LECTURE 1

THE PRINCIPLES OF MARINE INSURANCE

1.0 INTRODUCTION

There are fundamental principles of marine insurance that are universally applicable, regardless of variations in national laws or insurance terminology. These principles are articulated in the provisions of the English Marine Insurance Act 1906 (MIA). In this concise overview, it is not possible to delve into the intricate details of marine insurance law and policies, however, it is important to grasp insurance procedures and its relevance in maritime claims.

Section 1 of the Act defines marine insurance as follows: "Marine insurance is a contractual arrangement in which the insurer commits to indemnify the insured against marine losses, i.e., losses associated with a marine adventure, in the manner and to the extent agreed upon."

Section 3 of the Act establishes that a "marine adventure" occurs when "any ship, goods, or other movable property is exposed to maritime perils." Finally, Section 4 of the Act elucidates that "maritime perils" encompass perils arising from or connected to sea navigation, including perils of the sea, fire, war-related risks, piracy, theft, captures, seizures, actions of rulers and people, jettisons, barratry, and other perils designated by the policy.

These principles apply universally, whether the insurance policy pertains to Hull & Machinery (H&M), P&I, Loss of Hire (LOH), or other standard types of marine insurance. Different insurance policies may also extend coverage to additional perils as long as those perils have a maritime context.

DISCLOSURE AND THE DOCTRINE OF UTMOST GOOD FAITH

Both parties involved in a marine insurance contract, namely the insured and the insurer, are bound by the doctrine of utmost good faith (uberrimae fidei) during the negotiation of the insurance contract. This principle is fundamental to the legal framework of all countries and is enshrined in Section 17 of the English MIA, which stipulates: "A marine insurance contract is based on the utmost good faith, and any breach of this good faith by either party can render the contract voidable by the other party."

The rationale behind this principle, articulated by Lord Mansfield in the 1766 English case of Carter v Boehm, is that good faith prohibits either party from concealing information they privately possess to deceive the other party into a contract based on false premises.

However, the duty to disclose fully and honestly is typically more relevant to the information that should be disclosed by the insured to the insurer.

The insurer must rely on the information provided by the insured during contract negotiations since they cannot independently verify all material facts related to the proposed risk. This duty includes disclosing not only physical hazards but also the insured's personal history, such as instances of dishonesty, regulatory breaches, prior claims, and more.

The duty to disclose also extends to individuals within the insured's organization, independent contractors with delegated responsibilities related to the insured matter, and the insurance broker who acts on behalf of the insured. Failure to make a full and honest disclosure may grant the insurer the option to void the insurance contract and refund the premium. However, if the insured's non-disclosure is found to be fraudulent, the insurer may not be obliged to refund the premium.

In certain cases, the insurance terms may require the insured to inform the insurer of any material changes in the nature or extent of the risk occurring after the policy's inception but during its term. The policy may also specify whether the insurer can terminate the policy under such circumstances, with the particulars depending on the policy's terms and conditions.

WARRANTIES IN INSURANCE CONTRACTS

A warranty within an insurance contract constitutes a commitment made by the policyholder regarding a specific action that will or will not be taken, or the fulfillment of certain conditions. The policyholder may also warrant the accuracy of certain facts by affirming or denying them. This warranty can either be explicitly stated or implied, and it must be strictly adhered to. In the legal framework of the United Kingdom and other similar jurisdictions, compliance with the warranty is mandatory, regardless of its significance to the risk. Failure to comply with a warranty results in the insurer being relieved of all contractual obligations starting from the date of the breach.

For instance, if the policyholder promises not to operate a vessel in areas with ice-infested waters, carry inflammable or explosive cargoes, or operate in regions prone to armed conflict or disturbances, they will be considered in breach of the warranty if they break this promise.

Traditionally, voyage insurance policies have been deemed to include an implied warranty that the vessel must be seaworthy at the beginning of the voyage for the specific adventure. However, this warranty has limited practical relevance in cargo insurance, as most policies incorporate a "held covered" provision, as found in Clause 5 of the Institute Cargo Clauses (ICC) A, B, and C. This provision waives any breach of the implied warranty unless the policyholder is "privy to such unseaworthiness or unfitness at the time the subject-matter insured is loaded therein." In the case of cargo insurance, the policyholder is typically the goods' owner, not the shipowner, making it unlikely that they would be privy to the ship's unseaworthiness.

A similar situation arises with time policies. While there is no implied warranty in time policies, if the policyholder knowingly sends an unseaworthy ship to sea, the insurer is not liable for losses attributed to the unseaworthy condition. A ship is considered unseaworthy when it is not reasonably fit in all aspects to face the common perils of the sea for the insured venture. Consequently, shipowners are required to maintain a continuous diligence program and document their efforts. Insurers may request access to these records if there is reasonable suspicion that an incident was caused by the ship's unseaworthy condition.

INSURABLE INTEREST

A fundamental principle of marine insurance is that the policyholder must have an insurable interest in the subject matter of the insurance. An insurable interest exists when the policyholder has an equitable connection to the marine venture or insurable property at risk, allowing them to either benefit from its safe arrival, be harmed by its loss or damage, or incur liability due to such events.

Ownership of a vessel or cargo is the most obvious example of an insurable interest. However, a ship's mortgagee also holds an insurable interest as long as the loan remains unpaid because the ship serves as security for the mortgagee, who benefits from its well-being and suffers if it is lost or damaged. In contrast, a shipowner making a claim under a Loss of Hire insurance policy has no insurable interest in the loss of earnings during the ship's scheduled dry-docking, as it was a planned event unrelated to the insured peril.

In cases where a corporation owns the ship or cargo, the corporation itself, rather than its shareholders, holds the insurable interest in the property. This holds true even if a shareholder possesses all the company's shares since a corporation is a separate legal entity from its shareholders.

Unlike other types of insurance, a party requesting insurance coverage need not have an insurable interest at the time the insurance is initiated but must acquire it by the time the loss occurs. Thus, a prospective ship or cargo buyer can secure insurance coverage and claim compensation if the loss or damage occurs after taking ownership. Moreover, marine cargo insurance policies can be assigned, allowing a CIF seller of goods to obtain insurance protecting them before and the buyer after the risk transfer under the sales contract. However, insurers for other marine insurance policies usually retain the right to refuse consent for assignment.

THE MEASURE OF INDEMNITY

The insured party is entitled to indemnification only for the pecuniary loss resulting from an insured peril. In marine insurance, it is unique that the extent of indemnification can be agreed upon by the policyholder and the insurer when the insurance contract is concluded, known as a valued policy. Such an agreed-upon indemnity is binding between the parties, barring fraud, even if it is greater or lesser than the actual pecuniary loss.

In contrast, an unvalued policy does not specify a value in the policy, and the payment in case of a loss will be based on the actual value, calculated according to general insurance principles outlined in relevant legislation. Most H&M, Total Loss Insurance, LOH, and many cargo marine policies fall into the category of valued policies.

SUBROGATION

Subrogation refers to the insurer's right to step into the insured's shoes after paying a claim and pursue any rights the insured may have against a third party responsible for the loss or damage. For instance, if an H&M insurer settles a claim by a shipowner for hull damage resulting from a collision, the insurer can claim the shipowner's right to sue the other colliding vessel for the portion of damage attributable to the other ship's negligence.

If legal action against a third party is required, depending on the local laws, the insurer may initiate legal proceedings in their name or the insured's name or request the insured to pursue such proceedings on their behalf. However, subrogation is a right, not an obligation, and the insurer may choose not to pursue it in cases where it may lead to substantial counterclaims.

ABANDONMENT

Abandonment is closely tied to subrogation and allows the insured party (usually in cases of total or constructive total loss) to notify the insurer that they are abandoning the insured property, which means relinquishing all rights and interests in the abandoned property to the insurer. However, insurers often decline abandonment notices to avoid further liabilities related to the property, such as wreck removal, oil pollution cleanup, or disposal of damaged cargo.

SUE AND LABOUR

Marine insurance policies oblige the insured to make reasonable efforts to prevent or minimize losses caused by insured perils and to recover "any expenses properly incurred" in doing so. Insurers are obligated to cover these expenses, even if they are also obligated to pay the total sum insured under the policy. The sue and labor obligation is a separate obligation supplementary to the main insurance coverage.

2.0 THE GLOBAL NATURE OF MARINE INSURANCE

Many insurance policies are typically limited to specific geographical areas, but ships navigate across various oceans and visit ports worldwide. As a result, marine insurance must have a truly worldwide reach to match the international nature of the maritime industry. Shipowners and insurers face diverse risks and liabilities arising from various incidents in different jurisdictions, each governed by different legal rules. Therefore, the insurance coverage, which has evolved over centuries, must be comprehensive enough to encompass this wide range of risks.

THE EXTENT OF MARINE RISKS

Owners, operators, and charterers of ships, as well as cargo interests, generally require insurance coverage for:

1. Damage or loss to their own assets.
2. Loss of income.
3. Liabilities towards third parties (such as other ship owners, cargo owners, or environmental damage).
4. Legal and other related expenses.

However, experiencing a loss or liability does not automatically guarantee compensation under the insurance policy. Insurance protection is contingent upon the occurrence of an insured peril, which is essentially an unforeseen or accidental event agreed upon by the insurer. Hence, insurers do not cover inevitable losses like those resulting from inherent defects or normal wear and tear, or losses caused by the intentional misconduct of the insured.

Even when a loss results from an unforeseen event, it can stem from various types of occurrences, such as maritime perils like adverse weather, collisions, groundings, fires, or damage to cargo. It can also arise due to war risks, including civil war, revolutions, terrorism, or political risks like government expropriation, as well as other commercial risks such as contract frustration, repudiation, business interruption, and funds repatriation difficulties. Thus, those involved in maritime activities typically need different insurance coverages, tailored to the nature of the risks.

However, it can become complex because certain risks may not fall under the same category of insurance, affecting the available coverage under different policies. For instance, while "piracy" qualifies as a maritime peril under the English Marine Insurance Act 1906 and standard P&I insurance, it is commonly excluded from standard H&M insurance and is instead covered by war risk insurers. Therefore, it is crucial to review the specific risks covered by each insurance type.

PRIMARY CATEGORIES OF MARINE INSURANCE

This publication focuses primarily on the main forms of insurance relevant to losses, liabilities, and expenses outlined earlier. The terms "marine insurance" and "war insurance" are used here in a general sense, recognizing that they may encompass the same or different risks in various policies.

While there may be other stakeholders in a maritime venture, this commentary centers on the interests of the three major stakeholders: shipowners, charterers, and cargo owners.

INSURANCE FOR SHIPOWNERS

Shipowners typically require insurance coverage for damage or loss to their assets, loss of income, and potential liabilities to other parties.

Traditionally, shipowners could choose whether to insure against these risks and select the type and extent of coverage. However, compulsory insurance requirements, rising claims costs, and increased asset values have made adequate insurance almost essential for shipowners to operate their vessels effectively.

HULL AND MACHINERY INSURANCE (H&M)

Hull and machinery insurance protects a shipowner's economic interest in the ship, including the ship's hull, machinery, equipment, spare parts, bunkers, and lubricating oil owned by the shipowner. Containers, even if owned by the shipowner, are often covered separately under container insurance. H&M insurance can cover physical damage or loss to the ship, the shipowner's share of general average, salvage, and sue and labor expenses, as well as liability to third parties resulting from collisions or contact with other property.

Providers of H&M insurance can be found worldwide, with key hubs in London (Lloyds), Nordic countries, and China. It is offered by commercial insurers owned by third parties and mutual hull clubs owned and controlled by shipowners. However, terms, conditions, and deductibles vary across providers and policies, making the scope of H&M coverage non-standardized.

H&M insurance is typically placed with multiple insurers, each assuming a portion of the risk for each ship. A lead underwriter often facilitates premium assessment, rating for additional vessels, and claims handling on behalf of all insurers.

SEPARATE INSURANCES AGAINST TOTAL LOSS (TOTAL LOSS INSURANCE)

In cases of total loss of a ship, the recoverable amount under the H&M policy may not suffice to fully indemnify the shipowner, especially when the market value of the ship exceeds its insured value. Shipowners may also incur income losses during the time it takes to replace the lost ship. Consequently, shipowners often seek Hull Interest and Freight Interest insurances (sometimes referred to as 'Disbursements' or Increased Value (IV) insurances) to provide additional coverage.

Hull Interest insurance covers the difference between the ship's actual market value and its insured value under the H&M policy, along with collision liabilities exceeding the H&M insurance sum. Freight Interest insurance addresses income losses due to a ship's total loss. The maximum coverage for Hull Interest and Freight Interest insurance is usually capped at a percentage of the insurable value under the H&M policy, although this may vary depending on underlying conditions.

LOSS OF HIRE INSURANCE (LOH)

Traditional insurance policies typically do not cover delays, even if caused by insured perils. Loss of Hire (LOH) insurance addresses this gap in coverage. LOH insurance indemnifies shipowners for income losses resulting from events causing physical damage to the ship, regardless of the deductible level under the H&M insurance. The terms and conditions of LOH policies may vary, with some providing coverage even when there is no physical damage to the ship in specified circumstances.

Compensation under LOH insurance is typically based on the duration of income loss and the daily income lost. Many policies use a fixed daily amount corresponding to the ship's daily charterparty hire, multiplied by the number of days the ship cannot trade (usually after a predefined waiting period). LOH policies may also specify maximum recovery days per incident and aggregate recovery days for the entire insurance period.

Providers of LOH insurance are fewer compared to H&M insurance, and some LOH insurers may also assume a share of the H&M risk for the same vessel. Scandinavian providers have a significant market share, while there are fewer providers in the United Kingdom and Continental Europe.

STRIKES INSURANCE

Strike insurance covers the daily costs incurred by vessels delayed due to force majeure situations on board or ashore, beyond the shipowner or charterer's control. It is broader in scope than LOH insurance and covers gaps in LOH coverage, including periods within LOH insurance's excess period and time lost in incidents not covered by H&M insurance. It addresses various circumstances, such as strikes, boycotts, industrial disputes, weather-related effects, port closures, and more.

The primary provider of Strikes Insurance is the Strike Club, offering coverage on a mutual basis for some risks and on a fixed premium basis for extended coverage.

PROTECTION AND INDEMNITY INSURANCE (P&I)

P&I insurance has evolved over centuries in response to the growing demand from shipowners for insurance coverage related to liabilities to third parties and expenses not covered by standard H&M and other marine policies. In the modern era, P&I insurers offer coverage for a wide range of legal liabilities faced by the assured party concerning third parties and expenditures arising from:

1. Loss of or damage to cargo.
2. Pollution caused by the ship or its cargo.
3. Loss of life and injury to crew members or passengers.
4. Removal of wreck.
5. Damage to fixed or floating objects.
6. Collisions with other ships.

Most P&I insurers operate as P&I clubs, providing coverage on a mutual basis.

This means each club member agrees to share risks affecting other members and contribute funds to settle claims during the policy year. Consequently, coverage is available for risks commonly encountered by the majority of members, while unusual or exceptionally onerous liabilities may be excluded unless approved by the club. Members are also expected to utilize their rights to exclude or limit liability to protect the club's common funds and membership.

P&I insurance providers have the flexibility to offer cover beyond standard market insurers. This includes the discretion to cover risks not explicitly mentioned in the policy but considered incidental to the insured ship's operation, as per the 'Omnibus Rule.'

P&I INSURANCE PROVIDERS

Traditionally, P&I insurance has been provided by shipowners themselves through P&I clubs on a mutual non-profit basis. While these clubs maintain their independence, most cooperate as members of the International Group of P&I Clubs (IG) to offer high levels of coverage and share liabilities above a certain amount. Currently, thirteen P&I clubs are part of the IG, collectively covering the majority of the world's ocean-going tonnage and tankers.

Although individual P&I clubs have varying rules, their coverage aligns with the Pooling Agreement terms, allowing them to collectively purchase commercial market reinsurance for broader, higher-limit, and more secure coverage. The IG clubs issue "blue cards," which contracting states accept as evidence of compliance with international liability conventions, enabling the issuance of required certificates.

In recent years, some P&I clubs have begun offering extended coverage for specific risks not covered by the Pooling Agreement, often on a fixed premium basis. These extended coverages may vary and typically aren't reinsured by the IG clubs.

DEFENSE INSURANCE (FD&D)

FD&D insurance covers legal and other costs incurred by shipowners in connection with claims not covered by H&M, P&I, or other insurances. It includes costs for defending or pursuing claims, often arising from contracts related to ship operation, bills of lading, and insurance contracts. FD&D insurance providers may be P&I clubs or specialized defense clubs, and they exercise discretion when deciding coverage based on the case's merits.

WAR RISK INSURANCE

War Risk insurance covers claims resulting from war-related risks, typically excluded from traditional marine policies. It does not cover all risks, including those caused by nuclear, chemical, bio-chemical, or electromagnetic weapons. . Insurers can suspend or cancel coverage under specific critical circumstances, such as the outbreak of war between major global powers.

War Risk insurance is mainly provided by specialized organizations, including war risk mutual clubs and commercial providers in Lloyd's and London markets.

INSURANCE FOR THE CHARTERER

Charterers may require various types of insurance depending on their liabilities, which can include damage to the ship, cargo, third parties, property, or pollution.

Insurance for charterers, excluding bareboat charterers, can be similar to P&I insurance for shipowners. It may cover liability, damage to property (e.g., bunkers), loss of income or profit due to ship damage, and more.

CHARTERERS' LIABILITY INSURANCE PROVIDERS

The market for charterers' liability insurance has grown significantly, with several P&I clubs providing coverage for charterers' marine liabilities, including war risks. Specialized clubs, as well as fixed premium providers, offer varying levels of coverage in response to the increased liability exposure charterers face under international conventions and regulations.

3.0 INSURANCE FOR THE CARGO OWNER

Historically, cargo insurance has had a narrower focus compared to ship insurance. In most cases, cargo owners are primarily concerned with ensuring the safe and timely delivery of their goods at the end of a voyage. Therefore, the provision of cargo insurance plays a critical role in contracts for the sale of goods, where the terms determine who is responsible for obtaining insurance and for whose benefit it is provided.

For instance, in FOB (Free On Board) sales, it is the buyer's responsibility to acquire cargo insurance, whereas in CIF (Cost, Insurance, Freight) sales, the seller is responsible for obtaining insurance for the benefit of the buyer. In CIF sales, the seller must also provide the buyer with documentary evidence of insurance, and payment is typically made against documents, including the insurance certificate. Failure to provide the agreed-upon certificate, or providing it in an incorrect form, may hinder the seller's ability to receive payment from the buyer.

PROTECTION AGAINST DAMAGE TO, OR LOSS OF, CARGO

Cargo insurance commonly follows standard conditions, such as the Institute Cargo Clauses (ICC) A, B, and C. The extent of coverage varies depending on the chosen version of the ICC clauses. A clauses offer coverage for all risks, B clauses cover specifically nominated risks, and C clauses cover catastrophic risks only.

It's important to note that "all risks'' coverage doesn't equate to covering all possible losses. Cargo insurance covers losses or damages resulting from unforeseen events or accidents. Losses or damages caused by inevitable factors, inherent vice, or the natural characteristics of the cargo are generally excluded. However, if the loss or damage is due to a peril covered by the selected ICC clauses, cargo interests are typically insured against various factors, including loss or damage to cargo, salvage charges, general average charges, forwarding charges, expenses for averting or minimizing loss (sue and labor expenses), and costs incurred in preserving the insurer's subrogation rights.

Standard clauses may offer similar coverage to ICC clauses with slight variations.

Risks associated with war and strikes are typically excluded, but additional clauses like Institute War Clauses (Cargo) and Institute Strikes Clause (Cargo) can be added to the policy to cover these risks. Most modern cargo policies specify that coverage is not affected by vessel deviations or unseaworthiness, unless the cargo owner is aware of such unseaworthiness when the cargo is loaded.

PROTECTION AGAINST LOSS OR DAMAGE CAUSED BY DELAY

Cargo insurance typically doesn't provide coverage for losses or damages resulting solely from delays. However, special insurance policies for delay-related losses are available.

PROTECTION AGAINST LIABILITY TO THIRD PARTIES

Cargo owners may also face liabilities to third parties, necessitating liability insurance. ICC clauses indemnify cargo owners against their liability to contribute to general average or salvage, but liability can arise in various scenarios. For instance, if dangerous cargo transportation damages a ship, the cargo owner might require liability coverage. Such liability isn't covered under ICC clauses, but there's a growing market for liability insurance tailored to cargo owners and traders.

SUBROGATION

In cases where cargo is lost or damaged during transit, cargo owners usually claim under their cargo insurance instead of pursuing claims against the carrier. The insurer then becomes subrogated to the cargo owner's rights and may bring cargo claims against carriers. Cargo insurance is provided globally by a wide range of insurers, often following international norms for different types of cargo sales.

SHIP BUILDERS' RISKS INSURANCE BROKERS

Shipbuilders' risks involve prospective ship owners making payments to builders during construction. Insurance, like the Institute Clauses for Builders' Risks 1/6/88, is typically taken out by the builder to cover structure-related losses or damages during construction. It's advisable for the prospective shipowner to be included as a co-insured and have recoverable amounts applied to repair and replace equipment. Insurers in various marine markets, including Norway, London, Europe, and Singapore, provide shipbuilders' risk insurance. Local insurers may also play a role, but risks are often reinsured in established marine insurance centers. Standard policies, such as ICBR clauses, may have exclusions, but insurers can often amend or remove them to suit specific risks encountered during construction, such as earthquake or volcanic eruption exclusions.