

UNIVERSITY OF SOUTHAMPTON

FACULTY OF LAW, ARTS & SOCIAL SCIENCES

School of Law

**WARRANTIES IN MARINE INSURANCE:
A SURVEY OF ENGLISH LAW AND OTHER JURISDICTIONS
WITH A VIEW TO REMODELLING THE CHINESE LAW**

By

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ABSTRACT

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The doctrine of marine insurance warranties originated in English law in the seventeenth century and it is familiar to many jurisdictions that have been influenced by English law. It is submitted that the rationale of warranty is that the insurer only accepts the risk provided that the warranty is fulfilled. The doctrine of warranty was necessary when it was introduced into the common law over three hundred years ago; however, today it causes great hardship for the insured in both marine and non-marine insurance contracts.

There is a case for the reform of English law of insurance warranties. The Law Commission of England and Wales examined the problem in 1980 but so far no reform has been implemented in the marine insurance sector. English courts have been trying to alleviate the harshness of current law by way of judicial constructions of contracts. This has not been very successful. Considering the international practice of marine insurance law in other jurisdictions, the reform of English law in this area is overdue. In January 2006, the Law Commission launched a new project to investigate the possibility of reform in general insurance contract law. This seems to be a golden opportunity of introducing reforms in marine insurance warranties.

As influenced by the English Marine Insurance Act 1906, Chinese marine insurance law also recognizes the concept of warranty. However, there is some divergence between Chinese law and English law relating to warranties. Recently, there is a call for remodeling marine insurance law in China. Warranty is one of the hot topics among the list. This research is aimed to analyze the problems of the current regime of marine insurance warranties in English and Chinese law with a comparative study of other jurisdictions and seek the avenues open to the remodeling of warranties in Chinese marine insurance law.

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INTRODUCTION

1. Background

The doctrine of marine insurance warranties originated in English law in the seventeenth century and it is familiar to many jurisdictions that have been influenced by English law. In English law, marine insurance warranties are terms of a contract by which the insured promises that a state of fact is true or will remain true, or that he will behave or refrain from behaving in a particular way.¹ The effect of its breach is quite controversial. It is now settled in the House of Lords in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)*² that breach of warranty would bring the risk to an end automatically as from the time of breach. This rule has been held applicable to both marine and non-marine insurance contracts. Breach of warranty is one of the technical defences that insurers can use to defeat liability for claims. The unique characteristic of a warranty is that materiality and causation are irrelevant. It is submitted that the rationale of warranties is that the insurer only accepts the risk provided that the warranty is fulfilled.³ The doctrine of warranty was necessary when it was introduced into common law over three hundred years ago; however, today it causes great hardship for the insured in both marine and non-marine insurance contracts.

Certain work has already been started to seek solutions to the current problem of warranties in the UK and worldwide. In the U.K, the Law Reform Committee and the Law Commission has published two reports on the reform of this area of law.⁴ Reform was also urged in a report published by the National Consumer Council in 1997⁵ and in a report published by the British Insurance Law Association in 2002.⁶ It is generally accepted that the insurer should not be discharged for anything less than a material breach, and this would alleviate much of the unfairness of current law. Many academic commentators have also expressed their views as to the problem. However, all these initiatives are confined to non-marine insurance contracts and have not been implemented. Outside the U.K, reforms have already taken place in general insurance law in New Zealand and Australia. In particular, the

¹ Section 33 (1), Marine Insurance Act 1906.

² [1992] 1 A.C 233

³ *Ibid*, per Lord Goff.

⁴ (1957) Law Reform Committee, Fifth Report, *Conditions and Exceptions in Insurance Policies*; (1980) Law Commission No. 104: *Non-disclosure and Breach of Warranties*. In January 2006, the Law Commission launched a new project to review the Insurance Contract Law.

⁵ National Consumer Council, *Insurance Law Reform: the Consumer Case for Review of Insurance Law*, May 1997.

⁶ British Insurance Law Association, *Insurance Contracts Law Reform*, September 2002.

Australian Law Reform Commission has recently finished a review of their Marine Insurance Act 1909 and published the final report with a recommended draft Bill for reform, which has eradicated warranties from the 1909 Act. Apart from these national reform initiatives, international collaboration is also under-way. The CMI (Committee Maritime International) has shown an interest in the current problems of international marine insurance law and is keen to introduce some harmonisation among different jurisdictions. An International Working Group (IWG) was set up by the CMI to undertake a considerable amount of research into this project. The problem of warranties is on their priority list. So far, the IWG has not found any solution and it continues to identify and evaluate areas of difference between national laws and the possible means to unification of international marine insurance law.

With all these initiatives happening, the Chinese legislative body also started to evaluate the problem of its marine insurance law. Chinese marine insurance law is codified in Chapter XII of the Chinese Maritime Code 1993. The codification adopted many concepts and doctrines from the English Marine Insurance Act 1906 and warranty is one of them. In recent years, considering the huge international concern regarding the current problem of marine insurance law, the Chinese legislative body has been circulating consultation among academics and the insurance industry to invite proposals for the amendment of its marine insurance law. The issue of warranties is on the list for reform. So far, there is little academic work on this special topic of Chinese law and some thorough comparative research is necessary and urgent for the forthcoming Amendment of the Chinese Maritime Code 1993.

2. Aims and Objectives

This research is aimed at analysing the problems of the current regime of marine insurance warranties in English and Chinese law with a comparative study of other jurisdictions and seeking the avenues open to the remodeling of warranties in Chinese marine insurance law.

- The research will examine the history and development of marine insurance warranties, analyze the rationality of the mechanism and the complexity of the regime, and find out the purpose of its original existence. Marine insurance warranties originated in English law back in the eighteenth century. A historical review will illuminate how English law developed into its current state and whether its existence is still justified in today's law.

- The research will examine the principles underlying the current English law of marine insurance warranties, indicate the difficulties which surround their application both in direct insurance and reinsurance, illustrate them from the accidents of litigation and the practices of commerce, and justify or excuse their vagaries by a reference to their history. English law is admittedly the most developed and comprehensive on the subject of marine insurance warranties. An exposition and evaluation of the latest developments in English case law will help understand the law of marine insurance warranties to their fullness.
- The research will compare the current warranties regime in other jurisdictions. Recently there have been efforts to remodel marine insurance law world wide. The CMI has been circulating questionnaires among major maritime countries to ask for their positions on marine insurance warranties. Australia, New Zealand and Norway have already made some pioneering moves towards a more user-friendly approach to the issue of warranties in their marine insurance law. A comparative study of these different legal frameworks will provide some perceptions to the future of marine insurance warranties.
- The research will reflect on Chinese law and examine the marine insurance warranties in the Chinese legal system. The provision in CMC 1993 on warranties looks like the English one but is indeed different. The current Chinese law of warranties in marine insurance contracts is rather primitive and there are very few judicial decisions on it. Thus the Chinese law is less clear and rather confusing to lawyers and litigants. This is utterly incompatible with the recent rapid increase of maritime litigation in China. A study of the problems of the current Chinese law on marine insurance warranties will highlight the pitfalls that might arise for litigants and indicate where the law should be amended.
- The research will draw conclusions on the comparative studies of marine insurance warranties in different legal systems and put forward proposals for the remodeling of the Chinese law of marine insurance warranties with a view to making it compatible with the rest of the world. Becoming more and more involved in the world economy and international trade, China needs to make its legal system more and more open to the rest of the world. It is urgent to remodel

some areas of its current maritime and commercial law so as to be in line with the international commercial practices and customs. This will reduce the legal cost for both the Chinese and foreign litigants and bring about certainty and consistency in court decisions.

3. Structure and Methodology

The research is divided into three parts. Part I is a study of the marine insurance warranties in English law. Part II will be a comparison of the warranties in other legal systems. Part III is an analysis of the current state of Chinese law of marine insurance warranties and the possible avenues to its reform.

In Part I, the theme of research is to investigate the nature of marine insurance warranties and the effects of breach in the context of English law. The chapters in this part comprise a historical review on the origin and development of warranties in English marine insurance law, an evaluation of the codification of the Marine Insurance Act 1906, an analysis of the latest development of English case law in direct insurance and reinsurance, and an account of the practice in the London insurance market.

The research in this part will examine the law in a chronological order so as to reveal how the law evolved into its current position. Following the evolution line, the discussion will proceed on the basis of case law and scrutinise the incidents of litigation in both direct insurance and reinsurance. A study of the practice and response in the London market will also be carried out so as to complete the research. The underlying thread connecting all these chapters in this part is the search for the nature of warranties. At the end of the study of this part, the work will rationalise all the previous discussion and try to diagnose the problem of current English law. In doing so, the nature of marine insurance warranties will be analysed with reference to the general contractual concepts of warranties, conditions and innominate terms. In the meantime, the work will try to construct a new classification of terms in marine insurance contracts and investigate the possibility of more flexible remedies for breach of insurance contract terms.

In Part II, the theme of research is to investigate the feasibility of alternative legal frameworks to the English law of warranties. The chapter in this part will include a study of the current work of the CMI international working group, an analysis and evaluation of the law reforms in New Zealand and Australia, and a study of the Norwegian Marine Insurance Plan 1996.

The research in this part will adopt a comparative method throughout the chapter.

Adopting a comparative method in this chapter, the selected legal systems will be examined and compared to English law. As an introduction to the different legal systems, the current work of CMI will be first studied. Their working report is a good starting point for a general view of the current development of law in this special area in many other jurisdictions. In doing so, the research will conclude the divergence between different approaches to warranties in other jurisdictions. Then, the research in this part will focus on New Zealand and Australian law and Norwegian law as two distinctive directions of the current development of law in this area. New Zealand and Australia have reformed their law relating to warranties in general insurance contracts. Their reform Acts are viewed as a possible way-out for the English warranty regime. By contrast, Norwegian law provides a different approach from a continental civilian tradition. The Norwegian Marine Insurance Plan 1996 is the most comprehensive standard modern insurance contract in the world. The Norwegian regime does not employ the mechanism of warranties and address the purpose of warranties with other mechanisms. The chapter will compare English law with the laws in these jurisdictions and the discussion will be made in the light of both legal theory and commercial practice. In the end, the advantages and disadvantages of each legal framework will be highlighted.

In Part III, the theme of research is to investigate the necessity and possibility of remodeling the Chinese law in marine insurance warranties. The chapter in this part will include an analysis of marine insurance warranties in Chinese law, a comparison of Chinese law and English law on marine insurance warranties, and proposals for the remodeling of warranties in Chinese marine insurance law.

The research in this part will also use a comparative method. The research will first introduce the law and practice of marine insurance in China. In order to familiarise those who are new to the Chinese legal system, the introduction will include a brief summary of the Chinese legal method and the judicial system. Then, the discussion will evaluate and analyse current and potential difficulties of warranties in Chinese law. The analysis will be made against the background of Chinese general contract law and insurance law as marine insurance contracts are a special branch of contract law being also regulated by the general contract law and insurance law. Comparison to English law and other legal systems will be made where appropriate. The Chinese law of marine insurance warranties was modeled on English law. There are some similarities between the two, but there are also significant differences. The research will interpret the implications of these similarities and differences between English and Chinese law. At the end of this part, reflections and conclusions will be made on the possible avenues regarding the remodeling of Chinese law. Based on the previous research in

Part I and Part II, the conclusion will focus on the possibility of applying any of the present legal frameworks of marine insurance to Chinese law. Finally, proposals for amendment of the Chinese law will be put forward as a conclusion to the whole research.

4. Outcomes

As a result of the research, the following points should be made clear:

- Whether the mechanism of warranties is still justified in modern marine insurance;
- What are the problems of current English law of warranties;
- Whether the law reform in other jurisdictions has cured the defects of marine insurance warranties;
- Whether the purpose of warranties could be fulfilled by some other mechanism in insurance law;
- What are the avenues open to the reform of warranties in Chinese marine insurance law.

Chapter 1

THE HISTORY OF WARRANTIES IN ENGLISH MARINE INSURANCE LAW

The English law of marine insurance warranties has been a focus for criticism among academics and the legal profession for many years.¹ Under current English marine insurance law, the concept of warranty refers to a term of the policy, which must be strictly complied with by the insured, and any breach of which will discharge the insurer from his liability automatically as from the time of breach.² The doctrine of warranties is regarded as harsh and dated, and it is submitted that there is a case for reform or abolition of warranties in marine insurance law.³ Nonetheless, as a fundamental doctrine that survived in marine insurance law for over 300 years, there must be a reason for its being enshrined in English law. It is worthwhile to take a little journey back to history and discover the evolution of the law. What was the doctrine initially intended to do? What was the exact meaning and purpose of marine insurance warranties? How did the law develop into its modern position? It might be not possible to trace its genesis which is veiled in antiquity and lost in obscurity, but a historical review will at least tell us what the law has been and provide us with a foundation for further examination.

1. The 17th Century-- Genesis of Marine Insurance Warranties in English Law

It is suggested that the practice of marine insurance matured in Italy in the 14th century and came to be well known in England in the 16th century.⁴ Marine insurance was at the latest litigated or arbitrated in England in the 16th century.⁵ The earliest mention of a policy of insurance in England is to be found in the records of the court of Admiralty.⁶ However, there

¹ In 1957, the Law Reform committee published their report on problematic areas of insurance law, *Conditions and Exceptions in Insurance Policies*, Cmnd 62, 1957. The report touched upon the problem of warranties in insurance law. Afterwards, scholars were attacking the English law of warranties more vigorously. Cf: Hasson, *The basis of contract clause in insurance law*, (1971) M.L.R 34. In 1980, the Law Commission published another report on the defects and reform of warranties, *Insurance Law: Non-Disclosure and Breach of Warranty*, Law Com No 104, 1980. In January 2006, the Law Commission of England and Wales launched a new project in conjunction with the Scottish Law Commission to review the law of insurance contracts and consider the venues for reform. The project have already identified non-disclosure and breach of warranty as two areas for reform. They are now inviting comments on their scoping paper for the review of insurance law.

² Section 33, Marine Insurance Act 1906; *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1992] 1 AC 233.

³ Law Commission Report No. 104, 1980.

⁴ W.S Holdsworth, *A History of English law*, Vol VIII, 2nd ed., London, 1937, at 283.

⁵ The earliest policy in England is to be found in the record of the case of *Broke v. Maynard (1547)*. W.S Holdsworth, *A History of English law*, Vol VIII, 2nd ed., London, 1937, at 283.

⁶ *Broke v Maynard (1547)*, Select Pleas of the Admiralty (S.S.) ii. Lxxvi 47.

was no English legislation on marine insurance in those early days¹ and the trial of insurance cases was not grounded on English law but on the use and customs among merchants.² During the 16th and 17th centuries, both the court of Admiralty and the courts of common law had competing jurisdiction over disputes on marine insurance.³ As a result, the law of insurance was left in a very backward state. No general or certain rules had evolved in these tribunals. It was not until the latter part of the 18th century when English mercantile law began to emerge from 'its chaotic mediaeval parochialism' that marine insurance started to develop as a separate branch of English common law.

1.1 The *Jeffries v Legandra* Case

*Jeffries v Legandra*⁴ is probably the earliest marine insurance case on warranties that modern readers can easily get access to in the English Reports. This case was noted by several reporters in its time. This might be regarded as a starting point of the legal history of marine insurance warranties in English law.

In the case, the policy read that 'warranted to depart with convoy'. The ship departed with her convoy when she first set sail but was later separated from the convoy by severe weather and after that was captured by the French. The first issue for trial in the case was what the true meaning of those words in the warranty were, i.e. to depart with convoy at the commencement of the voyage only or depart with convoy for the whole voyage. The court decided that these words should be construed according to the usage among the merchants and the jury found in favour of the insured on this point. It was held that the words to 'depart with convoy', according to the usage among the merchants, meant 'sail with convoy for the whole voyage'.

The real point of interest in this case was whether the stipulation on departure with convoy was satisfied if she was afterwards separated by tempest or captured. The underwriter argued that the warranty made the policy a conditional contract, 'an executory promise upon an act done, and to be done to, or by a stranger'; and in such case it is not enough to say, that 'it was endeavoured, or that the circumstance was rendered impossible to be observed by the act of God', and if the condition was prevented from happening by the insured's fault, the

¹ The first piece of English legislation on marine insurance was enacted in 1601, *An Act touching policies assurances used among merchants*. The Act is an attempt to regulate the administration of marine insurance business and set up a commercial court for the hearing of actions upon policies of marine insurance.

² The earliest legislation on insurance comes from the Italian cities of Genoa and Florence in the last quarter of the 14th century and the first comprehensive code of insurance law is to be found in the statutes of Barcelona, codified in 1484. These statutes of Italian and Spanish law were especially important in the early history of insurance in England and in other European countries. See Holdsworth, *A History of English law*, Vol VIII, 2nd ed., 1937, at 281

³ Holdsworth, *A History of English law*, Vol VIII, 2nd ed., London, 1937, at 288.

⁴ *Jeffries v Legandra* (1692) 4 Mod. 58

insured would lose the premiums, if not, the contract was vitiated. However, the court did not take the underwriter's arguments on this point. They held that this undertaking would have been satisfied in cases where the ship was forced to separate from the convoy for reasons other than the willful default of the master and therefore the insurer was liable for the loss. It is sad that the court did not explain the reasons for this holding in much detail. It might be a reasonable guess today that the warranty was breached, but the breach was excused because the insured was not at fault in his breach of the warranty. Obviously, the court was very generous to the insured in this case.

1.2 Warranties as Contractual Terms Descriptive of the Risk

In two later cases of the seventeenth century,¹ the court construed warranties 'to depart with convoy', according to the customary usage among merchants. But in these cases, the point did not arise as to whether a breach of warranty could be excused if it was not the insured's fault.² The court was only asked to construe when and where the convoy was required.

The law of warranties in marine insurance was very primitive at this stage: there was no clear definition for warranties in these cases and the courts were not clear with the nature and consequences of its breach at all. So far, as to the origin of warranties in marine insurance, one thing we can be certain of is that the word was a term customarily used by merchants and was introduced to marine insurance contracts by brokers rather than lawyers. As to the purpose of it, it is suggested that a warranty was one of the few means that the underwriters could use to define the proposed risk accurately in the contract.³ This must be true considering the argument by the underwriter in *Jeffries v Legandra*, where it was contended that the insurance was about 'the mode of the voyage' and that 'to depart with convoy' was descriptive of the risk. In this sense, it might be safe to say that in their origin warranties functioned as a contractual term descriptive of the risk to be insured.

2. The 18th Century—Rules of Express Warranties

With the rapid increase of foreign trade, the business of marine insurance was blossoming in England in the 18th century. In this period, the law of marine insurance was also shaped into its modern form by Lord Mansfield in England and that was regarded as the foundation of English marine insurance law. Most of the cases on warranties in this century were

¹ *Lethulier's Case* (1693) 2 Salk, 443; *Gordon v Morley*, (1693) Strange, 1265

² Dr. Baris Soyer argues that the ration of these cases was that warranties were not breached by minor discrepancies, and therefore the insured was recovered. Baris Soyer *Warranties in marine insurance*, Cavendish Publishing Limited, 2nd ed., 2006, p.6

³ William R. Vance, *The history of the development of the warranty in insurance law*, 20 Yale L.J. 523 (1910-1911)

concerned with express warranties and the court was invited to consider the law in more sophisticated situations. In many of the decisions of this period, a ‘more definitive analysis’ of warranties in marine insurance law was given by the court.

2.1 The Law in Lord Mansfield’s Time

In fact, prior to the advent of Lord Mansfield (1705-1793),¹ the number of recorded decisions in marine insurance was very small. That said, during the 16th and 17th centuries, the law of marine insurance was rather unsettled and chaotic due to the competing jurisdictions between the admiralty court and the common law courts on insurance disputes.² Furthermore, marine insurance arbitration was quite often used to settle disputes.³ In 1756, Mansfield became Lord Chief Justice and during his period, many marine insurance cases were decided in the courts of the common law. His decisions laid down the foundations for English marine insurance law.⁴ In those seminal cases tried by Lord Mansfield, express warranties were examined and certain legal characters were attached to warranties in marine insurance contracts.

Materiality

The first recorded warranty case heard by Lord Mansfield is *Woolmer v Muilman*,⁵ where the insured ship and cargo were warranted to be neutral but were in fact British property. The ship sank at sea, and the underwriter refused to pay the claim. The insured argued that the warranty was not material to the risk. The court held that the underwriter was not liable. According to Lord Mansfield,

There was a falsehood, in respect to the condition of the thing assured; therefore, it was no contract. ... False warranty in a policy of insurance will vitiate it, though the loss happens in a mode not affected by that falsity.

In this case, it seemed that Lord Mansfield regarded those warranted descriptions of the insured subject-matter as representations and held that any falsehood would make the contract void retrospectively. So at this time of law, the court did not really recognise the difference between warranties and representations under utmost good faith and confused the two. This is quite understandable. The leading case on utmost good faith is *Carter v Boehm*,⁶ which came

¹ Edmund Heward, *Lord Mansfield*, Barry Rose (Publishers) Ltd., 1979

² See above p. 8.

³ Holdsworth, *A History of English law*, Vol VIII, 2nd ed., 1937, at 286.

⁴ Samuel Marshall, *Treatise on the law of Insurance* (3rd ed., 1823), Vol. I, p. 23.

⁵ (1763) 1 Wm Bl 427

⁶ (1766) 3 Burr. 1905

out in 1766, three years later than *Woolmer v Muilman*. Therefore, it is possible that even Lord Mansfield himself was not quite aware of the difference between representation and warranties when he decided the *Woolmer v Muilman* case.

In 1778, the term warranty was considered again by Lord Mansfield in *Pawson v Watson*.¹ In this case, when the insured ship was represented to the first underwriter, the instructions said that the ship had 12 guns and 20 men on board. However, this representation was not communicated to the following underwriters. The ship sailed with 27 men and boys aboard, of whom only 16 were men, and nine carriage guns and six swivels, which made the ship have more force than was represented. The ship was captured by an American privateer. The insurers denied liability and the case turned on the question whether the assured had warranted that the ship should literally have 12 guns and 20 men. The case raised a number of interesting issues. For the present purposes, it is to be noted that Lord Mansfield first pondered the distinction between a written and a *parol* representation. Lord Mansfield said:

There is no distinction better known to those who are at all conversant in the law of insurance, than that which exists, between a warranty or condition which makes part of a written policy, and a representation of the state of the case. Where it is a part of the written policy, it must be performed: as if there be a warranty of convoy, there it must be a convoy: nothing tantamount will do, or answer the purpose; it must be strictly performed, as being part of the agreement; for there it might be said, the party would not have insured without convoy. But as, by the law of merchants, all dealings must be fair and honest, fraud infects and vitiates every mercantile contract. Therefore, if there is fraud in a representation, it will avoid the policy, as a fraud, but not as a part of the agreement.²

According to this view of Lord Mansfield, warranties and representation are different in two aspects: first, warranties were contractual, written in the policy, whereas representations were merely statements made during the negotiation of the insurance and they were not necessarily included in the policy; secondly, warranties were different from representations in their effects on breach. As in the case, the instructions were not inserted or written into the policy, they were held to be representations and there was no fraud in the representation, therefore the underwriters should be liable. The reasoning here seems to be that the effect of misrepresentation is based on fraud: material misrepresentation involves fraud, so only material misrepresentation will avoid the contract. By contrast, the breach of warranty is based

¹ (1778) 2 Cowper 785

² (1778) 2 Cowper 785

on contract, so even immaterial breach of warranty is a breach of contract and it will also avoid the contract.

This holding was sensational for the underwriters at the time. It was recorded in the report of the case that on the following morning after the decision, the underwriters were eager to ask whether the court was of the opinion that to make written instructions valid and binding as a warranty, they must be inserted in the policy. Lord Mansfield answered that was most undoubtedly the opinion of the court. The significance of this distinction, as Ashhurst, J. said in *De Hahn v Hartley*,¹ 'is to preclude all questions whether it [warranty] has been substantially complied with; it must be literally so'.

Fault

Another point that had also been considered again in this century is whether breach of warranty can be excused if the breach of warranty was caused by something out of the insured's control. In *Bond v Nutt*,² the ship was warranted to have sailed on or before a particular day. The ship actually sailed before that date from her port of lading to another port to join the convoy; however, the ship was later detained there by an embargo beyond the date of sailing warranted in the policy. The underwriter defended the case by arguing that 'a strict departure by the precise day specified in the policy, is of the very essence of the contract. It is a condition precedent which must be complied with, or the underwriter will not be liable' and 'it is an express condition which neither storm nor enemies, unless complied with, can excuse'.

It is clear in the underwriter's defence that the breach of warranty could not be excused whether the breach was intentional or by accident, because strict compliance of the warranty was the ground on which the contract was based. Before the court allowed the jury to decide upon the facts, Lord Mansfield directed them by saying that:

[T]he policy was made ... upon the contingency of a fact which must have existed one way or the other at the time the policy was underwritten. That contingency was, that the ship should have sailed on or before the 1st of August... The question then is a matter of fact; and one that admits of no latitude, no equity of construction, or excuse. Had she or had she not sailed on or before that day? No matter what cause prevented her; if the fact is, that she had not sailed, though she staid behind for the best reasons, the policy was void: the contingency had not happened; and the party interested had a right to say, there was no contract between them.

¹ (1786) 1 TR 384

² (1777) 2 Cowp 601

It should be noted that the position was different from that in *Jeffries v Legandra* where the breach was excused if the insured was not at fault for the breach.¹ In another similar case, *Hore v Whitmore*,² the ship assured was also warranted to sail on or before a particular date, but was detained by an embargo and prevented from sailing on the date. The ship was later captured. The insured argued that the breach of warranty was expressly excused by another clause in the policy, which said that ‘free from . . . all restraints and detainments of kings, princes, and people of what nation, condition or quality soever’. The court took the underwriter’s view that the warranty was positive and express and therefore must be complied with. So far it seems that English law had established that there was no latitude of excuse for the breach of marine insurance warranties and it did not matter whether the breach of warranty was due to the insured’s fault or the insured was privy to the breach.

Finally, it might be of interest to note an obscure case *Lilly v Ewer*,³ in which the ship was also warranted to depart with convoy but later was separated from her convoy by perils of the sea. Lord Mansfield said that ‘though the convoy for the whole voyage is clearly intended, an unfortunate separation is an accident to which the underwriter is liable.’ This reasoning seems to say that accidental separation is allowed not to be a breach of warranty. The reasoning in *Lilly v Ewer* seems to say that when the accident that caused the breach of warranty was a peril of the sea insured against in the policy, the assured was still covered despite the breach. Considering this case and the decision in *Hore v Whitmore* together, it might be concluded that if the breach of warranty was caused by a risk that was excluded in the policy, the insurer was not liable; otherwise, the insurer should be liable when the breach of warranty was caused by a covered risk. However, it is unfortunate that this reasoning of Lord Mansfield was not appreciated in the later English courts, and the law was fashioned in a direction that Lord Mansfield might never have intended⁴: breach of warranty cannot be excused for any reason, whether the insured is at fault or not.

2.2 Warranties as Conditions in a Contingent Sense

In the last quarter of this century, the court finally had the chance to conclude almost all the important points of law on the marine insurance warranty in the celebrated case *De Hahn v Hartley*.⁵ The ship was warranted to sail with 50 men but actually sailed with 46 men aboard.

¹ See above p. 8.

² (1778) 2 Cowp 784

³ (1779) 1 Dougl 72

⁴ R.A Hasson, *The ‘basis of contract clause’ in insurance law*, 34 M.L.R (1971), p.34

⁵ (1786) 1 TR 343

Another six men were soon taken on board before she was captured. The insured argued that the warranty in those precedents had always been related to the voyage assured; but in the present case, the warranty was totally unconnected with the risk insured.

Lord Mansfield held that ‘it is perfectly immaterial for what purpose a warranty is introduced; but being inserted, the contract does not exist unless it be literally complied with’. Lord Mansfield also observed the nature of warranty as follows: ‘a warranty in a policy of insurance is a condition or contingency, and unless that be performed there is no contract.’ Here, it is clear that the term ‘condition’ was used in its contingent sense. It is a condition precedent to the formation or existence of the contract. However, this case was cited mostly as an authority to the proposition that warranties must be literally complied with. In fact, the court did not decide the case on the point of whether the underwriter was liable for losses after the breach was remedied, but it is a pity that the case was also cited in one leading text as an authority for the proposition that breach of warranty cannot be remedied.¹

This rule of *De Hahn v Hartley* was soon followed by other judges, but not in a defensible way. In *Blackburn v Cockell*,² the ship was warranted to be well on December 9th, 1784. However, the ship was lost on that day before the policy was underwritten. The court held that the warranty had been complied with if the ship was safe at any time of that day. According to Buller, J, ‘it is a matter of indifference whether the thing warranted be or be not material but it must be strictly complied with; and if it be so, that is sufficient’. It should be noted that in this case the literal compliance rule is in favour of the insured, but later the rule was mostly used against the insured.

So far in the eighteenth century, the warranties considered by the court were still mainly concerned with descriptive statements concerning the subject matter of the contract before the attachment of the risk. The rules laid down during this period were that warranties, whether material or not, must be literally complied with, and breach of warranty would avoid the contract *ab initio*. The nature of these warranties was held to be a condition upon which the existence of the contract depended. In many of the cases in this century, the element of materiality and fault seems to be held to be irrelevant in breach of warranty, but it is to be noted that these cases could be equally decided on other grounds which would justify the merits of these decisions. The law did not really touch the question of whether losses were covered after the breach was remedied.

3. The 19th Century I—Rules of Implied Warranties

¹ Howard Bennett, *The Law of Marine Insurance*, Oxford University Press, 1996, p.286

² (1789) 3 TR 360

During the nineteenth century, another distinctive type of warranty developed. Different from the warranty discussed above, they were not express in the policy, but they were deemed to be implied into the policy. These were the warranties of seaworthiness and legality.

3.1 Seaworthiness

Around the beginning of the 19th century, the point of seaworthiness was frequently considered in the courts and it was held there was an implied warranty of seaworthiness by law in every voyage marine insurance contract.¹

In *Christie v Secretan*,² the court held that where there is such a warranty, express or implied, compliance is a condition precedent to the underwriter's liability for a loss. In *Wedderburn v Bell*,³ Lord Ellenborough further expounded that, 'seaworthiness is a condition precedent to the policy attaching; and if it was not complied with, so that the peril was enhanced from whatever cause this might arise, and though no fraud was intended on the part of assured, the underwriter were not liable'. The rationale of an absolute rule of seaworthiness in marine insurance was expounded most clearly by Lord Eldon: 'there is nothing in matters of insurance of more importance than the implied warranty that a ship is seaworthy when she sails on the voyage assured ... both a view to the benefit of commerce and the preservation of human life ...'⁴ Obviously, public policy is a major consideration in the enforcement of this rule.

Around the mid-nineteenth century, the doctrine of implied warranty of seaworthiness was almost in its mature form. In *Dixon v Sadler*,⁵ Parke B gave the classic exposition of the warranty of seaworthiness:

In the case of an insurance for a certain voyage, it is clearly established that there is an implied warranty that the vessel shall be seaworthy, by which it is meant that she shall be in a fit state as to repairs, equipment, and crew, and in all other respects, to encounter the ordinary perils of the voyage insured, at the time of sailing upon it. If the assurance attaches before the voyage commences, it is enough that the state of the ship be commensurate to the then risk; and, if the voyage be such as to require a different complement of men, or state of equipment, in different parts of it, as, if it were a voyage down a canal or river, and thence across the open sea, it would be properly manned and equipped for

¹ *Woolf v Claggett* (1800) 3 Esp 257; *Wedderburn v Bell* (1807) 1 Camp 1; *Annen v Woodman* (1810) 3 Taunt 299; *Wilkie v Geddes* (1815) 3 Dow 57; *Parker v Potts* (1815) 3 Dow 23; *Douglas v Scougall* (1816) 4 Dow 276; *Clifford v Hunter* (1827) 3 C & P 16

² (1799) 8 TR 192

³ (1807) 1 Camp 1

⁴ *Douglas v Scougall* (1816) 4 Dow 276

⁵ (1839) 5 M & W 405, 414

it. But the insured makes no warranty to the underwriters that the vessel shall continue seaworthy, or that the master or crew shall do their duty during the voyage...

By the end of the century, the court in *Quebec Marine Insurance Co. v Commercial Bank of Canada*¹ drew a fine conclusion on the whole issue of implied warranty of seaworthiness. First, the court acknowledged that 'the law by which the warranty of seaworthiness is attached to the contract is a law known to the parties who make contracts of this description; and, therefore, they are prepared to understand that the implied warranty will be attached to the contract they are about to make. If, therefore, there is an intention to exclude that implied warranty, it ought to be expressed in plain language'.² The court then made the point that there was no hard and fast test on the standard of seaworthiness. The court held that:

The case of *Dixon v. Sadler*, and the other cases which have been cited, leave it beyond doubt that there is seaworthiness for the port, seaworthiness in some cases for the river, and seaworthiness in some cases, as in a case that has been put forward of a whaling voyage, for some definite, well-recognized, and distinctly separate stage of the voyage. This principle has been sanctioned by various decisions; but it has been equally well decided that the Vessel, in cases where these several distinct stages of navigation involve the necessity of a different equipment or state of seaworthiness, must be properly equipped, and in all respects seaworthy for each of these stages of the voyage respectively at the time when she enters upon each stage, otherwise the warranty of seaworthiness is not complied with.³

The reasoning here was that the standard of seaworthiness varies according to the different voyages undertaken and if the insured adventure is divided into several stages, seaworthiness should be decided by reference to the circumstances of each stage at the commencement thereof.⁴ Indeed, the concept of seaworthiness is a relative one and it really depends on the circumstances in each and every case. And the requirement of seaworthiness is only operative at the commencement of the voyage or the commencement of risk if the vessel is insured for port perils.⁵

It should be noted that the implied warranty of seaworthiness is only operative in the

¹ (1870), L.R.3 P.C

² *Ibid*, per Lord Penzance.

³ *Ibid*, per Lord Penzance.

⁴ *Foley v Tabor* (1861) 2 F. & F. 663; *Daniels v Harris* (1874) L.R. 10 C.P. 1

⁵ *Parmeter v Cousins* (1809) 2 Camp 235; *Annen v Woodman* (1810) 3 Taunt 299; *Gibson v Small* (1853) 4 H.L. Cas 353; *Buchanan & Co v Faber* (1899) 4 Com Cas 233

voyage policies. In the nineteenth century, a line of authorities developed which refused to imply any seaworthiness into time policies but recognized a defence of unseaworthiness based upon privity of the insured.¹ In the leading case *Gibson v Small*,² it was established that there was no implied warranty of seaworthiness in a time policy. Four reasons were given in the judgment. First, there was no such practice of implying seaworthiness as a warranty into insurance policies at the time. Secondly, the owner had no means of ascertaining the condition of the vessel at the moment when she came on risk. Thirdly, it was difficult to decide when the requirement of seaworthiness should operate. Fourthly, it was by no means certain of ascertaining the content of the supposed warranty. These reasons were very impressive in consideration of the time the case was decided. However, none of them is really convincing today.³

The justification of seaworthiness being an implied warranty is complicated.⁴ Besides the obvious concern of the safety of human life at sea, it is believed that the vessel should be warranted seaworthy at the commencement of the voyage for another two reasons. First, in the old days, when underwriters evaluated the risk and decided the rate of premium, the underwriter could not get instant information about the vessel as quickly as we can with today's technology. So they must presume and make it a condition precedent that the vessel is seaworthy. Indeed, this is kind of a guarantee from the insured. This is the technical side. Secondly, from the legal point of view, until the early twentieth century, the English law of causation in marine insurance still adopted the last in time doctrine. So if a vessel went to sea in an unseaworthy state and became total loss because of bad weather, the proximate cause of its loss would be perils of sea. In such a case, if there was no implied warranty of seaworthiness, the insured would be indemnified for his loss because the cause of the loss was covered in the policy. This could be unfair to the underwriters. Considering these factors, the implied warranty of seaworthiness was very necessary in marine insurance law. But with the passing of time, technology and law evolved and the necessity of the implied warranty of seaworthiness is now under question. The current English insurance law of causation adopts the test of efficacy and dominance.⁵ So the above noted scenario would not happen even if there was no implied warranty of seaworthiness. Nonetheless, the English position to the implied seaworthiness in marine insurance is still the same as 200 years ago.

¹ *Gibson v Small* (1853) 4 HL Cas 353; *Thompson v Hopper* (1856) 6 E & B 172

² (1853) 4 HL Cas 353

³ See Lord Mustill, *Fault and Marine Loss* [1988] L.M.C.L.Q. 310, pp.347-349

⁴ *Ibid*, pp.343-346

⁵ *Leyland shipping Co. v Norwich Union Fire Insurance Society Ltd* [1918] A.C. 350

3.2 Legality

Due to the consideration of public policy, another implied warranty, i.e. the warranty of legality, was also developed in this century. If the adventure is illegal from the outset, the policy insuring the adventure is void, irrespective of the ignorance or otherwise of the parties.

¹ However, the court realised that this might provide the underwriter with an unmerited defence, which should not be encouraged.

In *Gray v Lloyd*,² the British ship carrying goods from the Cape to the Isle of Bourbon was lost by hostile capture. The underwriter rejected the claim on the ground of illegality because the adventure was not confined to the sort of goods specified in the license and the adventure was also a breach of the monopoly of the East India Company. The court held that it was an illegal voyage and the underwriter was not liable. It is interesting to note that the court commented in this case that ‘it [warranty of legality] is ... an objection open for the underwriters to take, if they choose it; though the objection, being a bare legal one, is not to be favoured.’

4. The 19th Century II—Subtle Changes of Rules of Express Warranties

The nineteenth century also saw further development of express warranties. In this century, the court subtly changed their view on the nature and effects breach of express warranties.

In *Baines v Holland*,³ the ship was insured ‘at and from New York to Quebec, ... thence to the United Kingdom.’ The ship was warranted to sail from Quebec on or before 1st November 1853. Before the ship arrived at Quebec, it struck certain rocks and was totally lost. The loss happened after 1st November, when the ship was still at sea on her way from New York to Quebec, due to the late commencement of her voyage. The Court held the warranty was not breached and the insured was covered under the policy. Parke, B. J, said in his judgment, ‘So far as relates to the voyage from New York to Quebec, the policy is altogether without limitations as to time; but as regards the voyage from Quebec to the United Kingdom, the underwriters are not responsible unless the vessel sails from Quebec on or before the 1st of November, 1853.’ Platt, B. J, explained more clearly: ‘... as to the voyage from New York to Quebec, there are no limitations as to time, but that, with respect to the other part of the voyage, its commencement before the 1st of November 1853 is a condition precedent to the attaching of the risk’. So far the law of warranty in marine insurance had evolved to the rule

¹ *Parkin v Dick* (1809) 11 East 502; *Gray v Lloyd* (1812) 4 Taunt 136;; *Camelo v Britten* (1820) 4 B & Aid 184; *Redmond v Smith* (1884) 7 Man & G 457; *Cunard v Hyde* (1859) 2 E & E 1; *Australian Insurance Co v Jackson* (1875) 33 LT 286

² (1812) 4 Taunt 136

³ (1855) 10 Exch 802

that a warranty is a condition precedent to the attachment of the risk. Needless to say, the concept of ‘condition precedent to the attachment of the risk’ is dramatically different from that of ‘condition precedent to the contract.’ The former means the breach only discharges the underwriter from liability from the time of breach, because the risk is detached from that time; the latter means the breach avoids the whole contract, because the foundation of the contract collapsed due to the breach and there was no contract from the outset.¹

This proposition was confirmed in the House of Lords in *Thomson v Weems*,² where Lord Blackburn stated that:

In policies of marine insurance I think it is settled by authority that any statement of a fact bearing upon the risk introduced into the written policy is, by whatever words and in whatever place, to be construed as a warranty, and prima facie, at least that the compliance with that warranty is a condition precedent to the attaching of the risk.³

However, this change of view went almost unnoticed, as the insurer and the insured only wanted to know whether the loss was recoverable under the policy.

In this century, the court also had opportunities to consider the undecided question as to whether a breach of warranty could be remedied before loss. The law claimed to be contained in *De Hahn v Hartley*⁴ was developed into a line of authority, by which breach of warranties were irremediable. The point was considered in the context of an implied warranty of seaworthiness, and the rule is that even if the breach of warranty has been remedied before a loss, the underwriter is still not liable. In *Weir v Aberdeen*,⁵ Abbott, C.J said, *obiter*, that ‘... if a vessel, at the outset of her voyage, be by mistake or accident unseaworthy, owing to some defect which is immediately discovered, and remedied before any loss happens in consequence of it, still that the policy would be *void*, and the underwriters not liable.’ This rule was frequently enforced in the seaworthiness cases.⁶ In *Quebec Marine Insurance Co. v Commercial Bank of Canada*⁷, there was a defect in the boiler of the vessel, after being repaired and detained for some days in the port, she proceeded to sea, where she was lost in bad weather. The court held that the warranty of seaworthiness had not been complied with, although the defect was later repaired. As noted, this rule was considered by the court in those seaworthiness cases

¹ *De Hahn v Hartley* (1786) 1 TR 343

² (1884) 9 App. Cas 671

³ *Ibid*, at 684.

⁴ (1786) 1TR 343

⁵ (1819) 2 B & Ald 320

⁶ *Forshaw v Chabert* (1821) 3 Brod & B 158; *Foley v Tabor* (1861) 2 F&F 663; *Quebec Marine Insurance v Commercial bank of Canada*, (1870) L.R 3 PC 234

⁷ (1870) L.R. 3 PC 234

only, where the consideration of public policy justified its absoluteness. Unfortunately, this rule was later mistakenly interpreted to apply to both implied and express warranties and was finally codified into the Marine insurance Act 1906.

5. The Codification of Case Law—Marine Insurance Act 1906

At the close of the nineteenth century, one landmark was laid down in the English law of marine insurance. Following the trend of codification, serious attempts were made to codify the law relating to marine insurance. Due to the drafting efforts of Sir M. D. Chalmers, a Bill entitled the ‘Marine Insurance Codification Bill’ was introduced in the House of Lords in 1894. Eventually, the Act under the title of ‘An Act to Codify the Law relating to Marine Insurance’ was enacted in 1906 and was referred to as Marine Insurance Act 1906 (MIA 1906). As the name indicates, it did not set out to remodel the law relating to marine insurance, but merely to codify previous decisions and customary practice.

In the MIA 1906, ss 33-41 set out the rules of warranties. As with other parts of the MIA, these provisions are merely a codification of the English case law existing before and by 1906. Briefly, a warranty is a promise by the insured to the underwriter that something shall or shall not be done, or that a certain state of affairs does or does not exist.¹ A warranty must be literally and strictly complied with,² as otherwise subject to the two statutory exceptions, i.e., (a) where owing to a change of circumstances the warranty is no longer applicable, and (b) where compliance would be unlawful owing to the enactment of a subsequent law,³ the underwriter is discharged from liability as from the date of the breach.⁴ A breach of warranty may be waived by the underwriter.⁵ The Act also provides that warranties can be express or implied.⁶ Actually, there are only two implied warranties, i.e., warranty of seaworthiness and warranty of legality of the marine adventure,⁷ which do not actually appear but are tacitly understood to be incorporated in the policy by law.

So far, the law of marine insurance warranties was by and large settled in the 1906 Act. The Act manifestly stated that warranties must be exactly complied with and any breach would discharge the insurer from liability. During the years after the enactment, the litigants, like they used to be, were more concerned about whether there was a breach of the warranty rather than how the contract would stand after the breach. That said, the reason for this is presumably that the insurers were satisfied knowing that they were not liable for the loss and

¹ s.33(1), MIA 1906

² s.33(3), MIA 1906

³ ss.34(1)-(2), MIA 1906

⁴ s.33(3), MIA 1906

⁵ s.34(3), MIA 1906

⁶ s.33(2), MIA 1906

⁷ ss. 39 & 41, MIA 1906

rarely had an interest in knowing how they were discharged from liability until *The Good Luck* case in which the question of how exactly the insurer was discharged from liability was at stake in the litigation.

6. The Development of Case Law after the MIA 1906

After the MIA 1906, the case law of marine insurance warranties was roughly divided into two stages by the decision of *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)*¹ in the House of Lords in 1991. Before *The Good Luck*, the law was mostly concerned with the question of exact compliance and the courts confirmed that the early authorities of exact compliance still applies in modern contexts although there are complaints about the rule; since *The Good Luck*, the courts have been constantly required to consider what exactly the effects of breach of warranties are. This is a grey area that was rather obscure in the early authorities and the case law after the 1906 MIA. As a result, many surrounding questions are opened up for judicial examination.

6.1 Exact Compliance

Since the enactment of the MIA 1906, the courts have in various cases declared that English law has always been that: once a warranty is written in the policy or any other documents incorporated into the policy², it must be exactly complied with as it is literally written. Exact compliance itself would suffice, whether it is substantial or not. Any non-compliance would be deemed as a breach, whether it is immaterial to the risk or loss. Once breached, warranties cannot be remedied and no excuses would be allowed.

Literal but not necessarily substantial

The meaning of ‘exact compliance’ in those early authorities seems to have never created any doubt in modern cases. It is accepted that an exact performance of the warranty will suffice, and it does not matter in law whether it is a substantial compliance or not. It certainly does not make any good commercial sense in some cases, but all that is needed is simply a literal compliance. Undoubtedly, this has made the defence by way of warranty very odd in some situations when the warranty has been substantially complied with, but not literally, or the warranty is not material at all to the risk.

In *Overseas Commodities Ltd. v Style*,³ the insured shipped two consignments of tinned pork from France to London under an all risk policy. The policy contained a warranty which

¹ [1992] 1 A.C. 233

² Section 35 (2), MIA 1906

³ [1958] 1 Lloyd's Rep. 546

required that all the tins of pork should be marked by the manufacturers with their date of manufacture, while a portion of the tins were actually not marked. When the tins were delivered, many of them were found to be rusty or broken. The insurer rejected the insured's claim on the basis that the warranty was breached. The court held that lack of such marks on many of the tins amounted to a breach of warranty and the insurer was not liable. In *Yorkshire Insurance Company v Campbell*,¹ the horse insured for the transit by sea was misstated to be a certain pedigree. The Privy Council held that this was a warranty and it had been broken. Lord Summer observed that the pedigree of the horse was material as a horse of one particular pedigree might be more vulnerable to the sea than the other. This does not sound very convincing. Admittedly, this literal compliance rule is a 'double-edged sword'. Initially, it was supposed to stand in favour of the insured. However, it is now more often than not used to defeat liabilities as a technical defence in favour of the insurer.

Nonetheless, there is one limitation on this rule. In *Overseas Commodities Ltd. v Style*,² McNair J also states that:

Being satisfied that, as regards both policies, a substantial number of tins—well exceeding any tolerance that could be disregarded under the *de minimis* rule—were not marked with a code which enabled the true and correct date of manufacture to be established, I have no option to hold that the breach of the express warranty affords the underwriters a complete defence in this action.³

Thus, had only one tin out of a thousand not been stamped in accordance with the warranty, the warranty would not be held as broken. It is suggested that this strictness of the present law of warranties is not necessarily authorised by the earliest decisions.⁴ It must be true in view of those 18th century decisions where the facts in litigation were in any event material for the purpose of the duty of utmost good faith, and where the cases could equally well have been decided on that ground. That said, in those early decisions, the effect of breach of present warranty was regarded as avoidance of contract, which was the same as breach of the duty of utmost good faith.⁵

Causation between loss and breach not required

It is common ground that some breaches of warranty are causative of the loss and some

¹ [1917] A C 218

² [1958] 1 Lloyd's Rep. 546

³ *Ibid*, at 558.

⁴ Merkin, *Colinvaux & Merkin's insurance Law*, loose-leaf, B-0134

⁵ *De Hahn v Hartley* (1789) 3 TR 360

are not. However, the element of causation between loss and breach of warranty has been irrelevant in the defence of warranties since the very early days of marine insurance.¹ This proposition was consistently confirmed in numerous modern authorities.

The point was clearly made in the case *Forsikringsaktieselskapet Vesta v Butcher*² The policy had a warranty that there would be a 24-hour watch over the insured fish farm. One night all the fish were swept out of the farm by a heavy storm, and there was no watchman on duty as warranted. Although it was acknowledged that no watchman could prevent the loss in any event, the House of Lords held that under English law the insured's failure to maintain such a watch discharged the underwriters from their liability. Lord Griffiths commented with regret in his judgment that 'it is one of the less attractive practices of English law that breach of warranty in an insurance policy can be relied on to defeat a claim under the policy even if there is no causal connection between the breach and the loss.'³

However, so far as marine insurance is concerned, the position of English law is still unchanged. In *Brownswille Holdings Ltd v Adamjee Insurance Co. Ltd (The Milasan)*,⁴ the insurer suspected that the yacht was deliberately scuttled by the claimant and therefore rejected his claim. He denied liability on many grounds and one of them was breach of warranty requiring professional skippers and crew to be in charge of the yacht at all times. The court dismissed the claim on the ground of scuttling. Nonetheless, Aikens J also held that the insurers were entitled to win on the breach of warranty point in any event.⁵ It was made clear that English marine insurance law still does not require any causal link between breach of warranty and loss.

Breach cannot be excused or remedied

The modern law also does not have regard as to whether the breach of warranty is without fault, or even knowledge, of the insured, or owing to someone else's fault. It even does not matter whether the breach of warranty is under his control or not. The principle of frustration has no application in the context of warranty.

However, there are two situations where a breach of warranty can be excused. By virtue of section 34(1) of the MIA 1906, non-compliance is excused when a change of circumstance renders a warranty inapplicable to the circumstances of the contract or compliance becomes

¹ *Panson v Watson* (1778) 2 Cowp. 785, 788

² [1989] 1 Lloyd's Rep 331

³ *Ibid*, at p.335 The case was actually a reinsurance case and the House of Lords held that the warranty in the reinsurance contract should be given the same effect as it was in the direct policy, which was governed by the Norwegian law, under which breach of warranty does not make the policy null and void unless it is operative to the loss.

⁴ [2000] 2 Lloyd's Rep 458

⁵ *Ibid*, at 467.

unlawful. The basis of this rule dates back to the early authorities.¹ However, there are no modern cases that applied these rules. In *Agapitos v Agnew (No 2) (The Aegeon)*,² the point was argued but the court rejected the application of this rule suggested by the insured. In the case, the vessel was moored to undergo conversion from a roll-on roll-off car ferry to a passenger cruise. During the process, the vessel had been towed and moved from one anchorage to another. Shortly after that, sparks from the welding ignited and caused fire which rendered the vessel a total loss. It was common ground that the vessel was lost by an insured peril, but underwriters declined liability on the grounds that the owners were in breach of one or more of the policy warranties in its initial cover and renewals. One of the alleged breaches of warranties was that the LSA certificate required at the initial cover was a continuing warranty, and it expired shortly after the inception of risk and was not renewed. The insured contended that the moving of the vessel was a change of circumstance which rendered the warranty inapplicable. Moore-Bick J held that the circumstances to which the warranty had been directed had not changed irrespective of the vessel's location.³

Moreover, the modern law still enforces the rule that even if the breach of warranty has been remedied before the loss, the insurer is still entitled not to pay the claim. No doubt, this rigid rule is not in tune with modern commercial values. As a result, the modern law finds itself in a dilemma: on the one hand, it is confined by s. 34 of the MIA 1906 and early authorities; on the other hand, it tries to construe warranties as some other terms of a different nature. In *Kler Knitwear Ltd v Lombard General Insurance Co Ltd*,⁴ the sprinkler was warranted to be inspected within 30 days of renewal of the policy. No inspection had been carried out as required by that date, but there had been an inspection over 60 days later than required. After the delayed inspection, a storm took place and caused substantial loss to the insured. The insurer relied on the breach of warranty and denied liability. The court found the draconian nature of warranties made little commercial sense in the case and it would be absurd if the insured's claim was barred simply because an inspection had been carried out late. Therefore, they construed the term not as a warranty, but as a suspensive condition, by which the risk is suspended during any period of non-compliance. In a sense, this method of construction counters the notion that a breach of warranty cannot be remedied.⁵

¹ *Hore v Whitmore* (1778) 2 Cowp. 784; *Epsito v Bowden* (1857) 7 E. & B. 763

² [2003] Lloyd's Rep IR 54

³ *Ibid.*, at [59]

⁴ [2000] Lloyd's Rep. I.R. 47

⁵ See below p.56.

6.2 Automatic Discharge of Liability

As to the effect of breach of warranties, the MIA 1906 provided that it would discharge the insurer from liability subject to express provision in the policy. As said earlier, this point of law was quite obscure in those early authorities and even in those cases decided after the MIA 1906. In general, it was believed that once the warranty was breached, the underwriter would not be liable for the loss. That said, in some earlier authorities, it was held that a breach of warranty avoided the insurance contract in much the same way as a breach of the duty of utmost good faith. After the enactment of the MIA 1906, it had never been an issue for the courts to consider how exactly the insurer became not liable for the losses and it is conventionally believed that the insurer was entitled to elect to terminate the insurance upon breach of warranties.¹ In *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)*,² the House of Lords was subjected to an examination of the meaning of the MIA 1906 and their decision was regarded as a landmark in the modern law of marine insurance warranties.

The Good Luck case

In *The Good Luck*, the ship of that name was insured with the defendant club and mortgaged to the claimant bank. As required by the mortgage, the benefit of the insurance was assigned to the bank, and the club gave a letter of undertaking to the bank, whereby the club promised to advise the bank promptly if the club ceased to insure the ship. The ship was sent to the Arabian Gulf in breach of warranty under the insurance, was hit by Iraqi missiles and became a constructive total loss. Both the club and the bank knew of the loss but, whereas the club discovered the breach of warranty, the bank did not investigate the possibility. In the mistaken belief that the loss was covered, the bank made further loans to the shipowners. In view of the breach of warranty, the insurance could not be enforced, and the bank sued the club for having failed to give prompt notice on the fact that they had ceased to insure the ship. The trial judge upheld the bank's argument that the insured's breach of warranty had brought the risk to an end automatically and therefore the club was in breach of his contractual obligation in their letter of undertaking.³

However, the Court of Appeal, after reviewing the pre-1906 authorities, reached the conclusion that prior to 1906, breach of warranty did not automatically bring the risk to an end, and the 1906 Act, as a codification of the case law, had not intended to effect any change

¹ Law Commission: (1980) Report No. 104, para 6.6

² [1992] 1 A.C. 233

³ [1988] 1 Lloyd's Rep 514

to that position.¹ In the House of Lords, Lord Goff disapproved with the conclusion of the Court of Appeal. He held that an automatic discharge of liability was clearly intended in the plain words of the MIA 1906, s.33 (3) and the risk came to an end automatically upon the breach of warranty and the club was therefore in breach of its obligations to notify the bank.

Condition Precedent

As to the nature of a warranty in marine insurance, in the House of Lords, Lord Goff determined to ‘put the law back on the right path’.² He held that:

[I]f a promissory warranty is not complied with, the insurer is discharged from liability as from the date of breach of warranty, for the simple reason that fulfillment of the warranty is a condition precedent to the liability of the insurer.³

In the judgment, Lord Goff used the term ‘promissory warranty’ to refer to insurance warranties, but he was only referring to those warranties relating to the future of the contract, viz., continuing warranties, of which type was litigated in the case.⁴ He based his reasoning on the *Thomson v Weems* case,⁵ where Lord Blackburn held that compliance with warranties relating to the existing circumstances at the inception of the risk, viz., present warranties, is a condition precedent to the attaching of the risk. It is a pity that neither Lord Blackburn in the *Thomson v Weems* nor Lord Goff in *The Good Luck* could have made a complete exposition of the nature of warranties. Due to the English legal method, they were both constrained to the disputed warranty in their individual cases respectively. In his exposition of the nature of warranties, Lord Goff used the term ‘condition precedent’ to formulate his reasoning. He acknowledged that it is an ‘inveterate practice’ in marine insurance of using the word ‘warranty’ signifying a ‘condition precedent’. Then he clarified that in his use of ‘condition precedent’, the word ‘condition’ was used in its classical sense in English law, i.e., the coming into existence of (for example) an obligation, or the duty or further duty to perform an obligation is dependent upon the fulfillment of the specified condition. Put simply, the word ‘condition’ is used here in its contingent sense. Bearing this in mind, what Lord Goff meant is that insurer’s liability is contingent upon the insured’s compliance with the warranty. He was

¹ [1989] 2 Lloyd’s Rep. 238

² Malcolm Clarke, *The nature of warranty in contracts of insurance*, [1991] Cambridge Law Journal, 393-394

³ [1992] 1 A.C. 233, at pp. 262-3

⁴ To date, it is shared by the judiciary and the academia that the term ‘promissory warranty’ was used in the MIA 1906 as a collective term, embracing both present warranties and continuing warranties. As to continuing warranty and present warranty, see more discussion below at p.103

⁵ (1884) 9 App. Cas. 671

right on this point and this gave an excellent footnote to the MIA s.33 (3), where the word ‘condition’ was used without a clarified meaning. It is now clear that the word ‘condition’ is used in its contingent sense in the 1906 Act and it is completely different from the concept of ‘condition’ in general contract law, which means a major term of contract breach of which entitles the innocent party to terminate the contract.¹

However, it is to be noted that, it is the fulfillment of the warranty, not the warranty itself, that is a condition precedent to the insurer’s liability. This clarifies the confusing definition of warranty in s.33 (3) of MIA 1906. On this point, Lord Goff correctly declared what the common had always been and what the Act has really meant.

Termination of risk

As to the effect of breach of warranty, Lord Goff started with s.33 of the Marine Insurance Act 1906 and said that:²

Those words are clear. They show that discharge of the insurer from liability is automatic and is not dependent upon any decision by the insurer to treat the contract of insurance as at an end.

However, it might be argued that the words of s 33(3) of the MIA 1906 are not clear. They did not express the nature and effects of breach of warranty very clearly. The word ‘discharge’ is used in a passive voice in section 33(3). From a syntax view, it might be read to mean either that the discharge is operative automatically or that the discharge is at the insurers’ election. In fact, the word ‘discharge’ was and is still loosely used in many insurance occasions to mean that the insurer is no longer liable. Indeed, the Court of Appeal referred to an earlier draft of the 1906 Act which said ‘if it be not so complied with, the insurer may avoid the contract as from the date of the breach of warranty, but without prejudice to any liability incurred by him before such date’. They also referred to some notes to the Marine Insurance Act 1906, where the draftsman M. D. Chalmers himself wrote that:

It is often said that breach of a warranty makes the policy void. But this is not so. A void contract cannot be ratified, but a breach of warranty in insurance law appears to stand on the same footing as the breach of a condition in other branch of contract.³

¹ *Sale of Goods Act 1979*, s.11

² [1992] 1 A.C. 233, p 264.

³ M. D. Chalmers, *The Marine Insurance Act 1906*, 2nd ed. (1913), at p. 53.

Lord Goff, delivering the leading judgment of the court, disagreed with the Court of Appeal on this approach to the construction of s 33(3). He held that the previous draft was inadmissible as an aid to the construction of the Act. In his holding, Lord Goff held that s 33(3) was a codification of the common law, and in that way the warranty rule was treated as having been in existence since 1189¹ and was codified without change in 1906. If this is true, it means that the position of English law has always been that any breach of warranty automatically discharges the insurer from his liability. With respect, his understanding of the common law on this point was not well grounded and it is a pity that he cited no authority to support his own view.

It is well accepted that the MIA 1906 was a codification of the English common law on marine insurance. The approach taken to the interpretation of that type of legislation was established in *P Samuel & Co Ltd v Dumas*,² where Viscount Finlay stated that:

The law has been codified by such an Act as this, the question is as to the meaning of the code was shown by its language. It is, of course, legitimate to refer to previous cases to help in the explanation of anything left in doubt by the code, but, if the code is clear, reference to previous authorities is irrelevant.³

That said, the meaning of ‘discharge’ in s 33(3) is indeed ambiguous. Hence, previous authorities should be referred to so as to ascertain its meaning. Indeed, the common law authorities did not tell us that breach of warranty triggered an automatic discharge of liability.⁴ None of the pre-1906 authorities actually dealt with the point of automatic discharge, as all that really mattered in those cases was that the assured had no claim if there was a breach of warranty. By 1906, it was conventionally held that the effect of breach of warranty was avoidance of the contract. The English judiciary continued to hold this view even after the 1906 Act. In the two law reform evaluation reports that the Court of Appeal referred to,⁵ it was held that breach of warranty has the same effect as breach of condition in contract law, which entitles the insurer to repudiate the policy. According to this view, the breach of an insurance warranty should be accommodated into the general contract law concept of repudiatory breach which triggers no automatic discharge but merely affords the innocent

¹ The history of English common law is dated back to 1189 when Henry II came to the throne.

² [1924] AC 431

³ *Ibid*, at 45. See also *The Governor and Company of the Bank of England v Vagliano Brothers* [1891] AC 107, at 144-5, *per* Lord Herschell.

⁴ See above p. 10.

⁵ *Conditions and Exceptions in Insurance Policies*, (1957) Cmnd 62; *Insurance law: Non-disclosure and breach of warranty*, (1980) Cmnd 8064

party the right to accept the breach, and such acceptance prospectively discharges the parties from future performance of the primary contractual obligations.¹ Put simply, a breach of warranty only gives the insurer a right to affirm the contract or accept the wrongful repudiation and terminate the contract. Therefore, the insurer must make a decision and also let the decision known to the insured. It is submitted that all the commentators and the two Law Reform reports based their reasoning on the pre-1906 authorities, without consideration of the wording of the Act and later cases.² However, it is quite ironic that all the authorities in those books and reports had been carelessly ignoring the wording of the Act when they considered the English law position to the effects of breach of warranty, if this submission is true. As noted, in the earlier authorities and cases after the 1906 Act, what the insurers actually did was to refuse to pay under the policy and rescind or avoid the insurance contract. In this sense, the insurer is discharged from his liability by way of the rescission of the contract which is achieved by the unilateral election of the party entitled to rescind by notice to the other party, without court intervention. Therefore, proceeding on the authorities of common law, the Court of Appeal was right in saying that breach of a warranty entitled the insurer to elect to terminate the contract. Nonetheless, what the House of Lords said in *The Good Luck* is to be taken as law until it is overturned by Parliament or the House of Lords itself should another case turn on it and the House of Lords can be persuaded that it was plainly wrong in *The Good Luck*.

Under *The Good Luck*, breach of warranty discharges the insurer from his liability automatically, as the cover ceases to be applicable and the risk terminates. The implication of this effect on the insurance contract is stated to be:

What it does is (as section 33(3) makes plain) is to discharge the insurer from liability as from the date of breach. Certainly, [it] does not have the effect of avoiding the contract *ab initio*. Nor, strictly speaking, does it have the effect of bringing the contract into an end. It is possible that there maybe obligations of the assured under the contract which will survive the discharge of the insurer from liability, as for example a continuing liability to pay a premium. Even if in the result no further obligations rest on either party, it is not correct to speak of the contract being avoided; and it is, strictly speaking, more accurate to keep to the carefully chosen words in section 33 (3) of the Act, rather than to speak of the contract being brought to an end, though that may be the practical effect.³

¹ *Heyman v Darwins Ltd.* [1942] A.C. 356; *Photo Production Ltd. v Securicor Transport Ltd.* [1980] A.C. 827

² Baris Soyer, *Warranties in Marine Insurance*, (2006), pp. 146-147

³ *The Good Luck*, [1992] 1 AC 233, at 263

What Lord Goff said distinguishes the insurance warranty from the general condition in contract law: the latter, if broken, gives rise to both damages and discharge, but the discharge occurs only on the election of the aggrieved party, whereas in marine insurance breach of warranty operates as an event which automatically discharges the insurer, rather than merely giving the insurer the option to terminate the contract by election. It operates automatically, without any necessity for the insurer to make the election and let the election known to the insured.

The House of Lords did not list all the effects that an automatic discharge could have on the insurance contract. The effects he mentioned are only illustrative but not exhaustive. One thing that is obvious is that the insurance warranty does not have the normal effect of breach of contract as in general contract law. It is a peculiar breach of contract: it is neither a repudiatory breach nor a non-repudiatory breach, and therefore its effect is neither repudiation of the whole contract, nor does it sound in damages.¹ Its peculiarity lies in that the rights and obligations between the insurer and the insured prior to the breach are not affected; the contract is not terminated at the point of the breach, either, because some parts of the contract are still binding on the parties. The real effect of breach of warranty in the context of marine insurance is that the insurer is not liable for any loss incurred by the assured after the breach. It is worth mentioning that *The Good Luck* only applies where the risk has incepted and the warranty is subsequently broken; it does not apply where the warranty relates only to existing circumstances at the inception of the risk. In that case, the common law rule in *Thomson v Weems*² should apply instead.

7. Conclusion

The English law of marine insurance warranties started from the primitive concept of statements descriptive of the risk which formed the basis of the insurance policies and later developed into a mechanism, which enforces a strict compliance and automatic discharge upon breach. The nature of it has always been held to be a condition precedent, which is used in the contingent sense. It was first held to be a condition precedent to the contract, but later it was held to be a condition precedent to the attachment of the risk. As to the effect of breach of warranties, it has now been settled in *The Good Luck* that the insurer is automatically discharged from further liability from the time of breach, though it is not an easy decision for the insured to accommodate.

¹ See below at p. 46

² (1884) 9 App. Cas 671, 684

It is to be noted that in *The Good Luck* Lord Goff did say that ‘the rationale of warranties in insurance law is that the insurer only accepts the risk provided that the warranty is fulfilled’. This affirmed that the original purpose of the doctrine of warranty is to build a link between the risk and the warranty. What really matters is how the breach affects the risk.¹ That should be the real concern. In this connection, causation and materiality should be relevant. In doing so, the existence of warranties in marine insurance law will be more justified and the insured will be less likely to lose his cover for some trivial breach of warranty. Fortunately, the trend of law is already going in this direction, at least in the non-commercial and non-marine insurance contracts.²

¹ Cf. Dr Susan Derrington submitted in her PhD thesis that insurance is impliedly made on a particular basis, which may also be partly express, and that a change of risk which amounts to a departure from that basis will provide certain remedies for the insurer. *The law relating to non-disclosure, misrepresentation and breach of warranty in contracts of marine insurance: a case for reform?* PhD thesis 1998, University of Queensland.

² *Hussain v Brown (No.1)* [1996] 1 Lloyd’s Rep 627; *Printpak v AGF Insurance Ltd* [1999] Lloyd’s Rep IR 542; Insurance Conduct of Business Rules regulated by the Financial Services Authority (FSA) under the *Financial Services and Markets Act 2000*.

Chapter 2

THE CURRENT STATE OF MARINE INSURANCE WARRANTIES IN ENGLISH LAW

It is accepted that *The Good Luck* is a landmark decision in the law of marine insurance warranties. However, it is far from sufficient to resolve all the issues of insurance warranties. On the contrary, it left behind outstanding uncertainties. Can breach of a warranty be waived? How could the insurer discharge his entire liability under the policy when the breach is only related to a certain type of risk? In the meantime, *The Good Luck* has also been applied to non-marine insurance contracts in recent years, and the insured in consumer insurance contracts are crying out for fairness in this area of law. Indeed, the courts have shown a willingness to take a liberal stance in their decisions on a certain number of issues on warranties, but most of these decisions are related to non-marine insurance contracts. Nonetheless, as it is now settled that the law of warranties is generally the same in marine and non-marine insurance,¹ those non-marine insurance cases could be considered as stating general principles for warranties in both marine and non-marine insurance contracts. These cases illustrate the draconian nature of warranties and the courts' creativity and willingness to protect the insured by way of judicial constructions of contracts.

1. The Applicability of *The Good Luck*

The Good Luck was a marine insurance case. In the years after the case, the court was asked to consider whether the rule in *The Good Luck* was applicable to non-marine insurance cases. The significance of this is that if it has a general applicability, the law of insurance warranties will be generally considered as the same whether it is in a marine or non-marine context. It seems that this is a straightforward point for the courts.

1.1 General Application to both Marine and Non-Marine Insurance

In *Hussain v Brown*,² an insured obtained property insurance for his commercial premises. The property was damaged by fire, but the insurer denied liability for a breach of intruders alarm warranty. For the purpose of present discussions, it is of interest that Saville L.J.

¹ The major difference between marine and non-marine insurance warranties is that there is no implied warranty in a non-marine insurance contract.

² [1996] 1 Lloyd's Rep. 627

acknowledged the consequences of a breach of a continuing warranty was an automatic cancellation of cover and the fact that the loss had no connection with the breach was simply irrelevant. He said that:

It must be remembered that a continuing warranty is a draconian term. ... the breach of such a warranty produces an automatic cancellation of the cover, and the fact that a loss may have no connection at all with that breach is simply irrelevant.

This reasoning confirms that the House of Lords decision in the *The Good Luck* also applies to non-marine insurance cases. The decision *Hussain v Brown* was followed in *Printpak v AGF Insurance*.¹ Here, the insured was covered under a 'commercial inclusive policy' which comprised a number of sections, each of which afforded an insurance cover of different risks. The contested burglar alarm warranty was incorporated by endorsement into the policy under section B, the section covering the risk of theft. It was common ground that the burglar alarm warranty was breached. Later, the insured's property caught fire and sustained loss and damage. In the policy, fire was a risk covered under section A. The Court of Appeal acknowledged that the effect of s.33 (3) of the MIA 1906 was that any breach of warranty will bring the risk automatically to an end. The decision implied that the House of Lords decision in *The Good Luck* as to the meaning of Section 33 (3) of MIA 1906 also applied to non-marine insurance cases.

Most explicitly, in the recent film finance insurance case *HIH Casualty & General Insurance Ltd v Axa Corporate Solutions*,² the same stance was taken by the court. The case was one of a series of cases on insurance for film finance. Here, the insurer HIH had agreed to insure a number of persons who had invested in the production of films. Then, HIH in turn reinsured its liability with a number of reinsurers, including AXA. In the direct policy, there was a term which mentioned that a certain number of films were to be made so as to generate the revenue. There was a failure in the production and this therefore caused a shortfall in the number of films that were actually produced. In an earlier litigation, the Court of Appeal in *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co*³ held that the number of the films mentioned in the policy were express warranties.⁴ As to the effect of this, in the instant case, Mr. Sher Q.C said that:

¹ [1999] Lloyd's Rep IR 542

² [2002] Lloyd's Rep IR 325

³ [2001] Lloyd's Rep IR 396

⁴ [2001] 2 Lloyd's Rep 161

The moment that breach occurred the insurance cover was automatically discharged without any action or election by the insurer (or reinsurer) to accept the breach as a repudiatory breach discharging the contract of insurance (or reinsurance). This is the effect of the decision in the House of Lords in the 'Good Luck'. That of course was a decision based upon the Marine Insurance Act 1906. It is, however, common ground before me that this principle of automatic cessation of cover on breach of a promissory warranty in an insurance or reinsurance contract is not restricted to policies in the field of marine insurance and applies in the instant case to the insurances the subject of this litigation.

Thus, it is now settled that the law of warranties are generally the same in both marine and non-marine insurance contracts. In view of this, non-marine cases will be cited to illustrate the law of insurance warranties in the following discussions in this work.

1.2 Retrospective Application to Contracts Concluded before The Good Luck

One interesting case in this area is *Kumar v AGF Insurance*.¹ It raised the issue whether the House of Lords decision in *The Good Luck* was applicable to litigation arising from contracts concluded before the decision. In *Kumar v AGF Insurance*, under an excess liability insurance policy for a partnership of solicitors, one of the partners was alleged to have acted in a fraudulent fashion, rendering the partnership liable for £2 million and the claimant therefore sought to recover the second million under the excess liability insurance policy with the defendant insurers. The defendants denied liability on several grounds, including that a failure to correctly answer question on the proposal form constituted a breach of warranty. The insured argued that the insurer's right to deny liability on the basis of a breach of warranty was circumscribed by the policy, in particular by clause 5 which stated:

NON-AVOIDANCE: Subject to Paragraph 13 the Insurers will not seek to avoid repudiate or rescind this Insurance upon any ground whatsoever including in particular non-disclosure or misrepresentation.

The defendant insurers argued that this clause was not applicable to a breach of warranty because, following *The Good Luck*, liability was discharged automatically, and they need not 'avoid, repudiate or rescind' the contract. This argument was comprehensively rejected by Thomas J. on a number of grounds. Thomas J. stated, inter alia, that the fact that this contract

¹ [1998] 4 All E.R. 788, QBD

was drafted prior to the House of Lords' decision in *The Good Luck* meant that it was likely that the parties intended clause 5 to restrict the right to deny liability on the basis of a breach of warranty. In rejecting the insurer's right to rely on the breach of warranty he stated:

In my judgment, it is clear that what the parties were doing in 1990 was stating that in whatever way the insurers sought to escape from liability, they were not entitled to do so. The words were and are, in my judgment, to be read as preventing the insurer escaping from liability either by repudiating avoiding or rescinding the policy itself, or being discharged from liability under the insurance because of a breach of warranty.

With respect, the reasoning here must be flawed. Indeed, the precedent of *The Good Luck* has a retrospective effect, since it states the law as it has always been. So the law in *The Good Luck* should apply to the instant case even though the contract was concluded before House of Lords decision.¹ Fortunately, with the lapse of time, the chance of another case turning upon this point would be very slim.

2. Waiver of Breach of Warranty

One of the difficulties left behind *The Good Luck* is the problem of waiver of breach. Under s 34(3) of the MIA 1906, a breach of warranty may be waived by the insurer. In the past, the rules of waiver found in relation to other kinds of contract applied in cases of waiver of breach of insurance warranties.² But the law has never been the same since *The Good Luck*. It is less clear in *The Good Luck* how the breach of warranty can be waived if the breach automatically discharges the insurer from liability. The House of Lords was not explicit on this point. As to s 34(3) of the MIA 1906, Lord Goff only said that the effect of this provision 'is that, to the extent of waiver, the insurer cannot rely upon the breach as having discharged him from liability.'³ During the years after *The Good Luck*, the court was asked to re-consider this point in many situations and the law has gradually become more settled in light of the decision in *HIH Casualty & General Insurance Ltd v Axa Corporate Solutions*,⁴ where the court held that waiver by election or affirmation was not applicable in breach of warranties and that the only way that a waiver of breach of warranty works is by way of waiver by estoppel.

¹ *Kleinwort Ltd v Lincoln Council* [1998] 4 All ER 513

² Clarke, *The Law of Insurance Contracts*, (2002), LLP, 20-7A

³ [1992] 1 A.C 233, at 263.

⁴ [2002] Lloyd's Rep I.R. 325

2.1 The Modern Law of Waiver

The modern law of waiver has undergone a dramatic change from the old common law.¹ A leading exposition of the notions of waiver in modern English law is provided by the House of Lords in *Motor Oil Hellas (Corinth) Refineries S.A. v Shipping Corporation of India (The Kanchenjunga)*.² This was a voyage charter-party case. The ship was ordered by the charterers to a port which was not prospectively safe. The owners accepted the order and proceeded there. While she was waiting there, there was an air raid and the master moved the ship to a point of safety. The owners called for another nomination but the charterers refused. The issue of real concern was whether the owners had waived completely the breach by the charterers in nominating an unsafe port, which would have deprived the owners of all remedies. In the House of Lords, the question took the form of an argument as whether the owners' proceeding to the unsafe port was an election or an equitable estoppel. Lord Goff said that:

There is an important similarity between the two principles, election [waiver] and equitable estoppel, in that each requires an unequivocal representation, perhaps because each may involve a loss, permanent or temporary, of the relevant party's rights. But there are important differences as well. In the context of a contract, the principle of election applies when a state of affairs comes into existence in which one party becomes entitled to exercise a right, and has to choose whether to exercise the right or not. His election has generally to be an informed choice, made with knowledge of the facts giving rise to the right. His election once made is final; it is not dependent upon reliance on it by the other party. On the other hand, equitable estoppel requires an unequivocal representation by one party that he will not insist upon his legal rights against the other party, and such reliance by the representee as will render it inequitable for the representor to go back upon his representation. No question arises of any particular knowledge on the part of the representor, and the estoppel may be suspensive only. Furthermore, the representation itself is different in character in the two cases. The party making his election is communicating his choice whether or not to exercise a right which has become available to him. The party to an equitable estoppel is representing that he will not in future enforce his legal rights. His representation is therefore in the nature of a promise which, though unsupported by consideration, can have legal consequences; hence it is sometimes referred to as promissory estoppel.³

¹ See generally Spenser Bower, *The Law relating to Estoppel by Representation*, 4th ed., Butterworths, 2004

² [1990] 1 Lloyd's Rep 391

³ *Ibid.*, at p 399. Here, the word 'election' refers to waiver, and 'promissory estoppel' emphasizes the promissory nature of estoppel. This is appraisable because they are more direct and easy to understand.

According to this account, there are two types of waiver. The first type of waiver is a form of election and it requires only a clear choice between two inconsistent courses of action with the party's knowledge of relevant facts that he has the right to do so. It is not sufficient for a party to a contract to have alternative courses of action; the courses of action must be inconsistent.¹ The second is a form of equitable estoppel and it requires at least some special circumstances indicating that it is inequitable to go back upon one's representation.² The former is now called waiver by election or affirmation; the latter is called waiver by estoppel. It will be recalled that in *The Good Luck*, it was argued that if the insurer was discharged from liability as from the date of breach it would be impossible for the insurer to make any election and therefore he could not be liable for any subsequent waiver. Lord Goff did not reason much on this point but said that 'when the insurer waives a breach of a promissory warranty, the effect is that, to the extent of the waiver, the insurer cannot rely upon the breach as having discharged him from liability'.³ In the light of *The Kanchenjunga*, what Lord Goff really meant was that the insurer was estopped from pleading that the insurance had terminated by reason of the breach of warranty if he so decided.

This modern concept of waiver by estoppel was a natural result of the fusion of law and equity. It is not estoppel in the strict sense. As is known, in legal history, the concepts of waiver and estoppel are different. Waiver is a concept in common law; and estoppel is rooted in equity. The modern concept of estoppel as a fusion of law and equity evolved from a line of authorities in the first quarter of the 20th century⁴ and was only recognised in 1946 in the leading case *Central London Property Trust Ltd. v High Trees House Ltd.*⁵ In the case, Lord Justice Denning, MR, as he then was, breathed 'new life into the doctrine of equitable estoppel'. He observed that 'promises intended to be binding, intended to be acted on, and in fact acted on', should be binding on the party making it, even though under the old common law it might be difficult to find any consideration for it and in that sense, and that sense only that such a promise gives rise to an estoppel.⁶ The newness of this modern concept of estoppel is that in the past a representation as to the future would not give rise to an estoppel unless it was embodied as a contract.⁷

¹ *Bolton Metropolitan Borough Council v Municipal Mutual Insurance Ltd* [2006] EWCA Civ 50, per Longmore L.J. at [31]

² *Societe Italo-Belge pour Le Commerce et l'Industrie v Palm and Vegetable Oils (Malaysia) Sdn. Bhd. (The Post Chaser)* [1982] 1 All E.R. 19 at pp.25-27

³ [1992] 1 A.C. 233, at 263

⁴ *Fenner v Blake* [1900] 1 Q.B 426; *Re Wickham* (1917) 34 T.L.R 158; *Re William Porter & Co., Ltd* [1937] 2 ALL E.R 361; *Buttery v Pickard* [1946] W.N 25

⁵ [1947] K.B. 130

⁶ *Ibid*, at pp.134-135

⁷ *Jorden v Money* (1854) 5 H.L.C 185

Therefore, the question arises. When the MIA 1906 was enacted, this modern concept of estoppel as a fusion of law and equity was not yet declared. Therefore, the 1906 Act could not have meant waiver by estoppel. With respect, Lord Goff's observation as to s 34 (3) in *The Good Luck* must be flawed. Nonetheless, as it stands, the law is that in the context of warranty, a waiver of breach is waiver by estoppel. Furthermore, at the law stands today, those earlier decisions where breach of warranties were held to be waived by election must now be viewed as illustrations of the application of the principle of waiver by estoppel.¹

2.2 Waiver of Breach of Warranty by Estoppel

The proposition of waiver of breach of a warranty by estoppel has been considered in a number of cases since *The Good Luck*. In *J Kirkaldy & Sons Limited v Walker*,² Longmore J, concluded that the principle of waiver by election plays no part in the law of warranties and the only issue is whether the insurers are, by their conduct, estopped from denying that they wished the warranty in question to be complied with by the insured. The same view was also expressed in *Brownsville Holdings Ltd v Adamjee Insurance Co Ltd*³ and *Bhopal v Sphere Drake Insurance*.⁴ It is now settled in the leading case *HIH Casualty & General Insurance Ltd v Axa Corporate Solutions*,⁵ where it formed the ratio of the decision that the only possible way to render a breach of warranty ineffective is by estoppel.

It will be recalled that, in *HIH v Axa*, the warranty of the number of films was broken. The reinsurer AXA argued that the warranty had been incorporated into the reinsurance agreement and breach of the warranty as to the number of films independently gave the reinsurers a defence against HIH. As to this point, HIH contended that prior to HIH making the payment for the claim, AXA had been aware of the reduction in the number of films but had taken no steps to do anything further about it. It will be recalled that it was not until the Court of Appeal in *HIH v New Hampshire* decided that there was a warranty as to the number of films that AXA appreciated that they had a defence based on breach of warranty. As to the point of waiver by estoppel, Deputy Judge Sher Q.C said in the most explicit language that:

The traditional common law concept of waiver by election involves a choice by the waiving party between two inconsistent courses of action. Outside the insurance sphere, when there has been a repudiatory breach of a promissory warranty by one party the other has a choice whether to

¹ *Weir v Aberdeen* (1819) 2 B & Ald. 320; *Holdsworth v Lancashire and Yorkshire Insurance Co.* (1907) 23 T.L.R. 521; *West v National Motor and Accident Insurance Union* [1955] 1 All E.R. 800

² [1999] 1 Lloyd's Rep 410, at 422-423

³ [2000] 2 Lloyd's Rep 458, at 467

⁴ [2002] Lloyd's Rep I.R. 413

⁵ [2002] Lloyd's Rep I.R. 325

accept the breach as discharging the contract or to waive it and affirm the contract. If he does not accept it the contract continues in force. That is an example of a true election between two inconsistent courses. In the case of an insurance contract, on the other hand, breach of the promissory warranty discharges the cover (though not, technically, the entire contract) automatically, without any action or election on the part of the insurer. There is no choice involved at all. There is no election to be made. So much comes out of the 'Good Luck' and is not disputed before me as applicable to the insurances and reinsurances here. It follows that waiver by election can have no application in such a case and the waiver, therefore, referred to in section 34(3) of MIA 1906 must encompass waiver by estoppel, the second of the two concepts above-mentioned, rather than waiver by election.

This reasoning is consistent with Lord Goff in *The Kanchenjunga*.¹ Here, it was made more explicit that waiver by election involves a choice by the innocent party between two inconsistent courses of action. In the context of breach of warranty, the insurer has no choice to make, as the breach operated to discharge the insurer automatically, without any action or election on the part of the insurer. In the absence of any choice, there could be no waiver by affirmation. Therefore, the only possibility of making a breach of warranty ineffective is by estoppel. As said, it is common practice to refer to this kind of waiver of breach of warranty as 'waiver by estoppel'. Though it is called waiver, but in nature it is equitable estoppel. One of the reasons for keeping the misleading use of 'waiver by estoppel' seems to be due to the fact that the wording in section 34 (3) of MIA is 'a breach of warranty may be waived by the insurer'. It is preferable to substitute the term of 'waiver by estoppel' with the term estoppel so as to use it in line with other branches of English law. But for the avoidance of further confusion, the following discussion will still use the term 'waiver by estoppel' as it is commonly used in today's law.

The idea of waiver by estoppel is that once a clear and unequivocal representation by a party is made that he will not rely upon his legal rights it would be inequitable for him to withdraw from his representation if the other party has acted in reliance upon such a representation. In *HIH Casualty & General Insurance Ltd v Axa Corporate Solutions*,² as there was no real prospect of waiver by election, it was open to HIH to demonstrate that AXA had represented that it would not rely upon the breach of warranty and that it would be

¹ [1990] 2 Lloyd's Rep 391

² [2002] Lloyd's Rep I.R. 325

inequitable for AXA to go back on its representation. As to the test for such a waiver by estoppel, Deputy Judge Sher Q.C observed that:

Waiver by estoppel or promissory estoppel, as it is more commonly described, involves a clear and unequivocal representation that the reinsurer (or insurer) will not stand on its right to treat the cover as having been discharged on which the insurer (or insured) has relied in circumstances in which it would be inequitable to allow the reinsurer (or insurer) to resile from its representation. In my judgment it is of the essence of this plea that the representation must go to the willingness of the representor to forego its rights. If all that appears to the representee is that the representor believes that the cover continues in place, without the slightest indication that the representor is aware that it could take the point that cover had been discharged (but was not going to take the point) there would be no inequity in permitting the representor to stand on its rights. Otherwise rights will be lost in total ignorance that they ever existed and, more to the point, the representee will be in a position to deny the representor those rights in circumstances in which it never had any inkling that the representor was prepared to waive those rights. It is of the essence of the doctrine of promissory estoppel that one side is reasonably seen by the other to be foregoing its rights. There is nothing improbable in such a foregoing of rights. It might, for example, be prompted by considerations as to the preservation of future goodwill.

Thus, there are two requirements for estoppel. First, there must be a clear and unequivocal representation that the insurer will forgo his right. Second, the insured must have relied upon such a representation. On the facts of the case, Deputy Judge Sher Q.C ruled that there was no waiver because there was no clear and unequivocal representation by the reinsurers that they would forgo their rights. In particular, he emphasised that it was not enough that the reinsurers were aware of the facts which constituted a breach of warranty—it was additionally necessary for them to be aware of the legal consequences which followed from that knowledge. However, the representor does not have to know what exactly the nature of his right is. This was a point appealed by HIH in the Court of Appeal.¹ The Court of Appeal upheld the first instance decision and in the only reasoned judgment, Tuckey L.J stressed that it was not necessary for the representor to have conveyed to the representee that he was aware of the precise legal right which had discharged it from liability, but that at the very least it was necessary for the representor to

¹ [2003] Lloyd's Rep I.R 1

have made a representation which indicated some awareness of its legal right not to pay.

Therefore, it is now settled that to qualify as a waiver by estoppel the insurer must know that there is a breach of warranty and beware that, as a matter of law, he has the right to treat the risk as terminated for breach of warranty but having this in mind, he would not rely upon the right. Put another way, the representation must indicate the willingness of the insurer to forgo his rights, because otherwise it would not be equitable to hold the insurers to their conduct as they could otherwise lose rights which they never knew existed.

In practice, such a representation relied upon by the insured will often arise by way of conduct. In *Youell v Bland Welch & Co. Ltd (No. 2)*¹ Philips J said that 'such a course of conduct will only constitute a representation that he will not exercise the right if the circumstances are such as to suggest that he was either aware of the right when he embarked on a course of conduct inconsistent with it or that he was content to abandon any rights that he might enjoy which were inconsistent with that course of conduct'. In *Brownsville Holdings Ltd v Adamjee Insurance Co Ltd (The Milasan)*,² the warranty was breached but the insurer did not raise the point until proceedings were brought before the court five years later. Indeed, after the breach of warranty, the insurer continued to accept installments of premiums from the insured. The court held that the acceptance of premiums was not a clear and unequivocal representation and the insured did not rely upon the fact of the insurer's acceptance of premiums as a waiver of breach of warranty. In *HIH Casualty & General Insurance Ltd v AXA Corporate Solutions*,³ AXA was aware of the fact that there was a shortfall in the warranted number of films and made queries to HIH, but said nothing afterwards. On the facts of the case, it was held that inaction was not an unequivocal representation because silence could only amount to a representation where there was a duty to speak.

Indeed, there are no practical criteria for the court to draw a line between an unequivocal representation and one that is not. It has been suggested that it should be judged by the 'reasonable person', but the 'reasonable person' test, as it always does, has many uncertainties. Under the current test, it is quite difficult for the insured to contest that the insurer's action or omission is a clear and unequivocal representation.

¹ [1990] 2 Lloyd's Rep 431, at 450

² [2000] 2 Lloyd's Rep 458

³ [2002] Lloyd's Rep IR 325

2.3 The Problem

Obviously, the current test leaves the insured rather disadvantaged in terms of burden of proof. The rationale of the rule of waiver of breach of warranty is to protect the insured from the harshness of the automatic discharge. Unfortunately, the current test for waiver of breach of warranty has almost made this impossible for the insured. It has been suggested that such a strict test is necessary, because otherwise rights could be lost in total ignorance that they have ever existed. However, it is valid to argue whether the insurer is over protected by such a strict test. It must be noted that the current test requires good communication between the insured and the insurer when they become aware of the breach of warranty; they must explicitly express their intended position about it and ideally convey their intention by express words rather than by course of conduct.

However, it can be easily predicted that this happens only in an ideal scenario. In commercial reality, chances are: either the insurer or the insured realises that there has been a breach of warranty and the legal consequences it brings, but simply prefers to keep silent until the claim or trial comes; or neither of them realises that there has been a breach of warranty until the claim comes. As the Court of Appeal noted in *HIH Casualty & General Insurance Ltd v Axa Corporate Solutions*,¹ if neither party had been aware that there had been a breach of warranty, establishing waiver would have been extremely difficult. In such a case, constructive knowledge would not suffice. In *Bhopal v Sphere Drake Insurance*² a breach of the warranty that no portable gas heaters would be stored on the premises was held not to have been waived by the fact that a loss adjuster appointed by the insurers had inspected the premises following a claim for flood damage and might have seen such a heater. Nonetheless, it does not mean there is no real prospect of raising such a defence in any case. In *American International Marine Agency of New York Inc v Dandridge*³ the marine policy contained a classification warranty under which the risk was to terminate automatically in the event that there was a change of class without the written consent of the insurers. The vessel's classification expired and was not renewed for six days. The following week, the leading underwriter Axa issued a written endorsement approving the change of class and reducing the agreed value of the vessel. Although the point ultimately did not fall for determination, Deputy Judge Siberry Q.C was of the view that Axa had waived the breach and reinstated the risk. Therefore, there is no fast and hard rule on this. It is all guided by the judges' commercial sense. Fortunately, the English judiciary has

¹ [2003] Lloyd's Rep I.R 1, at [22].

² [2002] Lloyd's Rep I.R 413

³ [2005] EWHC 829 (Comm)

never lacked this and handled the problem well in hard cases.

3. The Continuing Duty to Pay Premiums

3.1 General Rule

In English insurance law, a premium is deemed to be earned in full once the risk is attached and the premium is not returnable unless there is a total failure of consideration¹ or it is otherwise agreed in the policy.² This rule dates back to an 18th century authority.³ If the insurer has been at risk in any way or for any period, there is no entitlement at common law to a recovery of any part of the premium paid. The rationale of the rule is expressed by Lord Mansfield:

If that risk of a contract of indemnity has once commenced, there shall be no apportionment or return of premium afterwards. For though the premium is estimated, and the risk depends upon the nature and length of the voyage, yet, if it has commenced, though it be only for twenty four hours or less, the risk is run; the contract is for the whole entire risk, and no part of the consideration is returned; and yet, it is as easy to apportion for the voyage as it is for the time.⁴

The principle applies to situations where there is a breach of warranty. Needless to say, this rule can work unfairly in the context of continuing warranties. As the law now stands, when a continuing warranty is breached, the insurer is discharged from his further liability automatically. The risk comes to an end, but the contract still exists.⁵ The insurer is entitled to his rights, like asking for the payment of premiums.⁶ The ridiculousness of this point was graphically illustrated in *J. A. Chapman v Kadirga Denizcilik ve Ticaret*.⁷ Here, the premium was agreed to be paid in instalments. A provision in the policy was made in the following terms: 'warranted each instalment of premium paid to underwriters within 60 days of due dates.' The insured had fallen behind the payment. The Court of Appeal held that the late payment of a single installment was a breach of the warranty and the insurer

¹ Section 84(1), MIA 1906. In the context of insurance, there will be or might be a total failure of consideration when the policy is never concluded or is cancelled *ab initio*, or is void or voidable *ab initio*. cf. John Birds, *Modern Insurance Law*, 6th ed., London: Sweet & Maxwell, 2004, p 169

² MIA 1906, s. 83. In practice, the standard clauses used in the London market provide in clear terms that a pro rata daily return of premium shall be made when the insurance automatically terminates. e.g. Clause 4, ITCH 83 and Clause 14, IHC 2003.

³ *Tyrie v Fletcher* (1777) 2 Cowp 666

⁴ *Ibid*, at 668.

⁵ *The Good Luck* [1992] 1 A.C. 233; *Brit Syndicates Ltd and others v Italudit SpA and another* [2006] EWHC 341 (Comm)

⁶ *Ibid*, at 263.

⁷ [1998] Lloyd's Rep IR 377

was discharged from liability as from the date of the breach but the insured was still liable for the installments of premiums that had not become due at the date of the breach.

Therefore, in general, when the insurer is discharged from liability for breach of a continuing warranty, any undue installment of premium still needs to be paid.

Furthermore, there will be no refund of any premium that has been paid unless it is otherwise agreed. Although this sounds ridiculous, on the strength of the rule that the premium is not divisible and is fully earned as soon as the risk incepts, it has to be the position in English law.

3.2 The Difficulties

The general rule can cause some difficulties in particular cases. So far as litigation is concerned, real difficulties arise in the 'premium warranty' cases. As noted, this type of warranty requires that installments of premiums should be paid at certain dates or within a certain period of time after the inception of the risk. In *Chapman*, the facts of which were briefly mentioned above, Thomas J held that the premium warranty was a warranty and the purpose of it was to ensure that the underwriters were to be paid on time. On a construction of the policy as a whole, the judge held that it was made clear that if the underwriters did not receive the premium on the due date then there would be a breach of warranty with the usual consequence that would flow from that, and that the sole effect of the warranty would be to postpone the date at which the premium had to be paid for a period of time as stipulated in the policy. The Court of Appeal upheld the decision on this point. However, Thomas J. held that the premium was apportionable to successive periods of insurance, so that, a breach having occurred in respect of one period, installments in respect of subsequent periods did not become payable. In the Court of Appeal, Chadwick L.J disagreed on this point and held that the premium was an entire premium, payable in respect of the entire risk, though the policy provided that the premium would be paid in installments at three monthly intervals. Chadwick L.J thought Thomas J.'s holding on the premium being divisible was wrong for the following reasons:¹

[T]he Judge's error was in failing (i) to appreciate that, although the payment of premiums clause provided for there to be four installment payments, there remained only one single premium—as is made clear by the words 'if the premium is to be paid by installments'—and (ii) to distinguish between what it was that that one single premium was paid

¹ [1998] Lloyd's Rep IR 377

for—namely, the entire risk accepted by insurers under the policy—and the manner in which the premium was to be paid—by installments at three monthly intervals. In fact, the fact that the successive installments are due and payable on dates which occur at three months intervals during the term of the policy does not, in my view, lead to the conclusion that the premium, which comprises the aggregate of those installments, is itself divisible between successive three month periods.

With respect, it seems that Chadwick L.J made a short point here and it was largely a matter of impression, too. The reason why he thought the premium was an entire one in the case was not well grounded. The reasoning here is: if the premium was an entire one in respect of the entire risk, the breach of warranty would not render the installments of premiums that had not become due as of the date of breach unpayable. Obviously, this is a different approach from the trial judge. Here, the emphasis is whether the risk is severable or apportionable, whereas in the first instance, the emphasis is whether the premium is apportionable. Nonetheless, whether the risk is apportionable is purely a matter of construction of the policy. This point was recently illustrated in *Swiss Reinsurance Company and Others v Untied India Insurance Company Limited*.¹ It concerned insurance for a construction project. The insurance period was stated to be both a Construction period and a Maintenance period. In the process, the construction work came to a halt due to financial difficulties. The court held that there was a material alteration of risk which brought the contract to an end. On the construction of the policy, it was held that apportionability of risk was not in the contemplation of the parties when the wording was agreed and therefore there was only one premium covering all the risks throughout the whole period of construction and maintenance. As a result, no refund of premium for the Maintenance period was allowed. Thus, it seems almost impossible to argue that the premium is divisible and apportionable unless the insured and the insurer can reach an agreement outside the contract.²

Another issue raised in the *Chapman* case is the broker's duty to pay the premium. English law as contained in s. 53 (2) MIA 1906 is that the broker must pay the insurer whether or not the assured has himself paid the broker. It follows that the broker has a cause of action in his own right against the assured in respect of unpaid premiums. In the first instance, the insured argued that this rule had been ousted by the premium warranty and thereby the broker had no right to claim the premium. Construing the policy as a whole, Thomas J. held that the

¹ [2005] EWHC 237 (Comm)

² *Ibid*, at [68]. Morrison, J acknowledged in his judgment that: Frequently the parties will be able to reach a commercial arrangement whereby part of the premium is returned. But in making such a deal the parties are acting outside the policy terms.

premium warranty was not meant to have that effect. The Court of Appeal upheld the decision that although the brokers had not paid the premium or might never pay the premium to the underwriter, they were still entitled to claim the premium from the insured as their duty to pay the premium was not discharged after the breach of warranty. Now, *Chapman* is regarded as a leading case on the status of the broker as a 'common agent' for the assured and the insurer or as a principal in his own right. But the question left open in *Chapman* is what the remedies would be for the insured if he has paid the broker on time but the broker has not paid the premium to the underwriter when it is due.

4. Remedies Open to the Insurer for Breach of Contractual Terms

In general contract law, the remedies for breach of contractual terms are the alternatives of termination for repudiation or damages for breach. It is familiar to common lawyers that if a term goes to the root of the contract, its breach is by definition a repudiation; and if it does not, its breach simply gives rise to an action for damages.¹ However, there are terms which are not clear at the outset as to whether they go to the root of the contract and the effects of their breach are to be determined by the seriousness of its consequences on the contract. They are known as innominate terms.² If the breach of such a term is so serious that it amounts to repudiation, the innocent party may terminate the contract. By contrast, if the breach is not serious enough to qualify as a repudiatory breach, the innocent party can only claim for damages. Therefore, in order to ascertain the remedies for breach of a contractual term, it is necessary to classify the term first. Once it is classified, the related remedies apply.

4.1 A Dilemma in Insurance Contracts

In the field of insurance contracts law, this classification of contractual terms seems to be of little application. Terms in an insurance contract are normally classified into three categories: the promissory warranty³, the condition precedent⁴ and ordinary conditions⁵. And the effects of breach of these classes of terms are not the same as those in general contract law.

Under *The Good Luck*, any breach of a promissory warranty will bring the risk to an end

¹ This dichotomy is known as conditions and warranties. However, the word 'warranty' is used in a different sense to the insurance law field.

² *Hong Kong Fir Shipping Co. Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 Q.B 26

³ Here, the word 'promissory' is added to distinguish the insurance warranty from the general contract law warranty and warranty that is in fact exclusions. MIA 1906, s. 33 (1)

⁴ There are two types of conditions precedent in insurance contracts. One is the condition precedent to the attachment of the risk or validity of the contract; the other is the condition precedent to the insurer's liability. Here, for the present purpose, it is only the second type that is examined.

⁵ Here, the word 'condition' is used in the promissory sense that the conformity of the performance rendered with that promised. Cf. G.H. Treitel, *Conditions and Conditions precedent*, L.Q.R. 1990, 185-192, at 185.

and discharge the insurance from future liability, but without prejudice to any loss incurred before the breach. This is a remedy which is distinctively different from the remedies available in general contract law.

As for breach of a condition precedent, if the contract does not stipulate in clear terms the consequences, the general common law rule applies: the insurers are simply not liable to meet the assured's claim irrespective of the seriousness of the breach or the degree of prejudice caused to them, as the assured has failed to carry out his obligations to establish the insurer's liability.¹ If the condition precedent only relates to a specific claim, any breach will only render that claim lost but leave other claims unaffected. Therefore, the insured may recover for a second loss if he subsequently complies with the condition.² By contrast, if the condition precedent does not relate to a specific claim but is of general application, it is rather unsettled what the effects would be. The courts have shown an inclination that wherever possible, such a clause will be construed as divisible, allocating any breach to the affected claim rather than other claims. In *Kazakhstan Wool Processors (Europe) Ltd v Nederlandsche Credietverzekering Maatschappij NV*,³ the policy provided in Article 13 that: (1) Due payment of all premiums (and other charges) ... and the due performance and observation of every stipulation in the policy or the proposal, shall be a condition precedent to any liability on our part (insurers); (2) in the event of any breach of any condition precedent we (insurers) also have the right to retain any premium paid and give written notice terminating the policy and all liability under it. The insured ceased trading in May 1998 and accordingly failed to pay premiums and charges in respect of goods dispatched in May and June 1998. The insured made further claims under the policy in August 1998. The insurers rejected the new claims and gave notice terminating the contract. At first instance, Toulson J held that art. 13.1 did not relieve the insurers of all liability for all outstanding claims under the policy where the assured was in breach of one or more policy conditions and that, the proper interpretation of art. 13.1 was that the insurers were relieved from liability for any claim in respect of which the relevant conditions had not been complied with.

Nonetheless, the most difficult situation in insurance contracts is the breach of ordinary conditions. Sometimes, the consequences of breach of such a term will be spelt out in the policy. Be it not so, the common law rules apply and the consequences of its breach depend on the nature of the term in question. The general approach is to classify the term as an innominate term, so that the remedies for the insurers depend on the seriousness of the

¹ It is to note that conditions precedent concern both the order of performance and the conformity of performance rendered with that promised.

² *Hood's Trustees v Southern Union General Ins. Co of Australasia* [1928] Ch.793, 806

³ [2000] Lloyd's Rep. IR. 371

assured's breach and the seriousness of the consequences of the breach for the insurers. If the breach is trivial, the insurers have to meet the claim but have a right to recover damages from the assured for any loss suffered by them. By contrast, if the breach is serious then the insurers may have the right to treat the policy as repudiated, allowing them to terminate the policy.¹

Therefore, it will be appreciated that in insurance law, the concept of breach of contract has only limited application. For example, in the case of promissory warranties and conditions precedent, when the insured does not comply with the term required in the policy, the insured is not in breach of contract, as the only consequence of that failure is his inability to make a claim: the insurers have not suffered any loss which can give rise to damages. It will also be appreciated that in insurance law the remedies for breach of ordinary conditions are almost an all-or-nothing dilemma. Although the innominate term approach is also brought into application in insurance law,² the alternatives of termination for repudiation or damages for breach is worth very little: repudiation is rarely made out, and a claim for damages is equally unlikely to succeed.³

4.2 The Notion of Repudiation of Claims—An Intermediate Remedy?

This dilemma of an all-or-nothing remedy is striking in policies where the term is not expressed to be a condition precedent but seemingly has the capacity of being a condition precedent. In recent years, there has been a general judicial reluctance to treat a term as a condition precedent, considering that it may give rise to wholly disproportionate effects in respect of what is no more than a trivial matter. Some of the English judiciary have been more conscious than others of this dilemma of English insurance law and have re-considered the remedies for breach of insurance policy terms. This all happened in the context of construction of whether an ordinary condition in a policy is a condition precedent. The motive for the courts to explore other alternative remedies for breach of such a policy term is to avoid the consequences of condition precedents which could potentially operate in a draconian fashion. So far, it is arguable that the court has effectively made new law on this point.

¹ *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corporation* [2005] EWCA Civ. 601. It is to be noted that this is only possible in exceptional cases.

² *Phonix General Insurance Co v Greece SA v Habanon Insurance Co Ltd* [1985] 2 Lloyd's Rep. 599 at 614 Hobhouse J. held that the co-operation provisions were innominate terms by nature and therefore the consequences of any breach for any individual claim or, indeed, for the contracts as a whole, must depend on the nature and gravity of the relevant breach or breaches.

³ The only example of an award of damages is *Hussain v Brown (No.2)*, unreported, (1997) 9 ILM 4. See Merkin, *Colinvaux & Merkin's Insurance Contract Law*, looseleaf, B-0092.

In *Alfred McAlpine plc v BAI (Run-Off) Ltd*,¹ the assured under a public liability policy, failed to comply with the notification obligations contained in a claims condition and indeed was several months late in doing so. The relevant clause in the policy said: ‘in the event of any occurrence which may give rise to a claim under this policy the insured shall as soon as possible give notice thereof to the Company in writing with full details...’ The insurers contended that the insured’s failure to notify them as soon as the loss occurred constituted a breach of a condition precedent and the policy was repudiated. At first instance, Colman J. held that such a clause was not a condition precedent but an ordinary contract term, which had to be judged by its importance and effects and breach of such a term would not give the insurers a right to regard the entire policy as repudiated, but merely entitled them to damages set off against the amount of the claim providing that the insurers could prove that they had suffered loss from the lateness of the claim in breach of the condition. On appeal, the Court of Appeal upheld this decision but had some different views on the remedies available to the insurers for breach of policy terms. Delivering the only reasoned judgment, Waller L.J held that the clause was an innominate term. Furthermore, he also held that the consequences of a breach may be so serious as to entitle the insurers to reject the claim albeit the breach is not so serious as to amount to a repudiation of the whole contract. On the facts before them, the Court of Appeal held that there was no repudiation of the claim, as it could not be said that by making a late claim the insured had evidenced an intention not to make any claim at all or the lateness of the claim was such as to cause serious prejudice to the insurers. The court was of the view that the insured had merely infringed a lesser ancillary condition, of which the nature and gravity of the breach would only sound in damages. This is something new to the notion of innominate terms in insurance contracts. In *Phoenix General Insurance Co v Greece SA v Halvanon Insurance Co Ltd*,² Hobhouse J invented the notion of the innominate term in insurance contracts, but he did not really examine whether there was an innominate remedy between repudiation of policy and damages. The Court of Appeal felt that the law was open to the possibility that a condition could be regarded as one the breach of which would not repudiate the entire policy but just the claim itself and leave the rest of the policy unaffected.

It should be noted that Waller L.J’s analysis of innominate terms in *Alfred McAlpine* was only *obiter*. That said, the case finally did not fall on the point of repudiation of the claim but the court on the facts held that the remedy for the insurer was damages, which they had abandoned in their pleadings. Nonetheless, this novel analysis of innominate terms was

¹ [2001] 1 Lloyd’s Rep 437

² [1985] 2 Lloyd’s Rep. 599

applied in subsequent cases. In *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters*¹ and *Glencore International AG v Ryan (The Beursgracht)*,² the analysis of an innominate remedy of repudiation of a claim was applied, but both these cases were not ultimately decided on this point and therefore the principle was arguably to be regarded as the ratio of these cases. The only case in which the concept of repudiation of a claim has been applied to defeat the assured's rights is *Bankers Insurance Co Ltd v South*.³ The case concerned a travel policy. The assured was held to be in serious breach of a policy condition that required the assured to notify as soon as reasonably possible full details of any incidents that might result in a claim and the insurer was therefore not liable.

Waller L.J.'s analysis of repudiation of the claim was welcome but was also received with reservation by academic commentators.⁴ It is believed that it increased flexibility of remedies in insurance contracts but the legal basis for the rule is open to question. First, it is suggested that Waller L.J.'s reliance on the Australian reinsurance decision *Trans-Pacific Insurance Co (Australia) Ltd v Grand Union Insurance Co Ltd*⁵ was questionable. There was a facultative obligatory reinsurance contract which contained the phrase 'claims co-operation clause' without further elaboration as to the nature and extent of the duty. Giles J. held that such a duty was innominate in nature. It is submitted that it is not a good authority for the proposition derived by the Court of Appeal. Secondly, it is suggested that if the approach advanced in *Alfred McAlpine* is followed, breach of claim conditions would constitute a breach of contract. This would create much confusion and would be impractical in operation. An example was given to illustrate the problem of this approach. If an insured innocently advanced a claim believing it to fall within the cover offered, and it was later proven to fall within an exception, could the insurer recover for their wasted expenditure in processing the claim?⁶

Undoubtedly, the notion of repudiation of a claim has been controversial and its legal basis is not entirely clear. Nonetheless, it is inspirational in the thinking of remedies for breach of insurance terms, including warranties. The approach advanced in *Alfred McAlpine* certainly provides some fresh ideas to the law of insurance contracts, although the relationship between repudiation of a claim and repudiation of a policy is unclear. If the principle established in *Alfred McAlpine* stands as good law, it would be possible that the effect of breach of warranty

¹ [2001] Lloyd's Rep IR 802

² [2002] Lloyd's Rep IR 335

³ [2004] Lloyd's Rep IR 1

⁴ April 2002, ILM 14.4(8); Birds, *Modern Insurance Law* (2004), p.163; *MacGillivray on Insurance Law*, 10th ed., London: Sweet & Maxwell, 2002, para.10-13.

⁵ (1989) 18 NSWLR 675. The case was in part based on the English authority of *Phoenix General Insurance v Habanon Ins. Co. Ltd* [1985] 2 Lloyd's Rep. 599

⁶ James Davey, *Insurance claims notification clauses: innominate terms & utmost good faith*. (2001) J.B.L 179-190

or condition precedent is only a rejection of claims related to the breach.

4.3 The Flux of Current Law

Recently, there has been a twist in the law relating to the notion of repudiation of claims in insurance contracts. In *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corporation*,¹ the Court of Appeal expressed serious doubts upon the existence of the concept of repudiation of a claim. Here, the assured was found to not have given due notice to his liability insurers under a clause that was not expressed as a condition precedent to liability. The relevant clause in the policy says that ‘any claims(s) ... shall be notified immediately by the Assured in writing to the Underwriters hereon.’ At first instance, Moore-Bick J., applying the reasoning of *Alfred McAlpine*, held that the term was an innominate term and the assured’s breach was not sufficiently serious to amount to repudiation of the policy itself or of the claim. In the Court of Appeal, Mance L.J., with whom Sir William Aldous agreed, could find no basis in the law of contract for such ‘a new doctrine of partial repudiatory breach’. By a 2:1 majority, the Court of Appeal upheld Moore-Bick’s finding that the term was an innominate term but they refused to apply the reasoning in *Alfred McAlpine* to the instant case. They held that the reasoning in *Alfred McAlpine* was obiter and therefore was not binding. Mance L.J. stated that ordinary rules of contract should apply whereby a breach was either fundamental or minor and did not allow the innocent party the intermediate option of refusing to perform certain of his obligations. Unsurprisingly, Waller L.J., who also sat in this court, dissented on this point and reaffirmed his position in *Alfred McAlpine*. It is to be noted that the reasoning in *Friends Provident* was also arguably obiter.² The case turned on the finding that the relevant conditions had been complied with and there was no repudiation at all. It is suggested that it is perhaps too soon to say that the analysis in *Friends Provident* is to be given priority, given that the *Alfred McAlpine* had been applied in later cases.³ Indeed, Mance L.J. in *Friends Provident* commented that the reasoning in *Alfred McAlpine* has been applied in some subsequent cases like the *The Mercandian Continent* and *The Beursgracht* but it was not an element of the ratio in those cases and therefore was not binding precedents. Waller L.J., in his dissenting judgment, shied away from this argument. Therefore, it is still open to question which of the two cases was to be preferred.

In his judgment, Mance L.J. suggested that Waller L.J.’s reasoning in *Alfred McAlpine* must be flawed as it was inconsistent with the general law of contract. Mance L.J. acknowledged that

¹ [2005] EWCA Civ. 601

² John Lowry, *Insurance Law: Doctrines and Principles*, 2nd ed., Hart Publishing, 2005, p.207

³ Merkin, *Colimanx & Merkin’s Insurance Contract Law*, looseleaf, release 13, B-0095 November, 2005.

in general contract law, it is possible that a particular contract may be severable into separate parts and a breach of a severable obligation does not necessarily mean that the whole contract comes to an end.¹ However, if the contract is a composite one, unless there is an express or implied condition precedent or provision to that effect, no party to a composite contract such as the present one may be relieved from a particular obligation by reason of a serious breach with serious consequences relating to an ancillary obligation. This is rightly so. However, viewed from a different perspective, it is undeniable that repudiation of a claim is an already existing remedy in insurance contract law in the case of breach of a condition precedent. Indeed, Waller L.J was confused or wrong when he said that breach of such an innominate term might be so serious that it would not be capable of a repudiatory breach of contract but only leading to a repudiation of the related claim. He failed to address the difficulties that arise when standard contractual principles are applied to insurance contract law in such a way. In fact, had he not used the analogy of repudiatory breach of contract, his reasoning would have been less confusing and controversial.

Furthermore, Mance L.J also expressed the view that English insurance law is already strict enough as it is in insurer's favour and he saw no reason to make it stricter. This is a rather interesting point. It seems that Mance L.J did not fully appreciate the fact that Waller L.J's introduction of the intermediate remedy of repudiation of claim was indeed to lessen the strict law of an all-or-nothing solution for breach of insurance terms. It seems that Waller L.J and Mance L.J looked at the two sides of a coin from different perspectives. From Mance L.J's perspective, awarding damages for a breach of an ancillary provision is more lenient to the insured than a repudiation of the claim. By contrast, from Waller L.J's perspective, repudiation of claim is a more favourable remedy to the insured than a total repudiation of the entire policy. With the same good will, Waller and Mance L.JJ actually agreed on the point that current insurance law is too strict in the insurer's favor. However, it is a pity to see that they are divided in their approach to mitigate the strictness of the law. It seems that neither of them has achieved any success so far. Waller L.J's introduction of repudiation of a claim was not well grounded in the theory of general contract law. Nonetheless, Mance L.J's recommendation of a remedy of damages is theoretically sound but rather 'illusory' in commercial practice.²

For the time being, the law relating to the remedies for breach of an innominate policy term is still remarkably unsettled. Outstanding uncertainties exist as to which approach of the two different authorities in *Alfred McAlpine* and *Friends Provident* represents the law. A ruling of

¹ *Benjamin's Sale of Goods*, 14th ed., London: Sweet & Maxwell, 1992, paras. 8-073 to 8-076

² [2005] EWCA Civ 601, *per* Waller L.J.

a unanimous Court of Appeal or by the House of Lords on this point would be welcome.

5. The Construction of Marine Insurance Warranties

5.1 Two Aspects of Construction

The construction of insurance warranties raises questions at two levels. On the first level, the question is when a term can be construed as a warranty. As is known, judges have a significant role in the control of contract terms by the way they interpret and apply them. Rules adopted by courts for the construction of insurance warranties are mostly the same as those applied in general contract terms. The words used in a warranty should be construed in their plain, ordinary and popular sense.¹ The construction should take into account the commercial object or function in which the warranty is formulated.² Furthermore, the entire policy should be construed as a whole so as to find out the meaning of the warranty.³

A good illustration of applying all these principles is *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co.*⁴ The facts of the case have been examined above. For the purpose of discussion here, it is only necessary to note that clause A of the preamble of the policy provided: ‘... Flashpoint Ltd [a financier and co-producer] has invested or is in the process of investing in six revenue generating entertainment projects collectively known as ‘7.23’ where all the revenue generated thereby ... is due to be paid into the Collection Account...’. And in the substantive part of the policy, clause 2 defined the ‘Insured Perils’ as follows: ‘Insured perils means the failure to generate a balance in the Escrow Account as at the last day of the Policy Period equal to the Sum Insured, for any reason whatsoever. This definition includes, but is not limited to, the failure of the Projects to generate a balance in the Collection Account equal to, or in excess of, the Sum Insured...’. At first instance, David Steel J. found that any commercially realistic construction of this clause required completion of the films; otherwise the policy would be a cash performance bond to answer even if no films were made. The Court of Appeal took another approach but arrived at the same conclusion that the completion of the number of films was a warranty to be complied with. Rix L.J held that the test for a term to be an insurance warranty is threefold: (i) did the term go to the root of the contract; (ii) was it descriptive of the risk or did it bear materially on the risk; and (iii)

¹ *Thomson v Weems* (1884) 9 App Cas 671, p 687

² *The Milasan* [2000] 2 Lloyd’s Rep 458; *Agapitos v Agnew (No 2) (The Aegeon)* [2003] Lloyd’s Rep IR 54; *Eagle Star Insurance Co Ltd v Games Video (GVC) SA (The Game Boy)* [2004] 1 Lloyd’s Rep 238; *Tektrol Ltd v International Insurance Co of Hannover* [2005] EWCA Civ 845; *GE Frankona Reinsurance Ltd v CMM Trust No. 1400 (The Newfoundland Explorer)* [2006] EWHC 429 (Admlty).

³ *Cornish v Accident Insurance Co* (1869) 23 QBD 453; *Hamlyn v Crown Accident Insurance Co* [1893] 1 QB 750; *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896; *Sirus International Insurance Co (Publ) v FAI General Insurance Ltd* [2005] EWCA Civ 294; *Royal and Sun Alliance Insurance plc v Dornoch* [2005] EWCA Civ 238

⁴ [2001] 2 Lloyd’s Rep 161

would damages be an inadequate or unsatisfactory remedy for breach? The Court of Appeal held that failure of the films to generate specific revenue 'for any reason whatsoever' was the essence of the risk but, unless completed, the films could not become revenue generating. It is submitted that this reasoning is questionable, because there would still be revenue generated even if fewer than six films were completed and the revenue might not be inevitably less than what six films would generate.¹ Indeed, the ruling in *HIH v New Hampshire* is quite outstanding; it confirms that the absence of the word 'warranty' or 'warranted' is not conclusive that a clause is not a warranty. Thus, it must be said that all that matters is the true intention of the contracting parties when they created the clauses, and a clear wording which articulates the effect of the breach of the term in the policy will be greatly helpful for the court to give a proper construction to the contested terms in the policy.²

If there is any ambiguity of the nature of the term, the court would construe the term as something else rather than a warranty in order to avoid obvious injustice. A normal technique for the court to apply to achieve this is to construe the term as a suspensive condition, also known as a term delimiting the risk. The concept of suspensive condition is quite familiar in insurance contracts. Under such a condition, the insured is not on risk when the specified circumstances come into being. The insured is not in breach of contract nor can the insurer terminate the policy; the insurer is simply not to be liable for losses incurred during the period when the specified circumstances remain in being.³ At common law, this concept has long been used in construction of policy as a way of bypassing the harsh effect of warranties because the same term may be equally appropriate to the creation of either a warranty or a suspensive condition.⁴ In *Farr v Motor Traders Mutual Insurance society*,⁵ the claimants warranted that the insured taxi would be driven for only one shift each day. But for a short time, it was driven for two shifts. An accident happened after this practice ceased. It was held that the term was merely descriptive of the risk, so that the insured was entitled to recover for an accident which happened at a time when the term was being complied with. Subsequently, a line of authorities developed in this direction.⁶

A more recent illustration is found in *Kler Knitwear Ltd v Lombard General Insurance Co Ltd*.⁷

¹ Chris Nicoll, *HIH litigation*, L.Q.R. 2003, 119 (Oct) 572, p. 574

² *Toomey v Vitalicio de Espana SA de Seguros y Reaseguros* [2005] Lloyd's Rep. I.R. 423; *G.E Reinsurance Group v New Hampshire Insurance Co* [2004] Lloyd's Rep IR 404

³ *Re Hooley Hill Rubber and Royal* [1920] 1 K.B 254, at 274; *Lake v Simmons* [1927] A.C 487, at 507

⁴ It is suggested that this rule dates back to the 19th century cases on marine insurance, and in particular the situation in which a ship warranted seaworthy ceased to be so for a short period and then was once again restored to a seaworthy condition. *Insurance Law Monthly*, January 2000, p.6

⁵ [1920] 3 K.B 669

⁶ See also *Provincial Insurance Co. v Morgan* [1933] A.C 240; *De Maurier (Jewels) Ltd v Boston Insurance* [1967] 2 Lloyd's Rep 550; *CTN Cash & Carry Ltd v General Accident Fire & Life Assurance Corporation Ltd* [1989] 1 Lloyd's Rep. 299

⁷ [2000] Lloyd's Rep IR 47

The claimant insured its factory and contents against a variety of risks, including storm damage. A storm took place and the claimant sustained a substantial loss. The insurers denied liability relying on a sprinkler installation warranty which they asserted had not been complied with. The sprinkler installations warranty provided that: 'It is warranted that within 30 days of renewal 1998 the sprinkler system... must be inspected by the a LPC approved sprinkler engineer with all necessary rectification work commissioned within 14 days of the inspection report being received'. And General Condition 2 of the policy stated that every warranty was to '... continue to be in force during the whole currency of this Insurance and non-compliance with any such Warranty, whether it increases the risk or not, or whether it be material or not to a claim, shall be a bar to any claim in respect of such property or item...'. It was common ground in the case that an inspection had been carried out but it was over 60 days later than the required date. The only live issue for the trial judge was whether the sprinkler installations warranty was a 'warranty' in the strict sense of the word. Morland J. held that the sprinkler installations warranty was in fact a suspensive provision, the effect of which was that the risk suspended during any period of non-compliance. It was argued by the insurer that General Condition 2 had made it clear that clauses described as warranties should be exactly that. Morland J. rejected this argument by holding that General Condition 2 was concerned only with setting out the consequences of a breach of a true warranty, and had no effect on the initial classification of the term.

It is to be noted that this concept of suspensive condition is entirely a judicial device specifically aiming to overcome the harshness of the continuing warranty¹ and in particular the rule that once a breach of warranty has put an automatic end to the risk there can be no reinstatement of the risk. However, the underlying problem in this case was that the manner in which a clause could be construed was almost at the discretion of the judge and it is impossible to draw any conclusions from the authorities as to the criteria necessary to distinguish one type of clause from the other.

On the second level, the question is that once a term is construed as a warranty, how it can be construed in a limited fashion so as to mitigate the harsh effect that results. As noted, the effect of breach of warranty is established in *The Good Luck* as an automatic discharge of the insurer's further liability to any claim as from the date of breach; it does not repudiate the whole contract; nor does it even repudiate the claim. However, it has been argued that *The Good Luck* could be interpreted in two different ways as regards to the effects of breach of warranty. So far, the courts have adopted a purposive approach and construed warranties

¹ This device may also operate in a manner adverse to the insured's interests even though it was not devised for that purpose. See *CTN Cash and Carry Ltd v General Accident Fire & Life Assurance Corporation Ltd* [1989] 1 Lloyd's Rep 299.

narrowly. This is illustrated in the following three methods.

5.2 A Purposive Approach

Warranties as Divisible in Multi-Section Policy

It will be recalled that in *Printpak v AGF Insurance Ltd*¹ the warranty in question provided that a burglar alarm had been installed in accordance with the alarm company's specification and was fully operational at all times when the factory was closed for business. The insurers sought to plead breach of warranty relating to a burglar alarm in relation to a fire claim. The Court of Appeal was determined not to allow this result. It was common ground that the burglar alarm warranty had been incorporated into the policy and it had broken; the only question for the Court of Appeal was whether the warranty was applicable to the 'fire' section of the policy. The Court of Appeal affirmed the holding by the trial judge that the burglar alarm warranty was a specific term which had not been incorporated into the 'fire' section of the policy but confined to the 'theft' section only; therefore it applied only to the theft-related claims. The law seems to take the stance that warranties in insurance contracts have a divisibility perspective, by which the breach of warranty tied to a certain type of claims will only block future claims befalling the related type of perils and other claims otherwise unaffected. Nonetheless, within the certain related type of claims, the absolute nature of warranty is without any doubt. So it is still harsh for the insured when the claim is technically blocked irrespective of the absence of any connection between the loss and the minor breach of warranty.

However, the insured is not entirely helpless when it comes to the draconian warranties in the insurance contracts. The court has confirmed the possibility that contracting parties may oust the harsh effect of breach of warranty by clear terms in the contract. The best illustration is also *Printpak v AGF Insurance Ltd*. In the case, another argument by the insurer related to condition 5 of General Terms and Conditions in the insurance contract. That clause provided that: 'Failure to comply with any Warranty shall invalidate any claim for loss, destruction, damage or liability which is wholly or partly due to or affected by such failure to comply'. This must now be seen as a poorly considered argument by the insurer, for it actually helped the judge to decide in favour of the insured. In the only reasoned judgment, Hirst L.J held that the wording of condition 5 constituted an 'express provision' to water down the effect of s 33 (3) of the MIA 1906 by confining the insurers' right to rely upon a breach of warranty to the situation in which the loss was in full or in part due to the breach.

¹ [1999] Lloyd's Rep IR 542

A more recent illustration of this approach is *Bennett v Axa Insurance Plc*.¹ The case concerned a combined all risks policy on a restaurant. It was warranted that all trade waste be swept up and bagged daily by the end of the day's trading and removed to a secure disposal area. The policy also contained a general provision that related to all warranties, which provided that: '...Non-compliance with any such warranty in so far as it increases the risk of loss destruction or damage shall be a bar to any claim in respect of such loss destruction or damage...' Although the case did not finally fall on this point, the court was of the view that this clause removed at least a part of the sting from the warranty, in that non-compliance was not an absolute defence but could operate only where breach of warranty 'increase the risk of loss destruction or damage'.

Warranties not as Continuing to the Future

The distinction between a present warranty and a continuing warranty has been noted earlier in this work.² As is known, a present warranty relates to the state of affairs existing at the date of the conclusion of contract. By contrast, a continuing warranty relates to the future: the insured promises to do or refrain from doing something or that a state of affairs will or will not exist. The distinction is of obvious significance: a present warranty will not have an effect on the future breach. Once again, it is a matter of construction whether a term is a present warranty or a warranty extending to the future.

Not very long ago, the courts took the view that there was a presumption that warranties in fire and burglary policies as to the condition of the premises and precautions taken to prevent loss would *prima facie* be construed as continuing otherwise such warranties would be of little value to the insurers.³ However, there have recently been some twists regarding this point. In *Hussain v Brown (No 1)*,⁴ the claimant completed and signed a proposal form for a Lloyd's fire policy in respect of his commercial premises. Question 9 of the proposal form asked: 'Are the premises fitted with any system of intruder alarm?'

The claimant answered this question 'Yes'. The Court of Appeal held questions contained in proposal forms, albeit in the present tense, cannot be taken to import warranties as to the future. According to Saville L.J:

There is no special principle of insurance law requiring answers in proposal

¹ [2004] Lloyd's Rep IR 615. This case is also an illustration that the purposive approach to construction of a warranty may equally protect the insurer.

² See above p. 26. See also below p.103.

³ *Beauchamp v National Mutual Indemnity Insurance Co* [1937] 3 All ER 19; *Hales v Reliance Fire and Accident Insurance Co* [1960] 2 Lloyd's Rep 391

⁴ [1996] 1 Lloyd's Rep 627

forms to be read, prima facie or otherwise, as importing promises to the future. Whether or not they do depends upon ordinary rules of construction, namely consideration of the words the parties have used in the light of the context in which they have used them and (where the words admit of more than one meaning) selection of that meaning which seems most closely to correspond with the presumed intentions of the parties.¹

Nonetheless, it does not mean that the courts will never construe a warranty framed in the present tense as continuing in the future. In *Agapitos v Agnew (No. 2)*,² at the time of the contract, the assured warranted that the insured vessel had London Salvage Association approval of location, fire fighting and mooring arrangements. Two weeks later, the LSA certificate expired and was not renewed. Moore-Bick J. held that this was a continuing warranty, as there was no sense in the underwriters securing such protection only to relinquish it days later. Another similar illustration is *Eagle Star Insurance Co Ltd v Games Video Co (GVC) SA (The Game Boy)*.³ The assured warranted that 'prior to attachment', London Salvage Association (LSA) recommendations, including ongoing recommendations, would be complied with. The assured failed to install appropriate telephones and to appoint security watchmen, contrary to what had been recommended. Simon J. ruled that this was a continuing warranty and that any other interpretation would have rendered it commercially meaningless.

Thus, the tense and the language used in a warranty are not conclusive. The words used should be construed against the objective or commercial function of the warranty. The courts exploited the distinction between present warranties and continuing warranties in their construction of the policy so as to minimise the harsh effect that flows out of the draconian nature of a continuing warranty. The rule can be summarised as that in the absence of clear wording, a warranty would not be construed as allowing an insurer to avoid all future liabilities under the policy especially when the breach of warranty has no connection with the loss.

Warranties as Warranties of Belief

The difference between belief and facts is of significance in insurance law. In the context of representation, if it is a representation of belief, the insured is discharged from his duty not to misrepresent as long as he honestly believes what he has said.⁴ By contrast, if it is a representation of fact, the matter must be true when it is judged objectively by a prudent

¹ *Ibid*, at 629.

² [2003] Lloyd's Rep IR 54

³ [2004]1 Lloyd's Rep 238

⁴ MIA 1906, s.20 (5). See *Rendall v Combined Insurance Co of America* [2005] EWHC 678 (Comm)

insurer.¹ This distinction of belief and facts is also applicable in the context of warranties. If it is held that a warranty is of belief only, it will be complied with so long as the proposer has honestly stated his belief, whereas if it is a warranty of fact, there will be a breach even in the event of an honest mistake by the proposer. This rule seems to be rooted in life insurance cases.² A modern illustration of this rule is *Gerling-Konzern General Insurance Co v Polygram Holdings and Metropolitan Entertainment Inc.*,³ the assured company warranted that it would ascertain from its employees whether the life assured, a musician, was to the best of their knowledge and belief in good health when the policy incepted. The warranty was held to be broken, as the assured had failed to ascertain from its employees their views on this matter. In the light of evidence, the court added that even if this had been done, the employees could not have believed that the life assured was in good health.

So far, there is no marine case turning on this point. Nonetheless, the same principle applies and it would provide the court with another way of avoiding the harsh effect of a warranty.

6. Conclusion

English law has developed a significant number of leading cases on the various issues left open by *The Good Luck*. However, they are by no means sufficient to resolve all the problems that flow out of the draconian nature of warranties. Several attempts were made by way of judicial innovation in the construction of contract, but the substantive law remains unchanged. The English judiciary, wrestling with the construction of contracts, indeed justified their decisions by using their commercial sense and generosity in most situations. However, the decisions of the court are not always easy to predict and might not be consistent. At present, it is difficult to draw a conclusion with any degree of certainty that English law requires a connection between loss and breach of warranty. To date, the court is still reluctant to touch on the point of causation in marine warranty cases, for they are constrained by the MIA 1906 and common law authorities. Therefore, legislative reform of substantive law is much needed.

¹ MIA 1906, s. 20 (4)

² *Ross v Bradshaw* (1761) 1 Wm. Bl. 312; *Southcombe v Merriman* (1842) Car & M. 286; *Thomson v Weems* (1884) 9 App. Cas 671

³ [1998] 2 Lloyd's Rep 544

Chapter 3

THE PRACTICE OF WARRANTIES IN THE LONDON MARINE INSURANCE MARKET

1. Introduction

A special feature of English marine insurance law is that it is closely related to commercial practice in the London market. As the world's leading shipping and insurance centre, the London market has developed its own distinctive customs of practice in broking and underwriting insurance. In the London market, marine insurance retains its historical position as a significant part of the city's internationally traded insurance and reinsurance markets based at Lloyd's of London and the London Underwriting Centre.¹ The influence of the London market is huge both nationally and internationally. As the purpose of English commercial law is to facilitate the business, these market practices are influential to the development of English law. Therefore, it is worthwhile to examine in detail the practice of underwriting in the London market and see how the market responds to the warranty rules in English law.

The marine insurance underwritten in the London market is by and large based on the standard Institute Clauses.² These clauses can be simply incorporated into the insurance policy by attachment to the policy. Among the various Institute clauses, warranties are most commonly used in the Institute Hull Clauses. They are known as standard warranties, like the Navigation Clause, Termination Clause and Disbursement Clause in ITCH 83.³ However, some clauses are arguably regarded as warranties, like the Institute Warranties Clauses 1/7/76. On the other hand, in some cases, there are also individually negotiated warranties in the policy. These warranties will be written or typed into the policy. For example, on the second

¹ Underwriters at Lloyd's are represented by a body called Lloyd's Underwriters' Association, whereas the vast majority of insurance companies writing marine insurance in the UK are members of the Institute of London Underwriters.

² The history of these clauses could be traced back to April 1883, when a meeting of the UK underwriting community was held at Lloyd's to consider the details and phraseology of certain hull clauses with a view to the general adoption of an established wording of these clauses. In 1884, the Institute of London Underwriters was formed and the first full set of Institute Time Clauses Hulls was released in 1888. For the last century, the 'Institute Time Clauses' have become the international standard for period insurance on vessels, providing the cover required by commercial interests, together with the greatest possible degree of certainty in the approach to claims. However, the clauses did have some changes as the trade and other circumstances changed. This happened in 1952, 1959, 1969, 1983, and 1995. The most radical revision of the clauses was undertaken in 1983 after the outcry of the developing countries for fair terms in marine insurance policies was echoed by the United Nations Conference on Trade and Development (UNCTAD). During the years, the ITCH 83 has been the most popular one in the market and there is only limited use of the ITCH 95 after its release, which turned out to be a failure in the market.

³ Standard warranty clauses are not only present the Hull clauses, but also in other categories of marine insurance, like the Laid up Warranty, Clause 4 in IYC 1/11/85. Cf. Baris Soyer, *Warranties in Marine Insurance*, (2006) at pp.28-40

page of the insurance policy issued by Lloyd's in the London market which is now known as the MAR forms, there is a schedule with a number of printed headings, one of which is *Clauses, Endorsements, Special Conditions and Warranties*. The underwriters and the insured can put any individually negotiated warranties under this heading. The following discussion in this chapter will focus on some standard warranties clauses in the Institute Hull Clauses and see what are the effects for breach of these warranties and how the London market use contractual devices to water down the rigid and harsh rules of English law.

2. The Institute Hull Clauses

The London marine market has long familiarised itself with the standard Institute Hull Clauses.¹ In 2001, after six years of loss in the London marine insurance market, it was acknowledged that with the competition from other markets, it was not a time to sell hard clauses in such a soft market. Therefore, the Joint Hull Committee in London (JHC)² was keen to make the Institute hull clauses as consumer-compatible as possible. The JHC started to review the 1983 and 1995 Clauses, hoping to adjust them to reflect current market practice.³ As a result, the new International Hull Clauses were released by the International Underwriting Association of London (IUA) on 1st November, 2002⁴. After a year's review, in November 2003, a revision of the new clauses was introduced, now known as IHC 2003.⁵ The new clauses are in three parts. Part I contains the principal insuring conditions (cls.1-33), part II comprises additional clauses (cls.34-44) and part III contains claims provisions (cls.45-

¹ The Hull insurance policies are effected in two ways: time policy or voyage policy. The Institute Hull clauses are accordingly drafted in two sets: the Institute Time Clauses (ITC) and the Institute Voyage Clauses (IVC). Today, the vast majority of insurance is effected on a time basis, whereas in the early days of insurance, virtually all policies were for a round voyage. Therefore, the discussion here will be based on the Institute Time Clauses, with reference to voyage policies when necessary. The Institute Hull Clauses (Time policy) has several versions. The newest version is the new International Hull Clauses 2003. After a year or so since the release of the IHC 2003, it seems that the new clauses are still of little use in the London market. However, it is too early to say that it will be ill-fated as the ITCH 1995. It might take some more time for the IHC 2003 to be welcomed by the market but before that, the ITCH 1983 is still the most adopted clause in marine hull insurance policies.

² The JHC is a joint initiative by the International Underwriting Association of London and Lloyd's Underwriters' Association. Its role is to support and develop the role of the London hull insurance market. The JHC acts as a focal point for hull insurance issues while providing advice and representation to members on technical, legal, promotional and educational issues.

³ In addition, the JHC considers that a number of supplementary clauses, which are now in everyday use, could be drafted to form part of an addendum. This addendum could then be amended or reissued at various times as appropriate, without requiring any change to the main wording.

⁴ The principal difference between the new clauses and the previous ones is that the new clauses are now in three parts: part one contains the principal insuring conditions; part two contains commonly used additional clauses, some mandatory and some which may be placed such as 4/4ths RDC and FFO cover, returns for lay-up, general average absorption and additional perils, and part three contains provisions for claims handling and sets out the duties of the insured and underwriters. The New International Hull Clauses will be reviewed every year and kept up to date with the latest development in the industry and legislative changes. The current version of the clauses is as of 1/11/2003. However, the new clauses remained on a 'named perils' basis rather than 'all risks' as recommended by brokers and very few owners have used them to date.

⁵ For the differences between the IHC 2002 and IHC 2003, see Howard Bennett, *English Marine Insurance And General Average Law*, Lloyd's Maritime and Commercial Law Yearbook 2004, p 104. See also Baris Soyer, *A Survey of the New International Hull Clauses 2002*, JIML 9 [2003] 3, 256-280

53). Unless overridden by express agreement, the contract will consist of part I (cls.1-33), cls.39-44, and part III. Clauses 40-44 contain optional extensions of cover incorporated only when agreed in writing.

The new clauses are not a fundamental rewriting of the existing standard clauses. The new clauses tried to ensure that the insurance wordings reflect current industry thinking and market developments, as well as legislative changes. One major amendment was made in view of the fact that the ISM compliance has become mandatory for so many ships and owners since the most recent wordings were launched in 1995. The opportunity was also taken to include some aspects of the London Market Principles 2001 (LMP),¹ and in addition to clarify London market hull claims procedures in the wording and/or addendum.

The discussion below will focus on some of the conditions which were treated as warranties in the Institute Hull clauses but are now treated differently. The warranty issue in the Institute Hull clauses is mainly related to conditions on the navigation limits, ship management, and ship classification. They are provided as warranties in ITCH 83, but some changes are made to them in the IHC 2003. Comparisons will be made below on the differences between the ITCH 83 and IHC 2003 and the legal implication of the changes will be analysed in detail.

2.1 Navigation Conditions

The changes in IHC 2003 are many and some are radical. One of the most radical changes is the removal of the word 'warranted' from the navigation conditions. As said, the process of the IUA in preparing these clauses was influenced by the call for reform in the London market - particularly in relation to warranties. The IUA has removed reference to the English 'warranty' from the hull clauses but still keep those conditions in the policy. As a reflection of the current judicial development in English law as to warranties, the IHC 2003 spelt out the effects of breach of those conditions as suspension of cover and in some cases even require causation before a breach can be used to defeat claims. These changes will be illustrated below.

In both ITCH 83 and IHC 2003, there are conditions on the usage of the vessel. In practice, clause 1.1 of ITCH 83 is generally accepted as a warranty, enforcing a limit for the vessel's navigational activity, which concerns the level of risk. Since the ITCH 83 was used in the market, there has been no argument on the effect of clause 1.1 as a warranty which, if broken, automatically discharges the insurer from liability. As to clause 1.2 of ITCH 83, it is viewed as an exclusion which suspends the cover when the specified circumstances are in

¹ For the content of LMP 2001, see <http://www.lloyds.com/index.asp?itemid=2443>.

operation.

That said, the rationale behind clause 1.1 is that it concerns the level of risk. Undoubtedly, towage will incredibly increase the risk of loss for the insured, because when the vessel is being towed or towing another vessel, she is no longer fully in control of her navigation. However, it does not necessarily mean that being towed or towing others, the vessel will inevitably incur a casualty. For example, if a vessel breaches the warranty of prohibition of towage in port, it is very likely that she stays intact after the towage. The difficulty of the current law is that, if the vessel then set off to sea and subsequently suffers a loss by perils of the sea, the insurer would deny liability with the defence of breach of warranty: he has been automatically discharged from liability at the time the warranty was breached. This is not sensible, but the reality is that, as clause 1.1 is clearly provided as a warranty, English law operates exactly this way. Being a warranty, the effect of breach of clause 1.1 is provided in MIA 1906 s. 33(3).

Having considered this and many other situations under the ITCH 83, the International Hull Clauses 2003 removed the word ‘warranty’ in the navigation conditions clause. In the IHC 2003, the navigation conditions are reproduced with some more astute language in Clause 10. The effect of breach of these provisions is made clear in the following terms in Clause 11:

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.

It has been suggested that clause 11 illustrates a new approach to warranties that was introduced with IHC 2002 and is maintained here. It gives a more proportionate remedy for each kind of breach, while enabling underwriters to maintain control over key areas of the risk. This is a dramatic change from the old clauses and it alters the landscape of warranties in marine insurance. As noted, under s. 33 of MIA 1906, warranties must be strictly complied with and any breach of them will discharge the insurer from liability automatically. This, in many cases, is too severe a penalty, particularly when the breach is unrelated to the loss. Now this new clause 11 uses clear words to provide a proportionate effect of breach of the

conditions.¹ Besides the navigation provisions in clause 10 of the IHC 2003, clause 32 of the IHC 2003 also has provisions on the navigating limits. These clauses are additional clauses and they largely retain the substance of the Institute Warranties 1/7/76. The effect of breach of these clauses is now spelt out in clause 33 of IHC 2003 as follows:

33. PERMISSION FOR AREAS SPECIFIED IN NAVIGATING LIMITMS

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 amendment terms of cover and any additional premium required by the Underwriters are agreed.

Under Clause 11, breach of any part of Clause 10 suspends the liability of the insurers during the period of breach unless notice is given to them and new terms and additional premium are agreed. So far, there has not been any judicial observation of this clause in the courts. However, some inclination might be drawn from authorities on the suspensive conditions in insurance. As noted earlier, there is a line of English authorities holding that the effect of such conditions is delimiting the time the insurer is on risk. In *Provincial Insurance Co. v Morgan*,² the proposal form for a motor insurance policy provided that the insured lorry was to be used only for carrying coal. It was in fact periodically used to carry timber instead of or as well as coal. Subsequently, the lorry was involved in an accident shortly after offloading a quantity of timber. The case went to the House of Lords, where it was upheld that limitation on the use of the lorry was a description of the circumstances in which the insurer would be on risk, so that, as the lorry had not been carrying timber when damaged, the insurers were liable. In *De Maurier (Jewels) Ltd v Bastion Insurance*,³ the insured warranted that the vehicle in which the insured jewels were to be carried was fitted with locks and alarms. The trial judge held that the inadequacy of the locks and alarms for a short period of time was not a breach of warranty, and subsequent claim made for a loss occurring when the insured was complying with the terms was valid.⁴ Recently, in *Kler Knitwear v Lombard General Insurance Co. Ltd*,⁵ the court construed that the sprinkler inspection warranty in a property policy was a suspensive provision so that although the inspection was carried out later than warranted, the loss was still recoverable as by the time of the loss the provision had been complied with. In view of

¹ This clause is a held covered clause. See below p. 70.

² [1933] A.C. 240

³ [1967] 2 Lloyd's Rep 550

⁴ See also *CTN Cash and Carry Ltd v General Accident Fire and Life Assurance Corporation Ltd* [1989] 1 Lloyd's Rep 299

⁵ [2000] Lloyd's Rep IR 47

these authorities, it might be safe to say that the effect of clause 11 will give the insurer a defence to liabilities occurred during the period of breach of those conditions in Clause 10, even in relation to loss or damage not caused by the breach, but the insurance cover is reinstated on remedy of the breach and subsequent claims are still valid.

Therefore, navigation conditions are no longer warranties but suspensive conditions. This reflects the existing law in some other jurisdictions and market practice. In the U.S.A and Canada, the courts have held that provisions on the navigating limits are only provisions delimiting the risk.¹ However, in English law, these provisions on the navigating limits have long been held as warranties,² though there are strong arguments about it.³ Now with the clear wording of the clause, the problem has been resolved.

2.2 Management Conditions

The Termination Clauses in ITCH 83 concern the management and classification of the ship and they are regarded as warranties. There are some changes in the new IHC 2003. The subjects in the old Termination clause in ITCH 83 are now dealt with in two separate clauses, i.e., Clause 13 and Clause 14. The new clause 14 takes a different approach to the management issues and they are more comprehensive. In the following discussion, clause 14 will be examined in detail and contrast will be made to the Termination Clause in ITCH 83. Clause 13 will be discussed later in the following section on classification and ISM.

Clause 14 comprehends many issues on the management and use of the vessel. It actually reproduces ITCH 83 Clause 1.3 and Clause 4.2 together in one clause. The new clause 14 is specially designed to address the issue of management of the vessel only. This clause is very complicated because it has provided different effects for the breach of the clause. Clause 14.1 is virtually the same as Clause 4.2 in ITCH 83 which addresses the ownership and administration of the vessel. It is a warranty in both ITCH 83 and IHC 2003: any breach would automatically terminate the insurance unless otherwise agreed. Clause 14.2 reproduces clause 1.3 in ITCH 83 which addresses the issue of sailing for sale or scrap. But the difference is that clause 14.2 is now a true warranty, breach of which automatically terminates the insurance unless otherwise agreed in writing. By contrast, in ITCH 83 clause 1.3, it only reduces the insured value to the scrap value when the vessel is sailing for sale or scrap. Clause

¹ *Federal Business Development Bank v Commonwealth Insurance Co Ltd* [1983] 2 CCLI 200; *La Reunion Francaise SA v Halbart*, [1999] AMC 14

² *Colledge v Hardy* (1851) 6 Exch 205; *Birrel v Dryer* (1884) 9 App Cas 345; *Provincial Insurance Co of Canada v Leduc* (1874) LR 6 PC 224; *Simpson SS Co Ltd v Premier Underwriting Association Ltd* (1905) Com Cas 198

³ See *Arnould's The Law of Marine Insurance and General Average*, 16th ed, London: Sweet & Maxwell, 1981, para 698. Cf. Baris Soyer, *Warranties in Marine Insurance*, (2006), at pp. 24-27

14.4 is new. It aims to enforce the compliance with requirement from the vessel's flag state and its classification society. Breach of these duties does not automatically terminate the contract, but only relieves the underwriter of liability if the breach is causative of the loss being claimed for. Therefore, the insurer needs to prove causation before he can use this clause to defeat liability.

It is too early to say whether this new clause 14 is of any value to the insured at this moment. But it is obvious that the new clause 14 is more flexible and takes on board different considerations of how the condition is breached. It is interesting to note that automatic termination is not an absolute remedy in clause 14 in IHC 2003. The termination can be deferred and it allows time and space for the insured to arrange other insurance in case of breach in certain specified circumstances. Special attention also needs to be paid to clause 14.4. This clause is not a warranty because it clearly requires causation between the breach and the loss. This is a big improvement over the ITCH 83.

2.3 Classification and ISM

The issue of classification is important because, to some extent, the seaworthiness of a vessel is represented by its classification.¹ When underwriters are approached with a proposal for insurance, the fact that a vessel is classed and the status of the classification society concerned are important considerations. But it is to be noted that Classification societies are only organisations that establish and apply technical standards in relation to the design, construction and survey of marine related facilities including ships and offshore structures. These standards are issued by the classification society as published rules. A vessel that has been designed and built to the appropriate rules of a society may apply for a Certificate of Classification from that society. The society issues this certificate upon completion of relevant classification surveys. Such a certificate does not imply, and should not be construed as an express warranty of safety, fitness for purpose or seaworthiness of the ship. It is an attestation only that the vessel is in compliance with the standards that have been developed and published by the society issuing the classification certificate.

Clause 4.1 of the ITCH 83 provides the conditions of classification in contractual terms and it is an express warranty. The effect of its breach is spelt out in clear contractual terms: it is provided that this clause is paramount above all other clauses and any breach of the clause will automatically terminate the insurance, unless the vessel is at sea, when the automatic

¹ There are more than 50 organisations worldwide that define their activities as providing marine classification. Ten of those organisations form the International Association of Classification Societies (IACS). It is estimated that these ten societies, together with the two additional societies that have been accorded associate status by IACS, collectively class about 94 percent of all commercial tonnage involved in international trade worldwide.

termination shall be deferred until arrival at her next port. Being a typical warranty, the clause does not consider the element of causation between the loss and the breach. It can be unfair to the insured in some cases. The IHC 2003 did not make any significant change to the conditions of classification and treat them as warranties as before. Indeed, they are even more specific and rigid with the classification conditions. They are now in Clause 13 of IHC 2003.

Under IHC 2003, Clauses 13.1.1-3 concern the class of the vessel. It is to be noted that the surveys carried out by a classification society are confined to the physical state of the vessel only and do not include other aspects of a vessel's seaworthiness, such as the competence and adequacy of the master and crew, which are also important to the seaworthy state of a vessel. Different from the ITCH 83, duties to comply with all requirements of the vessel's flag state and accident reporting requirements of the vessel's classification society have been added in clause 14.4 in the IHC 2003.

A new addition to the ITCH 83 is the conditions on compliance with the ISM code.¹ Clauses 13.1.4-5 concern the ISM code. Due to the implementation of the ISM code as of July 2002, all vessels over 500 gross tonnes are required to comply with the ISM code requirements, excepting only government operated ships used for non-commercial purposes. The potential problem with the condition of compliance with ISM code is readily to be found. Under the ISM code, compliance with the ISM code is primarily obtaining the Document of Compliance and Safety Management Certificate.² Once having these documents and certificates, it is understood *prima facie* that the ISM code has been implemented. Underwriters are not permitted to look behind these documents into the reality of the systems and procedures and equipment on board the insured vessel. Since quite a number of the requirements under the ISM code are concerned with paper work and proper documentation, there is the possibility that in some cases a trivial non-compliance with the ISM code does not affect the risk or cause the loss occurred. So it might be unfair to hold the underwriters to be discharged from liability when the insured has

¹ The ISM code refers to the International Management Code for The Safe Operation of Ships and for Pollution Prevention. It was initiated by the International Maritime Organization (IMO) and was adopted in 1993. In 1998, the ISM Code became mandatory. The Code establishes safety-management objectives and requires a safety management system (SMS) to be established by 'the Company', which is defined as the shipowner or any person, such as the manager or bareboat charterer, who has assumed responsibility for operating the ship. The Company is then required to establish and implement a policy for achieving these objectives. This includes providing the necessary resources and shore-based support. Every company is expected 'to designate a person or persons ashore having direct access to the highest level of management'. The procedures required by the Code should be documented and compiled in a Safety Management Manual, a copy of which should be kept on board.

² The Code establishes safety-management objectives and requires a safety management system (SMS) to be established by 'the Company', which is defined as the shipowner or any person, such as the manager or bareboat charterer, who has assumed responsibility for operating the ship. The Company is then required to establish and implement a policy for achieving these objectives. This includes providing the necessary resources and shore-based support. Every company is expected 'to designate a person or persons ashore having direct access to the highest level of management'. The procedures required by the Code should be documented and compiled in a Safety Management Manual, a copy of which should be kept on board.

breached one of the requirements of the ISM code.¹ Still, it might be argued that the implementation of ISM code can be justified for the reason that it concerns the potential risk of loss and it helps to improve the safety of human life at sea. However, it is obvious that the cost of that is unfair to the insured when the actual loss is not caused by the breach of ISM code. Under Clause 13.2 of the IHC 2003, the remedy for the breach of the ISM code is not proportionate to the gravity of the breach and therefore is too severe in some cases. As a sensible solution, causation and materiality need to be introduced into the defence of seaworthiness in general. This, under the current situation in the market, seems not to be immediately possible.

2.4 Disbursements Warranty

In both the ITCH 83 and the IHC 2003, there is a disbursement warranty. This is a special warranty in that it concerns the insured's moral hazard rather than the physical risk of the insured subject matter. The rationale of the disbursements warranty is to regulate other insurances which the insured is permitted to make on subject-matter other than the hull as well as the amounts of such insurances. This warranty appears in Clause 21 in the ITCH 83 and is reproduced in almost identical terms in Clause 24 in the IHC 2003. In fact, this clause is the only clause in the IHC 2003 where the word 'warranted' is still used.

The clause contains two parts. Clause 24.1 set out the limits on additional insurance for various interests. The nature and effects of this disbursements warranty are set out in Clause 24.2 in the IHC 2003. Under Clause 24.2, no insurance on any interests enumerated in Clause 24.1 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 so as to operate during the period of this insurance or any extension thereof by or for account of the Assured, Owners, Managers or Mortgagees. It seems that breach of this warranty will discharge the insurer from liability from the time of breach. The clause also provides 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.

¹ Cf: Baris Soyer, *Potential Legal Implications of ISM Code for Marine Insurance*, International Journal of Insurance Law, 279, (1998); Susan Hodges, *The Quest for Seaworthiness*, Chapter 6, D.R. Thomas, *The Modern Law of Marine Insurance*, Vol.2, LLP, 2002.

3. Held Covered Clause

The harshness of warranties was readily perceived even in its early days. In order to balance the interests of the insured, held covered clauses were used to protect the insured from the harsh effect that breach of warranties might bring. The existence of these clauses in marine insurance practice had been suggested to be as early as in the late nineteenth century.¹ With the lapse of time, it is now widely used as a mechanism to mitigate the harshness of warranties in the London market. The MIA 1906 did not touch upon the held covered clauses. Indeed, section 33 (3) of the MIA 1906 declares that the consequence of a breach of warranty is subject to any express provision in the policy and it is suggested that section 31 (2) MIA 1906 acknowledged the possibility of it implicitly.² As a result, it is agreed that held covered clauses are entirely a question of contract.³

In practice, held covered clauses are drafted in a variety of ways, but they are mainly of two types: held covered at a ratable premium⁴ and held covered with premium to be agreed. There is disagreement about the nature of the held covered clause. It is suggested that three approaches of legal analysis are available to the nature of the held covered clause: (i) the held covered clause is an integral part of the initial contract and the additional cover provided by the held covered clause is simply one category of cover; (ii) the held covered clause is an irrevocable offer by the underwriter to provide, if demanded, additional cover in accordance with the terms and conditions specified in the clause and the additional cover provided by the held covered clause is a distinct unilateral contract; (iii) the held covered clause is a hybrid of the above two and it establishes an immediate binding obligation in the contract of marine insurance, but of a particular character.⁵

Applying this analysis, it might be argued that the 'held covered at ratable premium' clause is an integral part of the initial contract on policy terms and any breach of the clause would be dealt with according to contract law principles and contract terms. By contrast, the 'held covered with premium to be agreed' clause is more problematic. The nature of this category

¹ D.R. Thomas, *Held covered clauses in marine insurance*, *The Modern Law of Marine Insurance*, chapter 1, Vol. II, LLP, 2002.

² *Simon Israel & Co. v Sedgwick* [1893] 1 Q.B 303; *Hyderabad (Deccan) Co. v Willoughby* [1899] 2 Q.B 530

³ Cf. D.R. Thomas, *Held covered clauses in marine insurance*, *The Modern Law of Marine Insurance*, Chapter 1, Vol. II, LLP, 2002. It is suggested that the h/c clauses are widely used in marine insurance and they represent a convenient and flexible way to provide protection to an assured in circumstances when the policy cover is inadequate, unavailable or subject to termination or repudiation. As a generic group, they cover a wide range of different held covered events other than breach of warranties, like risk arising outside the policy cover, the underwriters being entitled to elect to avoid the insurance, or breach of policy terms not being warranties. Here the discussion will be confined to the particular issues concerning warranties.

⁴ ITCH Cl.2; IHC 2003 Cl.12. These clauses provide automatic coverage on a pro rata premium when the policy lapse before the insured vessel has reached its destination and the vessel is missing or in distress. Equivalent provisions are found in freight clauses and in variations on the hull clauses.

⁵ D.R. Thomas, *Held covered clauses in marine insurance*, *The Modern Law of Marine Insurance*, Chapter 1, Vol. II, LLP, 2002. at pp.52-53.

of held covered clauses is not easy to prescribe. It is submitted that it is a new contract.¹ There is judicial support for this proposition.²

3.1 Held Covered with Premium to be Agreed

The standard wording of this type of clause is illustrated in the ITCH 83, where Clause 3 provides that:

BREACH OF WARRANTY

In the event of breach of specified warranty as to cargo, trade, locality, towage, salvage services or date of sailing, the insured shall be held covered provided notice be given to the underwriters immediately after receipt of advice and any amended terms of cover and any additional premium required by them be agreed.

There are also standard Held Covered Clauses in the Institute Cargo Clauses 1982 (A), (B) and (C)³, the Institute Voyage Clauses Hulls 1995.⁴ There seems to be little judicial examination on these standard Held Covered Clauses, but before the standard wording is adopted many variations of this type of held covered clause have been examined in the court. There are two requirements for the operation of this clause: prompt notice and additional premium and amended terms agreed. The following discussion will examine these two requirements and illustrate some of the difficulties in practice.

Prompt Notice

Under Clause 3 of the ITCH 1983, giving prompt notice is a condition precedent to the operation of a held covered with premium to be agreed clause. This is a codification of some previous common law authorities on held covered clauses. In *Thames and Mersey Marine Insurance Co. Ltd v H. T. Van Laun & Co*,⁵ it is provided in the policy that:

¹ Merkin, *Colimaux & Merkin insurance Contract Law*, Loose-leaf, A-0706; Baris Soyer, *Continuing duty of utmost good faith in insurance contracts: still alive?* [2003] L.M.C.L.Q. 39. Dr. Soyer did not distinguish these two types of held covered clauses and generally stated that they establish a distinct contract (at pp 64-66), but he later stated that the duty of good faith in the held covered at premium to be arranged situation is a pre-contractual duty of good faith and in the held covered at ratable premium situation, the duty is a post-contractual duty (at p. 68). This is very confusing. Indeed, Prof Merkin submitted that the duty of good faith in the former situation is a pre-contractual duty and in the latter situation, there is no such a duty at all.

² *Fraser Shipping Ltd v N.J. Colton & Others* [1997] 1 Lloyd's Rep 586; *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep IR 563.

³ Institute Cargo Clauses (A) (1982), Clause 10 provides that: Where, after attachment of this insurance, the destination is changed by the Assured, held covered at a premium and on conditions to be arranged subject to prompt notice being given to the Underwriters.

⁴ Institute Voyage Clauses Hulls 1995, Clause 2 provides that: Held covered in case of deviation or change of voyage or any breach of warranty as to towage or salvage services, provided notice be given to the Underwriter immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed.

⁵ [1917] 2 KB 48

In case of deviation or change of voyage the insured are to be held covered, provided notice be given and any additional premium required be agreed immediately after the receipt of advices.

The House of Lords held that 'it is an implied term of the provision that reasonable notice should be given that it is not competent to the insured to wait as long as he pleases before he gives notice and settles with the underwriter what extra premium can be agreed upon'.¹ According to their Lordships, the reason for this is to enable an additional premium to be agreed upon.² Subsequently, in *Hood v West End Motor Car Packing Co Ltd*,³ faced with a similar held covered clause, the Court of Appeal held that 'that it is an implied term of the contract, in the absence of any express term as to notice, that notice must be given to the underwriters within a reasonable time after the facts have come to the knowledge of the insured, if he wishes to rely upon the clause'.⁴

It is to be noted that the held covered clauses mentioned above were all of the 'held to be covered with premium to be agreed' type. It might be safe to say that in a 'held covered at rateable premium' clause, a prompt notice should also be implied as a condition precedent to the additional cover if the contract does not expressly provide so.

In *Hood*, it was held that reasonableness as to the time of giving a notice depends upon the particular circumstances of the case.⁵ However, in practice, the starting point of the reasonable time for giving notice is not always easy to decide. This is usually because the drafting of the clause does not make it clear. For example, the Held Covered Clause in the ITCH 83 only provides that: '...notice be given to the Underwriters immediately after receipt of advices and any amendment terms of cover and any additional premium required by them be agreed.' It is not clear whether it refers to the receipt of advices of an impending breach or actual breach of the warranty. In *Liberian Insurance Agency Inc. v Mossé*,⁶ the Held Covered Clause provided that 'it is necessary for the insured when they become aware of an event which is 'held covered' under this insurance to give prompt notice to Underwriters and the right to such cover is dependent upon compliance with this obligation'. The court held that 'the insured seeking the benefit of the clause must give prompt notice to underwriters of his claim to be held covered as soon as he learns of the facts which render it necessary for him to

¹ See also *Black King Shipping Corp & Wayang (Panama) S.A v Mark Ronald Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437

² *Ibid*, per Lord Halsbury and Lord Davey.

³ [1917] 2 K. B 38

⁴ *Ibid*, at 45, per Lord Justice Swinfen Eady.

⁵ *Ibid*, per Lord Halsbury.

⁶ [1977] 2 Lloyd's Rep 560

rely upon the clause' and that 'the insured cannot take advantage of the clause if he has not acted in the utmost good faith'. Therefore, it seems that the insured should give notice to the insurer as soon as he knows of any possibility that he would rely on the held covered clause. This was held to be due to the duty of good faith. However, Donaldson J. did not elaborate on the contents of utmost good faith in such a situation and it is not entirely clear what would constitute a bad faith.

The issue was later reopened in *Black King Shipping Corp & Wayang Panama SA v Mark Ranold Massie (The Litsion Pride)*¹. Here, the insured knew that the insured vessel entered the Persian Gulf, the most dangerous area at the time, attracting an additional premium at a very substantial rate, but the insured did not notify the underwriter until the loss occurred. Knowing of the loss, the insured sent to the underwriter a notice letter which was purportedly dated 10 days earlier than it was actually written. The underwriter denied the claim. The relevant clause in the policy provided, *inter alia*, that

Information of such voyage [described in the current Exclusions] . . . shall be given to Insurers as soon as practicable and the absence of prior advice shall *not* affect the cover . . .

The underwriter denied liability on many grounds. One of the arguments was that giving prompt notice was a condition precedent to the additional cover. Hirst J. found that the wording of the clause was not a traditional held covered clause; instead the clause in the case was extensive and elaborately drawn and therefore was to be distinguished from those clauses in the earlier authorities. Relying on *Hood v West End Motor Car Packing Co Ltd*,² he held that the words 'absence of prior advice shall not affect the cover' tended to emphasize that cover continued even in the absence of punctual information of the voyage. Indeed, he decided the case on another ground argued by the underwriter, the breach of duty of utmost good faith. Hirst J. held that the duty of utmost good faith continues after the making of the contract. It is common ground in the case that the insured forged his notice 10 days earlier than it was actually written. Since there was fraud in his act, his claim was not valid. On this basis, the underwriter was held not liable for the claim. It is to be noted that the wording of the held covered clause in *The Litsion Pride* was so extraordinary that it meant that the insured was held covered even though it had failed to inform the insurers that it was entering an additional premium area. As said, the court decided *The Litsion Pride* on the grounds of breach of utmost

¹ [1985] 1 Lloyd's Rep 437

² [1917] 2 KB 38

good faith, but the court did not address what constitutes the continuing duty of utmost good faith. Later, in *Manifest Shipping & Co v Uni-Polaris Insurance Co Ltd (The Star Sea)*,¹ the House of Lords overruled this proposition and held that the duty of good faith only had a limited application in the post-contract text. To date, the law is settled that in the held covered clause, the duty to give prompt notice is not a duty under the continuing duty of utmost good faith.²

There is another question that needs to be considered here. It is not unusual that the insured might become aware of the breach of warranty only after the loss occurs. In such a situation, if the insured immediately notifies the underwriter after he knows of the breach, is the notice still valid? In the light of *Mosse*,³ it might be argued that as long as the insured gives the notice promptly, without fraud, after he knows of the breach, he should be held covered. However, it might also be argued, as the insured did in *The Litsion Pride*, that giving prompt notice is important in many ways, including to enable underwriters to consider and place facultative reinsurance if necessary, to enable premiums to be agreed in advance, therefore notice after the loss should be invalid. Therefore, the question needs to be answered is whether prompt notice means immediate notice after breach, whether it is known to the insured, or it means notifying as soon as he discovers the breach. In an earlier case, *Greenock SS Co v Maritime Insurance Co Ltd*,⁴ the court was asked to consider such an interesting situation. The ship, after calling at a port, through the negligence of the master, sailed without sufficient coal to the next place of call, where in ordinary course she would coal again. The master burnt as fuel some of the ship's fittings, spars, and some of the cargo. The underwriter defended the claim on breach of implied warranty of seaworthiness. The insured claimed to be held covered and argued that he did not know the ship had left her port of call without sufficient coal until after the ship reached the next port. Bigham J. held that even if the breach was not discovered until a loss had occurred, the held covered clause still held good because the operation of the held covered clause was to entitle the shipowner, as soon as he discovered that the warranty had been broken, to require the underwriter to hold him covered. Indeed, now in modern held covered clause, like clause 3 in the ITCH 83, it is usually provided clearly that the notice should be given promptly after the insured's receipt of advice, and that means the insured are only required to give prompt notice once the breach is known to him, whether it is a impending breach or actual breach.

Additional Premium and Amended Terms

¹ [2001] 1 Lloyd's Rep 389

² See below p.90.

³ [1977] 2 Lloyd's Rep 560

⁴ [1903] 1 KB 367

For the 'held covered with premium to be agreed' clause, besides prompt notice, it is also necessary for the insured to agree on the additional premium or amended terms required by the underwriter in order to get extended cover under the clause. In this situation, after invoking the held covered clause by prompt notice, a new contract needs to be made to reflect the new risks. The insured is entitled to demand an additional premium and amended terms of cover. But it is suggested that the entitlement to demand amended terms of cover rarely, if ever, exists as an independent right. It always comes in addition to the additional premium.

Without doubt, the underwriter cannot ask for any premium as he likes, or alter the terms totally to his favour for the new risk. The additional premium and the altered terms should be reasonable. The leading case is *Greenock SS Co v Maritime Insurance Co Ltd*,¹ which was noted earlier. The policy provided that 'held covered in case of any breach of warranty, &c., at a premium to be hereafter arranged.' Bigham J. held that:²

[I]t ... entitles the underwriter to exact a new premium commensurate with the added risk. ... the parties must assume that the breach was known to them at the time it happened, and must ascertain what premium it would then have been reasonable to charge. If they cannot do it by agreement, they must have recourse to a Court of law.

Here, the rule is that the rate of additional premium should be calculated as it would have been reasonably calculated had they known the breach of warranty at the time when it happened. This rule is also reflected in Section 31 of the MIA 1906, which provides that:

Where an insurance is effected at a premium to be arranged, and no arrangement is made, a reasonable premium is payable.
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.³

What if the two parties cannot agree on the additional premium or the amended terms after prompt notice is given? Are the insured still held covered? There is no authority on this point. It might be argued that the insured should be held covered, because the purpose of the held covered clause is to provide protection for the insured in emergencies when some agreed events take the risk out of the ambit of the original cover. Therefore, the held covered clause

¹ [1903] 1 KB 367

² *Ibid*, pp. 374-375.

³ Pursuant to section 88 of the MIA 1906, what is reasonable is a question of fact.

should be an immediate binding obligation upon the underwriter by the prompt notice. In respect of an additional premium or amended terms, if they cannot be agreed upon, the insured does not have to pay any additional amount until the premium is fixed by the arbitration awards or court rulings.¹ According to section 31(2) MIA 1906, the amount of additional premium should be reasonable. Again this is a question of fact. It should be decided by reference to the current market at the time of rating of the additional risk. In a similar vein, the amended terms of cover should also be reasonable commercial terms and it is again primarily a market question. It is submitted that the reference to ‘amended terms’ does not produce any such uncertainty as would render the clause ineffective.²

3.2 The Duty of Utmost Good Faith in Held Covered Clause

As noted earlier, held covered clauses had been long associated with the duty of utmost good faith. In *Overseas Commodities v Style*³ McNair J. stated, obiter, that in order to ‘obtain the protection of the held covered clause, the assured must act with utmost good faith towards the underwriters, this being an obligation which rests upon them throughout the currency of the policy.’ It will be recalled that a similar obiter statement was also made in *Liberian Insurance Agency Inc. v Mosse*,⁴ where Donaldson J. said that ‘the assured cannot take advantage of the clause if he has not acted in the utmost good faith’. These discussions are very ambiguous because they seemed to imply that the duty of utmost good faith continues after the conclusion of the contract. Indeed, in recent years, the duty of good faith has been widely discussed as to whether it continues after the contract is made.⁵ In *Black King Shipping Corp & Wayang Panama SA v Mark Ranold Massie (The Litsion Pride)*,⁶ Hirst J. after reviewing various sources of previous authorities, including the above two held covered cases, expressed the view that a generalised post-contractual good faith exists in insurance law, but he did not explain what the content and scope of the duty is in the post-contract context. This view was rejected by the House of Lords in *Manifest Shipping & Co v Uni-Polaris Insurance Co Ltd (The Star Sea)*,⁷ where their Lordships took a restrictive view of the post-contractual duty of good faith but avoided to specify the ambit of the continuing duty of utmost good faith. The only point clearly made in the decision is that the duty, in any event, comes to an end at the

¹ *Kirby v Cosindit Societa Per Azioni* [1969] 1 Lloyd’s Rep 75

² *Arnould’s Law of Marine Insurance and Average*, (1981) 16th ed. Vol II, para. 703.

³ [1958] 1 Lloyd’s Rep 546

⁴ [1977] 2 Lloyd’s Rep 560

⁵ Howard Bennett, *Mapping the doctrine of utmost good faith in insurance contract law* [1999] L.M.C.L.Q 165; Baris Soyer, *Continuing Duty of Utmost Good Faith- Still Alive?* [2003] L.M.C.L.Q 39.

⁶ [1985] 1 Lloyd’s Rep 437

⁷ [2001] 1 Lloyd’s Rep 389

commencement of litigation.

The Scope of the Duty in 'Held Covered Clauses'

Very recently, there have been some developments in case law on the duty of post-contractual good faith. In *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*,¹ in the Court of Appeal, Longmore L.J. reviewed the cases in which a duty of good faith had been recognised in the post-contract context. These cases, as described by Longmore L.J., are illustrations of where good faith is required in a post-contract context.² These cases concern fraudulent claims, variation or renewal of the risk, held covered clauses, the exercise of a right to information arising under the policy and the position where an insurer took over the defence of a claim against his assured. Longmore L.J. opined that the duty of good faith was a continuing one but rejected the trial judge's view that there were only two categories of cases where the duty of good faith operates in the post-contract context: cases analogous to the pre-contract context and fraudulent claims. Longmore L.J. concluded that variation, renewal of risk and held covered clauses were in effect pre-contractual matters and were governed by the pre-contractual duty of good faith. But the Court of Appeal declined to draw a concluded view on whether fraudulent claims cases are a situation where the post-contractual good faith applies. Later the law on fraudulent claims including fraudulent devices was settled in *Agapitos v Agnew (The Aegeon)*.³ The Court of Appeal firmly stated that the rule about fraudulent claims including fraudulent devices was separate from the post-contract duty of utmost good faith. Therefore, it is clear now that the duty of good faith continues after the contract is concluded but ends once litigation is commenced. 'Held covered clause' is a situation, like variations and renewals of risk, where the duty of good faith is required. But the duty is not in nature a post-contractual duty. Indeed, as Longmore L.J. correctly warned, it is only a situation where the duty operates in a post-contract context. The duty is in nature a pre-contractual duty required by s.18 and s. 20 of MIA 1906, because the additional cover to the risk under held cover provisions is a new contract.⁴

It is to be noted that this analysis is not without difficulty. First, it is only applicable to a 'held covered with premium to be agreed' situation, as it is analogous to a variation which brings a new contract. As to the 'held covered at ratable premium' situation, it is less clear. As Longmore L.J. said in *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*:

¹ [2001] 2 Lloyd's Rep 563, at [40].

² *Ibid*, at [21].

³ [2003] Lloyd's Rep IR 54

⁴ *The Mercandian Continent* [2001] 2 Lloyd's Rep 563, at [22].

The requirement that an insurer hold the insured covered in certain circumstances has been held to require the exercise of good faith by the insured. To the extent that the result is a variation of the contract, e.g. because an additional premium has to be assessed, these cases are examples of (2) above [variations to the risk]; to the extent that they are only an exercise by the insured of rights which he has under the original contract they are somewhat puzzling...¹

Indeed, in the 'held covered at ratable premium' situation, no new contract is made. It might be argued that the duty of good faith, if any, in this type of clauses is a continuing duty of good faith required by s 17 of MIA 1906. This leads to another difficulty: how to define a 'want of good faith' in a post-contract context like this. The law on the content of continuing duty of good faith is still unsettled in English law. By contrast, it is submitted that there is no duty of utmost good faith in such a situation, as the premium has been agreed in advance and the insurer can be taken to have agreed to run the additional risk at the assured's demand.² This must be right. This type of held covered clause is an integral part of the original contract, and the additional cover is already contemplated in the consideration for that contract. Therefore, the assured's exercise of his rights under the original contract should not impose on him any obligation to disclose or represent material information again. Indeed, under this type of held covered clause, the additional cover is an extension of the current cover for a short period.³ All the assured is required to do is give prompt notice of the fact that he needs the additional cover. Therefore, giving prompt notice is a condition precedent to the additional cover, but it does not require any disclosure or representation of other information.

Furthermore, it is submitted that even the pre-contract duty of good faith in the 'held covered with premium to be agreed' situation has difficulty in its application.⁴ In the aftermath of *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co. Ltd*,⁵ the pre-contract duty contained in s 18 and s 20 of the MIA 1906 requires that the non-disclosure and misrepresentation is material to a prudent insurer and also induces the particular insurer to the contract. Such a requirement of inducement might be difficult to apply in held cover clauses. It is very difficult to accept that such a requirement of inducement is necessary for the insurer to raise the

¹ *Ibid*, at 567.

² Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Loose-leaf, A-0706

³ See Cl. 12 and Cl. 14, IHC 2003.

⁴ David Foxtton, *The post-contractual duties of good faith in marine insurance policies: the search for elusive principle*, a paper presented at International Colloquium on Marine Insurance, at Swansea University in July 2005.

⁵ [1993] 1 Lloyd's Rep 496

defense that the assured has failed to exercise good faith. In those early decisions,¹ what the assured's did was rather similar to the recent cases which involved fraudulent devices in the claims stage. They did not tell the truth but lied when relying on the held covered clauses. Therefore, it could be argued that once fraud is established, the held cover clause is ineffective. As to the test for fraud, it might be argued that the first limb of the test that Longmore L.J laid in *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*² for fraudulent claims could apply: the fraud must be material in the sense that the fraud would have an effect on the underwriters' ultimate liability.

Remedies for Breach of the Duty in Held Covered Clause

According to s. 17 of MIA 1906, avoidance of the contract is the only remedy for breach of the duty of utmost good faith. There is much discussion of the remedies for breach of the utmost good faith in the post-contract context. The leading authority on this is also *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*. In the case, Longmore L.J stated firmly that it is never suggested that 'lack of good faith in relation to a matter held covered by the policy avoids the whole contract'.³ Indeed, he opined that the assured's breach of duty would only render the extended cover voidable even though the breach occurred during the currency of the main original policy. This decision was recently applied in *O'Kane v Jones*.⁴

However, it is to be noted that avoidance of contract, even of the extended cover, can be a disproportionate remedy. It is submitted that there is doctrinal support for the propositions that avoidance should be declined as a remedy should the court, in the exercise of its discretion, consider it unjust or inappropriate and that damages should be recoverable as an additional or alternative remedy.⁵ Recently, there have been two different lines of authorities on this point. In *Brotherton v Aseguradora (No. 2)*,⁶ Mance L.J proceeded on the basis of common law and rejected the view that the court has a role in permitting or refusing to permit the insurers to avoid a policy, because avoidance is a self-help remedy. By contrast, in *Drake Insurance plc v Provident Insurance plc*,⁷ Rix L.J was of the view that modern cases show that the courts are willing to find means to introduce safeguards and flexibilities which had not been appreciated before and the doctrine of good faith should be capable of limiting the

¹ *Overseas Commodities v Style*[1958] 1 Lloyd's Rep 546; *Liberian Insurance Agency Inc. v Mosse* [1977] 2 Lloyd's Rep 560; *Black King Shipping Corp & Woyang Panama SA v Mark Ranold Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 560

² [2001] 2 Lloyd's Rep 563, at [35]

³ [2001] 2 Lloyd's Rep 563 at [22]

⁴ [2005] Lloyd's Rep IR 174

⁵ See Peter Eggers, *Remedies for the failure to observe the utmost good faith*, [2003] L.M.C.L.Q., 248.

⁶ [2003] Lloyd's Rep IR 746

⁷ [2004] Lloyd's Rep IR 277

insurer's right to avoid in circumstances where that remedy would operate unfairly. It is too early to say which view is to be preferred.¹

Thus, the law is not entirely clear about the effects of breach of the duty of good faith in a 'held covered clause'. It should be argued that if the court is constrained by purely academic discussions of the nature of the duty in post-contractual situations, whether it is an implied term of the contract or a duty at law, when considering the remedies, English law will get nowhere near the truth, but turn away from its tradition of facilitating the businessmen in their disputes. There is a strong case to argue that modern courts should welcome creation or adaptation of common law rules to attend the commercial purpose of contracts.

4. Waiver Clauses

Under section 34 (3) of MIA, the contracted parties in marine insurance can waive any breach of warranty by express terms in the policy. In practice, the wording of this kind of clause must be clear and unequivocal. Any ambiguous drafting would render the waiver clause difficult to be relied upon. Recently, there have been some interesting cases on this point of law. In essence, it is a matter of construction of contract and the English courts never lack a good commercial sense when doing it.

4.1 Waiver of Breach of Warranty by Express Terms

In *Kumar v AGF Insurance Ltd*², noted earlier, the policy contained a non-avoidance clause stating that 'the Insurers will not seek to avoid, repudiate, or rescind this insurance upon any ground whatever, including in particular misrepresentation or non-disclosure'. The underwriter defended the claim on many grounds and one of them was that the effect of breach of warranty was automatic discharge in the light of *The Good Luck*³, which was not mentioned in the clause, so it was not waived. Thomas J. focused his reasoning on the construction of contract and reasoned that when the clause was drafted, *The Good Luck* had not been decided in the House of Lords. Against that background, he held that the insurer must have intended to waive breach of warranty by the clause as well. As to the matter of construction, Thomas J cited with approval that when construing a contract, 'if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business

¹ As to the post contract context, the remedies for breach of the continuing duty of good faith, is now seemingly settled. In *The Mercandian Continent*, Longmore L.J stated that the law of post-contract good faith can be aligned with the insurer's contractual remedies.

² [1999] Lloyd's Rep IR 147

³ [1992] A.C 233

commonsense.¹

In another recent case, *HIH Casualty & General Insurance v Chase Manhattan Bank*,² the House of Lords was asked to construct a waiver clause again. Here, the policy provided, *inter alia*: '[6] the Insured will not have any duty or obligation to make any representation, warranty or disclosure of any nature, express or implied (such duty and obligation being expressly waived by the insurers)'. The insurers repudiated liability on the grounds of misrepresentation and non-disclosure, either fraudulent or negligent, on the part of the agent as broker. In the House of Lords, their Lordships were asked to decide whether on the true construction of the policies the insurers were entitled to (a) avoid and/or rescind the contracts of or for insurance, and (b) to damages from the bank for misrepresentation. Although the case did not touch upon warranties, the reasoning of their Lordship with regard to the waiver clause is worth mentioning. Lord Bingham reasoned that 'in assessing the extent to which the draftsman of that clause intended to modify the respective rights and obligations of the parties it is helpful to recall what, in the absence of such a clause, the rights and obligations of the parties would have been, a matter the draftsman must have had in mind.'³ This approach is simple and practical but might be still not easy to apply. In the same case, Lord Hobhouse believed that a more liberal attitude should be given to the construction of contract. He said that:⁴

[I]f a special clause is to be inserted into the insurance contract to protect the interests of the insured and curtail what would otherwise be the insurer's rights, consideration needs to be given, and agreement reached, as to how far the clause is to go—whether it is to cover all these matters or only some of them and, if so, in what terms. Such a clause, although it is protective of one party at the expense of the other, serves a genuine commercial purpose and enables insurance business to be done to the benefit of both parties (and of the broker). Whilst applying the normal canons of construction, there is no reason to give an unduly restrictive construction to such clauses or to fail to respect the commercial mutually beneficial purpose they are intended to serve.

So it is clear that in English law, a properly drafted waiver clause is able to waive the breach of warranty in advance. Indeed, there are no hard and fast rules for the drafting and construction of a waiver of breach of warranty clause. The problem with current waiver clauses is that the insurer tends to draft a wide, all-embracing clause which will inevitably

¹ *Antaios Compania Naviera SA v Salen Rederiema AB* [1995] 1 A. C. 191 201, per Lord Diplock

² [2001] Lloyd's Rep IR 191

³ *Ibid.*, at [4].

⁴ *Ibid.*, at [90].

create ambiguity by neglect. Like many drafting problems in insurance contracts, the best way to create a successful waiver of breach of warranty clause is to make the intention clear in unambiguous words so that disputes are unlikely to arise. There has not been any marine case arising on this point of law. Yet it is possible for the parties to draft this type of clause in marine insurance contracts.

4.2 Waiver of Implied Warranty of Seaworthiness in Cargo Insurance

That said, under section 39 of MIA 1906, there is an implied warranty of seaworthiness for every voyage marine insurance policy. There is a wealth of English case law which provides tests for unseaworthiness.¹ In general, 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.² In practical terms, the following three aspects are considered when seaworthiness is in question³: the condition of the vessel,⁴ competence and adequacy of master and crew;⁵ and stowage.⁶

As noted earlier, in English law, the implied warranty of seaworthiness is only required in a voyage policy.⁷ In principle, it is implied into every voyage contract, whether it is hull insurance or cargo insurance. But in practice, the warranty is waived in cargo insurance, due to the fact that very few owners of cargo insured can actually control the state of the carrying vessel. Therefore, in the London Institute Cargo clauses,⁸ it is admitted that the vessel is seaworthy. Clause 5.2 of the ICC 82 provides that:

The Underwriters 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, unless the insured or their servants are privy to such unseaworthiness or unfitness.

¹ *Forshaw v Chabert* (1821) 3 Brod. & B. 158; *Foley v Tabor* (1861) 2 F. & F. 663, 671; *Burges v Wickham* (1863) 3 B. & S. 669; *Daniels v Harris* (1874) L.R. 10 C.P. 1; *Hedley v Pinkney & Sons Steamship Co. Ltd.* [1894] A.C. 222,227; *Steel v State Line Steamship Co.* (1877) 3 App. Cas. 72, 77; *Bratley & Sons Ltd. v Federal Steam Navigation Co.* (1926) 24 Ll. L. Rep 446; *Manifest Shipping Co. Ltd v Uni-Polaris Insurance Co. Ltd (The Star Sea)* [2001] Lloyd's Rep IR 247. Cf: Baris Soyer, *Warranties in Marine Insurance*, chapter 3, at pp.55-131; Howard Bennett, *The Law of Marine Insurance*, Chapter 15, at 294-296; Merkin, *Colinvaux & Merkin's Insurance Contracts*, B-1098/1099

² Section 39(4), MIA 1906.

³ Merkin, *Colinvaux & Merkin's Insurance Contract Law*, looseleaf, B-1099.

⁴ *Turnbull v Ianson* (1877) 3 L.T. 635; *Hoffman & Co. v British General Insurance Co.* (1922) 10 Ll. L. R. 434; *Silcock & Sons Ltd v Maritime Lighterage Co. Ltd* (1937) 57 Ll. L. R. 78

⁵ *Annen v Woodman* (1810) 3 Taunt. 299; *Tait v Levi* (1811) 14 East 481; *Busk v Royal Exchange Assurance Co.* (1818) 2 B. & Ald. 73; *Holdsworth v Wise* (1828) 7 B. & C. 794; *Phillips v Headlam* (1831) 2 B. & Ad. 383; *Thomas v Tyne & Wear Insurance Association* [1917] 1 K.B. 938; *Thomas & Son Shipping Co. Ltd v London & Provincial Marine & General Insurance Co. Ltd* (1914) 30 T.L.R. 595

⁶ *Weir v Aberdeen* (1819) 2 B. & Ald. 320; *Foley v Tabor* (1861) 2 F. & F. 663; *Biscard v Shepherd* (1861) 14 Moo. P.C.C. 471; *Daniels v Harris* (1874) L.R. 10 C.P. 1

⁷ See above p. 15.

⁸ The current Institute Cargo Clauses were issued in 1982 and they are in three sets: Clause (A), (B), and (C).

Here, the seaworthiness cannot be raised as a defence to the claim unless the insured or their servants are privy to it. However, this does not mean that the underwriter requires no seaworthiness at all. In Clause 5.1, it provides that:

In no case shall this insurance cover loss damage or expense arising from unseaworthiness of vessel or craft, unfitness of vessel craft conveyance container or liftvan for the safe carriage of the subject-matter insured, where the insured or their servants are privy to such unseaworthiness or fitness, at the time the subject-matter insured is loaded therein.

Pursuant to clause 5.1, the underwriter is not liable for losses when the loss was caused by the unseaworthiness of the vessel and the insured is privy to the vessel's unseaworthiness. As privity and causation are required, the requirement of seaworthiness is no longer a warranty, but an exception.

5. Premium Warranty

The practice of payment of premium in the London market, as codified in s. 53 of the MIA 1906, is that the broker is liable for the premium to the insurer. The broker has to chase the insured for the premium to be paid to him. Therefore, the premium is fictionally deemed to have been received by the insurer and loaned back to the broker at the time when the premium is due.

In recent years, there is an increase in the use of premium warranties.¹ As noted earlier, it was established in *Chapman*² that it is a warranty and the breach of it will also discharge the insurer from liability. But it is less clear how the warranty would effect the operation of s. 53 of MIA 1906. Under s. 53(1) of the MIA, it is the duty of the broker to pay the premium to the insurers and the obligation arises as soon as the premium is due, and does not rest upon the broker having received the premium from the insured. This was regarded as common practice in the London insurance market. However, this triangular relationship among the insurer, broker and the insured is wholly fictional. The fiction underlying the mechanism is that the premium has been paid by the broker to the insurer and the amount of the premium has been loaned back to the broker so that the broker is the debtor of the insurers on that notional loan.³ In the light of this fiction, it seems that the 'payment of premium' warranty

¹ See above p.44.

² [1998] Lloyd's Rep IR 377

³ *Universo Insurance Co of Milan v Merchant's Marine Insurance Co* [1897] 2 QB 93

would never be breached. Indeed, in *Prentis Donegan & Partners Ltd v Leeds & Leeds Co Inc*,¹ Rix J held that the a premium warranty is ineffective even though it purports to bring the risk to an end if the premium is not paid on time, because the fiction underlying section 53(1) means that the premium is deemed to have been paid. In light of *Chapman*, this decision is undermined.

Recently, the law on the effect of the premium warranty was revisited in *Heath Lambert Ltd v Sociedad de Corretaje de Seguros*.² This is a complicated reinsurance case, where the policy and its many extensions contained the following term: ‘Warranted premium payable on cash basis to London Underwriters within 90 days of attachment’. The placing broker Health Lambert funded the initial premium and the extension premiums, but was not indemnified for the cost of the extension premiums. The question raised in the case is whether a placing broker must look to the (re)insured or the producing broker for indemnification of the amount of the premium. For the present discussion, the critical point is whether the premium warranty would be rendered ineffective if no premium was ever paid, because the fiction in section 53(1) would deem payment to have been made. The Court of Appeal held that the obligation on the broker to pay the premium is subject to the terms of the policy, and it is not automatically satisfied by the underlying fiction that the premium has been paid and the broker’s liability is to repay a nominal loan. The Court of Appeal held that the operative part of section 53(1) of the MIA here was simply that the obligation to pay was on the placing broker, and that the date on which payment was due was a matter for the policy, and that the premium warranty operated to confer 90 days’ credit on the placing broker so that the premium was not due for 90 days after the attachment of the risk. It is worth noting that the Court of Appeal reached the above conclusion on a careful construction of the wording of the premium warranty in the policy. First, the use of the word ‘payable’ in the phrase ‘warranted premium payable on cash basis to London Underwriters within 90 days of attachment’ meant that the premium was not payable at the outset but became due at the expiry of 90 days. Second, the words ‘in cash’ made it clear that there had to be a cash payment, so that the usual practice of net accounting could not operate. In light of this, the scope of 53 (1) of the MIA and the effect of the premium warranty are much more dependent on the exact wording of the policy. The case demonstrates that to find out the true intention of a particular premium warranty clause in the policy the court needs to construe the policy terms as a whole. The reality in the marine insurance world in the London market is that the wording of the policy is very often not carefully negotiated in an individual contract,

¹ [1998] 2 Lloyd’s Rep 326

² [2004] Lloyd’s Rep IR 905

and that the policy might be made up of several inconsistent wordings. In such a situation, it is difficult for the court to construe the policy in a reasonable and commercial sense, but even so, it has been suggested that it is not the job of the court to rewrite the agreement so as to overturn its plain meaning.¹

Therefore, at present, premium warranties are warranties in the sense of Section 33 of the MIA. The purpose of the premium warranty is to ensure that the underwriters are to be paid on time. It is not inconsistent with the statutory provision of section 53 of the MIA; the operative part of section 53 in terms of a premium warranty is that it only provides that it is the duty of the broker to pay the premium but the date on which the payment is due is a matter for the policy.

Fortunately, being aware of the confusion on this point of law, the IHC 2003 used clear wording in Clause 35 which is also concerned with the payment of premium.² The Clause requires that the premium shall be paid in full within 45 days of inception of the insurance. If the premium has not been so paid to the underwriters, the underwriter shall have the right to cancel the insurance by giving at least 15 days notice to the assured via the broker in writing. It is clear from the wording that this clause is not a premium warranty and its breach does not automatically discharge the insurer from liability.

6. Conclusion

The London Market has actively responded to the current development of English law. The changes in the IHC 2003 are a sign that the marine insurance underwriters are taking a less strict line towards warranties issues. However, it is submitted that the IHC 2003 has not been widely used in the market. Instead, the ITCH 83 is still popular with the assured. The assured and brokers are cautious and not willing to carry the risk of the uncertainty of the new Clauses. This is a dilemma not easy to overcome. It should be noted that the legislature rather than the market should take the initiative to codify the recent changes in case law. By doing so, the market will have confidence in using the new clauses and a more insured-friendly market will gradually emerge.

¹ See *Kazakhstan Wool Processor (Europe) Ltd v Nederlandse Creditverzekering Maatschappij NV* [2000] Lloyd's Rep 371

² Clause 35, IHC 2003.

Chapter 4

THE ENGLISH LAW AND PRACTICE OF WARRANTIES IN MARINE REINSURANCE CONTRACTS

In English law, the principles of warranties are generally applicable in the context of reinsurance. Until the last twenty years or so, litigation under reinsurance was very rare.¹ Reinsurance disputes arise partly due to the practice of placing reinsurance in the London market, and partly due to the laxity of the wording of the reinsurance contracts. Recently, a number of cases had a close bearing on warranties issues. These issues introduced a new dimension to the modern law of marine insurance warranties. The core of these issues is about the creation and construction of the warranties in reinsurance contracts, which relates to one of the key issues of reinsurance law itself.

The way of creation of reinsurance warranties, like many other terms of reinsurance, is mainly through the 'full reinsurance clause' or simply by words like 'as original'. What are the effects of these incorporating vehicles on the creation of warranties in reinsurance? Should the warranties created this way in reinsurance be construed as back-to-back with the warranties in direct insurance contracts when they are governed by different applicable laws? Warranties in reinsurance might also be created solely for the purpose of reinsurance and exist on their own. Without any equivalent in the direct insurance, how should these warranties be construed if the liability arises for the insurer but is disputed by the reinsurer for a breach of warranty? Would the 'follow the settlement' clause help the reinsured to recover in this situation? All these issues will be examined in this chapter.

1. Introduction to Reinsurance Contracts

The law and practice of reinsurance contracts is rather complicated because reinsurance is arranged in a variety of ways. For the present purpose, it is necessary to introduce some terminology in the reinsurance contexts and know the different types of reinsurance in practice.²

¹ See *Axa Reinsurance (U.K.) Plc. v Field*, [1996] 2 Lloyd's Rep. 233, at 239, per Lord Mustill. In fact, most reinsurance disputes were arbitrated in the past.

² See generally Merkin, *Butler & Merkin's Reinsurance Law*, Sweet & Maxwell, 2003.

1.1 Facultative Reinsurance and Treaties

Facultative reinsurances are the earliest form of reinsurance known to English law. A facultative reinsurance contract is simply reinsurance of a single direct risk accepted by the insurer. The essence of facultative reinsurance is that it is optional: the insurer is not bound to offer, and the reinsurer is not bound to accept any such offer and in legal terms it consists simply of an individual contract between reinsurer and reinsured; to this extent it differs little from an ordinary contract of original insurance. The traditional method in which a facultative reinsurance agreement is placed in the London market is by means of a single cover sheet—generally described as a Slip Policy—which is appended to the direct insurance policy to which it relates and in respect of which reinsurance is being given. The fact that the slip is referred to as a Slip Policy means that no further documentation is to be issued, and that the direct policy taken with the cover sheet constitutes the entire agreement between the parties. The terms of the reinsurance cover are generally described as the same as those in the direct policy. This is achieved by words such as ‘as original’. The Slip Policy will generally contain a small number of terms of its own and the reinsurer usually agrees to ‘follow the settlements’ or ‘follow the fortunes’ of the reinsured. The use of the slip policy with only general words of incorporation of the terms of the underlying cover may confuse the original policy and the reinsurance.¹ Therefore, the primary objective of the underwriter in the facultative reinsurance should be to ensure that the reinsurance protection exists on the same terms (except as to premium, commissions, etc.) as the direct policy.²

In recent years, the use of facultative reinsurance has declined steadily and reinsurance treaties have become more popular. A reinsurance treaty or contract may be regarded as a master agreement regulating a continuing relationship between insurer and reinsurer, and under which a number of separate direct policies may be reinsured. Once the terms of a treaty have been agreed upon between the parties, reinsurance is either automatic or a matter of relative simplicity, so that the insurer can underwrite any relevant business within the scope of the treaty without both the delay and cost of seeking *ad hoc* reinsurance for it.

1.2 Proportional and Non-Proportional

Both facultative reinsurance and treaty reinsurance can be proportional or non-proportional. Facultative reinsurances are for the most part proportional, i.e., the insurer retains for himself an agreed proportion of the risk, the remainder being reinsured at the

¹ *Balfour v Beaumont* [1982] 2 Lloyd's Rep 493; *Forsikringsaktieselskapet Vesta v Butcher* [1989] 1 Lloyd's Rep 331, *Toomey v Banco Vitalicio de Espana SA de Seguros y Reaseguros* [2004] Lloyd's Rep IR 354

² *Yonell v Bland Welch & Co. Ltd (No.1)* [1992] 2 Lloyd's Rep 127

original premium paid minus the insurer's commission. This type of facultative reinsurance is thus less attractive to an insurer and increasing use is being made of excess of loss facultative reinsurance, which is non-proportional, for certain types of business: under this kind of arrangement the reinsurer does not contract for a given proportion of the risk but merely agrees to indemnify the reinsured against liability incurred on an original policy above a stipulated sum. In such instances reinsurance will usually be arranged in layers, with reinsurers accepting liability in excess of different monetary limits.

Treaties come in various proportional and non-proportional forms. A proportional treaty is one under which the reinsured and the reinsurer effectively share the risk between them in agreed proportions, whereas a non-proportional treaty is based on financial limits, and the interests of the reinsurer and reinsured are less obviously linked. The feature common to all proportional treaties is that the reinsurer accepts a predetermined proportion of every cession made by the insurer in return for an equivalent proportion of the premium after the insurer's commission representing costs and profit have been deducted. Proportional treaties are usually in two forms: quota share treaty or surplus treaty. Under the quota share treaty, the scope of the treaty is determined by the subject matter of the direct insurance and any geographical limitations imposed by the reinsurer. The treaty may contain the full reinsuring clause, requiring the reinsurers to follow the settlements of the reinsured (although this is not always the case).¹ By contrast, under the surplus treaty, reinsurers do not demand that all business which falls into an agreed class is to be ceded, but rather that where the insurer underwrites more than it is willing to accept alone, the surplus above its retention must be ceded to the reinsurers.²

Non-proportional treaties take one of two forms, generally referred to as 'excess of loss' or 'stop loss' reinsurance. In the former, the reinsurer undertakes to indemnify the insurer against payments made on original policies in excess of a specified amount (variously referred to, without any obvious distinction, as the 'ultimate net loss', 'retention', 'priority', 'deduction' or 'excess').³ Stop loss reinsurance covers aggregates of losses up to a given amount in excess of a predetermined premium income, less all prior reinsurance costs. In those cases where the limits are expressed as fixed sums rather than percentages, this form of reinsurance is known as 'aggregate excess of loss' reinsurance.⁴

¹ *Great Atlantic Insurance Co v Home Insurance Co. & Others* [1981] 2 Lloyd's Rep 219; *Kingscroft Insurance Company Ltd and Others v Nissan Fire & Marine Insurance Company Ltd* [1999] Lloyd's Rep IR 603

² *Societe Anonyme d'Intermediaries Luxembourgeois & Another v Farex Gie & Others* [1995] LRLR 116

³ *Deeny v Gooda Walker Ltd* [1996] LRLR 183; *Berriman v Rose Thomson Young (Underwriting) Ltd* [1996] 2 Re LR 117; *Wynniatt-Husey v R.J Bromley (Underwriting Agencies) Plc* [1996] LRLR 310

⁴ *Hiscox v Outhwaite (No. 3)* [1991] 2 Lloyd's Rep 524

2. Warranties Incorporated To the Reinsurance Contracts

It is common practice of creating a reinsurance agreement in the London market by way of incorporation. As far as facultative reinsurance is concerned, the 'full reinsurance clause' is widely used in the reinsurance slip policy. The wording of the clause may vary from case to case, but the usual formulation is that the contract is stated to be, in relation to the direct policy, 'a reinsurance of and warranted same gross rate, terms and conditions as and to follow the settlements of the Reassured'.

2.1 Effects of the Full Reinsurance Clause

The functions of the clause are generally accepted to be two: first, incorporating the terms of the direct policy to the reinsurance contract; second, obliging the reinsurers to indemnify the reinsured for settlements which have been reached with the direct policyholder in a bona fide and business like manner. As to the incorporating effect of the clause, although there is a consistent line of authority to support the view, some doubts exist.

In *Forsikringsaktieselskapet Vesta v Butcher*,¹ Lord Griffiths expressed his concern on the incompatibility and inappropriateness created by the practice of incorporation. In his view, 'a contract of insurance will almost inevitably contain terms that are wholly inappropriate in a contract of reinsurance. The two contracts are dealing with entirely different subject matters. The original policy is concerned with defining the risk that the insurer is prepared to accept. The contract of reinsurance is concerned with the degree of that risk as defined in the policy that the reinsurer is prepared to accept.' By contrast to the generally accepted view, he observed that the 'full insurance clause' amounted to a warranty by the reinsured that the terms that he has disclosed to the reinsurers matched the terms of the underlying policy, upon which he placed the risk. This was such an extraordinary interpretation of the clause that the other members of the House of Lords did not indicate agreement with him. Very sadly, this proposition has never been subject to any subsequent judicial observation. In the light of the recent *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co*² case where Rix L.J laid down the tests for warranties, it seems that the clause might be construed as a warranty, because it does meet the hallmarks of an insurance warranty.

Recently, the issue was revisited in *Toomey v Banco Vitalicio de Espana SA de Seguros Y Reaseguros*.³ In 1996, a Spanish first division football club signed a contract with a broadcaster for the exclusive broadcasting rights in the club's home matches. The broadcaster obtained

¹ [1989] A.C 852

² [2001] Lloyd's Rep IR 396

³ [2004] Lloyd's Rep IR 354

insurance from a Spanish insurer, Vitalicio, to cover the risk that the football club was to be relegated from the first division. The Spanish insurer then sought and obtained a policy of facultative reinsurance for its liability in the London market. As usual, the reinsurance was in the form of a slip policy which was stated to be 'as original'. The claim arises because the club's first team was relegated from the first division of the League at the end of the 1999/2000 season. In first instance, the reinsurer raised two defences: first, the reinsured did not disclose the nature of the direct policy, which was a valued policy rather than a policy requiring proof of loss; second, the 'full insurance clause' was a warranty that the terms of the direct policy matched the presentation made to the reinsurers, which was breached. The trial judge had little difficulty in ruling that the reinsurer won on the first defence. Although the reinsurer had succeeded on the utmost good faith point, Smith J considered the second defence in full and rejected the argument by reliance on *Phoenix Insurance v Halvanon Insurance Co Ltd*,¹ where Kerr L.J. said this: '[The parties] clearly intended, probably as a matter of routine, that the 'full reinsurance clause' should be incorporated, because it usually is, and because its first part is an uncontroversial and virtually universal feature of reinsurance business, viz that the reinsurance should be on the basis of the same rate, terms and conditions as the primary insurance and that the reinsurers are bound to follow the settlements of the reinsured made properly and in good faith'. As to the observation of Lord Griffiths in *Vesta v Butcher*, Smith J thought that it should be narrowly read on the facts of that particular case. The reinsured appealed, inter alia, on this ruling of the trial judge in the Court of Appeal,² where the situation became a little bit obscure. While recognising that the majority in *Vesta v Butcher* were in favour of the incorporating effect of the full insurance clause, Thomas L.J., delivering the only reasoned judgment of the Court of Appeal, felt that it would be inappropriate to express any view on the matter and emphasised that he was not to be taken as expressing a view one way or the other on the point. This crucial reservation of position seems to indicate that the long-standing assumption that the full reinsurance clause has an incorporating effect may not be correct.

It was suggested that it is desirable that Lloyd's standard form of reinsurance be redrafted in grammatical, intelligible and unambiguous language.³ Unfortunately, the form is still in use without change after almost 15 years on. However, it is never too late to remind the brokers that the effect of the full reinsurance clause should be made in clear wording: it can either be drafted to mean that the terms of the original policy of insurance are to be terms of the

¹ [1988] Q.B. 216, at 278.

² [2005] Lloyd's Rep. IR 423

³ *Forsikringsaktieselskabet Vesta v Butcher* [1989] 1 Lloyd's Rep. 331, per Lord Griffiths and Lord Bridge of Harwich,

reinsurance contract, or to mean that the terms that the reinsured disclosed to the reinsurer are exactly the same as the terms upon which he placed the risk in the direct policy. Whichever their intention, the policy should be drafted to make it clear.¹ For the time being, in the light of *Toomey v Banco*, the effect of the ‘full reinsurance clause’ is incorporating the terms of the direct policy to the reinsurance contracts, but subject to the facts of the case, there are possibilities that the clause may amount to a warranty.

No doubt, even if the full reinsurance clause or the wording ‘as original’ has been construed to the effect of incorporating the direct policy into the reinsurance agreement, it is still questionable how much of the direct policy has been really incorporated. During the years, the courts have ruled that terms in the direct policy which are inconsistent with the reinsurance cannot be incorporated, and equally those which are repugnant to the very nature of a reinsurance agreement will not be incorporated.² Further, dispute resolution provisions—arbitration agreements,³ choice of law,⁴ and choice of jurisdiction clauses⁵—will not be regarded as incorporated unless express words of incorporation are used. This means that the precise content of a facultative reinsurance contract is not always clear from the outset.

2.2 A New Way of Construction

The matter is complicated by the consideration that, even where there has been incorporation, the incorporated term will in some instances operate in the same way at the reinsurance level as in the direct policy but in other cases simply amount to a statement of the circumstances in which the insurer will pay and thus operates as no more than a type of follow the settlements clause.

In *HIH Casualty and General Insurance Co v New Hampshire Insurance Co*,⁶ the preliminary issues had arisen in an action brought by HIH, which paid out over US\$ 30 million to the investors in a number of films, seeking recovery against the reinsurers. As noted before, the Court of Appeal in that case held that the term stipulating the number of films in the original policy constituted a warranty and it was incorporated into the reinsurance agreement. It was argued that the breach of warranty had been waived by the ‘cancellation clause’ in the original

¹ *Ibid*, per Lord Griffiths.

² *Home Insurance of New York v Victoria-Montreal Fire* [1907] AC 59; *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1996] LRLR 265; *CAN International Reinsurance v Companhia de Seguros Tranquilidade* [1999] Lloyd’s Rep IR 289

³ *Pine Top Insurance v Unione Italiana* [1987] 1 Lloyd’s Rep 476; *Excess Insurance v Mander* [1995] LRLR 358; *Trygg-Hansa v Equitas* [1998] 2 Lloyd’s Rep 439; *Cigna Life Insurance Co of Europe SA-NV v Intercaser SA de Seguros y Reaseguros* [2001] Lloyd’s Rep IR 821

⁴ *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.1)* [1999] Lloyd’s Rep IR 229

⁵ *AIG Europe (UK) Ltd v Ethniki* [2000] Lloyd’s Rep IR 343; *AIG Europe SA v QBE International Insurance Ltd* [2002] Lloyd’s Rep IR 22

⁶ [2001] Lloyd’s Rep IR 396

policy, which was also held to be incorporated into the reinsurance. Although the point was dismissed on the proper construction of the cancellation clause, the Court of Appeal fully considered the effect of the incorporated 'cancellation clause' in the reinsurance and held that it was only a form of the follow the settlements clause. In the light of this reasoning, it must follow that a direct warranty as incorporated does not necessarily take effect as a reinsurance warranty but rather functions as a 'follow the settlement' clause.¹

3. Warranties in Back-to-Back Cover Reinsurance

In proportional reinsurance, it is presumed that the risks accepted by the reinsured are matched--subject to any financial limits--by the cover provided by the reinsurer. This is known as back-to-back cover. This presumption has been accepted as a general principle in reinsurance law and it is considered to be an aid to the construction of the reinsurance agreement.² The following discussion will examine how the discrepancies between the insurance and reinsurance are resolved with the aid of this presumption and the limits of back-to-back coverage.

3.1 Reinsurance Warranties Identical to Direct Insurance

So far as the warranty issue is concerned, the first leading case on back-to-back cover in reinsurance is *Forsikringsaktieselskapet Vesta v Butcher*,³ discussed earlier in the 'full reinsurance clause' section. As said, the 'full reinsurance clause' in the reinsurance policy was construed as incorporating the terms of the direct policy into the reinsurance contract rather than creating a new warranty in the reinsurance. Furthermore, it was emphasised by the House of Lords that the two policies were on identical terms and a claim settled under the insurance policy would be a claim payable under the reinsurance policy. The difficulty confronted the House of Lord in *Vesta v Butcher* was the different positions of Norwegian and English law as to warranties. The claimant, a Norwegian insurance company who had insured the owner of the fish farm in Norway, reinsured its liability at Lloyd's. In the direct policy there was a 24-hour watch warranty, which was later incorporated into the reinsurance agreement. In the event, the fish in the farm was washed away by rough sea in a stormy night, during which time there was no watchman on duty. The insurer paid the claim under the direct policy to the insured. Under Norwegian law, the failure to keep the 24-hour watch was irrelevant because the presence of a watchman could not have prevented the storm damage. After the insurer paid

¹ See below p. 96.

² *Asxa Reinsurance (U.K) Ltd v. Field* [1996] 2 Lloyd's Rep 233 per Lord Mustill, at 238.

³ [1989] 1 Lloyd's Rep 331

the claim under Norwegian law, the reinsurer refused liability to pay the reinsured for the breach of the warranty under English law. Having realized the perceived ridiculous result of applying English law, the House of Lords held that the meaning and effect of the failure to comply with the warranty should be construed in the same manner even though the former was governed by Norwegian law and the latter was governed by English law. The result was that the reinsurers were unable to rely upon the breach of warranty. Here, the English court successfully avoided the harshness of the English warranty rules but did not touch the substantial law on the warranty itself. The reason underlying the judgment in *Vesta v Butcher* is that ‘the reinsurer agrees that if the insurer is liable under the policy the reinsurer will accept liability to pay whatever percentage of the claim he has agreed to reinsure’,¹ and therefore ‘in the absence of any express declaration to the contrary in the reinsurance policy, a warranty must produce the same effect in each policy.’²

Vesta v Butcher was later followed in *Groupama Navigation et Transports v Catatumbo C.A Seguros*,³ another similar reinsurance case. Here, the vessel was insured by a Venezuelan insurer. The policy contained a clause which effectively guaranteed maintenance of class according to the ABS standards and rules. The reinsurance was written facultatively in the London market and contained the words ‘as original’ in its conditions clause. The reinsurance slip also contained, *inter alia*, the following words: ‘warranted existing class maintained’. In the event, the vessel was heavily damaged in a storm. The Venezuelan insurer indemnified the loss under Venezuelan law, but the reinsurer sought to deny liability under English law. They alleged that the insurer was in breach of warranty of the vessel’s class. In fact, the insurer raised the breach of warranty defence to the insured under the direct policy as well but they failed under the Venezuelan law, where a breach of warranty was of no effect unless it was causative to the loss. At first instance, the trial judge held that the warranty in the reinsurance cover was to be construed so as to produce the same effect as the underlying warranty in Venezuelan law and later the Court of Appeal upheld the trial judge’s decision and emphasised that the incorporated warranties must have the same effect in both contracts and it was unrealistic to look at these warranties in isolation.

By contrast to *Vesta v Butcher*, where the insurance and reinsurance was sold as a package in identical terms, in *Groupama v Catatumbo* the warranty that appeared in the reinsurance slip was not identical to the warranty in the direct policy. The reinsurers contended that the warranty in the reinsurance was free-standing: in other words, the reinsurance cover was not back-to-back

¹ [1989] 1 Lloyd’s Rep 331, at 336.

² *Ibid.*, at 334.

³ [2000] 2 Lloyd’s Rep 350

cover with the insurance cover. On this point, both courts held that the warranties in the insurance and reinsurance were effectively identical and the parties had intended that the warranties in the two contracts would have the same effect. But it is to be noted that the Court of Appeal was very careful with this decision and warned that whether the parties intend a back-to-back cover is always a matter of construction of the contracts in context. So the outcome in each case very much depends on its own facts.¹

3.2 Reinsurance Warranties Absent in Direct Insurance

So far two scenarios have been discussed: the warranties in the reinsurance and insurance contracts were identical as seen in *Vesta v Butcher* or different but effectively identical as seen in *Groupama v Catatumbo*. Recently, another scenario arose in *G.E Reinsurance Group v New Hampshire Insurance Co*,² where the warranty in the reinsurance had no counterpart in the insurance contract. The case concerned the insurance of film financiers. Money was loaned to a film distribution and production company, and was later secured by the issue of notes to trustees acting for the noteholders, who engaged brokers to place insurance for them against the default of the borrower. As a result, the insurance was arranged with Axa, New Hampshire and other insurers in the following fashion: Axa took 40% of the risk, while New Hampshire took 60% of the risk, 20% of which he took for his own, and 40% of which he agreed to front for other insurers. Amongst the various conditions in the reinsurance slip, there was a clause in the following terms: ‘contracts of employment in respect of Steve Stabler as chief executive officer. . .to be maintained for the duration of the policy.’ Mr. Steve Stabler was described in the proceedings as the company’s creative mind and who was to be in charge of the production of films. In the event, the company became insolvent and a claim was made under the direct policy. New Hampshire had no available defence against the note holders and paid the claim. However, the reinsurers raised two defences against New Hampshire, one of which was based on the fact that Mr Steve Stabler had left the employment, which was contended to be a breach of warranty. The trial judge, Langley J, held that the presumption of back-to-back cover could only be used to modify the meaning of a reinsurance term which had a direct insurance equivalent and it could not be used to delete an express provision in a reinsurance contract which has no counterpart in the direct policy. In the instant case, there was nothing in the insurance contract touching upon the matter of the employment of Mr. Steve Stabler. On his finding of the material facts, Langley J acknowledged that the parties in the case intended the reinsurance and insurance to be back-

¹ *Ibid*, at 354, *per* Turkey L.J., agreed by Mance L.J.

² [2004] Lloyd’s Rep IR 404

to-back cover but he distinguished *Vesta v Butcher* and *Groupama v Catatumbo* from this case and reasoned that:

[I]n my judgment, *Vesta v Butcher* is itself only an illustration of the general approach to construction which enables a court to resolve ambiguities of wording in a way which it is satisfied the parties objectively intended, in that case both insurance and reinsurance contained the same wording but the potential for inconsistency arose from the different systems of law to which the two policies were subject. That, in my judgment, is substantially different from a factual position where, as here, one policy is wholly silent on the relevant words which the other contains.

This meant that the clause in the reinsurance slip regarding Mr. Stabler's employment had to be given effect and it was indeed a warranty in the light of *HIH v New Hampshire*. Thus, as soon as Mr Stabler's employment ceased, the risk under the reinsurance came to an end for breach of warranty.

However, this reasoning must be flawed. The judge took *Vesta v Butcher* only at its face value as an approach to construction. He failed to recognise the underlying principle established in *Vesta v Butcher* is that 'back-to-back cover' means the reinsurer agrees that if the insurer is liable under the policy the reinsurer will accept liability to pay whatever percentage of the claim he has agreed to reinsure.¹ It seems that the dictum of Mance L.J in *Vesta v Butcher* is of relevance here, where he said:²

Had the reinsurance and insurance contracts contained warranties expressed in different and irreconcilable terms, different considerations could have arisen. Likewise, if the reinsurance contained a warranty which had in terms no counterpart in the insurance. It would be clear that the two contracts were not and could not to that extent be treated as back to back. There would be no possibility of reconciling them, or of deriving the meaning or scope of the reinsurance warranty from any equivalent in the original insurance. The reinsurance warranty would in that situation be and remain a term to be viewed purely through the eyes of English law and s.33 (3) of the Marine Insurance Act.

Nonetheless, the *obiter dictum* of Mance LJ should be read with great care. Continuing the above observation, he confined the application of his proposition as follows: 'but it is because

¹ [1989] 1 Lloyd's Rep 331, at 336.

² *Ibid*, at 356.

the insurers would contrary to the normal contemplation, have so arranged affairs that the insurance they issued and the reinsurance they had were not back-to-back.¹ It might be safe to say that when the intention of the parties cannot be ascertained as to whether they want to make the two contracts back-to-back, it should be presumed that they are and that the risk in the reinsurance should be matched with the insurance. As a matter of course, it would be a different story if the parties intentionally make the two contracts not back to back.

3.3 The Limits of the Presumption of Back-To-Back Coverage

That said, the presumption of back-to-back cover is most accepted in the proportional reinsurance. As the non-proportional reinsurance is concerned, the position of English law is not entirely clear at the moment. It is suggested that non-proportional reinsurance, unlike proportional reinsurance, is not a co-adventure of the reinsured and the reinsurer. In the non-proportional reinsurance, the relationship between the direct policy and the reinsurance policy is essential to his profitability. Thus, in *Axa Reinsurance (U.K.) Plc. v. Field*,² the House of Lords refused to apply the presumption of back-to-back cover to non-proportional reinsurance. Recently, however, there have been some different views. In *Goshawk Syndicate Management Ltd v XL Specialty Insurance Co*,³ the reinsurance was arranged under the excess of loss slip policy. Morison J was keen to hold that the contracts were back to back. He held that the many references to ‘all as per original’ in the reinsurance contract demonstrated that its emphasis was on creating a back-to-back arrangement in relation to the risks covered. In his view, the parties had clearly intended that the insurance and reinsurance should be back to back, as evidenced by the ‘as original’ wording and any alternative interpretation would have exposed the reinsurers to no risk in respect of the premium paid to them. The decision seems to be based on the presumption that the premium charged for the reinsurance was based directly on the premium charged for the insurance, and accordingly the cover should match as far as possible. If that presumption has no factual basis, the decision itself is certainly open to doubt.

4. Warranties and the Follow the Settlement Clause

The previous discussion leads to the final question in this chapter—the effect of the follow the settlements clause. The ‘follow the settlement’ clause is sometimes included as a

¹ *Ibid*, at 356.

² [1996] 2 Lloyd’s Rep 233. See also *Youell v Bland Welch Co Ltd. (No.1)* [1992] 2 Lloyd’s Rep 127; *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.3)* [2002] Lloyd’s Rep IR 612

³ [2004] Lloyd’s Rep IR 683

part of the full reinsurance clause and helps to demonstrate the parties' intention to make the reinsurance and insurance contracts on a back to back basis. The clause relates to all the main issues in our previous discussion.

4.1 The 'Follow the Settlement' Clause

The clause was developed from the old fashioned 'to pay as may be paid thereon' clause used in the 19th century. In *Chippendale v Holt*,¹ it was held that the wording 'pay as may be paid thereon' did not compel the reinsurers to pay where there was in fact no liability on the original policy. The decision was not welcomed in the London market and attempts were subsequently made to avoid the consequence of that decision by using other words, e.g., adding the words 'and to follow the settlements'. In *Excess Insurance Co. Ltd v Mathews*,² insurers and reinsurers had combined the words 'to pay as may be paid thereon' with the words 'and to follow their settlements'. It was held that the effect of the words 'follow the settlements' bound reinsurers to a compromise by the insurers on a question of liability in the same way as they were bound under the words 'pay as may be paid thereon' on a question of amount. In the following years, the clause gradually deleted the 'to pay as may be paid thereon' part and simply employed the words 'follow the settlements'. The leading case on the effect of the modern clause was *Insurance Company of Africa v Scor (UK) Reinsurance Company Ltd*.³ In that case, the follow the settlements clause was concerned with the manner in which the reinsured could prove its loss under the direct policy. It was held that under such a clause, the reinsurers were bound to follow settlements provided (i) that the claim so recognised falls within the risks covered by the policy of reinsurance as a matter of law and (ii) that in settling the claim the insurers have acted honestly and have taken all proper and businesslike steps in making the settlement. However, the clause did not prevent reinsurers from contesting that the claim settled by insurers did not, as a matter of law, fall within the risk covered by the reinsurance policy.⁴ The implication of the case is that the general 'follow the settlement' clause wording entitles the reinsured to prove its loss under the direct policy by entering into a settlement with the insured in a bone fide and businesslike fashion. Put another way, the standard form of the 'follow the settlement' clause relieved insurers of the obligation to prove that the loss fell within the original cover, both as to liability and amount.⁵

¹ (1895) 1 Com. Cas. 157

² (1925) 23 Ll. L. Rep. 71

³ [1985] 1 Lloyd's Rep 312

⁴ *Ibid*, per Lord Goff at 330.

⁵ *Hill v Mercantile and General Reinsurance Co. Plc* [1996] 1 WLR 1239 at p 1251, per Lord Mustill

4.2 Conflict between Back-To-Back Coverage and 'Follow the Settlement' Clause

A crucial question unresolved in *Scor* is that: if the insurance and reinsurance are written on a back to back basis, and the reinsured enters into a settlement with the insured which is based on the reinsured's bone fide and businesslike assessment of its liability under the policy, are the reinsurers able to argue that the loss did not as a matter of law fall within the reinsurance agreement? In the context of the scenario discussed earlier in *G.E v New Hampshire*, where the warranty exists only in the reinsurance policy but is absent in the direct policy, the question that needs to be resolved is: is the reinsurer able to deny liability to indemnify the reinsured? To make the question a bit more academically abstract, which one of the following two concurrent principles should prevail in a back-to-back cover reinsurance: the reinsured must settle in a bone fide and businesslike fashion and thus can recover even if liability is disputed; or the reinsurers are nevertheless able to rely upon the terms of the reinsurance policy. The issue has recently been discussed at length in *Assicurazioni Generali SpA v CGU International Insurance plc*.¹ Although the case did not touch upon issues surrounding warranties, the importance of the case is that the general principle it established will inevitably illuminate the warranties issues in back-to-back cover reinsurance.

Principle of Follow the Settlements

In *Assicurazioni v CGU*, the Canadian insurer, CIC, issued a policy to Pirelli, a cable manufacturer, and agreed to cover risks occurred in the supply and installation of three single armoured high density submarine power cables. CIC, as a front, had a reinsurance treaty with Generali, which reinsured 100% of the risks that he had written. The CIC and Generali contracts were back to back, and no real issue arose under them. In the meantime, Generali had reinsured 80% of the risk he had written under an open cover with CGU. In the event, one of the cables was damaged by friction against rocks on the riverbed, and a claim was notified to CIC. Negotiations in respect of the claim were taken over by Generali and the claim was agreed to be settled for Can\$ 4 million. However, CGU contested its liability under the reinsurance policy on two grounds: the terms of the reinsurance excluded its liability in the circumstances of the case; and the payment by Generali was *ex gratia* on the facts of the case and thus outside the terms of the reinsurance. This led to two questions for the court to resolve: did the follow the settlements clause in the reinsurance require CGU to follow Generali's settlement; and if CGU was able to establish that the payment by Generali was *ex gratia*, would CGU have a good defence irrespective of its obligation to follow Generali's settlements?

¹ [2003] Lloyd's Rep IR 725; aff'd [2004] Lloyd's Rep IR 457

In first instance,¹ the trial judge Mr Kealey Q.C held that the settlements clause on its proper construction bound CGU to all settlements made by Generali as long as Generali had acted honestly and had taken all proper and businesslike steps in making the settlement. He reasoned that:

Thus, subject to the application of the two provisos [established by L.J Goff in *The Scor*], the effect of the follow the settlements wording is that the reinsurers are obliged to indemnify the insurers in respect of their compromise of the original assured's claim on both any question of liability and also any question of amount. The follow the settlements wording thus represents one possible way by which the parties may agree on how insurers can satisfy the requirement (recognised by Lord Mustill as the first part of the first obvious rule in *Hill v Mercantile and General Reinsurance Co. PLC*) that they should prove the loss in the same manner as the original insured must have proved it against them, i.e. that the loss falls within the cover of the policy reinsured.²

The settlements referred to in the follow the settlements wording are those between the insurers and their assureds. Therefore, the words do not, in themselves, relieve the insurers of their obligation to prove that the loss also falls within the cover created by the reinsurance. However, those words 'follow the settlements' do have an impact on how insurers may satisfy that requirement. The reason why they have an impact is because the parties have already, by the 'follow the settlement' clause, agreed that the insurers should be relieved of the obligation to prove that the loss falls within the cover of the policy reinsured. In its stead, they have agreed that it is sufficient for the insurers to show that they have settled a claim under the original policy and that they have acted honestly and have taken all proper and businesslike steps in doing so. It follows that what insurers, who have thus settled a claim under their contract of insurance, have to prove in order to secure an indemnity under their contract of reinsurance is not that the original loss falls within the cover created by the reinsurance but rather that the claim so recognised by them falls within the risks covered by the policy of reinsurance as a matter of law.

It is of import once to note that the judge emphasised that the insurers have to prove the 'claim'—not the 'loss'—falls within the risks covered by the policy of reinsurance as a matter of law. In his view, there is a huge difference between the two:³

¹ [2003] Lloyd's Rep IR 725

² *Ibid*, at [35]-[36].

³ *Ibid*, at [38].

The distinction between having to prove that an original loss falls within the cover provided by a contract of insurance and also by a contract of reinsurance, and having to prove that a claim that has been recognised by the insurers as falling within the cover provided by a contract of insurance also falls within the cover provided by a contract of reinsurance, is significant. In the former, one is examining what in fact happened and whether, on the basis of what actually happened, the insurers are liable to indemnify the insured under the contract of insurance and the reinsurers are liable to indemnify the insurers under the contract of reinsurance, according to their respective terms. In the latter, one is examining the claim recognised by the insurers by their settlement of it by admission or compromise and whether on that basis the claim falls within the reinsurance cover as a matter of law.

According to the judge, it must follow that when one is examining the claim recognised by the insurers when they settle it by admission or compromise, one is examining the real basis on which the claim has been settled.¹ In examining the real basis on which a claim has been settled, one is looking to identify the factual and legal ingredients of the claim embodied and thus recognised in the settlement.² The claim made by the insured and recognised by the insurers by their settlement of it under the insurance may have been settled on a basis which, even if valid, did not fall within the risks insured against as a matter of law.³ Considering *Hiscox v Outhwaite (No 3)*,⁴ the judge approved that:

[I]n a case where the risks reinsured are co-extensive with those originally insured, the effect of the reinsurers' agreement to follow the settlements of the insurers may be to bind the reinsurers by a compromise of a dispute between the insurers and their assureds as to liability, including as to whether the claim is covered by the risks insured under the contract of insurance as a matter of law, provided that the insurers have acted honestly and have taken all proper and businesslike steps in making the settlement: with the consequence that the reinsurers cannot reopen the precise same question for the purposes of disputing liability under the terms of the contract of reinsurance or contesting that the claim does not fall within the risks covered by the contract of reinsurance as a matter of law.⁵

¹ *Ibid*, at [39].

² *Ibid*, at [40].

³ *Ibid*, at [42].

⁴ [1991] 2 Lloyd's Rep 524

⁵ *Ibid*, at [49].

The effect of this reasoning is that the reinsured is able to prove its liability under the insurance by demonstrating that the basis on which the claim is settled is within the reinsurance as a matter of law. Put another way, if the reinsured can successfully prove that the basis upon which he made the settlement is as a matter of law within the insurance, the reinsurer must then pay the reinsured as he agreed in the reinsurance policy. However, this reasoning does not mean that the reinsurance contract is of no independent significance, as it is open to the reinsurers under the agreement to put the reinsured to proof of the basis upon which the direct claim by the insured has been settled. The outcome is that the reinsurers are entitled to examine the claim made by the insured and the acceptance of the claim by the reinsured, to ensure that the facts surrounding the loss and the wording of the insurance have not been disregarded.

The decision of Mr. Kealey Q.C was affirmed by Tuckey L.J in the Court of Appeal,¹ where the basic position recognised in *Hiscox v Outwaite (No 3)* was also confirmed. Tuckey L.J held that the reinsurers are bound by reasonable compromises on liability and quantum between the insurers and their assured under the terms of the original policy. He observed that the correct approach was to:

[G]ive substance to the fact that the reinsurer cannot require the insurer to prove that the insured's claim was in fact covered by the original policy, but requires him to show that the basis on which he settled it was one which fell within the terms of the reinsurance as a matter of law or arguably did so. This and the need for the insurer to have acted honestly and taken all reasonable and proper steps in setting the claim provide adequate protection for the reinsurer.

'Follow the settlement' clause overrides the back-to-back cover presumption

It is suggested that the principle laid down in *Assicurazioni Generali SPA v CGU International Insurance Plc* is not easy to apply.² The difficulty is in finding a formulation which gives independent effect to the reinsurance but at the same time does not permit the reinsurers to reopen the original settlement and to challenge the findings of the reinsured. The compromise is that the reinsured on receiving a claim must investigate it fully, and then in a bone fide and businesslike fashion determine the basis on which the claim is to be considered. If the reinsured proceeds to classify the claim in a manner which falls within the terms of the direct cover, then that classification is to all intents and purposes binding on the reinsurers given that

¹ [2004] Lloyd's Rep IR 457

² June 2004, *Insurance Law Monthly*, 16.6 (4).

the wording is the same.

It is of interest to note the implication of *Assicurazioni Generali SPA v CGU* to the scenario discussed in *G.E. v New Hampshire*. It will be recalled that in *G.E v New Hampshire* the reinsurer contested his liability on the terms of warranty which was present in the reinsurance policy but absent in the direct policy and that although the court held the two contracts to be back to back, it still sustained the reinsurer's denial of his liability to the reinsured. As said earlier, the decision cannot be justified if the presumption of back to back prevailed in the case. In hindsight, in view of *Assicurazioni Generali SPA v CGU* rule, the judgment in *G.E v New Hampshire* might be justified if the reinsurer can prove that the claim made by the insured and recognised by the insurers has actually not been settled on a basis which, even if valid, does not fall within the risks covered by the contract of reinsurance as a matter of law.

5. Conclusion

London is the world's leading centre for reinsurance. The peculiarity of English law warranties created so much trouble and uncertainty for the foreign reinsured seeking reinsurance in the London Market. Although the current English law has treated the difference between English law and foreign laws on warranties in a reinsurance contract nicely, it is largely done by way of applying the principles of reinsurance law. Therefore, the problem is not resolved at all. In order to attract more business to the London reinsurance market and assure the reinsured some certainty of the outcome of litigation, the law of warranties in direct insurance itself needs to be reformed.

Chapter 5

RATIONALISING THE ENGLISH LAW OF MARINE INSURANCE WARRANTIES

The English law of marine insurance warranties is undoubtedly confusing and unjustified. The law is confusing in several respects. First, warranties are essentially pre-contractual promises, but not all of them impose obligations on the insured. Second, they are contractual terms, but their breach is not breach of contract: they can only be used as a defence to indemnity, but not as a cause of action for damages for breach or termination for repudiation. Thirdly, they are fundamental terms in insurance contracts, but they are ancillary and collateral. The law is also unjustified in several respects. First, it allows insurers to use the warranty as a technical defence to reject genuine claims. In particular, it does not require any causal link between the loss and their breach. Secondly, it does not distinguish major and minor breaches and allows a disproportionate all-or-nothing solution to any breach.

It might be wondered what is wrong with the current law of warranties. Indeed, it is wrong in that insurance warranties cannot be fitted into the traditional contractual classification of contract terms and the related remedies for breach of contract. The warranty does not discriminate between the difference of the gravity and nature of breach and offers a simple remedy of automatic discharge of liability. The discussion in this chapter will try to rationalise the current state of English law and find solutions to resolve the current problem of warranties in marine insurance.

1. Categorization of Marine Insurance Warranties

Marine insurance warranties are pre-contractual promises by the insured that a given fact is true, or that a given fact will remain true, or that he will behave or refrain from behaving in a particular way. They have many variants. Indeed, it is a mistaken belief that the concept of warranties in English marine insurance law has a definite and consistent meaning and has one unified nature. It is to be regretted that the current law has not given enough attention to this question and used rather dubious terminology to refer to different types of warranties. As a starting point to find out the meaning and nature of marine insurance warranties, it is worthwhile to categorise them into categories with proper terminology.

1.1 The Variants of Marine Insurance Warranties

Express Warranties and Implied Warranties

That said, warranties in marine insurance are promises as regards the existence of a particular fact or undertakings to do or not to do something during the contract. These undertakings are either agreed between the insurer and the insured, or implied by law. Therefore, in different contexts, the term can mean ‘express warranties’, which are agreed by parties to the contract in express terms; or ‘implied warranties’, which are implied into the contract by the rule of law. As noted earlier in this work, in marine insurance, the only two implied warranties are seaworthiness and legality.¹ By contrast, express warranties are many and can be freely negotiated and agreed by the insurer and the insured under principle of freedom of contract.

Present Warranties and Future Warranties

The term express warranties can also mean two different classes of warranties: ‘present warranties’, which are promises that a particular fact exists or does not exist when the contract is concluded, and ‘future warranties’, which are promises that the insured shall do or shall not do a particular thing, or a particular fact will or will not exist during the insurance period. Indeed, it is quite popular in recent years to refer to the latter as ‘continuing warranties’ in English law. This terminology has certain merits considering that it tries to emphasise the performing nature of some future warranties. But it is certainly not accurate because not all the future warranties are of a performing nature and if the criterion used for classification is time. It is, therefore, preferable to call them future warranties and address the performing nature of the continuing warranties in another category with another name.²

It is to be noted that the term ‘promissory warranty’ is used differently in the US from the term used in the Marine Insurance Act 1906.³ In the United States, the term ‘affirmative warranty’ and ‘promissory warranty’ are sometimes used to refer to present warranties and future warranties respectively. This use of the terminology is very misleading. It is very sad that the MIA 1906 uses the term ‘promissory warranty’ without a clear definition. Although it is generally believed that it is used as a collective expression for all warranties in English law,⁴ the term ‘promissory warranty’ is sometimes indiscriminately used to refer to future warranties

¹ MIA 1906, s.39 & s.41. There are no implied warranties in other types of insurance.

² See below p.104.

³ Edwin W. Patterson, *Warranties in insurance law*, 34 Colum. L. Rev. 595 (1934)

⁴ Merkin, *Colinvaux & Merkin's Insurance Contract Law*, Looseleaf, para. B-0130.

in English law as well.¹ Therefore, the term ‘promissory warranty’ should not be used to avoid confusion.

True Warranties and Contractual Warranties

Express warranties can also be distinguished as ‘true warranties’ and ‘contractual warranties’. This terminology was used in Professor Clarke’s texts and the distinction was made by whether the warranty concerns the level of the risk.² However, it is better to use the terminology with a more accurate defining criterion. The desirable criterion for this category is whether the warranties are material to the risk. If they have a material bearing on the risk, they are true warranties; if they do not and they are simply given the status of warranties as part of the bargain, they are contractual warranties.³

This is a very important categorisation of warranties. It will be appreciated that the curiosity of marine insurance warranties is that the insurers can make anything they like included in the policy as warranties as long as they can make the insured agree and the term is in clear and unequivocal words. This has been the main source of injustice caused by warranties because some warranties are all but technical. Nonetheless, their breach will also lead to an automatic discharge of the insurer’s liability. For the last few decades, all the courts have done is try to find ways to construe contractual warranties as something else and only enforce the rigorous rule of discharge of liability when a warranty is a true warranty.

1.2 A Missing Terminology—Descriptive Warranties and Performing Warranties

It is to be noted that under the current classification of warranties, there are overlaps between the above categories of warranties. For example, ‘a professional skipper would be in charge of the yacht at all times’⁴ is an express warranty and it is also a future warranty. The terminology all depends on which criterion is used. Sometimes, it also depends on the context in which it is used. For instance, the implied warranty of seaworthiness is a present warranty in general, because the ship is only required to be seaworthy at the beginning of a voyage policy. However, as noted, if the voyage is divided into several stages, the insured should keep the vessel seaworthy at the beginning of each stage. Therefore, it might be a future warranty as well. Thus, the current terminology of warranties failed to provide one simple criterion to apply for classification and it causes overlaps and confusion in terminology.

¹ The term ‘promissory warranty’ is also used on many other accounts. This will be discussed below.

² Clarke, *The Law of Insurance Contracts*, 4th ed., LLP, 2002, para.20-2B.

³ It is submitted that this type of warranty is more commonly used in non-marine insurance by way of the basis of contract clause. Clarke, *The Law of Insurance Contracts*, 4th ed., LLP, 2002, para.20-2B.

⁴ *Brownswille Holdings Ltd v Adamjee Insurance Co. Ltd (The Milasan)* [2000] 2 Lloyd’s Rep. 458

It might be appreciated that the above classification of warranties did not reflect the difference of their functions. This is a missing point in current academic and judicial comments. Considering the way in which a warranty functions, it will be appreciated that some of the warranties are descriptive. They simply describe what the risk is or would be with the insured's promise that the description is true or will remain true. They are, therefore, better named as descriptive warranties. Some of the descriptive warranties are related only to the state of affairs at the inception of the risk; while others may be related to both the present and the future. For example, if a vessel is warranted to have a London Salvage Association certificate, it is applicable both at the inception of the risk and throughout the entire currency of the insurance period.¹ Nonetheless, they are all of a contingent nature and do not impose any contractual obligation on the insured. Therefore, they are non-obligatory and consequently their breach is not a breach of contract.

By contrast, other warranties require the assured to perform some obligation or make sure that certain conditions will remain in the future. They are, therefore, better named as performing warranties. These warranties are all related to the whole currency of the insurance, so they are all future warranties. They are obligatory because they are of a performing nature and any breach of them is a breach of contract. Under this kind of warranty, the insured promises to do something or refrain from doing something. For example, the insured warrants that a 24-hour watchman would be stationed on the fishing farm² or that there would be no hot work undertaken on board the vessel.³ These warranties impose a contractual obligation upon the insured and require performance or an active omission. Sometimes, performing warranties are used to incorporate clauses requiring the insured to take reasonable precautions. For example, in *De Maurier (Jewels) Ltd v Bastion Insurance Co.*,⁴ a warranty required that the insured's vehicles would be fitted with approved locks and alarm systems. However, clauses of this type used to be construed as a term descriptive of the risk or a suspensive condition, but not warranties in the proper sense.⁵ Now this type of clause is more likely to be expressed to be a condition precedent to the insurer's liability in the contract. For example, in a recent case *Hayward v Norwich Union Insurance*,⁶ a motor insurance policy contained a reasonable clause requiring the insured at all times take reasonable steps to safeguard the car from loss or damage and it was expressed to be condition precedent.

¹ *Agapitos v Agnew (No.2)* [2003] Lloyd's Rep. I.R. 54

² *Forsikringsaktieselskapet Vesta v Butcher* [1989] 1 Lloyd's Rep. 331

³ *Agapitos v Agnew (No.2)* [2003] Lloyd's Rep. I.R. 54

⁴ [1967] 2 Lloyd's Rep. 550

⁵ *C.T.N. Cash & Carry v General Accident* [1989] 1 Lloyd's Rep. 299; *Kler Knitwear Ltd v Lombard General Insurance Co. Ltd* [2000] Lloyd's Rep IR 47; See above p. 53.

⁶ [2001] Lloyd's Rep 410

The correct use of this new terminology is of great importance: it will help clarify the function and nature of a particular warranty. It will be seen shortly that different forms of warranties are different in nature and have different roles in marine insurance. The problem of current legal reasoning is that little care is given to the correct use of terminology for a warranty and there is always a temptation to generalise different warranties as a whole and give them a unified definition so as to find a unified rule of their nature and effects of breach. As a result, confusion is created. In the following discussion, the above proposed terminology will be used to distinguish different forms of warranties and clarify the confusion caused by the current incorrect use of terms.

2. The Role of Warranties in Marine Insurance

That point clarified, there are so many variants of warranties. It is clear that these variants of warranties have different roles in the insurance policy. To begin with, the role of marine insurance warranties must be viewed against the backdrop of the entire law of insurance. The objective of insurance law is to promote compensation and loss-spreading without encouraging foolish conduct. Thus, risk assessment and administration is highly important in order to safeguard the objective of insurance. As a result, insurance contracts and law are mostly concerned with the scope of cover and the measure of indemnity. There are many principles and mechanisms in marine insurance law that work together to achieve these ends. The defences available for the insurers usually are: whether the insured has an insurable interest, whether the risk is within the cover, whether the loss is proximately caused by a covered risk, whether the contract is avoided, whether the insurer is discharged from liability by the time of loss. Then, what is the role and function of marine insurance warranties in insurance law and contracts?

2.1 Descriptive Warranties Define the Scope of Cover

Every policy defines the scope of cover. Primarily, the policy will describe the risk covered by naming the subject matter insured and the risks to be covered. Should the risks so identified not materialise the insurer will simply never assume liability. Apart from describing the risk positively, the insurers also use a variety of ways to delimit the scope negatively so as to confine his liability. They are the exclusions, suspensive conditions and limitations.

Unlike the positive and negative ways of defining the scope of cover, descriptive warranties are uniquely used to help the underwriter delimit the risks in the cover. It will be recalled that in the negotiation the insured is obliged to volunteer to the insurer his knowledge

of the material information relevant to the subject matter of the contract.¹ These descriptive statements are written down either as terms of contract or as a basis of contract clause in the proposal form, which is incorporated into the contract later.² These warranties are descriptive warranties. They delimit the scope of the risk. When statements are made in the above two means, they are assumed to be material, no matter whether they are or are not material in fact.³

It might be wondered what is the difference between descriptive warranties and representations. It seems that the foremost difference between descriptive warranties and representations is in their formality: a representation is not a term of the insurance policy whereas descriptive warranties are. Furthermore, the most important difference lies in the burden of proof when they are breached. As noted, the insurer does not have to prove materiality in breach of warranties; if the warranties are not literally complied with, then there is a breach. By contrast, as regards representations, the insurer has to prove that what the insured misrepresents is material to the risk and has induced the insurers to the contract.⁴ Lord Mansfield said that ‘the distinction between a warranty and a representation is perfectly well settled. A representation must be fair and true ... the difference between the fact as it turns out and as represented must be material.’⁵ This is codified in section 20 of the MIA 1906.

As a result, warranties have reduced the burden of proof from the underwriters at two levels. First, it is sometimes difficult to prove the materiality of misrepresentations and once a representation is converted to a descriptive warranty, no materiality needs to be proved. Secondly, under the *parol evidence* rule,⁶ some representations are made oral, which are not permissible as evidence once the contract was finally written down. Descriptive warranties are written into the terms of the contract and are consequently easy to prove.⁷

Therefore, descriptive warranties are fundamental to insurance contracts. They define the scope of cover. They are contingent and non-obligatory in nature. Nonetheless, they do not

¹ Sections 18-20, MIA 1906.

² The basis of contract clause in proposal form is less used in marine insurance than in other forms of insurance, as marine insurance was mainly arranged by the professional brokers. And in the London insurance market, the instrument of ‘slip’ was used to initiate insurance, rather than proposal forms.

³ *Blackburn v Cockell* (1789) 3 TR 360

⁴ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501

⁵ *Macdowall v Fraser* (1779) 1 Doug 260

⁶ It means that a statement made in the course of negotiations, which would have been a term had the negotiations concluded with an oral agreement, cannot be held to be a term in that agreement when it is reduced to writing and the term finds no place in it.

⁷ H.A. Turner, *The principles of marine insurance*, p.43. He said that: ‘The principle [of utmost good faith] operates to protect underwriters from being liable in respect of insurances which are materially different from their understanding of the nature of the insurance at the time of acceptance. The representations made by the broker, however, and most of the material facts disclosed by the insured, are conveyed verbally to the underwriter, and apart from the attenuated details of the slip there are few written conditions binding the parties. Non-disclosure, or the misrepresentation, of material facts is notoriously difficult to prove, and for this reason underwriters very rarely rely upon this defence. A more practical method has been devised of ensuring that insurance is of the character that the underwriter believed it to be when rating and accepting the insurance, and the warranties which are employed for this purpose have been described as the safety valves of marine insurance.’

all have a material bearing on the risk. As noted earlier, the English judiciary has found a way of construing these descriptive warranties which have no material bearing on the risk as a suspensive condition.¹ This enables the court to find them only having a suspensive effect, the breach of which will only suspend the cover and reinstate the risk once the breach ceases.²

2.2 Performing Warranties Control the Post-Contractual Increase of Risk.

In English law, there are two types of changes of risk in insurance: increase of risk and alteration of risk. The former refers to cases in which the danger of loss increases during the currency of the policy but the risk remains of the same nature; the latter refers to cases in which the subject matter insured has altered and the risk becomes a different one.³

In English law, increase of risk is permitted during the currency of the policy. In other words, the insured has no obligation to take caution and reasonable care not to increase the risk under the cover unless the contract provides so. It is known that, '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 increase the danger of setting the house on fire'.⁴ The reason for this was well explained in *Law Guarantee Trust and Accident Society v Munich Re Insurance Company*:⁵ the increase of risk is already within the contemplation of the parties at the time when they entered into the contract; therefore, it is an element of the contract itself. In blunt terms, when the insurer accepts the risk, he has accepted that the particular risk will operate anyway and it does not matter that the risk runs with an increased chance of loss.

By contrast, alteration of risk amounts to a substantial change in the insured subject matter itself, and the common law rule is that the insurer is discharged automatically from all liability for loss to the subject matter even though the alteration is beyond the control of the insured or it actually diminishes the risk.⁶ The reason for this was recently well explained in *Kausar v Eagle Star Insurance Co Ltd*:⁷ the circumstances had so changed that it could be properly be said by the insurers that the new situation was something which, on the true construction of the policy, they had not agreed to cover.

This difference between increase of risk and alteration of risk is also illustrated in the

¹ They are otherwise known as terms descriptive of the risk in some earlier authorities.

² See above p.53

³ Merkin, *Colinvaux & Merkin's Insurance Contract Law*, looseleaf, para. B-0230.

⁴ *Baxendale v Harvey* (1849) 4 H & N 455

⁵ [1912] 1 Ch 138, at 153.

⁶ *Hartley v Buggin* (1781) 3 Dougl. 39; *Shaw v Robberds* (1837) 6 A & E. 75; *Company of African Merchants Ltd. v British & Foreign Marine Insurance Co. Ltd.* (1873) L.R. 8 Ex 154

⁷ [2000] Lloyd's Rep IR 154

recent case *Swiss Reinsurance Company and others v United India Insurance Company Limited*.¹ The case concerned a reinsurance policy written by Swiss Re for a construction project. The construction was stopped due to financial problems and workers walked off the site. The court held that the cessation of work on the construction site altered the nature of the risk and that made the policy come to an end. This effect is rather like a breach of warranty. Indeed, the rationale of alteration of risk is the same as that of descriptive warranties. They both define the nature of the risk and any change in the nature of the risk will take the subject matter insured outside the scope of the agreed cover. In fact, there may well be warranties to the effect that the insured will not alter the subject matter insured, and that any alteration will terminate the policy from that point. In fact, it is only a restatement of the common law in the contract.

Obviously, the absence of common law rules on the increase of risk is an undesired situation for the insurers. They want to have some limitations on what the insured could do and what he could not do during the insurance period so as to keep the risk of loss confined to a reasonable extent. The reason for this is that the estimation of the probable occurrence of the insured event is vital to the financial success of the insurance enterprise. Under the principle of freedom of contract, insurers usually modify their disadvantaged position by express provisions. There are several ways to make this possible.² One of the measures to hedge the insured's activities during the currency of the insurance is to impose performing warranties on the insured in the policy. By so doing, the insurer requires the insured to promise what they would do and what they would not do during the contract. These performing warranties are binding on the insured throughout the contract, and breach of these warranties would discharge the insurer from liability from the date of breach.³ So the activity of the insured during the insurance period is not totally at the insured's freedom, but dependent on the will and whim of the insurer and that more or less safeguards the risk from being increased.

Therefore, these performing warranties are for the administration of the risk. They are ancillary obligations in the insurance contract. Nonetheless, not all performing warranties necessarily have a material bearing on the risk, though they undoubtedly concern the level of risk. As noted earlier, the English judiciary has also found ways of construing them as suspensive conditions or construing them as conditions precedent to the bringing of a claim. It enables the court to distinguish those performing warranties that have a material bearing on

¹ [2005] EWHC 237 (Comm)

² Merkin, *Colinvaux & Merkin's Insurance Contract Law*, looseleaf, para. B-0234.

³ MIA 1906, s.33 (3), *The Good Luck* [1992] 1 A.C. 233

the risk from those that do not.

3. The Contractual Classification of Warranties in Marine Insurance

Warranties are all terms of marine insurance contracts. So far, it is made out that descriptive warranties are fundamental terms of the contract but they are contingent non-obligatory and that performing warranties are ancillary terms and they impose secondary obligations. Now the question is how to classify a particular marine insurance warranty according to the classification of general contractual terms. It is familiar to common lawyers that contractual terms are classified as conditions, warranties, and innominate terms and the effects of their breach are accordingly different. Does this also apply to marine insurance warranties? As noted earlier in this work, the English courts have tried to apply this classification to insurance contract terms with little success.¹ It is time to recognise that difficulties would arise when insurance contract law is developed by reference to standard contractual principles without recognition of the peculiarities of insurance contract theory. Therefore, it is necessary to ponder how to classify insurance contract terms correctly in the insurance context so as to ascertain the effects of their breach accordingly.

3.1 Contractual Terms in General Contract Law

A contract, in essence, is a legally binding agreement between parties who make promises to each other. It consists of promises which are exchanged with consideration. However, promises are not all equally important in a contract. Needless to say, they are different in view of their value to the fulfillment of the contract. For a long time, it was assumed that the *Sale of Goods Act 1893* contained an accurate and complete picture of the English law of contract as it existed prior to 1893, by which contractual terms are of two categories, i.e. warranties and conditions. The purpose of classifying the terms of a contract into different categories is to ascertain the effects of their breach.

‘Condition’ and ‘Warranty’

Traditionally, it is accepted that the general law of contract is contained in the law of sale of goods contracts. In a sale of goods contract, terms are classified under two categories: condition, breach of which entitles the innocent party to terminate the contract, and warranty, breach of which does not give rise to a right of termination, but only sounds in damages.²

¹ *Alfred McAlpine Plc v BAI (Run-Off) Ltd* [2000] 1 Lloyd's Rep. 437; *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corporation* [2005] EWCA Civ 601

² In the *Hong Kong Fir* case [1962] 2 Q.B. 26, a third class of terms, i.e. innominate terms, were recognized by the court. The breach of such terms may or may not entitle the injured party to put an end to the contract. It depends on the nature and effect of that breach.

The genesis and evolution

This sharp dichotomy is clearly articulated in the *Sale of Goods Act 1893*,¹ which was also drafted by Sir M. D. Chalmers. In his note to the 1893 Act,² he said that the import of condition and warranty into contract law was derived from the law of conveyancing, where, in the older cases, a distinction was drawn between ‘dependent promises’, the breach of which gives rise to a claim for damages only, and ‘independent promises’, breach of which gives rise to a right to treat the contract as repudiated. By the time Sir M.D. Chalmers drafted the 1893 Act, the term ‘dependent promise’ appears to have been merged with the wider term ‘condition precedent’³ To reflect this change, he adopted the term ‘condition’ in the *Sale of Goods Act 1893*, meaning a promise so vital to the contract that its complete performance by the party making it is a condition of the liability of the other party to perform his part. As the concept introduces an order of performance in the contract, it was also called condition precedent.

The growth of the special use of the word ‘condition’ led to the emergence of a special use of the word ‘warranty’, which was used to contrast the word ‘condition’. As a matter of fact, the evolution of the word ‘warranty’ was complex. For a considerable period, the law of warranties was represented by the development of the law of contractual promises in sales. In the older cases before the development of *assumpsit*, statements relating to goods sold were referred to as warranties and were conceived of as sounding in tort.⁴ Therefore, the connotation of the word ‘warranty’ in English law is essentially ‘promise’. It retained this connotation for some time after the evolution of *assumpsit* and was thought of in connection with the action of deceit.⁵ But in the 1893 Act, a special meaning was attributed to the term ‘warranty’, meaning a contractual promise regarded as less important terms of a contract the breach of which did not give rise to such a right as condition to treat the contract as discharged: viz, promises that were not conditions.⁶

The connotation and confusion

¹ The 1893 Act was repealed by the *Sale of Goods Act 1979*.

² *Sale of Goods* (2nd ed. 1894), pp. 164-165.

³ It is believed that ‘precedent’ is added to make a distinction with ‘subsequent’. *Benjamin’s Sale of Goods*, 4th ed. Sweet & Maxwell, p444. However, some scholars argued that the term ‘condition precedent’ was used as shorthand to describe a term whose performance is a condition precedent to the other party’s obligation to perform. See Robert Bradgate, *Termination of contracts*, Wiley Chancery, 1995, pp41-45. Anyway, the essence of dependent promises is that they require an order of performance of obligations, by which one party’s performance of obligation is dependent/conditional on the other party’s performance.

⁴ Simpson, *History of the Common Law of Contract* (1975), p.240.

⁵ *Benjamin’s Sale of Goods*, 4th ed. 1992, Sweet & Maxwell, p.437.

⁶ Section 11(1) (b) of *Sale of Goods Act 1893*.

That said, the expressions ‘condition’ and ‘warranty’ have accumulated certain connotations in their meaning during the development of law. Although the *Sale of Goods Act 1893* clarified their meaning in the Act, they have been used in a variety of senses.

It is submitted that one of the notorious sources of difficulty in the law of contract is the variety of senses in which it uses the expressions ‘condition’ and ‘condition precedent.’¹ Both terms can be used in both a contingent and a promise sense and were used interchangeably without distinction. In the contingent sense, they relate to the order of performance,² whereas in the promissory sense they relate to the conformity of the performance.³ To make the problem even worse, the expression ‘condition’ was commonly used to refer to ‘condition precedent’ as a contract to ‘warranty’ when the discussion concerned conformity of performance. In such a situation, the term was used in their promissory sense.⁴ Recent authorities have attempted to treat the two terms, ‘condition’ and ‘condition precedent’, as separate terms and use the term ‘condition precedent’ to denote the term ‘condition’ when it is used in the contingent sense.⁵

The same situation is also true of the term of ‘warranty’. As noted earlier, the old idea of warranty was associated with that of deceit. It was used to refer to statements or promises as to the goods sold and was regarded as giving rise to an action separate from those upon the main transaction. Therefore, it was treated as collateral to the main contract. This notion was indeed incorporated into the section 62 (1) of *Sale of Goods Act 1893*, which defined a warranty as ‘an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract.’ In this sense, warranty means contractual promises which are separate from the main contract, whether it is clearly prior or otherwise external to the contract, or contrary to the terms of the contract, or because the contract is reduced to writing.⁶ It is submitted that this ‘is a very misleading usage, for it makes the warranty which is a term of the contract easy to confuse with the warranty which is part, or the subject of a genuine collateral contract separate from the main contract.’⁷ Indeed, since the amalgamation of ‘warranty’ into the general law of contract in the 1893 Act, the term ‘warranty’ has also been used to refer to contractual promises when the maker was to be regarded as undertaking contractual liability on it. Therefore, warranties are capable of being used in two senses: warranties as collateral promises and warranties as less important

¹ G.H. Treitel, *Conditions and conditions precedent*, L.Q.R. 1990, 185-192.

² *Gator Shipping Corp v Trans-Asiatic Oil SA and Occidental Shipping Etablissement SA (The Odenfeld)* [1978] 2 Lloyd’s Rep. 357

³ *Bentsen v Taylor Sons & Co.* [1983] 2 Q.B. 274

⁴ *Ibid.*, at 281.

⁵ *State Trading Corp of India Ltd v Golodetz (M) Ltd* [1989] 2 Lloyd’s Rep. 277

⁶ See *Chitty on Contracts* (26th ed.), Vol. 1. § 846; Treitel, *Law of Contract* (8th ed.), pp 176 et seq; Law Com. No 154, Cmnd. 9700 (1986)

⁷ *Benjamin’s Sale of Goods*, 4th ed. 1992, Sweet & Maxwell, p.442.

contractual promises. The difference between them is the former, viz., collateral promise, is separate to the contract and sounds in tort, whereas the latter is a contractual promise imposing legal liability and sounds in contract. There is a line of English authorities establishing that if a statement or affirmation 'is made in the course of dealings for a contract for the very purpose of inducing the other party to act upon it, and actually inducing him to act on it, by entering into the contract, that is prima facie ground for interfering that it was intended as a warranty. It is not necessary to speak of it as being collateral. Suffice it to say that it was intended to be acted upon and was in fact acted on.'¹ However, it is now fairly rare to distinguish whether a warranty is a collateral promise or contractual promise in English law, because an action in tort or under section 2(1) of the Misrepresentation Act 1967 has been more readily available in recent years in respect of the same statements. The action upon a collateral contract is far from dead.

Innominate Terms—Repudiatory Breach and Non-Repudiatory Breach

The dichotomy of warranties and conditions is by no means perfect. The reality of contractual practice is far more complicated. The abstraction of contractual terms being either conditions or warranties as major and lesser terms from the outset would not do any justice when the aggrieved party terminates the contract simply because of some minor breaches of a major term which does not deprive the innocent party substantially of his contractual benefit. Furthermore, some contractual terms are not easy to be classified as either major or minor terms from the outset and the effects of their breach are difficult to ascertain.

The problem was addressed in the leading case *Hong Kong Fir Shipping Co. Ltd v Kawasaki Kisen Kaisha Ltd*.² The court was given the chance to consider the injustice caused by the dichotomy of conditions and warranties. As a result, it was held that there was a new category of contractual terms—innominate terms, the effects of whose breach depend on the seriousness of its consequences to the contract: if it is a repudiatory breach, which substantially deprives the innocent party of his benefit under the contract, he is entitled to accept the repudiation and terminate the contract, whereas if the breach is not repudiatory and has not substantially deprived the innocent party of his benefit under the contract, he is only entitled to damages. This approach introduces the test of repudiatory and non-repudiatory breach into the process of deciding what rights and remedies a breach of contractual term would give to the innocent party under the contract. As a result, a trivial breach of a contractual term might no longer entitle the aggrieved party to terminate the

¹ *Dick Bentley Productions Ltd. v Harold Smith (Motors) Ltd.* [1965] W.L.R. 623, at 627, per Lord Denning M.R.

² [1962] 2 Q.B. 26

contract so as to escape from a bad bargain.

Therefore, in English law, contract terms can be innominate in nature and whether the victim of the breach is discharged from performance of his obligations would depend on the seriousness of the consequences of the breach. This approach is welcome and creates some flexibility in awarding remedies for breach of contract.

3.2 Contractual Terms in Marine Insurance Contracts

Marine insurance contracts are known as contracts of indemnity. This nature of marine insurance contracts is so different from that of the sale of goods contracts and the application of the traditional classification of contractual terms is therefore problematic in marine insurance contracts. The contents of marine insurance contracts are of quite a peculiar character. As noted above, insurance contracts are basically concerned with scope of the cover and measure of indemnity. Therefore, it is doubtful whether the insurance contract terms can also be classified into the three categories of general contract law. Indeed, it is more and more accepted that there are specific rules in different kinds of contracts. It has been suggested that there is not a law of contract, but rather a law of contracts and the classical contract law contained in the sale of goods contracts should be marginalised in many contracts.¹

The Current Contractual Hierarchy of Policy Terms

It will be recalled that the current approach of identifying policy terms is to classify them as warranties, conditions precedent, and ordinary conditions. If a term is a warranty in the sense of s.33 (1), any breach of the term would discharge the insurer from his liability automatically. If a term is a condition precedent, on the construction of the whole policy, breach would entitle the insurer to defeat liability to the related claims or to all claims under the policy. It does not matter whether the breach is serious or causal to the claim or loss, as the condition precedent is used in its contingent sense and it concerns an order of performance here. If a term is an ordinary condition, it is usual to assume it is innominate in nature and wait and see the seriousness of its breach. If its breach is serious, it might amount to a repudiation of the whole policy; whereas if it is trivial, it would only entitle the insurer to damages.

As also noted earlier, there is a line of recent authorities establishing that a serious breach of an ordinary condition may only lead to a repudiation of the related claim, but leave the

¹ See generally J N. Adams & Roger Brownsword, *Understanding contract law*, 4th ed, Sweet & Maxwell, 2004.

policy unaffected.¹ This was seriously doubted in the Court of Appeal's decision in *Friends Provident Life & Pensions Ltd v Sirius International Insurance*.² It is now difficult to say whether there is a third type of innominate term, the breach of which might entitle the insurer to reject related claims only.

It is obvious that the current classification of policy terms is different to that in general contract law. The peculiarity is that the terms 'condition' and 'warranty' have different meanings in the classification. The effect of breach of 'warranty' and 'condition precedent' is rather unique: they are related to the risk and the liability for claims respectively. They have no effect on the contract. Breach of them is not repudiation of contract. The only commonality shared between insurance contracts and general contracts is when it comes to an ordinary condition a 'wait-and-see' approach is used to ascertain the effect of breach.

A New Classification of Insurance Contract Terms

It is obvious that the current classification of policy terms does not fully address the peculiarities of insurance contracts and the nature of their contents. That said, the primary concern for insurance contracts is the scope of cover and the measure of indemnity. Terms on these matters are definitive and descriptive. In addition to that, insurance contracts are also concerned about obligations on the insured. There are also obligations on the insurer but they are not the major concern in insurance. Therefore, it seems obvious that contractual terms in insurance are of two groups: non-obligatory group and obligatory group. This is the key feature of insurance contracts. To illustrate the point, here is a list of some of the most common policy terms to be found in insurance contracts:

- (1) Descriptions of the risks covered;
- (2) Suspensive conditions of when the insurer is on risk;
- (3) Exclusions for certain risks;
- (4) Limitations on an unacceptable aspect of the risk that is covered;
- (5) Warranties
- (6) Requirements to take reasonable care and caution;
- (7) Requirements to notify the specified events during the currency of insurance;
- (8) Time limits and procedures for claims;
- (9) Payment of premium;

¹*Alfred McAlpine Plc v BAI (Run-Off) Ltd* [2000] 1 Lloyd's Rep. 437; *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters* [2001] 2 Lloyd's Rep. 563; *Glencore International AG v Ryan (The Beursgracht)*, [2002] Lloyd's Rep. I.R. 335. *Bankers Insurance Company v Patrick South* [2003] EWHC 380.

² [2005] EWCA Civ. 601

(10) Measure of indemnity.¹

It is quite obvious that terms (1)--(4) are of the non-obligation group and they do not impose any obligations on the insured. Indeed, they are fundamental terms of the contract but they are of a contingent nature. They are all conditions precedent either to attachment of the risk or to the insurer's liability. Non-compliance will entitle the insurer to defeat claims. Descriptive warranties of (5) obviously belong to this group. By contrast, terms (6)--(9) are of a promissory nature. They are of the obligatory group and they impose obligations on the insured. Nonetheless, terms (6)--(8) are ancillary terms to the main purpose of the contract, whereas (9) is fundamental to the main purpose of the contract.² Performing warranties of (5) seem to fit into this group. Considering these features of contractual terms in marine insurance contracts, it is certainly unrealistic to assume that they can be classified as general contractual terms as in the sales of goods contracts. Rather, they had better be classified according to their nature in insurance contracts as contingent terms and obligatory terms.

Contingent Terms

Those non-obligatory terms do not belong to any category of the classification of general contractual terms. The reason why they cannot be classified as general contractual terms is that they are contingent in nature and they are non-obligatory. Therefore, they are better classified as a condition precedent in the contingent sense. They are condition precedent to the risk. Under current law, non-compliance with these contingent terms either prevents the risk from attaching, or suspends the risk, or brings the risk to an end automatically. The current law does not have regard as to whether the non-compliance has a material bearing on the risk or a causal link to the loss. This brings injustice to the insured. The law should be flexible and take these factors into consideration when ascertaining remedies.

Obligatory Terms

Obligatory terms cannot be classified into any category of the general contractual terms, either. They are obligatory but they are mostly ancillary terms.³ Under current English law, non-compliance with these terms would entitle the insurer either to terminate the policy for

¹ Measure of indemnity is rather different from all the above terms. It is about the calculation of indemnity for claims. There are also some other clauses in an insurance policy, e.g. jurisdiction, choice of law and arbitration clauses. They are of a special nature in that they are not affected when the contract is repudiated or cancelled. They are not the core terms of the contract. They are ancillary to facilitate dispute settlement. Therefore, they are not considered here.

² However, under English law and practice, breach of duty of paying the premium is rarely regarded as a repudiation of the contract.

³ In English law, payment of premium might be regarded as a fundamental term of insurance contracts. But non-payment of premium is not a repudiatory breach of contract and the insurer is not entitled to treat the policy as repudiated unless time is or has been made of essence, or unless the insured is unwilling or, by reason of insolvency, unable to pay. *Pacific & General Insurance Co Ltd v Hazell* [1996] L.R.L.R. 65

repudiation or damages unless it is otherwise agreed in the contract. However, it is submitted that few breaches of the obligations in an insurance contract would go to the root of the policy and amount to a repudiation of the policy. Therefore, the remedy of repudiation is of little use. As to the remedy of damages, it is admittedly 'illusory'.¹ The only case where damages were awarded is *Hussain v Brown (No.2)*² and it was by way of set-off against a counterclaim.³ This almost left the current insurance law in an all-or-nothing state as regards remedies for breach of obligatory terms. Indeed, Waller L.J.'s initiative in *Alfred McAlpine Plc v BAI (Run-Off) Ltd*⁴ to introduce the remedy of repudiation of a claim was a good move to solve this problem, but as noted, it has been rightly accused of being inconsistent with general contractual doctrines. It is sad that Waller L.J.'s innovation to improve the current state of English insurance law was so abruptly rejected without acknowledgement of its reasonable element. Considering the variable nature of breach of these obligatory terms, it should be argued that the remedies for breach of such terms should be decided according to the gravity and nature of the breach. As few of them would amount to a repudiation of the whole policy, rejection of a related claim should be regarded as a most appropriate remedy for its breach in most cases.

3.3 Reflections on the Nature of Insurance Warranties

It will be recalled that in *The Good Luck*⁵ it was held that the nature of insurance warranties is that of condition precedent and Lord Goff emphasised that the word condition is used in the contingent sense. In particular, a future warranty is a condition precedent to the insurer's liability, the breach of which will discharge the insurer automatically from further liability as from the time of breach⁶ and a present warranty is a condition precedent to the attachment of the risk, the breach of which will prevent the insurer from coming on risk.⁷ This restatement of warranties as conditions precedent in the contingent sense has some flaws.

First, Lord Goff did not address the fact that warranties are different from conditions precedent in general contract law and also failed to point out the difference between insurance warranties and other conditions precedent in insurance contracts. In general contract law, as noted earlier in this work, a condition precedent concerns an order of performance: the

¹ *Friends Provident Life & Pension Ltd v Sirius International Insurance Corporation* [2005] EWCA Civ 601, *per* Waller L.J.

² [1997] 9 ILM 4. See also Merkin, *Colinvaux & Merkin's Insurance Contract Law*, looseleaf, 2005, release 13, B-0092.

³ In *Friends Provident Life & Pension Ltd v Sirius International Insurance Corporation* [2005] EWCA Civ 601, Mance L.J. and Sir William Aldous shied away from this comment and they stated that in some cases the measure of damages would be speculative, but that in other cases damages could readily be calculated.

⁴ [2000] 1 Lloyd's Rep. 437

⁵ *The Good Luck*, [1992] 1 A.C. 233

⁶ *Ibid*, at 263.

⁷ *Thomson v Weems* (1884) 9 App. Cas 671, 684.

promisee cannot be required to perform his part of the contract until the condition precedent is satisfied because non-fulfilment of a condition precedent allows the promisee to automatically withhold performance of his counter-obligation. As seen, insurance warranties are related to the risk or the claims, and have nothing to do with the order of performance of obligations under the contract. Therefore, warranties are not the same as conditions precedent in general contract law. Nonetheless, there are condition precedents of the general contract law sense in insurance contracts. Take claim conditions, they are not related to the risk. Although they are also held to be conditions precedent to the insurer's liability, they actually concern an order of performance of obligations. Therefore, they are not the same conditions precedent as warranties but conditions precedent in the general contract law sense. Indeed, there is one common feature shared by these two types of conditions precedent: non-compliance with either type will provide an absolute defence to the innocent party without considering the seriousness of the breach. The point is illustrated in *George Hunt Cranes Ltd v Scottish Boiler and General Insurance Co Ltd*.¹ The policy concerned a notification of loss clause. Under Clause 2(c), the insured was required to notify the insurer of the claim in writing 30 days after the loss and no claim was to be payable unless the terms of this condition had been complied with. The insured did not notify the insurer as required and thus the condition was breached. The issue for the judge was whether compliance with clause 2(c) was a condition precedent to the liability under the policy or an ordinary condition of the policy, breach of which would only give a right to counterclaim for damages in respect of any increased expense or other loss incurred by the reason of the lateness of the claim. The Court of Appeal held that compliance with the condition was a condition precedent to the liability of the insurers, by which the insurers had an absolute defence irrespective of the seriousness of the breach or the degree of prejudice caused to them. So Lord Goff was only half way right in his approach to classify insurance warranties as conditions precedent: he recognised that warranties are conditions precedent in the sense that they afford the insurer an absolute defence to his liability, but he failed to appreciate that insurance warranties are related to the risk but not related to the order of performance of obligations and consequently failed to distinguish the difference between warranties and other conditions precedent in insurance contracts.

Secondly, Lord Goff's analysis of warranties is too general to be accurate in every situation considering the many variants of warranties. As noted earlier, warranties have a variety of

¹ [2002] Lloyd's Rep IR 178

functions and natures.¹ It will be appreciated that the current categorisations of warranties have many defects. There is no consistency with the criteria and there are overlaps between different groups of warranties. Moreover, under the current approach of categorisation, warranties are very easily confused with other terms of insurance contracts, such as suspensive conditions and conditions precedent. To resolve this problem, warranties and other terms of insurance contracts should be classified solely into two classes as discussed above: contingent terms and obligatory terms. It will be appreciated that insurance warranties are by no means all conditions precedent in the contingent sense. There are warranties of an obligatory nature. Therefore, their classification should be analysed individually according to their distinctive nature on the construction of the policy as a whole.

Thirdly, the House of Lords in *The Good Luck* was right in distinguishing marine insurance warranties from conditions in the general contract law sense. However, it was a pity that the House of Lords did not go further and explore the peculiarities of the contractual terms in insurance contracts and failed to find out the proper range of remedies for breach of policy terms. The ‘all-or-nothing’ remedy of automatic discharge of liability did not address the variable nature and breach of warranties. As noted earlier, the initiative of Waller L.J in *Alfred McAlpine*² is a valuable attempt to explore the proper range of remedies for breach of insurance contracts. In fact, the current insurer’s remedy for breach of insurance contracts is in most cases an ‘all-or-nothing’ approach. Another example is in the case of utmost good faith where an ‘all-or-nothing’ approach was also adopted. There is considerable criticism and call for reform to create more flexibility in the range of remedies in that area as well. It is submitted that ‘what is needed is a more sophisticated remedy more appropriate, and in that sense more proportionate, to the wrong suffered. The introduction of judicial discretion into this field would not be without its advantages.’³ Indeed, now there has been some increased flexibility of remedies for breach of utmost good faith in the post-contract context.⁴ In *K/S Merc-Scandia XXXXII v Lloyd’s Underwriters (The Mercandian Continent)*,⁵ Longmore L.J held that there was no right to avoid for breach of duty of utmost good faith in the post-contract context and the insurers are confined to contractual remedies of prospective termination or rejection of claim. However, this flexibility has not been appreciated in the context of breach of policy terms and there is strong resistance to the notion of rejection of claim as evidenced

¹ See above p. 103.

² [2000] 1 Lloyd’s Rep 437

³ *Pan Atlantic Insurance Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd’s Rep 496, at 508.

⁴ Nonetheless, it is to be noted that much of the judicial consideration of the existence, extent and consequences of any general post-contractual duty of good faith has occurred in the claims context.

⁵ [2001] 2 Lloyd’s Rep 563, paras. [26] and [35].

in *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corporation*.¹ It is suggested that ‘a unanimous ruling by the Court of Appeal or the House of Lords’ on the remedies of breach of policy terms should be welcome.²

In view of previous discussions, it could be argued that insurance contract terms bear different characteristics to general contract terms. They are either related to the risk or related to the claim. If it is a contingent term, it is related to the risk. If it is an obligatory term, it is related to the claim. Consequently, the effects of their breach should be different from general contract law and be linked to risk and claims where appropriate. If this suggestion is sustainable, there is a case to argue that the remedies for breach of these terms should be adaptive to their nature. Non-compliance with a contingent term does not necessarily have a material effect on the risk; therefore, the insurer should be entitled to elect whether he wishes to terminate the contract or not. Likewise, non-compliance with an obligatory term does not necessarily repudiate the whole contract; therefore, they are entitled to make claims unrelated to the breach. If this applies, it will alleviate the current defects of warranty rules and many other areas of insurance law.

4. Compatibility of Warranties with Other Principles and Doctrines of Marine Insurance Law

Insurance contracts are a very special branch of contract law. The peculiarity lies in that the contract is a contract of speculation. The insured pays the premium for the insurer’s promise to indemnify his loss caused by insured risks. From the insurer’s view, they collect the premium from the individual insured and manage the collected premium as a pool for indemnification of risks. When a particular insured suffers a loss by the risks insured against, the insurer has to pay the loss, which is much more than what the insured has paid for the premium. On the contrary, from the insured’s view, even if no loss happens to the insured during the insurance, the premium is still not returned. The essence of insurance is a mechanism of compensation by loss spreading. Furthermore, insurance is a contract of speculation in the sense that the insured has a superior knowledge of the insured subject matter than the insurer and the insurer has to rely on the insured to disclose information to him so as to evaluate the risk and calculate the premium.³ In addition, once the risk incepts, the insured subject matter is solely under the assured’s control, the insurer has little means to

¹ [2005] EWCA Civ 601

² Lowry and Rawlings, *Insurance Law: Doctrines and Principles*, 2nd ed., 2005, p.207.

³ *Carter v. Boehm* (1766) 3 Burr. 1905. Lord Mansfield said that ‘insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist ...’

control the risk. As a result, the law of insurance has developed principles and doctrines to protect the insurer from such a total blindness of the risk in the contract and the subsequent inability to control the risk. They are principles of utmost good faith and indemnity and the doctrine of alteration of risk. With these principles and doctrine, a rigid rule of warranties seems to be redundant.

4.1 Warranties and the Principle of Utmost Good Faith

English law requires a duty of utmost good faith in insurance contracts. This principle was codified in sections 17-20 of the MIA 1906. The Act says that the marine insurance contract is a contract of utmost good faith; the insured or his agent, before the contract is concluded, has the obligation to disclose every material circumstance he knows to the insurer; and every material representation made by the insured or his agent to the insurer during the negotiation for the contract and before the contract is concluded must be true.¹ Indeed, in the early English authorities, warranty seems to be a corollary to the principle of utmost good faith.² In fact, some scholars of the early 20th century believed that warranty was derived from the principle of utmost good faith.³ This might be thought right, because many of the early authorities on warranties were decided on the equal footing of breach of duty of utmost good faith, which avoided the contract. However, this could not be right. The distinction between warranty and the duty of utmost good faith was noted by Lord Mansfield in *Pawson v Watson*,⁴ where he said that:

It would be of dangerous consequence to add a conversation that passed at the time as part of the written agreement. It is a collateral representation and if the parties had considered it as a warranty, they would have instead in the policy...where it is a part of the written policy, it must be performed . . . nothing tantamount will do, or answer the purpose.

It was made clear that warranties are contractual.⁵ By contrast, the duty of utmost good faith operates as a rule of law. Recently, the difference between warranty and non-disclosure and misrepresentation was once again addressed in *HIH Casualty & General Insurance Ltd v New*

¹ There are debates on whether this duty continues after the conclusion of the contract.

² See above p. 10

³ Hurd, *Marine insurance*, (1922), p 20.

⁴ (1778) 2 Cowp. 785

⁵ In this case, Lord Mansfield did not consider the implied warranty when he gave the above dicta. As regards implied warranties, they are implied into the contract.

*Hampshire Insurance Co.*¹ Rix L. J said that:

Both those items [non-disclosure or misrepresentation] of subject matter are extra contractual. The first is dealing with arrangements collateral to the insurance contract, the second is dealing with pre-contractual negotiations. Breaches of warranty, however, are breaches of the contract of insurance itself.

The principle of utmost good faith is supposed to protect the insurer from a total blindness of the speculation of risks. However, it was far from sufficient for the underwriters to have only such a device to protect themselves, as the duty only requires the insured to disclose and not to misrepresent material information; and the insurer also must prove that the undisclosed information was material.² This made two things difficult for the insurers to successfully protect themselves: the control of the increase of risk after the contract was concluded and the burden of proof as to materiality of the misrepresentation. As a device to overcome these difficulties, warranties were used in the marine insurance contract along with representation and disclosure to improve the character of the insurance contract. In *De Maurier (Jewels) Ltd v Bastion Insurance Co.*,³ it is said that:

Representation ... would relate only to the time of the broking of the contract, but ... a warranty operates throughout the period of risk. The existence of a warranty can limit the duty of disclosure owed by an intending assured ... and for similar reasons can render a representation immaterial.

In the light of the recent judicial debate as to whether the duty of utmost good faith continues after the conclusion of contract,⁴ it might be wondered: if there is a continuing duty of utmost good faith, should it require the assured to disclose any material change of risk to the insurer? It is submitted that the nature and content of the continuing duty of utmost good faith is less clear in English law. As noted earlier, the law seems to come to a halt in the Court of Appeal in *K/S Merc-Scandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)*⁵ where Longmore L.J held that a continuing duty of good faith exists but it is limited to situations where there is express or implied term in the contract that requires the assured to provide information. Therefore, as far as the duty of disclosure is concerned, the continuing

¹ [2001] 2 Lloyd's Rep 161

² The test of materiality is now settled in the *Pan Atlantic Co Ltd v Pine Top Insurance Co* [1995] 1 AC 501 (H.L).

³ [1967] 1 Lloyd's Rep 550

⁴ *Black Shipping Corporation and Wayang (Panama) S.A v Mark Ranald Massie (The Litsion Pride)* [1985] 1 Lloyd's Rep 437; *Manifest Shipping Co Ltd v Uni-Plaris Insurance Co Ltd (The Star Sea)* [2001] Lloyd's Rep IR 247

⁵ [2001] 2 Lloyd's Rep 563

duty of good faith only exists where there is a contractual obligation to disclose. In all circumstances, the duty ends once litigation starts.¹ It is submitted that this outcome of the case created even more uncertainty.

Thus far, it seems that the doctrine of warranty has filled certain blanks left by the duty of utmost good faith. However, it is arguable whether the insurer still needs such double protection in modern days. Furthermore, the doctrine of warranties is also erosive to the principle of utmost good faith. It is accepted that the duty of good faith under s.17 of the MIA 1906 is a mutual duty owed both by the insured and the insurer. Recently, in *Drake Insurance plc v Provident Insurance plc*² it was argued whether the insurer's right to avoid the contract was limited by the duty of utmost good faith in circumstances where that remedy would operate unfairly. Rix L.J expressed the view that 'it might be necessary to give wider effect to the doctrine of good faith and recognise that its impact may demand that ultimately regard must be had to a concept of proportionality implicit in fair dealing.'³ In a similar vein, in cases where the broken warranty is a contractual warranty which has no material bearing on the risk, the insurer's rejection of claims for the insured's loss which is proximately caused by insured risks cannot be justified. It is right to argue that the insurer should act in good faith and not use warranties as a technical defence to defeat genuine claims. Therefore, it is a case to argue that when the insurer denies his liability for a loss proximately caused by insured risks on the ground that an immaterial warranty is broken, the operation of warranties invalidates the principle of utmost good faith.

4.2 Warranties and the Principle of Indemnity

English law states that the marine insurance contract is a contract of indemnity. This principle was codified in the MIA 1906.⁴ The implication of this principle is twofold. First, the insured can only claim for his genuine loss under the cover. Therefore, the loss must be caused by risks insured against in the cover and the insured must have an insurable interest on the subject matter. Secondly, the insured cannot receive more than the actual value of the subject matter insured. The only exception to this principle is the valued policy in practice, by which the value of the subject insured is agreed between the insurer and the insured. As an aspect of the principle of indemnity, English law also requires that the insured must have an insurable interest on the subject matter insured, which is known as the principle of insurable

¹ *K/S Merc-Skandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] Lloyd's Rep IR 802; *Agapitos v Agnew (The Aegeon)* [2002] Lloyd's Rep IR 573

² [2004] Lloyd's IR 277

³ *Ibid*, [89].

⁴ Section 1, MIA 1906.

interest¹ and that only the loss proximately caused by the risk insured against is recoverable from the insurer, which is known as the principle of proximate cause.²

The doctrine of warranties in marine insurance might in some cases evade the principle of indemnity. The application of warranties overrides the principle of indemnity in cases where the insured suffered a genuine loss but lost his cover for breach of a warranty which is neither causal to the loss nor material to the risk. It is understandable that the insured would not be indemnified when the breach of warranty has material bearing on the risk or is causative to the loss. But it is quite unfair that the insured is unable to claim for indemnification under the cover for a trivial breach of warranty which has not caused the loss or a breach of a trivial warranty that has little impact on the risk. In this case, the operation of the doctrine of warranties is obviously contradictory to the purpose of insurance as a contract of indemnity and cannot be justified.

4.3 Warranties and the Doctrine of Alteration of Risk

English law has recognised a doctrine of alteration of risk. As noted earlier,³ there are two types of changes of risk in insurance: increase of risk and alteration of risk. The common law rule for the alteration of risk is that the insurer is automatically discharged from the policy when the risk is altered.⁴ This rule was dated to those decisions on the change of voyage or deviation. However, if the nature of the risk is unaltered but only the probability of a loss occurring is increased by a change of circumstances, the insurer remains on risk.⁵

It will be recalled that warranties are either descriptive warranties defining the scope of the cover or performing warranties controlling the increase of risk. It seems that the function of descriptive warranties could be fulfilled by the doctrine of alteration of risk. When the risk is so changed that the nature of it is no longer what has been represented, the rule of automatic discharge kicks in. What is absent in English law is a rule of law when the risk is so changed that the probability of a loss is increased. The law does not require the insured to take reasonable care to prevent the increase of risk.⁶ However, the insurer is not completely helpless. They are capable of looking after themselves by using express terms in the policy⁷ and this has been the traditional values of English commercial and mercantile law.⁸ Therefore,

¹ MIA 1906, s 4(1). *Lucena v Craufurd* (1806) 2 Bos PNR 269; *National Oilwell (UK) Ltd v Davy Offshore Ltd* [1993] 2 Lloyd's Rep 582; *Feasey v Sun Life Assurance Co. of Canada* [2003] Lloyd's Rep IR 640

² S 55 (1), MIA 1906.

³ See above p.108.

⁴ *Hartley v Buggin* (1781) 3 Dougl. 39; *Shaw v Robberds* (1837) 6 A & E. 75; *Company of African Merchants Ltd. v British & Foreign Marine Insurance Co. Ltd.* (1873) L.R. 8 Ex 154

⁵ *Pim v Reid* (1843) 6 Man. & C. 1; *Thompson v Hopper* (1856) 6 E. & B 172

⁶ *Baxendale v Harvey* (1849) 4 H & N 455, 499, 452

⁷ *Friends Provident Life & Pension Ltd v Sirius International Insurance Corporation* [2005] EWCA Civ 601, *per* Mance L.J.

⁸ *Manifest Shipping & Co v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2001] 1 Lloyd's Rep 389, at [45], *per* Lord Hobhouse.

there is no necessity of a doctrine of automatic discharge for breach of performing warranties. It should be left to the freedom of contract.

5. Conclusion

The original idea of the warranty in English marine insurance law was to educate the insured to be responsible for their representation during the negotiation and behaviour during the currency of the contract. Therefore, the doctrine of warranty operates at two stages: pre-contract and post-contract. At the pre-contractual stage, the doctrine of warranty educates and enforces the insured to give correct and truthful representations to the insurer for the purpose of evaluation of the risk and decision of the rate of premium. Once the representations are written into the policy or incorporated into the policy, they are sanctified as warranties, which are conclusive evidence of what the subject matter is like or the risk will be, and there is no latitude of negligence or good faith in question. Therefore, it renders the representation immaterial and lessens the burden of proof on the insurer. At the post-contractual stage, the doctrine of warranty educates and encourages the insured to stay within the policy and not to alter the risk agreed to cover by the insurer. As there is no rule of increase of risk in English law,¹ the insured has no obligation to take due care of the insured subject matter at common law. As an alternative, the warranty is used to limit the possibility of the insured to endanger the insured subject matter. Nonetheless, it is arguable that these functions of warranties can be addressed by either existing principles/doctrines of marine insurance law or express policy terms. Indeed, the existence of warranties is rather redundant.

The current English law of marine insurance warranties is complex at many levels. Within insurance law, it is mixed up with the duty of representation and disclosure, and sometimes even tends to be erosive of the cardinal principles of marine insurance law. Outside insurance law, the law of marine insurance warranties is contrasted to general contract law where some concepts are the same by name but are different in nature. Finally, within the concept of marine insurance warranties itself, it can be very diverse in different contexts and its nature cannot be generalised as a unified one. As a result, it is a case to argue that the remedies for breach of warranty should be flexible and proportionate to the nature of the warranty and the gravity of the breach. However, such a rule of proportionality is not accepted in English law. As Rix L.J. rightly commented in *Drake Insurance plc v Provident Insurance plc*², 'on the whole

¹ It is to be noted that increase of risk and alteration of risk is two aspects of change of risk. Increase of risk refers to an increase of the chance of loss. The risk is still the same risk as the insurer contemplated. Alteration of risk refers to a change in the nature of the risk so that it no longer fall within the insurance cover. The common law rule on the alteration of risk is that the insurer is discharged automatically from liability upon the alteration of risk.

² [2004] Lloyd's IR 277, at [88]. See a similar comment in *The Star Sea*, [2001] 1 Lloyd's Rep 389 at [45], *per* Lord Hobhouse.

English commercial law has not favoured the process of balancing rights and wrongs under a species of what I suppose would now be called a doctrine of proportionality. Instead it has sought for stricter and simpler tests and for certainty.’ As the law stands today, the range of remedies for breach of warranties, like many areas of insurance contracts law, is still an ‘all-or-nothing’ approach.¹

To sum up, in order to change the current state of English law, the notion of warranty should be abolished from English insurance law. A new classification of policy terms should be introduced and a wider range of remedies should be recognised.

¹ The most striking example is the law of utmost good faith. It is submitted that English law should increase the flexibility of remedies in breach of the continuing duty of utmost good faith. See Bennett Howard, *Mapping the doctrine of utmost good faith in insurance contract law*, [1999] L.C.M.L.Q 165, at 219.

Chapter 6

THE LAW OF MARINE INSURANCE WARRANTIES FROM AN INTERNATIONAL PERSPECTIVE

It is undeniable that the influence of English marine insurance law goes beyond English borders. The problem of warranties under English law reaches far and wide. It is suggested that there is an international concern about the reform of warranties in English marine insurance law.¹ Few would argue against reform, but the obstacles are many and varied. The most important of all is how the law should be reformed and whether the reform would be feasible in solving the current problems. This chapter tries to discover the variety of approaches taken on the warranties issues in other jurisdictions and tries to compare the Australian and Norwegian legal framework to the English law of warranties. Their reformative approaches to warranties issues are regarded as pioneering solutions to the draconian regime of marine insurance warranties. They are best illustrations of two different ways of reforming the law, one by legislative reform, and one by standardised terms of the insurance contract. How relevant are they to the reform of English law? What are the prospects of English law of marine insurance warranties from this international perspective? This chapter will answer these questions.

1. An Overview of the International Marine Insurance Law²

Marine insurance is distinctly international and the English law of marine insurance is undoubtedly the most influential in many other jurisdictions. It is partly due to London's leading role in the world marine insurance market, and partly due to the influence of the old British Empire, which is represented by the commonwealth countries today.

In common law countries,³ the English Marine Insurance Act 1906 was either directly enacted as domestic law, or used as a model for their own domestic law of marine insurance. New Zealand and Australia enacted the English MIA 1906 as their own law of marine insurance in 1908 and 1909 respectively.⁴ In Canada,⁵ the law of marine insurance has been

¹ John Hare, Report on the CMI International Working Group meeting in London, Nov 2003.

² Cf: Trine-Lise Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties*, CMI Yearbook 2000, 332. The Australian Law Reform Commission Report 91, chapter 7.

³ Cf: Malcolm Clarke, *Marine insurance system in common law countries: status and problems*, a paper presented at the Oslo marine insurance symposium, June 1998. This paper is available at www.bmla.org.uk/annual_report/rep_marine_clark.htm

⁴ Sarah Derrington, 'The marine insurance law in Australia: Perspectives and permutations', D.R.Thomas, Chapter 11, *The Modern Law of Marine Insurance*, Vol. 2, LLP, 2002.

⁵ Cf: William Tetley, *International Maritime and Admiralty Law*, 2003.

long governed by provincial laws modelled on the English MIA 1906 or left to the common law. In 1993, the Canadian federal government enacted a federal marine insurance Act to resolve the uncertainty created by the differences between provincial laws and they again used the English MIA 1906 as the model. In the United States,¹ federal admiralty law has been greatly influenced by the English common law and federal courts have explicitly sought to keep federal marine insurance law in harmony with English law. However, the law of marine insurance in the U.S has been complicated by the decision in *Wilburn Boat v Fireman's Fund Insurance Co.*² In this case, the Supreme Court of the United States ruled that there was no federal law as to the effects of marine insurance warranties and therefore state law should apply. In the case, according to Texas Statutes, the breach of warranty was relevant only if the breach had contributed to the loss.³ Under *Wilburn Boat*, marine insurance questions in the United States may sometimes be resolved by reference to federal maritime law, but often will be controlled by the law of one of the fifty states.⁴

As a distinctive part of English marine insurance law, warranties are effective and facing criticism in these countries as well. By contrast, in the civil law countries, marine insurance followed a different route and the concept of warranties was not known in their legislations or contracts relating to marine insurance. In civil law countries,⁵ the law of marine insurance is usually contained in general insurance contracts legislations or in commercial codes rather than legislations applying specifically to marine insurance. In these countries, the law does not use the concept of warranties, but instead they have regulations about the alteration or increase of risk.⁶ Their laws do not recognise the elevation of a contractual term, however material to the risk or loss, to any special status akin to the English insurance warranties.⁷

¹ Cf: Buglass, *Marine insurance & general average in the United States*, 2nd ed. 1981, Cornell Maritime Press; Ed Cattell, *Marine insurance Survey: A comparison of United States law to the Marine Insurance Act 1906*, Tulane Maritime Law Journal Vol. 20, 1995, 1-103.

² 1955 AMC 467

³ This decision of the Supreme Court has been widely criticized. For a detailed account, see the Buglass, *Marine Insurance and General Average in the United States*, 2nd ed. 1981, Cornell Maritime Press, Maryland, 1981 pp.28-29. Cf: Michael F Sturley, *The Proposed Restatement of the Law of Marine Insurance*, a paper presented at the Houston Marine Insurance seminars, U.S.A, 1999. The paper is available at www.houstonmarineseminar.com/one.htm

⁴ *Wilburn Boat* creates problems on many levels, most of which go to the need for predictability and uniformity in the law governing marine insurance contracts. Since *Wilburn Boat*, in almost every case it has been an issue for debate whether state law or federal maritime law governs a particular question. With virtually no guidance from the Supreme Court, the lower courts are hopelessly divided in their attempts to answer this vertical choice of law question. Even when a court decides that state law should apply, it is often a complicated and difficult question to decide *which* state's law should apply. Finally, when a court has chosen a particular state's law, there is yet a further problem in applying that state's law in the marine insurance context.

⁵ Cf: The ALRC 91, chapter 7; Trine-Lise Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties*, CMI Yearbook 2000, 332.

⁶ Trine-Lise Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties*, CMI Yearbook 2000, at 376-377, Prof. Marc Huybrechts, *Marine insurance law: a san andreas fault between the common law and civil law*, Chapter 10, D.R. Thomas, *The Modern Law of Marine Insurance*, Vol. 2, LLP, 2002.

⁷ There are no rules on the alteration of risk in English law. Cf: Malcolm Clarke, *Aggravation of risk during the insurance period*, L.M.C.L.Q. 2003, 1(Feb), 109-124, Malcolm Clarke, *Policies and perceptions of insurance law in the twenty-first century*, Oxford University Press, 2005, pp.161-166.

2. The Way of Reform Relating to the Law of Warranties

There has long been a consensus that the current law of marine insurance warranties, represented by English law, needs to be reformed. However, the question is how the law should be reformed. Reform initiatives first started in general insurance law in the UK and were spread out in New Zealand and Australia by their respective law reform bodies. However, the reform has always been confined in the area of general insurance law until recently the Comité Maritime International (CMI) undertook a huge project of research on international marine insurance law, with an emphasis to introduce some harmonisation of the law, including warranties.

2.1 Domestic Efforts to Reform the Law of Insurance Warranties

The efforts to reform the law of warranties in general insurance have been widely seen in the common law countries for the last 50 years. The efforts were first initiated in the U.K in the 1950's and re-started in the 1970's, but there was no legislation enacted until recently. Following the U.K, reform efforts were made in New Zealand in the 1970's and followed by Australia in the 1980's, with reform legislations in the end. In the U.S and Canada, the judiciary has shown an inclination to alter the harsh rules of breach of warranty in a series of cases. However, no legislative reform has taken place, either. The following discussion will explore the reform options in these countries and compare the differences and similarities.

The U.K

In the U.K,¹ the reform of insurance law was picked up by the Law Reform Committee in 1957² and the Law Commission in 1980.³ The injustice worked by warranties was addressed in the Law Commission 1980 Report. Pursuant to clause 1 of the draft Bill in the 1980 report, the reform proposed is applicable to all classes of insurance other than those marine, aviation and transport (MAT) risks. The main reason for this is that the Law Commission took the view that MAT is largely commercial insurance between parties fully aware of their respective rights and duties, and its operation had not proved to have been unsatisfactory in the past. This is certainly no longer a sustainable argument, as there is also huge criticism in the MAT insurance section about warranties in recent years. Therefore, the proposed reform to warranties in the report is worth mentioning here as a reference point.

The draft Bill is concerned with three aspects of warranties: creation, construction and

¹ Cf: John Birds, *The reform of insurance law*, [1982] J.B.L 449 ; Peter North, *Law reform: Process and Problems* (1985) 101 L.Q.R. 338

² Law Reform Committee 1957 Fifth Report, Cmnd. 62.

³ Law Commission 1980 No.104, *Insurance Law: Non-disclosure and Breach of Warranty*, Cmnd. 8064.

effect of breach.¹ Assuming the concept of warranty would be retained, clause 8(1) of the draft Bill recommends that a statement or promise shall not be capable of constituting a warranty unless it relates to a matter that is material, i.e. a matter that would affect the judgment of a prudent insurer in assessing the risk or calculating the premium. Clause 10 (5) introduces a 'nexus' requirement between loss and breach of warranty and clause 10 (4) allows an insurer to reject a claim on the grounds of breach of warranty without the need for him to terminate the entire policy. Considering the nature of present warranty, clause 10 (1) allows the insurer to terminate the policy for breach only with effect from the date of which written notice is served upon the insured and clause 10 (3) provides that where the insurer seeks to avoid a contract after a loss he may do so by notice, avoidance being effective as from the date of service, but the claim itself is unaffected and the insurer can only refuse to pay if there is a 'nexus' between the breach of warranty and the loss. These recommendations are straightforward and strike right on the point but they have not been implemented for some mixed reasons, with the major one being opposition from the British insurance industry.²

In the meantime, facing the uprising of criticism, insurers in the sphere of individual non-business insurance have set up their own Statements of Practice.³ By virtue of these statements, an insurer will not repudiate on grounds of a breach of warranty or condition where the circumstances of the loss are unconnected with the breach 'unless fraud is involved.'⁴ It is suggested that the exception of fraud is not necessary, because the insurer can always reject a fraudulent claim.⁵ These statements are now in the Insurance Conduct of Business Rules regulated by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000.⁶ These Statements are only followed in non-business insurance when they are relevant.

In January 2006, the Law Commission of England and Wales launched a new project with the Scottish Law Commission to review current insurance contract law. This project aims to investigate the problem areas and the possibilities of reform in both marine and non-marine insurance as a general. It is too early to say whether this project will finally introduce any

¹ Robert Merkin, *Insurance law and law commission*, L.M.C.L.Q 1981 347 R.W.Hodgin, *Insurance law reform*, [1981] L.M.C.L.Q 284, at 292.

² Peter North, *Law reform: process and problems*, (1985) 101 L.Q.R. 338

³ They are the Statement of General Insurance Practice and the Statement of Long-term Insurance Practice. They were initially introduced in 1977 and later revised in 1986. For a more detailed account, see Birds, 'Self-regulation and Insurance Contracts', *New Foundations for Insurance Law*, ed. F. D. Rose, London Stevens & Son, 1987, Chapter 1.

⁴ Paragraph 2 (b) (iii), Statement of General Insurance Practice. See also para. (3) b of the Statement of Long-term Insurance Practice, which is similar but rather qualified. In fact, the wording of the Statements is now problematic. Following *The Good Luck*, there is no right to repudiate a contract for breach of warranty. These statements should be re-drafted to reflect this change of law.

⁵ Birds, *Modern Insurance Law*, 6th ed., Sweet & Maxwell, London 2004, p 166.

⁶ The Financial Services Authority (FSA) is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. For a general account of the FSMA 2000, see John Lowry & Philip Rawlings, *Insurance law: doctrines and principles*, 2005, pp.19-39.

reform in the area of marine insurance warranties.

New Zealand

In New Zealand,¹ the law of insurance generally, including marine insurance as codified by the Marine Insurance Act 1908, was extensively modified by the Insurance Law Reform Act 1977 (NZ). The Act provides that the insured remains entitled to be indemnified if there is a breach of warranty if he or she proves on the balance of probabilities that the loss was not caused or contributed to by the breach.² This introduces an element of causation but puts the onus on the insured to demonstrate that there was none. It is to be noted that, by virtue of section 11, the standard of proof of causation is on balance of probabilities that the loss in respect of which the insured seeks to be indemnified *was* not caused or contributed to by the breach. However, it is suggested that this section has been read down in recent cases, where *obiter* statements suggest that implied warranties are not affected by the Act.³

Australia

In Australia, the Australian Law Reform Commission considered a range of possibilities for reform of the law of general insurance relating to breaches of warranties and conditions in insurance contracts in their 1982 report, the ALRC 20.⁴ The reform was later enacted as Insurance Contracts Law 1984, coming into operation on 1 January 1986.

The commission adopted the New Zealand approach by entitling the insurer's right to refuse to pay claims only when there is causation between the breach and the loss, but the ALRC were especially aware that a test based on *actual* causation would deprive the insurer of all remedies where there is merely a statistical correlation between the conduct and an increase of risk. Therefore, the ALRC recommended a test of *potential* causation. This position was reflected in the Insurance Contracts Act 1984 s 54 (2), which says: subject to the succeeding provisions of this section, where the act could *reasonably* be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may refuse to pay the claim.

Different from the New Zealand and the UK approach to reform, which preserves the insurer's right to avoid liability in restricted circumstances where causation can be established, the ALRC also took the view that damages should also be considered, when avoidance of liability is not available. This is reflected in the ICA s 54(1): if the insurer cannot refuse to pay

¹ Cf: Johanna Vroegop, *Insurance law reform in New Zealand*, 3 J.B.L 1987 520. See also, David St Kelly, *Principles of Insurance Law in Australia and New Zealand*, Butterworths, 1991, pp.275-277.

² Section 11, Law Reform Act 1977 (NZ).

³ ALRC 91: *Review of Marine Insurance Act 1909*, para. 9.55-9.56.

⁴ ALRC 20: *Insurance contracts 1982*.

the claim, either in whole or in part, for the insured's breach of contract, his liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of that act. This approach has been proved to be problematic as it is not practical in litigation.¹

Recently, there has been another round of review focusing on the reform of Marine Insurance Act 1909 in Australia.² This review has been of international concern, and it has been acclaimed to achieve some success. A detailed discussion of the proposed reform in the review will be made shortly in this chapter.

Canada

In Canada,³ there has been no legislative effort to reform marine insurance law; however, the courts are aware of the defects and injustice that warranties could work. It is suggested that there has been a judicial amendment of the Canadian Marine Insurance Acts 1993.⁴

The Canadian court now requires that the insurer can only avoid his liability if the warranty is material to the risk and the breach has a bearing on the loss. In *Century Insurance Company of Canada v Case Existological Laboratories Ltd (The Bamcell II)*,⁵ a clause in the policy said that: 'warranted that a watchman is stationed on board the Bamcell II each night from 2200 hours to 0600 hours.' In fact, from the time the insurance commenced, no watchman had been stationed on the ship. The fact that there was no watchman on board during the prescribed hours had no bearing on the loss of the vessel, which occurred in mid-afternoon. The court held that the term was a suspensive condition and the breach only suspended the risk while the term was not complied with. Therefore, the insurer was liable. It is submitted that the Canadian judges in this case were desperate to circumvent the rule that a warranty, breach of which causes no loss, allowed the insurer to escape liability.⁶ This attitude of the Canadian judiciary is criticised to create more uncertainties in law, as their altering the clearly intended status of warranties would harm the distinction between warranties and other terms of a contract.⁷

U.S.A

As noted earlier, since the *Wilburn Boat* case, the law relating to marine insurance in U.S.A

¹Sarah Derrington, *Marine insurance law in Australia: the Australian law reform commission proposals*, [2002] L.M.C.L.Q. 214.

²ALRC 91: *Review of the Marine Insurance Act 1909*; ALRC Discussion Paper 63: *Review of the Marine Insurance Act 1909*. These documents are available at www.alrc.gov.au/publications/publist

³Rui M. Fernandes, *Marine Insurance Law of Canada*, 1987, Butterworths.

⁴Christopher J. Giaschi, *Warranties in Marine Insurance*, a paper presented to the Association of Marine Underwriters of British Columbia in Vancouver on April 10, 1997. The paper is available at www.admiraltylaw.com/papers/warranties.htm

⁵[1984] 1 WWR 97

⁶Andrew Longmore, *Good faith and breach of warranty: are we moving forwards or backwards?* [2004] L.M.C.L.Q. 158.

⁷B. Soyer, *Warranties in Marine Insurance* (2006), p.205.

is complicated by the choice of governing substantive law in each case.¹ It has been proposed that the American Law Institute (ALI),² in cooperation with the Maritime Law Association of the United States (MLA), undertake a *Restatement of the Law of Marine Insurance*.³ Although such a project could not correct all the damage that *Wilburn Boat* has produced, it has the best chance of bringing order and predictability to the law of marine insurance in the U.S.A. The MLA is currently moving forward with this suggestion. In the meantime, the American courts have also shown an inclination to interpret that breach of warranties would only have a suspensive effect.

2.2 Efforts to Reform and Harmonise the International Marine Insurance Law

At the CMI's Centenary conference in Antwerp in 1997 Lord Mustill, a Law Lord of the House of Lords in the U.K, suggested that the CMI put marine insurance in its work programme for the new millennium. With a flying start at the International Colloquium in Oslo in 1998, hosted by the Scandinavian Maritime Law Institute, lawyers from different countries identified the recurrent marine insurance problems with which their courts were confronted. Among others in the list, the problem of warranties was viewed as one of the most urgent areas where the current law should be amended. Following the colloquium, an International Working Group (IWG) was set up, consisting of a good mix of academics, practitioners (both common law and civilian systems) and an active underwriter. A questionnaire was distributed to all 53 National Maritime Law Associations affiliated to the CMI. Professor Trine-Lise Wilhelmsen from Scandinavian Maritime Law Institute made a thorough analysis of these answered questionnaires from member associations and produced

¹ Cf. Thomas Schoenbaum, *Warranties in the law of marine insurance: some suggestions for reform of English and American law*, Tulan Maritime Law Journal Vol. 23 1999 267; Michael F. Sturley, *Restating the law of marine insurance: A workable solution to the Wilburn Boat Problem*, J.M.L.C Vol. 29 No 1 (1998) 41-45; Michael F. Sturley, *A US perspective on marine insurance*, Chapter 12, D.R. Thomas, *The Modern Law of Marine Insurance*, Vol.2, 2002, LLP.

² The ALI is a non-profit organisation of approximately 3,500 lawyers, law professors, and judges dedicated to the reform and improvement of the law. Founded in 1923, the Institute has been highly influential in the development of United States law, primarily through its drafting of model legislation and its promulgation of 'Restatements' in a broad range of subjects. To give one indication of the ALI's influence, the Supreme Court has cited the Restatements in over eight hundred cases.

³ A Restatement goes through several distinct stages before final approval. First, the prospective reporter prepares a prospectus to outline the project and establish its scope. The Program Committee reviews the prospectus, and the Council (the ALI's 60-member governing body) approves it. The Director (the officer responsible for managing the ALI) then appoints a reporter (or co-reporters) and an advisory committee of practitioners, legal scholars, and judges with expertise in the subject. (These experts are not necessarily ALI members.) ALI members who wish to do so may join a 'members consultative group.' The reporter prepares a 'preliminary draft' covering some of the topics that will be included in the final Restatement. The ALI distributes this preliminary draft to the advisory committee and the members consultative group, which thereafter meet with the reporter for detailed discussions. The reporter revises the preliminary draft, based on this critical review, to prepare a 'council draft.' The reporter then meets with the Council for further review and discussion. Finally, with the Council's approval, the reporter prepares a 'tentative draft' for distribution to the full ALI membership and discussion at the annual meeting. At the end of this discussion, the membership votes on the draft. In the meantime, the reporter is already working on another preliminary draft covering another set of topics, and the annual cycle is repeated. When all of the topics have been addressed, and the full ALI membership has approved each of the tentative drafts, the reporter integrates all of the work into a final draft, which incorporates revisions adopted at annual meetings, reconciles inconsistencies, and updates references. The finished product is published as a printed volume and distributed widely.

a report, which was presented to the 37th CMI conference in Singapore in 2001.¹

In introducing the Marine Insurance Session at the Singapore conference, Professor John Hare pointed out that marine insurance works relatively comfortably across borders, in and out of differing jurisdictions and legal systems.² On its way, it applies a curious mix of local law, accepted foreign law and established practice. Whilst marine insurance has its roots in the civilian law, it has been fine tuned by the common law, which seemed to be a useful perspective.³ At the conclusion of the 37th CMI conference in Singapore, it was resolved that the IWG would continue its work to identify and evaluate areas of difference between national laws and identify where a measure of harmonisation might be feasible and desirable so as to better serve the marine insurance industry.

After another three years of continuing review of the law of marine insurance by the IWG, a final report of the IWG was presented at the 38th CMI conference in Vancouver in 2004, which brought to an end to the current marine insurance review initiative of the CMI.⁴ Without any resolution of reform options, the CMI produced some guidelines for the formulation of marine insurance law, including the problem of warranties. It is recommended that certain terms may be stated by the parties in the contract as requiring strict compliance, the breach of which shall entitle the other party to cancel the contract. But the English law warranty and its effects should be abolished.⁵ It was a bit sad that after years of efforts CMI could not produce any reform instrument in this area of law, but as it was predicted when the reviewing work started at the 37th conference in 2001, the work of IWG, at the worst, would promote better knowledge and understanding of the differences which exist in the area of marine insurance law. It is hoped that these CMI guidelines would lay very basic ideas for those who are now seeking to develop their laws.⁶

3. Marine Insurance Law Reform in Australia⁷

At present, in the common law countries, as far as marine insurance is concerned, the Law Reform in Australia has been the most successful. The Australian Law Reform Commission has finished their comprehensive review of their MIA 1909 and produced a final report on

¹ Trine-Lise Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties*, CMI Yearbook 2000, 332.

² CMI Newsletter, 2001 September.

³ Patrick Griggs, *Insurance codes—a middle way*, J.B.L. 2001, Nov 616-622, at 617.

⁴ John Hare, *The CMI review of marine insurance report to the 38th conference of the CMI Vancouver 2004*, CMI Yearbook 2004, at 248.

⁵ *CMI Guidelines for the Formulation of Marine Insurance Law* (draft for discussion), Clause 3. These guidelines only consider good faith, disclosure, alteration of risk & essential terms.

⁶ John Hare, *The CMI review of marine insurance report to the 38th conference of the CMI Vancouver 2004*, CMI Yearbook 2004, at 256.

⁷ Sarah Derrington, *Marine insurance law in Australia: the Australian law reform commission proposals*, [2002] L.M.C.L. Q 214; Ian Davis, *Reform of the Marine Insurance Act: options and constraints*, a paper presented at Maritime Law Association of Australia and New Zealand Annual Conference, August 2000. This paper is available at www.alrc.gov.au/events/speeches/ID/MLAANZ%20Paper.pdf; Derek Luxford, *Reform or revolution?* Maritime Advocate, Issue 16, September 2001. This paper is available at www.Maritimeadvocate.com/16_insu.php

the reform recommendations. As the Australian MIA 1909 is based very closely on the English MIA 1906, a study of their reform proposal is useful here.

3.1 The ALRC Report No 91

The law of marine insurance in Australia is governed by the Marine Insurance Act 1909, which is based upon the earlier English statute.¹ In Australia, there is also an Insurance Contracts Act 1984 (I.C.A). It applies to general insurance contracts other than marine insurance contracts. As noted, the I.C.A has already abolished the draconian consequences of breach of warranties. Therefore, there is a chasm of difference between the law of marine and general insurance in Australia. In 1997, the Australian Law Reform Commission (A.L.R.C) received a mandate to review the law relating to marine insurance and they produced their final report with recommendations to amend the M.I.A in April 2001.² The report concludes that the traditional M.I.A will be maintained and the division between general and marine insurance will be retained by separate Acts. In the meantime, the A.L.R.C seeks to achieve clarity and fairness, recognising the importance of some international consistency. The review is not yet law. There is no bill before parliament.

The most acclaimed improvement made in the A.L.R.C recommendations are: the remedies of draconian effect were removed and replaced with fairer, commercially appropriate mechanisms; a requirement that the insurer not be entitled to rely upon the breach of a policy term to refuse to pay a claim unless that breach was the proximate cause of loss; and the policy was required to be a complete and express statement of contract. It is acknowledged in the report that, at present, many of the limitations upon an insurer's obligation to pay are not set out in the contract itself but contained in the M.I.A as implied warranties or situations where the insurer is automatically discharged from liability.³ As far as warranties are concerned, these reform measures will resolve most of the problems in law.

3.2 Abolition of Warranties

It is recommended in the Report that the notion of warranties should be abolished and replaced with a system permitting the subject-matter currently covered by them to be the subject of express terms of the contract.⁴ This shows a determination to solve all the problems caused by the out-dated regime of warranties. As said, the notion of warranties is

¹ Sarah Derrington, *Australia: perspectives and permutations on the law of marine insurance*, Chapter 11, D.R. Thomas, *The Modern Law of Marine Insurance*, Vol. 2, LLP, 2002.

² Australia Law Reform Commission Report 91: *Review of Marine Insurance Act 1909*, which is available at www.alrc.org.au/publication/publist. See Kate Lewins, *Australia proposes marine insurance reform*, J.B.L 2002, May, 292-303.

³ALRC 91: *Review of Marine Insurance Act 1909*.

⁴ Recommendation 7, ALRC No. 91.

not known in the civil law countries, and their insurers have no problem with the insured in respect of defining the risk and issues of alteration of risk. Therefore, this can be feasible rather than being a fallacy.

The recommendation emphasises the freedom of contract and encourages the contracting parties to prescribe the insured's obligation in express terms. This is a radical change to the current notion of warranties. As noted, under the current regime, any words bearing on risk could be construed as warranties. It is not uncommon that the insured have no idea what they have agreed in the policy would amount to a warranty. Like in *HIH v New Hampshire*,¹ the number of films mentioned in the policy was regarded as a warranty. The insured was left in such a disadvantaged position by this statutory classification of the term as a warranty. As a solution, the abolition of the statutory classification of terms as warranties might be an easy way-out for the insured.

Bearing in mind that the notion of warranty includes both express and implied warranties, the report also recommends that implied warranties should also be abolished.² The report recommends that obligations of seaworthiness and legality should be dealt with in express terms of the contract as well. Pursuant to the proposal, the insurer is only discharged from liability to indemnify the insured for loss attributable to the breach of an express term of the contract relating to the seaworthiness of a ship where the insured is culpable of the breach.³ As to legality, the proposal distinguishes two situations: (1) so far as the insured can control the matter, the insured adventure shall have no unlawful purpose, otherwise, the insurer is discharged from all liability under the contract; (2) so far as the insured can control the matter, the insured adventure shall be carried out in a lawful manner, otherwise, the insurer is discharged from liability to indemnify the insured in relation to any loss that is attributable to that breach.⁴

However, this abolition of the notion of warranties will not solve all the problems relating to warranties in contemporary practice. The problem with the English law of marine insurance warranties is that warranties are recognised as distinctive types of terms in insurance contracts, the remedy for the breach of which is statutory and disproportionate, i.e., the automatic discharge of further liability. However, it is almost always uncertain which term in the insurance contract would be interpreted as a warranty. As noted earlier, in recent years, the Courts have developed a system of classification of insurance terms, and the most relevant to

¹ [2001] Lloyd's Rep IR 596

² Recommendation 7, 10 and 13, ALRC No. 91.

³ Recommendation 11, ALRC No. 91.

⁴ Recommendation 14 and 15, ALRC No. 91.

warranties, are conditions precedent. In *The Good Luck*,¹ the House of Lords held that warranties in marine insurance were conditions precedent. What of the notion of conditions precedent? If warranties are to be abolished, are they to be abolished too? It must be noted that conditions precedent are not synonyms of warranties. Warranties are conditions precedent, but conditions precedent are not necessarily warranties. As noted, claims conditions and claims co-operation clauses are conditions precedent, but they are not warranties. Therefore, if the concept of warranty is abolished, should the concept of conditions precedent still be retained? While retaining the concept of condition precedent, one foreseeable problem would be that the insured might use this concept to define their express terms and consequently take the insured into the same kind of disadvantaged situation like warranties have enabled them to do.

It must be acknowledged that the current problem of marine insurance law is, in essence, a lack of a sound and consistent system of classification of contractual terms. What is needed now is a clarification of the nature of different insurance terms and their effects of breach. Without such a system of classification of terms in insurance contracts, there would not be a complete solution to the current problem of warranties.

One final point to be considered at this stage is that not all warranties are obligations. Some warranties are of a contingent nature, i.e., an event the occurrence of which is a condition precedent to the existence of a contract or attachment of the risk. The proposal only mentions warranties which are obligations to be replaced by express terms. It does not mention those warranties which are not obligations. This is an unconsidered ground that needs further consideration.

3.3 Requirement of Causation

It is acknowledged that replacing warranties with express terms would not solve all the problems. Another distinctive aspect of the warranties problem is that insurers are able to avoid their liability for the most technical of breaches of warranty, even if there was no causal connection between the breach and the claim. In the reform proposal, the ALRC has wholly re-written the provision and the new regime introduces concepts of causal connection before an underwriter can decline a claim. It is recommended that subject to the contract, an insurer is only entitled to be discharged from liability to indemnify the insured for any loss proximately caused by a breach by the insured of any express term of the contract.

This requirement of causation between breach and loss as a pre-requisite in exercising the

¹ [1992] 1 A.C. 233

insurer's right to avoid liability is much needed in the current English law. It has been a long acknowledged defect of law by the Courts and it has been difficult for the courts to deliver justice and fairness in those hard cases by interpreting the warranties as terms of another type. However, it is submitted that the Court is misconstruing the contract if they interpret a term not to be a warranty simply because they want to avoid an unfair outcome in those cases where breach has no bearing on the risk or loss.¹ Pursuant to the proposal, the whole issue of this argument would be dissolved and it would also help create certainty in predicting the effects of breach, at least whether the insurer is discharged from liability or not.

However, again this requirement of proximate cause is not a solution to all the issues faced in the warranties regime. As noted, the remedies of breach of contractual terms in the insurance policy are quite controversial at the moment in insurance law. The obligations in an insurance contract are mainly from two sources: statutory and contractual. Under current law, remedies for breach of these obligations are various. If it is a breach of the statutory obligation of utmost good faith, breach will result in avoidance of the contract; if it is a breach of contractual obligation, remedies are different depending on the nature that a court would attribute to the term by way of construction. It can be a discharge of the entire liability under the insurance contract, or repudiation of a particular claim, or suspension of cover until the breach is remedied or even damages. When seeking these remedies, the requirement of causation is not always compulsory. Therefore, the proposal will certainly not make all the issues relating to remedies settled. If the breach has not proximately caused any loss, are the insurers entitled to seek any other remedies? The proposal does not say anything about that.

3.4 Denial of Proportionality Rules

In Australian general insurance law, the remedies for breach of insurance contract is regulated in section 54 of the Insurance Contract Act 1984, and it contains a rule of proportionality in remedies for breach of insurance contracts. The Act is not applicable to marine insurance, but the rule of proportionality is worth considering in the marine insurance context.

Pursuant to section 54 of ICA 1984, if the breach could not reasonably be regarded as being capable of causing or contributing to a loss in respect of which insurance cover is provided by the contract, the insurer may not refuse to pay the claim by reason only of the breach, but the insurer's liability in respect of the claim is reduced by the amount that fairly represents the extent to which the insurer's interests were prejudiced as a result of the breach.

¹ John Lowry, *Insurance law: doctrines and principles*, 2005 at 198.

This sounds reasonable, but in practice, how to assess the amount that represents the insurer's prejudiced interests would undoubtedly be a huge problem and in fact it has been the subject of much litigation.¹

The ALRC concluded that the ICA reforms do not provide a suitable model for the reform of the MIA 1909. The ICA provisions are 'broader than necessary to address the deficiencies of the present law of marine insurance.'² They thought that under section 54 of the ICA 1984, the room for dispute over whether or not a particular marine insurance claim is payable, and the extent to which it is payable, would be greatly expanded.³ Therefore, they do not recommend an element of proportionality as found in s 54 of ICA as the amendment to the MIA relating to the consequences of a breach of an express contractual term by the insured. It is true that under the ICA, even where a breach could reasonably be regarded as being capable of causing or contributing to a loss, the insured is still entitled to claim under the policy if the insured proves that either 'no part of the loss that gave rise to the claim was caused by the act or some part of the loss that gave rise to the claim was not caused by the act'.

The element of proportionality in the ICA s. 54 may be not practical in litigation and may lead to practical difficulties in quantifying an insurer's liability, but it is time to consider some alternative remedies for breaches of the minor or immaterial terms of contract. It is suggested that the insurer's remedies should vary in scope and it might include complete discharge from liability, termination of the insurance on notice, retention of the premium and rights to demand a proportionate additional premium.⁴

It is going to be very interesting to see how the market reacts to the review. One thing is for certain: if the majority recommendations by the A.L.R.C are enacted, the law and practice in marine insurance in Australia will be very different to what it has been in the past in crucial areas.

3.5 Miscellaneous

The ALRC also recommends that the insurer have a right to cancel the insurance by giving a written notice to the insured and the cancellation take effect either three business days after the insured received that notice or earlier if replacement insurance comes into effect before

¹ Sarah Derrington, *Marine insurance law in Australia: the Australian Law Reform Commission proposals*, [2002] L.M.C.L.Q 214, at 218.

² ALRC No. 91, para. 9.123.

³ ALRC No. 91, para 9.120.

⁴ Sarah Derrington, *The law relating to non-disclosure, misrepresentation and breach of warranty in contracts of marine insurance: A case for reform*, PhD thesis University of Queensland 1998

then.¹ This is a reasonable remedy for the insurer in case the breach of express terms affects the risk of loss and he wishes to terminate the risk. It is also protective to the insured by giving him some time to arrange alternative insurance.

As to the burden of proof, the ALRC recommends that the insurer bears the burden of proving that there was a breach of a term of the contract, whereas the insured bears the burden of proving that the loss for which it seeks to be indemnified was not proximately caused by or attributable to the breach.² It is submitted that the use of 'proximately caused' and 'attributable to' is deliberate for the consideration that in some unseaworthiness case, unseaworthiness is not a proximate cause of loss but can nonetheless be attributable to the loss.³

4. Norwegian Marine Insurance Law

In civilian countries, insurance law does not recognise the concept of warranties. Instead, the concept of alteration or increase of risk is used. It is not necessary to compare all the insurance legislation on alteration of risk in these countries in this thesis.⁴ Given the scope of this thesis, it is worthwhile to study the recently welcomed Norwegian Marine Insurance Plan 1996. It is regarded as the most comprehensive and successful marine insurance framework in the civilian countries and it has been regarded as user-friendly in the market.

4.1 The Norwegian Marine Insurance Plan

In Norway, there is a general Insurance Contracts Act (ICA) 1989. This Act is mandatory for all insurance contracts.⁵ However, there is an exception from this provision for insurance of commercial activity performed by ships that have to be registered according to the Maritime Code of 1994, or commercial activity dealing with international carriage of goods. Therefore, except for the national carriage of goods, there is complete contractual freedom for marine insurance.

The most important legal source for marine insurance has been the marine insurance plans, which are standardised conditions drafted jointly by insurers, assureds and other interested parties. The Plans contain comprehensive insurance conditions for different types of marine insurances, and are made applicable by direct reference in the relevant insurance contract. The first Plan was published in 1871 after which it has been revised with 10-30 year

¹ Recommendation 18, ALRC No. 91.

² Recommendation 19, ALRC No. 91.

³ Sarah Derrington, *Marine insurance law in Australia: the Australian Law Reform Commission proposals*, [2002] L.M.C.L.Q., 215, at 219.

⁴ The work has been done by Prof. Trine-Lise Wilhelmsen in *Duty of disclosure, duty of good faith, alteration of risk and warranties*, CMI Yearbook 2000, 332, pp.376-386.

⁵ Norwegian ICA, section 1-3.

intervals.¹ Until 1964-67 there was a common plan for shipowners insurance and cargo insurance, but this plan was replaced by the Norwegian Marine Insurance Plan of 1964 (NMIP 1964) for shipowners and the Norwegian Insurance Plan for the Carriage of Goods of 1967 (NIPCG) for cargo insurance. So far as warranties are concerned, the NMIP will be studied here. The current version of the NMIP is the 2003 version of Norwegian Marine Insurance Plan 1996.² Through the years, the Plans have in reality taken over the legislative tasks in the area of marine insurance.

Three distinctive features about the Norwegian Marine Insurance Plan 1996 must be noted. First, the Plan was drafted by a committee of twenty members, which presented the three main interested parties, the Norwegian Shipowners' Association, the Mutual Hull Clubs Committee (GSK) and the Central Union of Marine Underwriters (Cefor). Therefore, the Plan is a well-balanced and mutually-agreed set of conditions for marine insurance. Second, the Plan is under constant review by a standing revision committee, which evaluates the need for amendments and drafts specific texts with commentary for incorporation in the 1996 Plan. This ensures a constant updating of the Plan and an institutional framework around the revision work. Thirdly, the Plan is equipped with a comprehensive commentary to give a detailed authoritative explanation to the conditions in the Plan. The commentaries are viewed as an integral part of the Plans and are compared to preparatory works of Acts of Parliament.

The 2003 version of the NMIP 1996 consists of four parts. Part I, chapters 1-9, are rules common to all or several of the shipowners' insurances. Part II, chapters 10-13, regulates hull insurance; Part III, chapter 14-16, has rules about other insurances for ocean-going ships, including war risk insurance, loss of hire insurance; and Part IV, currently only chapter 17, provides special rules for fishing vessel and small freighters.³ In the following discussions, when the Plan is referred to, it refers to the 2003 version of the NMIP 1996.

4.2 Alteration of Risk

Definition

The notion of warranties does not exist in the Norwegian Marine Insurance Plan. In comparison, the mechanism dealing with the alteration of risk in the Plan is an equivalent to

¹ Hans Jacob Bull, *Scandinavian Maritime Law: The Norwegian Perspective*, Universitetsforlaget 2004, p.477.

² The NMIP 1964 was greatly revised in 1996 and the P & I insurance was taken out of the Plan.

³ Another two chapters have been also drafted: Chapter 18, insurance for offshore installations and chapter 19, insurance for building risk. But they have not been approved to be in the plan.

the English regime of warranties.¹ According to the Plan, an alteration of risk occurs when there is a change in circumstances which, according to the contract, are to form the basis of the insurance, and which alter the risk contrary to the implied conditions of the contract.² It sets out two general conditions which must be met: there must have been a change in the factual circumstances which affect the nature of the risk and this must amount to a breach of the implied conditions upon which the contract was based. According to the commentary of the Plan,³ for both aspects, the decisive factor will be the interpretation of the insurance contract in question. The issue becomes one of whether the insurer should be bound to maintain the cover without an additional premium in the new situation which has arisen, or whether it would be reasonable to give the insurer the opportunity to employ the sanctions provided in the Plan, which will be examined shortly. It is to be noted that the Norwegian concept of alteration of risk is broader than the English one. It actually refers to both a material change of the risk which takes the risk out of the cover and also the increase of risk, which refers to changes of risk that only increase the risk of loss, but does not change the nature of the risk.⁴

There are some general provisions on alteration of risk in the Plan, and also specific provisions for situations such as loss of Class, change of classification society, breach of trading limits, change of ownership, and illegal activities. Though dealing with almost the same subject matter as English law warranties, the Norwegian Plan has a distinctive approach in respect of sanctions in these situations.

Sanctions

The most appraisable feature of the NMIP 1996 on alteration of risk is that it offers a more flexible and proportionate system of sanctions in case of changed circumstances. The Sanctions are based in part on a set of general rules and in part on a set of special rules. It is suggested that the unspecified rules for alteration of risk are not particularly practical; therefore, they will not often become applicable.⁵ By contrast, the Plan provides in detail the

¹ The concept of alteration of risk is common in most civilian jurisdictions. The term is also interchangeably used with increase of risk. However, there is no unified definition of the concept. According to Prof. T.-L. Wilhelmsen, the definitions of alteration or increase of risk are based on four different approaches in different jurisdictions. The first approach is used that the risk must be increased compared to the written or implied conditions of the insurance contract. The second approach is that the risk must be altered or increased in such a way that the insurer would not have accepted the insurance at all, or would not have accepted the insurance on the conditions if he had known about the increase. A third method is to say that the risk is 'substantially' altered. The last approach is to connect the sanction to circumstances affecting or altering the risk after the contract is concluded without any further definition. The sanctions for the alteration or increase of risk are also slightly different in civilian countries. See Trine-Lise Wilhelmsen, *Duty of disclosure, duty of good faith, alteration of risk and warranties*, CMI Yearbook 2000, at 376-377.

² Clause 3-8, NMIP 1996 (version 2003).

³ § 3-8, Commentary to NMIP 1996 (version 2003).

⁴ It is a conclusion when § 3-8 and § 3-9 are read together.

⁵ Hans Jacob Bull, *Scandinavian Maritime Law: The Norwegian Perspective*, Universitetsforlaget 2004, p.490.

proportionate sanctions for each specified situation of alteration of risk. These sanctions can be automatic termination, suspension or liability and cancellation. The relationship between the general sanction rules and the specified sanction rules should be specified rules override the general rules when applicable. These sanctions will be examined carefully below.

General rule: Liability and Cancellation

The Plan provides a general sanction for alteration of risk. The insurer has a right to cancel the insurance in case of alteration of risk by giving 14 days notice.¹ Therefore, the insurer has to elect whether he wishes to cancel the contract or not and if so, he must give 14 days' notice. The insurer's duty to notify the insured of his intention of cancellation must be fulfilled in writing and without undue delay, otherwise he forfeits his right to cancel the contract or take other action.² This is different from the English position and it gives the insured enough time to arrange alternative insurance.

As to the insurer's liability between the time the alteration of risk occurs and the time the insurance is actually cancelled, the Plan provides that if the insured has intentionally caused or agreed to an alteration of risk, the insurer is not free from liability, provided that he would have accepted the insurance had he, at the time the contract was concluded, known that the alteration of the risk would take place.³ But his liability is confined to the extent that the loss was proved to be attributable to the alteration of risk.⁴ Here, the Plan requires a test of two elements for a discharge of liability: materiality and causation.

According to the commentary, the burden of proof rests on the insurer that he would in no way have entered into any contract had he known the potential alteration of risk. It is sufficient to demonstrate, on a balance of probabilities, that *the particular* insurer would not have accepted the risk; what other insurers might be expected to have done is irrelevant.⁵

However, two points are not clear, or rather missing from the Plan. First, it is not clear whether by 'free from liability' it is meant that the insurer is automatically discharged from all his future liabilities if he would not have accepted the insurance had he known that the alteration of risk would take place. Put another way, if the insurer would under no circumstances have accepted the insurance had he known the potential alteration of risk, can he refuse to indemnify all the losses which incurred after the alteration of risk? Secondly, it is not clear whether the insurer is free from liability if the alteration of risk is not caused or

¹ Clause 3-10, NMIP 1996 (version 2003).

² Clause 3-13, NMIP 1996 (version 2003).

³ Clause 3-9 (1), NMIP 1996 (version 2003).

⁴ Clause 3-9 (2), NMIP 1996 (version 2003).

⁵ § 3-3, Commentary to NMIP 1996 (version 2003).

agreed by the insured. The commentary does not tell us much about them. The answer to the first one is by no means clear. But it might be argued that the answer is yes, as the insured is culpable in the alteration of risk and the alteration is beyond the insurers' speculation of the risk. The answer to the second question seems to be no, as it seems to be logical from clause 3-9. Clause 3-9 provides for intentional alteration of risk, which involves fault or knowledge of the insured to the alteration. If upon such a more condemnable breach of contract the insurer is still liable to the extent that the loss is proved not to be attributable to the alteration of the risk, it must be assumed that the same rule applies to innocent alteration of risk where the insured has no fault or knowledge of the change. This is also evidenced in clause 3-11, which provides that if the insured becomes aware that an alteration of risk will take place or has taken place, he shall, without undue delay, notify the insurer; if the insured without justifiable reason, fails to do so, the rule in clause 3-9 will apply, even if the alteration was not caused by him or took place without his consent. This Clause seems to say that if the insured has notified the insurer without undue delay about the innocent alteration of risk, the insurer is not free from liability but his liability is subject to the extent provided in subparagraph 2 of clause 3-9. In this respect, the NMIP resembles English law, which awards an automatic discharge of liability.

To sum up, upon an alteration of risk, the insurer is entitled to cancel the insurance by 14 days notice; however, before the insurance is actually cancelled, if the insurer is liable, he is only liable for losses to the extent that the loss is proved not to be attributable to the alteration of risk. If the alteration is caused or agreed by the insured, and the insurer would not have accepted the insurance had he known that the alteration would take place at the conclusion of the contract, the insurer is free from any liability until the alteration of risk ceases to be material to him.¹

It can be seen that the difference between the English law of warranties and the NMIP provisions of alteration of risk are in four aspects. First, unlike English law, the NMIP does not allow the insurer discharge all his future liabilities as from the time the alteration of risk occurs. Therefore, the insurer cannot technically use it as a defence to all his future liabilities which are unrelated to the alteration of risk. Second, the NMIP imposes an obligation of notice on both the insured and the insurer, which is absent in the English law of warranties. Thirdly, the insurer's right to cancel the contract is in effect 14 days after serving his notice to the insured. By contrast, English law offers an instant termination of risk upon the breach of warranties, which leaves the insured no time to arrange alternative insurances. Fourthly, the

¹ Clause 3-13 (1), NMIP 1996 (version 2003).

NMIP also provides that the insurer is not entitled to discharge liability or cancel the insurance after the alteration of risk has ceased to be material to him,¹ whereas under English law, breach of warranties is irremediable.

Special rules: Termination and Suspension

Apart from the general rules as discussed above, there are also special rules for alteration of risk in specified situations. The sanctions for these specified alterations of risk are mainly termination or suspension. Needless to say, cancellation and liability are also available.

Termination

In the NMIP, the insurance is terminated in three situations: (1) if the ship loses its class or changes classification society during the insurance period, unless the insurer has expressly given his approval;² (2) if the ship, with the consent of the insured is used primarily for the furtherance of illegal purposes;³ (3) if the ownership of the ship changes by sale or in any other manner.⁴

Under situation (1), if the ship is at sea when the class is lost or changed, the insurance cover shall nevertheless continue until the ship arrives at the nearest safe port in accordance with the insurer's instructions. The new London International Hull Clauses 2003 have adopted a similar approach in this matter. However, it is not clear what the effects would be if the insurer explicitly consents to a continuation of the insurance. It must be assumed that the general rules of liability and cancellation would apply. But, has the insurer a right to ask for additional premium or any other conditions? It might be assumed that the answer is no.

In situation (2), the subject matter is the same as that in the implied warranty of legality in English law. Clause 3-16 once again illustrates that the NMIP is more flexible and proportionate than English law. By virtue of subparagraph 1 of clause 3-16, if any illegal activities occur the insurer cannot automatically discharge his future liability to the insured. The insurer is only not liable for loss as a result of the illegal activities if the insured has neither knowledge of nor negligence of preventing the illegal activities. So the test for the insurer to be free from liability is quite high. It requires two elements: (1) there is a causal link between the loss and the illegal activities; (2) the insured is not culpable for the occurrence of the illegal activities. If the insured fails to intervene without undue delay after become aware

¹ Clause 3-12, NMIP 1996 (version 2003). Subparagraph 2 in this clause provides two situations where the alteration of risk will be excused: (1) the risk is altered by measures taken for the purpose of saving human life, or (2) the risk is altered by the insured ship salvaging or attempting to salvage ships or goods during the voyage. It must be assumed that the salvage is not contractual salvage.

² Clause 3-14, NMIP 1996 (version 2003).

³ Clause 3-16, NMIP 1996 (version 2003).

⁴ Clause 3-21, NMIP 1996 (version 2003).

of the illegal activities, the insurer has a right to cancel the insurance by giving 14 days notice, but before the insurance is actually cancelled, the insurer is not liable for losses which are not resulted from the illegal activities.¹ It is to be noted that this is a special rule of cancellation and liability, which is different from the general rule of cancellation and liability embodied in clauses 3-9 and 3-10 where cancellation does not have a condition and liability is subject to the extent that the loss is proved to be attributable to the alteration of risk.

Suspension

In the NMIP, the insurance may also be suspended in two situations: (1) if the ship proceeds into an excluded trading area without the insurer's consent;² (2) if the ship becomes requisitioned or temporarily seized by a State power.³ When the stipulated situation is over, the insurance comes back into effect again.

Under situation (1), the subject matter is the same as that of the held-covered clause in the London Institute Hull clauses. However, clause 3-15 is more specific about the difference of trading areas. By virtue of the clause, trading areas are divided into three categories: ordinary trading area, conditional area and excluded area. Only when the ship is in an excluded area without the insurer's consent is the insurance suspended. For the conditional area, the NMIP provides, like the English held-covered clause, that the person effecting the insurance shall notify the insurer before the ship proceeds beyond the ordinary trading limit and the ship may sail in the conditional areas subject to an additional premium and to any other conditions that might be stipulated by the insurer. However, if the ship, with the consent of the insured, proceeds to the conditional area without giving the insurer notice, the insured is still able to claim for his loss but the claim shall be settled subject to a deduction of one fourth, maximum USD 150,000. This is a very generous stipulation for the insured. However, it is not clear how practical it is in commercial reality.

Under situation (2), the insurance is suspended during the time that the ship is requisitioned or temporarily seized by a State power. It is to be noted that in such circumstances only the marine risk insurance is suspended, leaving the war risk insurance cover still in effect. At such a time, insurance against war perils also covers marine perils as defined in clause 2-8 of the NMIP.

¹ Clause 3-16, NMIP 1996 (version 2003).

² Clause 3-15, NMIP 1996 (version 2003).

³ Clauses 3-17 and 3-19, NMIP 1996 (version 2003).

4.3 Seaworthiness and Safety Regulations

Seaworthiness

Unlike English law, seaworthiness is not an implied term of the insurance but is dealt with in express terms in clauses 3-22 and 23 of the NMIP 1996. By virtue of these clauses, the insurer is not liable for loss that is a consequence of the ship not being in a seaworthy condition, provided that the insured knew or ought to have known of the circumstances.

The threshold for the insurer to successfully discharge his liability by the defence of unseaworthiness is three-fold. First, the ship is not seaworthy. Whether a ship is seaworthy or not is a relative matter to be decided in the context of the particular case. It is submitted that the term of seaworthiness does not necessarily have the same content or meaning in different areas of maritime law but the core meaning is essentially the same and has been expressed in the Norwegian Seaworthiness Act §2.¹ Secondly, the loss is caused by the unseaworthiness. This is necessary because the insurer is only free from liability to the extent that there is a causative link between the unseaworthiness and the loss in question. However, it is suggested that the requirement of causation can make the burden of proving the ship was seaworthy or not in the first place redundant, because in some cases, under no circumstances will the unseaworthiness have been the cause of the casualty. Thirdly, the insured knew or ought to have known of the unseaworthiness at a time when it would have been possible for him to intervene. The insured must be culpable in being passive with the knowledge, either actual or constructive, of the fact of unseaworthiness.

Thus, it is clear that the NMIP is more proportionate in the remedies for unseaworthiness than English law. It gives the defence of unseaworthiness a very limited use when the insurer wants to deny liability. However, the importance of the requirement must not be understated. By virtue of clause 3-23, the insurer has a right to demand a survey of the ship at any time during the insurance period to verify that the ship is in seaworthy condition. And if the ship is unseaworthy, under clause 3-27 (1) and (2), the insurer may cancel the insurance by giving 14 days notice. Again, before the contract is actually cancelled, the insurer has to pay claims to the extent that the loss is proved to be not attributable to the unseaworthiness.

Lastly, the NMIP is explicit about the burden of proof in unseaworthiness cases. The

¹ Hans Jacob Bull, *Scandinavian Maritime Law: The Norwegian Perspective*, Universitetsforlaget 2004, p.493. Seaworthiness Act §2 reads: 'a ship is deemed to be unseaworthy if by reason of defects in hull, equipment, machinery or complement, or by reason of overloading of defective loading, or for other reasons it is in such state that, with due regard to the trade for which the ship is destined, it must be deemed to be attended by greater risk for human lives or put to sea in the ship than the voyage would normally involve.' Prof. Bull submitted that a ship is unseaworthy in relation to the marine insurance law rules when it is not in condition, crewed and equipped, as it should be in accordance with prudent seamanship for the voyage to be performed. This seems to be in the same line with English law as codified by the judgment of Cresswell J in *Papera Traders Co Ltd v Hyundai merchant Marine Co Ltd (The Eurasian Dream)* [2002] 1 Lloyd's Rep 719 See Merkin, *Colinvaux & Merkin's Insurance Contracts Law*, B-0198-0199.

insurer has to prove that the ship is not seaworthy. The insured needs to prove that there is no causative link between the loss and the unseaworthiness, and also that he neither knew nor ought to have known of the defects.¹

Safety regulations

If there is any implied term in the NMIP, safety regulations might be one of them. Pursuant to Clause 3-24, a safety regulation is a rule concerning measures for the prevention of loss issued by public authorities, stipulated in the insurance contract, prescribed by the insurer pursuant to the insurance contract, or issued by the classification society.² It is submitted that there is no limitation with respect to 'public authorities'. Therefore, they can be local or central, Norwegian or foreign. It is also irrelevant whether the regulation is Statute or International rules or conventions.³ Therefore, international regulations, such as the SOLAS conventions and the ISM code are safety regulations for the purpose of clause 3-24 of the NMIP by virtue of the Norwegian Seaworthiness Act. These are the important subject-matter under the Classification and ISM clauses in the International Hull Clauses 2003. However, unlike English law and the London Institute Hull Clauses, under the NMIP the insurance does not terminate automatically when these safety regulations are infringed. Clause 3-25 provides that in case of infringement of safety regulations, the insurer is only discharged from liability to the extent that the loss is proved not to be a consequence of the infringement. The insurer can only cancel the insurance by 14 days notice.

5. The Way out for the English law of warranties

Compared to the Australian and Norwegian marine insurance regime, the English law of marine insurance warranties is falling behind contemporary international practice and reform is overdue. In October 2005, the Law Commission of England and Wales launched a new project aiming to look at the reform of Insurance Contract Law.⁴ They have already identified two areas of insurance contract law to look at in their notice to the public, viz. non-disclosure and breach of warranty. This seems to be a response to the repeated appeal from Lord Justice Andrew Longmore, who urged the Law Commission to consider these areas of

¹ Subparagraph 2, Clause 3-22, NMIP 1996 (version 2003).

² According to clause, periodic surveys required by public authorities or the classification society constitute a safety regulation and such surveys shall be carried out before expiry of the prescribed time-limit.

³ Hans Jacob Bull, *Scandinavian Maritime Law: The Norwegian Perspective*, Universitetsforlaget 2004, p.496.

⁴ This is a joint project with the Scottish Law Commission. In fact, there is no legislation for non-marine insurance in the UK and most of the general principles of non-marine insurance law are the same as those codified in the MIA 1906.

law.¹ The Law Commission published an initial scoping paper in January 2006,² seeking to identify other areas of insurance contract law which are problematic and should be included within the review. It will, no doubt, take a long while for the Law Commission to produce a final report on the reform of insurance law. It might be even longer for that report to reach the Parliament and be materialised. As the 1906 Act itself illustrates, it took the draft Bill twelve years to finally reach the statute book. However, it is submitted that the Law Commission is by far the best-placed institution to determine how law reform can be taken forward.³ Unlike the 1980 Report, the current Law Commission's investigation will include marine, aviation and transport risks. Therefore, it seems to be a perfect chance to introduce some reform into marine insurance contract law.

5.1 A New Marine Insurance Act?

There seems to be a strong case for legislative reform.⁴ If there is to be any legislative reform, should it be a codification or just a piecemeal reform of the current defects of the general insurance contract law? It is certain that whatever the final result would be, it will not solve all the problems of marine insurance in particular. It will be appreciated that marine insurance has a distinctive nature and should be treated differently from general insurance. There should be a separate reform of the MIA 1906.

The current situation of statutory reform in England seems likely to be limited to statutes to correct particular defects of law. It has been suggested that reform by codification is 'an enormous task and invite yet further delay'.⁵ However, even a piecemeal reform of law is not an easy task, which also depends on Parliamentary time and inclination. This is a problem with the system and process of the legislature which we have to bear with.

Considering the scale and extent of the deficiency of the current English law of marine insurance, it is submitted that a new codification of marine insurance law rather than some

¹ Andrew Longmore, *An insurance contracts Act for a new century?* [2001] L.M.C.L.Q., 357-368. In his article, Lord Longmore urged that the following areas of insurance law should be re-considered: (1) the doctrine of utmost good faith; (2) the test for non-disclosure and misrepresentation; (3) the remedies available to the insurer for non-disclosure and misrepresentation; (4) the doctrine of breach of warranty; (5) proposal forms; and (6) damages for late payment. Also see Andrew Longmore, *Good faith and breach of warranty: are we moving forwards or backwards?* [2004] L.M.C.L.Q., 158-171.

² This paper is available at http://www.lawcom.gov.uk/insurance_contract.htm.

³ Andrew Longmore, *Good faith and breach of warranty: are we moving forwards or backwards?* [2004] L.M.C.L.Q., 158-171, at 171.

⁴ Although there is also criticism of the legislative approach of reform, there is no better suggested solution to that at the moment. Cf. Malcolm Clarke, *Doubts from the dark side—the case against codes*, J.B.L. 2001, Nov, 605-615; Robert Merkin & Colin Croly, *Doubts about insurance codes*, J.B.L. 2001, Nov, 587-604.

⁵ Andrew Longmore, *An insurance contracts Act for a new century?* [2001] L.M.C.L.Q., 357-368, at 364

microsurgery of the current defects of the MIA 1906 is needed.¹ The 1906 Act is one hundred years old and it is becoming more and more incapable of accommodating the new instances of development of the law. It is time to follow Sir Mackenzie .D. Chalmer's bravery and perseverance to codify the recent developments in marine insurance law as a whole.

There are concerns that this would damage the influence of English law abroad, which is known as consistent and advanced in case law. Especially considering the international influence of the Marine Insurance Act 1906, there are fears that a new codification might affect the confidence of the overseas insurance industry in English law as a trusted recourse of marine insurance litigation and arbitration. However, this argument is not entirely sustainable. The range of insurance services and the size of the indemnity capacity offered by the London insurance market are unbeatable in the world. English insurance law owes its popularity to the unique role of the London insurance market and cannot pride itself entirely on its own perfection. Therefore, as long as the London market is not going down in business, the reform of English marine insurance law would not affect the premiere position of English law in international litigation and arbitration. Instead, a sensible reform of English law would be well received by overseas markets in order to meet the current needs of the insurance industry and to strike a balance of obligations and rights between the insured and the insurer.

There are also concerns that a new codification would not resolve most of the disputes which arise in practice and a code might well give rise to a different range of disputes.² It is inevitable that 'no code can provide for every case that may arise, or always use language, which is absolutely accurate'.³ It is also submitted that a new code would not be cost-effective considering the time and legislative resources it would consume and the short-term dislocation it would produce.⁴ Therefore, it is submitted that legislative reform should be limited to those areas which have long been in need of reform. Indeed, common law thinking 'rejects systematization and takes pride in its pragmatic flexibility rather than in logical consistency'⁵. It is true that English courts have demonstrated over time that they are capable of reaching user-

¹ The new code should be an update of the 1906 codification of the marine insurance law. Much of the contents of the MIA 1906 can remain, but a few dated rules would be repealed and some new principles and rules need to be introduced where appropriate. The new code should not seek to resolve areas of doubts to leave space for further development of case law. Cf: Peter McDonald Eggers, *The Marine Insurance Act 1906: judicial attitudes and innovation—time for reform?* A paper presented at International Colloquium on Marine Insurance Law, Swansea University, 30 June 2005. By contrast, the most agreed reform option is believed to identify particular defects such as non-disclosure and warranties and join the waiting list for legislative reform. Indeed, this is the strategy of the current Law Commission's project launched in January 2006, which aims to reform the problem areas of insurance contracts law in manageable chunks. Cf: Robert Merkin & Colin Croly, *Doubts about insurance codes*, J.B.L. 2001, Nov, 587-604; Malcolm Clarke, *Doubts from the dark side—the case against codes*, J.B.L. 2001, Nov, 605-615

² Robert Merkin & Colin Croly, *Doubts about insurance codes*, J.B.L. 2001, Nov, 587-604.

³ M.D Chalmer, *A Digest of the Law relating to Marine Insurance*, 1901, London: William Clowes and Sons, Limited, at p.viii.

⁴ Robert Merkin & Colin Croly, *Doubts about insurance codes*, J.B.L. 2001, Nov, 587-604.

⁵ William Tetley, (2000) 24 Tulane Maritime Law Journal, 775, at pp.804-805.

friendly results.¹ However, the current problem with English marine insurance law cannot be dealt with in such a pragmatic way. As noted earlier, the problems with current English marine insurance law are many and interlocked. Therefore, any reform of the law needs to embrace systematization and logical consistency so as to deal with the problems thoroughly.

Furthermore, reform by the development of case law relies on the opportunity of litigation and is constrained by the principle of precedent. Therefore, it is rather unpredictable to have reform by judicial innovation on a case by case basis.

Indeed, there is now a golden opportunity for the marine insurance industry and maritime lawyers to codify a new Marine Insurance Act. The Law Commission 2006 project of reform of insurance contract law provides a chance to engage all parties interested in this area of law to work out a solution for the next one hundred years together. It is necessary to recall once again that it took twelve years for the Marine Insurance Act 1906 to reach the statute book. Bearing in mind that it finally became the MIA 1906 which served the world's marine insurance industry for a century, it justifies the long wait for its birth. How long it would take for the new codification to be passed in Parliament can not be known unless we try. Understandably, it is not going to be a short time.

5.2 One Fatal Obstacle

However, the reform of marine insurance law by a new codification has one fatal obstacle: the lack of support from the insurance industry. Two of the three identified forces that hold the future of marine insurance² have shown their support for the reform, viz., the academia and the judiciary.³ However, any law reform would not have a real chance unless the relevant industry is on board. This was the case for the last Law Commission Report No. 104. It was suggested that 'the insurance industry lobby has been active behind closed doors and has in fact won'.⁴ This is especially true when considering the practice of the London Market, where custom and tradition prevail all the time. People in the business just would not bother to take time and think of reform unless it had threatened their business. A hundred years ago, when Sir Mackenzie D. Chalmers drafted the Marine Insurance Bill, the mercantile opinion was in favour of the codification of existing law⁵, whereas the current mercantile thinking is quite the reverse. Nonetheless, this should not and cannot stop the effort to campaign for reform by a

¹ Robert Merkin & Colin Croly, *Doubts about insurance codes*, J.B.L. 2001, Nov, 587-604.

² Anthony Diamond, *The law of marine insurance—has it a future?* [1986] LMCLQ 26. It was submitted that the academia, the judiciary and the market place were the three forces that held the further of marine insurance.

³ Andrew Longmore, *An insurance contracts Act for a new century?* [2001] LMCLQ 356 and also *Good faith and breach of warranty: are we moving forwards or backwards?* [2004] LMCLQ 158; *MacGillivray on Insurance Law*, 10th ed., 2002, para. 17-106.

⁴ Peter North, *Law Reform: process and problem*, (1985) 101 L.Q.R. 338. Sir Peter North was one of the law commissioners who signed the 1980 report.

⁵ M.D. Chalmers, *A Digest of the Law relating to Marine Insurance*, 1901, London, William Clowes and Sons, Limited, at p.viii.

new codification of marine insurance, as least by academic lawyers. Although marine insurance is an area of commercial law where the courts' role is to facilitate business, justice or at least fair dealing still needs to be dealt with so that the disadvantaged can be protected. An insurance industry would not be healthy and long-lasting if the insured's rights are not treated properly. If the market is not willing to initiate the reform of the law, let the lawyers do it. It is worth quoting a passage of speech from the chairman of the IWG of CMI at the 38th CMI conference in Vancouver in 2004:

It is in my view, though I stress this to be a personal one, that although our brief as lawyers can be done in many instances by informing the market changes that the industry then promotes, but there must be times when we must ourselves correct accepted inadequacy or confusion in our respective domestic laws, whether in the common law systems this be judge-made law or whether legislation—especially where they have extra-territorial influence.¹

As for the industry's concern that a new Act would disturb the legal certainty in what is a competitive international market, it is suggested that any reform carries the risk of unforeseen consequences and the risk can be minimised if all interested parties engage with the consultation process. In fact, the current law does not have an acceptable level of certainty, and costly litigation is not absent even today.²

5.3 Proposals for the Reform of Warranties

So far as warranties are concerned, any reform of English marine insurance law should eradicate the doctrine of warranties, both express warranties and implied warranties. There is argument that the doctrine of warranties underpins the London insurance market and it is even feared that removing the concept of warranties would add further complications to the law and perhaps create more unfairness for the insured than today.³ These arguments hold some weight, but not much. As to the first argument, warranties in the English law of marine insurance have been notoriously known around the world to be instant killer to the insured. It is not a compliment to have it as an underpinning characteristic to distinguish the London insurance market from the rest of the world. As to the second argument, the current problem with the English law of insurance warranties is, in essence, a lack of proper classification of

¹ John Hare, *Report to the 38th Conference of the CMI Vancouver 2004*, CMI Yearbook 2004, Part II, 255.

² The Law Commission's scoping paper on reform of insurance contract law, January 2006.

³ Baris Soyer, *Warranties in Marine Insurance* (2006), 212-215.

contractual terms and a system of proportionate remedies in case of breach of contractual duties.¹ The notion of warranty is a major factor that created such a messy state of the law and therefore, it must be eradicated. Instead, the reasons to eradicate warranties are straightforward. First, it confuses the general contract law concepts of warranties and conditions. Secondly, the effect of breach of warranties is disproportionate and inflexible. Thirdly, its function is out-dated and can be replaced with other mechanism, viz. the increase of risk.

A New Classification of Insurance Contract Terms and More Proportionate Remedies

As noted, the Australian Law Commission has left many blanks in areas where warranties have been eradicated. This is due to the lack of a new system of classification of insurance contract terms. Assuming there will be a new Act of Marine insurance in the UK, the new Act should be on guard and make sure it will establish a new system of classification of insurance terms while eradicating warranties. As noted earlier in this work, in recent years the English courts have developed a hierarchy of insurance contract terms. These are warranties, conditions precedent,² innominate terms,³ and ordinary conditions.⁴ The way of the current classification of insurance contract terms is: first to identify whether a term is a warranty in the sense of s. 33 of the MIA 1906; and if not, whether it is a term of the following nature mentioned above. As also noted earlier in this work, the reason why warranties should be treated as a separate class of contractual terms is outdated, therefore there should be one classification system applicable to all terms of insurance contract, without applying the dichotomy of warranties and non-warranties first. Instead, a new classification of contingent terms and obligatory terms should be adopted to reflect the nature of insurance contract terms. This should be introduced into the new Act.

Obviously, it is a big question of how to define these two concepts in the new Act. The approach taken in the *Sale of Goods Act 1979* where conditions and warranties are defined should be a good example. Concepts of contingent terms and obligatory terms should be defined by the effects of their breach rather than by what constitutes their contents. The new Act should be able to provide the remedy for breach of these insurance terms. As noted earlier, the English judiciary has been longing for judicial discretion in this field.⁵ The remedy

¹ There is a similar case in the remedies for breach of utmost good faith. See Peter MacDonald Eggers, *Remedies for the failure to observe the utmost good faith*, [2003] L.M.C.L.Q., 249.

² *George Hunt Cranes v Scottish Boiler and General Insurance Co Ltd* [2000] Lloyd's Rep IR 178

³ *Alfred McAlpine plc v BAI (Run-off) Ltd* [2001] 1 Lloyd's Rep 437; *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters* [2001] 2 Lloyd's Rep 563

⁴ *Friends Provident Life & Pensions Ltd. v Sirius International Insurance and Others* [2005] EWCA Civ. 601

⁵ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1993] 1 Lloyd's Rep 496, at 508.

under current English marine insurance law is almost always all or nothing in most areas. It is suggested that what is needed is a more sophisticated remedy, which is more appropriate and more proportionate to the wrong suffered. Fortunately, the body of case law suggests that the English insurance law now seems to recognise remedies other than total avoidance of contract or discharge of all further liability.¹ However, as also noted earlier in this work, the law is still unsettled in the light of *Friends Provident Life & Pensions Ltd v Sirius International Insurance Corporation*² where the intermediate remedy of repudiation of claim was ruled out. Nonetheless, the Law Commission in its 2006 scoping paper is of the view that the principle of proportionality should be considered in English insurance contract law.³

As to the remedy currently recognised in English law for insurers, there is one remedy still missing. It is therefore worth mentioning that both the Norwegian Insurance Plan and the Australian reform proposal should be looked in this aspect. As noted in the previous comparative study, the Norwegian Plan generally entitles the insurer to cancel the insurance by giving 14 days notice and between the time that the contract was breached and the insurance is cancelled, the insurer is still liable to loss, but only to the extent that the loss is proved to be attributable to the breach. A similar approach was also adopted in the Australian draft Bill for marine insurance, which allows 3 days at most for the repudiation to take effect after the notice being served.⁴ This is a remedy absent in current English law. In fact, the UK Law Commission in their Report 104 (1980) proposed a similar remedy. The report recommended that the repudiation of contract should take effect by giving notice and it should not be retroactive to the date of the actual breach; and that the insurer would remain on risk between the date of breach and the effective date of repudiation, but would be entitled to reject all claims which occur during that period unless the insured could satisfy the nexus test.⁵ The difference between the Norwegian Plan and the Law Commission recommendation lies in when the repudiation take effect, at the time of the notice being served or 14 days after the notice being served. The Norwegian Plan seems to be more generous and reasonable and it should be adopted in the new Act as a final recourse of remedy for the insurer.

Seaworthiness and Legality

As for seaworthiness and legality, they are still important concepts in marine insurance law.

¹ *Phoenix General Insurance Co of Greece SA v Habanon Insurance Co Ltd* [1985] 2 Lloyd's Rep 599, at 614; *Manifest Shipping Co. v Uni-Polaris Shipping Co (The Star Sea)* [1997] 1 Lloyd's rep 360 at 370; *K/S Merc-Skandia XXXXII v Certain Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep 563, at [22].

² [2005] 2 Lloyd's Rep. 517

³ Law Commission Scoping Paper, January 2006.

⁴ Clause 47A, Australian Law Commission's Draft Bill for Marine Insurance.

⁵ Law Commission Report 104 (1980), para. 6.23.

Although they are to be eradicated as implied warranties, they still need to be dealt with in the new Act. For seaworthiness, the requirement of the 'nexus test' before the insurer can discharge his liability should be enforced. The approach in the Norwegian Plan, which requires causation between loss and breach and culpability on the insured, should be adopted. By contrast, the Australian approach should be ignored as it still leaves the opportunity for the insurer to use the defence of unseaworthiness as a technicality. For legality, the Australian approach should be adopted as it is more sophisticated than the Norwegian Plan. The Australian approach distinguishes two situations in case of illegality, viz., adventure with unlawful purpose, and adventure carried out in an unlawful manner. In the first situation, the insurer is able to discharge all liabilities and retain the premium; in the second situation, the insurer can only deny liability which is attributable to the breach. This approach strikes a good balance between the insurer and the insured and therefore should be adopted in the new Act.

Change of Risk

As noted earlier in this work,¹ the common law rule for change of risk is that the whole policy is discharged where there is a fundamental change to the risk, viz., the alteration of risk; but if the change to the risk is such that the risk of loss is increased, viz., increase of risk, there is no loss of cover. That said, the common law tolerance of post-contractual increase of risk is normally modified by express provisions such as warranties. If warranties are eradicated, the blank left should be filled with provisions on the increase of risk.

As to the alteration of risk, some situations have been mentioned in the MIA 1906 and the various versions of the Institute Hull Clauses.² Under these situations, the current English law and the Institute Clauses provide for an automatic discharge of liability from the date of breach, irrespective of the materiality of the breach to the risk or the loss. These situations of alteration of risk are in fact treated like warranties. They are certainly disproportionate in some situations. In fact, English law does not have regard as to whether the alteration has increased the risk of loss and award the same of remedy of automatic discharge. This rule has the same default as the rule of warranties. Therefore, they are also to be eradicated. It is a pity that the Australian Law Commission did not propose any replacement in their draft Bill after they repealed those sections of change of voyage in their Act.

Considering both of these factors, it should be suggested that the new English Act should abolish the dichotomy of alteration of risk and increase of risk and provide for some general

¹ See above p.82.

² As to MIA 1906, see Section 45: Change of voyage; Section 46: Deviation; Section 48: Delay in voyage. As to the Institute clauses, see the Classification clause.

principles on change of risk as a whole. The new Act could follow the Norwegian Marine Insurance Plan and provide a more flexible and proportionate remedy for both types of change of risk. The following points need to be considered in the new Act. First, the Act should provide for a requirement of notice at the time of receipt of advice of the change of risk. The new Act should not be specific as to particular situations of change of risk; otherwise, it would stifle the development of common law. Secondly, as to the effect of change of risk, the Norwegian Plan should be carefully looked at when seeking reference. The new Act should provide that the insurers are entitled to ask for an additional premium or amend terms for the changed risk if he agrees to cover. Moreover, the new Act should provide that the insurer is entitled to terminate the policy but must give prior notice, and that the insurer can deny liability before the contract is terminated but only to the extent that the loss is attributable to the change of risk. Thirdly, if the insurer becomes aware that a change of risk has taken place, he shall, without undue delay, notify the insured in writing whether he would continue to cover or terminate the policy. Otherwise, he forfeits his rights to the above remedies.

6. Conclusion

As concluded at the 38th CMI conference, it is the common law that has diverged from the civilian roots from which all marine insurance law is derived.¹ Nonetheless, today, marine insurance law is dominated by English law. Any efforts to harmonise international marine insurance law would not be successful without the active participation of reform of English law. As evidenced by the CMI marine insurance harmonization project, it is not realistic to hope that any model law or convention on marine insurance would bring harmonisation into international marine insurance law.² The fact that the London market still retains its control over international policy wordings, and that the London legal market retains its pre-eminence as a centre for arbitration and dispute resolution is not going to change in the immediate future. Therefore, the London insurance market and the London legal market should be encouraged to work together to maintain their premiere position in marine insurance by reforming English law by updating it and making it more user-friendly so as to leave more space for freedom of contract for the special needs of the insurer and insured. This seems to be a more practical way to achieve some international consistency in marine insurance.

It is predicted that the reform of English marine insurance law shall be a long process. It needs parliamentary interest and time, both of which are not at a premium at present. Even if

¹ John Hare, *The CMI review of marine insurance report to the 38th conference of the CMI Vancouver 2004*, CMI Yearbook 2004, at 258.

² Cf. Malcolm Clarke, *Doubts from the dark side—the case against codes*, J.B.L. 2001, Nov, 605-615; Patrick Griggs, *Insurance Codes—A middle way*, J.B.L 2001 Nov, 616-622.

both of them are ready, a dramatic change of current law is still not very likely. As witnessed in the Law Commission's scoping paper, warranties are listed but the approach to the problem still focuses on the requirement of causal connections. At present, it seems that more academic discussions should be engaged on the possible avenues for reform and some ground-breaking study is needed to provide some innovative thoughts on the development of English law.

Chapter 7

THE CHINESE LAW OF MARINE INSURANCE WARRANTIES AND ITS REFORM

The history of marine insurance in China is relatively short. The modern law and practice of Chinese marine insurance has only started to develop over the last 20 years or so. Currently, the law of marine insurance is codified in the Maritime Code of PRC 1993 (CMC 1993). There is also other legislation regulating marine insurance contracts in China (PRC). These laws read together provide a sound framework of marine insurance law in the PRC. The Chinese law of marine insurance was also closely influenced by English law. The English concept of warranties was adopted into the CMC 1993 as a rule of law. But the provision of warranties in CMC 1993 is rather primitive and creates much uncertainty in litigation. In the light of the international discussion on the reform of the English Law of warranties, the Chinese academia has also started to discuss reforms of the Chinese law relating to marine insurance warranties. This chapter aims to expose the present state of the Chinese law of marine insurance warranties, comment on the points of interest and difficulty in Chinese law and practice and finally draw a conclusion on the remodeling of the Chinese law relating to marine insurance warranties.

1. Introduction

Marine insurance started in China as an imported business 200 years ago. There was no legislation on marine insurance in China until 1929.¹ The current legal system in China has been established since the foundation of the PRC in 1949. The following is an overview of the history of the Chinese insurance industry and the legal framework of Chinese marine insurance law.

1.1 An Overview of the Chinese Insurance Industry

The History

The insurance industry in China started in the early 1800s. Insurance companies were first

¹ On the 30th December 1929, the Kuo-Min-Tang Government issued the Maritime Act and the Insurance Act. Both Acts were applicable to marine insurance.

set up in Guangdong (then known as Canton), where foreign trade was most prosperous.¹ The first few insurance companies were all set up and run by the English merchants and it was not until 1865 that the first insurance company run by the Chinese was opened in Shanghai. From 1865 to 1912, 35 Chinese insurance companies were established, which included 27 property and casualty insurance companies and eight life insurance companies. The only company with a far-reaching influence among them was the Commercial Bureau of Insurance (Shanghai), whose business was entirely based on marine insurance. By 1914, 26 of these 35 companies had become bankrupt. By contrast, there were 148 foreign insurance companies controlling almost 80% of the market at the time.

From 1912 to 1948, China was ruled under the Chinese National People's Party (Kuo-Min-Tang). During this period, the insurance industry had seen some ups and downs intervened by the two World Wars. By 1948, there were 241 insurance companies in China, 63 of which were foreign insurance companies.² These insurance companies were mostly clustered in Shanghai, the birthplace of China's own insurance industry and the main arena for insurance competition.

In 1949, when the People's Republic of China was founded, the government set up the People's Insurance Company of China, combining some domestic insurance companies. It was a department in the People's Bank of China, the central bank of China, and had a monopoly over the whole domestic insurance industry. In the following years, there was no insurance industry in China in a commercial sense, as insurance was regarded as unnecessary except in the area of international cargo transport and aviation. It was not until the 1980s when the country was opened up to the rest of the world and started successive economic reforms that the insurance industry in China started to catch up with the recent development of international insurance practice. In 1984, the State Council of China separated the state-run P.I.C.C from the People's Bank of China and standard insurance products such as life, property and reinsurance services began to emerge in the market.

The Current Situation

In the last 20 years or so, there has been a great change of scenery in the Chinese insurance market. In the early 1980s, the People's Insurance Company of China (P.I.C.C) was the only player in the market. It was a state-owned national comprehensive insurance company

¹ The first insurance company in China was established in Guangdong by the English merchants 1805. It was called the Canton Insurance Society.

² Stephen P.D'Arcy and Hui Xia, *Insurance and China's Entry into the WTO (English)*, University of Illinois. This paper is available at www.business.uiuc.edu/~s~darcy/papers/wto.pdf.

with headquarter in Beijing.¹ In order to create a more competitive domestic insurance market, the Central government relaxed regulations on setting up insurance companies in 1985 and there has been a boom of insurance companies setting up around the country. The most important are Ping An (Group) Insurance Co., headquartered in Shenzhen and China Pacific (Group) Insurance Co., headquartered in Shanghai. They are both comprehensive commercial insurance companies. They are the main providers of marine insurance in the Chinese market besides the P.I.C.C. From the 1990s, foreign insurance companies also started to set up their representative offices in China, waiting for further admission to running a full range of services in China. In 2001, China (P.R.C) gained its membership to the World Trade Organisation (WTO). Under the WTO laws, the Chinese insurance market will finally be open to foreign insurance companies and foreign investment.

The market for insurance in China is huge.² However, the market is still undeveloped and underserved. The recent brisk growth of the market presents both problems and opportunities for insurers operating in China. Chinese insurers are relatively inexperienced, but at the same time, the lack of experience is also an advantage as they do not have the problem of legacy systems and highly developed distribution structure that the Western insurers have.

The insurance law in China also needs to catch up with the international insurance practice so as to serve the market better. As a branch of insurance with a distinctive international character, marine insurance is one of the first few branches of insurance that have already closely followed the international practice. The Standard Hull Insurance Clauses used in the Chinese marine insurance market are modelled on the London Institute Clauses.³ In fact, the London Institute Clauses are also used in the Chinese market. However, the underwriting process for marine insurance is completely different from the English practice at Lloyd's: intermediaries are not used much in marine insurance; the insured and the insurer make direct contract before and after the contract is made.

1.2 The Legal Background of Chinese Marine Insurance Law

The current legal system in China (P.R.C) was gradually established after 1949. Between

¹ In 1996, PICC was reorganised into a holding company (P.I.C.C Group) with three completely independent subsidiaries (Property, Life and Reinsurance). The reason for such a re-organisation was to comply with the requirement of separating life and property business according to the Insurance Act of PRC 1995. They set up three sub-companies and split their business in life assurance, property insurance and re-insurance. Now, the P.I.C.C is known as P.I.C.C (Group). Co. Ltd.

² Currently, approximately 30 domestic and 30 foreign insurance companies are operating in China. The insurance premiums were about \$60 billion in 2005 and they are projected to grow to \$100 billion by 2009. China's insurance market is becoming a major focus of international activity for the world's largest insurers. See *China Marches Forward*, Insurance Networking News, 1 November 2005 at www.insurancenetworking.com.

³ The standard Hull Clauses in Chinese market are drafted by the PICC. They are known as the PICC Hull Clauses (1/1/86).

the mid-1950s and the early 1980s, there was not much legislative activity in China (P.R.C), due to the Cultural Revolution when the country was not ruled by law. The last 10 or 15 years have seen a dramatic increase in legislation in most areas of law. Thanks to the rapid increase of international trade and commerce, commercial law has gradually developed to a fuller extent. Maritime law, as a branch of commercial law, was codified in 1992 and became effective as from 1st July 1993.¹ Marine insurance law is mostly codified in Chapter XII of the CMC 1993. There are also other laws which have a bearing on marine insurance. The following discussion will identify the sources of law for marine insurance in China (P.R.C), the courts system and the legal method used in the Chinese jurisdiction.

Sources of Law

The law of marine insurance in China (P.R.C) is codified into the Maritime Code of PRC 1993. The code has a total of 278 articles, regulating all aspects of maritime and admiralty issues. Marine insurance is codified in Chapter XII and has 41 articles.

The provisions relating to marine insurance in the CMC 1993 are mostly modelled on the English MIA 1906; therefore, some concepts and principles of English marine insurance law were incorporated into the law. It is generally believed that under Chinese law, marine insurance is a contract of indemnity, where the insured must have an insurable interest in the insured subject –matter and the insurer is obliged to indemnify losses which are proximately caused by the risks covered in policy. It is also believed that marine insurance is a contract of speculation; therefore, both the insurer and the insured owe a duty of utmost good faith to each other.

It must be noted that the law of marine insurance has not been extensively litigated in China as that in English law. Moreover, unlike the common law system, under Chinese law, precedents are not binding nor regarded as a source of law. In recent years, things have slightly changed. In maritime litigation, precedents are cited in lawyers' submissions to the court to support an argument or illustrate the point of law, but they are still only persuasive.

Apart from the CMC 1993, marine insurance contract are also regulated by the Insurance Law of the PRC 1995² and the Contract Law of the PRC 1999 in China.³ According to

¹ The draft bill was adopted 1992 by the Standing Committee of the National People's Congress. The law became effective on 1 July 1993.

² In this piece of legislation, there are also provisions on the regulation of the insurance companies. Therefore, it is a combination of insurance company law and insurance contract law. The Insurance Law of PRC 1995 has been amended in 2002. Hereunder, it refers to the 2002 amended version unless otherwise specified.

³ There is another relevant piece of legislation which is entitled as General principles of Civil law. As a marine insurance contract is creating a civil rights and obligations relationship between the civil parties of equal capacity, it also falls within the scope of this legislation. However, this legislation was drafted in 1980s and it was very primitive. They do not have much bearing on marine insurance except the general rule of rights and obligations under contract.

Chinese Jurisprudence, these laws are general laws on insurance and contracts; therefore, they are only operative when the CMC 1993 has no provision on the relevant point of law. It is to be noted that the CMC 1993 was drafted much earlier than the other two Acts. As a result, some provisions in the latter two Acts might be in conflict with the CMC 1993, where new concepts and principles were not present. However, even in such a case, the CMC 1993 still overrides the other two.

By virtue of Art 268 of the CMC 1993,¹ international maritime practice is also a source of law. However, it is only a last resource of law when there is no provision in all the domestic laws mentioned above. These international maritime practices certainly include English marine insurance law and the practice of the London insurance market. In fact, pursuant to Article 269, the contracting parties can also choose foreign laws to be the applicable law in their insurance contract. The court has recognised this practice in a number of cases. In *Jiansu Overseas Entrepreneur Group v Feng Tai insurance (Asia) Co., Ltd., Shanghai*,² the policy provided that any dispute under the policy is subject to English law. The Maritime Court of Shanghai held that this clause was effective and decided the case according to English law.

The Judiciary

In China, the hierarchy of the court system is of four layers. From the bottom to the top, they are district or county courts, municipal courts, provincial courts and the Supreme Court. The jurisdiction of these courts is divided in two respects. First, at a horizontal dimension, a court, except the Supreme Court, will normally have jurisdiction over cases which are closely connected to its geographical territories. Second, at a vertical dimension, a large quantity of civil and commercial cases starts from the district/county courts or the municipal courts, depending on the amount of money in litigation and whether they are foreign-related. Only a very few cases will start from the provincial courts or the supreme courts, when they are extremely complicated and have serious effects on foreign matters. Most cases will be tried at most by two courts of different levels and the final decision of the appeal court will be a binding judgment on the litigants. In some exceptional cases, depending on the merits of the case, the litigants may wish to go to the provincial courts or the Supreme Court to appeal for a review on the final judgment they have been awarded.

However, maritime cases in China are subject to a different jurisdiction. Aside from the

¹ Article 268 (2) reads: International practice may be applied to matters for which neither the relevant laws of the PRC nor any international treaty concluded or acceded by the PRC contain any relevant provisions.

² (2001) Maritime Court of Shanghai, first instance No. 398. This case is available in Chinese at www.ccm.org.cn/hs/news/show.php

jurisdiction of these courts, there are also 10 maritime courts¹ with special jurisdiction on maritime cases. Their jurisdiction is divided by their geographical territories. The reason for having maritime courts is suggested to be that a normal court judge may not be competent to deal with the specialty and technicality of maritime cases. It is agreed that maritime litigation is usually very complicated and involves foreign factors. Therefore, it should be resolved by specially-trained judges or more experienced judges.

The relationship between the maritime courts and the normal courts is rather simple. Any maritime-related case will be tried at their first instance in a maritime court. These maritime courts are equal to the municipal courts in the hierarchy of the court system; therefore, if the litigants are not satisfied with their trial judgment, they may go on to the appellate court, which is the provincial court where the maritime court is located, for appeal.

Legal Method

The mechanism of precedents is not recognised in the PRC. The decisions of the ten maritime courts are not binding on one another. Sometimes, there is inconsistency between their views on a particular point of law. In such a situation, the Supreme Court has a supervisory role: they will give their interpretations when they thought it was necessary to clarify their views on a particular point of law, or they were asked by the lower courts to clarify their view to the law. These interpretations by the Supreme Court are not law. They are only judicial interpretations, but they are extremely persuasive to the lower courts and will undoubtedly be followed in their reasoning. In this sense, they are binding on lower courts.²

Apart from the Interpretations by the Supreme Court, the Institute of Practical Legal Research at the Supreme Court also regularly publish some of the most important cases that they think are either innovating or clarifying positions of law. These cases will also be considered and regarded as extremely persuasive to the lower courts in their reasoning. However, they are actually not binding on the lower courts.³

One important feature of the Chinese legal method is the importance of academic authorities in the interpretation of law. Academic authorities are frequently cited in submissions in litigation. Their view of law is extremely important to the legal research and to the judge's reasoning. In a sense, a statement of law by leading academics is regarded as authority when lawyers and judges formulate their reasoning. Therefore, it is seen as a normal practice for maritime lawyers to submit to the court a passage from leading academic texts or

¹ They are maritime courts in Tianjin, Dalian, Qingdao, Shanghai, Niboing, Xiamen, Wuhan, Guangzhou, Beihai, Haikou.

² There is huge criticism on this. In general, it is criticised that the Supreme Court, as a judiciary body, does not have the right to legislate. Therefore, their suggestions on points of law should not be binding at all.

³ Though, there is a lobby in Chinese academia urging that precedents should be considered as binding subject to certain rules in Chinese law.

a piece of consultation advice from a leading academic in the subject. This would be very persuasive to the courts. Nonetheless, they are not binding and it is up to the judge's discretion whether to take the view or not. However, it does provide some consistency in law.

That said, as a jurisdiction with some civil law characteristics, judgments are not regarded as declaration or statement of law. They are only binding on the litigants. As a result, China (P.R.C) does not have a tradition of case reporting. Judgments are only released to the litigants and are usually not published to the general public. Very recently, there have been some changes in the judiciary's practice for maritime and international commercial cases. Considering the necessity of bringing some consistency into these areas of law, the Supreme Court made an initiative to create an on-line case reporting system in cooperation with the 10 maritime courts and their provincial courts, on which judgments of maritime and international commercial cases are reported.¹ This initiative is part of the country's plan to become the leading centre for maritime litigation and arbitration in Asia. With this initiative, the judiciary can more efficiently exchange ideas and make their decision-making process more consistent. Judgments now tend to be much longer than they were five or 10 years ago and the reasoning of the judge is more and more transparent and detailed in the judgment.

2. Understandings of Warranties in Chinese Law

The concept of warranty is adopted in Article 235 of the CMC 1993. Article 235 provides that:

The insured shall notify the insurer in writing immediately where the insured has not complied with the warranties under the contract. The insurer may, upon receipt of the notice, terminate the contract or demand an amendment to the terms and conditions of the insurance coverage or an increase in the premium.

2.1 The Concept of Warranties

There is no definition of warranty in the entire CMC 1993 or elsewhere in the other two pieces of legislation relevant to marine insurance, i.e., the Insurance Law of the PRC 1995 and Contract Law of PRC 1999. It is suggested that the concept was first adopted in the P.I.C.C Hull Clause (1/1/86) and then was accepted by the draftsmen of the CMC 1993. According to Chinese market practice, those special conditions endorsed on the insurance policy are regarded as warranties. Without a definition in the CMC 1993, many leading academic texts

¹ The website address is www.ccmt.org.cn. The content of this website is in Chinese. So far, the size of this archive of judgements is still very small. The reported cases only start from 2000 and they are all in Chinese.

suggest that warranties in Chinese marine insurance have the same meaning as that in the English MIA 1906.¹ It is undeniable that the concept was adopted from English marine insurance law and therefore, it must have the same meaning as it was defined in s.33 of the MIA 1906 unless the draftsmen intended to change or modify it. Since such an intention was not obvious, it is suggested that s.33 (1) MIA 1906 can be referred to for a definition of Chinese warranties: the insured promises to do or not to do something or guarantees a certain state of facts exist or do not exist.

Litigation on warranty issues is very rare and there is generally no distinction between different types of warranties in Chinese marine insurance law. This is partly due to the very limited use of warranties in practice. In fact, the notion of warranty was seldom used as a defence known to the insurer. Only for academic purposes, it is submitted that warranties are divided into two kinds: *affirmative warranties* and *promissory warranties*.² This distinction seems to come from American jurisprudence. The former refers to warranties relating to the state of facts at the time the contract is concluded, whereas the latter refers to what the insured undertakes to do or not to do during the currency of the insurance. Needless to say, this distinction by the nature of affirmative and promissory is rather misleading, as the English MIA 1906 used 'promissory warranty' to distinguish marine insurance warranties as a whole from warranties in general contract law. This is an obscure point that has not been examined in Chinese law.

2.2 The Juristic Basis of Warranties—Utmost Good Faith

Among Chinese academia, it is generally believed that warranties originated from the principle of utmost good faith. In all leading academic texts, it is suggested that disclosure, representation, and warranties are the three pillars of duty of utmost good faith in marine insurance.

The principle of utmost good faith is often debated in China. The existence of the principle is not evident from the structure and content of the CMC 1993. Unlike the English MIA 1906, there is no provision of the duty of utmost good faith for marine insurance contracts in the CMC 1993. The duty seems to be a presumption by academics when they

¹ Prof. Si Yuzuo ed., *Maritime Law (Chinese)*, Dalian Maritime University Press 1999, p.476; Prof. Chen An ed., *International Maritime Law (Chinese)*, Beijing University Press, 1999, pp. 653-654, Prof. Wang Pengnan, *The Law of Marine Insurance (Chinese)*, 2nd ed., Dalian Maritime University Press, 2003, p.100

² Zhang Xianwei, *Warranties in marine insurance (Chinese)*, Vol. 8 (1997) Annual of China Maritime Law, pp.200-213.

explain insurance law.¹ In the law of marine insurance, it is generally believed that there are four cardinal principles in marine insurance law: the principle of utmost good faith, the principle of insurable interest, the principle of indemnity, and the principle of proximate cause. The absence of these principles from the legislation is now being noticed and addressed in various discussions.²

Although the principle of utmost good faith is not provided for in the CMC 1993, it is suggested in some academic texts that the duty is actually required by Article 5 of Insurance Law of the PRC 1995, which says: ‘all parties to the insurance contract should perform their rights and obligations under good faith.’ In their view, Articles 222, 223 and 224 of the CMC 1993 are in fact illustrations of the duty of utmost good faith. This view makes some sense considering that the Insurance Law of the PRC 1995 also applies to marine insurance contract. However, it is not convincing when considering that the duty of good faith is also required elsewhere outside Insurance Law of PRC 1995. It is in fact a general principle applicable to all commercial contracts in China. Both the Contract Law of the PRC 1999 and the General Principles of Civil Law 1986³ provide that contracting parties should perform their rights and obligations by good faith. So, the duty of good faith is generally applicable to every commercial contract, not exclusively to insurance contracts. There is a consensus that the duty of good faith in Chinese contract law has been adopted from ancient Roman law. In that case, it is safe to argue that it is not an equivalent to the duty of utmost good faith in the sense of s.17 of the MIA 1906. As under the duty of utmost good faith in the MIA 1906, the insured is required to volunteer material information to the insurer; any non-disclosure or misrepresentation will entitle the insurer to avoid the contract. This is regardless of whether the insured is innocent or fraudulent. By contrast, the Roman concept of good faith only requires that there is no fraud in the performance of the contract. In addition, when the exact wording of Article 5 of the Insurance Law of the PRC 1995 is examined, the duty of good faith can only be required after the contract is concluded, as the duty exists when the contracting parties perform their rights and obligations. Before the contract is concluded, there is no such a right-and-obligation relationship between the two; therefore, they are not bound by the duty to each other. The same is true of the wording of Article 6 of the Contract

¹ Influenced by the civil law system, the Chinese academics tend to summarise general principles for a particular area of law and try to rationalise and put the whole system of law in order with these principles. This method of legal method is regarded as very necessary in China because the legislation in China is mostly general with many aspects of legal points not covered in legislations. Using this method, judges have discretion in applying principles into contexts when there are no specific rules in the legislation and find proper solutions to individual disputes.

² Prof. Wang Pengnan, *Modern Marine Insurance Law and Practice (Chinese)*, 2004, Dalian Maritime University Press, pp.109-141.

³ As the name indicated, this Act only provides general principles in the law of civil liabilities and obligations. The Act was drafted in the 1980s when litigation on civil cases were relative undeveloped. The Contract Act 1999 has been regarded as a crucial amendment to these principles. The Act is soon going to be repealed by the Codification of Civil Liabilities and Obligations, which is still being worked on by the legislature.

Law of the PRC 1999. However, this must be seen as a technical mistake by the draftsmen and it is agreed that the duty of good faith is also required beyond the life of the contract under the Contract Law of the PRC 1999.¹ To date, under Chinese jurisprudence of contract law, it is accepted that there is an overarching duty of good faith in the making of contracts, during the period of the contract and after the contract.²

Influenced by this thinking, it is believed that the duty of utmost good faith is also an overarching duty in marine insurance contracts. Thus, compliance with warranties is suggested to be an obligation contained in the principle of utmost good faith. It is to be noted this concept of utmost good faith in Chinese marine insurance law is not exactly the same as that in English law. Nonetheless, it is suggested that compliance with warranties is only applicable in marine insurance because the concept of warranties are not known in non-marine insurance.³ It is a statutory duty specified in the CMC 1993, where it also provides for the remedies for the breach of this duty: the insurer has a right to terminate the insurance unless he wishes or asks for additional premiums or to amend the terms.⁴

2.3 The Rationale of Warranties—Control on the Increase of Risk

At the same time, Chinese academics also acknowledge that the necessity of warranties in insurance was prompted by the need to protect the insurer in the case of increase of risk, though the term ‘increase of risk’ is not used in the CMC 1993.

The importance of increase of risk is apparently well recognised in the Insurance Law of the PRC 1995 (2002 Amendment). Like in many civil law countries, Article 37 of Insurance Law of PRC 1995 reads that:

If the level of risk to the insured subject matter increases during the term of an insurance contract, the insured shall promptly inform the insurer in accordance with the contract, and the insurer shall be entitled to increase the premium, or else rescind the contract.

In the event that the insured fails to carry out the obligation to inform as described in the previous paragraph, the insurer shall not be liable to compensate for events resulting from such increased levels of risk.

There is no similar provision in the Marine Insurance Section of the CMC 1993. It should

¹ When Article 6 is read together with Articles 42, 43, 60, 92 and 125, it is clear that the duty of good faith is also required in both the pre-contract and post-contract period. These duties are statutory specified but the remedies for breach of these duties are not provided in the legislation.

² See Article 60, Contract Law of the PRC 1999.

³ Prof. Wang Pengnan, *Modern Marine Insurance Law and Practice (Chinese)*, Dalian Maritime University Press, 2004, p.130.

⁴ Article 235, CMC 1993.

be noted here that the Marine Insurance section of the CMC 1993 was closely influenced by the English MIA 1906 and the relevant English case law, whereas the Insurance Law of the PRC 1995 had been influenced by the German insurance law. Although they do not read exactly the same, their effects and intention are nonetheless very similar. Therefore, it might be assumed that the draftsmen of the CMC 1993 might have intended to use Article 235 as a similar mechanism to protect the insurer in case of increase of risk in marine insurance.¹

Given the fact that CMC 1993 was enacted earlier than the Insurance Law of the PRC 1995, it must be assumed that the later provision also applies to marine insurance as a general rule. Nonetheless, there is some ambiguity in the provision. Does the insured only have the duty of notice when he expressly agrees to do so in the insurance contract? It is submitted that notice is only required when the contract has provided such a duty.² It might be argued that, from a syntax view, the words 'in accordance with' simply indicate that the form and time of the notice should be agreed by the contracting parties in the policy. If they did not, it then should be done within a reasonable time and in an effective form.

2.4 The Nature of Warranties

The nature of warranties is now held as promissory condition precedent in English law.³ It is to be noted that the meaning of condition precedent is different in Chinese law from that in English law. Article 45 of the Contract Law of the PRC 1999 reads:

The parties may prescribe that effectiveness of a contract be subject to certain conditions. A contract subject to a condition precedent becomes effective once such condition is satisfied. A contract subject to a condition subsequent is extinguished once such condition is satisfied.

Where in order to further its own interests, a party improperly impaired the satisfaction of a condition, the condition is deemed to have been satisfied; where a party improperly facilitated the satisfaction of a condition, the condition is deemed not to have been satisfied.

By the definition in this article, English promissory warranties in marine insurance are actually not conditions precedent. From a Chinese perspective, it is submitted that an insurance contract with English law promissory warranties is a conditional contract which will automatically come to an end when the condition is satisfied. Therefore, English law marine

¹ Cf. Prof. Wang Pengnan, *Modern Marine Insurance Law and Practice (Chinese)*, Dalian Maritime University Press, 2004, pp.146-147.

² Prof. Wang Pengnan, *The Law of Marine Insurance (Chinese)*, 2nd ed., Dalian Maritime University Press, 2003, p.105.

³ *The Good Luck* [1992] 1 AC 233

insurance warranties are conditions subsequent in the sense of Article 45 of the Contract Law of the PRC 1999.

By virtue of Article 235 of the CMC 1993, the nature of Chinese law marine insurance warranties is different from the English one. It is not a condition which the effectiveness of the contract is subject to. Under Article 235, breach of warranty does not terminate the contract automatically, but only gives the insurer a right of election to terminate. This is a situation where the insurer has a statutory-prescribed right to terminate the contract. It is a self-help remedy.

It is to be noted that warranties are contractual terms and breach of them are breach of contract. But it is very difficult to put warranties under any category of contractual obligations under Chinese law. In general, contractual obligations are classified into main obligations and collateral obligations.¹ Main obligations are obligations determining the nature and purpose of the contract. They are the basic conditions which decide the character of the contract. Collateral obligations are mainly implied terms of the contract under the principle of good faith. By virtue of Article 60 of the Contract Law of the PRC 1999, the contracting parties shall abide by the principle of good faith and perform obligations such as notification, assistance, and confidentiality, etc. in light of the nature and purpose of the contract and in accordance with relevant customary usage. Warranties are neither of these two types. Therefore, contractual remedies for breach of obligations are not applicable to warranties. The effect of its breach is that the insurer can either terminate the contract or ask for additional premium or amended terms. They are, therefore, named as Special Clauses in the insurance policy.

In general contract law, there are two types of rights of termination: one is termination prescribed by legislation; the other is termination agreed by contracting parties.² This is also applicable in insurance law: once the insured risk is attached, the insurer cannot terminate the insurance, unless it is prescribed in the legislation or agreed by the contracting parties.³ There are a few situations where the insurer is entitled to a statutory termination of the insurance in marine insurance law. These are:

- (1) the insured did not take reasonable care of the subject-matter insured as agreed in the policy;⁴
- (2) the risk is increased;¹

¹ Here, contractual obligations do not include pre-contract and post-contract obligations. Under the Contract Law 1999, these are all contract-related obligations. By contractual obligations is meant obligations during the life of the contract.

² Articles 93 and 94, Contract Law of the PRC 1999.

³ Articles 16 and 35, Insurance Law of the PRC 1995 (2002 Amendment); Article 227, CMC 1993.

⁴ Article 36(3), Insurance Law of the PRC 1995 (2002 Amendment).

(3) Breach of warranties.²

The first two situations are straightforward because the conditions of termination are prescribed in the legislation itself. But, breach of warranties is rather complicated. The right to terminate is prescribed in the legislation, but the contents of warranties are agreed by contracting parties. Therefore, it is a statutory right of termination rather than a contractual right of termination.

3. Obscurities under Current Law

That said, Article 235 of the CMC 1993 is the only provision about marine insurance warranties in the entire Chinese law. The provision is somewhat primitive and leaves several points open to question.

3.1 Termination of Contract

The effect of breach of warranties provided in Article 235 is apparently different from the English position. The insurance is not automatically discharged from the time of breach. By virtue of Article 235, the insured should notify the insurer of the breach immediately after the breach of warranties, and upon the receipt of such notice, the insurer has a right to elect either to terminate the insurance or to continue the insurance while demanding amended terms or additional premiums. Therefore, when there is a breach of warranty, the future of the policy depends on the insurer's election on how he intends to treat the contract. He may terminate the contract or he may as well accept the continuance of the contract but at the same time asks for amended terms or additional premiums. It seems like a held-covered clause in the Institute Hull Clauses (1/10/83). However, it is not clear how the insurer can terminate the contract and when the contract is actually terminated.

When and how to terminate the insurance?

Article 235 reads that upon the receipt of the notice from the insured, the insurer may terminate the contract. It sounds a bit ambiguous: does the insurer have to wait for the insured's notice and he knows the breach before the insured if he wishes to terminate the contract? The answer is almost self-evident: the insurer can terminate the insurance as soon as he knows of the breach, and he does not have to wait for a notice from the insured. Otherwise, the effect of Article 235 would be barren if the insured intentionally withheld the notice. In fact, due to the principle of utmost good faith, the insured must notify the insurer

¹ Article 37 (1), Insurance Law of the PRC 1995 (2002 Amendment)

² Article 235, CMC 1993

of the breach without undue delay.

On the insurer's side, after becoming aware of the breach of warranty, the insurer must exercise his right of termination within a reasonable time. As noted, he does not have to wait for the insured notice before he can terminate the insurance if he knows of the breach. But by virtue of Article 95 of Contract Law of PRC 1999, the right of termination would expire if it is not exercised within a reasonable time. So the insurer also has to make the decision in a reasonable time. It is up to the court's construction on what is a reasonable time. It all depends on the factual matrix of the case.

Under Article 235, CMC 1993, the insurer's right to terminate the contract in case of breach of warranty is a statutory right of termination. Pursuant to Articles 93 of Contract Law of PRC 1999,¹ statutory termination of contract must be done by serving a notice from one contracting party to the other. Therefore, the insurer must make his decision to terminate the insurance known to the insured by notice. As to the form of the notice, there is no special requirement in Article 235. The Supreme Court is of the view that such notice should be in a written form.² Under general contract law, the effect of a written notice takes effect when it arrives at the insured's place. It could be his postal address, fax machine, or email address, as long as under normal circumstances the insured would have received it. It is no defence if the insured recklessly or negligently had not become aware of the existence of such a notice.

When is the insurance terminated?

Once the notice has been received by the insured, the contract is terminated. Nonetheless, it is not clear whether such a termination has a retrospective effect. Is the contract terminated from the time that warranty was breached or is it terminated from the time that the notice of termination is served on the insured? There are different views on this point under Chinese law.

In general contract law, the effect of termination of contract is not a definite matter. The mainstream of academia believes that termination of contract should be flexible in terms of its effect. It may be retrospective; it may well be prospective.³ It should depend on the

¹ There are two kinds of termination of contract in Chinese contract law. On the one hand is the statutory termination of contract, by which the right of termination is prescribed in the legislation; on the other hand is the contractual termination of contract, by which the right of termination is agreed upon between the parties in the contract. In both circumstances, the right of termination is operative when the situation prescribed in the legislation or agreed in the contract has arisen.

² The form of the notice by the insurer is not clear in the CMC 1993. On 18 August, 2005, the Supreme Court has drafted its third version of the Supreme Court Interpretations on the Law of Marine Insurance, in which Article 9 provides that the notice should be in written form.

³ Article 97 of Contract Act 1999 reads: Upon termination of a contract, a performance which has not been rendered is discharged; if a performance has been rendered, a party may, in light of the degree of performance and the nature of the contract, require the other party to restore the subject matter to its original condition or otherwise remedy the situation, and is entitled to claim damages.

individual merits of the case and there is no definite answer to that question. Therefore, it should be regarded as a remedy different from both avoidance of the contract which is retrospective and automatic discharge of the contract which is only prospective.¹ In the insurance context, the effect of termination of insurance also has two possibilities. For example, as to misrepresentation, Article 223 provides that the insurer may terminate the insurance if the insured is intentional and the insurer is not liable for any loss incurred by the insured before the termination, whereas if the insured was innocent in the misrepresentation, the insurer still has the right to terminate but he is liable for losses incurred before the contract is terminated. So, the effect can be retrospective or prospective in different situations.

If compliance with warranties is a duty under the principle of utmost good faith under Chinese law, it might be safe to argue that a similar approach to non-disclosure should be adopted: breach of warranties should be distinguished by the state of mind of the insured. If the insured caused the breach intentionally, the termination should be retrospective to the time of breach; if the insured was innocent with the breach, then the termination should be prospective only from the time of notice being served. It is suggested that if any loss occurs during the period between the breach of warranty and the time the insurance is actually terminated, the insurer should be liable for the loss if there is a causal connection between the breach and the loss.² However, the law is still open to question on this point.

3.2 Exact Compliance

It is not clear in Chinese law whether warranties should be exactly complied with. It is true that Article 235 is silent on the point. Some academics suggest that English law, as a source of international practice of marine insurance, should be referred to in the absence of any Chinese legislation on this point. Therefore, it is argued that any warranty, whether it is material to the risk or causative to loss, should be exactly complied with. Otherwise, warranties would lose their distinct character and would not be warranties.³ It should be noted that since the CMC 1993 did not mention whether warranty should be material to the risk, the courts have the discretion to consider what constitutes a warranty. According to the English MIA 1906, materiality is not required in creating warranties. There are no reported cases in Chinese law on whether warranties should be material to the risk and whether they should be substantially complied with or whether only literal compliance will suffice. It is generally

¹ As to the meaning of termination, there is some confusion in Chinese contract law. It is used interchangeably in many situations with discharge of contract.

² Wang Xin, *The legal consequences of breach of warranty in marine insurance (Chinese)*, Vol 12, (2001) Annual of China Maritime Law, Dalian Maritime University Press, pp.65-73.

³ Dr. Zheng Lei, *How to understand the 'warranty' in marine insurance (Chinese)*, Vol. 8, Annual of China Maritime Law (1997), 215-231, at p.228.

assumed that in Chinese law, the insurer can also put any term as a warranty in the policy as long as he makes the intention clear with express terms. Considering the rationale of warranties and the trouble and criticism in English law, it must be right to argue that warranties in Chinese law need to bear some materiality on the risk, otherwise, it could be used purely as a technical defence for the insurer to avoid his liability. In addition, considering the draconian nature of the English rules of warranties, the court should not adopt the English rule of exact compliance.

However, it should be emphasised that the element of causation is also not required under Chinese law. As said, the breach of warranty only gives the insurer a right of election to terminate the insurance. The insurer's right of election has nothing to do with causation. If the warranty is breached and he wishes to terminate the insurance, all he needs to do is give the insured notice. Therefore, causation is totally irrelevant.

3.3 Implied Warranties

There are no implied warranties in the CMC 1993. However, there are some controversies. It was thought that legality was the one and only implied warranty in Chinese marine insurance. To date, views have changed. It is suggested that there are no implied warranties at all. Nonetheless, the subject matter of seaworthiness and illegality are regulated in Chinese marine insurance law in other forms.

Seaworthiness

Unlike English law, seaworthiness is treated as one of the exclusions to the insurer's liability in hull insurance under the CMC 1993. Article 244 of the CMC 1993 reads:

Unless otherwise agreed in the insurance contract, the insurer shall not be liable for the loss of or damage to the insured vessel *arising from* any of the following causes:

- (1) Unseaworthiness of the vessel *at the time of the commencement of the voyage*, unless where *under a time policy the insured has no knowledge thereof*;
- (2) Wear and tear or corrosion of the vessel.

The provisions of this article shall apply *mutatis mutandis* to the insurance of freight.

There is no definition of seaworthiness in the CMC 1993 and the concept seems to be varied in different contexts. In carriage, it is suggested that seaworthiness is a relative concept according to the purpose and expected risk of the voyage. Normally, a vessel is deemed to be

seaworthy if it is fit for the risks that are normally expected in the marine adventure he is undertaking. There are four aspects in making a vessel seaworthy:

- The vessel is properly designed and constructed for the purpose of the maritime adventure;
- The vessel is manned with qualified and competent shipmaster and seamen;
- The vessel is equipped with necessities to enable the normal operation of the vessel;
- The holds, refrigerated or cool chambers and other parts of the vessel used for carrying the cargo are fit and safe for carrying and preserving the cargo concerned.¹

Under Chinese law, there might be a fifth aspect of seaworthiness. The vessel might be unseaworthy due to the nature of the dangerous cargo. In *People's Insurance (Guangxi) Company v Shipping Company Ltd of Tianjian*,² both the trial court and the appellate court took the view that the vessel was unseaworthy for the reason that the carrier had not informed the master of the dangerous nature of the cargo of zinc concentrate prior to the commencement of the vessel, which capsized during the voyage.

There are two qualifications to these duties. First, a vessel is deemed to be seaworthy when due diligence is exercised to ensure the above requirements are met. Therefore, undetectable defects in design should not render a vessel unseaworthy in the legal sense. Secondly, the vessel is only required to be seaworthy before or at the commencement of the voyage. Chinese law does not distinguish whether the insurance is a voyage policy or a time policy. According to the wording of Article 244, it must be read that time policies should be divided into several voyages and at the commencement of each voyage the vessel needs to be seaworthy for that particular voyage. Like English law, Article 244 does recognise that in a time policy, the insured is unable to know all the circumstances that would affect the seaworthiness of the ship. Therefore, it provides that in a time policy the insurer cannot deny liability when the insured has no knowledge of the unseaworthiness at the commencement of the voyage. It is suggested that the 'knowledge' in Article 244 should include the blind-eye knowledge.³ The insured is deemed to know the unseaworthiness if he is suspicious but turns a blind eye to the information that is available to him about the vessel. This is quite close to

¹ Articles 47 and 48 of CMC 1993. Cf. Si Yuzhuo ed., *Maritime Law (Chinese)*, Dalian Maritime University Press, 1995, pp.115-116, Chen An ed., *International Maritime Law*, Peking University Press, 1998, pp. 264-266.

² The case is reported in Vol. 37 (1998), No 3), *Maritime Trial (Chinese)* pp. 36-40.

³ Prof. Wang Pengnan, *Morden Marine Insurance Law and Practice (Chinese)*, Dalian Maritime Press, 2004, pp.176-177.

the standard of 'privity' in English law.¹

Recently, following the rectification of ISM code, it has become necessary for a vessel to have the two certificates required by the ISM convention, viz., the DOC (Document of Compliance) and the SMC (Safety Management Certificate) to be seaworthy. These two certificates aim to ensure that the vessel is under a sound system of safety management. Any breach of the ISM code will render the vessel unseaworthy, although in some cases it is only a minor breach of the documentary work.

It is also suggested that the concept of seaworthiness in marine insurance is broader than that in carriage. In marine insurance, besides the above requirements, the vessel needs to be properly loaded and stowed to be seaworthy.² It seems to be obvious that the way a vessel is loaded and stowed will certainly affect the condition of the vessel.

By virtue of Article 244, breach of seaworthiness does not give the insurer a right to terminate the insurance; therefore it is not a warranty in the sense of Article 235. Instead, it requires causation between the loss and the unseaworthiness. The burden to prove that the loss is caused by the unseaworthiness is on the insurer and it is relatively easy in practice. In most cases, as long as the insurer can prove that the vessel was not seaworthy, it is presumed that the loss was caused by the unseaworthiness. In a sense, the defence of unseaworthiness is used by the insurer as a pre-condition to accept his liability. However, it has never been argued that the policy is automatically discharged by the unseaworthiness.

Illegality

It is quite controversial whether illegality is an implied warranty in marine insurance under Chinese law.³ Legality is not mentioned in the CMC 1993, but it is argued that it is a general principle required in contract law that every contract should have a legitimate purpose and be carried out in a lawful manner.

Article 7 of the Contract Law of the PRC 1999 reads:

In concluding and performing a contract, the parties shall abide by the laws and administrative regulations, observe social ethics. Neither party may

¹ Section 39 (5), MIA 1906. *Companian Maritima Sa Basilio S.A v Oceans Mutual underwriting Association (Bermuda) Ltd. (The Eurysthenes)* [1976] 2 Lloyd's Rep 171, *The Star Sea*. [2001] 1 Lloyd's Rep 389

² Prof. Wang Pengnan, *Modern Marine Insurance Law and Practice, (Chinese)* Dalian Maritime University Press, 2004, p. 175.

³ The successive editions of Prof. Si Yuzuo ed., *Maritime Law (in Chinese)*, Dalian Maritime University Press, stated that legality is the one and only implied warranty in marine insurance under Chinese law. Currently, views have changed. It is argued that there is no necessity of any implied warranty in Chinese marine insurance law. See also: Prof. Wang Pengnan, *Warranty in the law of marine insurance (English)*, a paper presented at the 4th International Conference on Maritime Law, at Shenzhen, P.R.C., October 2002.

disrupt the socio-economic order or damage the public interests.

Article 52 of the Contract Law of the PRC 1999 reads:

A contract shall be null and void under any of the following circumstances:

- (1) A contract is concluded through the use of fraud or coercion by one party to damage the interests of the State;
- (2) Malicious collusion is concluded to damage the interests of the State, a collective or a third party;
- (3) An illegitimate purpose is concealed under the guise of legitimate acts;
- (4) Damaging the public interests;
- (5) Violating the compulsory provisions of the laws and administrative regulations.

It is also required by the Insurance Law of the PRC 1995 (Amended in 2002) that insurance should be carried out in a lawful manner and that the insured should have a legitimate insurable interest on the subject matter insured.

Article 5 of the Insurance Law of the PRC 1995 (Amended in 2002) reads:

In carrying out their obligations and exercising their rights, the parties to insurance activities shall abide by the principle of honesty and good faith.

Article 12 of the Insurance Law of the PRC 1995 (Amended in 2002) reads:

A proposer must have an insurable interest in the insured subject matter.

If a proposer has no insurable interest in the insured subject matter, the corresponding insurance contract shall be invalid.

Insurable interest means that the proposer holds a legally recognised interest in the insured subject matter.

Insured subject matter refers to property and the interests associated with such property or the life and health of a person taken as the subject of an insurance contract.

If these Articles are read together, it will be understood that Chinese law also requires that a marine insurance contract should have a lawful purpose and be carried out in a lawful

manner. There are two limbs in this connection: having a lawful purpose and being carried out in a lawful manner. If it does not have a lawful purpose the contract is null and void. In a sense, this is almost the same as English law: the risk does not attach at all. Nonetheless, the law is not clear what the effects are if the contract is not carried out in a lawful manner and there is no reported case on that point so far.

In fact, in the PRC, the point of legality in insurance has always been entangled with the concept of insurable interest. In *The Fu Da* (1994),¹ the vessel 'Fu Da' was owned by a foreign venture registered in China (PRC), whose business had nothing to do with the shipping industry. The vessel was registered under the Chinese flag in the name of a Chinese shipping company in Tianjian, PRC. The foreign venture had a management agreement with the shipping company under which the vessel operated in coastal shipping in the PRC. In the policy, the foreign venture was named as the insured. The vessel sank after a collision accident. The insured claimed against the insurer for total loss. The insurer denied liability on the ground that the insured did not have any legal insurable interest on the vessel because pursuant to the Ocean Vessel Registry Regulations in the PRC, at least 50% of the shares of a PRC registered vessel should be owned by Chinese investors and only vessels registered in China can undertake coastal transport in the PRC. At first instance, the Maritime Court of Tianjin held that the insured had violated the law and damaged the social-economic order in the shipping industry and therefore it breached the implied warranty of legality in marine insurance. The Court also held that the insured did not have a legitimate insurable interest. The insured appealed to the High Court of Tianjin, where the first instance judgement was reversed. The appellate court held that the management agreement between a foreign venture and a local shipping company was allowed in the PRC and the illegal registry under the Chinese flag and undertaking coastal shipping was not serious enough to exclude the insurer's indemnity liability. The court did not comment on the concept of implied warranty of legality and it also failed to decide the test of a legitimate insurable interest. However, it is interesting to note that the court raised the issue of how to assess the seriousness of the breach of law and its effect on the insurance contract. Unfortunately, the judgment did not provide much guidance on that point.

In another case, *The Sun Richie 3* (1997),² the insured obtained an insurance policy for his imported cargo of wire rod from Russia to China. The vessel sank at sea due to the entry of sea water and the cargo was lost. The insurer denied liability on many grounds. The insurer alleged that the insured had violated the regulation of the Foreign Trade Law of the PRC

¹ Prof. Wang Pengnan, *Modern Marine Insurance Law and Practice (Chinese)*, Dalian Maritime University Press, 2004, pp. 400-401.

² Prof. Wang Pengnan, *Modern Marine Insurance Law and Practice (Chinese)*, Dalian Maritime University Press, 2004, p. 402-404.

1994 by not having obtained the license for importing the cargo insured and therefore the insured did not have a legitimate insurable interest. At first instance, The Maritime Court of Guangzhou held that the insured had an insurable interest required by the Insurance Law of the PRC 1995 and the insurer had to pay the claim. On appeal, the appellate court reversed the decision and held that the insured had insurable interest, but it was not legitimate, so the insurance was void.

Thus, the law relating to the illegality of the insurance contract is uncertain. There is no general test for legality in marine insurance. It seems that if the issue is the legality of the purpose of the insurance, it is a matter of whether the insured has a legitimate insurable interest. If the issue is the legality of the performance of the insured adventure, it is a matter of whether the performance of the insured adventure has violated any legislation or administrative regulations. It is submitted that there are four aspects to consider in this connection.¹ First, an insurance contract is an affiliated contract to an underlying contract; if the underlying contract is an illegitimate contract, the insurance contract should be void. Secondly, continuity of the illegal act has to be considered; provisional, temporary or transient illegal acts might not cause the insurance contract to be void. Thirdly, the insurer is not responsible for any loss caused by the intentional illegal act of the insured. Finally, an insurance contract should not have provided indirect assistance to the illegal act of the insured. It might be safe to conclude that illegality in marine insurance does not in all situations void the contract. Its effects depend on the seriousness of the illegality. The insurance is void only when the illegality of the insurance seriously damages the public interest of the State or collectives. Otherwise, the insurer is only not liable for losses that are caused by the illegality of the insurance. The trouble is there is a huge body of administrative regulations issued by different governmental organisations in the PRC. These regulations are not legislation but they are also supposed to be observed by related parties. How much weight should be given to these regulations? Obviously, this leaves the court with a huge amount of discretion and it creates many uncertainties.

3.4 Miscellaneous

Recently, it has been considered by certain maritime courts that there is an implied warranty in marine insurance that the voyage shall be commenced at the date prescribed in the policy or within a reasonable time.

¹ Dr. Gao Wei, *Illegality and the effect of a marine insurance contract (Chinese)*, Chinese Maritime Law Association News Letter, (2000) Issue No. 53.

In *The Canadian Harvest (1997)*,¹ the insured obtained a voyage insurance policy for the vessel under the conditions of the PICC Hull Clauses (1/1/86). It was written in the policy that the voyage was to start on 20th April 1995. The vessel was towed to Canada for breaking up. During the voyage, the vessel sank at sea in severe weather conditions. The insurer denied liability on several grounds, one of which was that the vessel had not started the voyage at the particular date prescribed in the policy. The court held that the prescribed sailing date was a warranty according to international practice and the breach of this warranty entitled the insurer to terminate the contract or increase the premiums or amend the terms of insurance by virtue of Article 235 of the CMC 1993. The court did not state from what sources they recognised that the prescribed sailing date was a warranty in their judgment. It seems that the court had misread section 42 of the MIA 1906 as an implied warranty.² It was suggested that the court was misleading in ruling that sailing at a particular date was an implied warranty. The sound basis for the judgment should be that the insured breached the duty of notice at increase of risk.³ This is still open to question.

4. Practice in the Chinese marine insurance market

The standard insurance conditions for marine insurance in the Chinese insurance market are mainly drafted by the PICC and approved by the Central Bank of China and the Monitoring Bureau of Insurance Services. For the present purpose, only clauses for hull and machinery will be looked at here. The PICC Hulls clauses (1/1/86) are the conditions currently used for the ocean-going vessel operating in international waters. These clauses are a much shorter version of the London Institute Time Hulls Clauses and they are only 11 clauses in total.⁴ As far as warranties are concerned, only clause 6(2) needs to be examined. However, some other clauses will also be looked at below to illuminate the divergence between the Chinese PICC Hull Clauses and the London Institute Hull Clauses as to some of the warranty issues.

4.1 PICC Hull Clauses (1/1/86)

The PICC clauses are greatly influenced by the London Institute Time Clauses Hulls (1/10/83). Nonetheless, some features of the PICC Hull Clauses distinguish them as a more

¹ Prof. Wang Pengnan, *Cases on Marine Insurance (Chinese)*, Dalian Maritime University Press, 2004, pp.58-62.

² Section 42 of MIA 1906 reads: (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) ...

³ Prof. Wang Pengnan, *Cases on Marine Insurance (Chinese)*, Dalian Maritime University Press, 2004, pp.58-62.

⁴ They are: 1.scope of cover; 2.exceptions; 3.deductible; 4.navigation; 5. insurance period; 6.termination; 7. premium; 8. duties of the insured; 9. repairs; 10.claim and indemnity; 11.settlement of disputes.

popular set of conditions in the Chinese primitive market, where the insured is not conversant with insurance practice.

Two features are more noticeable than others. Firstly, the PICC Hull Clauses do not distinguish Time and Voyage insurance and they only provide one set of conditions for both situations. In practice, if the insured wants to insure the vessel only for a particular voyage, he then needs to specify the intended voyage in the policy.¹ If the insured wants to insure the vessel for a period of time, the maximum of time frame of the insurance is 12 months.² Secondly, the PICC Hull Clauses combined Total-Loss-Only and All-Risk cover in one policy. The insured needs to choose and specify which cover he intends to take in the policy. Total-Loss-Only covers the total loss of the insured vessel if the loss is caused by the named risks in the cover. All-risk covers both total loss and partial loss of the insured vessel. In addition, all-risk also covers liabilities arising from collision, general average, salvage reward, and sue and labour charges.

The PICC Hull Clauses (1/1/86) only provide cover for the basic risks, which exclude the risk of war or strike. If the insured wants to be covered for these risks, he needs to take the additional cover for war or strike risks. The clauses for war and strike risks are also drafted by the PICC and the current version was last updated on 1/1/86. These clauses cannot be taken separately on their own. They must be taken together with the cover for basic risks. The War and Strike Clauses override the Hull Clauses when they are in conflict.

4.2 Exclusions Clause

As noted, unseaworthiness is treated as exclusion under the CMC 1993. Clause 2 of the PICC Hull Clauses confirms the law and provided in express terms that:

The insurance does not cover loss, damage, liability or expense caused by:

- (1) Unseaworthiness, including not being properly manned, equipped or loaded, provided that the Insured knew, or should have known, of such unseaworthiness when the vessel was sent to sea;
- (2) Negligence or intentional act of the Insured or his representative;
- (3) Ordinary wear and tear, corrosion, rottenness or insufficient upkeep or defect in material which the Insured should have discovered with

¹ The time of the voyage is to be decided by Clause 5(2) of the PICC Hull Clauses. Clause 5(2) reads: Voyage insurance: to be subject to the voyage stipulated in the policy. The time of commencement and termination to be dealt with according to the following provisions: (1) with no cargo on board: to commence from the time of unmooring or weighing anchor at the port of sailing until the completion of casting anchor or mooring at the port of destination. (2) with cargo on board: to commence from the time of loading at the port of sailing until the completion of discharge at the port of destination, but in no case shall a period of thirty days be exceeded counting from midnight of the day of arrival of the vessel at the port of destination.

² Clause (5) 1 of the PICC Hull Clauses (1/1/86).

due diligence, or replacement of or repair to any part in unsound condition as mentioned above;

(4) Risks covered and excluded in the Hull War and Strikes Clauses of this Company.

This clause clearly requires causation between the loss and the unseaworthiness if the insurer wants to deny liability. The standard of seaworthiness is also provided. However, this is not exhaustive of all the circumstances that affect the seaworthiness of the vessel. The four factors of seaworthiness discussed in the previous section should apply. However, it is not clear whether the test for seaworthiness is an ‘objective’ test or a ‘subjective’ test. Under this clause, it seems that the test of seaworthiness should be subject to the due diligence of the insured. As long as the insured has performed his duty with due diligence to make the vessel seaworthy and he, with reasonable means,¹ would not be able to know the circumstances that make the vessel unseaworthy, the insurer cannot deny liability. This seems to be a reasonable result when sub-clauses (1) and (2) are read together.

Nonetheless, it is submitted that the recent requirement of compliance with the ISM Code makes the requirement of seaworthiness more of an ‘objective’ test. Under the ISM Code, the insured has to keep the management and operation system of the vessel up to the standard required by the code. The standards required by the ISM Code are so high and that makes it very easy for the insured to be caught as negligent in complying with the ISM Code.

4.3 Shipping Clause

The Navigation clause is modeled on Clause 1 of the Institute Time Clauses Hulls (1/10/83). It provides that:

Unless previously approved by the Insurer and any amended terms of cover and additional premium required have been agreed, this insurance does not cover loss, damage, liability and expense caused under the following circumstances:

(1) Towage or salvage services undertaken by the Insured vessel;

(2) Cargo loading or discharging operation at sea from or into another vessel (not being a harbour or inshore craft), including whilst approaching, lying alongside and leaving;

¹ As said, the Chinese maritime courts have adopted the recent development of the English case law and applied the blind-eye knowledge test in this connection.

(3) The insured vessel sailing with an intention of being broken up or sold for breaking up.

Under this clause, causation is also an element required for the defence to claim. They are, therefore, not warranties. They seem to be exceptions to the cover, but they are not exceptions in the strict sense. If the insured notifies the insurer of the forthcoming irregular navigation and agrees to the amended terms of cover and additional premium, the vessel is still covered.

In practice, under the Navigation clause, it is the insurer's burden to prove that the losses are caused by the irregular navigation. But the burden of proof is rather easy to fulfill. Once the insurer can prove that the vessel undertakes irregular navigation and losses occur during this period, it is presumed that there is causation between the two unless the insured can prove otherwise. This is very difficult for the insured. Therefore, it is submitted that these clauses are in effect like warranties in English law: once breached, the insurer is automatically discharged from further liabilities.

4.4 Termination Clause

Clause 6 of the PICC Hull Clauses provides for the circumstances where the insurance automatically comes to an end.

Clauses 6 of the PICC Hull Clauses reads;

(1) This insurance shall terminate automatically in the event of payment for total loss of the insured vessel;

(2) Unless previously agreed by the Insured in writing this insurance shall terminate automatically at the time of a change of the Classification Society of the insured vessel, change of cancellation or withdrawal of her class therein, change in the ownership or flag, assignment or transfer to new management, charter on a bareboat basis, requisition for title or use of the vessel, provided that, if the vessel has cargo on board or is at sea, such termination shall, if required, be deferred until arrival at her next port or final port of discharge or destination;

(3) In case of any breach of warranty as to cargo, voyage, trading limit, towage, salvage services or date of sailing, this insurance shall terminate automatically unless notice be given to the Insurer immediately after receipt of advice and any additional premium required be agreed.

This clause is a combination of the ‘Termination clause’ and the ‘Breach of Warranty Clause’ of the Institute Time Clauses Hull 1/10/83. Again, the language used in this Clause is rather more primitive than the English clauses. The reason is, again, not being too complicated for an unsophisticated insurance market. In practice, when ambiguity arises, the insurer or the Court has always looked to the English Clauses for reference. For example, in sub-clause 2, it provides that the insurance continues until the vessel’s arrival ‘at her next port or final port of discharge or at port of destination’. It is not clear when any of these ports would apply. Thus, the English clauses are used to give some guidance, as they are clearer.

It is submitted that sub-clause (2) is the only warranty in the entire PICC clauses. It provides that the insurance automatically terminates when any change relating to Classification or management occurs. The termination is automatic and does not require causation between the change and loss; the termination is also operative even if the change has been remedied. They are warranties in the real sense of Section 33 of the MIA 1906. But they are not warranties in the sense of Article 235 of the CMC 1993, because the insurer does not have to elect to terminate the insurance and give notice to the insured. The insurance is automatically terminated at the occurrence of the change. Therefore, this sub-clause makes the insurance a conditional contract, with subsequent conditions that will make the contract terminate automatically upon the fulfillment of the conditions.¹ It is different from the nature of warranties under article 235 of the CMC 1993.

Sub-Clause (3) is exactly the same as the English ‘Breach of Warranty’ Clause of ITCH (1/10/83) and it is also known as a held-covered clause in the Chinese marine market. It is suggested that Article 235 of the CMC is modelled on this clause. Looking at the language of this sub-clause and the CMC 1993, it must be right to say that the reason for the existence of Article 235 entirely lies in this sub-clause. The term ‘special condition’ is known in the Chinese market as equivalent to the English warranties. In practice, the insured and the insurer may agree upon any special conditions and prescribe them in the ‘SPECIAL CONDITIONS’ box at the front of the marine policy. It should be noted that the effect of breach of special conditions is very similar to the effect prescribed in the CMC 1993. Nonetheless, there is one difference between the two. The CMC 1993 provides that the insurer has a right to elect to terminate the insurance, whereas sub-clause (3) does not give the insurer such a choice. This is due to the special nature of these special conditions in sub-clause (2). The insurer has waived his right to terminate the insurance for any breach of the stipulated conditions under this sub-clause. However, if no agreement has been reached between the insurer and the insured upon

¹ Article 45, Contract Law of the PRC 1999.

any amended terms or any additional premium, or the insured did not notify the insurer of the breach immediately after receipt of advices, the insurance is automatically terminated. This seems like a combination of the English 'Breach of Warranty' clause and section 33(3) of the MIA 1906. Therefore, it is obvious that the draftsmen of sub-clause (3) had a perception that the effect of breach of warranty is automatic termination of insurance. Although it does not prescribe when the termination takes effect, but it should be assumed that it takes effect from the time of breach. It is rather curious how the perception was changed later in Article 235 of the CMC 1993.

5. Remodeling the Chinese Law of Marine Insurance Warranties

As seen, the Chinese law of marine insurance warranties is rather unsettled at the moment. It is generally agreed that the CMC needs some amendment to make the law of warranties clearer and more certain. But there are different views on how the regime should be amended in Chinese law. On the one hand, it is suggested that the doctrine of warranties is extremely useful in the current Chinese marine market, where the majority of the insured have little knowledge of insurance and of their obligations and the risk of moral hazard is considerably higher than in a mature market. Therefore, the draconian nature of English warranties should be adopted into the Chinese law and be given full effect.¹ On the other hand, it is also suggested that any amendment of Chinese law should avoid standing on the same line with English law. It is suggested that the Australian Law Reform proposal should be considered.² It must be right to say that neither of the above views is right, because both of their presumption is that the Chinese law of warranties is the same as that of English law. As noted, the current regime of warranties established in Article 235 of the CMC 1993 is completely different from English law. It should be argued that the better way to deal with the current problems might be to eradicate the doctrine of warranties from Chinese law and replace it with more legislation on the change of risk.

5.1 Current Reform Proposals

The work on the amendment of the CMC 1993 has already started in the PRC. Due to the increasing number of disputes arising in maritime litigation and criticism from academia, the Ministry of Communication of the PRC initiated a project of reviewing the CMC 1993. They appointed Dalian Maritime University to undertake the project with a view to providing suggestions on amendments to the CMC. The project started on 25 December 2000 and was

¹ Dr. Li Yuquan, *Study on the 'warranty' system in the Marine Insurance Act*, Vol. 15 (2004) Annual of China Maritime Law, Dalian Maritime University Press, 1-21, at 21.

² Prof. Wang Pengnan, *Modern Marine insurance: Law and Practice (Chinese)*, Dalian Maritime University Press, 2004, pp.130-131.

completed in about one and a half years. The project was divided into several sub-groups and Professor Wang Pengnan chaired the Marine Insurance group. In the meantime, that said, the Supreme Court has also been trying to draft some judicial interpretations to the difficult issues arising in marine insurance litigation¹. Both of these two initiatives include marine insurance warranties.

Nature of warranties

In the final report for the reviewing project, suggestions have been made on the amendment to marine insurance warranties. It is suggested that warranties should be retained in the CMC, but Article 235 needs some amendment. First, a definition of warranty should be added to the CMC. The definition of warranty in section 33(1) of MIA 1906 is accepted as a sound definition for warranty. Namely, a warranty is a special clause in the policy, by which the insurer undertakes that something shall or shall not be done, or whereby he affirms or negatives the existence of a particular state of affairs. It is also suggested that the rule of exact compliance should also be enforced in the CMC. However, it is not settled whether warranties have to be material to the risk. It is submitted in the final report that due to the significant effect of breach of warranty on the contract, any warranty must be provided for in express contractual terms; otherwise, it would not be binding on the insured.

In this connection, a Chinese marine insurance warranty is not very different from an English one. As a result, very often the Chinese academia and judiciary seem to confuse themselves by the difference between the nature of warranties in Article 235 of CMC 1993 and that in Section 33 of MIA 1906. They tend to attribute the same characteristic of an English warranty to the Chinese marine insurance warranties and that confuses the distinction between the two. This would leave the insured in a very similar disadvantaged situation as in English law.

Effects of Breach of Warranties

As to the effects of breach of warranties, there are some different views. Professor Wang Pengnan suggested in the final report that the current position of law as codified in the CMC should be retained.² By contrast, Dr. Li Yuquan, the Legal director of the PICC Property and Casualty Co. Ltd, contended that the English position of automatic discharge of liability upon breach subject to any express provision in the policy should be adopted.³ The Supreme Court

¹ These interpretations are still in circulation for discussion. They are now in the 3rd edition, which was issued on 18 August 2005. Hereunder, it will be referred to as the Supreme Court Interpretations on Marine Insurance Law (3rd draft).

² Prof. Wang Pengnan, *Morden Marine Insurance Law and Practice (Chinese)*, Dalian Maritime University Press, 2003, p.131.

³ Dr. Li Yuquan, *Study on the 'warranty' system in the Marine Insurance Act (Chinese)*, Vol. 15 2004, Annual of China Maritime Law, Dalian Maritime University Press, 1-21, at 18.

is of the view in their judicial interpretations that breach of warranty only gives the insurer a right to terminate the contract and insurance is not automatically discharged upon breach. As to the question whether the insured's notice is a precondition for the insurer to terminate the contract, Article 7 of the Supreme Court Interpretations on the Law of Marine Insurance (3rd draft) provides that, when the insured did not notify the insurer immediately of the breach of warranties, the insurer can terminate the contract from the date of breach. This clarifies the question and the answer is now confirmed. If the insurer does not want to terminate the insurance, he can request any amended terms or any additional premium. The insured is held covered if he agrees to the new contract with the insurer. Otherwise, according to the Supreme Court Interpretations on Marine Insurance,¹ the insurer can still exercise his right to terminate the insurance as prescribed in Article 235 of the CMC 1993.

It is a pity that the time of the notice is not considered in these two reform initiatives. As seen in the Norwegian Marine Insurance Plan 1996 and the Australian Reform Proposal, a smart approach to this problem is to prescribe that the insurer can give a certain number of days notice to terminate the contract. Therefore, it would make the law more predictable if it provides that the insurer can terminate the contract by giving certain number of days notice. Fourteen days should give a good balance for the interests of both the insured and the insurer.

As to the losses before the breach of warranty, it is common ground that the insurer is liable to indemnify the claim. But, as to the losses after the breach, there are different views. Some believe that the insurer is not liable for any loss after the breach even if it has happened before the termination of the contract.² As commented, this must be wrong as it was based on the presumption that the insurer is automatically discharged from his liability as from the date of breach, which is not the case under Chinese contract law. It is true that both Article 235 of the CMC 1993 and the Supreme Court Interpretations on Marine Insurance do not mention the requirement of causation and it must be assumed that no matter how trivial or immaterial the breach is, the insurer can always terminate the insurance if he wishes to do so. But the contract is only terminated when the notice of termination is served on the insured under the principles of Chinese Contract law. Therefore, the view that the insurer should be liable for loss that happens before the contract is terminated must be supported.³ In the final report of the reviewing project, Prof. Wang Pengnan suggested that the insurer is not liable for any loss

¹ Article 9 of the Supreme Court Interpretations on Marine Insurance Law reads: if the insured does not agree the additional premium or amended terms that the insurer required under Article 235 of the CMC 1993, the insurer is entitled to exercise his right of election to terminate the contract by a written notice to the insured.

² Dr. Zheng Lei, *How to understand the 'warranty' in marine insurance (Chinese)*, Vol. 8, (1997) Annual of China Maritime Law, 215-231, at 228.

³ Wang Xin, *The legal consequences of breach of warranty in marine insurance (Chinese)*, Vol 12, (2001) Annual of China Maritime Law, Dalian Maritime University Press, 65-73.

after the breach of warranty.¹ However, he also agrees that the contract is not terminated until the insured elects to do. This is a very fresh idea. If this is right, it must assume that the termination is retrospective as to the time of breach. But it would be better if this suggestion could be modified to the effect that the insurer is not liable for any loss arising from the breach of warranty before the contract is terminated.

Implied Warranties

As to the question of implied warranties, it is suggested in the final report of the reviewing project that there should be no implied warranty in marine insurance under Chinese law.² The reason is that implied warranties are a very obscure concept for the insured to grasp and the discretion of the court will create many uncertainties. It is suggested that the issue of legality should be dealt with in the matter of insurable interest under Chinese law and the issue of seaworthiness is already dealt with as exceptions in Article 244 of the CMC and in the PICC Hull Clauses. However, the Supreme Court has a different view on the issue of seaworthiness. In the Supreme Court Interpretations on Marine Insurance, it is provided that there is an implied warranty in every Voyage Hull policy that the vessel should be seaworthy at the commencement of the voyage. Subject to express provision in the contract, any breach of seaworthiness will discharge the insurer from his liability from the date of breach, without prejudice to any liability incurred before the breach.³ This seems to have altered the position adopted in Article 244 of the CMC, where it provides that the insurer can only deny liability for losses caused by the unseaworthiness. In fact, it did not bring much change at all. As commented earlier, the burden of proof on the causation between losses and unseaworthiness is very difficult to be satisfied and there is a presumption of causation between unseaworthiness and losses under Article 244 if the insured cannot prove otherwise. Therefore, the effect of the Supreme Court Interpretations on Marine Insurance is only to make the law more practical and that, in effect, elevated seaworthiness to an English warranty in the sense of section 33 of the MIA 1906. This change of law might be a response to the view of Dr. Li Yuquan, who strongly advocated that seaworthiness should be sanctified as a true warranty the breach of which will terminate the insurance automatically so as to educate the insured and promote the safety of navigation at sea.⁴ The necessity of this is obviously open to question. The Supreme Court Interpretations on Marine Insurance also provides that

¹ Prof Wang Pengnan, *Modern Marine Insurance Law and Practice (Chinese)*, Dalian Maritime University Press, 2004, p.139.

² *Ibid*, p.148.

³ Article 10 (1), the Supreme Court Interpretations on Marine Insurance Law.

⁴ Dr. Li Yuquan, *Study on the 'warranty' system in the Marine Insurance Act (Chinese)*, Vol. 15, (2004) Annual of China Maritime Law, Dalian Maritime University Press, p.15.

seaworthiness is not an implied warranty in a Time Hull policy, where the insurer is only free from liability if the ship is sent to sea in an unseaworthy state with the privity of the insured. This is the same as to the position in English law.¹

Return of Premium

As to the premium, the Supreme Court Interpretations on Marine Insurance provides that the insurer has a right to retain the prepaid full premium when he terminates the insurance for the breach of warranties. If the insured has not paid the premium at the time of termination, the insurer is entitled to the premium in proportion to the risk he has run.² If the insurer accepts premium or pay the claim after receipt of advice on the breach of warranty, he is deemed to have waived his right to terminate the insurance.³

5.2 The Prospect of Reform

While the discussion on the reform of the CMC is still going on among academics, a piece of legislation of Amendment to the CMC 1993 is not immediately imminent. Since the final report of the reviewing project was produced in 2002, the reform initiative seems to come to a halt. Now the draft of the recommended amendments to the CMC is waiting in the pipeline at the National Congress's Legislation and Law Reform Bureau. At the moment, their focus is on the more important legislation projects: the codification of the law of civil liabilities and obligations and the law of property. These projects are prioritised in their schedule and they are consuming much of their time and energy. It is suggested that unless these projects are completed, any project of lesser importance will not be considered.

Therefore, the prospects of legislative reform do not look good. For the time being, academic discussions are very helpful in raising the awareness of the ineffectiveness of the law and that hopefully will bring some changes to the judiciary's thinking in their interpretations of the law. As commented above, there are some discrepancies between the academic thinking and the judicial thinking as to warranties. Communication between the two needs to be improved so as to get a more unified view of what the law actually is and what it should be for commercial convenience.

As noted, the current thinking of reform prefers to retain the concept of warranties in marine insurance with some amendments to the CMC 1993. There is huge support for this approach both from the academia and the judiciary. It is a shared belief that the rule of

¹ Article 10 (2) of the Supreme Court Interpretations on Marine Insurance law.

² Article 7 (2) of the Supreme Court Interpretations on Marine Insurance law.

³ Article 8 of the Supreme Court Interpretations on Marine Insurance Law.

warranty still serves at least some purposes in the marine insurance market and it is still used in English law and practice. It might be safe to argue that this is an ill-informed belief, in light of the recent development in English case law and the new changes in the International Hull Clauses 2003. It should be argued that the concept of warranty in marine insurance will not last long and any legislative reform should consider the abolition of the concept to reflect this reality.

5.3 A Proposal

As an attempt to stimulate more discussions on the reform of marine insurance warranties in Chinese law, and also to conclude this thesis, it might be appropriate to propose the following reform to the CMC 1993 in relation to Article 235.

Abolition of the Concept of Warranties in Chinese Marine Insurance Law

Considering the recent development of warranties in marine insurance law and practice worldwide, it is a consensus that the concept of warranties is dated and needs to be abolished. As noted, under Article 235 of the CMC, a breach of Chinese marine insurance warranty will not automatically discharge the insurer from his further liability; instead, it only gives him a right of election to terminate the contract. Although they are not totally like the draconian English warranties, they shared many similarities with them: warranties need not be material; breach of warranty need not be causative to the loss, and breach of warranty is irremediable. These rigid rules cannot be justified in this modern age. Although it is argued that warranties serve to educate the insured in the current Chinese marine insurance market and prevent the risk of moral hazard,¹ the rationale for the existence of warranties is no longer valid. As commented earlier, the rationale of warranty is to control the increase of risk, and that purpose has already been served by provisions in the Insurance Law of the PRC 1995.² Therefore, the concept of warranty should be eradicated from the CMC, even though it has a more lenient approach than English law to the effects of its breach.

Repeal of Article 235 of the CMC 1993 with Rules for Change of Risk

If the concept of warranty is to be abolished, Article 235 will be no long needed in the CMC. The blank left can be filled with rules for change of risk. There are already provisions in relation to the increase of risk in Article 37 of the Insurance Law of the PRC 1995

¹ Dr. Li Yuquan, *Study on the 'warranty' system in the Marine Insurance Act (Chinese)*, Vol. 15 (2004) Annual of China Maritime Law, Dalian Maritime University Press, 1-21, at 15.

² Article 37, Insurance Law of PRC 1995 (2002 Amendment).

(amended in 2002). They are in effect very much like Article 235 of the CMC 1993. They could replace Article 235 in the CMC. However, as noted, there are some ambiguities in Article 37 of the Insurance Act and it only deals with the increase of risk. It does not include the situation where the nature of the risk is altered. With the repeal of Article 235, a set of accomplished rules regarding both types of change of risk should be put in place of Article 235 in the CMC.

That said, the Norwegian Marine Insurance Plan 1996 has provided a very sophisticated legal framework for change of risk. These rules are very close to the current understanding of warranties in the Chinese academia and judiciary. Both jurisdictions hold that the insurer has a right to terminate the contract upon increase of risk and the insurer is not liable for any loss which is a consequence of the increase of risk before the contract is terminated. Therefore, these rules in the NMIP 1996 could be a foundation to the proposed amendment to the CMC. Nonetheless, some points need to be noted here. First, the NMIP 1996 are standard insurance conditions and they are too specific in many aspects. As legislation, the amended CMC should not be as specific as the NMIP 1996. Therefore, some special rules concerning loss of class or change of classification society or ownership, trading limits and requisition would not be included in the CMC. These issues shall be dealt with in the marine insurance contracts by express terms. Secondly, the NMIP 1996 considers both alteration of risk and increase of risk. Although it uses the term alteration of risk in the Plan, it actually refers to change of risk as a whole. Currently, Chinese law does not have regard to alteration of risk in the Insurance Law of the PRC 1995, but Article 235 of the CMC 1993 might have considered alteration of risk. Now it is time to consider both of the two situations in the new rules. Thirdly, Clause 3-9 of the NMIP 1996¹ distinguishes intentional change of risk by the insured from innocent change of risk. But the rule is not very sound and should be dealt with great care. The rule of proportionality would not be very practical in claims and litigation in this particular type of situation. And also, if the insurer would have accepted the risk on other conditions at the time of contract, the insured surely has breached his duty of disclosure or not to misrepresent and the insurance is avoidable *ab initio*. Therefore, this rule will not be adopted in the CMC.

Considering current judicial thinking and the above analysis, the following rules are recommended for the amendment to the CMC in relation to warranties.

¹ Clause 3-9 of the NMIP 1996 reads:

- (1) If, after the conclusion of the contract, the insured has intentionally caused or agreed to an alteration of risk, the insurer is free from liability, provided that he would not have accepted the insurance if, at the time the contract was concluded, he had known that the alteration would take place.
- (2) If it must be assumed that the insurer would have accepted the insurance, but on other conditions, he is only liable to the extent that the loss is proved not to be attributable to the alteration of the risk.

- (1) *If the risk to the subject matter of the insurance changes during the period of the contract, the insured shall promptly notify the insurer and the insurer shall have the right to increase the premium and amend the terms of policy or terminate the contract.*
- (2) *If the insured did not notify the insurer promptly after being aware of the change of risk or did not agree with the additional premium or amended terms for the increased risk, the insurer can terminate the contract.*
- (3) *When the insurer terminates the contract, he must give a 14 days notice to the insured.*
- (4) *If the insurer becomes aware that a change of risk has taken place, he shall, without undue delay, notify the insured in writing whether he would continue to cover the risk or terminate the contract. If he fails to do so, he forfeits his right to invoke those remedies.*
- (5) *The insurer is free from liability for any loss which is a consequence of the change of the risk before the contract is terminated.*

No Implied Warranties—Seaworthiness Remains as an Exclusion

There should be no implied warranties in marine insurance in the amended CMC. Legality and seaworthiness are such delicate issues, considering the number of regulations issued by legislative and administrative bodies at different levels. Therefore, the insured would be extremely vulnerable if the insurer could use the defence of illegality and seaworthiness as an implied warranty. The importance of seaworthiness in promoting safety of life in marine navigation has already been addressed enough under Article 244 of the CMC. Clause 2 of the PICC Hull Clauses has also codified the same position. Therefore, seaworthiness should remain as exclusion.

Nonetheless, the CMC should be amended to give the insurer a right to terminate the contract when the ship will no longer be able to be seaworthy. This would leave the insurer fully protected in situations where the ship becomes permanently unseaworthy and the insurer does not wish to insure the risk any longer.

- (1) *The insurer may terminate the insurance by giving fourteen days notice when the ship cannot be considered seaworthy and the insured fails to have this rectified without undue delay.*

(2) *However, such notice shall take effect at the earliest on arrival of the ship at the nearest safe port, in accordance with the insurer's instructions.*

6. Conclusion

The legislative reform of the CMC 1993 is not possible in the immediate future. It is hard to predict how long it will take before any amendment is enacted. For the time being, it is necessary to have further discussions on the issue of warranties before any reform proposal is passed by the legislature. As noted, the current thinking among academia and the judiciary is to keep the doctrine of warranties in Chinese marine insurance law with some modification. This is the mainstream of opinions. According to the few, warranties are to be abolished and the Australian Reform proposal would be the main model as a back-up solution. Both of these views should be challenged and more research should be done. It must be noted that at present, discussions of warranties by Chinese lawyers have not given enough attention to the recent development of English law since *The Good Luck*; and the Norwegian Marine Insurance Plan 1996 has also been neglected in current discussions. It is obvious that any discussion without considering these elements would not be a well grounded discussion. Therefore, it is the purpose of this thesis to draw the attention of relevant research bodies and discussion groups to these elements of interest. The author wishes to use this thesis as a stimulating attempt to generate more thoughts in this particular area of Chinese law.

APPENDICES

Appendix I

Maritime Code of the People's Republic of China
(Adopted at the 28th Meeting of the Standing Committee of the Seventh National
People's Congress on November 7, 1992, promulgated by Order No. 64 of the
President of the People's Republic of China on November 7, 1992, and effective as of
July 1, 1993)

EXTRACTS
Chapter XII Contract of Marine Insurance

Section 1 Basic Principles

Article 216 A contract of marine insurance is a contract whereby the insurer undertakes, as agreed, to indemnify the loss to the subject matter insured and the liability of the insured caused by perils covered by the insurance against the payment of an insurance premium by the insured.

The covered perils referred to in the preceding paragraph mean any maritime perils agreed upon between the insurer and the insured, including perils occurring in inland rivers or on land which is related to a maritime adventure.

Article 217 A contract of marine insurance mainly includes:

- (1) Name of the insurer;
- (2) Name of the insured;
- (3) Subject matter insured;
- (4) Insured value;
- (5) Insured amount;
- (6) Perils insured against and perils excepted;
- (7) Duration of insurance coverage;
- (8) Insurance premium.

Article 218 The following items may come under the subject matter of marine insurance:

- (1) Ship;
- (2) Cargo;
- (3) Income from the operation of the ship including freight, charter hire and passenger's fare;
- (4) Expected profit on cargo;
- (5) Crew's wages and other remuneration;
- (6) Liabilities to a third person;
- (7) Other property which may sustain loss from a maritime peril and the liability and expenses arising therefrom.

The insurer may reinsure the insurance of the subject matter enumerated in the preceding paragraph. Unless otherwise agreed in the contract, the original insured shall not be entitled to the benefit of the reinsurance.

Article 219 The insurable value of the subject matter insured shall be agreed upon between the insurer and the insured.

Where no insurable value has been agreed upon between the insurer and the insured, the insurable value shall be calculated as follows:

- (1) The insurable value of the ship shall be the value of the ship at the time when the insurance liability commences, being the total value of the ship's hull, machinery, equipment, fuel, stores, gear, provisions and fresh water on board as well as the insurance premium;
- (2) The insurable value of the cargo shall be the aggregate of the invoice value of the cargo or the actual value of the non-trade commodity at the place of shipment, plus freight and insurance premium when the insurance liability commences;
- (3) The insurable value of the freight shall be the aggregate of the total amount of freight payable to the carrier and the insurance premium when the insurance liability commences;
- (4) The insurable value of other subject matter insured shall be the aggregate of the actual value of the subject matter insured and the insurance premium when the insurance liability commences.

Article 220 The insured amount shall be agreed upon between the insurer and the insured. The insured amount shall not exceed the insured value. Where the insured amount exceeds the insured value, the portion in excess shall be null and void.

Section 2 Conclusion, Termination and Assignment of Contract

Article 221 A contract of marine insurance comes into being after the insured puts forth a proposal for insurance and the insurer agrees to accept the proposal and the insurer and the insured agree on the terms and conditions of the insurance. The insurer shall issue to the insured an insurance policy or other certificate of insurance in time, and the contents of the contract shall be contained therein.

Article 222 Before the contract is concluded, the insured shall truthfully inform the insurer of the material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which may have a bearing on the insurer in deciding the premium or whether he agrees to insure or not.

The insured need not inform the insurer of the facts which the insurer has known of or the insurer ought to have knowledge of in his ordinary business practice if about which the insurer made no inquiry.

Article 223 Upon failure of the insured to truthfully inform the insurer of the material circumstances set forth in paragraph 1 of Article 222 of this Code due to his intentional act, the insurer has the right to terminate the contract without refunding the premium. The insurer shall not be liable for any loss arising from the perils insured against before the contract is terminated.

If, not due to the insured's intentional act, the insured did not truthfully inform the insurer of the material circumstances set out in paragraph 1 of Article 222 of this Code, the insurer has the right to terminate the contract or to demand a corresponding increase in the premium. In case the contract is terminated by the insurer, the insurer shall be liable for the loss arising from the perils insured against which occurred prior to the termination of the contract, except where the material circumstances uninformed or wrongly informed of have an impact on the occurrence of such perils.

Article 224 Where the insured was aware or ought to be aware that the subject matter insured had suffered a loss due to the incidence of a peril insured against when the contract was concluded, the insurer shall not be liable for indemnification but shall have the right to the premium. Where the insurer was aware or ought to be aware that the occurrence of a loss to the subject matter insured due to a peril insured against was impossible, the insured shall have the right to recover the premium paid.

Article 225 Where the insured concludes contracts with several insurers for the same subject matter insured and against the same risk, and the insured amount of the said subject matter insured thereby exceeds the insured value, then, unless otherwise agreed in the contract, the insured may demand indemnification from any of the insurers and the aggregate amount to be indemnified shall not exceed the loss value of the subject matter insured. The liability of each insurer shall be in proportion to that which the amount he insured bears to the total of the amounts insured by all insurers. Any insurer who has paid an indemnification in an amount greater than that for which he is liable, shall have the right of recourse against those who have not paid their indemnification in the amounts for which they are liable.

Article 226 Prior to the commencement of the insurance liability, the insured may demand the termination of the insurance contract but shall pay the handling fees to the insurer, and the insurer shall refund the premium.

Article 227 Unless otherwise agreed in the contract, neither the insurer nor the insured may terminate the contract after the commencement of the insurance liability.

Where the insurance contract provides that the contract may be terminated after the commencement of the liability, and the insured demands the termination of the contract, the insurer shall have the right to the premium payable from the day of the commencement of the insurance liability to the day of termination of the contract and refund the remaining portion. If it is the insurer who demands the termination of the contract, the unexpired premium from the day of the termination of the contract to the day of the expiration of the period of insurance shall be refunded to the insured.

Article 228 Notwithstanding the stipulations in Article 227 of this Code, the insured may not demand termination of the contract for cargo insurance and voyage insurance on ship after the commencement of the insurance liability.

Article 229 A contract of marine insurance for the carriage of goods by sea may be assigned by the insured by endorsement or otherwise, and the rights and obligations under the contract are assigned accordingly. The insured and the assignee shall be jointly and severally liable for the payment of the premium if such premium remains unpaid up to the time of the assignment of the contract.

Article 230 The consent of the insurer shall be obtained where the insurance contract is assigned in consequence of the transfer of the ownership of the ship insured. In the absence of such consent, the contract shall be terminated from the time of the transfer of the ownership of the ship. Where the transfer takes place during the voyage, the contract shall be terminated when the voyage ends.

Upon termination of the contract, the insurer shall refund the unexpired premium to the insured calculated from the day of the termination of the contract to the day of its expiration.

Article 231 The insured may conclude an open cover with the insurer for the goods to be shipped or received in batches within a given period. The open cover shall be evidenced by an open policy to be issued by the insurer.

Article 232 The insurer shall, at the request of the insured, issue insurance certificates separately for the cargo shipped in batches according to the open cover.

Where the contents of the insurance certificates issued by the insurer separately differ from those of the open policy, the insurance certificates issued separately shall prevail.

Article 233 The insured shall notify the insurer immediately on learning that the cargo insured under the open cover has been shipped or has arrived. The items to be notified of shall include the name of the carrying ship, the voyage, the value of the cargo and the insured amount.

Section 3 Obligation of the Insured

Article 234 Unless otherwise agreed in the insurance contract, the insured shall pay the premium immediately upon conclusion of the contract. The insurer may refuse to issue the insurance policy or other insurance certificate before the premium is paid by the insured.

Article 235 The insured shall notify the insurer in writing immediately where the insured has not complied with the warranties under the contract. The insurer may, upon receipt of the notice, terminate the contract or demand an amendment to the terms and conditions of the insurance coverage or an increase in the premium.

Article 236 Upon the occurrence of the peril insured against, the insured shall notify the insurer immediately and shall take necessary and reasonable measures to avoid or minimize the loss. Where special instructions for the adoption of reasonable measures to avoid or minimize the loss are received from the insurer, the insured shall act according to such instructions.

The insurer shall not be liable for the extended loss caused by the insured's breach of the provisions of the preceding paragraph.

Section 4 Liability of the Insurer

Article 237 The insurer shall indemnify the insured promptly after the loss from a peril insured against has occurred.

Article 238 The insurer's indemnification for the loss from the peril insured against shall be limited to the insured amount. Where the insured amount is lower than the insured value, the insurer shall indemnify in the proportion that the insured amount bears to the insured value.

Article 239 The insurer shall be liable for the loss to the subject matter insured arising from several perils insured against during the period of the insurance even though the aggregate of the amounts of loss exceeds the insured amount. However, the insurer shall only be liable for the total loss where the total loss occurs after the partial loss which has not been repaired.

Article 240 The insurer shall pay, in addition to the indemnification to be paid with regard to the subject matter insured, the necessary and reasonable expenses incurred by the insured for avoiding or minimizing the loss recoverable under the contract, the reasonable expenses for survey and assessment of the value for the purpose of ascertaining the nature and extent of the peril insured against and the expenses incurred for acting on the special instructions of the insurer.

The payment by the insurer of the expenses referred to in the preceding paragraph shall be limited to that equivalent to the insured amount.

Where the insured amount is lower than the insured value, the insurer shall be liable for the expenses referred to in this Article in the proportion that the insured amount bears to the insured value, unless the contract provides otherwise.

Article 241 Where the insured amount is lower than the value for contribution under the general average, the insurer shall be liable for the general average contribution in the proportion that the insured amount bears to the value for contribution.

Article 242 The insurer shall not be liable for the loss caused by the intentional act of the insured.

Article 243 Unless otherwise agreed in the insurance contract, the insurer shall not be liable for the loss of or damage to the insured cargo arising from any of the following causes:

- (1) Delay in the voyage or in the delivery of cargo or change of market price;
- (2) Fair wear and tear, inherent vice or nature of the cargo;
- (3) Improper packing.

Article 244 Unless otherwise agreed in the insurance contract, the insurer shall not be liable for the loss of or damage to the insured ship arising from any of the following causes:

- (1) Unseaworthiness of the ship at the time of the commencement of the voyage, unless where under a time policy the insured has no knowledge thereof;
- (2) Wear and tear or corrosion of the ship.

The provisions of this Article shall apply mutatis mutandis to the insurance of freight.

Section 5 Loss of or Damage to the Subject Matter Insured and Abandonment

Article 245 Where after the occurrence of a peril insured against the subject matter insured is lost or is so seriously damaged that it is completely deprived of its original structure and usage or the insured is deprived of the possession thereof, it shall constitute an actual total loss.

Article 246 Where a ship's total loss is considered to be unavoidable after the occurrence of a peril insured against or the expenses necessary for avoiding the occurrence of an actual total loss would exceed the insured value, it shall constitute a constructive total loss.

Where an actual total loss is considered to be unavoidable after the cargo has suffered a peril insured against, or the expenses to be incurred for avoiding the total actual loss plus that for forwarding the cargo to its destination would exceed its insured value, it shall constitute a constructive total loss.

Article 247 Any loss other than an actual total loss or a constructive total loss is a partial loss.

Article 248 Where a ship fails to arrive at its destination within a reasonable time from the place where it was last heard of, unless the contract provides otherwise, if it remains unheard of upon the expiry of two months, it shall constitute missing. Such missing shall be deemed to be an actual total loss.

Article 249 Where the subject matter insured has become a constructive total loss and the insured demands indemnification from the insurer on the basis of a total loss, the subject matter insured shall be abandoned to the insurer. The insurer may accept the abandonment or choose not to, but shall inform the insured of his decision whether to accept the abandonment within a reasonable time.

The abandonment shall not be attached with any conditions. Once the abandonment is accepted by the insurer, it shall not be withdrawn.

Article 250 Where the insurer has accepted the abandonment, all rights and obligations relating to the property abandoned are transferred to the insurer.

Section 6 Payment of Indemnity

Article 251 After the occurrence of a peril insured against and before the payment of indemnity, the insurer may demand that the insured submit evidence and materials related to the ascertainment of the nature of the peril and the extent of the loss.

Article 252 Where the loss of or damage to the subject matter insured within the insurance coverage is caused by a third person, the right of the insured to demand compensation from the third person shall be subrogated to the insurer from the time the indemnity is paid.

The insured shall furnish the insurer with necessary documents and information that should come to his knowledge and shall endeavour to assist the insurer in pursuing recovery from the third person.

Article 253 Where the insured waives his right of claim against the third person without the consent of the insurer or the insurer is unable to exercise the right of recourse due to the fault of the insured, the insurer may make a corresponding reduction from the amount of indemnity.

Article 254 In effecting payment of indemnity to the insured, the insurer may make a corresponding reduction therefrom of the amount already paid by a third person to the insured.

Where the compensation obtained by the insurer from the third person exceeds the amount of indemnity paid by the insurer, the part in excess shall be returned to the insured.

Article 255 After the occurrence of a peril insured against, the insurer is entitled to waive his right to the subject matter insured and pay the insured the amount in full to relieve himself of the obligations under the contract. In exercising the right prescribed in the preceding paragraph, the insurer shall notify the insured thereof within seven days from the day of the receipt of the notice from the insured regarding the indemnity. The insurer shall remain liable for the necessary and reasonable expenses paid by the insured for avoiding or minimizing the loss prior to his receipt of the said notice.

Article 256 Except as stipulated in Article 255 of this Code, where a total loss occurs to the subject matter insured and the full insured amount is paid, the insurer shall acquire the full right to the subject matter insured. In the case of under-insurance, the insurer shall acquire the right to the subject matter insured in the proportion that the insured amount bears to the insured value.

Chapter XIV Application of Law in Relation to Foreign-related Matters

Article 268 If any international treaty concluded or acceded to by the People's Republic of China contains provisions differing from those contained in this Code, the provisions of the relevant international treaty shall apply, unless the provisions are those on which the People's Republic of China has announced reservations.

International practice may be applied to matters for which neither the relevant laws of the People's Republic of China nor any international treaty concluded or acceded to by the People's Republic of China contain any relevant provisions.

Article 269 The parties to a contract may choose the law applicable to such contract, unless the law provides otherwise. Where the parties to a contract have not made a choice, the law of the country having the closest connection with the contract shall apply.

Article 270 The law of the flag State of the ship shall apply to the acquisition, transfer and extinction of the ownership of the ship.

Article 271 The law of the flag State of the ship shall apply to the mortgage of the ship.

The law of the original country of registry of a ship shall apply to the mortgage of the ship if its mortgage is established before or during its bareboat charter period.

Article 272 The law of the place where the court hearing the case is located shall apply to matters pertaining to maritime liens.

Article 273 The law of the place where the infringing act is committed shall apply to claims for damages arising from collision of ships.

The law of the place where the court hearing the case is located shall apply to claims for damages arising from collision of ships on the high sea.

If the colliding ships belong to the same country, no matter where the collision occurs, the law of the flag State shall apply to claims against one another for damages arising from such collision.

Article 274 The law where the adjustment of general average is made shall apply to the adjustment of general average.

Article 275 The law of the place where the court hearing the case is located shall apply to the limitation of liability for maritime claims.

Article 276 The application of foreign laws or international practices pursuant to the provisions of this Chapter shall not jeopardize the public interests of the People's Republic of China.

Appendix II

Insurance Law of the People's Republic of China (Amended)

(Adopted at the 14th Meeting of the Standing Committee of the Eighth National People's Congress on June 30, 1995, promulgated by Order No. 51 of the President of the People's Republic of China on June 30, 1995 and effective as of October 1, 1995; Amendment adopted at the 30th Meeting of the Standing Committee of the Ninth National People's Congress on October 28 2002 and effective as of January 1 2003.)

EXTRACTS

Chapter 1 General Provisions

Article 1 This Law is formulated to regulate insurance activities, protect the lawful rights and interests of the parties to insurance activities, strengthen the supervision and administration over the insurance industry and promote the healthy development of the insurance business.

Article 2 The term "insurance" as used in this Law refers to a commercial insurance transaction involving a contractual agreement in which a proposer pays a certain premium to the insurer, and the insurer undertakes liability to pay indemnity as reimbursement for property loss arising from the occurrence of certain possible events stipulated in the contract, or undertakes payment of corresponding insurance benefits upon the occurrence of the death, disability or illness of the insured, or the attainment of a certain age or time limit stipulated in the contract.

Article 3 This Law shall apply to all insurance activities undertaken within the territory of the People's Republic of China.

Article 4 Parties undertaking insurance activities must obey the law and administrative regulations, defer to the norms of accepted social ethics, and abide by the principle of free will.

Article 5 In carrying out their obligations and exercising their rights, the parties to insurance activities shall abide by the principle of honesty and good faith.

Article 6 Only insurance companies that are established according to the stipulations of this Law shall be permitted to engage in commercial insurance business operations. No other entities or individuals shall be allowed to engage in commercial insurance business activities.

Article 7 Legal persons and other organizations taking out insurance within the territory of the People's Republic of China shall make their proposals for insurance coverage to insurance companies located within the People's Republic of China.

Article 8 When conducting insurance business, insurance companies shall abide by the principle of fair competition, fully refraining from engagement in any unfair competitive activities.

Article 9 The insurance supervision and administration department(s) of the State Council shall be responsible for implementing supervision and administration in accordance with this Law.

Chapter 2 Insurance Contracts

Section 1 General Stipulations

Article 10 An insurance contract is an agreement in which a proposer and an insurer stipulate their respective obligations and rights in respect of an insurance transaction.

"Proposer" refers to the party that concludes an insurance contract with the insurer and undertakes the obligation to pay insurance premiums to the insurer.

"Insurer" refers to the insurance company that concludes an insurance contract with a proposer and undertakes the obligation to disburse insurance indemnity or benefits.

Article 11 In concluding an insurance contract, an insurer and a proposer shall mutually abide by the principles of fairness and mutual benefit, mutual agreement on all points at issue through negotiation and free will, and avoidance of harm to the public interest.

Except for instances mandated by law or administrative regulations, insurance companies or other organizations shall not coerce other parties to conclude insurance contracts.

Article 12 A proposer must have an insurable interest in the insured subject matter.

If a proposer has no insurable interest in the insured subject matter, the corresponding insurance contract shall be invalid.

"Insurable interest" means that the proposer holds a legally recognized interest in the insured subject matter.

"Insured subject matter" refers to property and the interests associated with such property or the life and health of a person taken as the subject of an insurance contract.

Article 13 An insurance contract is concluded when a proposer makes a request for insurance, the insurer agrees to underwrite the insurance and the terms and conditions of the contract are agreed upon. The insurer shall thence promptly issue a policy or other insurance certificate to the proposer, containing the contents of the contract as mutually agreed to by the parties.

Subject to consultation and agreement between the insurer and the proposer, other forms of written agreement may also be adopted to conclude an insurance contract.

Article 14 Once an insurance contract has been concluded the proposer shall pay insurance premiums according to the agreement, and the insurer shall undertake insurance liability according to the time schedule agreed to in the contract.

Article 15 Unless otherwise stipulated in this Law or the pertinent insurance contract itself, the proposer may rescind an insurance contract after it has been concluded.

Article 16 Unless otherwise stipulated in this Law or the pertinent insurance contract itself, the insurer shall not be permitted to rescind an insurance contract after it has been concluded.

Article 17 When concluding an insurance contract, the insurer shall make detailed explanation of the full contents of the contract to the proposer, and may also make relevant inquiries of the proposer regarding the insured subject matter or circumstances of the insured party, to which the proposer shall give truthful disclosure. In the event that the proposer deliberately conceals facts or fails to carry out its duty of truthful disclosure, or negligently fails to execute its duty of truthful disclosure so as to materially influence and alter the insurer's decision as to whether or not to provide the corresponding insurance coverage or to raise the corresponding premium rate, then the insurer shall be permitted to rescind the corresponding insurance contract.

In the event that the proposer deliberately fails to carry out its duty of truthful disclosure, the insurer shall not be liable to indemnify or pay insurance benefits or refund the insurance premium collected for insured events occurring prior to the rescission of the contract.

In the event that the proposer negligently fails to execute its duty of truthful disclosure, and such negligence has significant relevant bearing on the occurrence of an insured event, the insurer shall not be liable to indemnify or pay insurance benefits for such insured events occurring prior to the rescission of the contract, but may refund previously collected insurance premiums.

"Insured event" refers to an accident within the scope of insurance liability specified in the insurance contract.

Article 18: In the process of concluding an insurance contract, the insurer shall specifically explain all exemptions of its liability to the proposer; if an item of exemption is not specifically explained, the clause of the contract stipulating the said exemption shall not carry validity.

Article 19 An insurance contract shall contain the following items:

1. Name and domicile of the insurer;
2. Names and domiciles of the proposer and the insured, as well as the name and domicile of the beneficiary of life insurance;
3. The insured subject matter;
4. Insurance liability and liability exemptions;
5. Term of coverage and beginning date of coverage;
6. Insurance value;
7. Insured amount;
8. Insurance premium and corresponding payment schedule;
9. Schedule for payment of indemnity or insurance benefits;
10. Liability for breach of contract and settlement of conflict; and
11. Date of conclusion of contract.

Article 20 In addition to the items listed in the previous article, the proposer and the insurer may agree to other additional terms pertinent to a particular insurance transaction.

Article 21 During the term of an insurance contract, the proposer and the insurer may amend the content of said contract pursuant to mutual consultation and agreement to such changes.

Amendment to an insurance agreement shall be evidenced by the insurer placing an annotation on the original policy or other insurance certificate, or by attaching an endorsement, or else by the conclusion of a separate written agreement between the insurer and the proposer.

Article 22 The proposer, the insured or the beneficiary shall notify the insurer as soon as they respectively become aware of the occurrence of an insured event.

"Insured" refers to a party whose property or physical body is safeguarded by an insurance policy, and who has the corresponding right to claim indemnity or insurance benefits. The proposer may also appear as the insured party of a given insurance policy.

"Beneficiary" refers to the party to a contract of insurance of the person designated by the proposer or the insured as being vested with the right to claim insurance benefits. The proposer or the insured may also appear as the beneficiary of a given insurance policy.

Article 23 Subsequent to the occurrence of an insured event, and when making a claim for indemnity or payment of benefits in accordance with the insurance contract, the proposer, the insured or the beneficiary shall provide, to the best of its ability, all proofs and information available pertinent to determining the nature, cause, degree of damage and other circumstances of the insured event.

If, based on provisions of the insurance contract, the insurer deems that the above-mentioned relevant proofs and information are insufficient, the insurer shall notify the proposer, the insured or the beneficiary to provide the missing relevant proofs and information.

Article 24 The insurer shall carry out review of any claim for indemnity or payment of insurance benefits promptly after receiving such claim from the insured or the beneficiary, and notify the said insured or the beneficiary of the result of the review. Where insurance liability exists, the insurer should execute its obligation to make payment of indemnity or insurance benefits within 10 days after reaching an agreement with the insured or the beneficiary for such payment. Where the contract itself makes stipulation regarding the amount of indemnity or insurance benefits, or the deadline for such payment, payment shall be made according to such agreement. Where the insurer fails to carry out the obligations listed above, in addition to paying the relevant indemnity or insurance benefits, the insurer shall also compensate the insured or the beneficiary for losses incurred therefrom. No entity or individual may unlawfully interfere with the insurer's performance of its obligation to make payment of indemnity or insurance benefits, nor shall it restrict the rights of the insured or the beneficiary to obtain such payments.

"Insured amount" refers to the maximum amount of money that the insurer shall be liable to pay as indemnity or insurance benefits for a given insured subject matter.

Article 25 If a claim for payment of indemnity or insurance benefits from an insured or the beneficiary is beyond the scope of the insurer's underwritten liability, then upon receiving such claim from the insured or the beneficiary, the insurer shall issue a written notice of rejection of claim to the said insured or beneficiary.

Article 26 If the amount of indemnity or insurance benefits to be paid cannot be determined within 60 days after the insurer receives notification of a claim with corresponding information and proofs, the insurer shall first pay the minimum amount that may be expected to be due based on currently available proofs and information. After determining the final amount of indemnity or insurance benefits, the insurer shall make up the difference in respect of such indemnity or insurance benefits.

Article 27 For any type of insurance other than life insurance, the right of the insured or the beneficiary to claim indemnity or insurance benefits shall lapse if not exercised within two years from the date the insured or the beneficiary is aware of the occurrence of an insured event.

For life insurance, the right of the insured or the beneficiary to claim insurance benefits shall lapse if not exercised within five years from the date the insured or the beneficiary is aware of the occurrence of an insured event.

Article 28 In the event that the insured or the beneficiary fraudulently reports that an insured event has occurred when no such event has actually occurred, and furthermore claims payment of indemnity or insurance benefits based on such fraudulent report, the insurer shall have the right to rescind the insurance contract with no obligation to refund the premium.

In the event that the proposer, the insured or the beneficiary deliberately causes an insured event to occur, the insurer shall have the right to rescind the insurance contract and shall not be liable for payment of insurance indemnity or benefits, nor shall the insurer be obligated to refund the premium unless otherwise stipulated in the first paragraph of Article 65 hereof.

In the event that the proposer, the insured or the beneficiary fabricates false causes for an event or overstates the degree of losses by means of forged or altered relevant proofs, information or other evidence after the occurrence of such event, the insurer shall not be liable for payment of indemnity or insurance benefits for the portion that is false.

The proposer, the insured or the beneficiary shall return the insurance monies or reimburse the expenses paid by the insurer as a result of any of the acts in the preceding three paragraphs performed by the said proposer, insured or beneficiary.

Article 29 "Reinsurance" means that the insurer transfers a portion of its underwritten business to another insurer in the form of a cede policy.

At the request of the reinsurance assignee, the reinsurance assignor shall disclose information about the underwritten liability and other circumstances of the original insurance to the reinsurance assignee.

Article 30 The reinsurance assignee shall not request payment of premiums from the original proposer. The insured or the beneficiary of the original insurance contract shall not make claim for indemnity or payment of insurance benefits to the reinsurance assignee.

The reinsurance assignor (proposer for reinsurance) may not refuse to perform or delay the performance of its original insurance liability on the grounds of the failure of the reinsurance assignee to perform its reinsurance liability.

Article 31 When adjudicating conflict over the meaning of the terms and clauses of an insurance contract arising between the insurer and the proposer, the insured and/or the beneficiary of the contract, the people's court or arbitration committee presiding shall construe the contested terms and clauses in a manner favourable to the insured and the beneficiary.

Article 32 The insurer or reinsurance assignee shall be obligated to preserve the confidentiality of any information concerning the business, property or personal matters of the proposer, insured, beneficiary or reinsurance assignor that is disclosed in the process of concluding insurance business.

Section 2 Property Insurance Contracts

Article 33 Property insurance contracts are insurance contracts that take property and interests related to property as their insured subject matter.

Unless otherwise noted, the term "contract" as used in this section shall refer to property insurance contracts.

Article 34 When the insured subject matter is assigned, the insurer shall be informed of such assignment, and the pertinent insurance contracts shall be amended to reflect such assignment, subject to agreement from the insurer to continue to insure said property. However, contracts for insurance of goods in transit and contracts containing specific stipulations that provide otherwise shall be exempted from this requirement.

Article 35 Insurance contracts for goods in transit or shipping vehicles or vessels en route cannot be rescinded by the contractual parties once the underwriter's liability has begun.

Article 36 The insured shall abide by State provisions on fire prevention, safety, production operations, labour protection and so on, in order to protect the safety of the insured subject matter.

The insurer may, in accordance with the provisions of the contract, examine the circumstances of the safety of the insured subject matter, and at any time issue to the proposer and/or the insured party written proposals for the elimination of hazards and hidden dangers to the insured subject matter.

If the either proposer or the insured fails to carry out its contractual obligation to fully protect the safety of the insured subject matter, the insurer shall have the right to increase the premium, or else to rescind the contract. Subject to the consent of the insured, the insurer may take special measures to protect the safety of insured subject matter.

Article 37 If the level of risk to the insured subject matter increases during the term of an insurance contract, the insured shall promptly inform the insurer in accordance with the contract, and the insurer shall be entitled to increase the premium, or else rescind the contract.

In the event that the insured fails to carry out the obligation to inform as described in the previous paragraph, the insurer shall not be liable to compensate for events resulting from such increased levels of risk.

Article 38 In any of the circumstances listed below, unless the contract has other stipulations, the insurer shall reduce the premium and refund the corresponding premium calculated on a daily pro-rated basis:

1. a change occurs in the circumstances upon which the premium rate is determined, resulting in a significant decrease in the degree of risk to which the insured subject matter is exposed; or
2. the insured value of the insured subject matter decreases significantly.

Article 39 In the event that the proposer requests rescission of an insurance contract before the commencement of the insurance liability, the said proposer shall pay a processing fee to the insurer and the insurer shall refund the premium. In the event that the proposer requests rescission of an insurance contract after the commencement of the insurance liability, the insurer may retain the premiums for the period from the date of the commencement of the insurance liability until the date of the rescission of the contract, and refund the remainder.

Article 40 The insured value of insured subject matter may be agreed to between the proposer and the insurer and specified in the insurance contract, or may be determined as the actual value of the insured subject matter at the time of the occurrence of an insured event.

The sum insured shall not exceed the insured value, any amount in excess of the insured value shall be deemed invalid.

Where the sum insured is less than the insured value, the insurer shall undertake indemnity liability in accordance with the proportion of the sum insured to the insured value, unless the contract stipulates otherwise.

Article 41 Information relevant to dual insurance shall be reported by the proposer to all concerned insurers.

Where the total of the sums insured under dual insurance exceeds the insured value of the insured subject matter, the total amounts of indemnity contributed by all insurers shall not exceed the insured value. Each insurer shall undertake indemnity liability according to the ratio of the sum underwritten by it to the total of the sums insured, unless the contract provides otherwise.

"Dual insurance" refers to insurance under which the proposer enters into insurance contracts with two or more insurers for the same insured subject matter, the same insurable interest and the same insured event(s).

Article 42 When an insured event occurs, the insured shall be obligated to take every necessary measure to prevent or mitigate further damage.

The necessary, reasonable expenses incurred in the course of the insured taking measures to prevent or mitigate damage after the occurrence of an insured event shall be borne by the insurer. Such expenses shall be calculated separately from the compensation for the losses of the insured subject matter, but shall not exceed the sum insured.

Article 43 In the event that partial damage or loss occurs to the insured subject matter, the proposer may terminate the contract within 30 days of receiving indemnity from the insurer; the insurer may also terminate the contract unless the contract specifies otherwise. If the insurer terminates the contract, it shall give a minimum of 15 days prior notice to the proposer, and refund the premium on the undamaged portion of the insured subject matter after deducting the part of premium for the period from the commencement of insurance liability to the termination of the contract.

Article 44 Subsequent to the occurrence of an insured event for which the insurer has paid the sum insured in full, and for which the sum insured is identical to the insured value, all rights to the damaged insured subject matter shall pass to the insurer, or, where the sum insured is less than the insured value, the insurer shall obtain rights to the damaged insured subject matter proportionate to the share of the sum insured in the insured value.

Article 45 Where an insured event occurs due to damage to the insured subject matter caused by a third party, the insurer shall, from the date of payment of indemnity to the insured, be subrogated to the rights of the insured to claim compensation from the said third party within the amount of indemnity paid.

Where the insured has already obtained compensation from a third party following the occurrence of an insured event as mentioned in the preceding paragraph, the insurer may, at the time of paying the indemnity, deduct an amount equivalent to such compensation obtained by the insured from the third party.

The exercise by the insurer of its subrogated rights to claim compensation from a third party according to the first paragraph of this article shall have no impact on the insured's right to claim compensation from the third party for the portion that has not been compensated.

Article 46 Where the insured waives its rights to claim compensation from a third party subsequent to the occurrence of an insured event and before the insurer has paid indemnity to the insured, the insurer shall not be liable for the payment of indemnity.

Where the insured, without the consent of the insurer, waives its rights to claim compensation from a third party subsequent to having been paid indemnity by the insurer, such waiver shall be deemed invalid.

Where the insurer is unable to exercise its subrogated rights to compensation from a liable third party due to the fault of the insured, the insurer may correspondingly reduce the amount of indemnity to the insured.

Article 47 The insurer shall not be subrogated any rights to claim compensation from family members or members of the household of an insured, except in the case that such family or household members deliberately cause an insured event such as is described in the first paragraph of Article 45 hereof.

Article 48 When the insurer exercises subrogated rights to claim compensation from a third party, the insured shall provide the insurer with necessary documents and relevant known information.

Article 49 Necessary and reasonable expenses incurred by the insurer and the insured in the process of investigating and determining the nature and cause of an insured event and the degree of damage incurred to the insured subject matter shall be borne by the insurer.

Article 50 The insurer may directly indemnify a third party for damage to that third party caused by the insured under liability insurance in accordance with the provisions of laws or the terms of the contract.

"Liability insurance" refers to the type of insurance in which the insured subject matter is the insured's liability to indemnify a third party according to law.

Article 51 Where arbitration or legal proceedings are instituted against the insured under liability insurance as a result of damages caused to a third party by an insured event, the arbitration or court costs and other necessary and reasonable expenses paid by the insured shall be borne by the insurer, unless the contract provides otherwise.

Section 3 Contracts of Insurance of the Person

Article 52 A contract of insurance of the person shall refer to an insurance contract the subject matter of which is the life or body of a natural person.

In this section, the term "contract of insurance of the person" shall be abbreviated to "contract", unless expressly stated otherwise.

Article 53 A proposer shall have an insurable interest in the following persons:

- 1) oneself;
- 2) one's spouse, children or parents; and
- 3) other family members or close relatives, in addition to those aforementioned, who have a foster, support or maintenance relationship with the proposer.

In addition to the persons mentioned in the preceding paragraph, the proposer shall be deemed to have an insurable interest in any insured person who agrees with the proposer to conclude a contract for him.

Article 54 If a proposer untruthfully reports the age of the insured, and if the true age of the insured party is not within the range specified in the contract, the insurer may rescind the contract and refund the premium, less a service fee. However, this right shall lapse if not exercised within the first two years following execution of the contract.

If a proposer untruthfully reports the age of the insured party, resulting in the insurer collecting lower premium fees than it should be entitled to based on the true age of the insured, the insurer shall have the right to rectify the inaccuracy and simultaneously request the applicant to pay the balance, or alternatively may pay an amount adjusted in the same proportion that the amount of premium actually collected comprises relative to the amount of premium that should properly have been collected based on the true age of the insured, when making disbursement of corresponding insurance benefits.

If a proposer untruthfully reports the age of the insured party, resulting in the insurer collecting higher premium fees than it should be entitled to based on the true age of the insured, the insurer shall refund the excess premium to the applicant.

Article 55 A proposer may neither propose, nor may an insurer underwrite, a contract stipulating the death of a person without capacity for civil acts as the condition for payment of benefits.

Contracts proposed by parents for insurance of their minor children shall not be governed by the preceding paragraph, provided that the total sum insured payable upon the death of minor children whose lives are insured does not exceed the limit set by the insurance regulatory authority.

Article 56 An insurance contract under which the payment of insurance benefits is made conditional upon the death of the insured shall not be valid without the written consent of the insured giving approval of the sum insured.

An insurance policy issued under a contract taking the death of the insured party as the prerequisite for the payment of insurance benefits shall not be transferred or pledged without the written approval of the insured. Insurance proposed by parents for their minor children shall not be governed by the first paragraph.

Article 57 After a contract has been concluded, the proposer may pay the premium in a lump sum or in instalments as specified in the contract.

Where the contract stipulates payments of premium in instalments, the proposer shall pay the first instalment when the contract is concluded and pay the remaining instalments in accordance with the instalments schedule.

Article 58 Where the contract stipulates payments of premiums in instalments, and if, after making the first payment, the proposer fails to pay any subsequent instalment within 60 days after the prescribed time limit, the validity of the contract shall be suspended, or the insurer may reduce the sum insured according to the provisions of the contract, unless otherwise provided for in the contract.

Article 59 If the validity of an insurance contract is suspended according to the stipulation of the previous article, validity of the said contract may be restored after the insurer and proposer reach an agreement through negotiation and the proposer pays the outstanding premium. However, if no agreement is reached between the insurer and proposer within two years from the date of suspension, the insurer shall have the right to rescind the contract.

Where the insurer rescinds a contract according to the stipulation of the previous paragraph, and where the proposer has paid premiums for two or more years, the insurer shall refund the cash value of the policy to the proposer in accordance with the provisions of the contract; or if the proposer has paid premium for less than two years, the insurer shall refund the premium after deducting a service charge.

Article 60 The insurer shall not resort to litigation to require payment of insurance premiums for insurance policies of the person.

Article 61 The beneficiary of a contract of insurance of the person shall be designated by the insured or the proposer.

Where the beneficiary is designated by the proposer, the consent of the insured must be obtained.

Where the insured is an individual without capacity for civil acts or with limited capacity for civil acts, the beneficiary may be designated by his guardian.

Article 62 The insured or the proposer may designate one or more individuals as beneficiaries.

Where there are several beneficiaries, the order in which payment of insurance benefits shall be made and the proportions in which insurance benefits shall be distributed to individual beneficiaries shall be determined by the proposer or the insured. Where proportions for benefits distribution are not determined in advance, benefits shall be divided equally among the beneficiaries.

Article 63 The proposer or the insured may change the beneficiary and notify the insurer of this in writing. Upon receiving written notification of the change of beneficiary from the proposer or insured, the insurer shall make an endorsement to that effect on the insurance policy.

A change of the beneficiary made by the proposer shall be subject to the consent of the insurer.

Article 64 In any of the following circumstances, following the death of the insured, the relevant life insurance benefits shall become a legacy of the insured, and the insurer shall pay the corresponding insurance benefits to the heirs of the insured:

- 1) there are no beneficiaries designated;
- 2) a beneficiary passed away before the insured, and no other beneficiaries have been named; or

3) a beneficiary lawfully loses or waives his beneficiary right, and there are no other beneficiaries.

Article 65 Where the proposer or a beneficiary deliberately causes the death, injury or illness of the insured, the insurer shall bear no liability to pay corresponding insurance benefits. Where the proposer has already paid premium for two or more years, the insurer shall return the cash value of the policy to the other entitled beneficiaries as provided for in the contract.

Any beneficiary deliberately causing the death or injury of the insured, or attempting to murder the insured, shall forfeit the right to receive payment as a beneficiary under the contract.

Article 66 For a contract stipulating death as the condition for payment of insurance benefits, the insurer shall not be liable to pay insurance benefits in the case that the insured commits suicide, except in the case of the second paragraph of this article. In regard to the premium already paid, however, the insurer shall refund the cash value of the policy according to the policy terms.

For a contract stipulating death as the condition for payment of insurance benefits that has been in effect for two or more years, the insurer may pay insurance benefits in accordance with the contract if the insured commits suicide after two years from the date of conclusion of the contract.

Article 67 Where the insured is injured, disabled or killed in the course of committing an intentional crime, the insurer shall not be liable to make payment of insurance benefits. Where the proposer has paid premium for two or more years, the insurer shall return the cash value of the policy.

Article 68 Where the death, injury, disability or illness of the insured is caused by the action of a third party, the insurer shall not be subrogated the rights to claim compensation from said third party after making payment of insurance benefits to the insured or the beneficiary. However, the insured or the beneficiary shall retain the right to claim compensation from said third party.

Article 69 Where a proposer who has been paying premium for two or more years rescinds the contract, the insurer shall refund the cash value of the insurance policy within 30 days after receiving the notice of rescission. Where the proposer has been paying premium for less than two years, the insurer shall refund the premium after deducting a service charge in accordance with the contract.

Chapter 8 Supplementary Provisions

Article 153 The stipulations of the Maritime Law shall take precedence in matters of marine insurance business and this Law shall apply where the Maritime Law makes no pertinent stipulations.

Article 154 This Law shall apply to Sino-foreign equity joint insurance companies, wholly foreign-owned insurance companies, and branch companies of foreign insurance companies; however, where other laws or administrative regulations provide otherwise, such stipulations shall prevail.

Article 155 The State shall support the development of insurance business for agricultural production. Agricultural insurance shall be separately provided for by laws or administrative regulations.

Article 156 Insurance organizations of a nature other than insurance companies provided for in this Law shall be separately provided for in laws or administrative regulations.

Article 157 Insurance companies established upon approval in accordance with State Council regulations prior to the implementation of this Law shall be retained. Those that do not meet all the requirements provided herein shall come into compliance with the provisions of this Law within a specified time limit. Specific procedures shall be stipulated by the State Council.

Article 158 This Law shall be effective as of 1 October 1995.

Appendix III

Contract Law of the People's Republic of China

(Adopted at the Second Session of the Ninth National People's Congress on March 15, 1999 and effective as of October 1, 1999)

EXTRACTS

GENERAL PRINCIPLES

Chapter 1 General Provisions

Article 1 This Law is formulated in order to protect the lawful rights and interests of contract parties, to safeguard social and economic order, and to promote socialist modernization.

Article 2 For purposes of this Law, a contract is an agreement between natural persons, legal persons or other organizations with equal standing, for the purpose of establishing, altering, or discharging a relationship of civil rights and obligations.

An agreement concerning any personal relationship such as marriage, adoption, guardianship, etc. shall be governed by other applicable laws.

Article 3 Contract parties enjoy equal legal standing and neither party may impose its will on the other party.

Article 4 A party is entitled to enter into a contract voluntarily under the law, and no entity or individual may unlawfully interfere with such right.

Article 5 The parties shall abide by the principle of fairness in prescribing their respective rights and obligations.

Article 6 The parties shall abide by the principle of good faith in exercising their rights and performing their obligations.

Article 7 In concluding or performing a contract, the parties shall abide by the relevant laws and administrative regulations, as well as observe social ethics, and may not disrupt social and economic order or harm the public interests.

Article 8 A lawfully formed contract is legally binding on the parties. The parties shall perform their respective obligations in accordance with the contract, and neither party may arbitrarily amend or terminate the contract. A lawfully formed contract is protected by law.

Chapter 2 Formation of Contracts

Article 9 In entering into a contract, the parties shall have the appropriate capacities for civil rights and civil acts. A party may appoint an agent to enter into a contract on its behalf under the law.

Article 10 A contract may be made in a writing, in an oral conversation, as well as in any other form.

A contract shall be in writing if a relevant law or administrative regulation so requires. A contract shall be in writing if the parties have so agreed.

Article 11 A writing means a memorandum of contract, letter or electronic message (including telegram, telex, facsimile, electronic data exchange and electronic mail), etc. which is capable of expressing its contents in a tangible form.

Article 12 The terms of a contract shall be prescribed by the parties, and generally include the following:

- (i) names of the parties and the domiciles thereof;
- (ii) subject matter;
- (iii) quantity;
- (iv) quality;
- (v) price or remuneration;
- (vi) time, place and method of performance;
- (vii) liabilities for breach of contract;
- (viii) method of dispute resolution.

The parties may enter into a contract by referencing a model contract for the relevant contract category.

Article 13 A contract is concluded by the exchange of an offer and an acceptance.

Article 14 An offer is a party's manifestation of intention to enter into a contract with the other party, which

shall comply with the following:

- (i) Its terms are specific and definite;
- (ii) It indicates that upon acceptance by the offeree, the offeror will be bound thereby.

Article 15 An invitation to offer is a party's manifestation of intention to invite the other party to make an offer thereto. A delivered price list, announcement of auction, call for tender, prospectus, or commercial advertisement, etc. is an invitation to offer.

A commercial advertisement is deemed an offer if its contents meet the requirements of an offer.

Article 16 An offer becomes effective when it reaches the offeree.

When a contract is concluded by the exchange of electronic messages, if the recipient of an electronic message has designated a specific system to receive it, the time when the electronic message enters into such specific system is deemed its time of arrival; if no specific system has been designated, the time when the electronic message first enters into any of the recipient's systems is deemed its time of arrival.

Article 17 An offer may be withdrawn. The notice of withdrawal shall reach the offeree before or at the same time as the offer.

Article 18 An offer may be revoked. The notice of revocation shall reach the offeree before it has dispatched a notice of acceptance.

Article 19 An offer may not be revoked:

- (i) if it expressly indicates, whether by stating a fixed time for acceptance or otherwise, that it is irrevocable;
- (ii) if the offeree has reason to regard the offer as irrevocable, and has undertaken preparation for performance.

Article 20 An offer is extinguished in any of the following circumstances:

- (i) The notice of rejection reaches the offeror;
- (ii) The offeror lawfully revokes the offer;
- (iii) The offeree fails to dispatch its acceptance at the end of the period for acceptance;
- (iv) The offeree makes a material change to the terms of the offer.

Article 21 An acceptance is the offeree's manifestation of intention to assent to an offer.

Article 22 An acceptance shall be manifested by notification, except where it may be manifested by conduct in accordance with the relevant usage or as indicated in the offer.

Article 23 An acceptance shall reach the offeror within the period prescribed in the offer.

Where the offer does not prescribe a period for acceptance, the acceptance shall reach the offeror as follows:

- (i) Where the offer is made orally, the acceptance shall be dispatched immediately, unless otherwise agreed by the parties;
- (ii) Where the offer is made in a non-oral manner, the acceptance shall reach the offeror within a reasonable time.

Article 24 Where an offer is made by a letter or a telegram, the period for acceptance commences on the date shown on the letter or the date on which the telegram is handed in for dispatch. If the letter does not specify a date, the period commences on the posting date stamped on the envelop. Where the offer is made through an instantaneous communication device such as telephone or facsimile, etc., the period for acceptance commences once the offer reaches the offeree.

Article 25 A contract is formed once the acceptance becomes effective.

Article 26 A notice of acceptance becomes effective once it reaches the offeror. Where the acceptance does not require notification, it becomes effective once an act of acceptance is performed in accordance with the relevant usage or as required by the offer.

Where a contract is concluded by the exchange of electronic messages, the time of arrival of the acceptance shall be governed by Paragraph 2 of Article 16 hereof.

Article 27 An acceptance may be withdrawn. The notice of withdrawal shall reach the offeror before or at the same time as the acceptance.

Article 28 An acceptance dispatched by the offeree after expiration of the period for acceptance constitutes a new offer, unless the offeror timely advises the offeree that the acceptance is valid.

Article 29 If the offeree dispatched its acceptance within the period for acceptance, and the acceptance, which would otherwise have reached the offeror in due time under normal circumstances, reaches the offeror after expiration of the period for acceptance due to any other reason, the acceptance is valid, unless the offeror timely advises the offeree that the acceptance has been rejected on grounds of the delay.

Article 30 The terms of the acceptance shall be identical to those of the offer. A purported acceptance dispatched by the offeree which materially alters the terms of the offer constitutes a new offer. A change in the subject matter, quantity, quality, price or remuneration, time, place and method of performance, liabilities for breach of contract or method of dispute resolution is a material change to the terms of the offer.

Article 31 An acceptance containing nonmaterial changes to the terms of the offer is nevertheless valid and the terms thereof prevail as the terms of the contract, unless the offeror timely objects to such changes or the offer indicated that acceptance may not contain any change to the terms thereof.

Article 32 Where the parties enter into a contract by a memorandum of contract, the contract is formed when it is signed or sealed by the parties.

Article 33 Where the parties enter into a contract by the exchange of letters or electronic messages, one party may require execution of a confirmation letter before the contract is formed. The contract is formed upon

execution of the confirmation letter.

Article 34 The place where the acceptance becomes effective is the place of formation of a contract. Where a contract is concluded by the exchange of electronic messages, the recipient's main place of business is the place of formation of the contract; if the recipient does not have a main place of business, its habitual residence is the place of formation of the contract. If the parties have agreed otherwise, such agreement prevails.

Article 35 Where a contract is concluded by a memorandum of contract, its place of formation is the place where the parties sign or seal the contract.

Article 36 Where a contract is to be concluded by a writing as required by the relevant law or administrative regulation or as agreed by the parties, if the parties failed to conclude the contract in writing but one party has performed its main obligation and the other party has accepted the performance, the contract is formed.

Article 37 Where a contract is to be concluded by a memorandum of contract, if prior to signing or sealing of the contract, one party has performed its main obligation and the other party has accepted the performance, the contract is formed.

Article 38 Where the state has, in light of its requirements, issued a mandatory plan or state purchase order, the relevant legal persons and other organizations shall enter into a contract based on the rights and obligations of the parties prescribed by the relevant laws and administrative regulations.

Article 39 Where a contract is concluded by way of standard terms, the party supplying the standard terms shall abide by the principle of fairness in prescribing the rights and obligations of the parties and shall, in a reasonable manner, call the other party's attention to the provision(s) whereby such party's liabilities are excluded or limited, and shall explain such provision(s) upon request by the other party.

Standard terms are contract provisions which were prepared in advance by a party for repeated use, and which are not negotiated with the other party in the course of concluding the contract.

Article 40 A standard term is invalid if it falls into any of the circumstances set forth in Article 52 and Article 53 hereof, or if it excludes the liabilities of the party supplying such term, increases the liabilities of the other party, or deprives the other party of any of its material rights.

Article 41 In case of any dispute concerning the construction of a standard term, such term shall be interpreted in accordance with common sense. If the standard term is subject to two or more interpretations, it shall be interpreted against the party supplying it. If a discrepancy exists between the standard term and a non-standard term, the non-standard term prevails.

Article 42 Where in the course of concluding a contract, a party engaged in any of the following conducts, thereby causing loss to the other party, it shall be liable for damages:

(i) negotiating in bad faith under the pretext of concluding a contract;

(ii) intentionally concealing a material fact relating to the conclusion of the contract or supplying false information;

(iii) any other conduct which violates the principle of good faith.

Article 43 A party may not disclose or improperly use any trade secret which it became aware of in the course of negotiating a contract, regardless of whether a contract is formed. If the party disclosed or improperly used such trade secret, thereby causing loss to the other party, it shall be liable for damages.

Chapter 3 Validity of Contracts

Article 44 A lawfully formed contract becomes effective upon its formation.

Where effectiveness of a contract is subject to any procedure such as approval or registration, etc. as required by a relevant law or administrative regulation, such provision applies.

Article 45 The parties may prescribe that effectiveness of a contract be subject to certain conditions. A contract subject to a condition precedent becomes effective once such condition is satisfied. A contract subject to a condition subsequent is extinguished once such condition is satisfied.

Where in order to further its own interests, a party improperly impaired the satisfaction of a condition, the condition is deemed to have been satisfied; where a party improperly facilitated the satisfaction of a condition, the condition is deemed not to have been satisfied.

Article 46 The parties may prescribe a term for a contract. A contract subject to a time of commencement becomes effective at such time. A contract subject to a time of expiration is extinguished at such time.

Article 47 A contract concluded by a person with limited capacity for civil act is valid upon ratification by the legal agent thereof, provided that a contract from which such person accrues benefits only or the conclusion of which is appropriate for his age, intelligence or mental health does not require ratification by his legal agent.

The other party may demand that the legal agent ratify the contract within one month. If the legal agent fails to manifest his intention, he is deemed to have declined to ratify the contract. Prior to ratification of the contract, the other party in good faith is entitled to cancel the contract. Cancellation shall be effected by notification.

Article 48 Absent ratification by the principal, a contract concluded on his behalf by a person who lacked agency authority, who acted beyond his agency authority or whose agency authority was extinguished is not binding upon the principal unless ratified by him, and the person performing such act is liable.

The other party may demand that the principal ratify the contract within one month. Where the principal fails to manifest his intention, he is deemed to have declined to ratify the contract. Prior to ratification of the contract, the other party in good faith is entitled to cancel the contract. Cancellation shall be effected by notification.

Article 49 Where the person lacking agency authority, acting beyond his agency authority, or whose agency authority was extinguished concluded a contract in the name of the principal, if it was reasonable for the other party to believe that the person performing the act had agency authority, such act of agency is valid.

Article 50 Where the legal representative or the person-in-charge of a legal person or an organization of any other nature entered into a contract acting beyond his scope of authority, unless the other party knew or should have known that he was acting beyond his scope of authority, such act of representation is valid.

Article 51 Where a piece of property belonging to another person was disposed of by a person without the power to do so, such contract is nevertheless valid once the person with the power to its disposal has ratified the contract, or if the person lacking the power to dispose of it when the contract was concluded has subsequently acquired such power.

Article 52 A contract is invalid in any of the following circumstances:

- (i) One party induced conclusion of the contract through fraud or duress, thereby harming the interests of the state;
- (ii) The parties colluded in bad faith, thereby harming the interests of the state, the collective or any third party;
- (iii) The parties intended to conceal an illegal purpose under the guise of a legitimate transaction;
- (iv) The contract harms public interests;
- (v) The contract violates a mandatory provision of any law or administrative regulation.

Article 53 The following exculpatory provisions in a contract are invalid:

- (i) excluding one party's liability for personal injury caused to the other party;
- (ii) excluding one party's liability for property loss caused to the other party by its intentional misconduct or gross negligence.

Article 54 Either of the parties may petition the People's Court or an arbitration institution for amendment or cancellation of a contract if:

- (i) the contract was concluded due to a material mistake;
- (ii) the contract was grossly unconscionable at the time of its conclusion.

If a party induced the other party to enter into a contract against its true intention by fraud or duress, or by taking advantage of the other party's hardship, the aggrieved party is entitled to petition the People's Court or an arbitration institution for amendment or cancellation of the contract.

Where a party petitions for amendment of the contract, the People's Court or arbitration institution may not cancel the contract instead.

Article 55 A party's cancellation right is extinguished in any of the following circumstances:

- (i) It fails to exercise the cancellation right within one year, commencing on the date when the party knew or should have known the cause for the cancellation;
- (ii) Upon becoming aware of the cause for cancellation, it waives the cancellation right by express statement or by conduct.

Article 56 An invalid or canceled contract is not legally binding ab initio. Where a contract is partially invalid, and the validity of the remaining provisions thereof is not affected as a result, the remaining provisions are nevertheless valid.

Article 57 The invalidation, cancellation or discharge of a contract does not impair the validity of the contract provision concerning the method of dispute resolution, which exists independently in the contract.

Article 58 After a contract was invalidated or canceled, the parties shall make restitution of any property acquired thereunder; where restitution in kind is not possible or necessary, allowance shall be made in money based on the value of the property. The party at fault shall indemnify the other party for its loss sustained as a result. Where both parties were at fault, the parties shall bear their respective liabilities accordingly.

Article 59 Where the parties colluded in bad faith, thereby harming the interests of the state, the collective or a third person, any property acquired as a result shall be turned over to the state or be returned to the collective or the third person.

Chapter 4 Performance of Contracts

Article 60 The parties shall fully perform their respective obligations in accordance with the contract.

The parties shall abide by the principle of good faith, and perform obligations such as notification, assistance, and confidentiality, etc. in light of the nature and purpose of the contract and in accordance with the relevant usage.

Article 61 If a term such as quality, price or remuneration, or place of performance etc. was not prescribed or clearly prescribed, after the contract has taken effect, the parties may supplement it through agreement; if the parties fail to reach a supplementary agreement, such term shall be determined in accordance with the relevant provisions of the contract or in accordance with the relevant usage.

Article 62 Where a relevant term of the contract was not clearly prescribed, and cannot be determined in accordance with Article 61 hereof, one of the following provisions applies:

- (i) If quality requirement was not clearly prescribed, performance shall be in accordance with the state standard or industry standard; absent any state or industry standard, performance shall be in accordance with the customary standard or any particular standard consistent with the purpose of the contract;
- (ii) If price or remuneration was not clearly prescribed, performance shall be in accordance with the prevailing market price at the place of performance at the time the contract was concluded, and if adoption of a price mandated by the government or based on government issued pricing guidelines is required by law, such requirement applies;
- (iii) Where the place of performance was not clearly prescribed, if the obligation is payment of money, performance shall be at the place where the payee is located; if the obligation is delivery of immovable property, performance shall be at the place where the immovable property is located; for any other subject matter, performance shall be at the place where the obligor is located;
- (iv) If the time of performance was not clearly prescribed, the obligor may perform, and the obligee may require performance, at any time, provided that the other party shall be given the time required for preparation;
- (v) If the method of performance was not clearly prescribed, performance shall be rendered in a manner which is conducive to realizing the purpose of the contract;
- (vi) If the party responsible for the expenses of performance was not clearly prescribed, the obligor shall bear the expenses.

Article 63 Where a contract is to be implemented at a price mandated by the government or based on government issued pricing guidelines, if the government adjusts the price during the prescribed period of delivery, the contract price shall be the price at the time of delivery. Where a party delays in delivering the subject matter, the original price applies if the price has increased, and the new price applies if the price has decreased. Where a party delays in taking delivery or making payment, the new price applies if the price has increased, and the original price applies if the price has decreased.

Article 64 Where the parties prescribed that the obligor render performance to a third person, if the obligor fails to render its performance to the third person, or rendered non-conforming performance, it shall be liable to the obligee for breach of contract.

Article 65 Where the parties prescribed that a third person render performance to the obligee, if the third person fails to perform or rendered non-conforming performance, the obligor shall be liable to the obligee for breach of contract.

Article 66 Where the parties owe performance toward each other and there is no order of performance, the parties shall perform simultaneously. Prior to performance by the other party, one party is entitled to reject its requirement for performance. If the other party rendered non-conforming performance, one party is entitled to reject its corresponding requirement for performance.

Article 67 Where the parties owe performance toward each other and there is an order of performance, prior to performance by the party required to perform first, the party who is to perform subsequently is entitled to reject its requirement for performance. If the party required to perform first rendered non-conforming performance, the party who is to perform subsequently is entitled to reject its corresponding requirement for performance.

Article 68 The party required to perform first may suspend its performance if it has conclusive evidence establishing that the other party is in any of the following circumstances:

- (i) Its business has seriously deteriorated;
- (ii) It has engaged in transfer of assets or withdrawal of funds for the purpose of evading debts;
- (iii) It has lost its business creditworthiness;
- (iv) It is in any other circumstance which will or may cause it to lose its ability to perform.

Where a party suspends performance without conclusive evidence, it shall be liable for breach of contract.

Article 69 If a party suspends its performance in accordance with Article 68 hereof, it shall timely notify the other party.

If the other party provides appropriate assurance for its performance, the party shall resume performance. After performance was suspended, if the other party fails to regain its ability to perform and fails to provide appropriate assurance within a reasonable time, the suspending party may terminate the contract.

Article 70 Where after effecting combination, division, or change of domicile, the obligee failed to notify the obligor, thereby making it difficult to render performance, the obligor may suspend its performance or place the subject matter in escrow.

Article 71 The obligee may reject the obligor's early performance, except where such early performance does not harm the obligee's interests.

Any additional expense incurred by the obligee due to the obligor's early performance shall be borne by the obligor.

Article 72 An obligee may reject the obligor's partial performance, except where such partial performance does not harm the obligee's interests.

Any additional expense incurred by the obligee due to the obligor's partial performance shall be borne by the obligor.

Article 73 Where the obligor delayed in exercising its creditor's right against a third person that was due, thereby harming the obligee, the obligee may petition the People's Court for subrogation, except where such creditor's right is exclusively personal to the obligor.

The scope of subrogation is limited to the extent of the obligee's right to performance. The necessary expenses for subrogation by the obligee shall be borne by the obligor.

Article 74 Where the obligor waived its creditor's right against a third person that was due or assigned its property without reward, thereby harming the obligee, the obligee may petition the People's Court for cancellation of the obligor's act. Where the obligor assigned its property at a low price which is manifestly unreasonable, thereby harming the obligee, and the assignee was aware of the situation, the obligee may also petition the People's Court for cancellation of the obligor's act.

The scope of cancellation right is limited to the extent of the obligee's right to performance. The necessary expenses for the obligee's exercise of its cancellation right shall be borne by the obligor.

Article 75 The obligee's cancellation right shall be exercised within one year, commencing on the date when it became, or should have become, aware of the cause for cancellation. Such cancellation right is extinguished if not exercised within five years, commencing on the date of occurrence of the obligor's act.

Article 76 Once a contract becomes effective, a party may not refuse to perform its obligations thereunder on grounds of any change in its name or change of its legal representative, person in charge, or the person handling the contract.

Chapter 5 Amendment and Assignment of Contracts

Article 77 A contract may be amended if the parties have so agreed.

Where amendment to the contract is subject to any procedure such as approval or registration, etc. as required by a relevant law or administrative regulation, such provision applies.

Article 78 A contract term is construed not to have been amended if the parties failed to clearly prescribe the terms of the amendment.

Article 79 The obligee may assign its rights under a contract in whole or in part to a third person, except where such assignment is prohibited:

(i) in light of the nature of the contract;

(ii) by agreement between the parties;

(iii) by law.

Article 80 Where the obligee assigns its rights, it shall notify the obligor. Such assignment is not binding upon the obligor if notice was not given.

A notice of assignment of rights given by the obligee may not be revoked, except with the consent of the assignee.

Article 81 Where the obligee assigns a right, the assignee shall assume any incidental right associated with the obligee's right, except where such incidental right is exclusively personal to the obligee.

Article 82 Upon receipt of the notice of assignment of the obligee's right, the obligor may, in respect of the assignee, avail itself of any defense it has against the assignor.

Article 83 Upon receipt of the notice of assignment of the obligee's right, if the obligor has any right to performance by the assignor which is due before or at the same time as the assigned obligee's right, the obligor may avail itself of any set-off against the assignee.

Article 84 Where the obligor delegates its obligations under a contract in whole or in part to a third person, such delegation is subject to consent by the obligee.

Article 85 Where the obligor has delegated an obligation, the new obligor may avail itself of any of the original obligor's defenses against the obligee.

Article 86 Where the obligor delegates an obligation, the new obligor shall assume any incidental obligation associated with the main obligation, except where such incidental obligation is exclusively personal to the original obligor.

Article 87 Where the obligee's assignment of a right or the obligor's delegation of an obligation is subject to any procedure such as approval or registration, etc. as required by a relevant law or administrative regulation, such provision applies.

Article 88 Upon consent by the other party, one party may concurrently assign its rights and delegate its obligations under a contract to a third person.

Article 89 Where a party concurrently assigns its rights and delegates its obligations, the provisions in Article 79, Articles 81 to 83, and Articles 85 to 87 apply.

Article 90 Where a party has effected combination after it entered into a contract, the legal person or organization of any other nature resulting from the combination assumes the rights and obligations thereunder. Where a party has effected division after it entered into a contract, unless otherwise agreed by the obligee and obligor thereunder, the legal persons or other organizations resulting from the division jointly and severally assume the rights and obligations thereunder.

Chapter 6 Discharge of Contractual Rights and Obligations

Article 91 The rights and obligations under a contract are discharged in any of the following circumstances:

- (i) The obligations were performed in accordance with the contract;
- (ii) The contract was terminated;
- (iii) The obligations were set off against each other;
- (iv) The obligor placed the subject matter in escrow in accordance with the law;
- (v) The obligee released the obligor from performance;
- (vi) Both the obligee's rights and obligor's obligations were assumed by one party;
- (vii) Any other discharging circumstance provided by law or prescribed by the parties occurred.

Article 92 Upon discharge of the rights and obligations under a contract, the parties shall abide by the principle of good faith and perform obligations such as notification, assistance and confidentiality, etc. in accordance with the relevant usage.

Article 93 The parties may terminate a contract if they have so agreed.

The parties may prescribe a condition under which one party is entitled to terminate the contract. Upon satisfaction of the condition for termination of the contract, the party with the termination right may terminate the contract.

Article 94 The parties may terminate a contract if:

- (i) force majeure frustrated the purpose of the contract;
- (ii) before the time of performance, the other party expressly stated or indicated by its conduct that it will not perform its main obligations;
- (iii) the other party delayed performance of its main obligations, and failed to perform within a reasonable time after receiving demand for performance;
- (iv) the other party delayed performance or otherwise breached the contract, thereby frustrating the purpose of the contract;
- (v) any other circumstance provided by law occurred.

Article 95 Where the law or the parties prescribe a period for exercising termination right, failure by a party to exercise it at the end of the period shall extinguish such right.

Where neither the law nor the parties prescribe a period for exercising termination right, failure by a party to exercise it within a reasonable time after receiving demand from the other party shall extinguish such right.

Article 96 The party availing itself of termination of a contract in accordance with Paragraph 2 of Article 93 and Article 94 hereof shall notify the other party. The contract is terminated when the notice reaches the other party. If the other party objects to the termination, the terminating party may petition the People's Court or an arbitration institution to affirm the validity of the termination.

Where termination of a contract is subject to any procedure such as approval or registration, etc. as required by a relevant law or administrative regulation, such provision applies.

Article 97 Upon termination of a contract, a performance which has not been rendered is discharged; if a performance has been rendered, a party may, in light of the degree of performance and the nature of the contract, require the other party to restore the subject matter to its original condition or otherwise remedy the situation, and is entitled to claim damages.

Article 98 Discharge of contractual rights and obligations does not affect the validity of contract provisions concerning settlement of account and winding-up.

Article 99 Where each party owes performance to the other party that is due, and the subject matters of the obligations are identical in type and quality, either party may set off its obligation against the obligation of the other party, except where set-off is prohibited by law or in light of the nature of the contract.

The party availing itself of set-off shall notify the other party. The notice becomes effective when it reaches the other party. Set-off may not be subject to any condition or time limit.

Article 100 Where each party owes performance to the other party that is due, and the subject matters of the obligations are not identical in type and quality, the parties may effect set-off by mutual agreement.

Article 101 Where any of the following circumstances makes it difficult to render performance, the obligor may place the subject matter in escrow:

- (i) The obligee refuses to take delivery of the subject matter without cause;
- (ii) The obligee cannot be located;
- (iii) The obligee is deceased or incapacitated, and his heir or guardian is not determined;
- (iv) Any other circumstance provided by law occurs.

Where the subject matter is not fit for escrow, or the escrow expenses will be excessive, the obligor may auction or liquidate the subject matter and place the proceeds in escrow.

Article 102 After placing the subject matter in escrow, the obligor shall timely notify the obligee or his heir or guardian, except where the obligee cannot be located.

Article 103 Once the subject matter is in escrow, the risk of its damage or loss is borne by the obligee. The fruits

of the subject matter accrued during escrow belong to the obligee. Escrow expenses shall be borne by the obligee.

Article 104 The obligee may take delivery of the subject matter in escrow at any time, provided that if the obligee owes performance toward the obligor that is due, prior to the obligee's performance or provision of assurance, the escrow agent shall reject the obligee's attempt to take delivery of the subject matter in escrow as required by the obligor.

The right of the obligee to take delivery of the subject matter in escrow is extinguished if not exercised within five years, commencing on the date when the subject matter was placed in escrow. After deduction of escrow expenses, the subject matter in escrow shall be turned over to the state.

Article 105 Where the obligee released the obligor from performance in part or in whole, the rights and obligations under the contract are discharged in part or in whole.

Article 106 If the same party assumed all the rights and obligations under a contract, the rights and obligations thereunder are discharged, except where the contract involves the interests of a third person.

Chapter 7 Liabilities for Breach of Contracts

Article 107 If a party fails to perform its obligations under a contract, or rendered non-conforming performance, it shall bear the liabilities for breach of contract by specific performance, cure of non-conforming performance or payment of damages, etc.

Article 108 Where one party expressly states or indicates by its conduct that it will not perform its obligations under a contract, the other party may hold it liable for breach of contract before the time of performance.

Article 109 If a party fails to pay the price or remuneration, the other party may require payment thereof.

Article 110 Where a party fails to perform, or rendered non-conforming performance of, a non-monetary obligation, the other party may require performance, except where:

- (i) performance is impossible in law or in fact;
- (ii) the subject matter of the obligation does not lend itself to enforcement by specific performance or the cost of performance is excessive;
- (iii) the obligee does not require performance within a reasonable time.

Article 111 Where a performance does not meet the prescribed quality requirements, the breaching party shall be liable for breach in accordance with the contract. Where the liabilities for breach were not prescribed or clearly prescribed, and cannot be determined in accordance with Article 61 hereof, the aggrieved party may, by reasonable election in light of the nature of the subject matter and the degree of loss, require the other party to assume liabilities for breach by way of repair, replacement, remaking, acceptance of returned goods, or reduction in price or remuneration, etc.

Article 112 Where a party failed to perform or rendered non-conforming performance, if notwithstanding its subsequent performance or cure of non-conforming performance, the other party has sustained other loss, the breaching party shall pay damages.

Article 113 Where a party failed to perform or rendered non-conforming performance, thereby causing loss to the other party, the amount of damages payable shall be equivalent to the other party's loss resulting from the breach, including any benefit that may be accrued from performance of the contract, provided that the amount shall not exceed the likely loss resulting from the breach which was foreseen or should have been foreseen by the breaching party at the time of conclusion of the contract.

Where a merchant engages in any fraudulent activity while supplying goods or services to a consumer, it is liable for damages in accordance with the Law of the People's Republic of China on Protection of Consumer Rights.

Article 114 The parties may prescribe that if one party breaches the contract, it will pay a certain sum of liquidated damages to the other party in light of the degree of breach, or prescribe a method for calculation of damages for the loss resulting from a party's breach.

Where the amount of liquidated damages prescribed is below the loss resulting from the breach, a party may petition the People's Court or an arbitration institution to increase the amount; where the amount of liquidated damages prescribed exceeds the loss resulting from the breach, a party may petition the People's Court or an arbitration institution to decrease the amount as appropriate.

Where the parties prescribed liquidated damages for delayed performance, the breaching party shall, in addition to payment of the liquidated damages, render performance.

Article 115 The parties may prescribe that a party will give a deposit to the other party as assurance for the obligee's right to performance in accordance with the Security Law of the People's Republic of China. Upon performance by the obligor, the deposit shall be set off against the price or refunded to the obligor. If the party giving the deposit failed to perform its obligations under the contract, it is not entitled to claim refund of the deposit; where the party receiving the deposit failed to perform its obligations under the contract, it shall return to the other party twice the amount of the deposit.

Article 116 If the parties prescribed payment of both liquidated damages and a deposit, in case of breach by a party, the other party may elect in alternative to apply the liquidated damages clause or the deposit clause.

Article 117 A party who was unable to perform a contract due to force majeure is exempted from liability in part or in whole in light of the impact of the event of force majeure, except otherwise provided by law. Where an event of force majeure occurred after the party's delay in performance, it is not exempted from liability. For purposes of this Law, force majeure means any objective circumstance which is unforeseeable, unavoidable and insurmountable.

Article 118 If a party is unable to perform a contract due to force majeure, it shall timely notify the other party so as to mitigate the loss that may be caused to the other party, and shall provide proof of force majeure within a reasonable time.

Article 119 Where a party breached the contract, the other party shall take the appropriate measures to prevent further loss; where the other party sustained further loss due to its failure to take the appropriate measures, it may not claim damages for such further loss.

Any reasonable expense incurred by the other party in preventing further loss shall be borne by the breaching party.

Article 120 In case of bilateral breach, the parties shall assume their respective liabilities accordingly.

Article 121 Where a party's breach was attributable to a third person, it shall nevertheless be liable to the other party for breach. Any dispute between the party and such third person shall be resolved in accordance with the law or the agreement between the parties.

Article 122 Where a party's breach harmed the personal or property interests of the other party, the aggrieved party is entitled to elect to hold the party liable for breach of contract in accordance herewith, or hold the party liable for tort in accordance with any other relevant law.

Chapter 8 Other Provisions

Article 123 Where another law provides otherwise in respect of a certain contract, such provisions prevail.

Article 124 Where there is no express provision in the Specific Provisions hereof or any other law concerning a certain contract, the provisions in the General Principles hereof apply, and reference may be made to the provisions in the Specific Provisions hereof or any other law applicable to a contract which is most similar to such contract.

Article 125 In case of any dispute between the parties concerning the construction of a contract term, the true meaning thereof shall be determined according to the words and sentences used in the contract, the relevant provisions and the purpose of the contract, and in accordance with the relevant usage and the principle of good faith.

Where a contract was executed in two or more languages and it provides that all versions are equally authentic, the words and sentences in each version are construed to have the same meaning. In case of any discrepancy in the words or sentences used in the different language versions, they shall be interpreted in light of the purpose of the contract.

Article 126 Parties to a foreign related contract may select the applicable law for resolution of a contractual dispute, except otherwise provided by law. Where parties to the foreign related contract failed to select the applicable law, the contract shall be governed by the law of the country with the closest connection thereto. For a Sino-foreign Equity Joint Venture Enterprise Contract, Sino-foreign Cooperative Joint Venture Contract, or a Contract for Sino-foreign Joint Exploration and Development of Natural Resources which is performed within the territory of the People's Republic of China, the law of the People's Republic of China applies.

Article 127 Within the scope of their respective duties, the authority for the administration of industry and commerce and other relevant authorities shall, in accordance with the relevant laws and administrative regulations, be responsible for monitoring and dealing with any illegal act which, through the conclusion of a contract, harms the state interests or the public interests; where such act constitutes a crime, criminal liability shall be imposed in accordance with the law.

Article 128 The parties may resolve a contractual dispute through settlement or mediation.

Where the parties do not wish to, or are unable to, resolve such dispute through settlement or mediation, the dispute may be submitted to the relevant arbitration institution for arbitration in accordance with the arbitration agreement between the parties. Parties to a foreign related contract may apply to a Chinese arbitration institution or another arbitration institution for arbitration. Where the parties did not conclude an arbitration agreement, or the arbitration agreement is invalid, either party may bring a suit to the People's Court. The parties shall perform any judgment, arbitral award or mediation agreement which has taken legal effect; if a party refuses to perform, the other party may apply to the People's Court for enforcement.

Article 129 For a dispute arising from a contract for the international sale of goods or a technology import or export contract, the time limit for bringing a suit or applying for arbitration is four years, commencing on the date when the party knew or should have known that its rights were harmed. For a dispute arising from any other type of contract, the time limit for bringing a suit or applying for arbitration shall be governed by the relevant law.

Appendix IV

Special Maritime Procedural Law of the People's Republic of China (Adopted at the 13th Meeting of the Standing Committee of the Ninth National People's Congress on December 25 1999, promulgated by Order No. 28 of the President of the People's Republic of China on December 25 1999)

EXTRACTS

Chapter I General Provisions

Article 1 This Law is formulated for the purposes of maintaining the litigation rights, ensuring the ascertaining of facts by the people's courts, distinguishing right from wrong, applying the law correctly, trying maritime cases promptly.

Article 2 Whoever engages in maritime litigation within the territory of the People's Republic of China shall apply the Civil Procedure Law of the People's Republic of China and this Law. Where otherwise provided for by this Law, such provisions shall prevail.

Article 3 If an international treaty concluded or acceded to by the People's Republic of China contains provisions that differ from provisions of the Civil Procedure Law of the People's Republic of China and this Law in respect of foreign-related maritime procedures, the provisions of the international treaty shall apply, except those on which China has made reservations.

Article 4 The maritime court shall entertain the lawsuits filed in respect of a maritime tortious dispute, maritime contract dispute and other maritime disputes brought by the parties as provided for by laws.

Article 5 In dealing with maritime litigation, the maritime courts, the high people's courts where such courts are located and the Supreme People's Court shall apply the provisions of this Law.

Chapter II Jurisdiction

Article 6 Maritime territorial jurisdiction shall be conducted in accordance with the relevant provisions of the Civil Procedure Law of the People's Republic of China.

The maritime territorial jurisdiction below shall be conducted in accordance with the following provisions:

- (1) A lawsuit brought on maritime tortious may be, in addition to the provisions of Articles 19 to 31 of the Civil Procedure Law of the People's Republic of China, under jurisdiction of the maritime court of the place of its port of registry;
- (2) A lawsuit brought on maritime transportation contract may be, in addition to the provisions of Articles 82 of the Civil Procedure Law of the People's Republic of China, under jurisdiction of the maritime court of the place of its port of re-transportation;
- (3) A lawsuit brought on maritime charter parties may be under jurisdiction of the maritime court of the place of its port of ship delivery, port of ship return, port of ship registry, port where the defendant has its domicile;
- (4) A lawsuit brought on a maritime protection and indemnity contract may be under jurisdiction of the maritime court of the place where the object of the action is located, the place where the accident occurred or the place where the defendant has its domicile;
- (5) A lawsuit brought on a maritime contract of employment of crew may be under jurisdiction of the maritime court of the place where the plaintiff has its domicile, the place where the contract is signed, the place of the port where the crew is abroad or the port where the crew leaves the ship or the place where the defendant has its domicile;
- (6) A lawsuit brought on a maritime guaranty may be under jurisdiction of the maritime court of the place where the property mortgaged is located or the place where the defendant has its domicile; a lawsuit brought on a ship mortgage may also be under jurisdiction of the maritime court in the place of registry port;
- (7) A lawsuit brought on ownership, possession, and use, maritime liens of a ship, may be under jurisdiction of the maritime court of the place where the ship is located, the place of ship registry or the place where the defendant has its domicile.

Article 7 The following maritime litigation shall be under the exclusive jurisdiction of the maritime courts specified in this Article:

- (1) A lawsuit brought on a dispute over harbour operations shall be under the jurisdiction of the maritime court of the place where the harbour is located;

(2) A lawsuit brought on a dispute over pollution damage for a ship's discharge, omission or dumping of oil or other harmful substances, or maritime production, operations, ship scrapping, repairing operations shall be under the jurisdiction of the maritime court of the place where oil pollution occurred, where injury result occurred or where preventive measures were taken;

(3) A lawsuit brought on a dispute over a performance of a maritime exploration and development contract within the territory of the People's Republic of China and the sea areas under its jurisdiction shall be under the jurisdiction of the maritime court of the place where the contract is performed.

Article 8 Where the parties to a maritime dispute are foreign nationals, stateless persons, foreign enterprises or organizations and the parties, through written agreement, choose the maritime court of the People's Republic of China to exercise jurisdiction, even if the place which has practical connections with the dispute is not within the territory of the People's Republic of China, the maritime court of the People's Republic of China shall also have jurisdiction over the dispute.

Article 9 An application for determining a maritime property as ownerless shall be filed by the parties with the maritime court of the place where the property is located; an application for declaring a person as dead due to a maritime accident shall be filed with the maritime court of the place where the competent organ responsible for handling with the accident or the maritime court that accepts the relevant maritime cases.

Article 10 In the event of a jurisdictional dispute between a maritime court and a people's court, it shall be resolved by the disputing parties through consultation; if the dispute cannot be so resolved, it shall be reported to their common superior people's court for the designation of jurisdiction.

Article 11 When the parties apply for enforcement of maritime arbitral award, apply for recognition and enforcement of a judgement or written order of a foreign court and foreign maritime arbitral award, an application shall be filed with the maritime court of the place where the property subjected to execution or of the place where the person subjected to execution has its domicile. In case of no maritime court in the place where the property subjected to execution or in the place where the person subjected to execution has its domicile, an application shall be filed with the intermediate people's court of the place where the property subjected to execution or of the place where the person subjected to execution has its domicile.

Appendix IV

People's Insurance Company of China Hull Insurance Clauses (01/01/1986)

The subject matter of this insurance is the vessel, including its hull, lifeboats machinery equipment, instrument tackles, bunkers and stores.

This insurance is classified into Total Loss Cover and All Risks Cover.

I. Scope of Cover

(1) Total Loss Cover

This insurance covers Total loss of the insured vessel caused by:

- 1) earthquake, volcanic eruption; lightning, or other natural calamities;
- 2) grounding, collision, contact with any object, fixed, floating or otherwise, or other perils of the seas;
- 3) fire or explosions;
- 4) violent theft by persons from outside the vessel or piracy;
- 5) jettison;
- 6) breakdown of or accident to nuclear installations or reactors;
- 7) this insurance also covers total loss of the insured vessel caused by
 - a) accidents in loading, discharging or shifting cargo or fuel;
 - b) any latent defect in a machinery or hull of the vessel;
 - c) wrongful acts wilfully committed by the master or crew to the prejudice of the insured's interest;
 - d) negligence of the master crew or pilots repairers or charterers;
 - e) acts of any governmental authority to prevent or minimizing a pollution hazard resulting from damage to the vessel caused by risks insured against;

Provided such loss has not resulted from want of due diligence by the Insured, Owners or Managers.

(2) All Risks Cover

This insurance covers total loss of or partial loss of or damage to the insured vessel arising from the causes under the Total Loss Cover and also covers the under-mentioned liability or expense:

- 1) Collision Liabilities
 - a) This insurance covers legal liabilities of the Insured as a consequence of the insured vessel coming into collision or contact with any other vessel, or any other object, fixed, floating or otherwise. However, this clause does not cover any liabilities in respect of:
 - i.) loss of life, personal injury or illness;
 - ii.) cargo or other property on or engagements of the insured vessel;
 - iii.) removal or disposal of obstructions, wrecks, cargoes or any other thing whatsoever;
 - iv.) pollution or contamination of any property or thing whatsoever (including cost of preventive measures and clean-up operations) except pollution or contamination of the other vessel with which the insured vessel is in collision or property on such other vessel;
 - v.) Indirect expenses arising from delay to or loss of use of any object, fixed, floating or otherwise.
 - b) Where the insured vessel is in collision with another vessel and both vessel are to blame, then unless the liability of one or both vessels becomes limited by law, the indemnity under this clause shall be calculated on the principle of cross liabilities. This principle also applies when the insured vessel comes into contact with an object.
 - c) The Insurer's liability (including legal costs) under this clause shall be in addition to his liability under the other provisions of this insurance but shall not exceed this insured amount of the vessel hereby insured in respect of each separate occurrence.
- 2) General Average and Salvage
 - a) This insurance covers the insured vessel's proportion of general average, salvage or salvage charges, but in case of general average sacrifice of the vessel, the Insured may recover fully for such loss without obtaining contributions from other parties.

- b) General average shall be adjusted in accordance with the relative contract and of governing law and practice. However, where the contract of affreightment or carriage does not so provide, the adjustment shall be according to the Beijing Adjustment Rules or similar provisions of other rules.
 - c) Where all the contributing interests are owned by the Insured, or when the insured vessel sails in ballast and there are no other contributing interests, the provisions of the Beijing Adjustment Rules (excluding Article 5) or similar provisions of other rules if expressly agreed, shall apply as if the interest were owned by different persons. The voyage of 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 of call 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.
- 3) Sue and Labour
- a) Where there is loss or damage to the vessel from a peril insured against or where the vessel is in immediate danger from such a peril, and as a result reasonable expenditure is incurred by the Insured in order to avert or minimize a loss which would be recoverable under this insurance, the Insurer will be liable for the expenses so incurred by the Insured. This clause shall not apply to general average, salvage or salvage charges or to expenditure otherwise provided for in this insurance.
 - b) The Insurer's liability under this clause is in addition to this liability under the other provisions of this insurance, but shall not exceed an amount equal to the sum insured in respect of the vessel.

II. Exclusions

This insurance does not cover loss, damage, liability or expense caused by:

- (1) unseaworthiness including not being properly manned, equipped, or loaded, provided that Insured knew, or should have known, of such unseaworthiness when the vessel was sent to sea.
- (2) Negligence or intentional act of the Insured and his representative.
- (3) Ordinary wear and tear, corrosion, rottenness or insufficient upkeep or defect in material which the insured should have discovered with due diligence, or replacement of or repair to any part in unsound condition as mentioned above.
- (4) Risks covered and excluded to the Hull War and Strikes Clauses of this Company.

III. Deductible

- (1) Partial loss caused by a peril insured against shall be payable subject to the deductible stipulated in the policy for each separate accident or occurrence (excluding claims under collision liability, salvage and general average, and sue and labour).
- (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

This clause shall not apply to claim for total loss of the vessel, and the reasonable expense of sighting the bottom after grounding, if incurred specially for that purpose.

IV. Shipping

Unless previously approved by the Insurer and any amended terms of cover and additional premium required have been agreed, this insurance does not cover loss, damage, liability and expense caused under the following circumstances:

- (1) towage or salvage service undertaken by the Insured vessel;
- (2) cargo loading or discharging operation at sea from or into another vessel (not being a harbour or inshore craft) including whilst approaching, lying alongside and leaving;
- (3) the insured vessel sailing with an intention of being broken up or sold for breaking up.

V. Period of Insurance

This insurance is classified into Time Insurance and Voyage Insurance.

- (1) Time Insurance: Longest duration one year, the time of commencement and termination being subject to the stipulation in the policy. Should the insured 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 Insurer, be held covered to her port of destination with the payment of an additional pro rata daily premium. However, in case of a total loss of the vessel during such period of extension, an additional six months premium shall be paid to the Insurer.
- (2) Voyage Insurance: to be subject to the voyage stipulated in the policy. The time of commencement and termination to be dealt with according to the following provisions;
 - 1) With on cargo on board: to commence from the time of unmooring or weighing anchor at the port of sailing until the completion of casting anchor or mooring at the port of destination.

- 2) With cargo on board: to commence from the time loading at the port of sailing until the completion of discharge at the port of destination, but in no case shall a period of thirty days be exceeded counting from midnight of the day of arrival of the vessel at the port of destination.

VI. Termination

- (1) This insurance shall terminate automatically in the event of payment for total loss of the insured vessel.
- (2) Unless previously agreed by the Insured in writing, this insurance shall terminate automatically at the time of any change of the Classification Society of the insured vessel, change of cancellation or withdrawal of her class therein, change in the ownership or flag, assignment or transfer to new management, charter on a bareboat basis, requisition for title or use of the vessel, provided that, if the vessel has cargo on board or is at sea, such termination shall, if required, be deferred until arrival at her next port or final port of discharge or destination.
- (3) In case of any breach of warranty as to cargo, voyage, trading limit, towage, salvage service or date of sailing, this insurance shall terminate automatically unless notice be given to the Insurer immediately after receipt of advice and any additional premium required be agreed.

VII. Premium and Returns

- (1) Time Insurance: Full premium shall be due and payable on attachment, and if agreed by the Insurer payment may be made by instalments, but in the event of total loss of the insured vessel, any unpaid premium shall be immediately due and payable, premium is returnable as follows:
 - (a) If this insurance is cancelled or terminated, premium shall be returned pro rata daily net for the uncommenced days, but this clause shall not be applicable to clause VI (3).
 - (b) Where the insured vessel is laid up in a port or a lay-up area approved by the Insurer for a period exceeding thirty consecutive days irrespective of whether she is under repairs in dock or shipyard, loading or discharging, 50% (fifty percent) of net premium for such period shall be returned pro rata daily but in no case shall such return of premium be recoverable in the event of total loss of the vessel. In the event of any return recoverable under this clause being based on thirty consecutive days with which fall on successive insurances effected for the same Insured, such return of premium shall be calculated pro rata separately for the number of days covered by each insurance.
- (2) Voyage Insurance: In no case shall voyage insurance be cancellable and the premium thereof be returnable once it commences.

VIII. Duty of Insured

- (1) Immediately upon receipt of advice of any accident or loss to the insured vessel, it is the duty of the Insured to give notice to the Insurer within 48 hours, and if the vessel is aboard, to the Insurer's nearest agent immediately, and to take all reasonable measures for the purpose of averting or minimizing a loss which would be recoverable under this insurance.
- (2) Measure taken by the Insured or the Insurer with the object of averting or minimizing a loss which would be recoverable under this insurance shall not be considered as waiver or acceptance of abandonment or otherwise prejudice the rights of either party.
- (3) The Insured shall obtain prior agreement of the Insurer in determining the liabilities and expenses in respect of the insured vessel.
- (4) In submitting a claim for loss, the Insured shall transfer to the Insurer all necessary documents and assist him in pursuing recovery against the third party in case of third party liabilities or expense being involved.

IX. Tender

- (1) Where the Insured vessel is damaged and repairs are required, the Insured shall take such tenders as a diligent uninsured owner would take to obtain the most favourable offer for the repairs of the damaged vessel.
- (2) The Insurer may also take tenders or may require further tenders to be taken for the repair of the vessel. Where such a tender is accepted with the approval of the Insurer and allowance in respect of fuel and stores and wages and maintenance of the master and crew shall be made for the time lost between the despatch of the invitations to tender required by the Insurer and the acceptance of a tender, but the maximum allowance shall not exceed the rate of 30% per annum on the insured value of the vessel.
- (3) The Insured may decide the place of repair of the damaged vessel, however, if the Insured in taking such decisions does not act as a diligent uninsured owner, then the Insurer shall have a right of veto concerning the place of repair or a repairing firm decided by the owner or deduct any increased costs resulting therefrom from the indemnity.

X. Claim and Indemnity

- (1) In case of accident or loss insured against, no claim shall be recoverable should the Insured fail to submit claim document to the Insurer within two years following the accident or loss.
- (2) Total Loss
 - (a) Where the insured vessel is completely destroyed or so seriously damaged as to cease to be a thing of the kind insured or where the Insured is irretrievably of the vessel, it may be deemed an actual total loss, and the full insured amount shall be indemnified.
 - (b) Where no news is received of the whereabouts of the insured vessel over a period of two months after the date on which she is expected to arrive at the port of destination it shall be deemed an actual total loss and the full insured amount shall be indemnified.
 - (c) Where an actual total loss of the insured vessel appears to be unavoidable or the cost of recovery, repair and/or salvage or the aggregate thereof will exceed the insured value of the vessel, it may be deemed a constructive total loss and the full insured amount shall be indemnified after notice of abandonment of the vessel is given to the Insurer irrespective of whether the Insurer accepts the abandonment. Once the Insurer accepts the abandonment, the subject matter insured belongs to the Insurer.
- (3) Partial Loss
 - (a) Claims under this insurance shall be payable without deduction new for old.
 - (b) In no case shall a claim be admitted in respect of scraping, derusting or painting of the vessel's bottom unless directly related to repairs of plating damaged by an insured peril.
 - (c) Where repairs for owner's account necessary to make the vessel seaworthy and/or a routine drydocking are carried out concurrently with repairs covered by this insurance, then the cost of entering and leaving dock and the dock dues for the time spent in dock shall be divided equally.
Where it is necessary to place the vessel in drydock for repair of the damage covered by this insurance, the Insurer's liability for the cost of docking shall not be reduced, should the Insured has surveys or other work carried out while the vessel is in dock provided the time for the work for the Insured's account is not prolonged in dock or the cost of docking is not in any way increased.
- (4) In no case shall any sum be allowed under this insurance either by way of remuneration of the Insured 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 Insured to perform such services, unless prior agreement has been obtained.
- (5) Where the insured amount is less than the agreed value or the contributory value in respect of general average of salvage, the Insurer is only liable to pay that proportion of any loss or expense covered by this insurance that the amount insured bears to the agreed or contributory value.
- (6) Where the insured vessel comes into collision with or receives salvage services from another vessel owned by the Insured or under the same management, the Insurer shall be liable under this insurance as if the other vessel were owned by a third party.

XI. Treatment of Disputes

Should disputes arise between the Insured and Insurer and it is necessary to submit to arbitration or take legal action, such arbitration or legal action shall be carried out at the place where the defendant is domiciled.

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Review of the *Marine Insurance Act 1909*

Extract

Recommendation 7. The concept of warranties, both express and implied, as used in the law of marine insurance should be abolished and replaced with a system permitting the subject matter currently covered by them to be the subject of express terms of the contract. Except as provided by the Act as amended (see recommendation 14) and subject to the terms of the contract, a breach by the insured of an express term (including those replacing warranties) will entitle insurers to be relieved of liability to indemnify the insured for a loss where the breach is causative of that loss.

Express warranties

Recommendation 8. Obligations currently covered by express warranties should be dealt with as express terms of the contract.

Recommendation 9. Subject to the contract, the MIA should be amended so that an insurer is entitled to be discharged from liability to indemnify the insured for any loss proximately caused by a breach by the insured of any express term of the contract.

Warranty of seaworthiness

Recommendation 10. The MIA should be amended to repeal the implied warranties of seaworthiness. Obligations of seaworthiness should be dealt with as express terms of the contract.

Recommendation 11. The MIA should be amended so that an insurer is discharged from liability to indemnify the insured for any loss attributable to a breach of an express term of the contract relating to the seaworthiness of a ship where the insured knew or ought to have known of the relevant circumstances and that they rendered the vessel unseaworthy and where the insured failed to take such remedial steps as were reasonably available to it.

Alternative recommendation

Recommendation 12. If recommendations 10-11 are not adopted, the distinction between time and voyage policies with regard to the warranty of seaworthiness should be abolished and the formulation in MIA s 45(5) should be the basis of a common statement of the warranty. The implied warranty in MIA s 46(2) should be removed.

Warranty of legality

Recommendation 13. The MIA should be amended to repeal the implied warranty of legality. Obligations of legality should be dealt with as express terms of the contract.

Recommendation 14. The MIA should be amended so that where the insured is in breach of an express contractual term to the effect that, so far as the insured can control the matter, the insured adventure shall have no unlawful purpose, the insurer is discharged from all liability under the contract.

Recommendation 15. The MIA should be amended so that where the insured is in breach of an express contractual term to the effect that, so far as the insured can control the matter, the insured adventure shall be carried out in a lawful manner, the insurer is discharged from liability to indemnify the insured in relation to any loss that is attributable to that breach.

Change of voyage

Recommendation 16. The provisions of the MIA s 48 and 51-55 relating to change of voyage, deviation and delay should be repealed, permitting these concepts to be dealt with as express terms of the contract. MIA s 49-50, which deal with the attachment of the risk, should be retained.

Interpretation of express warranties

Recommendation 17. The provisions of the MIA dealing with the warranties of neutrality, nationality and good safety (MIA s 42-44) should be repealed as redundant because they are rarely used in practice and can be the subject matter can be dealt with by express terms.

Cancellation rights

Recommendation 18. The MIA should be amended to include new provisions based on ICA s 59-60 stipulating the insurer's rights of cancellation. These rights are subject to the terms of the contract. They arise when the insured has failed to comply with a term of the contract, breached the duty of utmost good faith, made a fraudulent claim under the contract or where otherwise permitted by the Act as amended in accordance with these recommendations. Written notice must be given to the insured. The cancellation may take effect either three business days after the insured received that notice or earlier if replacement insurance comes into effect before then.

Burden of proof

Recommendation 19. The MIA should be amended to insert new provisions that

- (1) the insurer bears the burden of proving that there was a breach of a term of the contract and
- (2) the insured bears the burden of showing that the loss for which it seeks to be indemnified was not proximately caused by or attributable to (as the case may be) the breach.

These provisions are not intended to alter the burdens of proof provided for elsewhere by common law or statute.

Appendix VI

Norwegian Marine Insurance Plan of 1996 (Version 2003)

EXTRACTS

Chapter 3 - Section 2 Alteration of the risk

§ 3-8. Alteration of the risk

An alteration of the risk occurs when there is a change in the circumstances which, according to the contract, are to form the basis of the insurance, and which alter the risk contrary to the implied conditions of the contract.

A change of the State of registration, the manager of the ship or the company which is responsible for the technical/maritime operation of the ship shall be deemed to be an alteration of the risk as defined by subparagraph 1.

§ 3-9. Alteration of the risk caused or agreed to by the assured

If, after the conclusion of the contract, the assured has intentionally caused or agreed to an alteration of the risk, the insurer is free from liability, provided that he would not have accepted the insurance if, at the time the contract was concluded, he had known that the alteration would take place.

If it must be assumed that the insurer would have accepted the insurance, but on other conditions, he is only liable to the extent that the loss is proved not to be attributable to the alteration of the risk.

§ 3-10. Right of the insurer to cancel the insurance

If an alteration of the risk occurs, the insurer may cancel the insurance by giving fourteen days' notice.

§ 3-11. Duty of the assured to give notice

If the assured becomes aware that an alteration of the risk will take place or has taken place, he shall, without undue delay, notify the insurer. If the assured, without justifiable reason, fails to do so, the rule in § 3-9 shall apply, even if the alteration was not caused by him or took place without his consent, and the insurer may cancel the insurance by giving fourteen days' notice.

§ 3-12. Cases where the insurer may not invoke alteration of the risk

The insurer may not invoke § 3-9 and § 3-10 after the alteration of the risk has ceased to be material to him.

The same shall apply if the risk is altered by measures taken for the purpose of saving human life, or by the insured ship salvaging or attempting to salvage ships or goods during the voyage.

§ 3-13. Duty of the insurer to give notice

If the insurer becomes aware that an alteration of the risk has taken place, he shall, without undue delay and in writing, notify the assured of the extent to which he intends to invoke § 3-9 and § 3-10. If he fails to do so, he forfeits his right to invoke those provisions.

§ 3-14. Loss of class or change of classification society

When the insurance commences the ship shall be classed with a classification society approved by the insurer.

The insurance terminates in the event of a loss of class or change of classification society, unless the insurer explicitly consents to a continuation of the insurance contract. If the ship is under way when the class is lost or changed, the insurance cover shall nevertheless continue until the ship arrives at the nearest safe port in accordance with the insurer's instructions.

Loss of class occurs where the assured, or someone on his behalf, requests that the class be cancelled, or where the class is suspended or withdrawn for reasons other than a casualty.

§ 3-15. Trading limits

The ordinary trading area under the insurance comprises all waters, subject to the limitations laid down in the Appendix to the Plan as regards conditional and excluded areas. The person effecting the insurance shall notify the insurer before the ship proceeds beyond the ordinary trading limit.

The ship may sail in the conditional trading areas, subject to an additional premium and to any other conditions that might be stipulated by the insurer. If damage occurs while the ship is in a conditional area with the consent of the assured and without notice having been given, the claim shall be settled subject to a deduction of one fourth, maximum USD 150,000. The provision in § 12-19 shall apply correspondingly.

If the ship proceeds into an excluded trading area, the insurance ceases to be in effect, unless the insurer has given permission in advance, or the infringement was not the result of an intentional act by the master of the ship. If the ship, prior to expiry of the insurance period, leaves the excluded area, the insurance shall again come into effect. The provision in § 3-12, subparagraph 2, shall apply correspondingly.

§ 3-16. Illegal activities

The insurer is not liable for loss which results from the ship being used for illegal purposes, unless the assured neither knew nor ought to have known of the facts at such a time that it would have been possible for him to intervene.

If the assured fails to intervene without undue delay after becoming aware of the facts, the insurer may cancel the insurance by giving fourteen days' notice.

The insurance terminates if the ship, with the consent of the assured, is used primarily for the furtherance of illegal purposes.

§ 3-17. Suspension of the insurance in the event of requisition

If the ship is requisitioned by a State power, the insurance against marine perils as well as war perils is suspended. If the requisition ceases before expiry of the insurance period, the insurance comes into force again. If the ship proves to be in substantially worse condition than it was prior to the requisition, the insurer may cancel the insurance by giving fourteen days' notice, to take effect at the earliest on arrival of the ship at the nearest safe port in accordance with the insurer's instructions.

If the ship is insured with The Norwegian Shipowners' Mutual War Risks Insurance Association, the insurance against war perils shall nevertheless not be suspended in the event of a requisition by a Foreign State power. The insurance against war perils shall in that case also cover the perils which, under § 2-8, are covered by an insurance against marine perils.

§ 3-18. Notification of requisition

If the assured is informed that the ship has been or will be requisitioned, or that it has been or will be returned after the requisition, he shall notify the insurer without undue delay.

The insurer may demand that the assured have the ship surveyed in a dock for his own account immediately after the ship is returned. The insurer shall be notified well in advance of the survey.

If the assured has been negligent in fulfilling his duties according to subparagraph 1 or 2, he has the burden of proving that any loss is not attributable to casualties or other similar circumstances occurring whilst the ship was requisitioned.

§ 3-19. Suspension of insurance while the ship is temporarily seized

If the ship is temporarily seized by a State power without § 3-17 becoming applicable, the insurance against marine perils is suspended. In that event the insurance against war perils shall also cover marine perils as defined in § 2-8. § 3-18 shall apply correspondingly.

§ 3-20. Removal of ship to repair yard

If there is reason to believe that the removal of a damaged ship to a repair yard will result in an increase of the risk, the assured shall notify the insurer of the removal in advance.

If the removal will result in a substantial increase of the risk, the insurer may, before the removal commences, notify the assured that he objects to the removal. If such notice has been given, or if the assured has neglected to notify the insurer in accordance with subparagraph 1, the insurer will not be liable for any loss that occurs during or as a consequence of the removal.

§ 3-21. Change of ownership

The insurance terminates if the ownership of the ship changes by sale or in any other manner.

Chapter 3 - Section 3 Seaworthiness. Safety regulations

§ 3-22. Unseaworthiness

The insurer is not liable for loss that is a consequence of the ship not being in a seaworthy condition, provided that the assured knew or ought to have known of the ship's defects at such a time that it would have been possible for him to intervene. However, this rule shall not apply if the assured is the master of the ship or a member of his crew and the fault that he has committed related to nautical matters.

The insurer has the burden of proving that the ship is not in seaworthy condition, unless the ship springs a leak whilst afloat. The assured has the burden of proving that he neither knew nor ought to have known of the defects, and that there is no causal connection between the unseaworthiness and the casualty.

§ 3-23. Right of the insurer to demand a survey of the ship

The insurer has the right at any time during the insurance period to verify that the ship is in seaworthy condition. If necessary for the purpose of such verification, he may demand a complete or partial discharge of the cargo.

If the assured refuses to let the insurer undertake the necessary investigation, the insurer shall subsequently only be liable to the extent that the assured proves that the loss is not attributable to defects in the ship which the investigation would have revealed.

If the investigation is not occasioned by a casualty or similar circumstances covered by the insurance, the insurer shall indemnify the assured for his costs as well as for the loss he suffers as a result of the investigation, unless the ship proves to be unseaworthy.

§ 3-24. Safety regulations

A safety regulation is a rule concerning measures for the prevention of loss issued by public authorities, stipulated in the insurance contract, prescribed by the insurer pursuant to the insurance contract, or issued by the classification society.

Periodic surveys required by public authorities or the classification society constitute a safety regulation under subparagraph 1. Such surveys shall be carried out before expiry of the prescribed time-limit.

§ 3-25. Infringement of safety regulations

If a safety regulation has been infringed, the insurer shall only be liable to the extent that it is proved that the loss is not a consequence of the infringement, or that the assured was not responsible for the infringement. The insurer may not invoke this rule where the assured is the master of the ship or a member of the crew and the infringement is committed in connection with his service as a seaman.

If the infringement relates to a special safety regulation laid down in the insurance contract, negligence by anyone whose duty it is on behalf of the assured to comply with the regulation or to ensure that it is complied with shall be deemed equivalent to negligence by the assured himself. The same applies if periodical surveys are not carried out as required by §3-24, subparagraph 2.

§ 3-26. Ships laid up

For ships which are to be laid up, a lay-up plan shall be drawn up which shall be submitted to the insurer for his approval. If this has not been done, or the lay-up plan has not been followed while the ship is laid up, § 3-25, subparagraph 1, shall apply correspondingly.

§ 3-27. Right of the insurer to cancel the insurance

The insurer may cancel the insurance by giving fourteen days' notice, however, such notice shall take effect at the earliest on arrival of the ship at the nearest safe port, in accordance with the insurer's instructions, if:

- (a) the ship, by reason of defects, unsuitable construction or similar circumstances, cannot be considered seaworthy,
- (b) the ship has become unseaworthy due to a casualty or other similar circumstances, and the assured fails to have this rectified without undue delay,
- (c) a safety regulation of material significance has been infringed, intentionally or through gross negligence, by the assured or by someone whose duty it is on his behalf to comply with the regulation or ensure that it is

complied with.

§ 3-28. Terms of contract

The insurer may require that certain terms shall be included in contracts concerning the operation of the insured ship, or that certain terms of contract shall not be included in such contracts. The requirement may be made in respect of contracts in general or in respect of contracts for a specific port or trade.

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