

Marine insurance paper

CML 625 S, 2005, Erik Reinmuth

1. Introduction

a) The CMI Guidelines

The guidelines to deal with in this paper are the outcome of an inquiry started by the CMI at the Oslo Symposium in 1998. The task was to evaluate the diverging practices in marine insurance in different countries¹. The aim was to help to harmonise the international practice in legislation and the general contract terms². They deal especially with the question of materiality of facts to disclose pre-contractual, alteration of risk, the consequences of lacking good faith and the peculiar warranty in English law³. Indeed, they consider more English law problems than those of civil law countries⁴.

Therefore the guidelines shall be examined with regard not only to the practice in South Africa, but necessarily also English law, in trying to point out the differences between the guidelines and the current situation in marine insurance, which is to a great part governed by English law, due to the importance of the London insurance market. Notwithstanding this, some comments shall be made to the practice in civil law countries.

b) Good faith

The first item of the guidelines states that marine insurance contracts are contracts of good faith. This follows the English law as stated in section 17 of the Marine Insurance Act of 1906, which provides that insurance contracts are based upon the “utmost good faith” and a breach of this requirement allows the other party to avoid the contract. The English marine insurance act influenced the legislation of many common law countries, which followed closely the English law. In civil law countries good faith is a more general concept, applicable not only to insurance contracts⁵.

The doctrine of “utmost good faith” goes back to the eighteenth century, when Lord Mansfield in *Carter v Boehm* stated, that the pre-contractual non-disclosure of facts materially affecting the risk is fraud, and even without mala fides the contract should be void. The reason lies in the specific nature of insurance contracts, where only the assured normally possesses the knowledge about the circumstances of the insured asset⁶. This gave rise to the English doctrine of utmost good faith, which

¹ J. Hare, The CMI review of marine insurance report to the 38. Conference of the CMI Vancouver, 2004 in CMI Yearbook 2004 p 249.

² Ibid p 251.

³ Ibid p 253.

⁴ Ibid p 257.

⁵ A. Tulloch, Utmost good faith in CMI Yearbook 2003 p 534.

⁶ 97 Eng. Rep. 1162 (K.B. 1766).

included the duty of truthful representation and voluntary disclosure of material facts, regardless of fraud or even knowledge, and that even without causation there will be a breach of contract⁷.

Even if the pre-contractual duty to disclose any material circumstances is the origin and maybe the most important case of the principle of “utmost good faith”, which burdens mainly the assured, the duty to behave in good faith is mutual and binds for instance the insurer at the stage of claims, as well⁸. This principle is mainly substantiated with the issues of non-disclosure and fraud, even if they are not the same concept⁹.

What the specific common law principle of “utmost good faith” means in comparison with the more general duty of good faith in civil law countries or the different situation in South Africa, where after the decision in *Mutual & Federal Insurance Company Ltd. v Oudtshoorn Municipality* the doctrine of “utmost good faith” does not apply anymore, at least in a non-maritime context¹⁰, becomes clearer when the different consequences of good faith will be depicted. So far as the guidelines state that insurance contracts are contracts of good faith, they seem to abandon the strict English rule of “utmost good faith”. But with regard to the definition, for instance, Schoenbaum uses: “the parties to contracts of marine insurance must not only avoid fraud and misrepresentation, but they are required to disclose voluntarily "every material circumstance."¹¹, the difference is not obvious, as these items are part of the duties according to the Guidelines, too.

2. Duty of disclosure

The second item of the Guidelines specifies acting in good faith as mentioned under the first point as the duty to be honest and especially to disclose and not misrepresent material facts during the currency of the contract. Further the duty to disclose any material alteration of the risk is mentioned. It summarises therefore the duties which are established under the doctrine of good faith, but which had its origin in the pre-contractual duty of disclosure. The purpose of the duty to disclose material facts is regarded as giving the insurer the best possible knowledge to assess the risk and therefore also the premium. The duty to pass the information lays mainly on the assured, as he is the person who knows the most about the circumstances of the assured assets. This duty is seen not only for the benefit of the

⁷ J. B. Struckhoff, *The irony of uberrimae fidei: Bad faith practices in marine insurance*, 29 Tul. Mar. L.J. 287 p 290.

⁸ A. Tulloch, *Utmost good faith in CMI Yearbook 2003* p 536.

⁹ J. Hare, *Shipping Law*, 1999 p 688.

¹⁰ 1985 (I) SA 419 (SCA) at 435.

¹¹ T. J. Schoenbaum, *The duty of utmost good faith in marine insurance law: a comparative analysis of American and English law*, 29 J. Mar. L. & Com. p 1.

insurer, but for the assured as well, as the insurer does not have to take into account the possibility that he does not know all material risks¹².

English law distinguishes between the duty to disclose and misrepresentation. The Marine Insurance Act, 1906 (MIA) deals with the duty to disclose in s 18. It provides in ss (1), that this duty is a pre-contractual one, that material facts are required to be disclosed and that the assured is deemed to know any circumstances, which should be known in business. To fail entitles the insurer to avoid the contract.

a) Duration

By virtue of the MIA 1906 and likewise in South Africa, it is clear that the duty exists only until the contract is concluded¹³. Thus the Guidelines are apparently different in proposing, that the duty to act in good faith, with the following duty to disclose etc., exists during the whole currency of the contract. But this seems to be less obvious regarding the relevant English cases. Even if the MIA clearly provides the conclusion of the contract as the relevant time for the duty to disclose, the general duty to act in good faith, utmost good faith, was considered to last for the whole currency of the policy. In *The Litsion Pride* the court extended this for culpable misrepresentation and non-disclosure¹⁴. In *The Star Sea* it was more clearly stated, that there is a difference between the pre- and the post-contractual duty, that the latter is confined to fraudulently claims¹⁵ and that a prolonged duty to disclose requires a variation of the policy with material facts for additional risks, because there is some element of re-negotiation¹⁶. This was specified in *The Mercandian Continent*¹⁷ as a fraudulent claim which would entitle the insurer to avoid the contract, if the gravity and materiality of the fraud makes it appropriate¹⁸.

Thus English law regards the duty to act in good faith as continuing, but confines it to fraud and cases of re-negotiation with additional risks. The Guidelines define the duty to disclose differently as lasting for the whole contractual relationship and by including the more civil law known concept of alteration of the risk.

¹² T.-L. Wilhelmsen, Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000 p 348.

¹³ J. Hare, Shipping Law, 1999 p 699.

¹⁴ J. B. Struckhoff, The irony of uberrimae fidei: Bad faith practices in marine insurance, 29 Tul. Mar. L.J. 287 p 293.

¹⁵ Ibid p 294.

¹⁶ A. Naidoo/ D. Oughton, The confused post-formation duty of good faith in insurance law, J.B.L. 2005, MAY, 346-371 p 356; M. Davies, Case note to „The Star Sea“ Insured’s post-contract duty uberrimae fidei, 32 J. Mar. L. & Com. p 507.

¹⁷ [2001] 2 Lloyd’s Rep. 563 (C.A.).

b) Test of materiality

According to s 18 (2) MIA a fact to disclose is material, if the insurer would be influenced by it in his judgement to take the risk and the assessment of the premium. Together with the scope of the duty to pass information as stated in ss (1), that means even information which is actually not known, but has to be known by the assured, it follows, that English law has an objective approach to determine materiality of facts¹⁹. Further it does not have to be decisive information, it is only required, that the insurer would take into account the information for assessing the risk²⁰. Since *Mutual & Federal Insurance Company Ltd. v Oudtshoorn Municipality*²¹, in which the doctrine of “utmost good faith” was abandoned, the inquiry to determine materiality in South Africa is less strict, as the test would ask for the opinion of “the reasonable man or average prudent person”²².

The guidelines propose, with item 4, a two tier-test. Both, the reasonable insurer and the reasonable assured would have to consider the non-disclosed fact (or the misconduct with regard to the general duty of good faith) as affecting the contract. Further the relevant issues are specified as follows: “acceptance of the risk, the assessment of the premium and or the evaluation of claims by the insurer, and or the acceptance of cover by the insured.” According to Hare the two-tier test would ask in a first step, if a reasonable underwriter would regard these facts as affecting the assessment of risk and premium and in a second, whether a reasonable assured ought to have known this²³. The specification of certain important matters seems to have its source in some civil law countries like France or Italy, where the insurance conditions deal with circumstances to disclose like the classification society of the vessel²⁴.

Thus the differences in approach between Guidelines and English and South African Law are significant. South Africa determines materiality alone from an assured’s point of view, whereas English law determines it with regard to the insurer. The Guidelines apparently try to achieve a compromise between these two extremes by proposing a two-tier test, which takes into account the points of view of both, the insurer and the assured. But the consequences of these different approaches are in my opinion rather insignificant. Guidelines and South African law determine the materiality with regard to the reasonable man in the position of the assured. This gives the court a broad scope to determine materiality. It will be not so high as in English law, where the insurer only has to aver the

¹⁸ J. B. Struckhoff, *The irony of uberrimae fidei: Bad faith practices in marine insurance*, 29 Tul. Mar. L.J. 287 p 294.

¹⁹ *Ibid* p 292.

²⁰ T.-L. Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000* p. 351; T. J. Schoenbaum, *The duty of utmost good faith in marine insurance law: a comparative analysis of American and English law*, 29 J. Mar. L. & Com. p 19.

²¹ 1985 (I) SA 419 (SCA) at 435.

²² J. Hare, *Shipping Law*, 1999 p 696.

²³ *Ibid* p 697.

²⁴ T.-L. Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000* p 352.

significance of the fact for their assessment of the premium, but it still allows the court to set a high limit in expecting what the reasonable man would consider as influencing the decision of the insurer in accepting the risk and fixing the premium.

The big difference between the Guidelines and English law is stated somewhere else and this is the required causative link between the breach of the duty to act in good faith and the loss or claim as stated in item 5. This proposal follows the example of the Nordic countries, especially the Norwegian Plan, 1996²⁵. In my opinion this requirement points on the often criticised point of English law, that materiality does not require a decisive influence. It was said, that it is too harsh and almost an “encouragement for reckless underwriting”²⁶. The Guidelines set a much higher hurdle, if the insurer has to aver further, that the disclosure actually would have led to a different decision of the company regarding the undertaking or the premium.

c) Sanctions

Item 6 of the Guidelines states that any material breach of the duty to disclose gives the aggrieved party the right to avoid the contract from the date of the breach and further to claim for damages. This follows the practice in South Africa and English law²⁷. Section 17 MIA in general and the following provisions dealing with disclosure and misrepresentation provide the right to avoid the contract. Thus the Guidelines introduce with the right to claim for damages something new, as in English law and South Africa the right to avoid the contract is the only remedy²⁸.

d) Misrepresentation

The Guidelines put misrepresentation in the same context as disclosure. English law deals with disclosure and misrepresentation in two different provisions. According to s 20 MIA a representation has to be true, but ss 4 defines misrepresentation as a deviation of a correct statement, which is material. Therefore the disclosure and misrepresentation are following the same concept of materiality²⁹ and the Guidelines does not give rise to a change.

Marine insurance contracts in South Africa are governed by the Short-term Insurance Act 2002³⁰. It contains provisions regarding representation and provides a measure for the test of materiality. According to s 53 of this act, a contract shall not be invalidated due to a representation, which likely

²⁵ Ibid p 368.

²⁶ T. J. Schoenbaum, The duty of utmost good faith in marine insurance law: a comparative analysis of American and English law, 29 J. Mar. L. & Com. p 20.

²⁷ T.-L. Wilhelmsen, Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000 p 359.

²⁸ Ibid p 365; T. J. Schoenbaum, The duty of utmost good faith in marine insurance law: a comparative analysis of American and English law, 29 J. Mar. L. & Com. p 38.

²⁹ T.-L. Wilhelmsen, Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000 p 349.

does not materially affect the assessment of the risk at the conclusion or any renewal or variation. This provision was interpreted in *Qilingele v SA Mutual Life Assurance Society*³¹ as a subjective test regarding the actual insurer with the actual terms of the contract, but is now, since the 2002 amendment, an objective test as well.

3. Alteration of risk

As mentioned above acting in good faith according to the second item of the guidelines requires the assured to disclose any material alteration of the risk. Contrary to civil law countries this is not a general concept in common law countries. In English law, topics which are covered in civil law countries under alteration of risk, are regulated with warranties, or for instance, in the provisions of the MIA dealing with voyage (s 42–49)³².

An alteration of risk can be regarded as an increase in the risk or accepting a substantially different risk, which would have influenced the insurer's acceptance of the policy³³. In case of an alteration of the risk the assured has to notify the insurer, but the consequences can be different. It is possible, that the insurer might be entitled to cancel the coverage, or if he accepts the alteration, to claim an additional premium³⁴. Further the breach of the duty to notify the insurer about any alteration of the risk gives rise to a variety of sanctions, especially comprehensive freedom of liability³⁵.

The reason for the concept of alteration of risk lies on the calculations and presumptions the insurance contract is based on³⁶. Therefore it is reasonable that the insurer should be informed to be able to decide, whether and under which terms he further undertakes coverage. This problem requires a business sense solution and it is not surprising, that even in English common law, where this topic is often covered by warranties, the problem is encountered by a similar solution, held covered clauses, which also, as will be mentioned below, introduce a duty to notify the insurer and entitles him to keep the insurance, but with a different premium. Therefore the differences lay in the approach and certainly in detail, but not in the general manner how law treats this problem. Since this problem is closely connected to the duty of disclosure, because it touches the basic presumptions upon which the contract is concluded, it makes sense to treat alteration of risk and duty of disclosure in general, similar to what the Guidelines propose.

³⁰ J. Hare, *Shipping Law*, 1999 p 700.

³¹ 1993 (I) SA 69 (SCA).

³² T.-L. Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000* p 382.

³³ *Ibid* p 376.

³⁴ *Ibid* p 378.

³⁵ *Ibid* p 379.

³⁶ *Ibid* p 374.

4. Warranties

The third item of the Guidelines proposes to allow the parties to stipulate terms whose breach gives the other party the right to cancel the contract, regardless of causation. Further it proposes that terms regarding compliance with safety at sea, classification, ownership and management should be such strict compliance terms. “Strict-compliance” terms have to be seen against the background of the English concept of warranties, even if the Guidelines aim to depart from the current English and common law practice.

According to s 33 (1) MIA warranties mean promissory warranties, i.e. the undertaking of the assured to fulfil exactly particular conditions during the currency of the policy, otherwise the insured is not liable from the date of the breach on, regardless, if the non-compliance is material or not (s 33 (3)). It does not even matter, if there is no intention or a necessity to breach the warranty³⁷. Even if this concept is only known to common law countries, civil law countries know similar contractual terms dealing for instance with classification, seaworthiness and ownership, but the legal problems are different to those, which occur in the specific English system³⁸. In spite of the harsh consequences, warranties can be implied like the warranty of seaworthiness according to s 39 MIA and even the so called expressed warranties do not have to be stated expressly, it is enough if they are included in the contract in a form, whose wording allows to infer that they shall be warranties (s 35 (1)). Strict compliance means, that in case of breach of the term neither causation nor materiality matters³⁹. In spite of a breach of a warranty, the assured can be still covered in case of held covered clauses, which require a notice submitted to the insurer and an increase of the premium⁴⁰ or the insurer decides voluntarily to waive the breach of the contract according to s 34 (3) MIA⁴¹.

Even some common law countries try to soften the strict consequences of warranties by regulation like South Africa or in some court decisions in the USA⁴². The regulation in South Africa did so with s 53 in the South African Short-term Insurance Act, 1998, which forbids any further obligations of the assured due to representations warranted by the assured to be true, which would have not materially affected the assessment of the risk. The effect is, that the insurer cannot cancel the contract due to non-

³⁷ T. J. Schoenbaum, Warranties in the Law of marine insurance: Some suggestions for reform of English and American law, 23 Tul. Mar. L.J. 267 p 282.

³⁸ T.-L. Wilhelmsen, Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000 p 385.

³⁹ Ibid p 388.

⁴⁰ Ibid p 390; T. J. Schoenbaum, Warranties in the law of marine insurance: Some suggestions for reform of English and American law, 23 Tul. Mar. L.J. 267 p 300.

⁴¹ T. J. Schoenbaum, Warranties in the law of marine insurance: Some suggestions for reform of English and American law, 23 Tul. Mar. L.J. 267 p 289.

⁴² T.-L. Wilhelmsen, Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000 p 390; T. J. Schoenbaum, Warranties in the Law of marine insurance: Some suggestions for reform of English and American law, 23 Tul. Mar. L.J. 267 p 295.

compliance with a warranty, unless this warranty is regarded as an essential term⁴³. As a representation is regarded as a statement of existing fact and not of intentions, the effect would be true only for affirmative and not for promissory warranties. The similarity between misrepresentation and affirmative warranties causes even problems in English law, as the difference in the consequences, a misrepresentation requires materiality and affirmative warranties not, is criticised as unfounded⁴⁴.

Similar to the concept of warranties are conditions both in civil and common law countries dealing with aspects of safety at sea. In English law this duty is put down in the Institute Time Clauses Hull 4, which imposes the duty on the assured to keep the vessel classed in a Society, following all requirements regarding seaworthiness, with the consequence in failing, that the insurer is not liable. Fault or causation are not necessary and therefore this term is similar to a warranty, even if it is not regarded as one⁴⁵. Some civil law countries like Norway are using similar terms with automatically termination of the insurance⁴⁶. Further seaworthiness is an important topic, which is dealt as an implied warranty in English law regarding voyage-policies according to s 39 MIA, whereas according to the Institute Cargo Clauses and again especially in the Scandinavian countries the non-compliance with this duty to keep the vessel seaworthy has the consequence that losses caused by unseaworthiness together with bad faith of the assured are excepted from the police⁴⁷. Similarly regarding questions of flag, change of ownership and management misconduct of the assured often gives rise to termination of the police in both, common and civil law countries⁴⁸.

The Guidelines reflect the importance which is given by insurers to questions of classification, seaworthiness etc., which are all related to the task of the assured to keep the vessel in a good condition, and which have in case of non-compliance have often the consequence, that the insurer is relieved from his liability regardless materiality or causation. Therefore the Guidelines still allow the stipulation of such terms of strict compliance, which in case of failing entitles the insurer to cancel the contract. But the effort to get rid of the often criticised concept of warranties becomes clear, besides the expressly stated wish to do so, in confining such strict-compliance clauses to matters related to seaworthiness, classification, which is of course related to seaworthiness as well, ownership and management and finally the ISM Code. Excepted the last item, due maybe to the fact, that the ISM-Code was just recently introduced, all of these topics are regarded as so important, that non-compliance already often gave rise to strict legislation or insurance terms, even in civil law countries. But the consequence are still the same: the insurer is relieved from liability regardless causation. The Guidelines are also not providing a different sanction. The automatic termination of the liability is part

⁴³ J. Hare, *Shipping Law*, 1999 p 707.

⁴⁴ T.-L. Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties in CMI Yearbook 2000* p 388.

⁴⁵ *Ibid* p 395.

⁴⁶ *Ibid* p 395.

⁴⁷ *Ibid* p 399.

of the criticism made with regard to the concept of warranties. Schoenbaum prefers voidability of the contract after analysing the links between promissory warranties, affirmative ones and misrepresentation⁴⁹.

Therefore the main difference especially to English law lays in the confinement of these clauses to the above mentioned important matters and maybe, that “warranties” will not be part of the insurance contract anymore as implied terms or without a clear expression in the contract, especially with regard to the harsh consequences.

5. Conclusion

As mentioned at the beginning of this work, the Guidelines deal mainly with problems in marine insurance law, which occur particularly in the English system. I could not find out certain main issues, which are especially problematic due to the regulation in civil law countries. Therefore the main question in my opinion is, whether the Guidelines try to solve some of these specific English law problems as indicated above and whether they can help to harmonise marine insurance law in general.

That marine insurance contracts should be contracts of good faith is in my opinion a basic statement, which is from a German point of view quite familiar, as each contract is ruled by the duty to observe “Treu und Glauben” according to s 242 of the German Civil Code (Bürgerliches Gesetzbuch) and where according to this provision contractual parties in general might have the duty to disclose certain material facts, are not allowed to hamper the fulfilment of the contractual duties and so on. But it seems that the choice of a different term more indicates a difference to “utmost good faith” as it has consequences in itself.

I can only assume that “utmost good faith” expresses itself in the way, English courts held the high standard of the test of materiality. And this standard was often criticised as too harsh and should be subjected to a due diligence standard, to better balance out the interests of insurer and assured⁵⁰. As the Guidelines propose a two-tier test for materiality, which takes into account not only the insurer, but the assured as well, they match one of the problems in English law. So far as I can see, English law would come closer to the practice in other countries in following a lower standard. And the outcome seems to be, that the less assured-friendly practice in Great Britain contributed to a smaller share of the London

⁴⁸ Ibid p 408.

⁴⁹ T. J. Schoenbaum, Warranties in the Law of marine insurance: Some suggestions for reform of English and American law, 23 Tul. Mar. L.J. 294.

⁵⁰ T. J. Schoenbaum, The duty of utmost good faith in marine insurance law: a comparative analysis of American and English law, 29 J. Mar. L. & Com. p 14; J. B. Struckhoff, The irony of uberrimae fidei: Bad faith practices in marine insurance, 29 Tul. Mar. L.J. 287 p 294.

insurance market⁵¹. Even more important regarding materiality seems to be the requirement of causation as proposed by the Guidelines. In my opinion it leads away from considering facts as material, which are not decisive for the insurer's decision. As the origin of the whole doctrine is, to make the assessment of risk and premium more calculable, I think a decisive element should be included and the non-causative English regime was considered to have strongly advantaged the insurer⁵².

With regard to the concept of warranties it is even more obvious, that this is a specific English problem. On the other hand, with regard to the practice in some civil law countries, the necessities of the business seem to require harsh consequences regarding basic presuppositions especially with regard to the safety of the vessel. Thus the similarity of the consequences both in English and civil law countries of such contractual terms recommend the maintaining of it. If English law would confine the scope of strict-compliance terms to the matters mentioned in the Guidelines, it seems, it would be a step closer to harmonisation of insurance law.

⁵¹ J. B. Struckhoff, The irony of uberrimae fidei: Bad faith practices in marine insurance, 29 Tul. Mar. L.J. 287 p 310.

⁵² M. Davies, Case note to „The Star Sea“ Insured's post-contrac duty uberrimae fidei, 32 J. Mar. L. & Com. p 509.