paragraph (1), after “means” insert “ (subject to paragraph (1A)) ”.
- (3) After paragraph (1) insert—
- “(1A) In relation to an offence under section 1 of the Fraud Act 2006 (fraud), “relevant event” includes—
- (a) if the fraud involved an intention to make a gain and the gain occurred, that occurrence;
- (b) if the fraud involved an intention to cause a loss or to expose another to a risk of loss and the loss occurred, that occurrence.”

Powers of Criminal Courts (Sentencing) Act 2000 (c. 6)

- 29 In section 130 (compensation orders), in subsections (5) and (6)(a), after “Theft Act 1968” insert “ or Fraud Act 2006 ”.

Terrorism Act 2000 (c. 11)

- 30 (1) In Schedule 9 (scheduled offences), in paragraph 10, at the end of sub-paragraph (d) insert “ and ” and omit paragraph (e).
- (2) After paragraph 22A of that Schedule insert—

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- 23 Offences under section 1 of the Fraud Act 2006 (fraud) subject to note 2 below.”
- (3) In note 2 to Part 1 of Schedule 9, for “paragraph 10(a), (c) or (e)” substitute “ paragraph 10(a) or (c) or 23 ”.
- 31 (1) In Schedule 12 (compensation), in paragraph 12(1), omit “ (within the meaning of section 15(4) of the Theft Act (Northern Ireland) 1969) ”.
- (2) After paragraph 12(1) of that Schedule insert—

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“(1A) “Deception” means any deception (whether deliberate or reckless) by words or conduct as to fact or as to law, including a deception as to the present intentions of the person using the deception or any other person.”

Criminal Justice and Court Services Act 2000 (c. 43)

32 (1) In Schedule 6 (trigger offences), in paragraph 1, omit the entry relating to section 15 of the Theft Act 1968.

(2) After paragraph 2 of Schedule 6 insert—

“3 Offences under the following provisions of the Fraud Act 2006 are trigger offences—

section 1 (fraud)

section 6 (possession etc. of articles for use in frauds)

section 7 (making or supplying articles for use in frauds).”

Armed Forces Act 2001 (c. 19)

33 In section 2(9) (definition of prohibited articles for purposes of powers to stop and search), for paragraph (d) substitute—

“(d) fraud (contrary to section 1 of the Fraud Act 2006).”

Licensing Act 2003 (c. 17)

34 In Schedule 4 (personal licence: relevant offences), after paragraph 20 insert—

“21 An offence under the Fraud Act 2006.”

Asylum and Immigration (Treatment of Claimants, etc.) Act 2004 (c. 19)

35 (1) In section 14(2) (offences giving rise to immigration officer's power of arrest), omit paragraph “(g)(ii)” and “(iii)”, in paragraph “(h)”, “15, 16” and paragraphs (i) and (j).

(2) After section 14(2)(h) insert—

“(ha) an offence under either of the following provisions of the Fraud Act 2006—

(i) section 1 (fraud);

(ii) section 11 (obtaining services dishonestly).”

Serious Organised Crime and Police Act 2005 (c. 15)

36 In section 76 (financial reporting orders: making), in subsection (3), for paragraphs (a) and (b) substitute—

“(aa) an offence under either of the following provisions of the Fraud Act 2006—

(i) section 1 (fraud),

(ii) section 11 (obtaining services dishonestly).”

37 In section 78 (financial reporting orders: making in Northern Ireland), in subsection (3), for paragraphs (a) and (b) substitute—

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“(aa) an offence under either of the following provisions of the Fraud Act 2006—

- (i) section 1 (fraud),
- (ii) section 11 (obtaining services dishonestly).”

Gambling Act 2005 (c. 19)

38 After paragraph 3 of Schedule 7 (relevant offences) insert—

“3A An offence under the Fraud Act 2006.”

SCHEDULE 2

Section 14(2)

TRANSITIONAL PROVISIONS AND SAVINGS

Maximum term of imprisonment for offences under this Act

1 In relation to an offence committed before the commencement of section 154(1) of the Criminal Justice Act 2003 (c. 44), the references to 12 months in sections 1(3)(a), 6(2)(a), 7(2)(a), 9(6)(a) and 11(3)(a) are to be read as references to 6 months.

Increase in penalty for fraudulent trading

2 Section 10 does not affect the penalty for any offence committed before that section comes into force.

Abolition of deception offences

- 3 (1) Paragraph 1 of Schedule 1 does not affect any liability, investigation, legal proceeding or penalty for or in respect of any offence partly committed before the commencement of that paragraph.
- (2) An offence is partly committed before the commencement of paragraph 1 of Schedule 1 if—
- (a) a relevant event occurs before its commencement, and
 - (b) another relevant event occurs on or after its commencement.
- (3) “Relevant event”, in relation to an offence, means any act, omission or other event (including any result of one or more acts or omissions) proof of which is required for conviction of the offence.

Scope of offences relating to stolen goods under the Theft Act 1968 (c. 60)

4 Nothing in paragraph 6 of Schedule 1 affects the operation of section 24 of the Theft Act 1968 in relation to goods obtained in the circumstances described in section 15(1) of that Act where the obtaining is the result of a deception made before the commencement of that paragraph.

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Dishonestly retaining a wrongful credit under the Theft Act 1968

- 5 Nothing in paragraph 7 of Schedule 1 affects the operation of section 24A(7) and (8) of the Theft Act 1968 in relation to credits falling within section 24A(3) or (4) of that Act and made before the commencement of that paragraph.

Scope of offences relating to stolen goods under the Theft Act (Northern Ireland) 1969 (c. 16 (N.I.))

- 6 Nothing in paragraph 11 of Schedule 1 affects the operation of section 23 of the Theft Act (Northern Ireland) 1969 in relation to goods obtained in the circumstances described in section 15(1) of that Act where the obtaining is the result of a deception made before the commencement of that paragraph.

Dishonestly retaining a wrongful credit under the Theft Act (Northern Ireland) 1969

- 7 Nothing in paragraph 12 of Schedule 1 affects the operation of section 23A(7) and (8) of the Theft Act (Northern Ireland) 1969 in relation to credits falling within section 23A(3) or (4) of that Act and made before the commencement of that paragraph.

Limitation periods under the Limitation Act 1980 (c. 58)

- 8 Nothing in paragraph 18 of Schedule 1 affects the operation of section 4 of the Limitation Act 1980 in relation to chattels obtained in the circumstances described in section 15(1) of the Theft Act 1968 where the obtaining is a result of a deception made before the commencement of that paragraph.

Limitation periods under the Limitation (Northern Ireland) Order 1989 (S.I. 1989/1339 (N.I. 11))

- 9 Nothing in paragraph 22 of Schedule 1 affects the operation of Article 18 of the Limitation (Northern Ireland) Order 1989 in relation to chattels obtained in the circumstances described in section 15(1) of the Theft Act (Northern Ireland) 1969 where the obtaining is a result of a deception made before the commencement of that paragraph.

Scheduled offences under the Terrorism Act 2000 (c. 11)

- 10 Nothing in paragraph 30 of Schedule 1 affects the operation of Part 7 of the Terrorism Act 2000 in relation to an offence under section 15(1) of the Theft Act (Northern Ireland) 1969 where the obtaining is a result of a deception made before the commencement of that paragraph.

Powers of arrest under Asylum and Immigration (Treatment of Claimants, etc.) Act 2004 (c. 19)

- 11 (1) Nothing in paragraph 35 of Schedule 1 affects the power of arrest conferred by section 14 of the Asylum and Immigration (Treatment of Claimants, etc.) Act 2004 in relation to an offence partly committed before the commencement of that paragraph.
- (2) An offence is partly committed before the commencement of paragraph 35 of Schedule 1 if—

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- (a) a relevant event occurs before its commencement, and
 - (b) another relevant event occurs on or after its commencement.
- (3) “Relevant event”, in relation to an offence, means any act, omission or other event (including any result of one or more acts or omissions) proof of which is required for conviction of the offence.

SCHEDULE 3

Section 14(3)

REPEALS AND REVOCATIONS

<i>Title and number</i>	<i>Extent of repeal or revocation</i>
Theft Act 1968 (c. 60)	Sections 15, 15A, 15B and 16. In section 18(1), “15, 16 or”. Section 20(2). In section 20(3), “ “deception” has the same meaning as in section 15 of this Act, and”. Section 24A(3) and (4). In section 25(5), “, and “cheat” means an offence under section 15 of this Act”.
Theft Act (Northern Ireland) 1969 (c. 16 (N.I.))	Sections 15, 15A, 15B and 16. Section 19(2). In section 19(3), “ “deception” has the same meaning as in section 15, and”. Section 23A(3) and (4). In section 24(5), “, and “cheat” means an offence under section 15”.
Theft Act 1978 (c. 31)	Sections 1 and 2. Section 4(2)(a). Section 5(1).
Theft (Northern Ireland) Order 1978 (S.I. 1978/1407 (N.I. 23))	Articles 3 and 4. Article 6(2)(a). Article 7(1).
Nuclear Material (Offences) Act 1983 (c. 18)	In section 1(1)(d), “15 or” (in both places).
Criminal Justice Act 1993 (c. 36)	In section 1(2), the entries in paragraph (a) relating to sections 15, 15A, 16 and 20(2) of the Theft Act 1968. Section 1(2)(b).
Theft (Amendment) Act 1996 (c. 62)	Sections 1, 3(2) and 4.
Criminal Justice (Northern Ireland) Order 1996 (S.I. 1996/3160 (N.I. 24))	In Article 38(2), the entries in sub-paragraph (a) relating to sections 15, 15A, 16 and 19(2) of the Theft Act (Northern Ireland) 1969. Article 38(2)(b).
Theft (Amendment) (Northern Ireland) Order 1997 (S.I. 1997/277 (N.I. 3))	Articles 3, 5(2) and 6.

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Terrorism Act 2000 (c. 11)	In Schedule 9, paragraph 10(e). In Schedule 12, in paragraph 12(1), “(within the meaning of section 15(4) of the Theft Act (Northern Ireland) 1969)”.
Criminal Justice and Court Services Act 2000 (c. 43)	In Schedule 6, in paragraph 1, the entry relating to section 15 of the Theft Act 1968.
Asylum and Immigration (Treatment of Claimants, etc.) Act 2004 (c. 19)	In section 14(2), paragraph (g)(ii) and (iii), in paragraph (h), “15, 16” and paragraphs (i) and (j).

APPENDIX 4

Institute Time Clauses - Hulls 1.10.83

This Insurance is subject to English law and practice

1 NAVIGATION

- 1.1 The Vessel is covered subject to the provisions of this insurance at all times and has leave to sail or navigate with or without pilots, to go on trial trips and to assist and tow vessels or craft in distress, but it is warranted that the Vessel shall not be towed, except as is customary or to the first safe port or place when in need of assistance, or undertake towage or salvage services under a contract previously arranged by the Assured and/or Owners and/or Managers and/or Charterers. This Clause 1.1, shall not exclude customary towage in connection with loading and discharging.
- 1.2 In the event of the Vessel being employed in trading operations which entail cargo loading or discharging at sea from or into another vessel (not being a harbour or inshore craft) no claim shall be recoverable under this insurance for loss of or damage to the Vessel or liability to any other vessel arising from such loading or discharging operations, including whilst approaching, lying alongside and leaving, unless previous notice that the Vessel is to be employed in such operations has been given to the Underwriters and any amended terms of cover and any additional premium required by them have been agreed.
- 1.3 In the event of the Vessel sailing (with or without cargo) with an intention of being (a) broken up, or (b) sold for breaking up, any claim for loss of or damage to the Vessel occurring subsequent to such sailing shall be limited to the market value of the Vessel as scrap at the time when the loss or damage is sustained, unless previous notice has been given to the Underwriters and any amendments to the terms of cover insured value and premium required by them have been agreed. Nothing in this Clause 1.3 shall affect claims under Clauses 8 and/or 11.

2 CONTINUATION

Should the Vessel at the expiration of this insurance be at sea or in distress or at a port of refuge or of call, she shall, provided previous notice be given to the Underwriters, be held covered at a pro rata monthly premium to her port of destination.

3 BREACH OF WARRANTY

Held covered in case of any breach of warranty as to cargo, trade, locality towage, salvage services or date of sailing, provided notice be given to the Underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed.

4 TERMINATION

This Clause 4 shall prevail notwithstanding any provision whether written typed or printed in this insurance inconsistent therewith.

Unless the Underwriters agree to the contrary in writing, this insurance shall terminate automatically at the time of

- 4.1 change of the Classification Society of the Vessel, or change, suspension, discontinuance, withdrawal or expiry of her Class therein, provided that if the Vessel is at sea such automatic termination shall be deferred until arrival at her next port. However where such change, suspension, discontinuance or withdrawal of her Class has resulted from loss or damage covered by Clause 6 of this insurance or which would be covered by an insurance of the Vessel subject to current Institute War and Strikes Clauses Hulls-Time such automatic termination shall only operate should the Vessel sail from her next port without the prior approval of the Classification Society.
- 4.2 any change, voluntary or otherwise, in the ownership or flag, transfer to new management, or charter on a bareboat basis, or requisition for title or use of the Vessel, provided that, if the Vessel has cargo on board and has already sailed from her loading port or is at sea in ballast, such automatic termination shall if required be deferred, whilst the Vessel continues her planned voyage, until arrival at final port of discharge if with cargo or at port of destination if in ballast. However in the event a requisition for title or use without the prior

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execution of a written agreement by the Assured, such automatic termination shall occur fifteen days after such requisition whether the Vessel is at sea or in port.

A pro rata daily net return of premium shall be made.

5 ASSIGNMENT

No assignment of or interest in this insurance or in any moneys which may be or become payable thereunder is to be binding on or recognised by the Underwriters unless a dated notice of such assignment or interest signed by the Assured, and by the assignor in the case of subsequent assignment, is endorsed on the Policy and the policy with such endorsement is produced before payment of any claim or return of premium thereunder.

6 PERILS

6.1 This insurance covers loss of or damage to the subject-matter insured caused by

- 6.1.1. perils of the seas rivers lakes or other navigable waters
- 6.1.2 fire, explosion
- 6.1.3 violent theft by persons from outside the Vessel
- 6.1.4 jettison
- 6.1.5 piracy
- 6.1.6 breakdown of or accident to nuclear installations or reactors
- 6.1.7 contact with aircraft or similar objects, or objects falling therefrom, land conveyance, dock or harbour equipment or installation
- 6.1.8 earthquake volcanic eruption or lightning.

6.2 This insurance covers loss of or damage to the subject-matter insured caused by

- 6.2.1 accidents in loading discharging or shifting cargo or fuel
- 6.2.2 bursting of boilers breakage of shafts or any latent defect in the machinery or hull
- 6.2.3 negligence of Master Officers Crew or Pilots
- 6.2.4 negligence of repairers or charterers provided such repairers or charterers are not an Assured hereunder
- 6.2.5 barratry of Master Officers or Crew
provided such loss or damage has not resulted from want of due diligence by the Assured, Owners or Managers.

6.3 Master Officers Crew or Pilots not to be considered Owners within the meaning of this Clause 6 should they hold shares in the Vessel

7 POLLUTION HAZARD

This insurance covers loss of or damage to the Vessel caused by any governmental authority acting under the powers vested in it to prevent or mitigate a pollution hazard, or threat thereof, resulting directly from damage to the Vessel for which the Underwriters are liable under this insurance, provided such act of governmental authority has not resulted from want of due diligence by the Assured, the Owners, or Managers of the Vessel or any of them to prevent or mitigate such hazard or threat. Master, Officers, Crew or Pilots not to be considered Owners within the meaning of this Clause 7 should they hold shares in the Vessel.

8 3/4THS COLLISION LIABILITY

8.1 The Underwriters agree to Indemnify the Assured for three-fourths of any sum or sums paid by the Assured to any other person or persons by reason of the Assured becoming legally liable by way of damages for

- 8.1.1. loss of or damage to any other vessel or property on any other vessel
- 8.1.2 delay to or loss of use of any such other vessel or property thereon
- 8.1.3 general average of, salvage of, or salvage under contract of, any such other vessel or property thereon,

where such payment by the Assured is in consequence of the Vessel hereby insured coming into collision with any other vessel.

8.2 The indemnity provided by this Clause 8 shall be in addition to the indemnity provided by the other terms and conditions of this insurance and shall be subject to the following provisions:

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- 8.2.1 Where the insured Vessel is in collision with another vessel and both vessels are to blame then, unless the liability of one or both vessels becomes limited by law, the indemnity under this Clause 8 shall be calculated on the principle of cross-liabilities as if the respective Owners had been compelled to pay to each other such proportion of each other's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured in consequence of the collision,
- 8.2.2 In no case shall the Underwriters' total liability under Clauses 8.1 and 8.2 exceed their proportionate part of three-fourths of the insured value of the Vessel hereby insured in respect of any one collision.

Exclusions

- 8.4 Provided always that this Clause 8 shall in no case extend to any sum which the Assured shall pay for or in respect of
- 8.4.1 removal or disposal of obstructions, wrecks, cargoes or any other thing whatsoever
- 8.4.2 any real or personal property or thing whatsoever except other vessels or property on other vessels
- 8.4.3 the cargo or other property on, or the engagements of, the insured Vessel
- 8.4.4 loss of life, personal injury or illness
- 8.4.5 pollution or contamination of any real or personal property or thing whatsoever (except other vessels with which the insured Vessel is in collision or property on such other vessels).
- 8.3 The Underwriters will also pay three-fourths of the legal costs incurred by the Assured or which the Assured may be compelled to pay in contesting liability or taking proceedings to limit liability with the prior written consent of the Underwriters.

9 SISTERSHIP

Should the Vessel hereby insured come into collision with or receive salvage services from another vessel belonging wholly or in part to the same Owners or under the same management, the Assured shall have the same rights under this insurance as they would have were the other vessel entirely the property of Owners not interested in the Vessel hereby insured; but in such cases the liability for the collision or the amount payable for the services rendered shall be referred to a sole arbitrator to be agreed upon between the Underwriters and the Assured.

10 NOTICE OF CLAIM AND TENDERS

- 10.1 In the event of accident whereby loss or damage may result in a claim under this insurance, notice shall be given to the Underwriters prior to survey and also, if the Vessel is abroad, to the nearest Lloyd's Agent so that a surveyor may be appointed to represent the Underwriters should they so desire.
- 10.2 The Underwriters shall be entitled to decide the port to which the Vessel shall proceed for docking or repair (the actual additional expense of the voyage arising from compliance with the Underwriters' requirements being refunded to the Assured) and shall have a right of veto concerning a place of repair or a repairing firm.
- 10.3 The Underwriters may also take tenders or may require further tenders to be taken for the repair of the Vessel. Where such a tender has been taken and a tender is accepted with the approval of the Underwriters, an allowance shall be made at the rate of 300fo per annum on the insured value for time lost between the despatch of the invitations to tender required by Underwriters and the acceptance of a tender to the extent that such time is lost solely as the result of tenders having been taken and provided that the tender is accepted without delay after receipt of the Underwriters' approval. Due credit shall be given against the allowance as above for any amounts recovered in respect of fuel and stores and wages and maintenance of the Master Officers and Crew or any member thereof, including amounts allowed in general average, and for any amounts recovered from third parties in respect of damages for detention and/or loss of profit and/or running expenses, for the period covered by the tender allowance or any part hereof, Where a part of the cost of the repair of damage other than a fixed deductible is not recoverable from the Underwriters, the allowance shall be reduced by a similar proportion.

10.4 In the event of failure to comply with the conditions of this Clause 10 a deduction of 15% shall be made from the amount of the ascertained claim.

11 GENERAL AVERAGE AND SALVAGE

11.1 This insurance covers the Vessel's proportion of salvage, salvage charges and/or general average, reduced in respect of any under-insurance, but in case of general average sacrifice of the Vessel the Assured may recover in respect of the whole loss without first enforcing their right of contribution from other parties.

11.2 Adjustment to be according to the law and practice obtaining at the place where the adventure ends, as if the contract of affreightment contained no special terms upon the subject: but where the contract of affreightment so provides the adjustment shall be according to the York-Antwerp Rules.

11.3 When the Vessel sails in ballast, not under charter the provisions of the York-Antwerp Rules, 1974 (excluding Rules XX and XXI) shall be applicable, and the voyage for this purpose shall be deemed to continue from the port or place of departure until the arrival of the Vessel at the first port or place thereafter other than a port or place of refuge or a port or place of call for bunkering only. If at any such intermediate port or place there is an abandonment of the adventure originally contemplated the voyage shall thereupon be deemed to be terminated.

11.4 No claim under this Clause 11 shall in any case be allowed where the loss was not incurred to avoid or in connection with the avoidance of a peril insured against.

12 DEDUCTIBLE

12.1 No claim arising from a peril insured against shall be payable under this insurance unless the aggregate of all such claims arising out of each separate accident or occurrence (including claims under Clauses 8, 11 and 13) exceeds _____ in which case this sum shall be deducted. Nevertheless the expense of sighting the bottom after stranding, if reasonably incurred specially for that purpose, shall be paid even if no damage be found. This Clause 12,1 shall not apply to a claim for total or constructive total loss of the Vessel or in the event of such a claim, to any associated claim under Clause 13 arising from the same accident or occurrence.

12.2 Claims for damage by heavy weather occurring during a single sea passage between two successive ports shall be treated as being due to one accident. In the case of such heavy weather extending over a period not wholly covered by this insurance the deductible to be applied to the claim recoverable hereunder shall be the proportion of the above deductible that the number of days of such heavy weather falling within the period of this insurance bears to the number of days of heavy weather during the single sea passage. The expression "heavy weather" in this Clause 12.2 shall be deemed to include contact with floating ice.

12.3 Excluding any interest comprised therein, recoveries against any claim which is subject to the above deductible shall be credited to the Underwriters in full to the extent of the sum by which the aggregate of the claim unreduced by any recoveries exceeds the above deductible.

12.4 Interest comprised in recoveries shall be apportioned between the Assured and the Underwriters, taking into account the sums paid by the Underwriters and the dates when such payments were made, notwithstanding that by the addition of interest the Underwriters may receive a larger sum than they have paid.

13 DUTY OF ASSURED (SUE AND LABOUR)

13.1 In case of any loss or misfortune it is the duty of the Assured and their servants and agents to take such measures as may be reasonable for the purpose of averting or minimising a loss which would be recoverable under this insurance.

13.2 Subject to the provisions below and to Clause 12 the Underwriters will contribute to charges properly and reasonably incurred by the Assured their servants or agents for such measures. General average, salvage charges (except as provided for in Clause 13,5) and collision defence or attack costs are not recoverable under this Clause 13.

13.3 Measures taken by the Assured or the Underwriters with the object of saving, protecting or recovering the subject-matter insured shall not be considered as a waiver or acceptance of

abandonment or otherwise prejudice the rights of either party.

13.4 When expenses are incurred pursuant to this Clause 13 the liability under this insurance shall not exceed the proportion of such expenses that the amount insured hereunder bears to the value of the Vessel as stated herein, or to the sound value of the Vessel at the time of the occurrence giving rise to the expenditure if the sound value exceeds that value, Where the Underwriters have admitted a claim for total loss and property insured by this insurance is saved, the foregoing provisions shall not apply unless the expenses of suing and labouring exceed the value of such property saved and then shall apply only to the amount of the expenses which is in excess of such value.

13.5 When a claim for total loss of the Vessel is admitted under this insurance and expenses have been reasonably incurred in saving or attempting to save the Vessel and other property and there are no proceeds, or the expenses exceed the proceeds, then this insurance shall bear its pro rata share of such proportion of the expenses, or of the expenses in excess of the proceeds, as the case may be, as may reasonably be regarded as having been incurred in respect of the Vessel; but if the Vessel be insured for less than its sound value at the time of the occurrence giving rise to the expenditure, the amount recoverable under this clause shall be reduced in proportion to the under-insurance.

13.6 The sum recoverable under this Clause 13 shall be In addition to the loss otherwise recoverable under this insurance but shall in no circumstances exceed the amount insured under this insurance in respect of the Vessel.

14 NEW FOR OLD

Claims payable without deduction new for old.

15 BOTTOM TREATMENT

In no case shall a claim be allowed in respect of scraping gritblasting and/or other surface preparation or painting of the Vessel's bottom except that

15.1 gritblasting and/or other surface preparation of new bottom plates ashore and supplying and applying any "shop" primer thereto,

15.2 gritblasting and/or other surface preparation of:
the butts or area of plating immediately adjacent to any renewed or refitted plating damaged during the course of welding and/or repairs, areas of plating damaged during the course of fairing, either in place or ashore,

15.3 supplying and applying the first coat of primer/anti-corrosive to those particular areas mentioned in 15.1 and 15.2 above,

shall be allowed as part of the reasonable cost of repairs in respect of bottom plating damaged by an insured peril.

16 WAGES AND MAINTAINANCE

No claims shall be allowed, other than in general average, for wages and maintenance of the Master Officers and Crew, or any member thereof except when incurred solely for the necessary removal of the Vessel from one port to another for the repair of damage covered by the Underwriters, or for trial trips for such repairs, and then only for such wages and maintenance as are incurred whilst the Vessel is under way.

17 AGENCY COMMISSION

In no case shall any sum be allowed under this insurance either by way of remuneration of the Assured for time and trouble taken to obtain and supply information or documents or in respect of the commission or charges of any manager, agent, managing or agency company or the like, appointed by or on behalf of the Assured to perform such services.

18 UNREPAIRED DAMAGE

18.1 The measure of indemnity In respect of claims for unrepaired damage shall be the reasonable depreciation in the market value of the Vessel at the time this insurance terminates arising from such unrepaired damage, but not exceeding the reasonable cost of repairs.

18.2 In no case shall the Underwriters be liable for unrepaired damage In the event of a subsequent total loss (whether or not covered under this insurance) sustained during the period covered by this insurance or any extension thereof.

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18.3 The Underwriters shall not be liable in respect of unrepaired damage for more than the insured value at the time this insurance terminates.

19 CONSTRUCTIVE TOTAL LOSS

19.1 In ascertaining whether the Vessel is a constructive total loss, the insured value shall be taken as the repaired value and nothing in respect of the damaged or break-up value of the Vessel or wreck shall be taken into account.

19.2 No claim for constructive total loss based upon the cost of recovery and/or repair of the Vessel shall be recoverable hereunder unless such cost would exceed the insured value. In making this determination, only the cost relating to a single accident or sequence of damages arising from the same accident shall be taken into account.

20 FREIGHT WAIVER

In the event of total or constructive total loss no claim to be made by the Underwriters for freight whether notice of abandonment has been given or not.

21 DISBURSEMENT WARRANTY

21.1 Additional insurances as follows are permitted:

21.1.1 *Disbursements, Managers' Commissions, Profits or Excess or increased Value of Hull and Machinery.* A sum not exceeding 25% of the value stated herein.

21.1.2 *Freight, Chartered Freight or Anticipated Freight, insured for time.* A sum not exceeding 25% of the value as stated herein less any sum insured, however described, under 21.1.1.

21.1.3 *Freight, or Hire, under contracts for voyage.* A sum not exceeding the gross freight or hire for the current cargo passage and next succeeding cargo passage (such insurance to include, if required, a preliminary and an intermediate ballast passage) plus the charges of insurance. In the case of a voyage charter where payment is made on a time basis, the sum permitted for insurance shall be calculated on the estimated duration of the voyage, subject to the limitation of two cargo passages as laid down herein. Any sum insured under 21.1.2 to be taken into account and only the excess thereof may be insured, which excess shall be reduced as the freight or hire is advanced or earned by the gross amount so advanced or earned.

21.1.4 *Anticipated Freight if the Vessel sails in ballast and not under Charter.* A sum not exceeding the anticipated gross freight on next cargo passage, such sum to be reasonably estimated on the basis of the current rate of freight at time of insurance plus the charges of insurance. Any sum insured under 21.1.2 to be taken into account and only the excess thereof may be insured

21.1.5 *Time Charter Hire or Charter Hire for Series of Voyages.* A sum not exceeding 50% of the gross hire which is to be earned under the charter in a period not exceeding 18 months. Any sum insured under 21.1.2 to be taken into account and only the excess thereof may be insured, which excess shall be reduced as the hire is advanced or earned under the charter by 50% of the gross amount so advanced or earned but the sum insured need not be reduced while the total of the sums insured under 21.1.2 and 21.1.5 does not exceed 50% of the gross hire still to be earned under the charter. An insurance under this Section may begin on the signing of the charter.

21.1.6 *Premiums.* A sum not exceeding the actual premiums of all interests insured for a period not exceeding 12 months (excluding premiums insured under the foregoing sections but including, if required, the premium or estimated calls on any Club or War etc. Risk insurance) reducing pro rata monthly.

21.1.7 *Returns of Premium.* A sum not exceeding the actual returns which are allowable under any insurance but which would not be recoverable thereunder in the event of a total loss of the Vessel whether by insured perils or otherwise.

21.1.8 *Insurance irrespective of amount insured against.*
Any risks excluded by Clauses 23, 24, 25 and 26 below.

21.2 Warranted that no insurance on any interests enumerated in the foregoing 21.1.1 to 21.1.7 in excess of the amounts permitted therein and no other insurance which includes total loss of the Vessel P.P.I., F.I.A., OI subject to any other like term, is or shall be effected to

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operate during the currency of this insurance by or for account of the Assured, Owners, Managers or Mortgagees, Provided always that a breach of this warranty shall not afford the Underwriters any defence to a claim by a Mortgagee who has accepted this insurance without knowledge of such breach.

22 RETURNS FOR LAY-UP AND CANCELLATION

22.1 To return as follows:

22.1.1 Pro rata monthly net for each uncommenced month if this insurance be cancelled by agreement.

22.1.2 For each period of 30 consecutive days the Vessel may be laid up in a port or in a lay-up area provided such port or lay-up area is approved by the Underwriters (with special liberties as hereinafter allowed)

(a) per cent not under repair

(b) per cent under repair

If the Vessel is under repair during part only of a period for which a return is claimable, the return shall be calculated pro rata to the number of days under (a) and (b) respectively.

22.2 PROVIDED ALWAYS THAT

22.2.1 a total loss of the Vessel, whether by insured perils or otherwise, has not occurred during the period covered by this insurance or any extension thereof.

22.2.2 in no case shall a return be allowed when the Vessel is lying in exposed or unprotected waters, or in a port or lay-up area not approved by the Underwriters but, provided the Underwriters agree that such non-approved lay-up area is deemed to be within the vicinity of the approved port or lay-up area, days during which the Vessel is laid up in such non-approved lay-up area may be added to days in the approved port or lay-up area to calculate a period of 30 consecutive days and a return shall be allowed for the proportion of such period during which the Vessel is actually laid up in the approved port or lay-up area.

22.2.3 loading or discharging operations or the presence of cargo on board shall not debar returns but no return shall be allowed for any period during which the Vessel is being used for the storage of cargo or for lightening purposes.

22.2.4 in the event of any amendment of the annual rate, the above rates of return shall be adjusted accordingly.

22.2.5 in the event of any return recoverable under this Clause 22 being based on 30 consecutive days which fall on successive insurances effected for the same Assured, this insurance shall only be liable for an amount calculated at pro rata of the period rates 22.1.2 (a) and/or (b) above for the number of days which come within the period of this insurance and to which a return is actually applicable. Such overlapping period shall run, at the option of the Assured, either from the first day on which the Vessel is laid up or the first day of a period of 30 consecutive days as provided under 22.1.2 (a) or (b), or 22.2.2 above.

**The following clauses (23-26) shall be paramount
and shall override anything in this insurance inconsistent therewith**

23 WAR EXCLUSION

In no case shall this insurance cover loss damage liability or expense caused by

23.1 war civil war revolution rebellion insurrection or civil strife arising therefrom, or any hostile act by or against a belligerent power.

23.2 capture seizure arrest restraint or detainment (barratry and piracy excepted), and the consequences thereof or any attempt thereat.

23.3 derelict mines, torpedoes bombs or other derelict weapons of war.

24 STRIKES EXCLUSION

In no case shall this insurance cover loss damage liability or expense caused by

24.1 strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions.

24.2 any terrorist or any person acting from a political motive.

25 MALICIOUS ACTS EXCLUSION

In no case shall this insurance cover loss damage liability or expense arising from

25.1 the detonation of an explosive

25.2 any weapon of war
and caused by any person acting maliciously or from a political motive.

26 NUCLEAR EXCLUSION

In no case shall this insurance cover loss, damage, liability or expense arising from any weapon of war employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.

APPENDIX 5

"These clauses are purely illustrative. Different policy conditions may be agreed. The specimen clauses are available to any interested person upon request. In particular:

- (a) in relation to any clause which excludes losses from the cover, insurers may agree a separate insurance policy covering such losses or may extend the clause to cover such events;
- (b) In relation to clauses making cover of certain risks subject to specific conditions each insurer may alter the said conditions."

(FOR USE WITH THE CURRENT MAR POLICY FORM)

INTERNATIONAL HULL CLAUSES (01/11/03)

PART 1 - PRINCIPAL INSURING CONDITIONS

1 GENERAL

- 1.1 Part 1, Clauses 32-36 of Part 2 and Part 3 apply to this insurance. Parts 2 and 3 shall be those current at the date of inception of this insurance. Clauses 37-41 of Part 2 shall only apply where the Underwriters have expressly so agreed in writing.
- 1.2 This insurance is subject to English law and practice.
- 1.3 This insurance is subject to the exclusive jurisdiction of the English High Court of Justice, except as may be expressly provided herein to the contrary.
- 1.4 If any provision of this insurance is held to be invalid or unenforceable, such invalidity or unenforceability will not affect the other provisions of this insurance, which shall remain in full force and effect.

2 PERILS

- 2.1 This insurance covers loss of or damage to the subject-matter insured caused by
 - 2.1.1 perils of the seas, rivers, lakes or other navigable waters
 - 2.1.2 fire, explosion
 - 2.1.3 violent theft by persons from outside the vessel
 - 2.1.4 jettison
 - 2.1.5 piracy
 - 2.1.6 contact with land conveyance, dock or harbour equipment or installation
 - 2.1.7 earthquake, volcanic eruption or lightning
 - 2.1.8 accidents in loading, discharging or shifting cargo, fuel, stores or parts
 - 2.1.9 contact with satellites, aircraft, helicopters or similar objects, or objects falling therefrom.
- 2.2 This insurance covers loss of or damage to the subject matter insured caused by

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- 2.2.1 bursting of boilers or breakage of shafts but does not cover any of the costs of repairing or replacing the boiler which bursts or the shaft which breaks
- 2.2.2 any latent defect in the machinery or hull, but does not cover any of the costs of correcting the latent defect
- 2.2.3 negligence of Master, Officers, Crew or Pilots
- 2.2.4 negligence of repairers or charterers provided such repairers or charterers are not an Assured under this insurance
- 2.2.5 barratry of Master, Officers or Crew

provided that such loss or damage has not resulted from want of due diligence by the Assured, Owners or Managers.

- 2.3 Where there is a claim recoverable under Clause 2.2.1, this insurance shall also cover one half of the costs common to the repair of the burst boiler or the broken shaft and to the repair of the loss or damage caused thereby.
- 2.4 Where there is a claim recoverable under Clause 2.2.2, this insurance shall also cover one half of the costs common to the correction of the latent defect and to the repair of the loss or damage caused thereby.
- 2.5 Master, Officers, Crew or Pilots shall not be considered Owners within the meaning of Clause 2.2 should they hold shares in the vessel.

3 LEASED EQUIPMENT

- 3.1 This insurance covers loss of or damage to equipment and apparatus not owned by the Assured but installed for use on the vessel and for which the Assured has assumed contractual liability, where such loss or damage is caused by a peril insured under this insurance.
- 3.2 The liability of the Underwriters shall not exceed the lesser of the contractual liability of the Assured for loss of or damage to such equipment or apparatus or the reasonable cost of their repair or their replacement value. All such equipment and apparatus are included in the insured value of the vessel.

4 PARTS TAKEN OFF

- 4.1 This insurance covers loss of or damage to parts taken off the vessel, where such loss or damage is caused by a peril insured under this insurance.
- 4.2 Where the parts taken off the vessel are not owned by the Assured but where the Assured has assumed contractual liability for such parts, the liability of the Underwriters for such parts taken off shall not exceed the lesser of the contractual liability of the Assured for loss of or damage to such parts or the reasonable cost of their repair or their replacement value.
- 4.3 If at the time of loss of or damage to the parts taken off the vessel, such parts are covered by any other insurance or would be so covered but for this Clause 4, then this insurance shall only be excess of such other insurance.
- 4.4 Cover in respect of parts taken off the vessel shall be limited to 60 days whilst not on

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board the vessel. Periods in excess of 60 days shall be held covered provided notice is given to the Underwriters prior to the expiry of the 60 day period and any amended terms of cover and any additional premium required are agreed.

- 4.5 In no case shall the total liability of the Underwriters under this Clause 4 exceed 5% of the insured value of the vessel.

5 POLLUTION HAZARD

This insurance covers loss of or damage to the vessel caused by any governmental authority acting under the powers vested in it to prevent or mitigate a pollution hazard or damage to the environment or threat thereof, resulting directly from damage to the vessel for which the Underwriters are liable under this insurance, provided that such act of governmental authority has not resulted from want of due diligence by the Assured, Owners or Managers to prevent or mitigate such hazard or damage or threat thereof. Master, Officers, Crew or Pilots shall not be considered Owners within the meaning of this Clause 5 should they hold shares in the vessel.

6 3/4THS COLLISION LIABILITY

- 6.1 The Underwriters agree to indemnify the Assured for three fourths of any sum or sums paid by the Assured to any other person or persons by reason of the Assured becoming legally liable by way of damages for

6.1.1 loss of or damage to any other vessel or property thereon

6.1.2 delay to or loss of use of any such other vessel or property thereon

6.1.3 general average of, salvage of, or salvage under contract of, any such other vessel or property thereon,

where such payment by the Assured is in consequence of the insured vessel coming into collision with any other vessel.

- 6.2 The indemnity provided by this Clause 6 shall be in addition to the indemnity provided by the other terms and conditions of this insurance and shall be subject to the following provisions

6.2.1 where the insured vessel is in collision with another vessel and both vessels are to blame then, unless the liability of one or both vessels becomes limited by law, the indemnity under this Clause 6 shall be calculated on the principle of cross-liabilities as if the respective Owners had been compelled to pay to each other such proportion of each other's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured in consequence of the collision

6.2.2 in no case shall the total liability of the Underwriters under Clauses 6.1 and 6.2 exceed their proportionate part of three fourths of the insured value of the insured vessel in respect of any one collision.

- 6.3 The Underwriters shall also pay three fourths of the legal costs incurred by the Assured or which the Assured may be compelled to pay in contesting liability or taking proceedings to limit liability, provided always that their prior written consent to the incurring of such costs shall have been obtained and that the total liability of the Underwriters under this Clause 6.3 shall not (unless the Underwriters' specific

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written agreement shall have been obtained) exceed 25% of the insured value of the insured vessel.

EXCLUSIONS

- 6.4 In no case shall the Underwriters indemnify the Assured under this Clause 6 for any sum, which the Assured shall pay for or in respect of
- 6.4.1 removal or disposal of obstructions, wrecks, cargoes or any other thing whatsoever
 - 6.4.2 any real or personal property or thing whatsoever except other vessels or property on other vessels
 - 6.4.3 the cargo or other property on, or the engagements of, the insured vessel
 - 6.4.4 loss of life, personal injury or illness
 - 6.4.5 pollution or contamination, or threats thereof, of any real or personal property or thing whatsoever (except other vessels with which the insured vessel is in collision or property on such other vessels) or damage to the environment, or threat thereof, save that this exclusion shall not exclude any sum which the Assured shall pay for or in respect of salvage remuneration in which the skill and efforts of the salvors in preventing or minimising damage to the environment as referred to in Article 13 paragraph 1(b) of the International Convention on Salvage, 1989 have been taken into account.

7 SISTERSHIP

Should the insured vessel come into collision with or receive salvage services from another vessel belonging wholly or in part to the same Owners or under the same management, the Assured shall have the same rights under this insurance as they would have were the other vessel entirely the property of Owners not interested in the insured vessel; but in such cases the liability for the collision or the amount payable for the services rendered shall be referred to a sole arbitrator to be agreed upon between the Underwriters and the Assured.

8 GENERAL AVERAGE AND SALVAGE

- 8.1 This insurance covers the vessel's proportion of salvage, salvage charges and/or general average, without reduction in respect of any under-insurance, but in case of general average sacrifice of the vessel the Assured may recover in respect of the whole loss without first enforcing their right of contribution from other parties.
- 8.2 General average shall be adjusted according to the law and practice obtaining at the place where the adventure ends, as if the contract of affreightment contained no special terms upon the subject; but where the contract of affreightment so provides the adjustment shall be according to the York-Antwerp Rules.
- 8.3 When the vessel sails in ballast, not under charter, the provisions of the York-Antwerp Rules, 1994 (excluding Rules XX and XXI) shall be applicable, and the voyage for this purpose shall be deemed to continue from the port or place of departure until the arrival of the vessel at the first port or place thereafter other than a port or place of refuge or a port or place of call for bunkering only. If at any such intermediate port or place there is an abandonment of the adventure originally

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contemplated, the voyage shall thereupon be deemed to be terminated.

- 8.4 The Underwriters shall not be liable under this Clause 8 where the loss was not incurred to avoid or in connection with the avoidance of a peril insured under this insurance.
- 8.5 The Underwriters shall not be liable under this Clause 8 for or in respect of
- 8.5.1 special compensation payable to a salvor under Article 14 of the International Convention on Salvage, 1989 or under any other provision in any statute, rule, law or contract which is similar in substance
- 8.5.2 expenses or liabilities incurred in respect of damage to the environment, or the threat of such damage, or as a consequence of the escape or release of pollutant substances from the vessel, or the threat of such escape or release.
- 8.6 Clause 8.5 shall not however exclude any sum which the Assured shall pay
- 8.6.1 to salvors for or in respect of salvage remuneration in which the skill and efforts of the salvors in preventing or minimising damage to the environment as referred to in Article 13 paragraph 1(b) of the International Convention on Salvage, 1989 have been taken into account
- 8.6.2 as general average expenditure allowable under Rule XI(d) of the York-Antwerp Rules 1994, but only where the contract of affreightment provides for adjustment according to the York-Antwerp Rules 1994.

9 DUTY OF THE ASSURED (SUE AND LABOUR)

- 9.1 In case of any loss or misfortune it is the duty of the Assured and their servants and agents to take such measures as may be reasonable for the purpose of averting or minimising a loss which would be recoverable under this insurance.
- 9.2 Subject to the provisions below and to Clause 15, the Underwriters shall contribute to charges properly and reasonably incurred by the Assured their servants or agents for such measures. General average, salvage charges (except as provided for in Clause 9.4), special compensation and expenses as referred to in Clause 8.5 and collision defence or attack costs are not recoverable under this Clause 9.
- 9.3 Measures taken by the Assured or the Underwriters with the object of saving, protecting or recovering the subject-matter insured shall not be considered as a waiver or acceptance of abandonment or otherwise prejudice the rights of either party.
- 9.4 When the Underwriters have admitted a claim for total loss of the vessel under this insurance and expenses have been reasonably incurred in saving or attempting to save the vessel and other property and there are no proceeds, or the expenses exceed the proceeds, then this insurance shall bear its pro rata share of such proportion of the expenses, or of the expenses in excess of the proceeds, as the case may be, as may reasonably be regarded as having been incurred in respect of the vessel, excluding all special compensation and expenses as referred to in Clause 8.5.
- 9.5 The sum recoverable under this Clause 9 shall be in addition to the loss otherwise recoverable under this insurance but shall in no circumstances exceed the insured value of the vessel.

10 NAVIGATION PROVISIONS

Unless and to the extent otherwise agreed by the Underwriters in accordance with Clause 11

- 10.1 the vessel shall not breach any provisions of this insurance as to cargo, trade or locality (including, but not limited to, Clause 32)
- 10.2 the vessel may navigate with or without pilots, go on trial trips and assist and tow vessels or craft in distress, but shall not be towed, except as is customary (including customary towage in connection with loading or discharging) or to the first safe port or place when in need of assistance, or undertake towage or salvage services under a contract previously arranged by the Assured and/or Owners and/or Managers and/or Charterers
- 10.3 the Assured shall not enter into any contract with pilots or for customary towage which limits or exempts the liability of the pilots and/or tugs and/or towboats and/or their owners except where the Assured or their agents accept or are compelled to accept such contracts in accordance with established local law or practice
- 10.4 the vessel shall not be employed in trading operations which entail cargo loading or discharging at sea from or into another vessel (not being a harbour or inshore craft).

11 BREACH OF NAVIGATION PROVISIONS

In the event of any breach of any of the provisions of Clause 10, the Underwriters shall not be liable for any loss, damage, liability or expense arising out of or resulting from an accident or occurrence during the period of breach, unless notice is given to the Underwriters immediately after receipt of advices of such breach and any amended terms of cover and any additional premium required by them are agreed.

12 CONTINUATION

Should the vessel at the expiration of this insurance be at sea and in distress or missing, she shall be held covered until arrival at the next port in good safety, or if in port and in distress until the vessel is made safe, at a pro rata monthly premium, provided that notice be given to the Underwriters as soon as possible.

These Clauses 13 and 14 shall prevail notwithstanding any provision whether written typed or printed in this insurance inconsistent therewith.

13 CLASSIFICATION AND ISM

- 13.1 At the inception of and throughout the period of this insurance and any extension thereof
 - 13.1.1 the vessel shall be classed with a Classification Society agreed by the Underwriters
 - 13.1.2 there shall be no change, suspension, discontinuance, withdrawal or expiry of the vessel's class with the Classification Society
 - 13.1.3 any recommendations, requirements or restrictions imposed by the vessel's Classification Society which relate to the vessel's seaworthiness or to her maintenance in a seaworthy condition shall be complied with by the dates

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required by that Society

- 13.1.4 the Owners or the party assuming responsibility for operation of the vessel from the Owners shall hold a valid Document of Compliance in respect of the vessel as required by chapter IX of the International Convention for the Safety of Life at Sea (SOLAS) 1974 as amended and any modification thereof
- 13.1.5 the vessel shall have in force a valid Safety Management Certificate as required by chapter IX of the International Convention for the Safety of Life at Sea (SOLAS) 1974 as amended and any modification thereof.
- 13.2 Unless the Underwriters agree to the contrary in writing, in the event of any breach of any of the provisions of Clause 13.1, this insurance shall terminate automatically at the time of such breach, provided
 - 13.2.1 that if the vessel is at sea at such date, such automatic termination shall be deferred until arrival at her next port
 - 13.2.2 where such change, suspension, discontinuance or withdrawal of her class under Clause 13.1.2 has resulted from loss or damage covered by Clause 2 or by Clause 5 or by Clause 41.1.3 (if applicable) or which would be covered by an insurance of the vessel subject to current Institute War and Strikes Clauses Hulls-Time, such automatic termination shall only operate should the vessel sail from her next port without the prior approval of the Classification Society.

A pro rata daily net return of premium shall be made provided that a total loss of the vessel, whether by perils insured under this insurance or otherwise, has not occurred during the period of this insurance or any extension thereof.

14 MANAGEMENT

- 14.1 Unless the Underwriters agree to the contrary in writing, this insurance shall terminate automatically at the time of
 - 14.1.1 any change, voluntary or otherwise, in the ownership or flag of the vessel
 - 14.1.2 transfer of the vessel to new management
 - 14.1.3 charter of the vessel on a bareboat basis
 - 14.1.4 requisition of the vessel for title or useprovided that, if the vessel has cargo on board and has already sailed from her loading port or is at sea in ballast, such automatic termination shall if required be deferred, whilst the vessel continues her planned voyage, until arrival at final port of discharge if with cargo or at port of destination if in ballast. However, in the event of requisition for title or use without the prior execution of a written agreement by the Assured, such automatic termination shall occur fifteen days after such requisition whether the vessel is at sea or in port.
- 14.2 Unless the Underwriters agree to the contrary in writing, this insurance shall terminate automatically at the time of the vessel sailing (with or without cargo) with an intention of being broken up, or being sold for breaking up.

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- 14.3 In the event of termination under Clause 14.1 or Clause 14.2, a pro rata daily net return of premium shall be made provided that a total loss of the vessel, whether by perils insured under this insurance or otherwise, has not occurred during the period of this insurance or any extension thereof.
- 14.4 It is the duty of the Assured, Owners and Managers at the inception of and throughout the period of this insurance and any extension thereof to
- 14.4.1 comply with all statutory requirements of the vessel's flag state relating to construction, adaptation, condition, fitment, equipment, operation and manning of the vessel
- 14.4.2 comply with all requirements of the vessel's Classification Society regarding the reporting to the Classification Society of accidents to and defects in the vessel.

In the event of any breach of any of the duties in this Clause 14.4, the Underwriters shall not be liable for any loss, damage, liability or expense attributable to such breach.

15 DEDUCTIBLE(S)

- 15.1 Subject to Clause 15.2, no claim arising from a peril insured under this insurance shall be payable under this insurance unless the aggregate of all such claims arising out of each separate accident or occurrence (including claims under Clauses 2, 3, 4, 5, 6 (including, if applicable, Clause 6 as amended by Clauses 37 or 38), Clauses 8 and 9 and, if applicable, Clause 41 exceeds the deductible amount agreed in which case this sum shall be deducted. Nevertheless the expense of sighting the bottom after stranding, if reasonably incurred specially for that purpose, shall be paid even if no damage is found.
- 15.2 No claim for loss of or damage to any machinery, shaft, electrical equipment or wiring, boiler, condenser, heating coil or associated pipework, arising under Clauses 2.2.1 to 2.2.5 and Clause 41 (if applicable) or from fire or explosion when either has originated in a machinery space, shall be payable under this insurance unless the aggregate of all such claims arising out of each separate accident or occurrence exceeds the additional machinery damage deductible amount agreed (if any) in which case that amount shall be deducted. Any balance remaining, after application of this deductible, with any other claim arising from the same accident or occurrence, shall then be subject to the deductible referred to in Clause 15.1.
- 15.3 Clauses 15.1 and 15.2 shall not apply to a claim for total or constructive total loss of the vessel or, in the event of such a claim, to any associated claim under Clause 9 arising from the same accident or occurrence.
- 15.4 Claims for damage by heavy weather occurring during a single sea passage between two successive ports shall be treated as being due to one accident. In the case of such heavy weather extending over a period not wholly covered by this insurance the deductible to be applied to the claim recoverable under this insurance shall be the proportion of the deductible in Clause 15.1 that the number of days of such heavy weather falling within the period of this insurance and any extension thereof bears to the number of days of heavy weather during the single sea passage. The expression "heavy weather" in this Clause 15.4 shall be deemed to include contact with floating ice.

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- 15.5 Claims for damage occurring during each separate lightning operation and/or each separate cargo loading or discharging operation from or into another vessel at sea, where recoverable under this insurance, shall be treated as being due to one accident.

16 NEW FOR OLD

Claims recoverable under this insurance shall be payable without deduction on the basis of new for old.

17 BOTTOM TREATMENT

The Underwriters shall not be liable in respect of scraping, gritblasting and/or other surface preparation or painting of the vessel's bottom except that

- 17.1 gritblasting and/or other surface preparation of new bottom plates ashore and supplying and applying any "shop" primer thereto
- 17.2 gritblasting and/or other surface preparation of
- 17.2.1 the butts or area of plating immediately adjacent to any renewed or refitted plating damaged during the course of welding and/or repairs
- 17.2.2 areas of plating damaged during the course of fairing, either in place or ashore
- 17.3 supplying and applying the first coat of primer/anti-corrosive to those particular areas mentioned in Clauses 17.1 and 17.2
- 17.4 supplying and applying anti-fouling coatings to those particular areas mentioned in Clauses 17.1 and 17.2,

shall be included as part of the reasonable cost of repairs in respect of damage to bottom plating caused by a peril insured under this insurance.

18 WAGES AND MAINTENANCE

Other than in general average, the Underwriters shall not be liable for wages and maintenance of the Master, Officers and Crew or any member thereof, except when incurred solely for the necessary removal of the vessel from one port to another for the repair of damage covered by the Underwriters, or for trial trips for such repairs, and then only for such wages and maintenance as are incurred whilst the vessel is under way.

19 AGENCY COMMISSION

No sum shall be recoverable under this insurance either by way of remuneration of the Assured for time and trouble taken to obtain and supply information or documents or in respect of the commission or charges of any manager, agent, managing or agency company or the like, appointed by or on behalf of the Assured to perform such services.

20 UNREPAIRED DAMAGE

- 20.1 The measure of indemnity in respect of claims for unrepaired damage shall be the reasonable depreciation in the market value of the vessel at the time this insurance terminates arising from such unrepaired damage, but not exceeding the reasonable

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cost of repairs.

- 20.2 In no case shall the Underwriters be liable for unrepaired damage in the event of a subsequent total loss of the vessel (whether by perils insured under this insurance or otherwise) sustained during the period of this insurance or any extension thereof.
- 20.3 The Underwriters shall not be liable in respect of unrepaired damage for more than the insured value of the vessel at the time this insurance terminates.

21 CONSTRUCTIVE TOTAL LOSS

- 21.1 In ascertaining whether the vessel is a constructive total loss, 80% of the insured value of the vessel shall be taken as the repaired value and nothing in respect of the damaged or break-up value of the vessel or wreck shall be taken into account.
- 21.2 No claim for constructive total loss of the vessel based upon the cost of recovery and/or repair of the vessel shall be recoverable hereunder unless such cost would exceed 80% of the insured value of the vessel. In making this determination, only the cost relating to a single accident or sequence of damages arising from the same accident shall be taken into account.

22 FREIGHT WAIVER

If a total or constructive total loss of the vessel has been admitted by the Underwriters, they shall make no claim for freight whether notice of abandonment has been given or not.

23 ASSIGNMENT

No assignment of or interest in this insurance or in any moneys which may be or become payable under this insurance is to be binding on or recognised by the Underwriters unless a dated notice of such assignment or interest signed by the Assured, and by the assignor in the case of subsequent assignment, is endorsed on the policy and the policy with such endorsement is produced before payment of any claim or return of premium under this insurance.

24 DISBURSEMENTS WARRANTY

- 24.1 Additional insurances as follows are permitted by the Underwriters:
- 24.1.1 *Disbursements, Managers' Commissions, Profits or Excess or Increased Value of Hull and Machinery.* A sum not exceeding 25% of the value stated herein.
- 24.1.2 *Freight, Chartered Freight or Anticipated Freight, insured for time.* A sum not exceeding 25% of the value as stated herein less any sum insured, however described, under Clause 24.1.1
- 24.1.3 *Freight or Hire, under contracts for voyage.* A sum not exceeding the gross freight or hire for the current cargo passage and next succeeding cargo passage (such insurance to include, if required, a preliminary and an intermediate ballast passage) plus the charges of insurance. In the case of a voyage charter where payment is made on a time basis, the sum permitted for insurance shall be calculated on the estimated duration of the voyage, subject to the limitation of two cargo passages as laid down herein. Any sum insured

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under Clause 24.1.2 to be taken into account and only the excess thereof may be insured, which excess shall be reduced as the freight or hire is advanced or earned by the gross amount so advanced or earned.

24.1.4 *Anticipated Freight if the vessel sails in ballast and not under Charter.* A sum not exceeding the anticipated gross freight on next cargo passage, such sum to be reasonably estimated on the basis of the current rate of freight at time of insurance plus the charges of insurance. Any sum insured under Clause 24.1.2 to be taken into account and only the excess thereof may be insured.

24.1.5 *Time Charter Hire or Charter Hire for Series of Voyages.* A sum not exceeding 50% of the gross hire which is to be earned under the charter in a period not exceeding 18 months. Any sum insured under Clause 24.1.2 to be taken into account and only the excess thereof may be insured, which excess shall be reduced as the hire is advanced or earned under the charter by 50% of the gross amount so advanced or earned but the sum insured need not be reduced while the total of the sums insured under Clause 24.1.2 and Clause 24.1.5 does not exceed 50% of the gross hire still to be earned under the charter. An insurance under this Clause may begin on the signing of the charter.

24.1.6 *Premiums.* A sum not exceeding the actual premiums of all interests insured for a period not exceeding 12 months (excluding premiums insured under the foregoing sections but including, if required, the premium or estimated calls on any Club or War etc. Risk insurance) reducing pro rata monthly.

24.1.7 *Returns of Premium.* A sum not exceeding the actual returns which are allowable under any insurance but which would not be recoverable thereunder in the event of a total loss of the vessel whether by perils insured under this insurance or otherwise.

24.1.8 *Insurance irrespective of amount against. Any risks excluded by Clauses 29, 30 and 31.*

24.2 It is warranted that no insurance on any interests enumerated in the foregoing Clauses 24.1.1 to 24.1.7 in excess of the amounts permitted therein and no other insurance which includes total loss of the vessel P.P.I., F.I.A., or subject to any other like term, is or shall be effected to operate during the period of this insurance or any extension thereof by or for account of the Assured, Owners, Managers or Mortgagees. Provided always that a breach of this warranty shall not afford the Underwriters any defence to a claim by a Mortgagee who has accepted this insurance without knowledge of such breach.

25 CANCELLING RETURNS

If this insurance shall be cancelled by agreement, the Underwriters shall pay a pro rata monthly net return of premium for each uncommenced month, provided always that a total loss of the vessel, whether by perils insured under this insurance or otherwise, has not occurred during the period of this insurance or any extension thereof.

26 SEPARATE INSURANCES

If more than one vessel is insured under this insurance, each vessel insured is deemed

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to be separately insured, as if a separate policy had been issued in respect of each vessel.

27 SEVERAL LIABILITY

The Underwriters' obligations are several and not joint and are limited solely to the extent of their individual subscriptions. The Underwriters are not responsible for the subscription of any co-subscribing Underwriter who for any reason does not satisfy all or part of its obligations.

28 AFFILIATED COMPANIES

In the event of the vessel being chartered by an associated, subsidiary or affiliated company of the Assured, and in the event of loss of or damage to the vessel by perils insured under this insurance, the Underwriters waive their rights of subrogation against such charterers, except to the extent that any such charterer has the benefit of liability cover for such loss or damage.

These Clauses 29, 30 and 31 shall be paramount and shall override anything contained in this insurance inconsistent therewith.

29 WAR & STRIKES EXCLUSION

In no case shall this insurance cover loss, damage, liability or expense caused by

- 29.1 war, civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power
- 29.2 capture, seizure, arrest, restraint or detention (barratry and piracy excepted), and the consequences thereof or any attempt thereat
- 29.3 derelict mines, torpedoes, bombs or other derelict weapons of war.
- 29.4 strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions.

30 TERRORIST, POLITICAL MOTIVE AND MALICIOUS ACTS EXCLUSION

In no case shall this insurance cover loss, damage, liability or expense arising from

- 30.1 any terrorist
- 30.2 any person acting from a political motive
- 30.3 the use of any weapon or the detonation of an explosive by any person acting maliciously or from a political motive.

31 RADIOACTIVE CONTAMINATION, CHEMICAL, BIOLOGICAL, BIO-CHEMICAL AND ELECTROMAGNETIC WEAPONS EXCLUSION

In no case shall this insurance cover loss, damage, liability or expense directly or indirectly caused by or contributed to by or arising from

- 31.1 ionising radiations from or contamination by radioactivity from any nuclear fuel or

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from any nuclear waste or from the combustion of nuclear fuel

- 31.2 the radioactive, toxic, explosive or other hazardous or contaminating properties of any nuclear installation, reactor or other nuclear assembly or nuclear component thereof
- 31.3 any weapon or device employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter
- 31.4 the radioactive, toxic, explosive or other hazardous or contaminating properties of any radioactive matter. The exclusion in this Clause 31.4 does not extend to radioactive isotopes, other than nuclear fuel, when such isotopes are being prepared, carried, stored, or used for commercial, agricultural, medical, scientific or other similar peaceful purposes
- 31.5 any chemical, biological, bio-chemical or electromagnetic weapon.

PART 2 - ADDITIONAL CLAUSES (01/11/03)

32 NAVIGATING LIMITS

Unless and to the extent otherwise agreed by the Underwriters in accordance with Clause 33, the vessel shall not enter, navigate or remain in the areas specified below at any time or, where applicable, between the dates specified below (both days inclusive):

Area 1 - Arctic

- (a) North of 70° N. Lat.
- (b) Barents Sea

except for calls at Kola Bay, Murmansk or any port or place in Norway, provided that the vessel does not enter, navigate or remain north of 72°30'N. Lat. or east of 35° E. Long.

Area 2 - Northern Seas

- (a) White Sea.
- (b) Chukchi Sea

Area 3 - Baltic

- (a) Gulf of Bothnia north of a line between Umea (63°50'N. Lat.) and Vasa (63°06'N. Lat.) between 10th December and 25th May.
- (b) Where the vessel is equal to or less than 90,000 DWT, Gulf of Finland east of 28°45'E.Long. between 15th December and 15th May.
- (c) Vessels greater than 90,000 DWT may not enter, navigate or remain in the Gulf of Finland east of 28°45'E. Long. at any time.
- (d) Gulf of Bothnia, Gulf of Finland and adjacent waters north of 59°24'N. Lat. between 8th January and 5th May, except for calls at Stockholm, Tallinn or Helsinki.

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- (e) Gulf of Riga and adjacent waters east of 22°E. Long. and south of 59°N. Lat. between 28th December and 5th May.

Area 4 - Greenland

Greenland territorial waters.

Area 5 - North America (east)

- (a) North of 52°10'N. Lat. and between 50°W. Long. and 100°W. Long.
- (b) Gulf of St. Lawrence, St. Lawrence River and its tributaries (east of Les Escoumins), Strait of Belle Isle (west of Belle Isle), Cabot Strait (west of a line between Cape Ray and Cape North) and Strait of Canso (north of the Canso Causeway), between 21st December and 30th April.
- (c) St. Lawrence River and its tributaries (west of Les Escoumins) between 1st December and 30th April.
- (d) St. Lawrence Seaway
- (e) Great Lakes.

Area 6 - North America (west)

- (a) North of 54°30'N. Lat. and between 100°W. Long. and 170°W. Long.
- (b) Any port of place in the Queen Charlotte Islands or the Aleutian Islands

Area 7 - Southern Ocean

South of 50°S. Lat. except within the triangular area formed by rhumb lines drawn between the following points

- (a) 50°S. Lat.; 50°W. Long
- (b) 57°S. Lat.; 67°30'W. Long.
- (c) 50°S Lat.; 160°W. Long.

Area 8 - Kerguelen/Crozet

Territorial waters of Kerguelen Islands and Crozet Islands.

Area 9 - East Asia

- (a) Sea of Okhotsk north of 55°N. Lat. and east of 140°E. Long. between 1st November and 1st June.
- (b) Sea of Okhotsk north of 53°N. Lat. and west of 140°E. Long. between 1st November and 1st June.
- (c) East Asian waters north of 46°N. Lat. and west of the Kurile Islands and west of the Kamchatka Peninsula between 1st December and 1st May.

Area 10 - Bering Sea

Bering Sea except on through voyages and provided that

- (a) vessel does not enter, navigate or remain north of 54°30'N. Lat.; and
- (b) the vessel enters and exits west of Buldir Island or through the Amchitka, Amukta or Unimak passes; and

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- (c) the vessel is equipped and properly fitted with two independent marine radar sets, a global positioning system receiver (or Loran-C radio positioning receiver), a radio transceiver and GMDSS, a weather facsimile recorder (or alternative equipment for the receipt of weather and routing information) and a gyrocompass, in each case to be fully operational and manned by qualified personnel; and
- (d) the vessel is in possession of appropriate navigational charts corrected up to date, sailing directions and pilot books.

33 PERMISSION FOR AREAS SPECIFIED IN NAVIGATING LIMITS

The vessel may breach Clause 32 and Clause 11 shall not apply, provided always that the Underwriters' prior permission shall have been obtained and any amended terms of cover and any additional premium required by the Underwriters are agreed.

34 RECOMMISSIONING CONDITION

As a condition precedent to the liability of the Underwriters, the vessel shall not leave her lay-up berth under her own power or navigate following a lay-up period of more than 180 consecutive days unless the Assured has arranged for the Classification Society or a surveyor agreed by the Underwriters to examine the vessel and has carried out any repairs or requirements recommended by the Classification Society or such surveyor.

35 PREMIUM PAYMENT

35.1 The Assured undertakes that the premium shall be paid

35.1.1 in full to the Underwriters within 45 days (or such other period as may be agreed) of inception of this insurance; or

35.1.2 where payment by instalment premiums has been agreed

(a) the first instalment premium shall be paid within 45 days (or such other period as may be agreed) of inception of this insurance, and

(b) the second and subsequent instalments shall be paid by the date they are due.

35.2 If the premium (or the first instalment premium) has not been so paid to the Underwriters by the 46th day (or the day after such period as may have been agreed) from the inception of this insurance (and, in respect of the second and subsequent instalment premiums, by the date they are due), the Underwriters shall have the right to cancel this insurance by notifying the Assured via the broker in writing.

35.3 The Underwriters shall give not less than 15 days prior notice of cancellation to the Assured via the broker. If the premium or instalment premium due is paid in full to the Underwriters before the notice period expires, notice of cancellation shall automatically be revoked. If not, this insurance shall automatically terminate at the end of the notice period.

35.4 In the event of cancellation under this Clause 35, premium is due to the Underwriters on a pro rata basis for the period that the Underwriters are on risk but the full premium shall be payable to the Underwriters in the event of loss, damage, liability or expense arising out of or resulting from an accident or occurrence prior to the date of

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termination which gives rise to a recoverable claim under this insurance.

- 35.5 Unless otherwise agreed, the Leading Underwriter(s) designated in the slip or policy are authorised to exercise rights under this Clause 35 on their own behalf and on behalf of all cosubscribing Underwriters. Nothing in this Clause 35.5 shall, however, prevent any co-subscribing Underwriter from exercising rights under this Clause 35 on its own behalf.
- 35.6 Where the premium is to be paid through a Market Bureau, payment to the Underwriters will be deemed to occur on the day of delivery of a premium advice note to the Bureau.

36 CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

- 36.1 No benefit of this insurance is intended to be conferred on or enforceable by any party other than the Assured, save as may be expressly provided herein to the contrary.
- 36.2 This insurance may by agreement between the Assured and the Underwriters be rescinded or varied without the consent of any third party to whom the enforcement of any terms has been expressly provided for.

37 FIXED AND FLOATING OBJECTS

If the Underwriters have expressly agreed in writing, then Clauses 6 and 7 are amended to read as follows

- 6.1 The Underwriters agree to indemnify the Assured for three fourths of any sum or sums paid by the Assured to any other person or persons by reason of the Assured becoming legally liable by way of damages for
- 6.1.1 loss of or damage to any other vessel or fixed or floating object or property thereon
 - 6.1.2 delay to or loss of use of any such other vessel or fixed or floating object or property thereon
 - 6.1.3 general average of, salvage of, or salvage under contract of, any such other vessel or property thereon,
- where such payment by the Assured is in consequence of the insured vessel coming into collision with any other vessel or striking any fixed or floating object.
- 6.2 The indemnity provided by this Clause 6 shall be in addition to the indemnity provided by the other terms and conditions of this insurance and shall be subject to the following provisions
- 6.2.1 where the insured vessel is in collision with another vessel and both vessels are to blame then, unless the liability of one or both vessels becomes limited by law, the indemnity under this Clause 6 shall be calculated on the principle of cross-liabilities as if the respective Owners had been compelled to pay to each other such proportion of each other's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured in

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consequence of the collision

- 6.2.2 in no case shall the total liability of the Underwriters under Clauses 6.1 and 6.2 exceed their proportionate part of three fourths of the insured value of the insured vessel in respect of any one collision.
- 6.3 The Underwriters shall also pay three fourths of the legal costs incurred by the Assured or which the Assured may be compelled to pay in contesting liability or taking proceedings to limit liability, provided always that their prior written consent to the incurring of such costs shall have been obtained and that the total liability of the Underwriters under this Clause 6.3 shall not (unless the Underwriters' specific written agreement shall have been obtained) exceed 25% of the insured value of the insured vessel.

EXCLUSIONS

- 6.4 In no case shall the Underwriters indemnify the Assured under this Clause 6 for any sum which the Assured shall pay for or in respect of
- 6.4.1 removal or disposal of obstructions, wrecks, cargoes or any other thing whatsoever
- 6.4.2 any real or personal property or thing whatsoever except other vessels or any fixed or floating object struck by the insured vessel or property on other vessels or any such fixed or floating object
- 6.4.3 the cargo or other property on, or the engagements of, the insured vessel
- 6.4.4 loss of life, personal injury or illness
- 6.4.5 pollution or contamination, or threats thereof, of any real or personal property or thing whatsoever (except other vessels with which the insured vessel is in collision or property on such other vessels) or damage to the environment, or threat thereof, save that this exclusion shall not exclude any sum which the Assured shall pay for or in respect of salvage remuneration in which the skill and efforts of the salvors in preventing or minimising damage to the environment as referred to in Article 13 paragraph l(b) of the International Convention on Salvage, 1989 have been taken into account.
7. Should the insured vessel come into collision with another vessel or fixed or floating object belonging wholly or in part to the same owners or under the same management or receive salvage services from another vessel belonging wholly or in part to the same owners or under the same management, the assured shall have the same rights under this insurance as they would have were the other vessel or the fixed or floating object entirely the property of owners not interested in the insured vessel; but in such cases the liability for the collision or the amount payable for the services rendered shall be referred to a sole arbitrator to be agreed upon between the underwriters and the assured.

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If the Underwriters have expressly agreed in writing, then Clause 6 is amended such that the words "three fourths of" are deleted on each occasion in which they appear in Clause 6.

39 RETURNS FOR LAY-UP

- 39.1 If the Underwriters have expressly agreed in writing, such percentage of the net premium as agreed by the Underwriters shall be returned for each period of 30 consecutive days the vessel may be laid up, not under repair, in a port or in a lay-up area provided such port or lay-up area is approved by the Underwriters.
- 39.2 The vessel shall not be considered to be under repair when work is undertaken in respect of ordinary wear and tear of the vessel and/or following recommendations in the vessel's Classification Society survey, but in the case of any repairs following loss of or damage to the vessel or involving structural alterations, whether covered by this insurance or otherwise, shall be considered as under repair.

39.3 PROVIDED ALWAYS THAT

- 39.3.1 a total loss of the vessel, whether by perils insured under this insurance or otherwise, has not occurred during the period of this insurance or any extension thereof
- 39.3.2 a return of premium shall not be allowed when the vessel is lying in exposed or unprotected waters, or in a port or lay-up area not approved by the Underwriters
- 39.3.3 loading or discharging operations or the presence of cargo on board shall not debar a return of premium but no return shall be allowed for any period during which the vessel is being used for the storage of cargo or for lightering purposes
- 39.3.4 in the event of any return of premium recoverable under this Clause 39 being based on 30 consecutive days which fall on successive insurances effected for the same Assured, this insurance shall only be liable for an amount calculated at pro rata of the agreed percentage net for the number of days which come within the period of this insurance or any extension thereof and to which a return is actually applicable. Such overlapping period shall run, at the option of the Assured, either from the first day on which the vessel is laid up or the first day of a period of 30 consecutive days as provided under Clause 39.1 above.

40 GENERAL AVERAGE ABSORBTION

- 40.1 If the Underwriters have expressly agreed in writing and subject to the provisions of Clause 8, the following shall apply in the event of an accident or occurrence giving rise to a general average act under the York-Antwerp Rules 1994 or under the provisions of the general average clause in the contract of affreightment.
- 40.2 The Assured shall have the option of claiming the total general average, salvage and special charges up to the amount expressly agreed by the Underwriters, without claiming general average, salvage or special charges from cargo, freight, bunkers, containers or any property not owned by the Assured on board the vessel (hereinafter the "Property Interests").

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- 40.3 The Underwriters shall also pay the reasonable fees and expenses of the average adjuster for calculating claims under this Clause 40, in addition to any payment made under Clause 40.2.
- 40.4 If the Assured claims under this Clause 40, the Assured shall not claim general average, salvage or special charges against the Property Interests.
- 40.5 Claims under this Clause 40 shall be adjusted in accordance with the York-Antwerp Rules 1994, excluding the first paragraph of Rule XX and Rule XXI, relating to commission and interest.
- 40.6 Claims under this Clause 40 shall be payable without the application of the deductible(s) in Clause 15.
- 40.7 Without prejudice to any other defences that the Underwriters may have under this insurance or at law, the Underwriters waive any defences to payment under this Clause 40 which would have been available to the Property Interests, if the Assured had claimed general average, salvage or special charges from the Property Interests.
- 40.8 In respect of payments made under this Clause 40, the Underwriters waive their rights of subrogation against the Property Interests, save where the accident or occurrence giving rise to such payment is attributable to fault on the part of the Property Interests or any of them.
- 40.9 Claims under this Clause 40 shall be payable without reduction in respect of any under-insurance.
- 40.10 For the purposes of this Clause 40, special charges shall mean charges incurred by the Assured on behalf of or for the benefit of a particular interest to the adventure, for which charges the Assured is not responsible under the contract of affreightment.

41 ADDITIONAL PERILS

- 41.1 If the Underwriters have expressly agreed in writing, this insurance covers
- 41.1.1 the costs of repairing or replacing any boiler which bursts or shaft which breaks, where such bursting or breakage has caused loss of or damage to the subject matter insured covered by Clause 2.2.1, and that half of the costs common to the repair of the burst boiler or the broken shaft and to the repair of the loss or damage caused thereby which is not covered by Clause 2.3
- 41.1.2 the costs of correcting a latent defect where such latent defect has caused loss of or damage to the subject matter insured covered by Clause 2.2.2, and that half of the costs common to the correction of the latent defect and to the repair of the loss or damage caused thereby which is not covered by Clause 2.4
- 41.1.3 loss of or damage to the vessel caused by any accident or by negligence, incompetence or error of judgment of any person whatsoever
- provided that such loss or damage has not resulted from want of due diligence by the Assured, Owners or Managers.
- 41.2 Master, Officers, Crew or Pilots shall not be considered Owners within the meaning of Clause 41.1 should they hold shares in the vessel.

PART 3 - CLAIMS PROVISIONS (01/11/03)

42 LEADING UNDERWRITER(S)

- 42.1 Where there is co-insurance in respect of this insurance, all subscribing Underwriters agree that the Leading Underwriter(s) designated in the slip or policy may act on their behalves so as to bind them for their respective several proportions in respect of the following matters (in addition to Clause 35.5)
- 42.1.1 the appointment of surveyors, experts, average adjusters and lawyers, in relation to matters which may give rise to a claim under this insurance
 - 42.1.2 the duties and obligations to be undertaken by the Underwriters including, but not limited to, the provision of security
 - 42.1.3 claims procedures, the handling of any claim (including, but not limited to, agreements under Clause 43.2) and the pursuit of recoveries
 - 42.1.4 all payments or settlements to the Assured or to third parties under this insurance other than those agreed on an 'ex-gratia' basis.

Notwithstanding the above, the Leading Underwriter(s), or any of them, may require any such matters to be referred to the co-subscribing Underwriters.

- 42.2. The co-subscribing Underwriters shall, to the extent of their respective several proportions, indemnify and hold harmless the Leading Underwriter(s) in respect of all liabilities, costs or expenses incurred by the Leading Underwriter(s) in respect of the matters in Clause 42.1.
- 42.2 If the Leading Underwriter(s) require expenses incurred for or on behalf of the Underwriters to be collected for a party instructed by the Leading Underwriter(s), the collecting party shall be entitled to charge 5% of the amount collected for this service or such other amount as may be agreed in advance by the Leading Underwriter(s), such fee to be paid by the Underwriters.
- 42.3 The agreement in this Clause 42 between the Leading Underwriter(s) and co-subscribing Underwriters is subject to the exclusive jurisdiction of the English High Court of Justice and is subject to English law and practice.

43 NOTICE OF CLAIMS

- 43.1 In the event of an accident or occurrence whereby loss, damage, liability or expense may result in a claim under this insurance, notice must be given to the Leading Underwriter(s) as soon as possible after the date on which the Assured, Owners or Managers become aware of such loss, damage, liability or expense so that a surveyor may be appointed if the Leading Underwriter(s) so desire.
- 43.2 If notice is not given to the Leading Underwriter(s) within 180 days of the Assured, Owners or Managers becoming aware of such loss, damage, liability or expense, no claim shall be recoverable under this insurance in respect of such loss, damage, liability or expense, unless the Leading Underwriter(s) agree to the contrary in writing.

44 TENDER PROVISIONS

- 44.1 The Leading Underwriter(s) shall be entitled to decide the port to which the vessel shall proceed for docking or repair (the actual additional expense of the voyage arising from compliance with the Leading Underwriter(s)' requirements being refunded to the Assured) and shall have a right of veto concerning a place of repair or a repairing firm.
- 44.2 The Leading Underwriters(s) may also take tenders or may require further tenders to be taken for the repair of the vessel. Where such a tender has been taken and a tender is accepted with the approval of the Leading Underwriter(s), an allowance shall be made at the rate of 30% per annum on the insured value for the time lost between the despatch of the invitations to tender required by the Underwriters and the acceptance of a tender to the extent that such time is lost solely as the result of tenders having been taken and provided that the tender is accepted without delay after receipt of the Leading Underwriter's approval.
- 44.3 Due credit shall be given against the allowance in Clause 44.2 for any amounts recovered in respect of fuel, stores, wages and maintenance of the Master, Officers and Crew or any member thereof, including amounts allowed in general average, and for any amounts recovered from third parties in respect of damages for detention and/or loss of profit and/or running expenses, for the period covered by the tender allowance or any part thereof.
- 44.4 Where a part of the cost of the repair of damage other than a fixed deductible is not recoverable from the Underwriters the allowance shall be reduced by a similar proportion.
- 44.5 If the Assured fails to comply with this Clause 44, a deduction of 15% shall be made from the amount of the ascertained net claim.

45 DUTIES OF THE ASSURED

- 45.1 The Assured shall, upon request and at their own expense, provide the Leading Underwriter(s) with all relevant documents and information that they might reasonably require to consider any claim.
- 45.2 Upon reasonable request, the Assured shall also assist the Leading Underwriter(s) or their authorised agents in the investigation of any claim, including, but not limited to
- 45.2.1 interview(s) of any employee, ex-employee or agent of the Assured
 - 45.2.2 interview(s) of any third party whom the Leading Underwriter(s) consider may knowledge of matters relevant to the claim
 - 45.2.3 survey(s) of the subject-matter insured
 - 45.2.4 inspection(s) of the classification records of the vessel.
- 45.3 It shall be a condition precedent to the liability of the Underwriters that the Assured shall not at any stage prior to the commencement of legal proceedings knowingly or recklessly
- 45.3.1 mislead or attempt to mislead the Underwriters in the proper consideration of a claim or the settlement thereof by relying on any evidence which is false

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45.3.2 conceal any circumstance or matter from the Underwriters material to the proper consideration of a claim or a defence to such a claim.

45.4 Clause 45.3 does not require the Assured at any stage to disclose to the Underwriters any document or matter which under English law is protected from disclosure by legal advice privilege or by litigation privilege.

46 DUTIES OF THE UNDERWRITERS IN RELATION TO CLAIMS

46.1 The Leading Underwriter(s) may, at their sole discretion, upon the notification of loss, damage, liability or expense arising from an accident or occurrence which may result in a claim under this insurance

46.1.1 instruct a surveyor who shall report to the Leading Underwriter(s) concerning the cause and extent of damage, the necessary repairs and the fair and reasonable cost thereof and any other matter which the Leading Underwriter(s) or the surveyor consider relevant

46.1.2 confirm the appointment of an independent average adjuster to assist the Assured in the preparation of the claim. If not already agreed, the Assured shall propose the average adjuster to be appointed who may be a Fellow of the Association of Average Adjusters of the United Kingdom or any other average adjuster mutually acceptable to the Assured and the Leading Underwriter(s).

46.2 Where such appointments are made, the Underwriters shall be responsible for payment of reasonable fees directly to the surveyor and the average adjuster irrespective of whether a claim ultimately arises under this insurance. However, the Underwriters' liability for the fees of the appointed average adjuster shall cease no later than at such time as the Underwriters pay, settle or communicate their intention to deny the claim under this insurance or when it becomes apparent that any claim is unlikely to exceed the relevant deductible(s) in Clause 15.

46.3 The making of such appointments is not an admission by the Underwriters that the accident, occurrence or resulting claim is covered under this insurance or a waiver of any rights or defences that the Underwriters may have under this insurance or at law.

46.4 The reports of the surveyor shall, subject to no conflict of interest being identified by the Leading Underwriter(s), be released without delay to the Assured and the appointed average adjuster.

46.5 The Leading Underwriter(s) shall be entitled to request the appointed average adjuster to provide status reports at any stage.

46.6 The Leading Underwriter(s) shall give prompt consideration to the making of a payment on account upon the recommendation of the appointed average adjuster or, if no adjuster is appointed, upon the request of the Assured supported by appropriate documentation.

46.7 The Leading Underwriter(s) shall make a decision in respect of any claim within 28 days of receipt by them of the appointed average adjuster's final adjustment or, if no adjuster is appointed, a fully documented claim presentation sufficient to enable the Underwriters to determine their liability in relation to coverage and quantum. If the Leading Underwriter(s) request additional documentation or information to make a decision, they shall make a decision within a reasonable time after receipt of the

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additional documents or information requested, or of a satisfactory explanation as to why such documents and information are not available.

47 PROVISION OF SECURITY

If the Assured is obliged to provide security to a third party in order to prevent the arrest of, or to obtain the release of, the vessel, due to an accident or occurrence giving rise to a claim alleged to be covered under this insurance, the Underwriters shall give due consideration to assisting the Assured by providing security on behalf of the Assured or counter-security in a form to be determined by the Leading Underwriter(s).

48 PAYMENT OF CLAIMS

Claims payable under this insurance shall, subject to the terms of any assignment, be paid to the loss payee or, if no loss payee has been agreed, to the Assured or as they may direct in writing. Such payment, whether in account or otherwise, when made shall be a complete discharge of the Underwriters' obligations under this insurance in respect of the amount so paid.

49 RECOVERIES

49.1 The Assured shall, whether or not the Underwriters have paid a claim or agreed to pay a claim or potential claim under this insurance, take reasonable steps to

49.1.1 assess as soon as possible whether there are any prospects of a recovery from third parties in respect of matters giving rise to a claim or to a potential claim under this insurance

49.1.2 protect any claims against such third parties if necessary by the commencement of proceedings and the taking of appropriate steps to obtain security for the claim from third parties

49.1.3 keep the Leading Underwriter(s) and the appointed average adjuster (if any) advised of the recovery prospects and any action taken against third parties

49.1.4 co-operate with the Leading Underwriter(s) in the taking of such steps as may be reasonably required to pursue any claims against third parties.

49.2 Underwriters shall pay the reasonable costs incurred by the Assured pursuant to this Clause 49 in the same proportion as the insured losses bear to the total of the insured and uninsured losses (as defined in Clause 49.4.2).

49.3 Where the Assured have incurred reasonable costs pursuant to Clause 49.1.2 and where no claim is recoverable under this insurance, provided always that the Underwriters' written agreement to the reimbursement of such costs shall have been obtained prior to the incurring of such costs, the Underwriters shall reimburse such costs to the extent agreed, notwithstanding that no claim is recoverable under this insurance.

49.4 In the event of recoveries from third parties in respect of claims which have been paid in whole or in part under this insurance, such recoveries shall be distributed between the Underwriters and the Assured as follows

49.4.1 the reasonable costs and expenses incurred in making such recoveries from

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the third party shall be deducted first and returned to the paying party

49.4.2 the balance shall be apportioned between the Underwriters and the Assured in the same proportion that the insured losses and uninsured losses bear to the total of the insured and uninsured losses. For the purposes of Clause 49.2 and this Clause 49.4.2, uninsured losses shall mean loss of or damage to the subject-matter insured and any liability or expense which would have been recoverable under this insurance, but for the application of deductible(s) under Clause 15 and the limits of this insurance

49.5 In the event that under this insurance coverage is not provided in accordance with Clause 6, the following shall apply

49.5.1 Where the insured vessel is in collision with another vessel and both vessels are to blame then, unless the liability of one or both vessels becomes limited by law, any recovery due to the Underwriters shall be calculated on the principle of cross-liabilities as if the respective Owners had been compelled to pay to each other such proportion of each other's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured in consequence of the collision.

50 DISPUTE RESOLUTION

Subject to the overriding provisions of Clause 1.3, disputes between the Assured and the Underwriters may, if not settled amicably by negotiation, be referred at the request of the Assured or the Underwriters to mediation or other form of alternative dispute resolution and, in default of agreement as to the procedure to be adopted, any such mediation or other form of alternative dispute resolution shall be in accordance with the current CEDR Solve model procedures.

APPENDIX 6

1/1/09

INSTITUTE CARGO CLAUSES (A)

RISKS COVERED

Risks

1. This insurance covers all risks of loss of or damage to the subject-matter insured except as excluded by the provisions of Clauses 4, 5, 6 and 7 below.

General Average

2. This insurance covers general average and salvage charges, adjusted or determined according to the contract of carriage and/or the governing law and practice, incurred to avoid or in connection with the avoidance of loss from any cause except those excluded in Clauses 4, 5, 6 and 7 below.

"Both to Blame Collision Clause"

3. This insurance indemnifies the Assured, in respect of any risk insured herein, against liability incurred under any Both to Blame Collision Clause in the contract of carriage. In the event of any claim by carriers under the said Clause, the Assured agree to notify the Insurers who shall have the right, at their own cost and expense, to defend the Assured against such claim.

EXCLUSIONS

4. In no case shall this insurance cover
 - 4.1 loss damage or expense attributable to wilful misconduct of the Assured
 - 4.2 ordinary leakage, ordinary loss in weight or volume, or ordinary wear and tear of the subject-matter insured
 - 4.3 loss damage or expense caused by insufficiency or unsuitability of packing or preparation of the subject-matter insured to withstand the ordinary incidents of the insured transit where such packing or preparation is carried out by the Assured or their employees or prior to the attachment of this insurance (for the purpose of these Clauses "packing" shall be deemed to include stowage in a container and "employees" shall not include independent contractors)
 - 4.4 loss damage or expense caused by inherent vice or nature of the subject-matter insured
 - 4.5 loss damage or expense caused by delay, even though the delay be caused by a risk insured against (except expenses payable under Clause 2 above)
 - 4.6 loss damage or expense caused by insolvency or financial default of the owners managers charterers or operators of the vessel where, at the time of loading of the subject-matter insured on board the vessel, the Assured are aware, or in the ordinary course of business should be aware, that such insolvency or financial default could prevent the normal prosecution of the voyage
This exclusion shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract
 - 4.7 loss damage or expense directly or indirectly caused by or arising from the use of any weapon or device employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.
5. 5.1 In no case shall this insurance cover loss damage or expense arising from
 - 5.1.1 unseaworthiness of vessel or craft or unfitness of vessel or craft for the safe carriage of the subject-matter insured, where the Assured are privy to such unseaworthiness or unfitness, at the time the subject-matter insured is loaded therein
 - 5.1.2 unfitness of container or conveyance for the safe carriage of the subject-matter insured, where loading therein or thereon is carried out
prior to attachment of this insurance or
by the Assured or their employees and they are privy to such unfitness at the time of loading.
- 5.2 Exclusion 5.1.1 above shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract.
- 5.3 The Insurers waive any breach of the implied warranties of seaworthiness of the ship and fitness of the ship to carry the subject-matter insured to destination.
6. In no case shall this insurance cover loss damage or expense caused by
 - 6.1 war civil war revolution rebellion insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power
 - 6.2 capture seizure arrest restraint or detention (piracy excepted), and the consequences thereof or any attempt thereat
 - 6.3 derelict mines torpedoes bombs or other derelict weapons of war.
7. In no case shall this insurance cover loss damage or expense
 - 7.1 caused by strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions
 - 7.2 resulting from strikes, lock-outs, labour disturbances, riots or civil commotions
 - 7.3 caused by any act of terrorism being an act of any person acting on behalf of, or in connection with, any organisation which carries out activities directed towards the overthrowing or influencing, by force or violence, of any government whether or not legally constituted

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INSTITUTE CARGO CLAUSES (A) (1/1/09)

- 7.4 caused by any person acting from a political, ideological or religious motive.

DURATION

Transit Clause

8. 8.1 Subject to Clause 11 below, this insurance attaches from the time the subject-matter insured is first moved in the warehouse or at the place of storage (at the place named in the contract of insurance) for the purpose of the immediate loading into or onto the carrying vehicle or other conveyance for the commencement of transit,
- continues during the ordinary course of transit
- and terminates either
- 8.1.1 on completion of unloading from the carrying vehicle or other conveyance in or at the final warehouse or place of storage at the destination named in the contract of insurance,
- 8.1.2 on completion of unloading from the carrying vehicle or other conveyance in or at any other warehouse or place of storage, whether prior to or at the destination named in the contract of insurance, which the Assured or their employees elect to use either for storage other than in the ordinary course of transit or for allocation or distribution, or
- 8.1.3 when the Assured or their employees elect to use any carrying vehicle or other conveyance or any container for storage other than in the ordinary course of transit or
- 8.1.4 on the expiry of 60 days after completion of discharge overside of the subject-matter insured from the oversea vessel at the final port of discharge, whichever shall first occur.
- 8.2 If, after discharge overside from the oversea vessel at the final port of discharge, but prior to termination of this insurance, the subject-matter insured is to be forwarded to a destination other than that to which it is insured, this insurance, whilst remaining subject to termination as provided in Clauses 8.1.1 to 8.1.4, shall not extend beyond the time the subject-matter insured is first moved for the purpose of the commencement of transit to such other destination.
- 8.3 This insurance shall remain in force (subject to termination as provided for in Clauses 8.1.1 to 8.1.4 above and to the provisions of Clause 9 below) during delay beyond the control of the Assured, any deviation, forced discharge, reshipment or transhipment and during any variation of the adventure arising from the exercise of a liberty granted to carriers under the contract of carriage.

Termination of Contract of Carriage

9. If owing to circumstances beyond the control of the Assured either the contract of carriage is terminated at a port or place other than the destination named therein or the transit is otherwise terminated before unloading of the subject-matter insured as provided for in Clause 8 above, then this insurance shall also terminate *unless prompt notice is given to the Insurers and continuation of cover is requested when this insurance shall remain in force, subject to an additional premium if required by the Insurers, either*
- 9.1 until the subject-matter insured is sold and delivered at such port or place, or, unless otherwise specially agreed, until the expiry of 60 days after arrival of the subject-matter insured at such port or place, whichever shall first occur,
- or
- 9.2 if the subject-matter insured is forwarded within the said period of 60 days (or any agreed extension thereof) to the destination named in the contract of insurance or to any other destination, until terminated in accordance with the provisions of Clause 8 above.

Change of Voyage

- 10.10.1 Where, after attachment of this insurance, the destination is changed by the Assured, *this must be notified promptly to Insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained cover may be provided but only if cover would have been available at a reasonable commercial market rate on reasonable market terms.*
- 10.2 Where the subject-matter insured commences the transit contemplated by this insurance (in accordance with Clause 8.1), but, without the knowledge of the Assured or their employees the ship sails for another destination, this insurance will nevertheless be deemed to have attached at commencement of such transit.

CLAIMS

Insurable Interest

- 11.11.1 In order to recover under this insurance the Assured must have an insurable interest in the subject-matter insured at the time of the loss.
- 11.2 Subject to Clause 11.1 above, the Assured shall be entitled to recover for insured loss occurring during the period covered by this insurance, notwithstanding that the loss occurred before the contract of insurance was concluded, unless the Assured were aware of the loss and the Insurers were not.

Forwarding Charges

12. Where, as a result of the operation of a risk covered by this insurance, the insured transit is terminated at a port or place other than that to which the subject-matter insured is covered under this insurance, the

INSTITUTE CARGO CLAUSES (A) (1/1/09)

Insurers will reimburse the Assured for any extra charges properly and reasonably incurred in unloading, storing and forwarding the subject-matter insured to the destination to which it is insured.

This Clause 12, which does not apply to general average or salvage charges, shall be subject to the exclusions contained in Clauses 4, 5, 6 and 7 above, and shall not include charges arising from the fault, negligence, insolvency or financial default of the Assured or their employees.

Constructive Total Loss

13. No claim for Constructive Total Loss shall be recoverable hereunder unless the subject-matter insured is reasonably abandoned either on account of its actual total loss appearing to be unavoidable or because the cost of recovering, reconditioning and forwarding the subject-matter insured to the destination to which it is insured would exceed its value on arrival.

Increased Value

14.14.1 If any Increased Value insurance is effected by the Assured on the subject-matter insured under this insurance the agreed value of the subject-matter insured shall be deemed to be increased to the total amount insured under this insurance and all Increased Value insurances covering the loss, and liability under this insurance shall be in such proportion as the sum insured under this insurance bears to such total amount insured.

In the event of claim the Assured shall provide the Insurers with evidence of the amounts insured under all other insurances.

14.2 Where this insurance is on Increased Value the following clause shall apply:

The agreed value of the subject-matter insured shall be deemed to be equal to the total amount insured under the primary insurance and all Increased Value insurances covering the loss and effected on the subject-matter insured by the Assured, and liability under this insurance shall be in such proportion as the sum insured under this insurance bears to such total amount insured.

In the event of claim the Assured shall provide the Insurers with evidence of the amounts insured under all other insurances.

BENEFIT OF INSURANCE

15. This insurance

- 15.1 covers the Assured which includes the person claiming indemnity either as the person by or on whose behalf the contract of insurance was effected or as an assignee,
- 15.2 shall not extend to or otherwise benefit the carrier or other bailee.

MINIMISING LOSSES

Duty of Assured

16. It is the duty of the Assured and their employees and agents in respect of loss recoverable hereunder

- 16.1 to take such measures as may be reasonable for the purpose of averting or minimising such loss, and
- 16.2 to ensure that all rights against carriers, bailees or other third parties are properly preserved and exercised

and the Insurers will, in addition to any loss recoverable hereunder, reimburse the Assured for any charges properly and reasonably incurred in pursuance of these duties.

Waiver

17. Measures taken by the Assured or the Insurers with the object of saving, protecting or recovering the subject-matter insured shall not be considered as a waiver or acceptance of abandonment or otherwise prejudice the rights of either party.

AVOIDANCE OF DELAY

18. It is a condition of this insurance that the Assured shall act with reasonable despatch in all circumstances within their control.

LAW AND PRACTICE

19. This insurance is subject to English law and practice.

NOTE:- Where a continuation of cover is requested under Clause 9, or a change of destination is notified under Clause 10, there is an obligation to give prompt notice to the Insurers and the right to such cover is dependent upon compliance with this obligation.

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APPENDIX 7

1/1/09

INSTITUTE CARGO CLAUSES (B)

RISKS COVERED

Risks

1. This insurance covers, except as excluded by the provisions of Clauses 4, 5, 6 and 7 below,
 - 1.1 loss of or damage to the subject-matter insured reasonably attributable to
 - 1.1.1 fire or explosion
 - 1.1.2 vessel or craft being stranded grounded sunk or capsized
 - 1.1.3 overturning or derailment of land conveyance
 - 1.1.4 collision or contact of vessel craft or conveyance with any external object other than water
 - 1.1.5 discharge of cargo at a port of distress
 - 1.1.6 earthquake volcanic eruption or lightning,
 - 1.2 loss of or damage to the subject-matter insured caused by
 - 1.2.1 general average sacrifice
 - 1.2.2 jettison or washing overboard
 - 1.2.3 entry of sea lake or river water into vessel craft hold conveyance container or place of storage,
 - 1.3 total loss of any package lost overboard or dropped whilst loading on to, or unloading from, vessel or craft.

General Average

2. This insurance covers general average and salvage charges, adjusted or determined according to the contract of carriage and/or the governing law and practice, incurred to avoid or in connection with the avoidance of loss from any cause except those excluded in Clauses 4, 5, 6 and 7 below.

"Both to Blame Collision Clause"

3. This insurance indemnifies the Assured, in respect of any risk insured herein, against liability incurred under any Both to Blame Collision Clause in the contract of carriage. In the event of any claim by carriers under the said Clause, the Assured agree to notify the Insurers who shall have the right, at their own cost and expense, to defend the Assured against such claim.

EXCLUSIONS

4. In no case shall this insurance cover
 - 4.1 loss damage or expense attributable to wilful misconduct of the Assured
 - 4.2 ordinary leakage, ordinary loss in weight or volume, or ordinary wear and tear of the subject-matter insured
 - 4.3 loss damage or expense caused by insufficiency or unsuitability of packing or preparation of the subject-matter insured to withstand the ordinary incidents of the insured transit where such packing or preparation is carried out by the Assured or their employees or prior to the attachment of this insurance (for the purpose of these Clauses "packing" shall be deemed to include stowage in a container and "employees" shall not include independent contractors)
 - 4.4 loss damage or expense caused by inherent vice or nature of the subject-matter insured
 - 4.5 loss damage or expense caused by delay, even though the delay be caused by a risk insured against (except expenses payable under Clause 2 above)
 - 4.6 loss damage or expense caused by insolvency or financial default of the owners managers charterers or operators of the vessel where, at the time of loading of the subject-matter insured on board the vessel, the Assured are aware, or in the ordinary course of business should be aware, that such insolvency or financial default could prevent the normal prosecution of the voyage
This exclusion shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract
 - 4.7 deliberate damage to or deliberate destruction of the subject-matter insured or any part thereof by the wrongful act of any person or persons
 - 4.8 loss damage or expense directly or indirectly caused by or arising from the use of any weapon or device employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.
5. 5.1 In no case shall this insurance cover loss damage or expense arising from
 - 5.1.1 unseaworthiness of vessel or craft or unfitness of vessel or craft for the safe carriage of the subject-matter insured, where the Assured are privy to such unseaworthiness or unfitness, at the time the subject-matter insured is loaded therein
 - 5.1.2 unfitness of container or conveyance for the safe carriage of the subject-matter insured, where loading therein or thereon is carried out
prior to attachment of this insurance or
by the Assured or their employees and they are privy to such unfitness at the time of loading.
- 5.2 Exclusion 5.1.1 above shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract.
- 5.3 The Insurers waive any breach of the implied warranties of seaworthiness of the ship and fitness of the ship to carry the subject-matter insured to destination.
6. In no case shall this insurance cover loss damage or expense caused by
 - 6.1 war civil war revolution rebellion insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power

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- 6.2 capture seizure arrest restraint or detainment, and the consequences thereof or any attempt thereof
- 6.3 derelict mines torpedoes bombs or other derelict weapons of war.
- 7. In no case shall this insurance cover loss damage or expense
 - 7.1 caused by strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions
 - 7.2 resulting from strikes, lock-outs, labour disturbances, riots or civil commotions
 - 7.3 caused by any act of terrorism being an act of any person acting on behalf of, or in connection with, any organisation which carries out activities directed towards the overthrowing or influencing, by force or violence, of any government whether or not legally constituted
 - 7.4 caused by any person acting from a political, ideological or religious motive.

DURATION

Transit Clause

- 8. 8.1 Subject to Clause 11 below, this insurance attaches from the time the subject-matter insured is first moved in the warehouse or at the place of storage (at the place named in the contract of insurance) for the purpose of the immediate loading into or onto the carrying vehicle or other conveyance for the commencement of transit,
 - continues during the ordinary course of transit
 - and terminates either
 - 8.1.1 on completion of unloading from the carrying vehicle or other conveyance in or at the final warehouse or place of storage at the destination named in the contract of insurance,
 - 8.1.2 on completion of unloading from the carrying vehicle or other conveyance in or at any other warehouse or place of storage, whether prior to or at the destination named in the contract of insurance, which the Assured or their employees elect to use either for storage other than in the ordinary course of transit or for allocation or distribution, or
 - 8.1.3 when the Assured or their employees elect to use any carrying vehicle or other conveyance or any container for storage other than in the ordinary course of transit or
 - 8.1.4 on the expiry of 60 days after completion of discharge overseas of the subject-matter insured from the overseas vessel at the final port of discharge, whichever shall first occur.
- 8.2 If, after discharge overseas from the overseas vessel at the final port of discharge, but prior to termination of this insurance, the subject-matter insured is to be forwarded to a destination other than that to which it is insured, this insurance, whilst remaining subject to termination as provided in Clauses 8.1.1 to 8.1.4, shall not extend beyond the time the subject-matter insured is first moved for the purpose of the commencement of transit to such other destination.
- 8.3 This insurance shall remain in force (subject to termination as provided for in Clauses 8.1.1 to 8.1.4 above and to the provisions of Clause 9 below) during delay beyond the control of the Assured, any deviation, forced discharge, reshipment or transshipment and during any variation of the adventure arising from the exercise of a liberty granted to carriers under the contract of carriage.

Termination of Contract of Carriage

- 9. If owing to circumstances beyond the control of the Assured either the contract of carriage is terminated at a port or place other than the destination named therein or the transit is otherwise terminated before unloading of the subject-matter insured as provided for in Clause 8 above, then this insurance shall also terminate *unless prompt notice is given to the Insurers and continuation of cover is requested when this insurance shall remain in force, subject to an additional premium if required by the Insurers, either*
 - 9.1 until the subject-matter insured is sold and delivered at such port or place, or, unless otherwise specially agreed, until the expiry of 60 days after arrival of the subject-matter insured at such port or place, whichever shall first occur,
 - or
 - 9.2 if the subject-matter insured is forwarded within the said period of 60 days (or any agreed extension thereof) to the destination named in the contract of insurance or to any other destination, until terminated in accordance with the provisions of Clause 8 above.

Change of Voyage

- 10.10.1 Where, after attachment of this insurance, the destination is changed by the Assured, *this must be notified promptly to Insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained cover may be provided but only if cover would have been available at a reasonable commercial market rate on reasonable market terms.*
- 10.2 Where the subject-matter insured commences the transit contemplated by this insurance (in accordance with Clause 8.1), but, without the knowledge of the Assured or their employees the ship sails for another destination, this insurance will nevertheless be deemed to have attached at commencement of such transit.

CLAIMS

Insurable Interest

- 11.11.1 In order to recover under this insurance the Assured must have an insurable interest in the subject-matter insured at the time of the loss.
- 11.2 Subject to Clause 11.1 above, the Assured shall be entitled to recover for insured loss occurring during the period covered by this insurance, notwithstanding that the loss occurred before the

INSTITUTE CARGO CLAUSES (B) (1/1/09)

contract of insurance was concluded, unless the Assured were aware of the loss and the Insurers were not.

Forwarding Charges

12. Where, as a result of the operation of a risk covered by this insurance, the insured transit is terminated at a port or place other than that to which the subject-matter insured is covered under this insurance, the Insurers will reimburse the Assured for any extra charges properly and reasonably incurred in unloading, storing and forwarding the subject-matter insured to the destination to which it is insured.

This Clause 12, which does not apply to general average or salvage charges, shall be subject to the exclusions contained in Clauses 4, 5, 6 and 7 above, and shall not include charges arising from the fault, negligence, insolvency or financial default of the Assured or their employees.

Constructive Total Loss

13. No claim for Constructive Total Loss shall be recoverable hereunder unless the subject-matter insured is reasonably abandoned either on account of its actual total loss appearing to be unavoidable or because the cost of recovering, reconditioning and forwarding the subject-matter insured to the destination to which it is insured would exceed its value on arrival.

Increased Value

14.14.1 If any Increased Value insurance is effected by the Assured on the subject-matter insured under this insurance the agreed value of the subject-matter insured shall be deemed to be increased to the total amount insured under this insurance and all Increased Value insurances covering the loss, and liability under this insurance shall be in such proportion as the sum insured under this insurance bears to such total amount insured.

In the event of claim the Assured shall provide the Insurers with evidence of the amounts insured under all other insurances.

14.2 Where this insurance is on Increased Value the following clause shall apply:

The agreed value of the subject-matter insured shall be deemed to be equal to the total amount insured under the primary insurance and all Increased Value insurances covering the loss and effected on the subject-matter insured by the Assured, and liability under this insurance shall be in such proportion as the sum insured under this insurance bears to such total amount insured.

In the event of claim the Assured shall provide the Insurers with evidence of the amounts insured under all other insurances.

BENEFIT OF INSURANCE

15. This insurance

15.1 covers the Assured which includes the person claiming indemnity either as the person by or on whose behalf the contract of insurance was effected or as an assignee,

15.2 shall not extend to or otherwise benefit the carrier or other bailee.

MINIMISING LOSSES

Duty of Assured

16. It is the duty of the Assured and their employees and agents in respect of loss recoverable hereunder

16.1 to take such measures as may be reasonable for the purpose of averting or minimising such loss, and

16.2 to ensure that all rights against carriers, bailees or other third parties are properly preserved and exercised

and the Insurers will, in addition to any loss recoverable hereunder, reimburse the Assured for any charges properly and reasonably incurred in pursuance of these duties.

Waiver

17. Measures taken by the Assured or the Insurers with the object of saving, protecting or recovering the subject-matter insured shall not be considered as a waiver or acceptance of abandonment or otherwise prejudice the rights of either party.

AVOIDANCE OF DELAY

18. It is a condition of this insurance that the Assured shall act with reasonable despatch in all circumstances within their control.

LAW AND PRACTICE

19. This insurance is subject to English law and practice.

NOTE:- Where a continuation of cover is requested under Clause 9, or a change of destination is notified under Clause 10, there is an obligation to give prompt notice to the Insurers and the right to such cover is dependent upon compliance with this obligation.

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APPENDIX 8

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INSTITUTE CARGO CLAUSES (C)

RISKS COVERED

Risks

1. This insurance covers, except as excluded by the provisions of Clauses 4, 5, 6 and 7 below,
 - 1.1 loss of or damage to the subject-matter insured reasonably attributable to
 - 1.1.1 fire or explosion
 - 1.1.2 vessel or craft being stranded grounded sunk or capsized
 - 1.1.3 overturning or derailment of land conveyance
 - 1.1.4 collision or contact of vessel craft or conveyance with any external object other than water
 - 1.1.5 discharge of cargo at a port of distress,
 - 1.2 loss of or damage to the subject-matter insured caused by
 - 1.2.1 general average sacrifice
 - 1.2.2 jettison.

General Average

2. This insurance covers general average and salvage charges, adjusted or determined according to the contract of carriage and/or the governing law and practice, incurred to avoid or in connection with the avoidance of loss from any cause except those excluded in Clauses 4, 5, 6 and 7 below.

"Both to Blame Collision Clause"

3. This insurance indemnifies the Assured, in respect of any risk insured herein, against liability incurred under any Both to Blame Collision Clause in the contract of carriage. In the event of any claim by carriers under the said Clause, the Assured agree to notify the Insurers who shall have the right, at their own cost and expense, to defend the Assured against such claim.

EXCLUSIONS

4. In no case shall this insurance cover
 - 4.1 loss damage or expense attributable to wilful misconduct of the Assured
 - 4.2 ordinary leakage, ordinary loss in weight or volume, or ordinary wear and tear of the subject-matter insured
 - 4.3 loss damage or expense caused by insufficiency or unsuitability of packing or preparation of the subject-matter insured to withstand the ordinary incidents of the insured transit where such packing or preparation is carried out by the Assured or their employees or prior to the attachment of this insurance (for the purpose of these Clauses "packing" shall be deemed to include stowage in a container and "employees" shall not include independent contractors)
 - 4.4 loss damage or expense caused by inherent vice or nature of the subject-matter insured
 - 4.5 loss damage or expense caused by delay, even though the delay be caused by a risk insured against (except expenses payable under Clause 2 above)
 - 4.6 loss damage or expense caused by insolvency or financial default of the owners managers charterers or operators of the vessel where, at the time of loading of the subject-matter insured on board the vessel, the Assured are aware, or in the ordinary course of business should be aware, that such insolvency or financial default could prevent the normal prosecution of the voyage
This exclusion shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract
 - 4.7 deliberate damage to or deliberate destruction of the subject-matter insured or any part thereof by the wrongful act of any person or persons
 - 4.8 loss damage or expense directly or indirectly caused by or arising from the use of any weapon or device employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.
5. 5.1 In no case shall this insurance cover loss damage or expense arising from
 - 5.1.1 unseaworthiness of vessel or craft or unfitness of vessel or craft for the safe carriage of the subject-matter insured, where the Assured are privy to such unseaworthiness or unfitness, at the time the subject-matter insured is loaded therein
 - 5.1.2 unfitness of container or conveyance for the safe carriage of the subject-matter insured, where loading therein or thereon is carried out prior to attachment of this insurance or by the Assured or their employees and they are privy to such unfitness at the time of loading.
- 5.2 Exclusion 5.1.1 above shall not apply where the contract of insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract.
- 5.3 The Insurers waive any breach of the implied warranties of seaworthiness of the ship and fitness of the ship to carry the subject-matter insured to destination.
6. In no case shall this insurance cover loss damage or expense caused by
 - 6.1 war civil war revolution rebellion insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power
 - 6.2 capture seizure arrest restraint or detention, and the consequences thereof or any attempt thereat
 - 6.3 derelict mines torpedoes bombs or other derelict weapons of war.
7. In no case shall this insurance cover loss damage or expense

INSTITUTE CARGO CLAUSES (C) (1/1/09)

- 7.1 caused by strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions
- 7.2 resulting from strikes, lock-outs, labour disturbances, riots or civil commotions
- 7.3 caused by any act of terrorism being an act of any person acting on behalf of, or in connection with, any organisation which carries out activities directed towards the overthrowing or influencing, by force or violence, of any government whether or not legally constituted
- 7.4 caused by any person acting from a political, ideological or religious motive.

DURATION

Transit Clause

8. 8.1 Subject to Clause 11 below, this insurance attaches from the time the subject-matter insured is first moved in the warehouse or at the place of storage (at the place named in the contract of insurance) for the purpose of the immediate loading into or onto the carrying vehicle or other conveyance for the commencement of transit,
continues during the ordinary course of transit
and terminates either
 - 8.1.1 on completion of unloading from the carrying vehicle or other conveyance in or at the final warehouse or place of storage at the destination named in the contract of insurance,
 - 8.1.2 on completion of unloading from the carrying vehicle or other conveyance in or at any other warehouse or place of storage, whether prior to or at the destination named in the contract of insurance, which the Assured or their employees elect to use either for storage other than in the ordinary course of transit or for allocation or distribution, or
 - 8.1.3 when the Assured or their employees elect to use any carrying vehicle or other conveyance or any container for storage other than in the ordinary course of transit or
 - 8.1.4 on the expiry of 60 days after completion of discharge overseaside of the subject-matter insured from the overseas vessel at the final port of discharge,
whichever shall first occur.
- 8.2 If, after discharge overseaside from the overseas vessel at the final port of discharge, but prior to termination of this insurance, the subject-matter insured is to be forwarded to a destination other than that to which it is insured, this insurance, whilst remaining subject to termination as provided in Clauses 8.1.1 to 8.1.4, shall not extend beyond the time the subject-matter insured is first moved for the purpose of the commencement of transit to such other destination.
- 8.3 This insurance shall remain in force (subject to termination as provided for in Clauses 8.1.1 to 8.1.4 above and to the provisions of Clause 9 below) during delay beyond the control of the Assured, any deviation, forced discharge, reshipment or transshipment and during any variation of the adventure arising from the exercise of a liberty granted to carriers under the contract of carriage.

Termination of Contract of Carriage

9. If owing to circumstances beyond the control of the Assured either the contract of carriage is terminated at a port or place other than the destination named therein or the transit is otherwise terminated before unloading of the subject-matter insured as provided for in Clause 8 above, then this insurance shall also terminate *unless prompt notice is given to the Insurers and continuation of cover is requested when this insurance shall remain in force, subject to an additional premium if required by the Insurers*, either
 - 9.1 until the subject-matter insured is sold and delivered at such port or place, or, unless otherwise specially agreed, until the expiry of 60 days after arrival of the subject-matter insured at such port or place, whichever shall first occur,
or
 - 9.2 if the subject-matter insured is forwarded within the said period of 60 days (or any agreed extension thereof) to the destination named in the contract of insurance or to any other destination, until terminated in accordance with the provisions of Clause 8 above.

Change of Voyage

10. 10.1 Where, after attachment of this insurance, the destination is changed by the Assured, *this must be notified promptly to Insurers for rates and terms to be agreed. Should a loss occur prior to such agreement being obtained cover may be provided but only if cover would have been available at a reasonable commercial market rate on reasonable market terms.*
- 10.2 Where the subject-matter insured commences the transit contemplated by this insurance (in accordance with Clause 8.1), but, without the knowledge of the Assured or their employees the ship sails for another destination, this insurance will nevertheless be deemed to have attached at commencement of such transit.

CLAIMS

Insurable Interest

11. 11.1 In order to recover under this insurance the Assured must have an insurable interest in the subject-matter insured at the time of the loss.
- 11.2 Subject to Clause 11.1 above, the Assured shall be entitled to recover for insured loss occurring during the period covered by this insurance, notwithstanding that the loss occurred before the contract of insurance was concluded, unless the Assured were aware of the loss and the Insurers were not.

Forwarding Charges

12. Where, as a result of the operation of a risk covered by this insurance, the insured transit is terminated at a port or place other than that to which the subject-matter insured is covered under this insurance, the

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Insurers will reimburse the Assured for any extra charges properly and reasonably incurred in unloading, storing and forwarding the subject-matter insured to the destination to which it is insured.

This Clause 12, which does not apply to general average or salvage charges, shall be subject to the exclusions contained in Clauses 4, 5, 6 and 7 above, and shall not include charges arising from the fault, negligence, insolvency or financial default of the Assured or their employees.

Constructive Total Loss

13. No claim for Constructive Total Loss shall be recoverable hereunder unless the subject-matter insured is reasonably abandoned either on account of its actual total loss appearing to be unavoidable or because the cost of recovering, reconditioning and forwarding the subject-matter insured to the destination to which it is insured would exceed its value on arrival.

Increased Value

14.14.1 If any Increased Value insurance is effected by the Assured on the subject-matter insured under this insurance, the agreed value of the subject-matter insured shall be deemed to be increased to the total amount insured under this insurance and all Increased Value insurances covering the loss, and liability under this insurance shall be in such proportion as the sum insured under this insurance bears to such total amount insured.

In the event of claim the Assured shall provide the Insurers with evidence of the amounts insured under all other insurances.

14.2 **Where this insurance is on Increased Value the following clause shall apply:**

The agreed value of the subject-matter insured shall be deemed to be equal to the total amount insured under the primary insurance and all Increased Value insurances covering the loss and effected on the subject-matter insured by the Assured, and liability under this insurance shall be in such proportion as the sum insured under this insurance bears to such total amount insured.

In the event of claim the Assured shall provide the Insurers with evidence of the amounts insured under all other insurances.

BENEFIT OF INSURANCE

15. This insurance

15.1 covers the Assured which includes the person claiming indemnity either as the person by or on whose behalf the contract of insurance was effected or as an assignee,

15.2 shall not extend to or otherwise benefit the carrier or other bailee.

MINIMISING LOSSES

Duty of Assured

16. It is the duty of the Assured and their employees and agents in respect of loss recoverable hereunder

16.1 to take such measures as may be reasonable for the purpose of averting or minimising such loss, and

16.2 to ensure that all rights against carriers, bailees or other third parties are properly preserved and exercised

and the Insurers will, in addition to any loss recoverable hereunder, reimburse the Assured for any charges properly and reasonably incurred in pursuance of these duties.

Waiver

17. Measures taken by the Assured or the Insurers with the object of saving, protecting or recovering the subject-matter insured shall not be considered as a waiver or acceptance of abandonment or otherwise prejudice the rights of either party.

AVOIDANCE OF DELAY

18. It is a condition of this insurance that the Assured shall act with reasonable despatch in all circumstances within their control.

LAW AND PRACTICE

19. This insurance is subject to English law and practice.

NOTE:- Where a continuation of cover is requested under Clause 9, or a change of destination is notified under Clause 10, there is an obligation to give prompt notice to the Insurers and the right to such cover is dependent upon compliance with this obligation.

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