THE MODERN LAW OF MARINE INSURANCE

BASIC CONCEPTS AT COMMON LAW

Wang Yan-Ling

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PREFACE

The publication is designed primarily for students of the subject of international trade law, or narrowly conceived, maritime law, and practitioners new to the field as part of their legal training. The work is focus mainly on the main topics of modern law of marine insurance, especially the basic concepts at common law. With the idea to suit to students to use, the book is offered as clear and simple as possible, and it will be proved useful.

It is my pleasure to express my thanks to Ms Li Xue-Fang, Ms Wang Yan, and the staffs of Dalian Maritime University Press for their assistance, patience and understanding throughout the production of this work.

Responsibility for any errors or omissions is mine.

Wang Yan-Ling
Dalian, January 2007

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Chapter 1 Introduction to Marine Insurance and the Law

Activity often combines the opportunity of advantage with the risk of loss. Thus, the financial rewards of international trade have to be offset against the numerous risks involved in transporting goods, particularly in the potentially dangerous environment of the sea, a maritime disaster can involve loss of life, loss of ship, loss of cargo and much more. A person engaged in international commerce could bear its risks himself, with legal recourse for compensation against anyone who has caused him a loss by breach of contract or tort, but otherwise relying on his own resources. However, the adverse risks of a particular adventure or type of trade are a disincentive to participation in commerce, then some kind of method to avoid or minimize uncertainty is urgently needed, that is to say, insurance, or originally, marine insurance. It provides individuals and organizations with financial protection against the outcome of events which involve monetary losses or liabilities which were not anticipated or predicted, and over which they had no effective control. In return for this financial protection, the "insured" individual or organization pays money, usually by way of a "premium", to another individual or company, the "insurer", and a policy or contract of insurance is drawn up to formalize the legal relationship between those parties.

1. The history of marine insurance

The origin of marine insurance

As a matter of fact, long before there was fire, accident, liability and even life insurance, there were forms of marine insurance. Yet, why there is insurance, or marine insurance? Who was the first to think of such a concept anyway?

Marine insurance, as practiced today, developed during the 19th and 20th centuries. A work written by Dillani① provides the earliest record of naval insurance. In which, he stated that a system of marine insurance was devised by the Jews in 1182 at the time of their expulsion from France, and that they introduced the system into Lombardy in that same year. Then, the system was improved by the Italians. A work named *The Chronyk Van Vaen Vern* gives one of the earliest records of marine insurance markets, in which, a passage contained the first reference to the word "assurance" as it is now understood—"... on the demand of the inhabitants of Bruge, they came to Flanders permitted in the year 1310, the establishment in this town of a chamber of assurance, by means of which the merchants could insure their goods exposed to the risks of sea or of air, on paying a stipulated percentage..."— thus, the merchants of the Hansiatic League appeared to be the first to create a marine insurance market.

Bottomry and Respondentia

Discussing marine insurance, bottomry and respondentia should be mentioned. The practice of borrowing money on the security of a ship (known as bottomry) and its cargo (known as respondentia) developed in some time prior to the 13th century. And, the marine insurance was distinguished from bottomry and respondentia in the 14th century.

A form of business which is recorded in Putsch's *Lies* is very similar to bottomry, that a moneylender required his borrowers to form a large company and when there were fifty partners and as many ships for his security, he took one share in the company himself, and was represented by a quinta, a freeman of his, who accompanied his clients on all their ventures. In this way his security was not imperilled or only a small part of it, and his profits were large.

The contribution of Lombards

With modifications, the Lombards seemed to have adopted the concept.

① An Italian historian who lived in 14 century.

In 1236, Pope Gregory IX declared usurious, and thus illegal, the practice of merchants borrowing money on ships and cargo to finance their adventure on the condition that the loans would only be repaid if the adventure was successful, of course, with vast sums in interest. From this time onwards, in order to obtain the loan, a sum of money, called a "premia", had to be paid by the merchant to the moneylender. ① The Carthaginians, Phoenicians and Romans also trafficked in bottomry bonds, and the Roman emperor Justinian's edict, dated AD 533, fixed the maximum rate of interest on such bonds at 12%. ②

It seems that although Jews have invented marine insurance, the Lombards improved on it. The first standard policy③ issued by London marine underwriters, known as the S. G. form, began with the following statement: "This writing of policy of insurance shall be as much Forced and Effect as the Surest Writing or policy of assurance heretofore made in Lombard Street..." Although arguments appeared whether the Lombards had established the business of marine insurance in London, Dutch marine insurance policies in 1925 stated that the contract should be as binding and as of the same effect as if it had been underwritten in Lombard Street in the City of London, which also illustrated the importance and reputation that London had in international commerce even then.

Moneylenders, bankers and merchants in London carried on marine in-

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① However, should fate have other things in store, such as storms, pirates, wars, plagues and other unpleasantnesses, causing the vessel to sink, disappear or otherwise go astray, the banker could of course no longer collect either his loan or the interest. This transaction therefore constituted the first successful risk transfer from the shipowner to another party, namely the moneylender, and seems to be very closely related to that "new invention" on the global (re)insurance markets referred to as ART (alternative risk transfer).

② The rate of interest reflected not only the use of the money loaned, but compensation for the risk of loss of the loan if there was a shipwreck or the adventure otherwise failed. —See *O' MAY ON MARINE INSURANCE*, Sweet & Maxwell, p. 1, 1993.

③ The origin of the word "policy", as pplied to marine insurance, is obscure. The word is said by some to have been derived from the Greek poly(many) and ptyz (fold), via the French word police (a bill of lading). Other writers have suggested different origins, as outlined below:

(1) Latin pollice (with thumb), based on a probability that early policies were subscribed by a thumbprint instead of a signature.

(2) Italian polizza (an invoice or warrant for funds, or a gamble by lottery).

(3) Latin pollicitatio (a promise).

The above suggestions of the word are all speculative, but there can be no doubt that in modern phraseology a policy of insurance is a promise to pay certain amounts (indemnity/sum insured) on the occurrence of certain events (perils), subject to the conditions and limitations of the contract.

surance as a sideline during the 16th and the 17th centuries. There was no central organization, and merchants or shipowners who needed to insure their property had to send their clerks or specially appointed agents—who subsequently became known as insurance brokers-to persons who were known to be willing to insure such risks. Policies were made out and taken round to the various offices, and any person who desired to take a share would sign the policy at the foot using the following wording: "£ ... I-, am content with this assurance which God preserves, for £ ..., this-day of-." It was this practice of signing at the foot of the policy that led to the name "underwriters" being applied to persons who accepted such liabilities. Each underwriter was liable only for the proportion of the risk he had subscribed to.

As mentioned above, the business of insurance spread across Europe and was established in England by the grant of rights in the city of London, in what became known as Lombard Street. Inevitably, domestic competitors entered the market, which moved to the Royal Exchange. Business was done in coffee houses, the most famous of which developed into Lloyd's of London, now the world's most prominent insurance corporation, with its own distinctive building. Insurance may be sought from members of Lloyd's or from insurance companies or elsewhere.

2. Lord Mansfield

In 1756 Lord Mansfield became Chief Justice of the Court of King's Bench① and he may be said to have created marine insurance law as it now exists in the UK, or even the main shipping countries during the world. Before his time, the number of marine insurance cases decided by the courts and reported is less than 60, and few of these are of any value as precedents, because they are either general verdicts or the opinions of single judges who generally left the whole case to the jury without any minute statement from the bench of the principles of law that governed contracts of insurance.

① Lord Mansfield, a Scot with a broader educational background than the generality of English judges of his time, presided in the Court of King's Bench from 1756 to 1788. During that time he introduced many changes in procedure and the approach to substantive commercial law.

Lord Mansfield improved on all this. He studied all the Continental codes of marine insurance that were in existence in his time and adopted many of the leading principles contained in them. He also took into account the customs and usages of trade that he learned from special jurors. He thus made a speciality of marine insurance law, and in his summing up of cases to juries he enlarged upon the rules and practices of law as applicable to each special case, and then left it to the jury to apply these rules and practices to the evidence before them.

During Lord Mansfield's era, the number of reported cases grew enormously, and many of his judgments became firmly established authorities for future decisions in similar cases, and several of the sections of the Marine Insurance Act of 1906 merely give legislative effect to decisions of this famous judge.

3. The Marine Insurance Act 1906 and S. G.[①] Policy

The Marine Insurance Act of 1906, which is the only code of marine in-

① The origin of these letters, which are printed in capitals in the top left-hand corner of all Lloyd's marine policies, has remained a mystery despite the curiosity and the investigation that they have excited. Many ingenious suggestions have been made, and practically every writer on marine insurance has put forward a different theory to account for their inclusion in the policy, There is, however, no existing record that shows what the letters stand for or why they were inserted, and the following two notes give the main solutions offered and the reasons on which they are based:

1. Ship and Goods. This explanation is favored by Chalmers and Archibald in their treatise on the Marine Insurance Act of 1906, and also by Gow, and is based on the fact that the policy form was designed to cover either ship or goods. Gow and other writers, however, suggest that as freight was also freely insured by similar policies from the earliest times, it is strange that no abbreviation was adopted for this interest.

2. Salutis Gratia (Latin: For the sake of safety). This solution was offered by Sir Henry M Hozier, KCB, Secretary of Lloyd's from 1 April 1874 to 1 October 1906, who pointed out that these words were commonly used in various commercial transactions in the Middle Ages.

surance in the UK, repealed the earlier Acts of 1745①, 1788②(as far as they related to marine policies) and 1868③, but the provisions contained in them were reproduced in practically the same form in the 1906 Act. The provisions of the1906 Act, as far as the policy is concerned, may be summarized as:

(a) Every contract of marine insurance must be embodied in a policy.

(b) Every policy must contain the name of the assured or agent, subject-matter insured and perils covered, voyage or period of time or both, the sum or sums insured and the names of the underwriters.

(c) Every policy must be stamped in accordance with the Finance Act in force at the time of issue.

(d) Every policy must be signed by the underwriters or their duly authorized agents.

The Marine Insurance Act of 1906 does not prescribe any particular form of policy, but Lloyd's Form is given in the First Schedule as a form that may be used, together with rules for the construction of its terms.

With the exception of the provisions relating to the execution and stamping of policies, practically the whole of UK marine insurance law is based upon decisions of the courts in cases in which the interpretation of the policy has been in dispute. These cases were codified by the Marine Insurance Act of 1906. It is for this reason that the antiquated wording of the policy that has been handed down from the time marine insurance was first practiced in the UK has been retained. To use expressions coined by several famous judges, the policy is "a strange, very peculiar, absurd, incoherent, clumsy, imperfect, obscure, incomprehensible, tortuous document, drawn up with much

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① *The Marine Insurance Act of* 1745—This Act had been passed to prohibit the issue of wagering policies and also policies of reinsurance, which in those days were regarded similarly to wager policies. This Act was finally repealed by the Marine Insurance Act of 1906 (Second Schedule), but its provisions with regard to PPI and similar policies are reproduced in section 4(d) of the 1906 Act, and this Act will be discussed thoroughly below.

② *Re Marine Insurance Act of* 1788—This Act required the name of the assured to be inserted in all policies of marine insurance. It was finally repealed by the Marine Insurance Act of 1906(Schedule 11), but its provisions were reproduced in effect in section 23 (1) of the 1906 Act.

③ *The Policies of the Marine Insurance Act of* 1868—This made provision for the assignment of policies and granted assignees power to sue in their own name. It was repealed by the Marine Insurance Act of 1906 (Schedule 11), but its provisions were reproduced in section 50 of that Act.

laxity..."①, "a very strange instrument, as we all know and feel"②, but even so its phraseology is not likely to be altered or modernized —for the very reason that the whole system of marine insurance law in UK has been grafted on to it, and the adoption of a new form would doubtless cause greater difficulties and more disputes than the continued use of a form, practically every phrase of which has been authoritatively interpreted by the courts. Modern requirements are met by the addition of marginal clauses and, subject to the effect of such clauses, the form of policy that has been used for so long is likely to remain the instrument by which future contracts of marine insurance will be expressed.

In conclusion, The Marine Insurance Act of 1906 introduced no new principles, but reproduced as faithfully as possible the case law built up by Lord Mansfield and his successors prior to that date, and embodied many of the well-established practices and usages of the business. The Marine Insurance Act of 1906 is not nearly as comprehensive in its scope as most Continental codes and, in the opinion of many of those well qualified to judge, a number of its provisions are stated in terms that leave many issues open to argument. What is clear is that litigation in marine insurance matters has been very frequent since the Act was passed in UK, and every year fresh problems are being solved by the authority of the courts.

4. "The Quiet Revolution" and whatever happened to it

Lloyd's marine insurance policy was drawn up in a standard form in 1779 and the wording remained practically unchanged until 1982 for cargo policies, and 1983 for hull policies although it was generally modified and broadened in later years.

The trigger for this intellectual activity on the part of the London insurance market was a document published in November 1978 by the Secretariat

① *Trade Indemnity Co. Ltd. v. Workington Harbour and Dock Board* [1937] A.C. 1. 17.
② *Le Cheminant v. Pearson* (1812) 4 Taunt. 367 at 380.

of the United Nations Conference on Trade and Development(UNCTAD) with the title *Marine Insurance-Legal and Documentary Aspects of the Marine Insurance Contract.* The UNCTAD report recognized the ascendancy of the United Kingdom as "the international market centre of marine insurance" and subsequently concentrated the major part of its investigatory activity on an analysis of the English marine insurance regime, bestowing in the process bouquets and brickbats with even-handed largesse.

In consequence of this groundswell for reform, Lloyd's Underwriters' Association and members of the Institute of London Underwriters, working through a system of joint committees, instituted a review of the important policy forms in daily use. Thus began the process of "The Quiet Revolution".

Now, over twenty years later, whatever happened to the revolution? Well, it would seem that the new cargo forms have been welcomed, but the same cannot be said for the succession of so-called standard hull forms, with which shipowners and their advisers have had to content since 1983. First came the Institute Time Clauses, Hulls, 1/10/83, which was considered a praiseworthy advance on the form of 1969 and 1970. This was followed by the Institute Time Clauses, Hulls, 1/11/95, which was universally condemned for its attempts to introduce excessively hard and restrictive conditions.

Now in a new millennium, and after a great deal of research and rethinking, the Joint Hull Committee has launched the International Hull Clauses, this form was first issued on 1/11/02, and was re-presented to clients a year later to the day, after an unprecedented orgy of inter-organization discussion, involving shipowners, managers, brokers and average adjusters, and have yet to receive that degree of acceptance which they undoubtedly deserve. All these will be discussed in this book later.

Chapter 2 Formation of Marine Insurance Contracts and Policies

The basis of insurance is the law of contract. The relationship between assured and underwriter is primarily a contractual relationship with the mutual and reciprocal obligations, rights and powers of the parties defined in terms of contract. Although the marine insurance exists within the broad jurisprudential environment of the common law of contract, it is special. The speciality revealed from the formation process, the nature, and the formal element.

1. The process of marine insurance contract formation

As mentioned in Chapter 1 above, the practice of a number of underwriters subscribing to the same risk is centuries old and permits the placing of risks too large for one insurer to accept. The broker, an intermediary who acts as the agent of the assured, prepares a memorandum of agreement, called a

slip,① in the shorthand of the market and then approaches underwriters seeking subscriptions to the cover. Using his market knowledge, the broker will take the slip first to a leader who may be expected to be an expert in that particular field and whose lead is likely to be followed by his fellow underwriters. The leader, if he agrees to participate, will put alongside the identifying initials or number of his syndicate, or, in the case of a company, the name of the company, the amount he is prepared to write, which is usually expressed as a percentage of the insured value. The broker then takes the slip to other underwriters, the underwriter who wishes to participate in the insurance will initial the slip, stating, almost invariably in the form of a percentage, the proportion of the risk he is prepared to underwrite, this is termed the underwriter's "line". Once the broker has obtained the desired level of subscriptions, the slip is closed.② A formal policy is frequently not prepared until some months later. Although an unstamped slip could not give rise to a legally valid and enforceable contract of marine insurance, it was nevertheless held to be admissible as evidence of the parties' intentions regarding the relevance of the policy. Moreover, formation of a marine insurance contract does not require embodiment of the contract in a policy but occurs upon the acceptance by the underwriter of the assured's offer. Where the underwriter initials the

① As a key part of the London Market Principle's (LMP) programme, the LMP 2001 Slip Creation Guidelines set out best practice guidelines for the creation of slips and associated documents. The LMP slip, one of the main products of the LMP programme, is a uniform document which was first placed in the market in 2002. Its use increased gradually throughout 2003 and was made mandatory by the Lloyd's Franchise Board as from 2 January 2004. Since that date, all slips placed in Lloyd's must be in a LMP format, although certain limited exemptions to the mandate are allowed. The lamp BRAT slip, which was issued in November 2003 has recently been superseded by the LMP slip of April 2005, which reflects changes in the exemptions to the Lloyd's mandate, recent regulatory requirements and feedback from the market. The objectives of the LMP slip are to provide all the information required to place a risk with increased contract clarity, clearly setting out the roles and responsibilities of the parties, in a standard format. This, in turn, will enable the market to provide faster premium payments, earlier policy production and improved claims processing with faster settlement of claims. The business benefits which the LMP slip is designed to achieve include: a standard framework that ensures all information is set out in an unambiguous and structured way to reduce complexity and streamline contract processing; clarity at the point of contract formation; certainty on how the contract of insurance will be managed; a framework that facilitates the production of timely and accurate insurance documentation; improved downstream processing (Closing and Claims); and more efficient agreement of contract changes.

② It is common in practice for the slip to be oversubscribed—that is, the total subscriptions to exceed 100 percent of the agreed value or sum insured.