The formation of insurance contract in London market.

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THE FORMATION OF INSURANCE CONTRACT IN LONDON MARKET

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ABSTRACT

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THE FORMATION OF INSURANCE CONTRACT IN LONDON MARKET

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The processes involved in the formation of a marine insurance contract are different from the processes by which other types of contracts are formed. The formation of insurance contracts in London Market typically takes the following course: a prospective assured who is seeking the insurance cover approaches a Lloyd's accredited broker. The broker prepares the slip and takes it around the market seeking subscriptions. Then the underwriter, who wishes to participate in the insurance, will initial the slip, stating the percentage and the proportion of the risk he is prepared to underwrite. Once the broker has obtained the desired level of subscriptions, the slip is closed. A formal policy is frequently issued later.

In general, the formation of a contract of marine insurance is governed by the ordinary principles of contract law. The purpose of this thesis is to analyse the application of contract law principles to the legal issues that arise at the formation stage in marine insurance contracts and to investigate whether these principles are suitable to dealing with the practical difficulties that arise in the London insurance market.

The main body of the thesis is divided into three parts. The first part is about the legal issues arising before the marine insurance contract is concluded. The second part concentrates on the insurance broker who is playing a significant role during the process of contract formation. Legal issues on the duties, rights and liabilities of the insurance broker will be discussed. The third part focuses on legal issues arising after the marine insurance contract is concluded. Although the issues to be discussed arise in the post-contractual stage, they can often be traced to the processes involved at the formation stage.

DECLARATION

This work has not previously been accepted in substance for any degree and is not being concurrently submitted in candidature for any degree.

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STATEMENT 1

This thesis is the result of my own investigations, except where otherwise stated. Where correction services have been used, the extent and nature of the correction is clearly marked in a footnote(s).

Other sources are acknowledged by footnotes giving explicit references. A bibliography is appended.

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CHAPTER 1

INTRODUCTION

1.1 AN INTRODUCTION TO THE LONDON INSURANCE MARKET

The "London Insurance market" is a distinct, separate part of the UK insurance and reinsurance industry centred on the City of London. It comprises insurance and reinsurance companies, Lloyd's syndicates, P&I clubs and brokers who handle most of the business.[1]

London is a geographically highly concentrated market with many underwriters and brokers located in the City. Thus brokers can know personally the strengths, specialisms and reputations of the underwriters with whom they deal. Similarly the assured can meet underwriters, and market information is spread rapidly among all participants in the market. It can be said that the London insurance market that possesses the capacity and expertise required for the underwriting of virtually any type of risk, and that brokers will be able to obtain the best terms for their clients, the assured.

The London insurance market has got a strong international character. This character is reflected both in the sources of its business and in the nationalities of its participants. A majority of the companies underwriting in the London market are foreign companies or foreign-owned ones. Two important features of the London insurance market should be emphasized; first, this market is largely a "subscription market";[2] and secondly the insurance brokers control most of the business placed in

[1] The legal position of main players operating in this market will be further discussed at p 5 below.

[2] The London market operates generally on a subscription basis, with underwriters each accepting a percentage of the risk. How the process operates and potential legal problem that can arise will be elaborated at p 18 below.

the market.[3]

In broad terms, the London insurance market is composed of two elements: Lloyd's of London and the Companies market.

1.2 LLOYD'S OF LONDON

1.2.1 History of Lloyd's of London

Lloyd's of London is a British insurance market. The actual date when Lloyd's was originally established is not known, but records show that Lloyd's started from Edward Lloyd's coffee house, along the Thames in Tower Street, London. By 1688, there is evidence to suggest that Lloyd's coffee house was well known by businesses in London.

Edward Lloyd did not deal with insurance himself but provided the coffee house, reliable shipping news and other services to facilitate the business of marine insurance. Certain marine risks would present themselves for insurance and a number of wealthy individuals would choose to insure a certain proportion of the risk, until the entire risk was covered. This process of signing the policy by placing one name under another gave rise to the term 'underwriter', which is still used today.

Edward Lloyd died in 1713, but the coffee house was carried on and the wealthy individuals still continued to underwrite shipping risks. By the end of the 18th century, the underwriters elected a committee and moved to new premises in the Royal Exchange. Strict business rules remained in force and only members of Lloyd's were permitted to accept insurance business. In 1871, the Lloyd's Act was passed and the Society of Lloyd's (the Society) was incorporated, which provided the

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[3] The role of the brokers, who play a significant role during the formation of insurance contract in London market, will be further discussed in Chapter 3 below.

legal basis for Lloyd's. This legislation formalised and promoted the development of the Lloyd's market.[4]

The Royal Exchange building was destroyed by the fire of 1838 and Lloyd's moved again, but only temporarily, to South Sea House before returning back to the re-built Royal Exchange in 1844. By the 1900s, Lloyd's had evolved into the international insurance market, providing insurance almost for every type of risk. In 1928, the Society moved to Leadenhall Street, which was the first building it owned. Further growth necessitated another move to a second building in Lime Street in 1958. However, even the Leadenhall Street premises were outgrown, and in 1978 the architect Richard Rogers (now Lord Rogers) was commissioned to redevelop the site. In 1986, HM The Queen officially opened the new spectacular building at One Lime Street, which Lloyd's continues to occupy. Now, Lloyd's of London is a self-regulating organisation operating under the provisions of the Lloyd's Act 1982.

1.2.2 Lloyd's of London as a Market rather than a Company

Lloyd's of London is the world's best known insurance organisation. Lloyd's is not an insurance company itself but rather is best understood as a market place where the underwriting syndicates compete for business. These same competing syndicates work together to offer a vast amount of choice, knowledge, experience and specialism in one place.

The London insurance market is the world's leading centre for international insurance and reinsurance, and Lloyd's accounts for 52% of its gross premium.

[4] In 1871 the members of the Lloyd's underwriting community were united by Act of Parliament into a society and corporation and incorporated by the name of Lloyd's. The objects of the society are as follows:

> "The carrying on by members of the society of the business of insurance of every description including guarantee business; The advancement and protection of the interests of members of the society in connection with the business carried on by them as members of the society and in respect of shipping and cargoes and freight and other insurable property or insurable interests or otherwise; The collection publication and diffusion of intelligence and information; The doing of all things incidental or conducive to the fulfilment of the objects of the society." (Lloyd's Act 1911, s. 4.)

Insurers from all over the world do businesses at Lloyd's, including Munich Re (Germany), Mitsui (Japan), AIG (USA) and ACE (Bermuda). The business of Lloyd's is traditionally divided into four principal categories: marine, non-marine, aviation and motor. Nowadays, Lloyd's underwrites a huge range of businesses and projects internationally, including oil rigs, underground transport networks, airlines and the world's top five manufacturers of personal computers.

The considerable strength of Lloyd's derives from itself being a market. When compared with other insurance or reinsurance companies, it is difficult to understand the manner in which Lloyd's conducts its business and the way it structures its organizations. Generally, Lloyd's itself does not underwrite insurance business, leaving that to its members.

1.2.3 The Structure of Lloyd's Market

As stated earlier, Lloyd's of London is not an insurance company. It is an insurance market. As the oldest continuously active insurance marketplace in the world, Lloyd's has retained some unusual structures and practices that differ from all other insurance or reinsurance companies today.

Structurally Lloyd's is governed by the *Council of Lloyd's*,[5] an 18 member body roughly equivalent to the board of directors of a company. The Council administers the *Corporation of Lloyd's* which runs its various services and administrative operations.. The Council delegates most of its responsibilities for the day to day

[5] The Council of Lloyd's is the body charged with the management and superintendence of the affairs of the society and the power to regulate and direct the business of insurance at Lloyd's (Lloyd's Act 1982, s. 6(1)). To that end, the Council is empowered to: (i) make such byelaws as from time to time seem requisite or expedient for the proper and better execution of Lloyd's Acts 1871–1982 and for the furtherance of the objects (Lloyd's Act 1911, s. 4, set out in fn 4 above) of the Society, including such byelaws as it thinks fit for any or all of the purposes specified in Sch. 2 of the Act; and (ii) amend or revoke any byelaw made or deemed to have been made thereunder (Lloyd's Act 1982, s. 6(2))

oversight of Lloyd's and this delegation, of course, is necessary to ensuring that the market operates efficiently and successfully.

Who are the main players in Lloyd's market?

1.2.3.1 Lloyd's Members

Members of Lloyd's provide the supporting capital on which the market is built. Lloyd's members include corporate members and individual members. Corporate members include investment institutions and international insurance companies. Individual members are known as "names".

For most of Lloyd's history, names were those rich individuals who backed policies written at Lloyd's from their personal wealth and with unlimited liability. Since 1994, Lloyd's has allowed corporate members into the market, with limited liability. The losses in the early 1990s devastated the finances of many names. By that time upwards of 1,500 out of 34,000 names were declared bankrupt and this scared away others. Today, individual names provide only 10% of capacity at Lloyd's, with corporations accounting for the rest. No new names with unlimited liability are admitted, and the importance of individual names will continue to decline as individual names slowly withdraw, convert (generally into Limited Liability Partnerships) or die.

1.2.3.2 Underwriting Syndicates

An insurance syndicate is a group of Lloyd's members, corporate or individual, who provide capital to back the liabilities they insure. Syndicates are annual ventures. Syndicates operate as independent business units within Lloyd's market and are run by managing agents, who appoint the underwriting team which writes risk on behalf of the syndicate membership.

The membership of a syndicate at Lloyd's is not like owning shares in a company. An individual can join for one calendar year only and this is known as the famous 'Lloyd's annual venture'. At the end of the year, the syndicate as an ongoing trading entity is effectively disbanded although it is common for the syndicate to re-form for the next calendar year with more or less the same membership and the same identifying number. In this way, a syndicate can *appear* to have a continuous existence going back fifty years or more when in reality it does not. There would have been fifty separate incarnations of the syndicate, each one a unique trading entity that underwrote insurance for one calendar year only.

1.2.3.3 Managing Agents

Syndicates are run by managing agents who now have a franchise to operate within Lloyd's market. Some managing agents are quoted companies listed on the stock exchange, others are private companies. In some instances, managing agents act as capital providers to the syndicates they manage and so have a multi-faceted role as corporate members of the market, agents and franchisees.

The main functions of the managing agent are to employ the active underwriter and to manage the business of the syndicate; the services provided can include general management, accounting, business development, computer services and other shared services. Managing agents may run more than one syndicate.

1.2.3.4 Lloyd's Brokers

A Lloyd's broker is a partnership or corporate body permitted by the Council to broke insurance business at Lloyd's on behalf of its clients. Most of the largest broking firms in the world own a Lloyd's broking subsidiary. Outsiders, whether individuals or other insurance companies, cannot do business directly with Lloyd's syndicates. They must hire Lloyd's brokers, who are the only customer-facing companies at Lloyd's. They are therefore often referred to as "intermediaries". Lloyd's brokers do not place all of their business through the Lloyd's market. They also deal with UK insurance companies and overseas insurance markets.

Lloyd's brokers must be approved in order to place business with Lloyd's underwriters on behalf of their clients. Only the accredited (registered with the General Insurance Standards Council, or equivalent) Lloyd's Brokers are entitled to place risks in the Lloyd's market on behalf of clients. These Brokers use their specialist knowledge to negotiate competitive terms and conditions for clients. To protect investors, Lloyd's performs a careful assessment of all applicant Brokers, affirming their reputation and financial standing and investigating the character and suitability of officers and employees before making the decision to accredit. Firms receive provisional accreditation for three years before becoming entitled to use the term "Lloyd's Broker".

1.2.3.5 Integrated Lloyd's Vehicles (ILVs)

It also should be mentioned that following the admission of corporations to Lloyd's membership some changes in the traditional structure of Lloyd's resulted. In particular, insurance companies did not want to rely on the underwriting skills of syndicates they did not control, so they started their own. An integrated Lloyd's vehicle is a group of companies that combines a corporate member, a managing agent, and a syndicate under one ownership. Some ILVs allow minority contributions from other members, but most now try to operate on an exclusive basis.

1.3 THE COMPANIES MARKET

The London Insurance market is comprised of Lloyd's of London alongside the companies market, providing an alternative source of cover. The companies market has its origin in the ILU (Institute of London Underwriters) which was formed in 1884 to represent the interests of London marine insurance companies. It was later expanded to include the emerging aviation and energy markets. By the 1980s, the non-marine sector in the companies market had grown to match the Lloyd's market. And to further strengthen the companies market, in 1991, the LIRMA (the London International Insurance and Reinsurance Market Association) was created.

In 1996, LIRMA formally adopted an international approach to its constitution. Membership was opened to companies throughout the European Union and the European Economic Area. The creation of the International Underwriting Association of London ("IUA"), with its global outlook, was the next logical step. The IUA came into being on 1 January 1999, following the merger of the ILU with LIRMA. Bringing together marine, non-marine and reinsurance interests and uniting two separate traditions, the creation of the IUA gave the company market a single voice for the first time.

Marine insurance cover may be obtained either at Lloyd's of London or in the companies market. In the companies market, a company will grant insurance upon the same terms, rules of contract and agency law, and at similar rates to Lloyd's. However there is an important difference in the insurance regimes: when insurance cover is obtained, on the companies market it is the assured who must bear the risk that the company's liability will be limited, by definition. There will be little recourse beyond the company's assets after a liquidation has taken place. A policy of insurance effected at Lloyd's, on the other hand, entitles the assured to obtain all the assets of those members of Lloyd's who have subscribed to the contract through their authorized agent. The contract is between the assured and many members, each of whom is individually liable for his own agreed share, but not the shares of others.[6]

1.4 THE MAIN LEGAL ISSUES TO BE ANALYSED IN THE THESIS

In general, the formation of a contract of marine insurance is governed by the ordinary principles of contract law. However, the application of these principles must be considered, in the context of certain, sometimes unique, practices of the London insurance markets. Placing a risk at the Lloyd's market entails taking the following steps: the prospective assured approaches a Lloyd's accredited broker with a risk to be insured. The broker prepares a "slip" with the details of the insurance. The Broker then approaches underwriters with a view to obtaining written lines of insurance which total 100% or more of the risk. If the underwriter is interested, he will sign on the slip to accept a percentage of the total risk. When the subscription reaches the desired level, the slip is closed and later the insurance policy is issued.

The purpose of this thesis is: (1) to analyse the application of contract law principles to the legal issues that arise at the formation stage in marine insurance contracts and (2) to investigate whether these principles are suitable in dealing with the practical difficulties that arise in the London insurance market. The main body of the thesis is divided into three parts.

[6] Christopher Henley, *The Law of Insurance Broking* (2nd ed, Sweet & Maxwell, 2004) at p 423.

PART 1: the legal issues arising *before* the marine insurance contract is concluded.

It is well established that once a slip has been fully subscribed, there is a binding contract of insurance between the assured and the underwriter who has initialed it. However, the issue often becomes more complicated in practice. In practice, a slip will normally be partially subscribed by several underwriters and there are some doubts about the legal status of a partially subscribed slip. It is important to discuss the legal significance of the process of subscription. The primary question to be considered in this chapter is whether the subscription on the slip should be considered as an *acceptance* by the underwriter or an *offer* from the underwriter.

When analysing the legal status of partial subscription, the rules of offer and acceptance in general contract law should be applied. However, when a reinsurance contract is formed, the analysis of the rules of offer and acceptance cannot fit easily into the traditional understanding of these concepts. Particular problems arise where a contract of reinsurance is formed *before* the original insurance contract. Accordingly, it is important to analyse the issue again under the specific conditions of reinsurance. The question of when the contract of reinsurance should be regarded as concluded and the duty of utmost good faith under these circumstances will be discussed.

The slip plays an important role at the formation stage; it is the main document in the Lloyd's system. However, in the past, when the broker prepared the slips, they could use different formats and there was no restriction on the format to be adopted. These various formats were frequently unclear and open to misinterpretation. Since the policy is normally drafted on slip wording, the above situation could affect the efficiency of policy preparation and signing and it could also cause delay and errors. An attempt has been made in the market to address the problem caused by the use of various types of slip formats which will be analysed in this chapter.

Generally speaking, in cases where the underwriter initials the slip without adding conditions, the subscription amounts to an acceptance and a contract that is binding on both parties is established. However, when the underwriter subscribes the slip but puts some kind of qualification on it, will that subscription be an acceptance amounting to a contract between two parties at that point? These issues will be considered in light of contract law principles.

The most important clause which appears in most marine policies is a "leading underwriter" clause. The purpose of such clauses is to permit the broker and the leading underwriter to agree modifications to the terms of cover which will bind all the following underwriters without them being consulted. It can solve various possible difficulties arising out of the contract formation procedure. However, it also introduces some important legal questions such as: the legal nature of a leading underwriter clause, the power of the leading underwriter to vary or amend the terms of the insurance contract, the affect on the pre-contractual duty of utmost good faith, and the practical operation of the leading underwriter clause. All these issues will be debated in this chapter.

There is a common practice in the Lloyd's market known as the signing down process. Under this practice, brokers will not necessarily close the slip upon obtaining 100 percent subscription. Rather the broker is entitled to continue collecting subscriptions with the end result that the cover reflected by the slip exceeds that which the broker has been authorized to obtain. However, by virtue of market custom, on the closure of the slip, each subscription is automatically subject to a *pro rata* reduction so that the aggregate of all subscriptions totals exactly 100 percent. The reasons why 'signing down' exists and the manner it operates in practice will be considered.

PART 2: the role of the broker during the formation stage of marine insurance contracts.

At the formation stage, it is the broker who will prepare the slip on behalf of the prospective assured; it is the broker who will take the slip around the market searching for subscriptions and again it is the broker who will prepare the policy wording at the later stage. It is clear that, the broker plays a significant role in placing insurance at the Lloyds. This Chapter will focus mainly on legal issues about the duties, rights and liabilities of the broker.

An insurance broker is the agent of the principal who employs him to obtain a contract of insurance for a required term. Accordingly, this chapter will start by analysis the legal nature of the broker's duty to his principal.

Where the duty is set out in specific contractual terms, the broker is under a duty to exercise his duties in accordance with contractual terms; where the duties of the broker have not been contractually agreed, the broker is under an obligation to take "reasonable care". It is vital at this stage to evaluate what can reasonably be expected of the broker.

The broker owes duties to the insurer by virtue of the relevant statute. Generally speaking, there are two primary duties owed by brokers to the insurer, the first is the duty to pay the premium and the second is the duty of utmost good faith. The duty of utmost good faith owed by the broker to the insurer will be analyzed in detail under the headings of the duty of disclosure, the duty not to make misrepresentations. Recent attempt, to reform the law in this area will also be considered briefly..

There is of course the possibility that a broker may act in a dual capacity, as the agent for both the assured and the underwriter. This may occur, for example, in the context of reinsurance, where the broker places the reinsurance for the assured and accepts the risk on behalf of the underwriter under a "binding authority". A binding authority is a contract between insurer and broker, which delegates some underwriting powers to the broker. By using a binder, the broker can obtain the cover in circumstances that reflect both the interest of the insurer and the assured.

The potential conflicts of interest that may arise through the operation of the binder system and the possible solutions to these conflicts will be discussed.

The main right of the broker is to claim his commission once the contract is made. Legal questions such as: who should pay the broker's commission, when should he be paid, what happens if the contract is cancelled at a later stage, is the broker entitled to retain the commission, will be considered at this stage. It will also be important to analyse the liabilities of the broker when he is in breach of his duties to the principal, e.g. where he fails to obtain proper insurance or breaches his duty of disclosure under the duty of utmost good faith. Once the liabilities are considered, it will then be important to determine the nature of damages that can be claimed; for example whether the applicable damages are (1) the amount, which the assured could have been able to claim under the policy, if the policy provided the required cover, or (2) the cost of finding alternative cover or (3) wasted costs. Of course, in some circumstances, the broker may be able to limit or exclude his liabilities and these possibilities will also be discussed. For instance, if the broker can prove that the damage was contributed to by the negligence of the assured, he can limit his liability and further, the broker can exclude his liability if he can prove that there exists an independent ground for the insurer to disclaim his liability.

PART 3: The legal issues that arise after the marine insurance contract is concluded.

Although the legal issues to be discussed here no doubt arise in the *post-contractual* stage, they can often be traced, nonetheless, to the processes involved at the formation stage.There are two important documents at the formation stage of the marine insurance contract, known as the "slip" and the "policy". When there is a discrepancy between a slip and a policy, the question that arises is whether the policy supersedes the slip or the slip prevails over the policy. The first issue focused on in this chapter is the relationship between the slip and the policy. When there is discrepancy between the slip and policy, the answer to the question of which document supersedes the other depends on the parties' intentions. Accordingly, the method of establishing what the parties' intention actually is, becomes a key issue that needs to be analyzed in further detail.

Another issue to consider in this chapter is the role of held cover clauses. A "held covered clause" is a contractual term, under which the insurer's liability will be expanded. The effect of a held covered clause is to extend the original policy cover. When the situation stated in the term occurs the assured remains covered provided any specified conditions are fulfilled, usually notification of the event by the assured to the insurer and agreement upon any appropriate additional premium and change of terms. The legal importance and significance of these clauses to post contractual issues, the nature of such clauses and the applications of the duty of utmost good faith under held covered clauses will be analysed in further detail.

In summary, this chapter will attempt to consider issues which relate to contract formation even though they might arise at a later stage.

CHAPTER 2

FORMATION OF MARINE INSURANCE CONTRACTS: A LEGAL ANALYSIS

INTRODUCTION

The processes involved in the formation of a marine insurance contract are different from the processes by which other types of contracts are formed. This Chapter commences analysis by comparing the formation of a typical marine insurance contract in the London market with the formation of a non-marine insurance contract.

The Lloyd's broker plays a significant role during the formation stage of insurance contracts in the London market. He prepares the slip and takes it around the market seeking subscriptions. Then, underwriters, who wish to subscribe the risk, initial the slip. Once the broker obtains the desired level of subscriptions, the slip is closed. At this stage the insurance contract is concluded. The current Chapter will focus on 6 important legal issues that arise during the formation stage of a marine insurance contract.

First, it is well established that once a slip has been fully subscribed, there is a binding contract of insurance between the assured and each underwriter who has initialed it. In practice, normally a slip is not subscribed by only one underwriter; it is partially subscribed by several underwriters. The legal status of a partially subscribed slip will be analysed in this chapter.

Secondly, in cases where a reinsurance contract is formed before the original marine insurance contract, the question of when the contract of reinsurance comes to existence and the nature of the duty of utmost good faith at this stage requires further deliberation.

Thirdly, in the past, brokers used various slip formats for various types of risks causing interpretation difficulties and uncertainty. An attempt has been made in the market to address the problem caused by the use of various types of slip formats. The effect of this new practice needs to be considered in full.

Fourthly, during the process of formation of marine insurance contracts, the underwriter may put some kind of qualification on the slip when he subscribes it. This creates interesting legal disputes, for example, whether such a subscription amounts to an acceptance and creates a contract between the two parties. The issue will be further analysed in the light of principles emerging from the general contract law.

Fifthly, there will be a consideration of clauses which parties invariably insert into contracts with a view to clarifying their legal positions at formation stage. The most important clause of this nature is a "leading underwriter" clause. The purpose of such clauses is to permit the broker and the leading underwriter to agree modifications to the terms of the cover which will bind all the following underwriters without them being consulted. It can solve various possible difficulties arising out of the contract formation procedure. However, it also raises some questions in practice, which will be debated in this chapter.

At last, but not least, there is a common practice in Lloyd's market known as the "signing down" process. The justification of the process and the manner it operates in practice will be discussed.

2.1 THE FORMATION OF MARINE INSURANCE CONTRACTS COMPARED TO THE FORMATION OF NON-MARINE INSURANCE CONTRACTS

2.1.1 Formation of a non-Marine Insurance Contract

A contract of insurance is a contract between an insurer and an assured. The relationship between the two parties is primarily a contractual relationship with the mutual obligations and rights of the parties defined in the terms of the contract. In law, the contract is complete when the offer, normally provided by the assured, is accepted by the other party, the insurer. The typical process of formation of such a contract is as follows:

A prospective assured who is looking for insurance cover from an insurer, will normally make a proposal, an offer, to the insurer. If the insurer accepts the offer, there will be a concluded insurance contract between the two parties. However, if the insurer is not willing to accept the offer, he may respond with policy terms which are not part of the offer. The response is considered as a counter-offer. The counter-offer is left to the prospective assured to accept or reject. If the prospective assured accepts the response, the insurance contract will be concluded. If the prospective assured rejects the insurer's counter-offer and comes back with a further proposition, the assured makes a further counter-offer. The insurer may accept it or reject it, and so on. In the case of *CTI Inc v. Oceanus Mutual Underwriting Assn (Bermuda) Ltd,*[7] LJ Kerr stated that:[8]

> "When the negotiations extend over a period, the principle is that the whole course of the negotiations must be considered in order to see whether or

[7] [1984] 1 Lloyd's Rep 476.

[8] *Ibi d,* at p 505.

> not full agreement on all the material terms was reached at any stage, and if it is contended that this happened at a particular point, then the Court must also have regard to the subsequent events in order to determine whether or not this contention has been established."

Accordingly, it may be said that the negotiation of an insurance contract will not continue indefinitely. Rather the court will look at the entirety of the negotiations to determine at which point a relevant agreement has been reached. If no agreement can be deemed to have taken place there is simply no contract to talk of.

2.1.2 Formation of Marine Insurance Contracts in the London Market

In the formation of marine insurance contracts in the London market, a proposed assured may not approach Lloyd's underwriters directly, but must act through the medium of a broker[9] who is normally recognized by Lloyd's. The formation of insurance contracts at Lloyd's typically takes the following course:

Placing insurance in the London market commences with an instruction from the proposed assured who is seeking the insurance cover. The instruction is sent to the Lloyd's broker, who should first confirm the instructions to avoid later dispute.[10] Once the instructions have been accepted and confirmed or clarified, the broker should prepare a brief document, known as the slip.[11] The slip is a document which must be in standard form for the Lloyd's market[12] and it sets out a brief and

[9] *The Institute of London Underwriters: An Introduction* (The Institute of London Underwriters, 1987) puts it, "The London market is the part of the British insurance industry which specializes in covering major or complex risks- that is, almost exclusively, risks incurred by business and not by private consumers. It is characterized by the use of brokers, who are the commercial marketing arm of the industry and whose function is to seek out the best cover to answer their customers' needs."

[10] The duty of brokers and the corresponding issues will be further discussed in detail in Chapter 3.

[11] A slip is one of two key documents for marine insurance. The other one is the policy. Issues regarding the relationship between these two documents will be further discussed in Chapter 4.

[12] e.g. LMP slip and LMP BRAT slip. This will be further discussed below at p 44.

abbreviated statement of the subject matter of the risk and the proposed insurance conditions.[13] This document contains all the particulars of the proposal, necessary to allow underwriters to make a decision whether or not the risk is acceptable and at what premium. Some standard terms may also be included in the slip, such as "leading underwriter clauses".[14] The slip forms the basis of any negotiations which may take place between the broker and the underwriter.

After preparing the slip the broker determines which underwriters are most likely to wish to subscribe to the risk, and submits the slip to them in turn. Then the underwriter, who wishes to participate in the insurance, will initial the slip, stating the percentage and the proportion of the risk he is prepared to underwrite. The above process is known as "scratching". Once the broker has obtained the desired level of subscriptions, the slip is closed. A formal policy is frequently not prepared until some months later.

The point at which the contract of marine insurance is concluded is an issue that should be clarified in the first instance: is it concluded, at the time the subscription is finalised or at the time the policy is issued? The Marine Insurance Act 1906 draws a distinction between a contract and a policy of marine insurance. Section 21 of the MIA 1906 provides that "A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; " Accordingly, the marine insurance contract is concluded at the time of subscription, even if the policy is not issued. The policy remains of significance as section 22 of the MIA 1906 provides that a marine insurance contract is inadmissible in evidence unless embodied in a policy, and section 22 further

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[13] There is one issue should be noted regarding the abbreviated provisions in the slip. Various aspects of the proposed contract are abbreviated on the slip, but these should be in common use and capable only of one meaning if later dispute or liability of the broker for negligence are to be avoided. Any non-standard provision which the broker wishes to incorporate into the contract should be attached in full to the slip, but standard clauses or wordings need only be identified by title, number and date of issue, especially if the broker intends to use an old wording which may have been superseded.

[14] This will be further discussed below at p 47.

provides that the policy "may be executed and issued either at the time when the contract is concluded, or afterwards."

2.1.3 Some Other Differences between the Process of Formation of Marine Insurance Contracts and non-Marine Insurance Contract

2.1.3.1 Slip and Proposal Form

In the formation of non-marine insurance contracts, the form used to present a risk to the underwriter is known as a "proposal form". "In US practice, the document used to proffer a wish to obtain insurance seems more usually to be named an application form where UK usage tends to be a proposal."[15] This document is completed by the person or body who is seeking insurance. While forming a marine insurance contract, the form used by the broker is known as a "slip".

There are considerable differences between a slip and proposal from. First, the slip in its terms spells out the shape of the policy which underwriters will issue if the insurance proceeds, while, in the proposal, normally no undertaking as to the type of policy appears. Secondly, the slip is proffered by the broker on its own slip form while the proposer signs the proposal on a form prepared and printed by the insurer. Thirdly, until the policy is issued the slip constitutes a contract of insurance in its own right while the proposal constitutes an invitation to the insurer to make an offer.[16]

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[15] Gordon Shaw, *The Lloyd's Broker* (Lloyd's of London Press Ltd. 1995) at p 71.

[16] *Ibi d,* at p 88.

2.1.3.2 Cover Note

In a non-marine insurance context, the proposal form will be considered by the insurer and further information may be required or terms imposed before any contract of insurance is concluded. This process might take time. Temporary insurance may, therefore, be issued to the assured in the form of a cover note. The cover note provides fully effective cover from the date of application, and is particularly useful in cases of compulsory insurance, such as motor insurance. The temporary cover will expire after a specific period, or when the policy is issued or cover refused, or when revoked. The policy will replace the cover note but only if the insurer wishes to contract; the date of the insurance will usually be retroactive to the inception of the insurance in the cover note, but the cover note will remain in force until the policy is issued so that any claim arising in the period prior to its issue will be determined according to the terms of the cover note.

However, in the marine insurance context, a broker's cover note has no contractual effect and is no more than a representation by the broker that he has obtained cover on certain terms. If he has not, he will be liable to the assured. A cover note will only have contractual effect where the broker is authorized by the assured to find an insurer for the contract of insurance, in which case the cover note will be the contract of insurance, enforceable by the assured against the insurer.

2.2 THE SIGNIFICANCE OF THE SUBSCRIPTION

As discussed above, in the formation of insurance contracts in the London market, the Lloyd's broker prepares the slip and takes the slip around the market seeking the subscription. Once the broker has obtained the desired level of subscriptions, the slip is closed. The insurance contract is concluded. It is well established, if there is only one underwriter who wishes to participate in the insurance and subscribes up to 100 percent of the risk, there is a binding contract of insurance between the assured and that underwriter who has initialed it. Neither the assured nor the underwriter may resile from it.

However, the issue often becomes more complicated in practice than the above simple scenario suggests. In practice, a slip will normally be partially subscribed by several underwriters. The partially subscribed status can cause some difficulties. The following are some examples:

(1) The broker may obtain subscription for 50 per cent of the risk, and be unable to obtain any more;
(2) The broker may obtain subscriptions for 50 per cent of the risk, and then his client may decide that insurance is not required;
(3) The broker may obtain subscriptions for 100 per cent of the risk and then his client may decide that insurance is not required;
(4) The broker may obtain subscriptions for more than 100 per cent of the risk;
(5) Underwriters other than the leading underwriter may want to alter the terms of the slip;
(6) A loss giving rise to a claim arises after the partial, and before the complete, subscription of the slip.

Accordingly, there are doubts as to the legal status of a partially subscribed slip and the following questions arise:

(1) When is the contract of marine insurance concluded, at the time the whole slip is closed or following each individual subscription?
(2) What will happen if the loss occurs after the partial subscription of the contract but before the full subscription?
(3) What is the contractual position after the slip has been partially subscribed and before it has been subscribed to the extent of 100 percent?
(4) Is there a binding contract between the assured and each underwriter when each participating line is written?
(5) If each line results in a binding contract does the assured nevertheless have an option to rescind such a contract?

In order to seek the answers to the above questions, it is important to discuss the significance of the subscription. The basic principles of offer-acceptance in contract law may be useful in the marine insurance context but the question that then needs to be considered is whether the subscription on the slip should be considered as *an acceptance by* the underwriter or *an offer from* the underwriter. There are different views as follows:

2.2.1 The Traditional Rule

In *Ivamy's General Principles of Insurance Law*,[17] the traditional rule was explained as follows,

"The initialing of the 'slip' by the underwriter is the **acceptance**[18] of the

[17] *Ivamy's Genera l Principles of Insurance Law*, (2nd ed. 1970) at p 85.

[18] Emphasis added

> assured's proposal. He thereby binds himself to sign a policy in accordance with the 'slip' when tendered to him for signature, and he cannot refuse to do so except on grounds which call into question the validity of the acceptance. The signing of a policy is, however, a mere formality; it may take place even after loss, and the underwriter cannot refuse to sign the policy on the ground that the broker failed to tender it within a reasonable time after the initialling of the 'slip'. The contract is complete upon the initialling of the 'slip', and, if there is no formal policy in existence, the underwriter may be sued upon the 'slip'. The 'slip' is not a mere honorary undertaking to issue a policy; it constitutes in itself a binding contract of insurance".

According to this traditional rule, the action of the broker to present the slip to the underwriter for signature should be considered as an offer and the action of the underwriter to initial the slip should be considered as an acceptance. The contract is concluded at the point when the subscription is completed.

2.2.2 Donaldson's Approach

In *Jaglom v. Excess Insurance Co. Ltd.*[19] the legal position on the time of formation of an insurance contract was considered and Mr. Justice Donaldson brought forward his new approach regarding the nature of subscription which is against the traditional rule.

***Jaglom* Case**

In this case, J asked his insurance broker to obtain insurance for his wife's jewellery. The broker sent a "slip" to underwriters, who took "lines" on it. At various stages amendments were made by underwriters to the terms and conditions on the slip. After the slip had been fully subscribed, but before a policy had been drawn up, a loss occurred, and a dispute arose as to the terms of the contract of insurance, if any, in force at the moment of the loss. It was held that the true legal analysis of the slip

[19] [1971] 2 Lloyd's Rep 171.

procedure was that each underwriter who agreed to take a line was making an offer on the terms of the slip as they were when he signed it, retaining the right to modify that offer to accord with different terms inserted by underwriters taking subsequent lines. Once the risk is fully subscribed a contract is formed on the terms of the slip in its final form.

Judgment

Mr. Justice Donaldson first stated the traditional rule in his judgment and then cited an example of the absurd situation which may occur following the traditional rule above. If there is only one underwriter, or just few of them had been prepared to make the subscription, and only 20 percent of the risk had been undertaken, the assured has to be compelled to accept a policy for only 20 percent, despite the fact that in the absence of 100 per cent cover, he might well wish to make different arrangements. Then Mr. Justice Donaldson gave the following judgment and provided his own point of view,[20]

> "These absurd consequences leave me in no doubt that the underlying legal analysis is fallacious. **The true analysis is that each underwriter who agrees to take a line is making and not accepting an offer[21]......** I think that business efficacy requires that it be treated as an offer by the underwriters."

According to Mr. Justice Donaldson's approach, the subscription from the underwriter should be considered as an offer from the underwriter, but not an acceptance. If the view expressed by Donaldson J., should be applied in market practice there will be difficulties caused accordingly.

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[20] *I bid,* at p 257.

[21] Emphasis added.

2.2.3 Difficulties caused by Mr. Justice Donaldson's Approach

If the view of Donaldson J., is correct that in the initialling of the slip, an offer is made by the underwriter, in order to convert that offer into a contract there must be an acceptance from the assured, and a subsequent communication by the assured through the broker. However, in a case where no amendments were made and the slip was consequently not resubmitted to each underwriter, there would be no such communication at all. Indeed it is the usual course of practice at Lloyd's for no amendments to be made to the slip.

Another difficulty is that, according to the view of Donaldson J., the offer made by the insurer is one from which the insurer cannot, or would not, resile because to do so would be contrary to the understanding of the market at Lloyd's. But the rules of offer and acceptance do not permit the adoption of the solution proposed in the *Jaglom*[22] case. This is the case because if the underwriter makes the offer to the assured by initialling the slip, like any other offeror, the underwriter should have the right to withdraw his offer, pending communication of acceptance from the assured's broker.

2.2.4 The *Fennia's* Approach

Donaldson's approach was firmly rejected both by Staughton. J., at first instance and by the Court of Appeal in *General Reinsurance Corporation and Others v. Forsakeringsaktiebolaget Fennia Patria.*[23]

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[22] [1971] 2 Lloyd's Rep 171.

[23] [1982] 1 Lloyd's Rep 87, and [1983] 2 Lloyd's Rep 287.

Fennia Case

Here the defendant, Fennia, was the marine insurer of a cargo of paper and board, and had reinsured its liability under two facultative policies; a whole account cover, providing all risks protection; and a specific account cover, providing protection only against fire and floor damage to the goods while warehoused. The precise relationship between these insurances had never been resolved, and on February 14, 1997 Fennia instructed its brokers to effect an amendment to the specific cover reinsurance by virtue of which the excess under that policy was to be increased to 25 million Finmarks. The result as between the policies was as follows: without the amendment, a loss of 27 million Finmarks would have been distributed, 15 million Finmarks to the specific loss reinsurers and 10 million Finmarks to the whole account reinsurers. With the amendment, a loss of 27 million Finmarks would have been distributed, 2 million Finmarks to the specific loss reinsurers and 20 million Finmarks to the whole account reinsurers.

The amendment slip prepared by Fennia's brokers had been presented to the remainder.I It became clear that a serious loss had taken place on the night of February 11 to 12, 1977, at which point Fennia instructed its brokers to withdraw the amendment slip. The two specific loss reinsurers who had scratched the slip argued that they had entered into a binding amending agreement with the assured, so that the slip could not be withdrawn as against them. Fennia asserted that either they were not bound by the amendment slip until it had been initialled by all 28 of the reinsurers on the specific cover, or they had the right to cancel it until this had been done. The right to cancel is said to arise as an implied term, either to give business efficacy to the contract or by reason of the custom and practice of the London insurance market.

The main issue to consider is whether the first plaintiffs were entitled to rely on the amendment slip, or whether Fennia by their brokers were entitled as of right to cancel it.[24]

Judgment

By holding that the subscription by the insurer was the acceptance, Staughton. J., rejected the Donaldson approach at first instance and stated that, [25]

> "Two propositions were in my judgment clear from the evidence, and I do not think that they were in dispute: first, that **as soon as an underwriter has put his initials on a slip, he is bound by what he has subscribed. If a loss occurs the next day, he must pay.**[26] The second is that, in the event of over-subscription as in case (D) above, the broker is entitled to reduce proportionately the subscriptions of all, until they total no more than 100 per cent……With the greatest possible respect to those who hold the contrary opinion, in the light of the evidence that the market considers underwriters bound and the difficulty of finding any later stage when the contract can be said to be concluded, **I hold it to be an acceptance.** [27] "

This part of the judgment was approved in the Court of Appeal. Lord Justice Kerr stated that[28]

> "I am in no doubt that Mr. Justice Staughton was right in the present case in concluding, that the orthodox understanding of the position is correct, viz.

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[24] [1982] 1 Lloyd's Rep 92 at p 93, "This particular dispute concerns a risk placed on the non-marine market, with companies as opposed to Lloyd's underwriters, for reinsurance rather than direct insurance. However it was not suggested that there was a material distinction, in any of those three respects, between this case and others that might arise. The authorities which I was referred to, and the evidence which I heard of custom and practice, would not support any such distinction, save in one or two minor respects which I shall specifically mention."

[25] *Ibi d,* at p 97.

[26] Emphasis added.

[27] Emphasis added.

[28] [1983] 2 Lloyd's Rep 287 at p 290.

> **the presentation of the slip by the broker constitutes the offer, and the writing of each line constitutes an acceptance of this offer by the underwriter *pro tanto*[29].**"

But Staughton. J., held in the first instance that when an original slip is going round the market and is not yet subscribed for 100 percent, there can be some instances that exist where the contract can be varied unilaterally on behalf of the assured. Those underwriters who have subscribed may require time-on-risk premium if the cover has already commenced. The reason for the above judgment is the existence of the signing down process.[30] The signing down process was stated to be one instance of when the contract must be capable of being varied. The variation exists by reason of custom and practice and reflects the need for business efficacy. The judge also believed that that this would be the reasonable solution to the absurd situation stated by Mr. Justice Donaldson in *Jaglom*[31] case that "the assured could be compelled to accept insurance for 20 per cent of the risk only when he was unable to obtain any more cover."

However, the Court of Appeal rejected the notion that there could be instances where the contract can be varied unilaterally on behalf of the assured. According to Lord Justice Kerr,[32]

> "With the greatest respect to Mr. Justice Staughton, I cannot begin to accept that any of this evidence goes anywhere near to establish a binding custom entitling an insured or reinsured, as of right and at his unfettered opinion, to cancel the contract resulting from the writing of a line which - as everyone agreed - is immediately binding on the underwriter......For these reasons I am left in no doubt that this appeal must be allowed and that Fennia's counterclaim for payment on the basis of the original unamended

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[29] Emphasis added

[30] This process will be further discussed below at p 58.

[31] [1971] 2 Lloyd's Rep 171.

[32] [1983] 2 Lloyd's Rep 287 at p 295.

slip must be dismissed. They had no right to require cancellation of the line written by Mr. Hollis on the endorsement slip."[33]

As a result of the above discussion and the Court of Appeal decision in *Fennia* case , answers to the various possible questions raised at the beginning of this part can be given in the following manner:

a. Each subscription constitutes an individual contract

Are the obligations under the slip enforceable against individual underwriters, or must such enforcement be collective? The House of Lords held in *Fennia,*[34] that a slip and the subsequent policy constitute a bundle of individual contracts. A further consequence of the binding nature of a slip is the principle that each subscribing underwriter accepts individual, rather than collective, obligations to the assured. Therefore, where a slip is subscribed by more than one underwriter, there is established a distinct and separate contract with each underwriter. There is no interrelationship between the various contracts. Each underwriter is severally liable and there exists no joint or joint and several liabilities.

[33] What is going to be the possible solution to the absurd situation referred to by Mr. Justice Donaldson (that "the assured could be compelled to accept insurance for 20 per cent of the risk only when he was unable to obtain any more cover.") The Court of Appeal proposed solution is not the only one. Actually there are two alternative possible way to resolve it, the first of which is the "quotation slip". Where a broker wishes to test the market, it is always open to him to circulate a "quotation slip", which makes it plain that he is merely seeking a quotation rather than a contract, so that he can then decide whether or not to proceed by means of an unqualified slip on the same or different terms. After using the quotation slip, the assured can reduce the chances to make himself fall into the above absurd situation. Secondly, there is no doubt that such situations would in practice be readily resolved by the agreement of both parties, possibly subject to any "time on risk" premium which may be due, if and when requests for cancellation are made.

[34] [1982] 1 Lloyd's Rep 87.

b. Both the assured and the underwriter are bound to each subscription before full subscription.

The assured has no right of cancellation before full subscription. Each signature gives rise to a distinct binding contract between each underwriter and assured, which can subsequently be cancelled only by the agreement of both parties. So the underwriter who has initialed the slip is bound to the assured before the slip has been fully subscribed in the event of a loss taking place prior to full subscription. And the assured is not permitted to change his mind and withdraw the slip after some underwriters have initialed it but before full subscription.

c. The assured cannot resile from the contract where the slip has been fully subscribed.

The broker may obtain subscriptions for 100 per cent of the risk and then his client may decide that insurance is not required. Where the slip has been fully subscribed and the assured subsequently decides that he wishes to resile from the insurance, he has no entitlement to do so in law, except that the insurer agrees to cancel. According to Staughton, J., "They may require time-on-risk premium if the slip has commenced; and they may agree more readily if the assured can point to some change in circumstances or other good reason for his wish to cancel."[35] But the assured has no right either of market practice or implied term so to do.[36]

d. The underwriter is liable for the loss prior to full subscription

Where the loss occurs prior to the broker having obtained full subscription to the slip

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[35] *The Fe nnia* [1982] 1 Lloyd's Rep 87 at p 89.

[36] *The Fe nnia* [1983] 2 Lloyd's Rep 287 at pp 295-297.

the underwriter is liable for his stated proportion of the total amount on the basis of the principle that an underwriter is bound by his initialing of a slip.

e. Each underwriter may be bound to the assured on different terms

The following situation might occur: after the slip has been subscribed by some underwriters and it comes to a particular underwriter, it may unacceptable to that underwriter in the absence of some alterations. If there are alterations in the slip, can those amendments operate to the benefit of such underwriters who have previously initialed the slip? The Court of Appeal, in *Fennia*,[37] did not give full consideration to the problem of alterations to the slip. The general tenor of the judgment in that it regards a scratched slip as a binding agreement between each underwriter and assured would nevertheless indicate that unilateral variations are not possible, so that the position is indeed that each underwriter may be bound to the assured on different terms. If the slip is unacceptable to particular underwriters and alterations to it are made, these amendments do not, it seems, benefit such underwriters who have previously initialed the slip.

[37] *I bid.*

2.3 COUNTER OFFER

The legal analysis carried out at the beginning of the chapter is based on the assumption that the underwriters initial the slip without adding new conditions. However, this is not always the case in practice. Accordingly, the consequences of adding conditions to the slip need to be considered. In the straightforward situation the subscription amounts to an acceptance and establishes a contract that is binding on both parties. However, when the underwriter subscribes the slip and puts some kind of qualification on it, will that subscription be an acceptance and will there be a concluded contract between the two parties at that point?

Most contracts of insurance are contracts between the underwriter and the assured. In law, their contract is made when the offer normally provided by the assured is accepted by the other party, the insurer. However, if the underwriter is not willing to accept the offer, he may respond with a counter-offer, which may then be accepted by the assured. And, further, the assured may meet the counter-offer with a further offer of his own, for acceptance by the underwriter. This process continues until the counter-offer of one or other is finally accepted or rejected.

Where the assured has made an offer to the underwriter, the response of the underwriter may be considered a positive one in two situations; either where the underwriter accepts the offer or where a counter offer is made. If the terms of "acceptance" differ from the terms of the offer, it may be considered as a counter offer, but it may not in some circumstance. Whether or not there is a counter offer depends on the answer to the question whether there is any *real* inconsistency between the offer and the "acceptance".

When there is no real inconsistency, the difference between the offer and the "acceptance" will not cause a counter offer and such "acceptance" brings the contract into existence. For example, in *Coheeney v Westgate Ins Co Ltd*,[38] an insurer responded to a proposal of liability insurance for a sole trader with a standard policy which was wide enough to cover persons in his employment. Here there was no real inconsistency; the wider cover was "surplus to requirements", was clearly in excess of the cover that the proposer had paid for, and was ignored. If there is real inconsistency, the "acceptance" is not a real acceptance in law, it is a counter offer. But the situation will be a little different, when the insurer only makes a tentative move to see if the assured who provides the offer can accept the difference. If the assured rejects the difference, the insurer will withdraw it and accept the original offer. There is no counter offer in this situation.

A counter offer is normally exemplified by the situation in which a condition is imposed by the insurer on binding acceptance. The conditional acceptance is a counter offer; the "acceptance" can be regarded as conditional in the sense that it contains terms not found in the offer. Here there is real inconsistency, the "acceptance" does not correspond with the offer. In *Canning v Farquhar*,[39] Canning's proposal was "accepted" by the insurer but with a clause not found in the offer, that "No assurance can take place until the first premium is paid". Canning died and his agent tendered the premium to the insurer. The Court of Appeal held that there was no contract. Lindley LJ said:[40]

> "It is true that there has been an acceptance of Canning's offer, but he had not at this time assented to the company's terms; and until he had assented there was no contract binding the company. The company's acceptance of Canning's offer was not a contract but a counter offer."

There is one important issue that needs to be discussed in more detail, regarding the offer, acceptance and counter offer, which is whether silence can constitute

[38] High Court,1989 unreported.

[39] (1886) 16 QBD 727.

[40] *I bid,* at p 733

acceptance.

Generally speaking, when the insurer actually accepts the assured's offer, it is necessary to request notification of the fact that there is an acceptance. There will be no question when positive notification is given. However, difficulties arise when there is no such kind of positive notification. Whether silence can constitute acceptance is of particular significance in the insurance context, for there may be cases in which the insurer, having received a proposal, either fails to act on it or neglects to notify the assured of a decision to accept it.

General contractual principle dictates that mere silence by the insurer cannot amount to acceptance.[41] To be acceptance of an offer, conduct must be positive: silence, generally, is not normally sufficient. However, there are several exceptional situations in which the silence will be considered as acceptance. The first one is when there is a previous agreement that silence shall be regarded as consent; here silence does amount to acceptance. In a further example of silence being adequate to constitute acceptance, it is unlikely that an insurer who sits upon a proposal for an inordinate length of time will be estopped from denying the existence of an agreement.[42] Furth ermore, it may be that silence will amount to acceptance where the insurer has imposed upon himself an obligation to notify the assured within a given period in the event of the proposal being rejected: in such a case, silence as a method of acceptance is normally accepted.

In *New Hampshire Insurance Co v MGN Ltd,*[43] a slip for fidelity insurance was agreed between insurers and brokers acting for the assured, and subsequently a policy differing in material respects from the slip was tendered. As the terms of that

[41] *Felth ouse v Bindley* (1862) 11 CBNS 869.

[42] *Rust v Abbey Life Assurance Co.* [1979] 2 Lloyd's Rep 334.

[43] [1997] LRLR 24.

policy had not been agreed at an earlier stage, the policy was classified as a counter-offer, and the only question was whether the counter-offer had been accepted by the assured by failing to object to the differences between the policy and the slip. The Court of Appeal, recognized that the general rule that silence does not constitute acceptance no longer had the same sanctity as in the nineteenth century, and that a party could agree that his silence should be assent Nonetheless it held that in the present case there was no such agreement as there had not been any requirement for a policy to be issued to replace the slip, and, in any event, a court was to proceed with some caution before giving too large a licence to one party to a proposed contract to thrust terms on the other without his explicit approval. The counter-offer in this case was not, therefore, to be regarded as having been accepted.

2.4 REINSURANCE

According to the *Fennia* approach discussed above, the rules of offer and acceptance in general contract law should be applied in the formation of marine insurance contracts in the following manner: the contract commences with the broker taking the slip around the market seeking signatures; this should be considered as an offer from the broker on behalf of the prospective assured. Once the underwriter who wishes to participate in the cover scratches on that slip, the insurance contract between the assured and that particular underwriter is concluded. So the subscription by the underwriter should be considered as an acceptance to the offer. However, when a reinsurance contract is formed, the analysis of the above rules of offer and acceptance could be quite different particularly where the reinsurance contract is formed before the original insurance contract. Accordingly, it is important to analyse the legal issue again from the perspective of reinsurance contracts.

There are two primary scenarios:

In the first scenario the reinsurance is formed after the insurance contact is concluded.

Under such circumstances, the underwriter for the original insurance contract will ask his broker to present a slip to the reinsurer for signature. After the reinsurer initials the slip, the contract is concluded. Unless the slip is qualified or is expressly circulated to obtain a quotation, it then contains the contract of reinsurance in the same way as original insurance does. In this case the reinsurance contract is formed by a conventional offer and acceptance in correspondence. The broker who acts for the reinsured will present slip to the reinsurer and this action should be considered as an offer. The reinsurance contract is formed by the reinsurer initialing that slip and the reinsurer's action should be considered as an acceptance.

However, the procedure is more complicated where the reinsurance is formed in the manner envisaged by the second scenario i.e. before the original insurance contract is concluded. One example of how this may occur is where the underwriter for the original insurance has subscribed to a "line slip". Line slips are a facility whereby a group of underwriters give a leading underwriter authority to accept proposals for insurance of risks within a defined class on their behalf. These underwriters will obtain reinsurance in advance against their liability on insurances to be concluded on their behalf by the leading underwriter. The reinsurance slip may be initialed before conclusion of the primary insurance contract, so that by the time when the reinsurer signs on the slip, he may not know who will be the reinsured.

The question raised under this circumstance is again when the contact of reinsurance is concluded. Should the signature of the reinsurer on the slip still be considered as an acceptance? If so, the broker's slip will be considered as an offer to the reinsurer and the contract of reinsurance is concluded at the time the reinsurer signs the slip. However, the difficult question is "who will be the offeror in the above case".

Another issue regarding the second scenario under the reinsurance contract is about the duty of disclosure.[44] The duty to act with the utmost good faith applies to reinsurance contacts because a reinsurance contract is still by its nature a contact of insurance. The duties of the reinsured to the reinsurer ought to be measured by the same standard expected of the original assured. Accordingly the duty of disclosure in reinsurance is the same as in primary insurance; the reinsured must disclose to the reinsurer all facts known, or deemed in law to be known, to him and which are not known or deemed to be known to the reinsurer, which are material to the risk in the sense that the prudent reinsurer would take them into account when deciding whether or not to take the risk and what to charge for it. According to sections 17, 18 and 19 of the MIA 1906, the duty of disclosure comes to an end before the insurance contract is concluded.

Obviously, under the first scenario when the reinsurance contract is concluded after the original insurance, the duty of disclosure on the broker and reinsured comes to an end when the reinsurer signs on the reinsurance slip. However, under the second scenario when the reinsurance is formed before the original insurance contract, the question about when the duty discussed above should be exhausted need some further analysis.

In the case of *Bonner v. Cox*[45] the question of the duty of utmost good faith owed by a reinsured when the reinsurance is made in advanced of insurance was considered.

Bonner: relevant facts

The Claimants are all Lloyd's Syndicates [Nos. 535, 62, 187 & 228] whose business included writing risks in the energy market. The defendants are reinsurers - Cox Syndicate, Euclidian, Lloyd's Syndicate No. 1688, Tryg and the insurance broker

[44] The duty of utmost good faith will be further discussed below at p 81.

[45] [2005] Lloyd's Rep IR 569.

AON.

The Claimants and Euclidian jointly participated in an Open Cover-77 Cover which was not itself a contract of insurance but rather a standing offer by the subscribing Cover Underwriters to be bound to risks accepted by the leader, 535, within the terms of the Cover. Prior to 1999, the year of the 77 Cover, the Cover Underwriters arranged their own reinsurance. For about two years prior to 1999 both the insurance and reinsurance markets in the energy field were weakening. In order to facilitate their brokering task, AON decided that they would seek reinsurance for the Cover which could then be offered to those insurers who were prepared to subscribe to the 77 Cover for 1999.

The terms of the reinsurance were set out in a slip, and were finalized on 23 November 1998 when 1688 wrote a 50 per cent line and scratched the slip. On 7 December 1998 Tryg (fronted by Euclidian) scratched for the remaining 50%.

When Aon approached the Cover underwriters at the beginning of December 1998 to invite them to renew their participation in the Cover for the 1999 year, Aon was armed with 1688's offer of reinsurance. The dates on which the various underwriters agreed to participate on the Cover for 1999 and purchase the reinsurance were as follows:

(i) On 3 December 1998, 535 scratched an endorsement to the Cover renewing 535's 50 per cent leading line on the Cover for 1999.

(ii) Also on 3 December 1998, Syndicate 62 agreed to renew their 25 per cent line on the Cover for 1999, and at the same time accepted the reinsurance offered by 1688

(iii) Syndicates 187 and 228 each agreed to renew their lines (for 8.34 per cent and 6.66 per cent respectively) on the Cover and to purchase the reinsurance offered by 1688 either on Friday 4 December or on Monday 7 December 1998

On 23 November 1998 there was a well blow-out (Elk-Point loss) the risk of which was covered by the 77 Cover. The insurance cover was limited to US$20 million on any one accident or occurrence in excess of US$5 million.

AON became aware of this on 1 December 1998, having received newspaper cuttings from the US. On 8 December AON received a preliminary report from loss adjusters suggesting a reserve of US$10m, although by 11 December AON had become aware that the loss could potentially reach US$20m.

The basic issue in the present case was whether the Elk Point loss ought to have been disclosed to the reinsurer by AON.

Judgment

It is common ground between the parties that

(1) the duty of utmost good faith owed by a broker on behalf of his client ends when the contract of insurance has been made; (2) the Elk point loss was a material fact which the brokers on behalf of the Cover Underwriters were under a duty to disclose once they became aware of it;

However, there were a few difficult questions raised in this case.

First, when was the contract of reinsurance concluded?

Second, when did the brokers become aware of the Elk Point loss so that they were under a duty to disclose the facts about it to the prospective reinsurers-was it as from 1 December or 8 December?

If we look at the second question first, the answer can be found from the Judgment as follows: [46]

> "In my judgment, as at 8 December AON were aware of a loss which was material to be disclosed to any prospective Cover Underwriter or Reinsurer. I reject the submission that AON had that knowledge as from 1 December 1998. At that date there were simply two newspaper cuttings and although there may have been telephone calls there was nothing sufficiently concrete to 'go on' to require disclosure in the context of a broker. Until there was some hard factual material, such as a loss adjuster's report and estimate, whether the insurance written to the Cover for the 1998 year was going to be hit was unknown. The un-contradicted evidence of Mr Outhwaite and Mr Holmes was clear on this point and I unhesitatingly accept it."

Accordingly, Morison J held that AON had acquired the relevant knowledge of the Elk Point loss on 8 December 1998, the earlier information being too anecdotal and imprecise to amount to specific knowledge.

This meant that if Syndicate 1688 had become bound to the reinsurance before 8 December 1998 the duty of disclosure had come to an end and there would be no right to avoid. The first question about when the contract of reinsurance was concluded should be considered next.

During the original insurance contact formation, the broker's slip will be considered as an offer and the underwriter's signature on the slip will be taken as the acceptance. Can the signature of the reinsurer on the slip be also considered as an acceptance at this point?

The essential issue here was exactly what the legal consequences had been of the scratching of the slip by Syndicate 1688 on 23 November 1998.

The analysis of Hobhouse J in The *Zephyr*[47] is applicable here.

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[46] *Ibi d,* at para 88.

[47] [1984] 1 Lloyd's Rep 58.

In this case, the broker obtained reinsurance cover before the underlying insurance had been placed. With the assistance of the reinsurance slip signed by the reinsurer, the broker obtained insurance cover. The Court held, amongst other things, that the broker was acting throughout on behalf of the assured; that a binding contract between insurer and reinsurer was concluded even though the insurers' acceptance of the reinsurance was not communicated to the reinsurer; the fact that at the time when the reinsurer signed the slip the identity of the reinsured was not known did not affect the position.[48]

In market practice, it is frequently the case that, a broker will try and get a promise of reinsurance before attempting to place the original insurance. The fact that reinsurance is available is likely to make a material difference to the underwriter's decision whether or not to undertake the risks.

This practice was described by Mustill LJ as he then was in *The Zephyr*[49] as follows,

> "... a practice has developed whereby a broker instructed to obtain a primary cover will on his own initiative approach potential reinsurers to obtain from them in advance a binding promise to provide reinsurance for whatever person may subsequently write a line on the primary cover and desire to reinsure the whole or part of that line. The reinsurer conveys this promise by initialling a percentage line on a slip, which identifies the subject-matter, the nature of the risk and the value. The slip does not, however, identify the reassured and could not do so: for at the stage when the potential reinsurer is approached, it is not known whether the primary insurance will ever be written at all, and if so by whom; or whether any of the primary insurers will desire to effect reinsurance; or whether any insurer who does desire to reinsure will be willing to do so with the reinsurer whom the broker has approached, and on the terms which he has offered. With this promise "at large" in his pocket, the broker can offer to an underwriter a

[48] The analysis that reinsurance placed in advance of insurance takes effect as a standing offer of the type recognised in *Carlill v Carbolic Smoke Ball* [1893] 1 QB 256, so that as soon as an insurer agreed to accept the underlying risk, then a contract of insurance with that insurer — even though not identified at the time of the offer — would come into existence.

[49] [1985] 2 Lloyd's Rep 529 at p 532.

package consisting of the opportunity to take a line on the primary cover, and at the same time to place an order for reinsurance."

In *The Zephyr* consideration was given to the question as to when a binding contract of reinsurance came into existence. The Court of Appeal noted not simply that market practice could indicate when a binding promise occurred, but that on a strict contractual analysis in law there was a binding contract once the reinsurance had been accepted, and even without communication of that acceptance to the reinsurers. This was the analysis that Morison J adopted in the Bonner case. He held that once the reinsurer had scratched the slip offering the reinsurance there was an open offer capable of acceptance simply by the offeree renewing the Cover for the year 1999.

Thus, the slip signed by 1688 on 23 November 1998 was an offer addressed to Cover Underwriters. The duty of disclosure only existed during the period up to the conclusion of the binding contract of insurance or reinsurance. Once concluded there is no such further duty. So, the outstanding question was the date on which the insuring syndicates had accepted the reinsurance, as the duty of disclosure came to an end at that point. Morison J was satisfied that most of the acceptances were in place before 8 December 1998, so that there had been no breach of any duty of disclosure.

Accordingly, it should be concluded as follows:

When the reinsurance is placed after the original insurance, the broker who presents the reinsurance slip to the reinsurer will be the offeror just like in the original insurance contract formation stage. The reinsurer who wants to take the risk will sign on the slip and his signature will be construed as an acceptance of the offer. The duty of disclosure will come to the end when the reinsurer signs on the slip.

However, when the reinsurance is placed before the original insurance, the offer and acceptance rule operates in a different manner and the duty of disclosure will not come to an end when the reinsurer signs on the slip. Because the signature of the reinsurer on the slip is considered to be the *offer* of reinsurance, the contract of reinsurance is concluded when the *reinsured accepts* this offer. Accordingly, the duty of disclosure can only be exhausted when the reinsured signs on the slip.

2.5 THE REGULATORY ASPECTS OF THE SLIP SYSTEM AT LLOYD'S

As examined above, the slip plays a significant role at the formation stage of insurance contracts at the London market. It is the basis of the contract of insurance negotiated between the underwriter and the broker and it documents the intentions of the parties to the contract. However, in the past, when the broker prepared the slips, they could use different formats and there was no restriction on the format to be preferred. Those various formats were frequently unclear and open to misinterpretation. Since the policy is normally drafted on slip wording, the above situation could effect on the efficiency of policy preparation and signing and it could also cause delay and errors. Accordingly, there was a need for a standard slip format to resolve these difficulties.

2.5.1 Lloyd's Standard Slip

The Standard Slip was first introduced into the Market in March 1970. From September 1971 it became mandatory for all slips submitted to LPSO (London Policy Signing Office) for signing purposes to be in the standard slip format. At that time, the relevant page in the Lloyd's Policy Signing etc Manual read as follows:

> "2.2 Types of Standard slip
> The following slips should be used for the particular class of business
> (A) Non-treaty Standard Slip
> This is to be used for all business both direct and reinsurance other than treaty scheme and excess of loss reinsurance business.
> (B) Treaty Standard Slip
> This is to be used for all treaty and excess of loss reinsurance business, ie

other than facultative reinsurance. It is an adaptation of the non-treaty Standard Slip and basically follows the Standard Slip format but with different sub-headings for placing detail… In recognition of the difficulty of producing the above Standard Slips by modern methods, the option of producing Standard Slips in each of the above instances, based upon A4 size stationery, is available to Brokers…
NB Where the term 'Standard Slip' is used in this chapter it refers to the non-treaty and treaty Standard Slips. The term "Standard A4 Slip" is used when referring to the Standard Slips based on A4 size stationery.
2.3 Format of the Standard Slip
Each has a standard format which must be followed exactly by Brokers in preparing the layout of their slip."

2.5.2 LMP Slip

The LMP (London Market Principles) slip was introduced in October 2001 and was first registered in Feb 2002. Now it accounts for the majority of slips placed in the London market.

The "London Market Principle 2001" emerged from a review by Lloyds of its procedures. "LMP 2001" represented a rationalization of these procedures with the aim of allowing Lloyds to maintain its market position. The reforms to the market systems were intended to allow for,

(1) clarity in contractual terms leading to certainty of coverage and fewer disputes
(2) faster premium payments
(3) earlier production of insurance documentation,
(4) streamlining the scheme for claims into one structure
(5) faster claims processing and settlement
(6) streamlining the way in which changes to contracts are handled
(7) improving processing by synchronizing it with international practice.[50]

Among the benefits to the market of mandating the LMP slip are first, the standardized LMP Slip format does improve clarity and sets out the post placing

[50] Christopher Henley, *The Law of Insurance Broking* (2nd edn Sweet & Maxwell 2004) p 425.

administration and processing requirements; secondly, the LMP Slip format enables improvement of client service and reduces the cost of processing in London; finally the use of the LMP slip is an important step in improving contractual certainty and in documenting contractual terms. This is important for processing efficiency.

2.5.3 LMP BRAT Slip

Recently, at the start of 2004 Lloyd's has released its first report on slip quality since mandating the use of the LMP (London Market Principles) slip. In light of this experience brokers and underwriters have agreed to an enhanced LMP slip referred to as the LMP BRAT (Broker reform Action) Slip. The Lloyd's Franchise Board has agreed that the LMP BRAT Slip will be mandatory for all slips from 2nd January 2004.

LMP slips must contain four sections entitled as Risk Details; Subscription Agreement; Information; Fiscal and Regulatory.

One of the key aims of the LMP programme is to ensure certainty at inception so that the LMP BRAT slips do not include any TBA (or "to be agreed") provisions that do not indicate the appropriate action to be taken by whom and by a specific date or which are ambiguous. The other of the main aims of the LMP reforms and the BRAT slip is faster premium payment, ensuring monies are paid to underwriters earlier and within the agreed terms. Because the slip includes payment terms and brokerage, there is room for stipulating particular terms on which the premium payments must be made and for determining who should settle them.[51]

[51] Tim Goodger *"Avoiding the traps if brokers go bust"* [21 Jan 2004] Insurance Day

2.6 LEADING UNDERWRITER CLAUSE

According to *Fennia's*[52] approach, a binding contract is concluded at the moment that the underwriter makes the subscription on the slip which is submitted to him by the broker on behalf of the assured. However, in order to satisfy the demands or needs of a subsequent underwriter, there are occasions when a slip is amended after being initialled by one underwriter. Such cases may happen when the subsequent underwriters insist on different terms to which the broker may agree, albeit reluctantly, or when there may be some other intervening event, such as a change of circumstances or a change of mind by the insured, or when the broker is not able to procure completion of the slip up to 100 percent on any terms which are acceptable to him. Accordingly it may happen that different underwriters will have become bound on different terms. The position was acknowledged by Mr. Shaw in his evidence: "market practice abhors a slip on different terms; it is possible, but daft."[53]

"A slip on different terms" may cause some considerable difficulties. Here are some instances. First, when the policy is prepared, it would have to show which underwriters were bound by which terms and this can be a difficult process itself. Secondly, claims and recoveries might require different accounting treatments for different underwriters. Thirdly, it has to be accepted that cases could arise where some underwriters could be liable and some might not under such a system. Where the brokers had not re-submitted the slip to those underwriters who had initialled the slip before amendments to the terms were inserted, it is likely that such underwriters would alone be liable for those claims excluded by the terms imposed by following underwriters.[54]

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52 [1983] 2 Lloyd's Rep 287

53 *Ibi d,* at p 289.

54 Cockerell and S haw, *Insurance Broking and Agency, The Law and the Practice* (London : Witherby, 1979) at p 124.

However, in practice, the problem will rarely arise because the underwriters do not take an equal role in the negotiating process. The above various possible difficulties arising out of the contract formation procedure and the prospect of different contracts are rendered unlikely by the use of "leading underwriter clauses".[55]

A "leading underwriter" clause is the most important device used in Lloyd's market to ensure that the obligations of all subscribing underwriters are concurrent.

In practice the market is happy to follow the judgment of leading underwriters on the terms of cover and also as to any renegotiation of terms that may become necessary. There is no standard wording for this type of clause but the general purpose is to permit the leading underwriter to agree amendments to the slip and thereby to bind the following market.[56] The purpose of such clauses is to permit the broker and the leading underwriter to agree modifications to the terms of the cover which will bind all following underwriters without their being consulted. The leading underwriter is often the first subscribing underwriter, and it is irrelevant that that underwriter had taken only a small part of the risk in comparison to underwriters in the following market.

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[55] An alternative solutio n to the difficulties arising out of the contract formation procedure is line slips.
A line slip is more or less an authority conferred upon one syndicate by a number of other syndicates, authorizing that syndicate to accept risks of a specified description and up to a specified amount on their behalves. Accordingly, by approaching a single syndicate, a broker may be able to obtain a substantial proportion of the necessary placement without the need to approach individual subscribing underwriters. Line slips are the agreement between the underwriters, so, the syndicate which is pointed out by the others is only the agent of the other syndicates. The terms of the line slips only bind the syndicates, not the assured, for the assured is not a party to the line slips. This was made clear by the House of Lords in *Touche Ross v Baker*, [1192] 2 Lloyd's Rep 207, in which line slips, arranged by brokers, authorized the leading underwriter to issue liability policies on behalf of himself and the subscribers to the line slip. The House of Lords ruled that the line slips, not being any form of agreement between the assured and the underwriters, were not admissible as evidence as to the meaning of the policies issued under these arrangements.

[56] The following is a typical leading underwriter clause: "All alterations, additions, deletions, extensions, agreements, rates and charges in conditions to be agreed by the leading Lloyd's Underwriter. Such agreement to be binding on all underwriters subscribing hereon"

2.6.1 Nature of a Leading Underwriter Clause

From the above statement, the general effect of a leading underwriter clause in the slip is to require each subscribing underwriter to delegate decision making to the leading underwriter in respect of the matters falling within the scope of the clause. It is important to analyse the nature of such a clause and in particular to discuss the relationship between the leading underwriter and the following market.

The issues surrounding leading underwriter clauses were considered by Andrew Smith J in *Unum Life Insurance Co of America v Israel Phoenix Assurance Co Ltd.*[57]

Unum v. Israel Facts

Reinsurer, Unum was the claimant who had subscribed to a reinsurance slip with the defendant, Israel Phoenix. The reinsurance slip was circulated in 1995, stating that the wording was to be agreed by the leading underwriter only. Liberty was the first company to sign the slip, and signed an endorsement in September 1998. On 5 December 2000, Liberty agreed a provision for arbitration. The claimant brought a claim against the defendant for declarations that he had on 19 July 2000 validly avoided contracts of this quota share reinsurance of personal accident business for the reason of the defendant was in breaches of the duty of utmost good faith.

The defendant argued that Liberty was the leading underwriter and had agreed to arbitration on behalf of all of the subscribing reinsurers, including the claimant, so the proceedings should be stayed in accordance with the arbitration clause, under section 9 of the Arbitration Act 1996. The claimants argued that the Liberty was not the leading underwriter, and that even if it was, it had not entered the arbitration agreement on behalf of the following market.

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[57] [2002] Lloyd's Rep IR 374.

Judgement

Andrew Smith J held that,[58]

> "...the provision of the slip is not, in my view, wide enough for this to be the effect of an arbitration agreement entered into by Liberty Mutual. In the absence of special circumstances — and, in my view, there are none here — general words of incorporation do not have the effect of incorporating an arbitration agreement...The argument here is that if the reinsurance has been validly avoided, that ended the power of the leading underwriter to bind to treaty wording...On the limited evidence that I do have ... the claimant has shown on the balance of probabilities that the agreement has been validly avoided."

According to Andrew Smith J, the clause was ineffective for two reasons. First, the general rule was that an arbitration clause could not be incorporated into an agreement without specific reference to arbitration in that agreement, so that a general clause conferring authority on the leading underwriter to agree terms did not extend to arbitration. Secondly, and quite independently, even if the leading underwriter did have authority to agree to arbitration, that authority could be derived only from the reinsurance slip. However, the slip had been avoided in July 2000, with the effect that it was to be treated as never having existed: accordingly, the leading underwriter could not rely upon the slip as the basis of any power to agree to arbitration.

The Court of Appeal held that Andrew Smith J was right on the second ground that if there had been a valid avoidance of the reinsurance on 19 July 2000 then the leading underwriter Clause could no longer bite on 5 December 2000 when the leading underwriter agreed a wording; however, the judge had been wrong on the first point.

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[58] *Ibi d.* at p 377.

Lord Justice Mance stated that,[59]

> "It seems to me that the cases on incorporation have little if anything to do with the scope of a leading underwriter's capacity to bind the following market under a Clause such as the present Clause 'wording to be agreed by Leading Reinsurer only'. That capacity is either to be defined in terms of agency which is Mr Edwards' preferred approach and which is certainly thoroughly arguable for present purposes, or in terms of a trigger mechanism whereby the leading underwriter, although not an agent in legal terms, acts as a trigger in a way which has the effect that the following market is bound to follow his action. "

Perhaps the most important aspects of the judgments are the comments made by the courts on the effects of the leading underwriter clause. The following point is worthy of mention.

What is the nature of the obligation imposed by a leading underwriter clause? On this point, there is a conflict of authority.

2.6.1.1 Agent View - traditional analysis of the position as being one of agency

The generally accepted view, which flows from *Roadworks Ltd v Charman*,[60] is that the leading underwriter clause is not just an agreement between the assured and underwriters but also an agency agreement between the leading underwriter and the following subscribers. In that case, Judge Kershaw held that the slip constituted both the terms of the contract between the underwriters and the assured, and evidence of an agreement between subscribing underwriters themselves whereby the leading underwriter is designated as having authority to vary the contract on behalf of the following market. Judge Kershaw further accepted that where the leading

[59] *Ibi d.* at p 380.

[60] [1994] 2 Lloyd's Rep 99.

underwriter accepted a variation in the terms of the slip, the leading underwriter clause did not have the effect of binding the following market automatically if it was the intention of the leading underwriter simply to vary the terms of the slip for his own syndicate.

According to this 'agency' view, if the acts of the leader are within the scope of his authority, those acts are automatically binding on the following market. This analysis achieves the obligation to follow, but it also raises the possibility that the following markets are owed duties of care and skill by the leader and also that the leader may face liability to the assured if he agrees to something beyond his powers.

2.6.1.2 Trigger View

In *Mander v Commercial Union Assurance Co plc,*[61] the issue was whether a leading underwriter who purported to act in excess of his mandate might be liable for breach of warranty of authority to the person with whom he was dealing. Rix J. was keen to avoid this possibility thus tentatively suggested that a leading underwriter is not the agent of the following market but that his actions are simply the "trigger" by which the following market become bound. On this analysis, any action beyond the leading underwriter's mandate may be effective to bind him, but does not bind the following market as there is no triggering event which causes the underwriters in the following market to be bound; in the same way, the leading underwriter cannot be in breach of any warranty of authority, as he has not held himself out as having the authority to bind the following market.

2.6.1.3 Which View should be Applied

Whether the leading underwriter acts as the agent of the following market or only as

[61] [1998] Lloyd's Rep IR 93 relying upon dicta of Steyn J. in *The Tiburon* [1990] 2 Lloyd's Rep 418 at p 422.

the "trigger" discussed above, actually depends upon the scope and terminology of the clause. In *Barlee Marine Corporation v Mountain,*[62] the marine slip in question covered three cases of interest: hull; time and charter hire; and loss of earnings. The leading underwriter extended the slip by accepting endorsements lengthening the duration of the insurance. Hirst J. held that the leading underwriter clause- which covered "amendments, additions and deletions"- was sufficiently widely worded to cover extensions of time affecting all three interests.

2.6.2 Can the Leading Underwriter Vary or Amend the Terms of the Insurance Contract under the Leading Underwriter Clauses?

Under a leading underwriter agreement, the underwriters who follow the lead may agree to accept any minor amendments or additions to the policy without the need for their specific approval or authority, as long as the leader has agreed to accept the alteration.

When there is no such agreement, every later amendment must be agreed by every underwriter before it can bind him. Following underwriters may also refuse to be bound by the leader, or request that they are advised of all amendments.

When there is such agreement in the insurance contract, because it is clearly an efficient way of effecting changes to the contract without renegotiating with every subscribing underwriter, it effectively constitutes the leading underwriters as the agent of the following underwriters with specified and limited authority to amend their contract with the insured.

Generally, the leading underwriter agreement will authorize the leader to agree:
"(1) any item which is stated in the slip "to be advised" or "to be agreed", such as the

[62] [1987] 1 Lloyd's Rep 471.

attachment date or premium;[63]

(2) additional premiums where the assured is held covered, i.e. where cover can be continued or widened under the contract;

(3) settlements of claims, or not;

(4) amendments of an administrative nature."[64]

However, the leading underwriter cannot agree to a material alteration of the risk even if there is a leading underwriter agreement. The leader's authority must be limited to prevent a following underwriter discovering that the risk that he agreed to write has not metamorphosed into something quite different as a result of any changes agreed between the broker and leader. The broker must know of the relevant restrictions, since if he purports to obtain the leader's agreement to an alteration which should have been agreed with all underwriters because it falls outside the leader's authority, he may be liable to the assured who will believe that this is covered by a different insurance and may act accordingly, subject to any claim against that leader for breach of warranty of authority. Such a claim will be rare because the broker is or should be aware of the extent of the leader's authority but it could occur if the leader were to misrepresent the position.

In *Barlee Marine Corporation v Mountain (The "Leegas")*,[65] an argument that the leading underwriter clause could be "pumped up" to permit infinite variation was rejected by Hirst J. partly upon a construction of the clause and its application to the amendment in question, and partly on the basis that:[66]

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[63] The terms of the agreement will usually be followed in the slip by the abbreviation "tba l/u" i.e. "to be agreed by leading underwriter". The phrase usually means that a contract has been concluded and that the underwriter will be liable if a loss occurs before the term has been finally agreed, provided that the contract is not void for uncertainty.

[64] Christopher Henley, *The Law of Insurance Broking* (2nd edn Sweet & Maxwell 2004) at p 426.

[65] [1987] 1 Lloyd's 471.

[66] *I bid,* at p 475.

"…any notion that a marine policy could be converted into, say, an aviation policy is fanciful in the extreme. Equally fanciful is the notion that the following underwriters could be saddled willy-nilly with indefinite extension without their knowledge, since they would continue to receive premium and could, in any event, have recourse, if they wished, to the termination clause. Underlying the whole relationship between the leading underwriter and the following underwriters, furthermore, is the former's manifest duty of care."

2.6.3 Can the Following Underwriter Vary or Amend the Terms of the Insurance Contract under the Leading Underwriter Clauses?

In *The Zephyr*[67], Hobhouse, J., observed that "a following underwriter in practice has no scope to vary or amend the terms of the insurance contract he is being offered. Therefore his exercise of judgment goes principally to the size of line he will write." "In law, therefore, the following underwriters have ample scope, but the expertise of the leader and the market dislike of policies embodying contracts on different terms are powerful constraints on its practical operation."[68]

2.6.4 Pre-contractual Duty of Utmost Good Faith under the Leading Underwriter Clause

It is clear that the assured's duty of utmost good faith at the pre-contractual stage comes to an end as soon as the slip has been fully subscribed, whether or not a policy has been issued by the relevant authorities at Lloyd's. What is less clear is the extent of the duty of utmost good faith where circumstances have changed after the slip has been scratched by the leading underwriter but before it has been scratched by any following underwriter.

[67] [1984] 1 Lloyd's Rep 58 at p 66.

[68] Howard N. Bennett, *The Role of the Slip in Marine Insurance Law* [1994] Lloyd's Maritime and Commercial Law Quarterly at p 95.

First, as discussed above, because each underwriter has a separate contract with the assured, the duty of utmost good faith applies to each underwriter. Secondly, when there is a false statement made to the leading underwriter which allows him to avoid the contract, but is not deemed to have been repeated to the following market, due to the absence of a causative link between the statement and the decisions of the following market, the following market cannot avoid the contract in the same way. However, it may be that, if the broker is aware of his misrepresentation, he is under a duty to disclose it to the following market.[69]

It seems that the following conclusion can be drawn from the above scenario: A binding contract exists between the assured and the leading underwriter, so that the duty of utmost good faith is broken as it applies to the leading underwriter, but remains good for the following market.

2.6.5 How does the Leading Underwriter Clause Work in Practice?

Here is an example. The broker takes the slip in the first instance to an underwriter whom he has selected to deal with as leading underwriter, i.e., one who has a reputation in the market as an expert in the kind of cover required and whose lead is likely to be followed by other insurers in the market. The broker and the leading underwriter go through the slip together. They agree on any amendments to the broker's draft and fix the premium. When an agreement has been reached the leading underwriter initials the slip for his proportion of the cover and the broker then takes the initialled slip round the market to other insurers who initial it for such proportion of the cover as each is willing to accept. For practical purposes all the negotiations about the terms of the insurance and the rate of premium are carried on between the broker and the leading underwriter alone. For instance, clause 42 of the International Hull Clauses (01/11/03) states as follows that,

[69] See ss.19 and 20 of the MIA 1906

"42.1. Where there is co-insurance in respect of this insurance, all subscribing underwriters agree that the Leading Underwriter(s) designated in the slip or policy may act on their behalves so as to bind them for their respective several proportions in respect of the following maters (in addition to Clause 35.5)

42.1.1 the appointment of surveyors, experts, average adjusters and lawyers, in relation to matters which may give rise to a claim under this insurance

42.1.2. the duties and obligations to be undertaken by the Underwriters including, but not limited to, the provision of security

42.1.3 claims procedures, the handling of any claim (including, but not limited to, agreements under Clause 43.2) and the pursuit of recoveries

42.1.4 all payments or settlements to the Assured or to third parties under this insurance other than those agreed on an 'ex-gratia' basis.

Notwithstanding the above, the Leading Underwriter(s), or any of them, may require any such matters to be referred to the co-subscribing Underwriters."

2.7 SIGNING DOWN PROCESS

Finally, in this chapter, an important practice during the formation of insurance contracts at Lloyd's, known as the signing down process, should be discussed. It is common on Lloyd's market that brokers will not necessarily close the slip on obtaining 100 percent subscription. The broker is entitled to continue collecting subscriptions with the end result that the cover reflected by the slip exceeds that which the broker has been authorized to obtain. However, by virtue of market custom, on the closure of the slip, each subscription is automatically subject to a *pro rata* reduction so that the aggregate of all subscriptions totals exactly 100 percent. This process is called "signing down".[70] In reported cases, the level of subscription has reached as high as 300%.[71]

2.7.1 The Reasons Why "Signing Down" Exists

When there is a binding contract between the assured and each underwriter, any reduction or signing down is a breach of contract. Thus, on the face of it signing down is not permissible. However, as alluded to earlier in this Chapter, the signing down process was first given detailed consideration by Staughton J. in *Fennia*,[72]and

[70] The following is an example of the process. After preparing the slip a Lloyd's broker takes the slip around the market seeking £100 pounds for the subject matter of insurance. Underwriter A wishes to participate in the insurance and initials the slip, stating that he is preparing to take 60 percent of the risk which is £60. Underwriter B wishes to take 30 percent of the risk which is £30 pounds. However, when the slip is closed the broker obtains another 60 percent of subscription from Underwriter C. So 150 percent of subscription is obtained at the end of the day. According to the singing down process, the final subscription of A is reduced to 60percent x 100percent/150percent = 40percent = £40; the subscription of B is reduced to 30percent x 100percent/150percent =20percent = £20 and the subscription of C is reduced to 60percent x100percent/150percent = 40percent= £40. All subscriptions total £100, exactly 100 percent.

[71] Malcolm Clark, *The Law of Insurance Contracts*,(4th ed, LLP, 2002) at p 286.

[72] [1983] 2 Lloyd's Rep 287.

the learned judge accepted that Lloyd's custom and practice had conferred legal status on signing down. These views were subsequently approved by the Court of Appeal[73]. A clear legal basis for signing down is now established

A number of reasons for the practice of signing down may be given. The practice, first, enables brokers to show their business to more underwriters and these larger lines make the risk appear more attractive to following underwriters. In this way signing down enables the broker to reach 100 per cent subscription, (and therefore full subscription) for the assured, more quickly. Secondly, if the assured subsequently wishes to increase the value insured, the initial commitment of underwriters to a larger percentage than ultimately obtained provides an indication of where some spare capacity may be found.

2.7.2 If the Broker Made no or little Attempt to Over-subscribe the Slip or Otherwise Failed to Make His Target, is there any Remedy the Underwriters can Get and if so What is Legal Basis for that Remedy?

2.7.2.1 Signing Indication

It is quite difficult for the underwriter to subscribe the slip if his subscription may be reduced to an uncertain extent. Consequently, the broker will generally be asked to provide a "signing indication". The underwriter will take heed of such indication given in deciding the size of line to write, judging the proportion of the risk he considers prudent to assume not by reference to the size of the line he actually writes but by reference to that line proportionally reduced according to the indication of the broker.

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[73] *The Fe nnia* [1983] 2 Lloyd's Rep 287

2.7.2.2 Indication- a Promise Given by the Broker

It is readily apparent, however, that a signing indication which proves to be erroneous will cause some loss to the underwriter: if the degree of over-subscription is greater than indicated, the underwriter will receive proportionately less of the risk than he had hoped for; if, on the other hand, the degree of over-subscription is less than indicated by the broker, the underwriter may face a greater proportion of the risk than he may have judged prudent. So the indication could amount to a promise given by the broker for which the underwriter provides consideration by entering into a contract of marine insurance. A remedy for these eventualities is clearly desirable.

2.7.2.3 Remedy

The underwriter may be able to have an action against the broker in tort for a misleading signing indication. This kind of remedy was considered at length by Hobhouse J. and the Court of Appeal in *General Accident Fire and Life Assurance Corporation v Tanter (the Zephyr)*[74] Hobhouse J. denied the existence of any collateral contract between the broker and the leading underwriter on the terms that his liability on the slip would be reduced to one-third, but held that the broker had been negligent in giving the signing indication and was thus liable to the leading underwriter in tort.

There was no appeal to the Court of Appeal on the finding of liability towards the leading underwriter, but the Court of Appeal nevertheless expressed the view that questions of his nature ought to be analyzed in terms of contract rather than in terms of tort and that, conceptually, it would have been more satisfactory to hold the broker liable for breach of an implied undertaking to use his best endeavours to ensure that there would be a 300% subscription on the slip. The negligence alleged lay in failure

[74] [1984] 1 Lloyd's Rep 58.

to exercise the best endeavours to achieve the signing down indication; it was assured that the lack of best endeavours could be equated with lack of reasonable care. The following observations are from the Court:[75]

> "There are therefore no legal reasons why a legal duty of care of a broker to take reasonable steps to see that the signing down indication is achieved should not be recognized. There are no practical or business reasons why it should not be; indeed the business reasons are strongly in favour of recognizing it. The market appears itself to recognize the existence of such a duty..."

[75] *Ibi d,* at p 75.

CHAPTER 3

THE ROLE OF BROKERS AT THE FORMATION STAGE OF MARINE INSURANCE CONTRACTS

INTRODUCTION

As stated in the previous Chapter, during the formation of marine insurance contracts, it is the broker who prepares the slip for the prospective assured and takes the slip around the market searching for subscriptions. Once the contract is concluded the broker prepares the policy wording at the later stage. Accordingly, it is clear that the broker plays a significant role in placing insurance at the London market. As Shaw states,

> "The London market is the part of the British insurance industry which specialises in covering major or complex risks- that is, almost exclusively, risks incurred by business and not by private consumers. It is characterised by the use of brokers, who are the commercial marketing arm of the industry and whose function is to seek out the best cover to answer their customers' needs."[76]

According to the practice in the London market, the insurance contract with a Lloyd's member is normally arranged by a Lloyd's broker.[77] The Lloyd's broker is a

[76] Gordon Shaw, *The Lloyd's Broker*, (1st ed. Lloyd's of London Press Ltd. 1995) at p 71.

[77] The privileged position of Lloyd's brokers was examined by Sir Henry Fisher in 1980 who concluded that they should be entitled to retain their monopoly as a result of:

(a) their specialised knowledge and experience;

(b) the additional financial capacity required to discharge their strict liability to Lloyd's underwriters for premiums;

(c) the additional administrative infrastructure required to enable them to fulfil the additional duties which member of the Lloyd's community. There is a special bonding relationship between the Lloyd's broker and Lloyd's community. The Green Book[78] sets out the basis for this relationship in the first paragraph of its foreword as follows: "Lloyd's brokers have a special relationship with Lloyd's in that Lloyd's provides both a market place and a regulatory authority for them". Toward the end[79] of the Green Book the following passage appears: "...Lloyd's should reserve the right to test the character and suitability of individual members of a Lloyd's broker's staff". Accordingly a prospective Lloyd's broker must satisfy the Council of Lloyd's that they are a suitable partnership or body corporate to negotiate business at Lloyd's, through their integrity, financial status and market experience and ability.

If the assured's broker is not accredited at Lloyd's, he will have to contact a Lloyd's broker to obtain the insurance at Lloyd's and share the commission with the Lloyd's broker. The broker who produces the proposal to the Lloyd's broker is called the "producing broker". The Lloyd's broker who actually "places" the insurance is called the "placing broker".

The current Chapter will focus mainly on legal issues about duties, rights and liabilities of the broker. The duties of the broker include his duties to his main principle, the assured, and the duties of brokers to the third party, the insurer, when the broker is playing a dual role. Among the duties of the brokers to the insurer, the duty of utmost good faith is the most important one and this will be analyzed in more

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do not usually fall upon non-Lloyd's brokers, such as the preparation of a policy;

(d) the personal relationships that are built between underwriters and brokers which would be diluted by opening the Room to all brokers; and

(e) the commitment that the Lloyd's broker has to Lloyd's and his central role there, in particular his crucial part in the marketing of Lloyd's around the world.

The position of the Lloyd's brokers has not of yet attracted the attention of the authorities dealing with the competition law issues within the EU.

[78] Cons ultative Document: The Regulation of Lloyd's Brokers, November 1987.

[79] The Regulation of Lloyd's Brokers, November 1987, p B 10.

detail, including the duty of disclosure, the duty not to make misrepresentation and the recent reform of insurance law.

3.1 DUTIES OF THE BROKER

3.1.1 Duties of Brokers to Assureds

An insurance broker is the agent of the principal who employs him to carry out a specific piece of business, namely, obtaining a contract of insurance for a required term. Accordingly, the starting point in the legal analysis is that the broker is the agent of the assured.[80]

The extent of broker's obligations depends on the nature of the relationship between the broker and the assured. There are two main scenarios: first where the duty is set out in specific contractual terms and secondly where are no such terms in the contract.

If the contract contains express terms and sets out express rights and duties of the assured and the broker, e.g. the broker agrees to obtain insurance for a specific risk for a specific period at a specific rate, the duties of the broker to the assured can be found in the agreement. The broker in that case is under a duty to exercise his duties in accordance with contractual terms. He must follow every single step set in the contract. He cannot exercise any discretion unless there is specific authorization in the agreement.

In the first scenario the duties of the broker to the assured are clearly defined in the contract. The broker must exercise his duties according to the contract terms.[81]

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[80] There are also instances which the broker acts in dual capacity which will be further discussed below at p 111.

[81] In *Strong v. S.Allison* [1926] 25 Lloyd's Rep 504, the broker was held to be in breach of his duty to fail to make the contracts of insurance according to instructions of assured. In *Talbot Underwriting Ltd v. Nausch Hogan*

However, in the second scenario the duties of the broker have not been contractually agreed. Perhaps the best *short* statement of the duty of the broker to the assured in this scenario is as follows "It is the broker's responsibility to arrange as wide a cover as is required at the most economical rate to his client, bearing in mind the financial security and service provided by the underwriter." [82] In a broader sense these requirements represent an obligation on the broker to take "reasonable care". However it is necessary to define further the detailed nature and extent of the broker's duty of care.[83] It is vital at this stage to evaluate what can reasonably be expected of the broker under the heading of "reasonable care".

3.1.1.1 Duty to Obtain Sufficient Cover

During the process of obtaining insurance, an insurance broker owes a duty to the assured to obtain *sufficient* cover. In *Yuill & Co v. Robson*[84] cattle were purchased at Buenos Ayres, at a price including cost, freight, and insurance, for shipment to Durban; by the contract of sale the seller was to insure the cattle "against all risks." The broker of the seller obtained and handed a policy of insurance, which was an ordinary "all risks" Lloyd's policy, to the buyer but which, in accordance with the usual practice among insurance brokers and underwriters with regard to such policies, contained a warranty against "capture, seizure and detention, and the consequences thereof." Disease broke out among the cattle on the voyage, and on arrival at Durban the authorities forbid their landing and the cattle were consequently slaughtered. The seller was held to be liable to the buyer in damages for breach of contract because his broker obtained insurance cover only for certain risks.

& Murray Inc (The Jason 5) [2006] Lloyd's Rep IR 531, the assured instructed the broker to obtain a shipbuilders' all risks policy of insurance on the vessel's hull and machinery, including specifically the shipyard as co-assured. The broker managed to place the risk in London market but the shipyard was not named as a co-assured. It was held that the assured and the shipyard had suffered loss from the broker's failure to included the shipyard as a co-assured under the policy, the broker was reliable.

[82] Chartered I nsurance Institute Journal No. 10/1.

[83] Christopher Henley, *The Law of Insurance Broking*, (2nd ed, Sweet & Maxwell, 2004) at p 25.

[84] [1908] 1 KB 270.

In *Yuill & Co v. Robson,*[85] the legal analysis is very straightforward. However, in some other cases, courts have extended the duty further.

In *Youell v Bland Welch & Co Ltd,*[86] where the reinsurance cover expired before the primary insurance that it was supposed to protect. The brokers knew that the insurers (the reassured) were unaware of the time limit on the reinsurance cover, and that it was not part of their orders for reinsurance. It was held by Philip J. that the broker's failure to inform insurers and to obtain the appropriate extension of reinsurance were breaches of the duty to take reasonable care. The insurers were negligent in failing to check that the reinsurance contract protected them as they wished. On the facts and the evidence, the brokers were liable for 80 per cent of the insurer's liability. In this case an insurance broker not only owes the assured the duty to obtain appropriate cover and but also owes the assured the duty to inform him of limitations in the insurance cover. This extension of the duty should be construed in all types of insurance contracts, since the limitation of the insurance cover is one of the important elements in the extent of the insurance cover. It will directly affect the sufficiency of the insurance cover.

Similarly in *Aneco Reinsurance Underwriting Ltd. (in liquidation) v. Johnson & Higgins Ltd*[87] the duty of care was extended to giving advice as to the availability of cover. The insurer was invited by the broker to subscribe to a particular risk. The insurer agreed but stated that he would subscribe only if the broker obtained reinsurance cover on similar terms. The broker obtained reinsurance cover but not for the whole risk as the market turned against the risk. The insurer suffered losses in excess of US $ 35 million. Only US $ 11 million was recoverable under the

[85] *Ibi d.*

[86] [1990] 2 Lloyd's Rep 431.

[87] [2002] 1 Lloyd's Rep 157.

reinsurance contract. However, reinsurers denied they should have to pay even for that amount on the basis that the broker misrepresented the risk to them. The re-insurers were successful in their plea. The reassured (insurers) turned to the broker for compensation and claimed: a) US $ 11 million- for losing the cover due to the broker's misrepresentation and b) US $ 24 million- for not advising that it was going to be difficult to get reinsurance cover for this particular risk.

The House of Lords held that[88]

> "the duty of the brokers was not confined to the obtaining of excess of loss protection for Aneco and informing Aneco that they had done so; at the very least they owed a duty to inform Aneco whether or not reinsurance was available; if they had told Aneco that reinsurance was not available, it would have been obvious to Aneco that the unavailability was due to the current market assessment of the risks."

Therefore, lack of advice allowed the insurers to get compensation for the US $ 24 million.

This case is clearly different from *Youell v Bland Welch & Co Ltd.*[89] T he facts in *Aneco* were rather extraordinary. In this case, the insurer agreed to subscribe, but he would only do so if the broker could obtain reinsurance cover on similar terms. That was actually a specific condition in the agency agreement between the insurer (re-assured) and the broker. Here the broker was under a duty to exercise these duties to the assured in accordance with the contract terms strictly.

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[88] *Ibi d,* at p 180.

[89] [1990] 2 Lloyd's Rep 431.

3.1.1.2 Duty to Obtain Insurance Cover with the Most Suitable Insurer

In the execution of the contract of agency, the broker's duty is to use reasonable skill and care and to act honestly. The payment of commission to the broker is to reward him for his expertise in placing the risk, since the assured usually leaves the broker to obtain the best terms at the best rate in the broker's discretion. A broker may therefore be negligent if he recommends an insurer to the assured which any broker with a reasonable knowledge of the insurance market place might consider to be unsuitable. In *Osman v Moss*[90] the assured was foreign and did not read or understand English well. His broker recommended to him a motor insurance company known to be in financial difficulties. It was held that the broker was negligent in recommending an insurer known to be in financial difficulties, and the assured was entitled to recover.

However, if the broker is in the process of obtaining reinsurance for a professional insurer, as opposed to insurance for a client not versed in insurance, it may be that he is entitled to rely to some degree upon the knowledge and ability of that professional insurer, who can be expected to know something about the quality of the market selected. Nevertheless, in *Youell v Bland Welsh*[91] Mr Justice Phillips said: "I can see no justification for imposing on the client a duty owed to the broker to check the suitability of the cover obtained with a degree of care similar to that which the broker is paid to employ when obtaining it." Nevertheless, the judge reduced the damages payable by the broker to reflect the contributory negligence of the professional insurer, although only by 20 percent. The rationale for this is that the professional client owes a duty of care to run its business properly.

It could be said that this case reflects two sometimes conflicting notions. On the

[90] [1970] 1 Lloyd's Rep 313.

[91] [1990] 2 Lloyd's Rep 431 at p 454.

one hand an insurer may be expected to have sufficient expertise to understand and assess the reinsurance policy. However, against this, it seems wrong to penalize an insurer for failing to notice flaws or errors in the reinsurance policy when it has appointed a broker to perform this function. It could be said that Phillips J.'s decision accurately reflects the balance to be sought between these notions.

3.1.1.3 Duty to Obtain Insurance Cover within a Reasonable Time

An insurance broker is under a duty to obtain insurance cover within a reasonable time. If the broker is unable to perform the contract within a reasonable period of time or at all, he must inform the assured immediately so that the assured is in a position to protect his interests, and is not misled into believing that these interests have already been protected by the broker's performance of the contract.

In *Cock, Russell v. Bray, Gibb*[92] the assured asked his broker to obtain insurance cover for his cargo in one day, but the broker failed to do so. The assured claimed damages from the broker on the ground that he did not comply with his duty to obtain insurance cover within a reasonable time. Mr. Justice Bailhache held[93]

> "In my opinion it was too late that evening to take any effective steps towards getting this risk covered. On Saturday morning Mr. Brown, one of the brokers employed by the defendants, took the draft slips round to the British General Insurance Company...The leading Underwriter of the British General did not like the look of the risk either from the point of view of the steamer or the subject matter. Mr. Brown, according to his evidence, showed the draft slip to other Underwriters and failed to get it underwritten... After that it was impossible to get this cargo insured at any sort of premium that would be worth paying. Consequently, the whole case turns on whether there was an undue delay on the part of the brokers in failing to get this risk underwritten on the Saturday. In my opinion, having regard to the nature of the risk, the defendants were not guilty of any

[92] [1920] 3 Lloyd's Rep 71.

[93] *Ibi d,* at p 72.

unreasonable delay at all."

The reasonable time requirement is not a fixed pre-determined period. In the above case, a delay of less than one day was thought not to be unreasonable but in other circumstances a delay of one day may be considered unreasonable. For instance, if a prudent, experienced broker is asked to obtain insurance for a popular risk, one day may be considered sufficient time and failing to secure insurance may be attributed to unreasonable delay. Accordingly, the concept of reasonable time depends on different circumstances. It can be one day, one week, one month or longer, depending on the commercial context.

3.1.1.4 Duty Regarding Policy Wording

It is the broker who obtains the policy from Lloyd's market for the assured. Accordingly, during the process of obtaining insurance, the broker is also responsible for the policy wording. In cases where this duty is exercised, it should be remembered that the contract might be interpreted *contra proferentem*[94] at a later stage. The extent of this duty is wide enough to encompass the following elements:

(1). If the assured inquiries about the meaning of the policy wording, the insurance broker is under a duty to advise the assured as to the meaning of his policy.

In *Melik & Co. Ltd. v. Norwich Union Fire Insurance Society Ltd,*[95] the assured inquired whether the policy remains in effect when the burglar alarm is temporarily out of action. The broker answered positively without checking. Woolf, J (as he then

[94] *Con tra Proferentem* Rule: Ambiguous wording in a contract should be interpreted against the party who is relying on it/or who has put it in the contract.

[95] [1980] 1 Lloyd's Rep 523.

was) suggested that[96]

> "it was the broker's duty to raise the matter much more clearly with the defendants and to get the clear and positive answer that the plaintiffs required; the broker had instead relied on his own judgment that the plaintiffs were insured and if they were not insured he would have been in default and that would have been sufficient to find liability assuming that there was a loss in respect of that default."

(2). An insurance broker is also bound by a duty to bring important clauses in the policy (e.g. exemption clause) to the assured's notice. In *JW Bollom & Co Ltd v Byas Mosley & Co Ltd,*[97] BM had acted as property insurance brokers for JWB for 30 years. After some false alarms, JWB decided not to switch a yard alarm on over the weekend. A fire broke out and caused GBP 8 million worth of damage. JWB's insurers repudiated liability on the basis that there had been a breach of clauses requiring the maintenance and use of alarms and protections, but settled the claim at GBP 5 million. JWB sued BM for failing to take reasonable steps to bring the said clauses to its notice. It was held that if JWB had been aware that a failure to keep the alarms in operation would entitle the insurers to repudiate liability, they would have taken steps to ensure that the alarm was set. The BM was in breach of his duty of care.

(3). An insurance broker is also under a duty to retain all the relevant documents, e.g. the slip, and policy.

In *Grace v Leslie & Godwin Financial Services Ltd,*[98] it was held that an insurance broker was under a duty to keep policy slips relating to his principal's policy throughout the period during which a reasonable broker might regard a claim as

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[96] *Ibi d,* at p 534.

[97] [2000] Lloyd's Rep IR 136.

[98] [1995] LRLR 472.

being possible, so that he was ready to collect claims when necessary. Failure to retain relevant documents for such a period amounted to breach of contract.

(4). An insurance broker is under a duty to check the contents of the policy and the policy wording.

In *Tudor Jones v Crowley Colosso Ltd*[99] the assured instructed the broker to obtain cover and approved the terms obtained, which included an exclusion clause applicable to any part of the works for which a completion certificate had been issued before the damage occurred. Later when there was damage the following market relied on the exclusion clause to deny the claim for damage to the marina. It was held that that C were in breach of their duty of care by failing to make clear to the following market that full cover for the project should include any phases which might be completed before the others. As a prudent broker, C should have drawn the instructing broker's attention specifically to the exclusion clause that represented a potential problem.

3.1.1.5 Duty to provide Advice or Information to the Assured

During the process of formation of insurance contracts, the broker also owes a duty to provide sufficient advice and information to the assured. Which kind of information should the broker tell the assured? What level of advice is required?

(1) An insurance broker is under a duty to provide qualified information in accordance with the inquiries of the assured. In *Sarginson Brothers v. Keith Moulton & Co. Ltd*,[100] the assured desired to insure their stock of timber against war risks under the commodity Insurance Scheme on 30th Oct 1940.

[99] [1996] 2 Lloyd's Rep 619.

[100] [1942] 73 Ll L Rep 104.

They sought the advice and assistance of the broker. The broker informed them that their stock of timber was not insurable under the scheme or at all, and the assured accepted and acted upon that advice. Later, the stock of timber of the assured was destroyed by enemy action and they found that their stock was insurable under the scheme. It was held that the broker was negligent in expressing an unqualified opinion without taking reasonable care to furnish themselves with information to support that opinion. Thus, he was liable for the damages suffered by the assured.

(2) An insurance broker affecting an insurance policy on behalf of the assured owes a duty of care to inform the assured of any exemption under the policy, which may affect the cover given. In the case of *McNealy v Pennine Insurance Co,*[101] the defendant insurance company offered motor insurance at low premium rates to certain categories of motorists; specifically excluded from such categories were, *inter alia*, "part-time musicians." The plaintiff approached the defendant brokers with a view to affecting a motor insurance and also with their assistance, he completed a proposal form stating his occupation truthfully, as that of a property repairer. The plaintiff did not disclose, nor he was he asked whether he was also a part-time musician. The defendant insurers subsequently denied liability with respect to damage suffered by the plaintiff in a motor accident, on the grounds that the plaintiff as a part-time musician was excluded by the policy. At first instance the brokers were held liable to indemnify the plaintiff. It was held, dismissing the brokers' appeal, that since they were aware of the exempted categories under the policy, they were in breach of their duty of care to the plaintiff in failing to inquire whether he fell within such exemptions.

[101] [1978] 2 Lloyd's Rep 18.

(3) It is the insurance broker's duty to advise the assured about the information and extent of information that the assured must disclose to the insurer regarding the subject matter of the insurance. In *John Woods (Lisglynn) v. Carroll*[102] the appellant company insured its vehicles through an insurance broker. It informed the broker, by telephone, that it had arranged to trade-in one of its old vehicles for a new vehicle, but did not give him all the details required to put the new vehicle on cover. The company thought that the missing details were not vital, but was not warned by the broker that the new vehicle was not covered. The new vehicle was involved in an accident for which the company was found liable to pay damages. At first instance, Gibson L.J. directed judgment to be entered for the broker in an action by the company to recover damages from him. Allowing the appeal, the Court of Appeal held that it is the duty of an insurance broker, to warn a client that he is not covered until all the required details are produced and the broker had not done so in this case.

[102] [1980] 3 NIJB

3.1.2 Duties of Brokers to Insurers

The broker's status as agent of the assured does not exclude all possibility of him being liable to persons other than the assured.[103] In some circumstances, a broker may act in a dual capacity as the agent for both the assured and the underwriter, for instance, regarding the placing of reinsurance and in accepting risks under a binding authority.[104] Generally speaking, there are two primary duties owed by brokers to the insurer, the first is the duty to pay the premium to the insurer and the second is the duty of utmost good faith.

3.1.2.1 The Duty Regarding the Premium

The duty of the brokers to the insurer regarding to the premium is stated in s. 53(1) of the MIA 1906:

> "Unless otherwise agreed, where the marine insurance policy is effected on behalf of the assured by a broker, the broker is directly responsible to the insurer for the premium..."

From the wording of this section, it can be said that: first, "directly" means that the insurer cannot claim the premium from the assured directly and he can only claim it from the broker. Second, "the broker is directly responsible" means that the insurer can claim the premium from the broker even if the broker has not received the premium from the assured. Third, the broker legally becomes liable to pay the premium to the insurer as soon as the premium becomes due.

The rule of law by which it is the broker, but not the assured who is liable to the

[103] See generally M Clarke, *"Insurance Intermediaries: Liability to Third Parties"* [1995] IJIL 162.

[104] See p 111 below regarding further discussion of binding authority and placing of reinsurance.

insurer for the premium is founded on the custom in the London market for more than about a century.

In *Power v. Butcher*[105] Mr. Justice Bayley explained the matter as follows:

> "According to the ordinary course of trade between the assured, the broker and the underwriter, the assured does not in the first instance pay the premium to the broker, nor does the latter pay it to the underwriter. But, as between the assured and the underwriter, the premiums are considered as paid. The underwriter, to whom, in most instances, the assured are unknown, looks to the broker for payment, and he to the assured. The latter pay the premiums to the broker only, who is a middleman between the assured and the underwriter. But he is not merely an agent; he is a principal to receive the money from the assured, and to pay it to the underwriters."

The rationale for the custom of looking to the broker rather than the assured for payment was pointed out by Lord Wensleydale (then Parke J.) in *Power v. Butcher:*[106]

> "by the course of dealing (that is, by the custom) the broker has an account with the underwriter; in that account the broker gives the underwriter credit for the premium when the policy is effected, and he, as agent of both the assured and the underwriter, is considered as having paid the premium to the underwriter, and the latter as having lent it to the broker again, and so becoming his creditor. The broker is then considered as having paid the premium for the assured."

Later in *Universo Insurance Co. of Milan v. Merchants Marine Insurance Co. Ltd.*,[107] Mr. Justice Collins provided a justification for making the broker directly liable to the insurer on a fiction. He explained the position in this way:[108]

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[105] (1829) 10 B. & Cr. 329 at p 340.

[106] *Ibi d,* at p 347.

[107] [1897] 1 QB p 205.

[108] *Ibi d,* at p 209.

> "It is a well recognised practice in marine insurance for the broker to treat himself as responsible to the underwriter for the premiums; by a fiction he is deemed to have paid the underwriter, and to have borrowed from him the amount with which he pays. If that is a correct explanation of the origin of the custom, it is as applicable to this form of policy as to a Lloyd's policy. No doubt there is here a contract to pay by the assured, but by custom the broker is treated as personally liable, the same fiction being applicable, namely, that the broker has paid the premium, and has so absolved the assured from his liability, having first borrowed the money from the underwriter to make the payment."

According to Mr. Justice Collins's explanation the practice of making the broker directly liable to the insurer is based on the fiction that once the contract is concluded, it is assumed that the insurer loans the amount of premium to the broker so that the broker becomes debtor of that loan. The Court of Appeal affirmed this fiction and Lord Esher M.R. said,[109]

> "It has never been supposed hitherto that that course of dealing is in contradiction of the terms of the policy. It is not a contradiction of the terms of the policy, but a mode of carrying them out. The policy says that the assured is to pay the premium, but the mode in which the payment is to be made is according to the custom."

This view gets further support from the judgment in the case of *Prentis Donegan & Partners Ltd. v. Leeds & Leeds Co. Inc.*[110] which states that by reason of the custom which had itself given rise to s. 53(1) of the Marine Insurance Act, 1906 the premiums were deemed to have been paid by broker to underwriter and advanced by the underwriter back to broker again by way of loan; so even if the policy contained an express clause requiring the assured to pay the underwriters, the liability remained that of the broker not of the assured.

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[109] [1987] 2 QB 93 at p 96.

[110] [1998] 2 Lloyd's Rep 326.

However, the fiction was challenged in the later case of *Heath Lambert Ltd. v. Sociedad de Corretaje de Seguros*[111].

Heath Lambert Facts

INC, a dredging company and a substantial shipowner in Venezuela, retained SCORT, a firm of Venezuelan insurance brokers, to place its marine insurance. In 1994 Banesco became the local insurer, fronting for the London reinsurance market. As part of its overall responsibilities, SCORT was also involved in obtaining the reinsurance for Banesco in the London market. For this purpose, Blackwell Green Ltd. (since subsumed into Heath Lambert), a firm of Lloyd's brokers, was retained as placing broker.

The 1996 reinsurance was duly placed by Heath Lambert with a number of Lloyd's syndicates and London market insurance companies. The Cover Note issued by Heath Lambert on Jan. 26, 1996 and addressed to SCORT confirmed that reinsurance had been effected on the basis of "All clauses, terms and conditions as original and to follow settlement of same". Amongst the conditions in the insurance contract was a term providing for "Warranted premium payable on cash basis to London Underwriters within 90 days of attachment". Following the placement of the reinsurance in London, a number of extensions were agreed by underwriters between January, 1996 and July, 1996, in respect of each of which additional premiums were payable. The premiums due on these extensions were not paid by either defendant.

The issues regarding the payment of premiums that arose from this case are as follows:

(1) whether SCORT or Banesco were liable to pay the premiums to Heath Lambert:

[111] [2005] 1 Lloyd's Rep 597.

(2) whether Heath Lambert was under any liability to pay underwriters the premium under s. 53(1) of the Marine Insurance Act, 1906 or otherwise, and insofar as Heath Lambert did pay the premium did it do so as a volunteer with no right to be indemnified.

SCORT, in this case was the producing broker, Bansco was the assured and Heath Lambert was acting as a placing broker. The issues before the judge were whether the assured and the producing broker were liable for the premium to the placing broker and whether the placing broker was liable for the premium to the underwriter.

As to the first issue, it was held by Hirst J., that,[112]

> "Where a producing broker employed a placing broker at Lloyd's, the general rule was that there was privity of contract between those brokers, and no privity between the principal and the placing broker. The producing broker was liable to the placing broker for the premium, which the producing broker had to collect from the principal. There might however be special factors which led to the exceptional case that there was privity between principal and placing broker, but even then the privity might not be exclusive. It was not possible at this stage to decide which of the defendants was liable for the premium. There was a reasonable prospect that Scort was not liable and there was a reasonable prospect that Banesco was liable. It would be unjust to release Banesco from the action at this stage unless it was certain that the claim against SCORT was bound to succeed."

The Judge took the view that the case against SCORT was much stronger than that against Banesco, but concluded that there was nonetheless a reasonable prospect that SCORT was not liable. He concluded therefore that it was not possible to say which defendant was liable. However, the judge also confirmed the general rule that when a producing broker employed a placing broker the producing broker was liable to the placing broker for the premium, which the producing broker had to collect from the principal.

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[112] *Ibi d,* at p 597.

As to the second issue, it was held by L.J., Phillips that,[113]

> "it is important to note that it is not (as we understand it) suggested that the case falls outside s. 53(1) of the 1906 Act. This is a case in which the policy was effected on behalf of the re-assured by a broker, namely Heath Lambert, so that the effect of s. 53(1) is that, "unless otherwise agreed", Heath Lambert was directly responsible to the reinsurers for the premium and the reinsurers would have been liable to the re-assured for any losses under the policy. It is also common ground that "unless otherwise agreed" it is the general rule in these circumstances that the broker (Heath Lambert) has a cause of action in its own right against the re-assured in respect of unpaid premiums...Since it is not suggested that it was "otherwise agreed", it follows that it is common ground that SCORT or Banesco was in principle liable to Heath Lambert for the premium. ..It seems to us that the answer to that question should in principle depend upon the terms of the relevant policy."

In this case, the terms of the brokers' cancellation clause quoted in the insurance contract show that Heath Lambert was a party to the terms of the policy. Thus the reinsurers' right against Heath Lambert to the premium stems from the policy, as does Heath Lambert's right to recover premium from SCORT or Banesco and Banesco's right to recover any relevant losses under the policy from the reinsurers. According to the judgment from this case, it can be argued that the fiction theory was superseded by the wording of "unless otherwise agreed" in s.53(1) of the MIA 1906 which intends to regulate payment of premiums. Whether the broker or the assured is liable for the premium all depends upon the true construction of the policy. Therefore, this section did not have an impact on the provisions of the marine insurance contract. In the light of this, if there is a premium warranty in the contract, which states that it is the assured who will pay the premium, that warranty is not supplanted by the custom and can still operate.

[113] *Ibi d,* at p 601.

3.1.2.2 The Duty of Utmost Good Faith

3.1.2.2.1 General Introduction to the Broker's Duty of Utmost Good Faith

In *Carter v. Boehm*[114], Lord Mansfield stated:

> "Insurance is a contract based 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 underwriter trusts to his representation and proceeds upon the confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk as if it did not exist."

Subsequently, the English common law developed the concept that all contracts of insurance were contracts *uberrimae fidei*, it being required that each party to the contract must act with "utmost good faith" in dealing with the other.

The duty of utmost good faith in relation to insurance contracts is set out at Section 17 of MIA 1906. It states:

> "A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party."

The duty of utmost good faith on the broker to the insurer is set out at Section 19 and 20 of MIA 1906:

> "19. Disclosure by agent effecting insurance
> Subject to the provisions of the preceding section as to circumstances that need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer-
> Every material circumstance which is known to himself, and an agent to

[114] (1766) 3 Burr 1909.

insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to him; and

Every material circumstance that the assured is bound to disclose unless it came to his knowledge being too late to communicate it to the agent

20. Representations pending negotiation of contract

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

Compared to the position of the assured, it is fair to suggest that the broker's duty of good faith is more extensive. The broker is not only under the duty to disclose material circumstances that is known to the assured and himself but also the material circumstances that in the ordinary course of business ought to be known by himself.[115] The rest of this part will analyse the broker's duty of utmost good faith in more depth.

3.1.2.2.2 Duty of Disclosure

One of the key aspects of the duty of utmost good faith is the duty of disclosure. This aspect of the general duty is specifically developed in section 18 of MIA 1906. It states:

> "(1) Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract. (2) Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk."

[115] This will be further discussed in below at p 92.

3.1.2.2.2.1 The Test of "Materiality"

3.1.2.2.2.1.1 Meaning of Materiality

In sections 18, 19 and 20 of MIA 1906 there is reference to "materiality". The statutory test of the "materiality" of a circumstance is contained in section 18 (2), which states: "Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk."

In the case of *Container Transport International Inc and Reliance Group Inc v. Oceanus Mutual Underwriting Association Ltd.*[116] S tephenson LJ explained the wording of this section:[117]

> "...I conclude from the language of the sub-sections in their context and from the authorities that everything is material to which a prudent insurer, if he were in the proposed insured's place, would wish to direct his mind in the course of considering the proposed insurance with a view to deciding whether to take it up and on what terms, including premium."

Here it should be mentioned that there has never been any uncertainty in marine insurance law that it must be a hypothetical **prudent insurer**[118] who determines the "materiality" of a circumstance. Lord Mustill in *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd.*[119] stated that,

> "...I pause for a moment to consider the other conspicuous feature of the

[116] [19 84] 1 Lloyd's Rep 476 (CA)

[117] *Ibi d,* at p 529.

[118] Emphasis added

[119] [1994] 2 Lloyd's Rep 427 at p 445.

> earlier law, namely, the presence in the equation of the hypothetical prudent underwriter. Just when and how this feature was added cannot be deduced from the materials now available, but it is at least as old as 1823...and may well be much older. It is a fair assumption that at least one reason must have been that the principles stated by Lord Mansfield required fair dealing, and it would have been unfair to the assured to require disclosure of matters which a reasonable underwriter would not have taken into account."

The wording of section 18 (2) makes it clear that it is the judgment of a hypothetical prudent insurer that determines whether the undisclosed circumstance is material or not. However, the section fails to clarify the degree or manner of influence which the undisclosed information has to have upon the mind or judgment of the prudent insurer.

3.1.2.2.2.1.2 How is the Materiality assessed?

The question following the above discussion is, how the "materiality" of a circumstance is assessed; in other words, what criterion is to be used to determine whether a circumstance is, or is not, material.

(a) The "Decisive influence" test

It was thought in some quarters that, to satisfy the test for materiality and to quality for the right to avoid the contract, the court has to be satisfied that a hypothetical prudent insurer has to be decisively influenced by the non-disclosure of the material circumstance. Lord Goff in *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd.* said: [120]

> " ...it must be shown that full and accurate disclosure would have led the prudent insurer either to reject the risk or at least to have accepted it on more onerous terms. This has been called the 'decisive influence' test."

[120] *Ibid,* at p 430.

This decisive influence test was supported in the judgment of Lloyd J, in the court of first instance,[121]

> "...whenever an insurer seeks to avoid a contract of insurance or reinsurance on the ground of misrepresentation or non-disclosure, there will be two separate but closely related questions:
> (1) Did the misrepresentation or non-disclosure induce the actual insurer to enter into the contact on those terms?
> (2) Would the prudent insurer have entered into the contract on the same terms if he had known of the misrepresentation or non-disclosure immediately before the contract was concluded?
> If both questions are answered in favour of the insurer, he will be entitled to avoid the contract, not otherwise."

(b) The rejection of the "Decisive influence" test

However, the Court of Appeal in *Container Transport International Inc and Reliance Group Inc v. Oceanus Mutual Underwriting Association Ltd.*[122] renounced the "decisive influence" test.

CTI is a container leasing company. CTI affected insurance with the defendant underwriters to cover damage suffered by their containers. However, CTI failed to inform the insurers that they had been refused insurance cover by other underwriters because of their inaccurate claims record.

The Court of Appeal ruled that the insurers were not liable under the policy, because under section 18(2) of the Act, the non-disclosure would have influenced the judgment of a prudent insurer. The court considered the meaning of the word

[121] *Container Transport International Inc and Reliance Group Inc v. Oceanus Mutual Underwriting Association Ltd.* [1982] 2 Lloyd's Rep 178.

[122] [19 84] 1 Lloyd's Rep 476 (CA)

"judgment" within the context of section 18. Kerr, L.J., stated,[123]

> "The point at issue turns mainly on the meaning of 'judgment' in the phrase 'would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk'. The judge in effect equates 'judgment' with 'final decision', as though the wording of these provisions "would induce a prudent underwriter to fix a different premium or to decline the risk...This interpretation differs crucially from what I have always understood to be the law... the word 'judgment'- to quote the Oxford English Dictionary to which we were referred- is used in the sense of 'the formation of an opinion'. To prove the materiality of an undisclosed circumstance, the insurer must satisfy the court on a balance of probability- by evidence or from the nature of the undisclosed circumstance itself- that the judgment, in this sense, of a prudent insurer would have been influenced if the circumstance in question had been disclosed. The word 'influenced' means that the disclosure is one which would have had an impact on the formation of his opinion and on his decision making process in relation to the matters covered by s18(2)."

This test was also rejected in the case of *Pan Atlantic Insurance Ltd v. Pine Top Ltd.*[124] In this case, Pan Atlantic reinsured their excess of loss with insurers other than Pine Top for the years 1977-1979. Pine Top were reinsurers for the first time under the 1980 contract. As Pan Atlantic in 1982 sought a reduced premium, it was natural for Pine Top to be primarily interested in their loss record, before any re-arrangement of premium would be discussed. However, the loss record of Pan Atlantic over the years 1977-1979 was misrepresented to Pine Top and there were additional losses sustained by Pan Atlantic between 1980 and 1982 which were not disclosed to them either. Consequently, Pine Top declined any payment of losses, on the grounds of non-disclosure. The House ruled in favour of the underwriters, in that there was a material non-disclosure and, thus, the insurer was entitled to avoid the contract.[125]

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[123] *Ibi d,* at pp 491, 492.

[124] [1994] 2 Lloyd's Rep 427.

[125] Although this was non-marine reinsurance, the point of law was considered as one of construction of ss 18 and 20 of the MIA 1906

In *Pan Atlantic*, Lord Mustill rejected the decisive influence test:,[126]

> "...must it be shown that full and accurate disclosure would have led the prudent underwriter to a different decision on accepting or rating the risk; or is a lesser standard of impact on the mind of the prudent underwriter sufficient; and, if so, what is that lesser standard?...The main thrust of the argument for Pan Atlantic is that this expression calls for the disclosure only of such circumstances as would, if disclosed to the hypothetical prudent underwriter, have caused him to decline the risk or charge an increased premium. I am unable to accept this argument...I am bound to say that in all but the most obvious cases the 'decisive influence' test faces them with an almost impossible task. How can they tell whether the proper disclosure would turn the scale? By contrast, if all that they have to consider is whether the materials are such that a prudent underwriter would take them into account, the text is perfectly workable...Accordingly, treating the matter simply as one of statutory interpretation I would feel little hesitation in rejecting the test of decisive influence."

Lord Slynn of Hadley agreed with Lord Mustill:[127]

> "I agree with him that the 'decisive influence' test is to be rejected and that a circumstance may be material for the purposes of an insurance contract (whether marine or non-marine) even though had it been fully and accurately disclosed it would not have had a decisive effect on the prudent underwriter's decision whether to accept the risk and if so at what premium..."

And Lord Goff made his decision to support Lord Mustill as follows,[128]

> "I turn next to the first question, which is whether the decisive influence test is the appropriate test for deciding whether a fact which has not been disclosed is a material fact. Here there is a difference of opinion between my two noble and learned friends, Lord Lloyd accepting the decisive influence test and Lord Mustill rejecting it. On this point, I respectfully prefer the

[126] [1994] 2 Lloyd's Rep 427 at pp 434, 440, 441.

[127] *Ibi d,* at p 454.

[128] *Ibi d,* at p 431.

reasoning of Lord Mustill."

(c) The actual inducement test

The case of *Pan Atlantic Insurance Ltd v. Pine Top Ltd*[129] has advocated another test, the "actual inducement" test, which means that the actual insurer must be shown to have been induced into the contract by the material non-disclosure. Under this test, the insurer must show that he/she is induced to enter into the contract as result of that non-disclosure. Lord Goff stated this test in his judgment that,[130]

> "I accept that the actual inducement test accurately represents the law...I conclude that there is to be implied in the Marine Insurance Act, 1906 a requirement that a material misrepresentation will only entitle the insurer to avoid the policy if it induced the making of the contract; and that a similar conclusion must be reached in the case of a material non-disclosure." And Lord Mustill also supported the actual inducement test:,131 "... there is to be implied in the 1906 Act a qualification that a material misrepresentation will not entitle the underwriter to avoid the policy unless the misrepresentation induced the making of the contract, using 'induced' in the sense in which it is used in the general law of contract. This proposition is concerned only with material misrepresentations..."

In the later case of *St Paul's Fire and Marine Insurance v. McConnell Constructors Ltd*[132] the court of appeal supported the "actual inducement" test. In this case the appellants were a construction company contracted to build the parliament building in the Marshall Islands. They then effected a "contractors all risks" policy with the defendants but, at the time the insurance contract was drawn up, the plans shown to the insurers showed the building to have piled foundations. When subsidence later occurred, the insurers refused payment on the claim because it became evident that

[129] *Ibi d,* at p 427.

[130] *Ibi d,* at p 431.

[131] *Ibid,* at pp 447, 452.

[132] [1995] 2 Lloyd's Rep 116.

the building had been constructed without piled foundations. The court of Appeal ruled that there had been a non-disclosure of a material fact that had induced the insurers into underwriting the policy. Evans LJ. stated in his judgment that,[133]

> "there is only a right to avoid when the misrepresentation or non-disclosure was 'material' and when the actual insurer was induced thereby to enter into the contract...As regards inducement, it is common ground that the insurer must prove that he was induced by the non-disclosure or misrepresentation to enter into a contract on terms which he would not have accepted if all material facts had been made known to him, and that the test of 'inducement' is the same as is established by many authorities in the general law of contract."

(d) A presumption of the inducement

The "actual inducement" test has raised a related question, which is the notion of the presumption of inducement. In the *Pan Atlantic Insurance Ltd v. Pine Top Ltd*[134]case, Lord Mustill was clear in his mind that there is such a "presumption" in favour of the insurer. He stated in his judgment that,[135]

> "As a matter of common sense however even where the underwriter is shown to have been careless in other respects the assured will have an uphill task in persuading the Court that the withholding or misstatement of circumstances satisfying the test of materiality has made no difference. There is ample material both in the general law and in the specialist works on insurance to suggest that there is a presumption in favour of a causative effect."

(e) An exemption of the presumption of the inducement

But, it is worth mentioning that there are some circumstances where the presumption

[133] *Ibi d,* at pp 122, 124.

[134] [1994] 2 Lloyd's Rep 427.

[135] *Ibi d,* at p 453.

of inducement could be rebutted. For instance, if it could be shown that the insurer has not acted with the required care or skill the presumption of inducement will not apply.

An example of where rebuttal is possible is found in the judgment of Longmore J. in *Marc Rich and Co AG v. Portman.*[136] The assured were traders in crude oil, and to perform their sale and purchase contracts they chartered vessels to collect oil from several loading ports. They insured their oil cargoes against loss or damage, and they also insured against incurring liabilities as charterers. The insurance also provided demurrage cover. When demurrage claims arose, the insurers paid some, but declined payment in respect of some other substantial claims on the grounds of non-disclosure. This non-disclosure included the lack of any information regarding demurrage claims (the loss experience), which the assured had previously paid to the shipowners. Furthermore, the assured had failed to disclose adverse port characteristics (such as bad weather or difficult tides) which are likely to give rise to demurrage claims. The court ruled in favour of the assured in respect of the non-disclosure of the characteristics of the port, in that these were held not to be material facts. However, the insurer was entitled to avoid liability in respect of the non-disclosure of the loss experience. Longmore, J., held that in cases where imprudence in the writing of the risk can be shown, the presumption of inducement is rebutted and the underwriters must prove actual inducement in order to avoid the contract. However, in the present case the underwriters were able to show that they were in fact induced to enter the contract as a result of this non-disclosure. Longmore J. stated that,[137]

> "In my view, the question whether the actual underwriter was induced to write the relevant risk is to be determined by reference to the actual risks underwritten...In either event, the risk would not have been written on the terms it was. In these circumstances, I hold that insurers have shown that they were induced to write the risk on the terms they did by reason of the

[136] [19 96] 1 Lloyd's Rep 430.

[137] *Ibid,* at p 441.

non-disclosure of the loss experience."

Later, the impact of case *Assicurazioni Generali SpA v Arab Insurance Group (BSC)*[138] also seems to restrict the presumption of inducement significantly.

Assicurazioni Facts

The claimants, Generali, were an Italian insurer and reinsurer. The defendants, ARIG, were an insurer and reinsurer. The claim in this case arises out of a quota share retrocession contract whereby Generali retroceded to ARIG a 7.5 per cent line in respect of certain US contractors' risks insured by United Insurance Group of Pennsylvania. It is common ground between the parties that the contract was initially for the insurance year from 2 July 1992 to 2 July 1993 but that it was extended until 1 September 1993 by agreement between the parties in April/May 1993. ARIG continued to accept premium and pay claims until February 1999 but refused to pay any more claims after that date. Generali issued proceedings alleging that ARIG owed it over $6m by way of unpaid claims. ARIG's defense raised a number of issues one of which was that there was a breach of duty of utmost good faith on that the reinsurance was "supported" by Munich Re.

On 20 July 1992 ARIG received from Generila, as a part of the 62 page facsimile, copies of the security sheets which plainly showed which companies were participating in which sections of the packages. Munich Re were shown as participants in the programme on section A only and not on section B. ARIG said that he focused his attention on the retrocession slips and that he 'did not review the rest of the 62 page facsimile' 'with any care'.

[138] [2002] CLC 164.

It was held by J. Morison that,[139]

> "...had the information before the contract was made and his failure to read the enclosures is no excuse. If, which I doubt, Mr Rehman was under any misapprehension it was due to his own preconceived ideas and a failure to study the paperwork properly. In fact, 1 formed a favourable view of Mr Rehman as a careful man and witness. I have to say I find it incredible that he would have not read the fax in July as carefully as he did the retrocession slips which were a part of it. All the other signs are that he approached the underwriting decisions with meticulous care...I regard the Munich Re point as devoid of legal or factual merit: it seems to me that there was no falsity in the representation about support and that there was no inducement and ARIG knew the full picture before they signed and returned the retrocession slips."

According to the above judgment, if the reinsurer ARIG has exercised his required care and skill, he should be able to get the information which was presented to him. Thus, the rules of presumption of inducement under this circumstance should be restricted.

3.1.2.2.2.2 The Scope of the Duty of Disclosure on the Broker

Section 19 of MIA 1906 requires disclosure of three different categories of material circumstance. First, under section 19 (b) of the MIA 1906 a broker is expected to disclose every material circumstance that the assured is bound to disclose under section 18, unless it comes to the assurd's knowledge too late for it to be communicated to the broker. The other two categories fall within Section 19 (a) of the MIA 1906 which provides that an insurance broker must disclose every fact known to him-the actual knowledge and which he ought to have known in the ordinary course of his business-the constructive knowledge. Whether the broker should disclose particular information within his ordinary course of business is a question of fact and will depend on the nature of that particular information and the time available for communicating with the underwriter between receipt of the

[139] *Ibi d,* at p 172.

information and placement of the risk.[140] How to define the constructive knowledge which ought to be known by the broker in his ordinary business mirrors the question of how to define the circumstances that the insurer is presumed to know in his business which will be further discussed later.[141]

Section 18(3) of MIA 1906 sets up the exclusions of the broker's duty of disclosure which states the following:

> "In the absence of inquiry the following circumstances need not be disclosed, namely-(a) Any circumstance which diminishes the risk; (b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know; (c) Any circumstance as to which information is waived by the insurer, (d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty."

It is quite clear that the facts or circumstances which reduce the risk will not fall into the scope of the duty of disclosure. For example, in the case of *The Dora*[142] the assured failed to disclose the fact that the insured vessel would have been kept in a builder's yard during the period of construction. It was held that this information fell outside the scope of the information which needed to be disclosed to the insurer. In the case of *The Elena G*,[143] the fact that a yacht was kept in secure mooring was held to be immaterial as the security precautions diminished the risk.

However, the circumstances which are presumed to be known to the insurer are not easy to define. Although in the above section it has been explained that the insurer is presumed to know the matters which an insurer in the ordinary course of his business

[140] *Con tainer Transport International Inc and Reliance Group Inc v. Oceanus Mutual Underwriting Association Ltd.* [1982] 2 Lloyd's Rep 178 at p 197.

[141] On how to define the circumstances that the insurer is presumed to know, see p 94 blow.

[142] [1989] 1 Lloyd's Rep 69.

[143] [2002] Lloyd's Rep IR 450.

ought to know, there has not yet been analysis about the *scope* of the "ordinary course of business". Accordingly, an elaboration of the circumstances that the insurer is presumed to know is provided below.

3.1.2.2.2.2.1 How to Define the Circumstances that the Insurer is Presumed to Know

Several cases have addressed this issue.

The first one is *Bolivia v. Indemnity Mutual Marine Assurance Co.*[144] In this case the assured, while obtaining insurance cover for his vessel, failed to disclose that there was war in the part of the world where the vessel would have navigated. The Court held that the insurer should have been aware of the situation in the course of his business.

The next one is the case of *The Moonacre.*[145] In this case the assured, during the process of obtaining insurance cover for his yacht, disclosed to the underwriter where the vessel was going to be kept. However, the assured failed to disclose that a number of burglaries had taken place in that marina. The Court held that the insurer should have been aware of this in the course of his business. Also, the insurer is deemed to be aware of information which is posted on a place where the insurer should check or be aware of in the course of business. It was held by Judge Colman that,[146]

> "On the whole of the evidence I am not satisfied that a prudent underwriter would have been influenced in deciding on renewal by information that thieves had broken into the vessel while she was laid up at Puerto Banus. As a matter of common sense the precise value of what the thieves stole is of

[144] [1909] 1 KB 785.

[145] [1992] 2 Lloyd's Rep 501.

[146] *Ibid,* at p 518.

secondary importance to the fact of breaking in and to the fact that there was also an attempt to take a television and the actual theft of the Panda car from alongside. But the fact of exposure to theft of this kind must be common to every single vessel laid up at a mooring in Spain and there was not shown to be anything in the circumstances of this theft which would have taken it out of the ordinary incidents to be anticipated during lay-up so as to make it a matter which a prudent underwriter entertaining a renewal would wish to take into account in deciding whether to write the risk and, if so, on what terms. The 1987 radio theft therefore was not a fact which ought to have been disclosed when in December, 1987 the third defendants applied for renewal of the policy."

Another case is *Friere v. Woodhouse.*[147] In this case there were two vessels, X and Y that sailed from the same port at the same time. After their departure, the owner of X obtained insurance cover for X. However, X failed to disclose to the insurer that the other vessel, Y, which sailed at the same time as X, had in fact arrived safely. The Court held that this was not a circumstance, which needed to be disclosed because the safe arrival of Y had already been published in Lloyd's List. It seems fair to conclude that the assured did not need to disclosure the information which was posted on a place where the insurer should check or be aware of in the course of business.

However, the Court of Appeal had a different opinion in *London General Insurance Co. Ltd. v. General Mutual Marine Underwriters Association*[148]. On September 25th, 1918, the plaintiffs effected with the defendants a policy of reinsurance upon the cargo of the steamship Vigo, "lost or not lost," which the plaintiffs had themselves previously insured. On the night of September 24th it was known at Lloyd's that part of the cargo had been destroyed by fire on board the Vigo. The fact was posted on the casualty board at Lloyd's in the morning of September 25th, and a casualty slip containing the information was at the same time sent by Lloyd's to their subscribers, including the plaintiffs. At 10 o'clock on September 25 the plaintiffs instructed their

[147] (1817) Holt NP 572.

[148] [1921] 1 KB 104.

brokers to effect the reinsurance policy at Lloyd's. They did it at 4 o'clock on the same afternoon. The plaintiffs, although they received the casualty slip, did not read it, and did not, in fact, know of the casualty. The defendants when they wrote the risk were equally ignorant of it. It was held that[149] the defendants were entitled to judgment on the ground of non-disclosure of a material circumstance. The plaintiffs ought in the ordinary course of business to have known of the casualty in time to recall their instructions to their brokers to effect the reinsurance. They had no right to neglect the casualty slips in a case where the risk had already materialised on the ship. The defendants, on the other hand, if they had looked at the slips, could not be expected to have in mind information about a vessel which at the time they got the information would be of no interest to them at all.

From the above two cases it can be said that it is significant to the Lloyd's Underwriter whether information is published in Lloyd's List or in the, less reputable, Casualty Board at Lloyd's. However, a reasonable underwriter is expected to be aware of both in the ordinary course of business. In the later case the Court of Appeal made the decision on the ground that the defendant had no insurable interest in the ship at the time the relevant item was posted. The decision will be different if the defendant did have an insurable interest at the time when the relevant item was posted. An example is where an existing insurance contract between the plaintiff and the defendant is about to expire and the two parties want to renew it. In this case the defendant will be expected to know of the casualty in his ordinary course of business.

The definition of circumstances that the insurer is presumed to know can be briefly summarized in the two following cases. In *Carter v. Boehm*[150] Mr. Kealey argued that an underwriter who insures a risk within a particular industry ought to know or find out the practices of the industry or trade, and the matters which are in general

[149] *Ibi d.*

[150] (1766) 3 Burr 1905.

well known by persons in that trade. He also submitted that if an underwriter is writing a class of business he should be conversant with the course of losses affecting the types of risk which fall within that class, although he cannot be presumed to know about particular losses which particularly affect certain assureds. In *North British Fishing Boat Insurance Co., Ltd., v. Starr,*[151] Justice Rowlatt stated that,

> "But how am I to look at the question, what ought an underwriter doing this business to know in the ordinary course of his business with regard to such a matter as is now before me? It seems to me that as this is a marine policy, I must look at the underwriter in this case as a person doing the business of insuring ships and as necessarily conversant with the course of losses affecting particular classes of ships. What he is not bound to know in the ordinary course of his business are particular circumstances specially affecting ships or lines of ships, and specially affecting some limited number of ships."

3.1.2.2.2.2.2 Express and Implied Waiver

It is logical that the circumstances covered by an express or implied warranty fall outside the scope of the duty of disclosure for if the parties cover those aspects contractually, there is no need to intervene with an utmost good faith concept.[152] It is possible for circumstances to be waived by either express agreement or through implied waiver.

Express waiver

There should be no difficulty with an express agreement to waive. A typical waiver agreement will state the following: "To the fullest extent permissible by applicable law, the Insurer hereby agrees that it will not seek to or be entitled to avoid or rescind

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[151] [1922] 13 Ll L Rep 206.

[152] *The D ora* [1989] 1 Lloyd's Rep 69. The court held that this non-disclosure had no effect on the cover, since the issue in question is covered by an express warranty.

this Policy on the grounds of non-disclosure or misrepresentation by the assured or his agents or any other similar grounds."

However, it should be discussed further about what kind of conduct of the assured or broker can be expressly waived. Is it, for example, possible to waive fraud on the part of the broker or assured? Is there any limitation on the power to waive of the assured or broker? A modern authority on this point was raised up in *HIH Casualty and General Insurance Ltd. v New Hampshire Insurance Co. and Others.*[153]

HIH Facts

In this case HIH the underwriter of two film finance insurance policies, sought a determination of two preliminary issues relating to its claim against reinsurers, NHI, IIC and AXA. The insured, LDT, was indemnified in the event of a shortfall between the amount of finance provided and the revenue collected from two film projects. HIH having paid LDT sums totaling over U.S.$31 m. sought to recover under the reinsurance agreements. The reinsurers refused to indemnify HIH on the grounds that HIH should not have paid LDT or alternatively that, whatever the position under the insurance contract they were not obliged to pay under the reinsurance contracts for various reasons including breaches of warranty and breaches of the duty of good faith.

The reinsurers contended that the underlying insurance contained a warranty to the effect that a slate of six or 10 films respectively would be made and that the reinsurance contained such a warranty and a further warranty that the insurers would obtain the consent of reinsurers to any amendment to the terms of the underlying insurance.

[153] [2001] 2 Lloyd's Rep 161.

The claimants submitted that cl. 8 of the policy wording disabled them from relying on any breach of warranty by the original assured and that as cl. 8[154] was a term of the reinsurance it precluded the reinsurers from relying on any breach of warranty and further precluded the insurers from relying upon any misrepresentation or non-disclosure unless the same was fraudulent.

The key issue in this case was the effect of cl. 8, the relevant important issue being whether cl. 8 excluded fraudulent misrepresentation and non-disclosure and negligent misrepresentation and non-disclosure.

In the first instance Mr. Justice David Steel held that cl. 8 covered and thus excluded a defence based on negligent misrepresentation and non-disclosure. He stated as follows, [155]

> "It is conceded by reinsurers that the clause prohibits avoidance on the grounds of innocent non-disclosure and innocent misrepresentation. At the other end of the spectrum, there are in fact no allegations of fraud against HIH or its agents. For the record, I hold that it is not open to a party to exclude liability for his own fraud in inducing the contract: see *S. Pearson & Son Ltd. v. Dublin Corporation*, [1907] A.C. 351."

However, it was held in the Court of Appeal by L.J. Rix that,[156]

> "I note that in HIH Casualty and General Insurance Ltd. v. Chase Manhattan Bank, [2001] 1 Lloyd's Rep. 30 at par. 44 the case of Pearson v. Dublin Corporation is analysed by Mr. Justice Aikens, and that he concludes at pars. 45-46 that it is conceptually possible to have a clause in a contract of

[154] "Clause 8 Disclosure and/or Waiver Of Rights

8.1 To the fullest extent permissible by applicable law, the Insurer hereby agrees that it will not seek to or be entitled to avoid or rescind this Policy or reject any claim hereunder or be entitled to seek any remedy or redress on the grounds of invalidity or unenforceability of any of its arrangements with Flashpoint Ltd. or any other person (or of any arrangements between Flashpoint Ltd. or the Purchaser) or non-disclosure or misrepresentation by any person or any other similar grounds. The Insurer irrevocably agrees not to assert and waives any and all defences and rights of set-off and/or counterclaim (including without limitation any such rights acquired by assignment or otherwise) which it may have against the Assured or which may be available so as to deny payment of any amount due hereunder in accordance with the express terms hereof."

[155] [2001] 1 Lloyd's Rep 378 at p 388.

[156] [2001] 2 Lloyd's Rep 161 at pp 186, 187.

> insurance that excludes or limits the consequences of fraudulent non-disclosure by the assured's agent."

> "It is for that reason that its effect will appear equivocal and so the Court naturally asks: what did the parties actually intend to cover by these general words? I think that the Canada Steamship case rules of construction were not intended to apply to a particular clause that is specifically directed at exempting liability for the breach of a particular type of absolute duty, where the breach can be established whether or not negligence (or fraud) is proved."

So, subject to the limitations concerning fraud, discussed above, it seems that it can be argued that provided a clause in a contract of insurance is clearly and specifically intended to cover the consequences of a breach of the duty of disclosure or the "duty" not to misrepresent material facts, there should be no limitation on using fraud or negligence in non-disclosure or misrepresentation as the ground for a right to avoid a breach of the duty of good faith.

Implied waiver

In contrast to the clarity of express waivers, it is quite difficult to detect an implied Waiver. Such a waiver might arise if the insurer asks no further question even though the assured provided sufficient information or even though the insurer became aware of circumstances which ought to have put him on inquiry. In such a case it could be argued that by asking no further information the insurer has waived the disclosure requirement on the part of the assured. In *Mann Macneal & Steevens Ltd. v. Capital and Counties Insurance Co*[157], the assured, while obtaining insurance cover for his vessel, disclosed that the vessel was at sea at that point in time and carrying cargo. The nature of the cargo was not disclosed by the assured but was in fact petrol stored in drums. Later, the insurer became aware of the nature of the cargo and attempted to avoid the policy for non-disclosure. It was ruled by Mr.

[157] [1920] 4 Lloyd's Rep 57.

Justice Greer[158] that

> "It seems to me that the fact that she was then definitely fixed to carry these dangerous goods makes all the difference, because the insurers who were told that, would know at the time, and would say, 'I am asked to make an insurance on a cargo which is definitely fixed to the extent of 2500 drums of this dangerous, material.' I (his Lordship) describe it as dangerous material, because it was clear that so long as it remains in the drums it is just as innocent as toffee or syrup in drums, but at the same time one knows of the innumerable risks run by a ship during the course of the voyage from the time the goods are put into the ship until the time they are taken out of the ship at the other end. I think this is a fixture which ought to have been disclosed as a material fact, and ought to have been known to the Underwriters."

Accordingly the insurer had waived the information since sufficient information was provided by the assured to put him on inquiry, but nevertheless no question was asked as to the nature of the cargo.

3.1.2.2.2.3 The Duty of Discloser on Sub-broker

Another important issue regarding such kind of duty on the broker is the duty of disclosure on sub-brokers. One of the most popular examples of a sub-broker situation is stated at the beginning of this Chapter: when a broker is not accredited to obtain the insurance cover for the assured from the market he may contact another broker who is capable of doing the business. The latter is called the placing broker and the former, the producing broker. The relationship between them in effect is that the placing broker acts as the broker to the producing broker. Accordingly, he is the sub-broker for the original assured. As discussed above, section 19 of MIA 1906 sets out the duty of disclosure of the broker. However, it does not contain any clear reference to the required status of the broker. Should that section be restricted to the producing broker only, or, do the placing broker and other sub-brokers also owe such

[158] *Ibi d,* at p 58.

a duty?

This question has been referred recently in the case of *BP plc v. Aon Ltd.*[159]

BP Facts

BP and 28 co-assureds were insured for the period 31 December 1998 to 1 July 2000 under an all risks open cover. The insurance had been placed by Aon. Aon presented the risk to London, European and US market insurers in 1998. The policy was on a declaration basis, so that each individual risk had to be declared before the insurance attached to it. It was determined by Aon that Aon London would handle declarations to the open cover emanating from BP's London office, whereas declarations emanating from Chicago would be handled by Aon companies in the US and transmitted to London. In April 1999 BP and Aon Texas executed a three-year service agreement which set out the obligations of the parties and the fee structure for Aon Texas. By June 2000 some 30 projects were declared to the leading underwriters. Of those, four were withdrawn and 14 did not give rise to losses. The remaining 12 projects produced claims of some US$220m which were disputed by the underwriters on coverage grounds and also on the basis of misrepresentation and non-disclosure. A number of the declarations were accepted, but four were not and a further three were subjected to increased premium and additional deductibles. The leading underwriters commenced proceedings against BP in New York and subsequently in London, asserting that the declarations were invalid. BP joined Aon London and Aon Texas to the English proceedings, alleging breach of the service agreement and breach of duty of care.

BP's assertion was that Aon London owed a duty of care to BP which it had broken by failing to exercise reasonable care and skill in making timely declarations to the open cover. Aon London denied liability. It rejected the suggestion that it owed any

[159] [2006] Lloyd's Rep IR 577.

duty of care, in that the relationship between BP and Aon was set out in the service agreement which set out the entirety of the parties' obligations worldwide. Aon London had never been a party to that agreement, and thus did not owe any duties.

Before Colman J. made his decision, he turned to the decided cases on the specific question of whether a sub-agent owed a duty of care to the principal.

The point has arisen in a number of insurance and reinsurance cases. There are different points of view that have been taken regarding such a duty on a sub-agent. In some cases where a duty of care was established there had been either a concession or an assumption to that effect.[160] While in other cases a duty of care had been denied[161] or at best held to be arguable so that the claim should not be struck out.[162]

The question in the present case was, therefore, whether Aon London had assumed responsibility towards BP in the making of declarations. After a lengthy review of the facts, Colman J concluded that there had indeed been the required assumption of responsibility and, accordingly, that Aon London had owed a duty of care to BP. Colman J was satisfied that Aon London undertook responsibility to BP to provide the services of a broker under the open cover with proper professional skill and care, and that BP relied upon that undertaking. The learned judge continued:[163]

> 'The very essence of the service which BP was entitled to expect Aon London to provide was the provision of complete cover for each notified project and not merely cover from the leading underwriters. On each occasion when Aon London received from BP London or

[160] see *Coolee Ltd v Wing, Heath & Co* (1930) 38 Ll LR 188; *Mint Security Ltd v Blair* [1982] 1 Lloyd's Rep 188; *O'Brien v Hughes-Gibb & Co Ltd* [1995] LRLR 90; *Tudor Jones II v Crawley Colosso Ltd* [1996] 2 Lloyd's Rep 619.

[161] *Pa ngood Ltd v Barclay Brown & Co Ltd* [1999] Lloyd's Rep IR 405.

[162] *Eur opean International Reinsurance Co Ltd v Curzon Insurance Ltd* [2003] Lloyd's Rep IR 793.

[163] [2006] Lloyd's Rep IR 577.

> from BP Chicago … a notification of a project to be declared to the Open Cover Aon London's professional duty of care was engaged. Once it received the instructions its duty attached to that project and it was obliged to take such steps as were reasonably required to procure cover by declaring the project to all the underwriters on the London and continental markets, including all the Frankona Defendants. Its omission to do so would amount to a breach of its professional duty of care in tort."

In reaching this conclusion Colman J analysed the terms of the service agreement itself, including the indemnity provisions which conferred an obligation on Aon to indemnify BP for liabilities or losses suffered by it or its associates, and found nothing in it which was inconsistent with the imposition of a duty of care on Aon London. Colman J went on to hold that Aon London had owed a duty of care not just to BP, but also to its affiliates, co-venturers and contractors who were the co-assureds under the open cover. Those parties had relied upon BP's procurement of cover, and there could be an assumption of responsibility even if it was indirectly conveyed. In the present case the communication to BP by Aon London of an assumption of responsibility was also a representation to other co-assureds of Aon London's personal responsibility to them, given that they had relied on Aon London to perform its delegated functions.

English law has yet to give a definitive answer to the question of whether a placing broker who has no contractual relationship with the assured owes a duty of care to the assured in the placement of the risk, or whether liability is borne entirely by the producing broker with whom the assured does have a contract. In *BP plc v Aon Ltd* case, the point arose not in the context of a placing broker, but in the context of the sub-brokers to whom the duty to declare risks to an open cover had been delegated. Colman J held that the sub-broker had a duty of care to the assured despite the absence of any contract between them, and in so deciding has opened the way to a more generalised finding that placing brokers do owe duties of care.

3.1.2.2.3 Duty not to make misrepresentation

Another key aspect of the duty of utmost good faith is the duty not to make misrepresentation. This aspect of the general duty is specifically developed in the Section 20 of MIA 1906 which states:

> "20. Representations pending negotiation of contract
> Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract... (3) A representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief"

According to the above section, a representation could be either a representation of facts or a representation of opinion or a representation of intention.

3.1.2.2.3.1 Representation of Fact

An example where the representation is one of facts can be shown in *Williams v. Atlantic Assurance Company, Limited*[164]. In this case the assured stated that a cargo of textile goods was worth 8,000 pounds, but in fact it was worth only 250 pounds. The representation of the cargo's price was the representation of facts. It was held by Slesser L.J. that[165],

> "I hold that, under s. 20 of the 1906 Act, the underwriter was entitled to avoid the contract for an untrue material representation. That is to say, I find the value which was declared at 8000 to have been in fact 250 and no more."

In another case, a representation as to where the cargo was stored was the relevant

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[164] [1933] 1 KB 81.

[165] *Ibi d,* at p108.

representation of facts. In *Liberian Insurance Agency Inc. v. Mosse*[166], while obtaining the insurance cover, the assured described the cargo as cups and plates in wooden cases. When the goods arrived, it was found that the cargo was stored in cardboard-boxes. It was held by Mr. Justice Donaldson that,[167]

> "There are, however, other matters which underwriters say should have been disclosed in accordance with the duty of disclosure imposed by s. 18 of the Marine Insurance Act, 1906, or which involved material misrepresentation and gave rise to a right to avoid the contract under s. 20 of that Act. I can deal with these briefly, because there is little in dispute. (a) There was a failure to disclose that the cargo included 823 cartons as contrasted with wooden cases. This fact was clear from the invoices, which were in the possession of L.I.A. when the risk was placed. It is a mystery why the goods were described simply as being 'in wooden cases' and who was responsible for this misdescription. On the evidence, Mr. Phillips concedes, as he must, that this was a material non-disclosure or misrepresentation. The fact that part of the cargo was contained in cartons would have affected the premium or rendered underwriters unwilling to accept the risk at all. The reason is that cartons are more susceptible to water damage and, if so damaged, may fail to protect the enamelware."

3.1.2.2.3.2 Representation of Opinion

An example of a representation of opinion can be seen in *Anderson v. Pacific Fire and Marine Insurance Co.*[168]. It was held in this case that a statement by the captain of a vessel that a meeting point on a sea voyage was "a good and safe anchorage and well sheltered" was an honest opinion.

The valuation of a subject-matter of insurance is also a representation of opinion.[169] When the representation of the valuation is more than the real value of the

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[166] [1977] 2 Lloyd's Rep 560.

[167] *Ibi d,* at p 565.

[168] [1872] LR 7 CP 65.

[169] *Io nides v. Pender* [1874] LR 9 QB 531.

subject-matter, there is an excessive valuation. For example, a cargo of spirits worth 500 pounds was insured under a valued policy for 3,000 pounds and this is an excessive valuation. In some circumstances, excessive valuation is a misrepresentation. However, in some other cases, such kind of valuation does not constitute a misrepresentation. The following two cases were both about overvaluation. But the judgment was completely different in each.

The first case is *Eagle Star Insurance Co. Ltd. v Games Video Co. (GVC) S.A. (the "Game Boy")*[170]

The Game Boy Facts

The vessel *Game Boy* was insured by the claimant under a marine hull policy at a value of U.S.$1,800,000. The insurance was taken out to cover the period while the vessel was laid up at Chalkis and whilst the repairs were carried out at Avlis shipyard. The resulting damage caused *Game Boy* to list to starboard and partially to sink. The defendants were the named assureds under the insurance policy and made a claim against the insurers under the policy. The insurers sought a declaration that the contract of insurance had been validly avoided and/or that they were under no liability to the defendants. The insurers argued that the defendants had made material misrepresentations about the condition and value of the vessel, and in particular that the vessel's true value was significantly less than the value of U.S.$1,800,000 in the insurance contract.

It was held by Simon J. as follows,[171]

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[170] [2004] 1 Lloyd's Rep 238.

[171] *Ibi d,* at p 248.

"the defendants had no genuine belief that the value of the vessel was U.S.$1,800,000; the documents said to form the basis for the defendants' stated belief were, to their knowledge, not genuine; they were created because the defendants knew very well that the valuation of U.S.$1,800,000 could not be justified without them; the true value of the vessel at the time of the contract of insurance was U.S.$100-150,000, and the defendants knew that; the misrepresentation was material, and was relied on by the insurers; the insurers were therefore entitled to avoid the contract of insurance"

In the light of the findings of facts in the Game Boy case, it should be concluded that the assured had no genuine belief that the value of the vessel was U.S. $ 1,800,000 and the assureds knew very well that the valuation of U.S.$1,800,000 could not be justified. This case further establishes that valuation is a matter of opinion and that a statement of value can only amount to a misrepresentation if made in bad faith.[172]

In contrast, the decision in the case of *North Star Shipping Ltd v Sphere Drake Insurance Plc*[173] was completely different.

North Star was purchased by one of the Kent companies in a damaged condition for US$1.3 million in September 1989. In April 1994 an agreement was entered into to sell the vessel at a price of US$1.4 million. The vessel was insured with the defendants under a war risks policy. The war risks cover was for US$4 million. In this case, the insurers raised two main grounds of defence. First, they alleged that the loss was not caused by an insured peril because the explosion was deliberately caused or procured by the assured owners for the purpose of advancing a fraudulent claim on underwriters.

[172] see s. 20(5) of the Marine Insurance Act 1906 and *Economides v. Commercial Union Assurance Co. Plc* [1998] QB 587, per Lord Justice Peter Gibson at p 606:

"Once statute deems an honest representation as to a matter of belief to be true, I cannot see that there is scope for inquiry as whether there were objectively reasonable grounds for that belief. Of course the absence of reasonable grounds for belief may point to the absence of good faith for that belief. But in a case such as the present where the bad faith of the plaintiff is not alleged, I can see no basis for the implication of a representation of reasonable grounds for belief."

[173] [2006] 2 Lloyd's Rep 183.

Secondly, the insurers alleged that they were entitled to avoid the policies for misrepresentation and non-disclosure of a number of matters, one of which was regarding the value of the vessel that there had been excessive valuation of the vessel at US$4 million when the market value was only US$1.4 million.

It was held by LJ. Lloyd at the Court of Appeal that,[174]

> "the excessive valuation was a material fact. The test of materiality was whether the disparity between the insured value and the market value was consistent with prudent ship management. The market value of *North Star* was agreed at US$1,350,000. An underwriter knowing the market value roughly would appreciate the difference between US$4 million and US$1.35 million, and ask questions if he were interested in finding out what the reasons were for the differential. The sale logically added nothing to the knowledge that the underwriter had of the market value. If the sale had no relevance the underwriter could see for himself that the difference between US$4 million and the vessel's market value would raise questions. The underwriter might prefer to take the extra premium rather than investigate whether the good management reasons established US$4 million as opposed to some lesser figure"

Normally, excessive valuation is a misrepresentation. However, there are several situations where an excessive valuation will not avoid the contract. First if both parties are aware of the excessive valuation there is agreement between the assured and the insurer on the subject-matter of insurance and hence the rationale for avoiding the contract falls. Secondly where the insurer is not aware of the excessive valuation, but the excessive valuation can be explained as a part of an ordinary business transaction it might be justified. The North Star case belongs to the second scenario .

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[174] *Ibi d,* paras 46-48.

3.1.2.2.3.3 Representation of Intention

In *Seismik Sekuritik AG. v. Spere Drake Insurance Co. plc*,[175] the assured, during negotiations, indicated that the insured vessel would not be chartered. Later, during the currency of the policy, the insured vessel was chartered and the insurer attempted to avoid the policy for misrepresentation. The court held that this did not amount to misrepresentation as when the statement was made the assured had genuinely intended this to the case even though he later changed his mind.

3.1.2.2.3.4 A Special Circumstance

There is a particular issue that should be discussed here which is whether inaccurate answers to ambiguous questions amounts to misrepresentation. This question was discussed in *Willmott v. General Accident Fire.*[176] In this case a motor boat which was insured under a time policy sank during a gale. The insurer attempted to avoid the policy because during negotiations the assured stated that the value of the vessel was 200 pounds even though he bought it for much less but spent a lot of money to upgrade her. The question posed to the assured was "What did it cost to you?" The question is ambiguous, because it could mean two things: "What did it cost to you to buy?" or "What did it cost to you to put her in the state she is now?" It was held that the sinking was due to perils of the sea and was not caused by the defective condition of the vessel or through the plaintiff's failure to repair, that the change of plan as to mooring was made subsequent to the date of policy, and that as such a change was not prohibited by the policy the question of non-disclosure of that material fact did not arise; and that the incorrect answer made by the plaintiff as to the value of the vessel was probably due to the fact that he was incorrectly questioned by the defendant's agent, who himself completed the proposal form. Judgment was for the

175 [1997] 8 CL 351.

176 (1935) 53 LlL Rep 156.

plaintiff for the actual value of the vessel. Accordingly, the representation made by the assured was not a wrong one.

3.1.2.3 Other Duties of Broker to Insurers

As discussed above, regarding the intermediary of the broker, the main rule is that the broker is the agent of the party seeking insurance and he must not allow any other possible duty to conflict with his obligations to his primary principal. If such a conflict is perceived to exist, the broker must obtain the principal's fully informed consent to permit him to act in a dual capacity.[177] In some circumstances, a broker may act in a dual capacity as the agent for both the assured and the insurer if two conditions are satisfied, (i) the broker must, in a clear manner, assume responsibility to the insurer and (ii) this assumption of responsibility must not have an actual or potential impact on the duty of the broker to the assured, e.g. regarding claims, regarding collection and payment of premiums, in relation to the placing of reinsurance, and in accepting risks under a binding authority. This chapter will only focus on the duties of the broker to the insurer at the formation stage- under a binding authority and in relation to the placing of reinsurance.

3.1.2.3.1 Under a Binding Authority

A binding authority is a contract between an insurer and a broker delegating certain underwriting powers to the broker. Under a "binding authority", an underwriter may authorise a broker to rate and accept specified risks on his behalf without reverting to the underwriter to obtain his approval. The broker therefore becomes the agent of the

[177] In *North and South Trust Company v. Berkeley* [1970] 2 Lloyd's Rep 467, a Lloyd's broker obtained for underwriters an adjuster's report which the insured wished to see. The underwriters applied for an injunction to prevent the brokers from providing it. Donaldson J., as he then was, held that although the practice of Lloyd's underwriters in using brokers to communicate with assessors on their behalf was wholly unreasonable and therefore incapable of being a legal usage the brokers when acting for the underwriters were not acting in discharge of any duty to the insured and were therefore not under a duty to pass on to the insured the confidential information they obtained on behalf of the underwriters.
In Anglo-African Merchants Ltd v. Bayley [1969] 1 Lloyd's Rep 268, it was held that it was in law inconsistent with a Broker's duty to the Assured for the broker to act as agent for Lloyd's Underwriters without the consent of the Assured.

underwriter. It is the broker who deals with the negotiation of terms, although they are not usually capable of much argument, and issues the necessary documentation to the assured.

The advantages of using a binding authority include saving time and avoiding excessive administration because the process enables routine risks to be placed at Lloyd's without the need for individual negotiation of each risk. Also there is one dispute that was removed by the operation of a "binder". By using a binder, any information given to the broker will be transferred to the underwriter, so that avoidance for nondisclosure cannot be attempted later by the underwriter in respect of such information if the broker has not passed it on.

"Binding authorities" evidence is an accepted practice at Lloyd's in which the broker acts in a dual capacity. On the one hand he is arranging insurance for the insured on the best possible terms, and yet on the other he is obtaining business for his other principal, the underwriter, and obtaining further commission for himself. There are various conflicts of interest that might arise in the operation of a binder. For instance, the assured could obtain insurance cover with better conditions from other insurers, but the broker, by using the binder ties him to the insurer from whom the broker got the binding authority. In short, in such a case, both the insurer and the broker benefit from using the binder but the assured loses out.[178] On the other hand, the assured might not be able to obtain any insurance cover from the market or he could obtain the cover at a higher cost, but the broker, by using the binder, provides him a reasonable cover from his insurer. In this situation, it is the broker and the assured who benefit from using the binder while the insurer loses out.

As discussed above,[179] in insurance the broker is specifically instructed by the

[178] In practice, however, the assured should be able to evaluate the quality of the insurance obtained by the broker and can take his business elsewhere if it proves unsatisfactory or uncompetitive.

[179] See p 64.

assured to obtain the best possible insurance for that assured, and the assured will believe that the broker is doing exactly that, without concern for personal gain or with other motives. Megaw L.J. in *Eagle Star Insurance Co v. Spratt*[180] stated that "an agent for one party should not act for the opposite party in connection with the same transaction without the latter's informed consent" Thus any failure of the broker in complying with the above dictum may lead to liability for breach of his duties as an agent, provided that damage can be proven. Accordingly, one method of avoiding the conflict of interest is to request the broker to make it clear to the assured whether he is under any binding authority with any insurers and to obtain the consent of the assured.

3.1.2.3.2 In Relation to the Placing of Reinsurance

Since the eighteenth century the law has accepted that the broker is the agent of the assured and that duties of the broker are owed to the assured rather than to underwriters. That principle has in recent years begun to break down in the light of the realities of insurance and reinsurance markets.[181] Brokers will often find themselves representing different parties up and down a reinsurance chain, and it has been accepted that a broker owes a duty of utmost good faith to underwriters when placing a risk and a broker can be liable to underwriters for losses incurred on their policies where the underwriters were induced to enter into those policies by promises of reinsurance cover.[182]

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[180] [1971] 2 Lloyd's Rep 116.

[181] One of the leading cases is *Everett v. Hogg Robinson & Gardner Mountain (Insurance) Ltd* [1973] 2 Lloyd's Rep 217; Another case where the Lloyd's broker breached a duty owed to underwriters is *Forsikringsaktieselskapet Vesta v. Butcher, Bain Dawes and others* [1988] 1 Lloyd's Rep 19. The modern test of liability is whether the broker has assumed responsibility to the insurer under the reinsurance over, a point illustrated by the decision of the Court of Appeal in *European International Reinsurance Co Ltd v Curzon Insurance Ltd* [2003] Lloyd's Rep IR 805.

[182] The duty of the broker to the reinsurer under the reinsurance cover has also been be considered above at p 36.

3.1.2.4 The Reform of Insurance Law on the Duty of Utmost Good Faith

In the final discussion of the duties of the broker, the recent reforms of insurance law, particularly the reforms regarding the duty of utmost good faith will be discussed. In the course of 2006 and 2007, the English and Scottish Law Commissions published three Issues Papers which led up to publication of an consultation paper in July 2007. [183] That document sets out the Law Commissions' provisional recommendations on Utmost Good Faith, Warranties and Intermediaries.

3.1.2.4.1 Utmost Good Faith

The Law Commissions' review of current insurance law and the approach towards its reform has been based on the distinction between consumer insurance and business insurance. In outline, the Law commission has proposed that there should be no duty of disclosure in consumer insurance, but only an obligation to answer questions. The duty of disclosure would be retained in business insurance.

3.1.2.4.1.1 Consumer Insurance

The Law commission has proposed that there should be no duty of disclosure in consumer insurance, on the basis that "[i]nsurers should ask questions about what they want to know; consumers should not be expected to give information that has not been asked for."[184] Faced with such a question, the duty of the assured under the current recommendation is to give accurate answers.

The remedies are available to the insurer when the assured has made a material false

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[183] The La w Commission Consultation Paper No 182 and the Scottish Law Commission Discussion Paper No 134, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured (2007)*

[184] Ibid, at para 1.75.

statement to the questions and the insurer can prove that he was induced by the false statement to enter into the insurance contract. The insurer's remedies depend upon the assured's state of mind. If the assured has given his answers to questions honestly and carefully, he is entitled to have his claim paid and the insurer has no remedy against him; if the assured has deliberately or recklessly given false answers to questions which a reasonable assured ought to have known would be relevant to the insurer, the policy may be avoided; if the assured has been negligent in his answers, the insurer's remedy will be based on the principle that he should be returned to the position where they would have been in if there is no such misrepresentation.[185]

As to the materiality of the statement, the "prudent insurer" test would be replaced with the "prudent assured" test accordingly. The test is whether the fact in question would appear be material to a reasonable assured in the circumstances but not the insurer.

3.1.2.4.1.2 Business Insurance

In contrast to the proposals for consumer insurance, the duty of disclosure is to be retained for business insurance. In business cases, therefore, there is both duty of disclosure and a duty not to misrepresent facts.

As far as disclosure is concerned, the remedies for the insurer is available if the assured did not disclose the material facts to the insurer and the insurer was induced by the non-disclosure to enter into the insurance contract. The above abolition of the prudent insurer test and its replacement with the prudent assured test, recommended by the Law Commissions as the approach to be adopted in consumer insurance, has been adopted by the Law Commissions as the default rule for business policies as

[185] For i nstance, if the insurers would have charged an additional premium, the amount of the claim is reduced in proportion to degree of underinsurance; if the insurers would have excluded a particular risk, the claim will not be payable if it would have fallen within the exclusion; and if the insurers would have declined the risk, the policy is to be avoided and premiums returned.

well.

As far as misrepresentation is concerned, the recommendation follows those for consumer policies. The remedies will be available to the insurer if there was false statement, a reasonable assured would have been aware that the information was relevant to the insurer, and there was the necessary inducement. Different remedies should be applied depending upon whether the assured was innocent, negligent or fraudulent. The Law Commissions have adhered to their view that if the assured made the misrepresentation innocently, he should be able to recover and that if a policy obtained by fraud, that policy should be voidable. However, as far as negligence is concerned, it has yet to be decided whether to apply the consumer principle of putting the insurers into the position they would have been in but for the negligence or whether negligence should be treated in the same way as fraud.

3.1.2.4.2 Intermediaries

The issues of the role of intermediaries are considered by the Law Commissions. The question of the incidence of the agency of an intermediary matters when the intermediary has obtained information from the assured to put to the insurers in an application for cover, but has either failed to disclose facts revealed by the assured or has misstated them. If the intermediary is the agent of the assured, those risks are borne by him; if the intermediary is the agent of the insurers, they are deemed to know what the agent has been told and thus cannot rely upon the defences of non-disclosure or misrepresentation.

The Law Commissions have proposed that an intermediary should be regarded as the insurer's agent for the purposes of obtaining pre-contract information and such an intermediary should remain the insurer's agent while completing a proposal form. While, the intermediary who is genuinely searching the market on the assured's behalf should be regarded as the agent of assured.

However, in business insurance, the position of brokers is more complex. The presumption of the common law is that a broker is the agent of the assured, starting with the search for insurance and ending with the progression of claims, and in particular in the presentation of information to insurer. Despite his role as agent of the assured, the broker may be the agent of the insurer for other purpose. Since it does not automatically follow that a person who searches the market on the assured's behalf should remain the agent of the assured when presenting information to the insurers,[186] the question of whether the broker should be treated as the agent of insurer in placing business is proposed.

The point of if it is appropriate to transfer the agency of the broker in the placement process is discussed in the LCCP. There were four possible justifications for transfer were discussed in the paper, but were thought to be not convincing.[187] However, the retaining the present agency rule that the broker is the agent of the assured in placement was argued by Professor Rob Merkins that, "the present agency rule is incompatible with the Law Commissions' own recommendations, which turn on the state of mind of the assured. The Law Commissions have to some extent recognised

[186] Rob Merkin and John Lowry, *Reconstructing Insurance Law: The Law Commission's Consultation Paper*, [2008] MLR 71 (1) 95 at p 104.

[187] The La w Commission Consultation Paper No 182 and the Scottish Law Commission Discussion Paper No 134, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty by the Insured (2007)*, at paras 10.7-10.23 which were:

(i) the deep pocket theory, namely that insurers are more likely than brokers to be able to meet the assured,s claim and so insurers should bear liability;

(ii) the ease of enforcement argument, namely that the assured can simply sue the insurers for the defaults of the broker rather than first suing the insurers, losing and then turning to the broker;

(iii) the reasonable expectations argument, namely that the assured expects the broker to be acting for insurers; and

(iv) the market discipline argument, which is that insurers rather than assureds will be aware of broker shortcomings so that inefficient brokers would fall by the wayside if insurers were responsible for their actions.

this in their discussion of section 19(a) of the1906Act."[188]

Section 19 (a) of the MIA 1906 provides that an agent to insure must disclose every fact known to him or which he ought to have known in the ordinary course of his business. The Law Commission have recommended the repeal of section 19 (a) in its application to consumer insurance. The LCCP proposes that where a broker has failed to disclose facts which were known by him but were not known to the assured, the insurer should no longer have the right to avoid the policy. Instead, the insurer should have the right to claim damages from the broker, on the basis that the section 19(a) duty is imposed on the broker rather than on the assured. "If section 19(a) is left untouched in business insurance, then under the Law Commissions' proposals an assured who was wholly unaware of facts relevant to the insurers could still find that the insurers had the right to avoid by reason of the broker's knowledge of those facts and his failure to disclose them, once again making a mockery of the notion that an innocent assured is to be protected."[189]

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[188] Rob Merkin and John Lowry, *Reconstructing Insurance Law: The Law Commission's Consultation Paper*, [2008] MLR 71 (1) 95 at p106.

[189] Ibid. at p105.

3.2 RIGHTS OF THE BROKER

3.2.1 Payment for the Broker's Service

The main right of the broker is to claim his commission once the contract is made. A broker is usually employed to obtain insurance for a specific period of a particular risk on the best possible terms for the assured. Therefore, he is entitled to the remuneration when a valid and binding contract of insurance has come into existence, which covers the required or appropriate risks.

3.2.1.1 Who Pays the Broker's Commission

The British Insurance Broker's Council accepted[190] that the broker's remuneration is paid by the insurer, and did not suggest that it should be paid directly by the assured to the broker. This practice is well established and fully sanctioned by the court. In *Pryke v. Gibbs Hartley Cooper*[191] Waller J. made the following statement,

> "...the traditional view is that brokerage is promised and paid by the insurer for the introduction of business...the insured is content for the broker to receive that brokerage because it constitutes remuneration for the services he has performed and is performing for the insured..."

3.2.1.2 When will the Broker be Paid?

The liability of the insurer to pay brokerage to the broker comes into existence when the contract is formed. The time for payment of brokerage to the broker is not upon the formation of a binding contract, which can exist without payment of premium or even agreement as to premium, but upon the payment of premium by the broker. The broker is invariably paid by commission, which is deducted by him upon receipt of

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[190] See 1876 Consultative Document published the Council.

[191] [1991] 1 Lloyd's Rep 602.

the gross premium from the assured, prior to forwarding the balance to the insurer.

3.2.1.3 What Happens if the Contract is Cancelled at Later Stage? Is the Broker Entitled to Retain the Commission?

It has already been emphasized that although the broker's duties and obligations are primarily owed to his client---the assured, it is the insurer who is actually liable to pay the brokerage. Following *Velos v. Harbour Insurance Services*[192] it has been equally clear that brokerage is earned once the contract of insurance is formed, so that any later cancellation or termination does not require the broker to return the "unearned" brokerage, even if the premium from which brokerage is deducted is payable in instalments. He can keep the amount he got.

However, the situation is different where a contract is avoided *ab initio*. It is as though it never existed, and the parties must be returned to their original positions. The insurer is responsible to the assured for the return of the gross premium paid by the assured. The question then arises of what happens to the brokerage. Usually it is returned by the broker to the insurer if the insurer has paid the gross premium direct to the assured, or added by the broker to the net premium returned by the insurer to the broker, before returning the gross sum to the assured.

3.2.2 Lien on Policy

Section 53(2) of the Marine Insurance Act 1906 states:

> "Unless otherwise agreed, the broker has, as agent of the assured, a lien upon the policy for the amount of the premium and his charges in respect of effecting the policy; and where he has dealt with the person who employs him as principal, he also has a lien on the policy in respect of any balance on any insurance account which may be due to him from such person, unless when the debt was incurred he had reason to believe that such person was

[192] [1997] 2 Lloyd's Rep 461.

only an agent."

This lien entitles the broker to retain any policy document until all liabilities in respect of the contract of insurance agency have been extinguished, but the broker cannot retain any policies for monies due for other services unconnected with the insurance.

Although he can exercise a lien on any policy in respect of any balance on any insurance account due to him from the assured, the lien is lost in the following situations: (a) if the insured pays the broker what he is owed, (b) if the broker waives his right to the lien, (c) if he validly parts with the possession of the policy document, or (d) if he does any other act inconsistent with the continuing existence of the lien.

3.3 LIABILITIES OF BROKER

3.3.1 The Broker's Professional Liability to the Assured

An insurance broker is usually instructed at the beginning of his legal relationship with his principal, the assured, to obtain quotations for intended contracts of insurance, or to procure the best possible insurance, which he must do by using his best endeavours and exercising reasonable skill and care. In light of the analysis carried out in the previous part,[193] the broker's liabilities usually arise in the following ways:

First, the broker's liabilities arise when the broker fails to obtain proper insurance. Where details of the risk are clearly specified by the assured, the broker is requested to obtain the requisite cover. When there is no specific request from the assured about the insurance cover, the broker is requested to exercise his duty of reasonable care to obtain a reasonable cover from a reasonable underwriter within a reasonable time. A failure to obtain the above insurance may give rise to liability. However, if the broker can show that he took all reasonable steps to effect the insurance but that it was unobtainable, and that he informed his principle, the assured, accordingly, or took reasonable steps to do so[194] and by the fastest method of communication,[195] such a failure may not give rise to liability.

There are two points need to be mentioned here. First, in the UK, a contract of insurance involving an insurer who is not authorized and regulated by the Department of Trade and Industry/Financial Services and Markets Act 2000 is illegal

[193] See the Duties of brokers above at p 75.

[194] *United Mills Agencies Ltd v. RE Harvey Bray & Co* [1951] 2 Lloyd's Rep 631.

[195] The rationale behind this additional obligation is to allow his principal, the assured, to attempt to obtain insurance elsewhere.

and therefore in principle, unenforceable by either party. In *Bates v Barrow*[196] the court held the Financial Services Act 1986[197] to be retrospective in effect so that an assured could enforce payment by an unauthorized insurer for post 1982 contracts. As a result of *Bates v Barrow*[198] it is currently the law that a broker should exercise reasonable skill and care to ensure that any insurer with whom he places insurance is licensed in the United Kingdom and regulated by the FSA. Accordingly, the broker's liability may arise if he placed the insurance with an unauthorized insurer. Second, what does a reasonable cover mean? Is the broker expected to obtain the cheapest policy? The cheapest policy may not always be the best suited to the assured's requirements. For a broker to discard on renewal an insurer with whom the assured has had a good relationship in order to obtain a cheaper policy may even be negligent, unless full disclosure has been made to the assured.[199] Indeed, the cheapest policy may indicate an overriding desire on the part of the insurer to obtain premium income now and dispute any claim later.[200] Thus a more expensive policy with a reputable insurer may well be in the assured's best interest. Liability, however, will not lie on the broker who has not obtained the cheapest policy unless the assured can show that the same insurance was reasonably available elsewhere at a cheaper price, or that the broker unreasonably attributed too much to one factor or term and not enough to another.

Secondly, as discussed above, an insurer is entitled to avoid the contract at anytime if he learns that a fact material to the risk has not been disclosed to him prior to the date the contract was concluded. A fact is material if a prudent insurer would take it into account when considering the risk or if it would influence a prudent insurer when

[196] [1995] 1 Lloyd's Rep 680.

[197] The Financial Services Act 1986 (the "Old Act") was replaced by the Financial Services and Markets Act 2000.

[198] *Ibi d.*

[199] In *Norlympia Seafoods Ltd v Dale and Co Ltd* [1988] ILR 6475, the broker was liable for failing to disclose to the assured the inferior quality of the insurer.

[200] Christopher Henley, *The law of insurance broking,* (2nd ed, Sweet & Maxwell, 2004) at p 396.

considering whether to take the risk or the amount of premium to be charged. The assured may consider that he has provided all relevant information, but he has approached the broker with a view to obtaining his professional expertise and the assured fully appreciates the extent of his duty of disclosure, and that all such information is passed to insurers. Accordingly, the broker's liabilities may arise when the broker breaches his duty of disclosure in utmost good faith.

3.3.2 Damages Could be Claimed

When the insurer refuses to make the payment to the assured because the broker breached his duty, the assured should be allowed to claim damages from the broker. The general principle is that the assured should be placed in the same position as if the act giving rise to non-payment by the insurer had not occurred which means that the assured should be compensated as if the contract had been properly performed and as if the loss had not taken place, so that a valid contract of insurance existed. Thus, the damages that can be claimed back from the broker include the amount which the assured could have been able to claim under the policy had the policy provided the required cover, or the cost of alternative cover and the wasted costs.

(1) The amount, which the assured could have been able to claim under the policy, had the policy provided the required cover.

Example: the broker is required to obtain the cover for a cargo of coal, worth £ 10,000, against all risks. But the cover is obtained by the broker only against "perils of the seas, theft and explosion". Later, there is a fire and a total loss of the cargo. So the cargo is lost as a result of fire which is not a risk covered by the insurance obtained. Under this cover, the insurer will not be liable for the uncovered risk and, therefore, will not pay for the assured's loss. The insurer would of course have paid for the total loss, £ 10,000, if the broker had obtained the cover from him against "all risks". So the broker is liable for his own mistake and the damages that can be claimed back from the broker amount to £10,000, the amount that the assured could have been able to claim back under the policy if that policy provided the cover for "all risks".

For instance, in the case of *Youell v. Bland Welch & Co Ltd (No 2)*[201], the brokers had been instructed to obtain reinsurance on the London market on behalf of insurers, in respect of construction risks on three new building vessels. The brokers erroneously informed the insurers that they had obtained reinsurance as "original". The reinsurance was subject to a cut-off clause whereby the cover terminated 48 months after the commencement of construction. The brokers failed to inform the insurers. Had the insurers been given that information, they would not have accepted the reinsurance, and would have written greatly reduced lines on the original insurance. Phillips J held that the brokers were in breach of their duty of care both in contract and tort. Consequently, the measures of damages should be equal to the difference between the amount for which the insurers became liable on the original insurance, and the amount for which they would have been liable if they had written the reduced lines.

In comparison, in *Aneco Reinsurance Underwriting Ltd v. Johnson & Higgines Ltd*,[202]the House of Lords recently held that following a broker's negligent omission to advise that adequate reinsurance was not available in respect of insurance cover that the claimant was seeking to enter into, the proper measure of damages was the full extent of the claimant's losses.

The facts of the case were that Aneco was invited by the defendant brokers (Johnson) to participate in an excess of loss account of certain Lloyd's marine syndicates under a proportional treaty. Aneco made it a condition of their arrangement with the broker

201 [1990] 2 Lloyd's Rep 431.

202 [2001] UKHL 51.

that their entry into the treaty was subject to the broker's obtaining satisfactory reinsurance on similar terms. Johnson, therefore, not only acted as brokers for the syndicate, but as brokers for Aneco for the reinsurance. Johnson obtained the reinsurance and Aneco thus entered into the proportional treaty. In due course Aneco suffered losses in excess of US$35 million under that treaty US$11 million of which would have been covered by the reinsurance but for the fact that the reinsurance was properly avoided by the reinsurers on the grounds of non-disclosure by Johnson. It further emerged that if the brokers had made the enquiries, presentation and disclosure that they should have made, they would have discovered that the outwards reinsurance cover on which Aneco relied from the start was never available.

The issue for the House of Lords was whether the quantum of damages should be restricted to the sum of US$ 11 million or the entirety of the loss of more than US$ 35 million.

Lord Steyn characterized the question in these terms- the former would be applicable if the defendants' duty was limited to obtaining reinsurance cover but not if it extended to advising on the availability of such cover in the market. At a more general level, the distinction is whether defendants had undertaken a duty merely to provide information as against a duty to advise the claimant.

If on one side the defendants had only undertaken a duty to provide information, the quantum of damages should be restricted to the sum of 11 million. This follows the judgment in *Banque Bruxelles Lambert SA v. Eagle Star Insurance Co Ltd.*[203] In this case the House of Lord's decision has serious implications for the measure of damages which could be claimed by the claimant in the event of a breach. On the side of this case, the duty is only confined to taking reasonable care that the information provided is correct and any liability for damages shall be measured

[203] [1997] AC 191.

along the lines of the foreseeable consequences of the information being incorrect. As Lord Nicholls of Birkenhead said in *Nyekeredit Mortgage Bank Plc v. Edward Erdman Group Ltd (No 2)*[204], the defendant

> "is not liable for all the consequences which flow from the claimant entering into the transaction. He is not even liable for all the foreseeable consequences. He is not liable for consequences which would have arisen even if the advice had been correct. He is not liable for these because they are the consequence of the risks the claimant would have taken upon himself even if the...advice had been sound. As such they are not within the scope of the duty owed to the claimant by the defendant."

If on the other hand, the duty of the broker was to advise the insurer, the defendant must take reasonable care to consider all potential consequences of the course of action advised to the claimant and if there is a breach he or she shall be liable for all foreseeable consequences of that course of action having been followed. After a quick review of the applicable principles of law, Lord Steyn held that the brokers had in fact taken on the role of adviser and as such should be made responsible for all the foreseeable consequences of the claimant taking the advised course of action which was to underwrite the risk. As such, they were liable for the totality of the loss.[205]

(2) The cost of alternative cover.

Example: The broker is required to obtain cover for a cargo of coal worth £10,000, against all risks. But the cover is obtained from an insurance company, A, only against "perils of the seas, theft and explosion" for the premium of £2,000. Later, the assured realizes this mistake and obtains insurance cover from another insurance company, B, against "fire" by paying an additional premium of £500. However, if the broker obtains the cover, including fire, from A, the premium will be £2,200. Now

[204] [1997] 1 WLR 1627 at p 1631.

[205] This case has dealt a severer blow on broker's acting in a dual capacity role which is discussed above at p 75. The dilemma is this-the broker, whilst laboring under a duty to the insured to place the insurance, is also simultaneously under a duty of care to the insurer to provide advice to him on whether or not to write the insurance at all.

the assured has to pay his two premiums with both A and B for £2,500. So the assured paid £300 more than he should pay. In this case, the broker is liable for £300 damages for the assured which is the cost of obtaining alternative cover.

(3) Wasted costs.

Example: The broker is required to obtain cover for a cargo of coal worth £10,000, against all risks. However, he did not disclose a material situation which would have influenced the insurer's decision on whether to take the risk or not. Later, after the contract has been completed there is a loss on the cargo caused by a risk which *is covered* by the existing insurance contract. However, the insurer refuses to pay for the loss suffered by the assured on the grounds of non-disclosure by the broker. The assured decided to sue the insurer and the broker for his own damages. In this case the broker is going to be liable not only for the loss suffered by the assured, but also for the litigation cost which is the "wasted cost".

3.3.3 Limiting and Excluding broker's Liability

Liability may arise when the broker breaches his duties, however, in some circumstances, he may be able to limit or exclude his liabilities.

First, brokers can limit or exclude their liability if they can prove that the assured is responsible for or has contributed to the lack of suitable insurance.

According to section 1(1) of the Law Reform (Contributory Negligence) Act 1945: " (1) Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage . . ." It can be said that the broker can limit his liability if he can prove that the negligence of the assured contributed to the damage . In *JW Bollom & Co Ltd v. Byas Mosley & Co Ltd*[206] the court clearly accepted that the brokers could utilize any alternative defence open to an insurer to counter the assured's claim and that the damages payable by the brokers to the insured could therefore be reduced commensurately.

Secondly, the broker can also exclude his liability if he can prove the existence of an independent ground for the insurer to disclaim liability. In the case of *Fraser v. Furman*[207] the assured had an employer's liability policy with the insurer which was due for renewal shortly. The broker neglected to renew the assured's liability policy. When a loss arose, the assured was unable to claim compensation from the insurer. The assured, then, turned to his broker. The broker accepted that he was negligent but pleaded that the assured had failed to take reasonable precautions for the safety of its employees, in breach of a condition in the policy, which would have entitled the insurer to repudiate liability. The Court of Appeal held that the assured had not contravened the relevant condition, but added that if the insurer would have been able to plead a defence of that nature, the broker would have been able to deny liability.

Thirdly, the broker may succeed if he can show that the assured would not have been insured in the circumstances irrespective of any failure on the part of the broker.
In *Gunns v. Par Insurance Brokers*[208] the assured made a claim for approximately £348,000 under his policy for loss of jewellery kept in a safe at his house. The insurers declined to pay this loss, alleging his non-disclosure of material facts. The

[206] [2000] Lloyd's Rep IR 136.

[207] [1967] 3 All ER 57.

[208] [1997] 1 Lloyd's Rep 173.

assured then sued the brokers for the amount of the loss, alleging that they were liable by reason of their failure properly to answer questions in the proposal form on his behalf. He claimed that he had responded correctly to these questions when they were put to him by the brokers or that he had passed on to them information which would have enabled them to answer these questions correctly, but that the broker had then failed to answer the questions properly on his behalf. In addition he alleged that the broker did not properly explain the true meaning of the questions and the answers required. A further issue arose out of the fact that at the time of the burglary, the assured had failed to activate the burglar alarm at the property, and had failed to lock all of the locks on the back door of the property despite being aware of the high value of the contents of the house, and having believed that he had been followed prior to the burglary by would-be burglars. The brokers claimed that the assured had himself written the answers to the relevant questions in the proposal form, and that he had told them nothing about any previous losses or declinature.

The court accepted the brokers' evidence and applied the presumption that where there had been a non-disclosure of material information, the insurers had been induced to give cover or to give cover on the terms they did. The judge also found that the assured was an experienced businessman who was aware the misrepresentation or non-disclosure could lead to claims being repudiated. The brokers were therefore not liable for any non-disclosure or misrepresentation. In addition, the court held that the assured had been in breach of a condition in the policy that they would take all reasonable precautions to avoid loss and to safeguard the property from loss or damage. Accordingly, even if the brokers had been liable in respect of the non-disclosures, the assured would still not have recovered by reason of the breach of condition.

Fourthly, can the brokers limit or exclude their liabilities if they can prove that the assured is not insurable at the moment the insurance contract is concluded?

In *Everett v Hogg, Robinson & Gardner Mountain (Insurance) Ltd*[209] the broker wrongly told the insurer that plastic was not used in the assured's products, which it was, and the insured failed to disclose its adverse claims record, both of which amounted to breaches of the duty of utmost good faith. The insurance was voidable, but the issue was whether it would in fact have been avoided. One defence open to a broker where he appears liable for a non-disclosure is the argument that had the broker correctly specified all relevant facts, that the assured would have been uninsurable. The court didn't accept such an argument and preferred to believe that "some accommodation would have been reached between the insured and the insurer" such as charging an additional premium[210]

Later, in the case *0 & R Jewelers v. Terry & Jardine Insurance Brokers*[211] this principle was considered in a case where the insurers had in fact been able to avoid for non-disclosure. The court said that the uninsurability of the assured could not amount to a complete defence because it disregarded the possibility that the assured may have found some other way of protecting himself against loss, so that damages against the brokers were, in principle, available. So it cannot be said that the brokers can limit or exclude their liabilities if they can prove that the assured is not insurable at the moment the insurance contract is concluded. However, things will be different if it is absolutely clear that insurance could not be obtained anywhere by the assured. In *0 & R Jewelers v. Terry & Jardine Insurance Brokers*[212]the judge commented that the proper way was "to take into account all the ifs and buts and come to a comprehensive estimate of the chance of obtaining insurance."

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[209] [1973] 2 Lloyd's Rep 217.

[210] *Mint Security V. Blair* [1982] 1 Lloyd's Rep 188.

[211] [1999] Lloyd's Rep IR 436.

[212] *Ibid.*

CHAPTER 4

LEGAL ISSUES ARISING AFTER THE MARINE INSURANCE CONTRACT IS FORMED

INTRODUCTION

As discussed in the earlier chapter,[213] at the formation stage of marine insurance contracts, the broker prepares a brief document-slip and then takes the slip around the market seeking subscriptions. Once the broker has obtained the desired level of subscriptions, the slip is closed. Some months later, another document, a formal policy, is prepared.

Accordingly, there are two important documents (slip and policy) involved during the formation of marine insurance contracts. The significance, and the role of these two documents, has been stated in the MIA 1906. Section 22 of the MIA 1906:

> "*Contract must be embodied in policy.* Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with the Act. The policy may be executed and issued either at the time when the contract is concluded, or afterwards."

The provision which explains the legal nature of the slip is Section 89 of the Act:

> "Slip as evidence. Where there is duly stamped policy, reference may be made, as heretofore, to the slip or covering note, in any legal proceeding."

The first issue focused in the current chapter is the relationship between the slip and the policy. When there a discrepancy between these two documents arises it needs to

[213] See Chapter 2.

be considered in which document the basis of the agreement can be found.

A further issue to consider at this point is the role of held cover clauses. A "held covered clause" is a contract term, under which the insurer's liability will be expanded. Once the requirements of a held covered clause are satisfied, i.e. notice is given to the underwriter and additional premium is agreed, the assured remains covered. The legal importance and significance of these clauses to post contractual issues, the nature of such clauses and the applications of the duty of utmost good faith under held covered clauses will be analysed below. It should be noted that held-covered clauses are able to create a new contract as existing one continue, so they are relevant to our analysis on formation of marine insurance contract.

Even though these issues arise after the contract is formed, the roots of the problems can be traced to the formation stage of the contract. The matters are, therefore, closely connected to the formation stage and need to be examined in depth. It is the main purpose of this chapter to analyse the legal issues arising after the contract is formed as long as they are linked to the pre-contractual stage.

4.1 DISCREPANCY BETWEEN POLICY AND SLIP

As stated above, there are two important documents at the formation stage of the marine insurance contract, known as the "slip" and the "policy". With all contracts, there exists the possibility of discrepancy between the actual agreement and any subsequent written record thereof. In the case of contracts of marine insurance, this possibility is exacerbated by the use of a slip with a formal policy. When there is a discrepancy between a slip and a policy, the question raised is whether the policy can supersede the slip or the slip can prevail over the policy. The next part will discuss various ways of approaching this problem.

4.1.1 Narrow Approach

The narrow approach completely denies that the slip is admissible in order to aid the construction of the policy, which means that if there is discrepancy between the two documents, the slip cannot be considered as evidence. It follows that the slip will not be available to assist the true construction of the insurance contract at all. This approach was evident in *Youell v Bland Welch & Co Ltd.*[214] This case concerned a contract of reinsurance at Lloyd's. The slip was superseded by a formal policy. It was common place for this to happen, but the defendant reinsurers submitted that the slip could be looked at as an aid to the construction of the policy. Mr. Justice Phillips (as he then was) disagreed. He held that the *parol evidence rule*[215] made the slip inadmissible. He said that,[216]

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214 [1990] 2 Lloyd's Rep 423.

215 "parol testimony cannot be received to contradict, vary, add to or subtract from the terms of a written contract, or the terms in which the parties have deliberately agreed to record any part of their contract." *Bank of Australasia v palmer* [1879] AC 540 at p 545.

216 [1990] 2 Lloyd's Rep 423 at p 428.

> "But if prior written agreements or drafts were admitted in evidence as an aid to construction the result would be that the Courts would often be called upon to consider a profusion of documents in cases where there was an issue as to the true construction of the final version of the contract. The English Court has firmly set its face against such a practice. It has done so by adopting the so-called *parol evidence rule* . . ."

This approach denies the admissibility of the slip as an aid to the interpretation of the contract on the basis that the slip is "extrinsic evidence", that is evidence outside the four corners of the document. However, this traditional rule of inadmissibility, at least in so far as it extends beyond the exclusion of negotiations, is inconsistent with the modern approach to extrinsic evidence. Today, language is always understood as contextual; the contract is always a product of the circumstances in which it was drafted.[217] Thus, even where the wording of a contract can be given meaning when

[217] Lord Hoffmann in *Investors Compensation Scheme Ltd v. West Bromwich Society* [1998] 1 WLR 896 (HL) revisited and restated the general approach to the construction of contracts as follows,

"The principles may be summarized as follows;

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see *Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd.* [1997] AC 749 .

(5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must

read in isolation, the extrinsic evidence will still be admissible to establish the background against which the contract was concluded. In this way the extrinsic evidence may give a better indication of the true intention of the parties and influence the interpretation of the contract accordingly.

4.1.2 Liberal Approach

The liberal approach is in keeping with the modern approach to extrinsic evidence, highlighted above. This approach was evident in the decision of the Court of Appeal in *HIH Casualty & General Insurance Ltd v New Hampshire Insurance Co.*[218] According to Rix LJ, there is no rule of law that has the effect of rendering the slip inadmissible:

> "In my judgment, there is nothing in these citations which binds this Court to rule that where a prior contract has been followed by a further contract, or where in an insurance context a slip contract has been followed by a policy, there is a rule of law which makes it inadmissible to consider the terms of the prior contract..."[219]

Under this approach the parties' intention will determine the evidential utility of the slip. It may be the case that the parties *intended* the contract as stated in the policy to supersede the contract as stated in the slip. On the other hand the parties may have intended the slip to take precedence over the policy.[220]

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have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Compania Naviera S.A. v. Salen Rederierna A.B.* [1985] AC 191 , 20, '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 commonsense.'"

[218] [2001] 2 Lloyd's Rep 161.

[219] *Ibi d,* at p 178.

[220] *Ibi d,* paras 69-79

4.1.2.1 The Policy Superseding the Slip

If it is the intention of the parties for the policy to supersede the slip, it must follow that the parties' contract is found exclusively in the policy. In such circumstances the slip cannot be used to add to, or modify the policy and any discrepancy between the slip and the policy will be resolved in favour of the policy. However, the slip will retain an interpretive role and if there is a need to construe the terms or the wording of the contract, as stated in the policy, reference can then be made to the slip. Rix LJ., asked,[221]

> "But does it follow that the earlier contract cannot even be looked at for the purposes of construing the later contract? In principle, it would seem to me that it is always admissible to look at prior contracts as part of the matrix or surrounding circumstances of a later contract...a cautious and sceptical approach to finding any assistance in the earlier contract in the slip seems...a sound principle."

Where the parties' intention is that the policy supersedes the slip, there is one exception to the rule that the policy prevails. The exception arises where the meaning of the policy is unclear but the meaning of the slip is clear. In these circumstances, the discrepancy between the two documents can be resolved in favour of the slip. In *The Aikshaw,*[222] according to the slip a vessel was covered "at and from any port or ports and (or) place or places on the west coast of South America in any rotation, while there" and for a voyage to Europe. On the wording of the policy, however, the cover attached only "at and from any ports and (or) places of loading". When the vessel was lost after arriving at a port on the west coast of South America but before arrival at a port of loading, the terms of the slip prevailed as the real expression of the parties' intentions. Also, in *Motteux v London Assurance*,[223] the policy was

[221] *Ibi d,* at p 179.

[222] (1893) 9 TLR 605.

[223] (1739) 1 ATK 545.

unclear whether it attached "at and from" or only "from" a port. The court read the policy in accordance with the clear wording of the slip.

4.1.2.2 The Slip Prevailing

The second possibility is that the parties intend the slip to prevail. In such a case, subject to evidence that the discrepancy results from a decision to vary the contract, inconsistencies should be resolved in favour of the slip.

In *Western Assurance Co v Poole*,[224] expert evidence established that incorporation in the policy of a sue and labour clause[225] contradicted the phrase "no s/c" in the slip and the insurer was accordingly held not liable for suing and labouring expenses. In *Eagle Star & British Dominion Insurance Co Ltd v AV Reiner*,[226] a vessel was stranded while leaving the port of Valencia at the outset of a voyage from Spain to Antwerp. According to the wording of the policy, the whole voyage was covered, but under the slip, as construed, risk did not attach until Gibraltar. As a result of this discrepancy, Salter J stated as follows:[227]

> "I am satisfied that the policy is not in accordance with the contract the parties made and that there was a mistake common to them both. The contract which they in fact made appears upon the slip and was a contract under which the risk attached and was meant by both parties to attach 'at and from and off' Gibraltar"

[224] (1903) 8 Com Cas 108.

[225] A sue and labour clause extends cover by expressly authorizing the taking of reasonable steps in mitigation of the consequences of an insured casualty and promising indemnification in respect of expenses reasonably incurred thereby.

[226] (1927) 27 LIL Rep 173.

[227] *Ibi d*, at p 177.

4.2 THE PARTIES' INTENTION

From the above discussion, it is quite clear that when there is discrepancy between the slip and policy, the question of which document supersedes the other depends on the parties' intention. Accordingly, the method of establishing what the parties' intention actually is becomes a key issue that needs to be analysed in further detail.

The intention of the parties must inevitably fall upon the wording chosen by them. However, the meaning to be given to those words may be affected by a wide range of factors.

4.2.1 The Natural Meaning of the Words

The starting point in interpreting the words chosen by the parities to express their agreement is their ordinary and natural meaning. The inquiry as to the true interpretation of a contract "will start, and usually finish, by asking what is the ordinary meaning of the words used"[228]

In *Melanesian Mission Trust Board v Australian Mutual Provident Society,*[229] Lord Hope reasoned as follows:

> "Where ordinary words have been used they must be taken to have been used according to the ordinary meaning of those words. If their meaning is clear and unambiguous, effect must be given to them because that is what the parties are taken to have agreed to by their contract. Various rules may be invoked to assist interpretation in the event that there is an ambiguity. But it is not the function of the court, when construing a document, to search for an ambiguity… It is of course legitimate to look at the document as a whole and to examine the context in which these word have been used, as the context may affect the meaning of the words. But unless the context

[228] *Charter Rei nsurance Co. Ltd v Fagan* [1997] AC 313 at p 384, per Lord Mustill.

[229] [1996] UKPC 53.

shows that the ordinary meaning cannot be given to them or that there is an ambiguity, the ordinary meaning of the words which have been used in the document must prevail."

4.2.1.1 When there is an Ambiguity about the Meaning of the Words

When there is an ambiguity about the meaning of the wording, for example, where some relevant clause in the contract is capable of two or more equally legitimate interpretations, the ambiguity entitles the court to invoke the *contra proferentem* rule.[230] Under this rule, the ambiguity is resolved against whichever party is responsible for the ambiguous clause. During the formation of marine insurance contracts, the wording of a policy is generally put together by the broker. The broker, as agent of the assured, then tenders the wording in the form of a slip to the insurer for consideration of the acceptability of the risk, including the precise terms, and the appropriate level of premium. Where the term that proves ambiguous is one inserted by or on behalf of the assured, the *contra proferentem* rule requires interpretation in favour of the insurer and against the interests of the assured. Where, by contrast, the ambiguity resides in an amendment to the slip introduced by the insurer, the ambiguity will be resolved against the insurer.

In *M/S Aswan Engineering Establishment Co Ltd v Iron Trades Mutual Insurance Co Ltd*,[231] the policy adopted the insurer's standard liability form and excluded "the cost of replacing or making good defective materials, plant, machinery, goods or commodities." In this case pails supplied by the assured collapsed as a result of inadequate packing and stowage. Since such a scenario was not clearly covered by the wording of the exclusion, it followed that the insurer could not benefit from that exclusion. Hobhouse J held that the insurer was not protected by the exclusion:

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[230] The expression "*contra proferentem* rule" is a convenient abbreviation of the maxim *verba chartarum fortius accipiuntur contra proferentem.*

[231] [1989] 1 Lloyd's Rep 289.

> "This was not liability for the cost of replacing or making good anything. What the wording refers to on its natural meaning is a situation where the assured has undertaken a contractual liability to replace or make good as under a guarantee clause in a contract for the sale of goods. If, contrary to my view, it is not clear that this wording has this meaning then it is at best ambiguous and capable of more than one meaning, and the ambiguity must be resolved against the defendants."[232]

4.2.1.2 Where the meaning of the words may Lead to an Excessively Unreasonable Result

The natural meaning of the words should be respected when two parties' intention is deduced. However, the situation becomes more complicated when the questioned words could lead to an excessively unreasonable result.

In *Schuler (L) AG v. Wickman Machine Tool Sales Ltd,*[233] clause 7(b) of the contract required exclusive sales agents to visit each of six named potential customers each week and to ensure that the visits were all carried out by the same named representative or, in unavoidable default, by the same named alternative representative. The clause was described as a "condition". The question was whether the word "condition" was employed in its technical legal sense to denote a term any breach of which as a repudiation of the contract. The House of Lords refused to accept that the word "condition" was used in its technical sense. Had the term been used in its technical sense a solitary failure to visit one firm in one week by the representative or alternative would have entitled the principal to terminate the contract. Yet there was no provision in the contract for substitution of the primary or alternative representatives even if one or both should die, retire, or otherwise leave the company, or to cover simultaneous illness of both eligible representatives, or to cover refusal by one of the customers to accept a visit each and every week. A technical interpretation of the word 'condition' could, therefore, have produced

[232] *Ibi d,* at p 293.

[233] [1974] AC 235.

results described variously as "so unreasonable"[234], "absurd"[235], and "grotesque"[236]. On the issue of interpretation, Lord Reid stated as follows:[237]

> "The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable a result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear."

It seems reasonable to infer from this judgment that a wording which may lead to an excessively unreasonable result is unlikely to be taken to reflect the true intention of the parities.

However, in the case of *Kuwait Airways Corp v Kuwait Insurance Co SAK (No 1)*,[238] Lord Hobhouse took a different view.

In this case an aviation policy covered aircraft hulls against a range of perils set out in six paragraphs lettered (a) to (f). Paragraph (a) comprised war, invasion, hostilities and similar perils while paragraph (e) contained perils of deprivation of possession including seizure. An extension of the policy to aircraft spares covered the same range of perils "other than paragraph (a)" which was to apply only to spares in transit. This reflected the caution with which the insurance market approaches war risks; where war-risks operate, cover for goods, in principle, is often confined to goods in transit. A considerable quantity of insured spares were seized by Iraqi forces when they invaded Kuwait. *Prima facie*, this loss could be regarded as caused by any one of a range of perils listed in paragraph (a) and also by seizure. The question was whether, in the context of the cover for spares not in transit, cover against the perils

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[234] *Ibi d,* at p 251, per Lord Reid.

[235] *Ibid,* at p 256, per Loard Simon.

[236] *Ibi d,* at p 272, per Lord Kilbrandon.

[237] *Ibi d,* at p 251.

[238] [1999] 1 Lloyd's Rep 803.

in paragraph (a) had been merely omitted from cover or, as argued by the insurers, excluded. A majority of the Court of Appeal found in favour of the insurers.[239] If the insurers did not want to cover the loss of spares by war except while in transit, it made no commercial sense to cover exactly such a loss under another name. Reading the extension as merely omitting paragraph (a) would be an "over-literal interpretation"[240]

This holding was however, reversed by the House of Lords. According to the House of Lords, background market concerns regarding the extent of cover that it was prudent to offer for goods not in transit were irrelevant. The wording of the extension was clear. The perils mentioned in paragraph (a) were omitted, not excluded, and there was simply no rationale to permit the court to rescue an insurer from an imprudent bargain. According to Lord Hobhouse,

> "it must...be stressed that it is not for the courts to tell the parties what contract they should have made nor, after the event, to evaluate the merits and demerits of their bargain. If, as here, the parties have used plain language to express their intentions, that should be the end of it: the court should enforce the contract in accordance with its terms"[241]

Accordingly, the conclusion should be "If the contract on its true interpretation is commercially bizarre, the courts cannot rewrite it. Any remoulding by the court in the course of the construction process of the parities' obligations expressed in the language used must be founded on the intention of the parties whether express or implied in the document itself read in the relevant matrix of facts."[242] *Kuwait Airways Corp* makes it clear that the parties are responsible for their own commercial arrangements, however foolish, and the Court will not intervene to mitigate any undesirable consequences that arise from an imprudent bargain. The House of

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[239] [1997] 2 Lloyd's Rep 687 at pp. 695,701.

[240] *Ibi d,* at p 695, per Staughton LJ.

[241] [1999] 1 Lloyd's Rep 803 at p 816.

[242] Howard Bennett, *The Law of Marine Insurance*, (2nd ed, Oxford University Press, 2006) at p 275.

Lords is no doubt right to observe that one can have a clear intention that is nonetheless foolish; it is not within the jurisdiction of the Court to remedy such lack of commercial good sense.

4.2.2 The Business Common Sense of the Words

Lord Hoffmann in the case of *Investors Compensation*[243] stated:

> "Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were in at the time of contract"

So, in order to search for the true intention of the parties, it is also important that the wordings should be construed in a manner consistent with what makes commercial sense. "The less commercially sensible an interpretation, the less likely the parties as deemed reasonable commercial people are to have intended it."[244] Thus, it has been said that "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 common sense"[245]

In *Quorum v Schramm*,[246] in the aftermath of a fire that had probably damaged a painting insured under a fine art policy, the parties agreed a clause addressing the measure of indemnity for partial loss. Part of this clause operated as an average clause, rendering the assured its own insurer for the proportion of the risk corresponding to the difference between the sum insured and the market value of the painting immediately prior to the loss. This average clause left part of the risk with the assured if the value of the painting had risen above the sum insured. This made

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[243] *Inves tors Compensation System Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at p 913.

[244] *Man nai Investments Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 at p 771.

[245] *Ant aors Compania Naviera SA v Salen Rederierna AB* [1985] AC 191 at p 201, per Lord Diplock.

[246] [2002] 1 Lloyd's Rep 249.

commercial sense. However, on its wording, the clause also left part of the risk with the assured where the value of the painting had fallen below the sum insured. This was an extraordinary commercial consequence, as the premium would have been paid on the basis of the sum insured and there would be no commercial logic in this consequence. Accordingly, and indeed at the insurer's invitation, Thomas J held that the average clause should be construed in accordance with the plain intention of the parities that it should apply only where the market value had risen above the sum insured.

4.2.3 How can the Parties' Intention be Expressed?

As discussed above the parties' intention is of paramount importance in the resolution of discrepancies between the slip and policy and now it is appropriate to consider how the parties' intention can be expressed.

4.2.3.1 Expressing the Intention for the Policy to Supersede the Slip

According to Rix LJ in *HIH v New Hampshire*[247], "In the insurance market…it may well by now be possible to talk of a general presumption that a policy is intended to supersede a slip."[248] It is the normal inference whenever a slip is followed by a policy that the parties' intention is for the policy to supersede the slip. This intention to supersede has been stated to be the understanding of Lloyd's market where the slip is sent to the Lloyd's Policy Signing Office (now superseded by Ins-sure) and a policy is duly issued.[249] It is not necessary therefore to explicitly state that the policy will supersede the slip.

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[247] [2001] 2 Lloyd's Rep 161.

[248] *Ibi d,* at para 85.

[249] *New Hampsh ire Insurance Co v MGN Ltd* [1997] LRLR 24 at p 33.

4.2.3.2 Expressing the Intention for the Slip to Prevail over the Policy

To express the intention for the slip to prevail over the policy can prove difficult. However, designating the slip as the "slip policy" or "slip contract" can be considered as an indication that the wording of slip is intended to be final.[250]

In *HIH v New Hampshire*[251] itself, Rix LJ considered that the parties had not intended the policy to supersede the slip for two reasons. First, the slip was designated a "slip policy" and, secondly, the policy was incomplete as demonstrated by its silence with respect to premium.[252]

Likewise, in *Assicurazioni Generali SpA v Ege Sigorta AS*,[253] the slip was stated to be a "slip contract". Colman J held that the subsequent tendering of wording by the broker for approval by the insurer was a "purely ministerial exercise". In the event that the wording did not accurately reflect the slip, its tender was not an offer to vary the contract but an error in completing the contract wording. An acceptance by the insurer was not an agreement to any new wording.

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[250] However, it might also mean that both documents will live together, which will be further discussed below at p 150.

[251] [2001] 2 Lloyd's Rep 161.

[252] *Ibi d,* at para 95.

[253] [2002] Lloyd's Rep IR 480 at p 484.

4.3 RECTIFICATION

A discrepancy may sometimes arise between the agreement of the parties and any subsequent written record thereof. For instance, in marine insurance contracts such a discrepancy could be found in either the slip or policy, where one or both fail to reflect the agreement that was actually reached by the parties. Rectification is the equitable remedy by which a court can remedy mistakes in the recording of the parties' agreement. Thus, it has been said that: "Courts of equity do not rectify contracts; they may and do rectify instruments purporting to have been made in pursuance of the terms of contract." [254]

Rectification is generally confined to failures by the written record accurately to reflect the common intention of the parties. The conditions to be satisfied were summarized by Slade LJ as follows:[255]

> "First, there must be a common intention in regard to the particular provisions of the agreement in question, together with some outward expression of accord. Secondly, this common intention must continue up to the time of execution of the instrument. Thirdly, there must be clear evidence that the instrument as executed does not accurately represent the true agreement of the parties at the time of its execution. Fourthly, it must be shown that the instrument, if rectified as claimed, would accurately represent the true agreement of the parties at that time..."

For example, in a marine insurance contract, if the policy contains terms contradictory to or inconsistent with a prior contract between the parties, one party may bring an action for its rectification. The burden of proof lies upon the party seeking rectification. This party must adduce convincing proof of the parties' outward expression of accord or common intention. The burden of discrediting a

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[254] Howard Bennett, *The Law of Marine Insurance*, (2nd ed, Oxford University Press, 2006) at p 294.

[255] *Agi p SpA v Navigazione Alta Italia SpA* [1984] 1 Lloyd's Rep 353 at p 359.

policy on oral evidence alone is an exceptionally difficult one to discharge,[256] and rectification is achieved usually only in cases where there has been some written expression of the parties' intention, such as a slip. Accordingly, during this process reference might be made to the slip.

4.3.1 The Utility of the Slip in Any Given Rectification Action will Depend on the Intention of the Parties

The utility of the slip in any given rectification action will depend on the intention of the parties as to whether the policy should supersede the slip. In *A. Gagniere & Co. Ltd v The Eastern Company of Warehouses Insurance*,[257] Bankes LJ stated:[258]

> "If you prove that the parties have come to a definite parol agreement, and you then afterwards find in the document which is intended to carry out that definite agreement something other than that definite agreement has been inserted, then it is right to rectify the document in order that it may carry out the real agreement between the parties. But in order to bring that doctrine into play it is necessary to establish beyond doubt the real agreement between these parties was that which it is sought to insert in the document in place of agreement which appears there."

[256] In *Parsons v. Bignold* (1846) 15 L.J.Ch.379: A applied to an insurance office for a policy on the life of B, his son. The insurers' agent gave him a form to complete. It included a question as to his interest in the life assured. A did not complete the answer to the question in writing, but explained orally to the agent that he possessed an interest in certain lands, held of the Dean and Chapter of Wells, for so long as his son, B, lived. The agent then filled up the form incorrectly, including certain other lands in the declaration of interest. On B's death, the insurers declined to pay on the ground that the declaration of interest was untrue and avoided the policy, into which it had been incorporated as the basic of the contract. A claimed rectification of the policy to accord with his answer given to the agent, who, it was assumed for the sake of argument, had acted as the insures' agent in writing down the answer. No adequate evidence of their conversation was, however, given by A and, although the agent had freely admitted in a letter that he might well have made a mistake, he did not give evidence to support that admission. Rectification was refused, the Lord Chancellor saying that, "nothing short of the most clear and distinct evidence would be sufficient.

[257] (1921) 8 LIL Rep 365.

[258] *Ibi d,* at p 366.

4.3.2 Where the Two Parties' Intention is that the Policy is Intended to Supersede the slip

In these circumstances, the natural inference is that any discrepancy in terms between the two documents has been agreed by the parties and represents the product of a *deliberate* variation of the contract. If there is any difference between the wording of the slip and that of the formal contract which is embodied in the policy, the natural assumption is and should be that the wording of the policy has been designed to reflect better the agreement between the parties. To refer to the slip as an aid to the construction of the policy would make little sense in these circumstances and indeed would run counter to one of the objects of replacing the slip with the policy.

Of course rectification may still be available in these circumstances, but the party who is seeking rectification cannot use the slip as evidence of the accurate record of the transaction.

4.3.3 Where the Two Parties' Intention is that Slip is Intended to Supersede the Policy

In this case, the slip represents the final terms of a binding contract, and in the event of any discrepancy between the slip and the later policy, the slip will prevail and the policy will be rectified accordingly.[259] An example of an assured successfully relying on the slip is provided by *Wilson Holgate & Co Ltd v Lancashire & Cheshire Insurance Corp Ltd.*[260] The underwriters' defence of misdescription of the insured goods failed where the slip accurately described the goods as palm oil but the policy referred to them as palm kernel oil, a quite different substance. According to Bailhache J, the slip represented the original and real contract and the error in the policy was to be disregarded or, if necessary, rectified. Likewise, in *Symington & Co*

[259] *Banque Sabbag SAL v Hope* [1972] 1 Lloyd's Rep 253 at p 263.

[260] [1922] 13 LILR Rep 486.

v Union Insurance Society of Canton Ltd (No 2),[261] the insurers argued that the slip should be read as incorporating an implied term that the contract was subject to the usual terms of the insurer in order to take advantage of a marginal note in the policy restricting the cover that the slip recorded as grounded. The Court of Appeal held, however, that any intended disparity between the terms as recorded on the slip and the final policy had to be expressly contemplated on the slip.

4.3.4 Rectification of Both Slip and Policy

Rectification of both slip and policy is possible. In *The Demetra K*,[262] the insurers' unsuccessful rectification claim arose out of a change of terms of renewal. In 1995, the Demetra K was insured under a policy that incorporated the Institute Time Clauses Hulls (1/10/83) modified by a so-called "October memorandum" that added war risks and "risks of loss or damage by acts of vandalism and/or sabotage and/or malicious mischief". In 1996, cover was renewed on a slip that again incorporated the Institute Time Clause Hulls (1/10/83), but the terms of the October memorandum, although originally incorporated, were struck out. During the currency of the renewed cover, the vessel was seriously damaged by a fire that, for the purposes of the action, was assumed to have been started deliberately but not by the assured owners. The assureds claimed under the insurance for loss caused by the covered peril of fire. The insurers accepted that war risks had simply not been included in the 1996 policy but argued that the underwriter and broker had agreed an express exclusion of "loss or damage by acts of vandalism and/or sabotage and/or malicious mischief" and sought rectification of the policy accordingly.

The Court of Appeal held that, in the absence of the express exclusion for which the insurers contended, the loss would be covered by the policy. On balance, the evidence favoured the assureds' contention that the underwriter and broker had

[261] [1928] 32 LIL Rep 287.

[262] [2002] 2 Lloyd's Rep 581.

agreed merely to delete the October memorandum but not to add an express exclusion. Alternatively, the insurers had failed to adduce convincing evidence of an antecedent agreement conflicting with the terms of the 1996 slip as required for rectification. Although the parties had clearly agreed on the deletion, there was no evidence of any agreement as to the intended effect of that deletion on the scope of the cover provided by the policy.

Accordingly, it can be suggested that, provided there is clear evidence, the policy may be rectified to accord with the parties' proven agreement even if the agreement is contrary to both the slip and the policy.

4.4 HELD COVERED CLAUSES

A "held covered clause" is a clause with a special character that may be agreed to by parties to a marine insurance contract. Under such a term the underwriter agrees to an extension or modification of cover subject to agreement on reasonable alteration of terms and this clause normally is invoked after the conclusion of the original contract by the assured giving notice to the insurer. The effect of a held covered clause is to extend the original policy cover. The notice under the held covered clause amounts to a request to the insurer to quote terms for "new cover" or "variation"[263] And the process is in parallel to the "presentation of the risk" process prior to the formation of the contract. It is vital to analyse the relevant legal issues under this clause at this stage.

4.4.1 Held Covered Clauses are Designed to Offer Protection to the Assured

According to the common law, and specially stipulated in the Marine Insurance Act 1906, the risks which are covered under a marine insurance policy should be clearly stated in the contract. The insurer is not responsible for the risks which fall outside of the range referred to in the contract. The doctrine of "alteration of risk" should be viewed as inflexible and weighted heavily in the insurer's favour.

However, held covered clauses are an exception to the above rules. Under the held covered clause, when the situation stated in the term occurs and this situation constitutes an alteration of risk, the insurer's liability is not prospectively discharged and he is still responsible. Instead, the assured remains covered provided any specified conditions are fulfilled, usually notification of the event by the assured to the insurer and agreement upon any appropriate additional premium and change of terms.

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[263] The nature of this clause will be further considered below at p154.

Here are a few examples of held covered clauses:

Clause 10 of the Institute Cargo Clauses (A), (B) and (C) is a held covered clause covering change of voyage. The "breach of warranty" clause in the Institute Time Clauses Hulls (cl. 3) is a held covered clause covering "any breach of warranty as to cargo, trade, locality, towage, salvage services or date of sailing". The "change of voyage " clause in the Institute Voyage Clauses Hull (cl. 2) is a held covered clause covering not only change of voyage but also deviation and "any breach of warranty as to towage or salvage services". In each case, the assured is held covered provided notice is given to the insurers[264] and any amended terms of cover and additional premium required are agreed.

Accordingly, the purpose of the held covered clause is to offer protection to the assured. However, the protection must be within the limits and subject to the conditions of the clause.

4.4.2 Two Different Types of Held Covered Clauses

According to Longmore. L.J., in *The Mercandian Continent*[265] there are two kinds of held covered clauses named "traditional held covered clauses" and "held covered clauses."

The "Traditional held covered clause"

A clause qualifies as "a traditional held covered clause" where, if the assured gives notice to the insurer and the parties agree an additional premium or other terms, the assured can get an opportunity to extend the scope of cover.

[264] The cargo clauses require "prompt notice", while the hulls clauses require notice "immediately after receipt of advices"

[265] [2001] 2 Lloyd's Rep 563.

A typical example of this kind of clause is the Institute Time Clause Hulls (1995) clause 3, which stated, "Held covered in case of any breach of warranty as to cargo, trade, locality, towage, salvage services or date of sailing provided notice be given to the Underwriters immediately after receipt of advices and any amended terms of cove and any additional premium required by them be agreed." This kind of clause enables the assured to extend the limits of cover if the notice is given and an additional premium is agreed.

The "Held covered clause"

Held covered clauses are clauses which provide "automatic" coverage on a *pro rata* premium.

A typical example of this kind of clause is the Institute Time Clause Hulls (1995) clause 2, which stated that, "Should the Vessel at the expiration of this insurance to be at sea and in distress or missing, she shall, provided notice be given to the Underwriters prior to expiration of this insurance, be held covered until arrival at the next port in good safety, or if in port and in distress until the vessel is made safe, at a pro rata monthly premium." Under this kind of clause, the limits of the additional cover have already been determined and a premium agreed in advance, so all that the assured does is to exercise rights which he has under the original contract.

4.4.3 The Nature of Held Covered Clauses

Held covered clauses are terms stipulated in the marine insurance contract. The parties' obligations under these terms are not carried out until the held covered clauses are invoked by giving notice from the assured. Once the assured does give notice, the original risk alters and the cover is extended. "A held covered clause is undoubtedly a valid contract"[266] but the question remains about the precise nature of such clauses. In particular the question should be considered whether the held covered clause is just part of the existing insurance contract or creates a new contract apart from the original one; the legal status of the held cover clause and the obligations arising under it may differ depending on its true status.

Since the held covered clause is one of the terms in the original contract, it is possible to view the held covered clause as an integral part of the initial contract. If the held covered clause is regarded as part of the initial contract, the extended cover provided by this clause may be viewed as one category of covers arising under the original policy. Accordingly, a held covered clause would be said to establish an immediate binding obligation in the insurance contract which the parties have entered into.

However, contractual terms create a bilateral obligation, while, held covered clauses, in fact, create only a unilateral obligation which requires the underwriter to provide the specified additional cover if the assured gives notice. Accordingly, the answer to the question raised earlier should be that the held covered clause creates a distinct contract of insurance. The held covered clause is perceived as an offer made by the underwriter to provide. If demanded, additional cover is provided in accordance with the terms and conditions specified in the clause. Beyond being unilateral, the offer is also irrevocable. The underwriter is bound to maintain the offer for as long as the held covered clause is capable of being invoked by the assured, which period may extend beyond the duration of the initial insurance contract. The assured accepts the offer and provides consideration by giving a valid notice as specified in the clause. In giving notice, the assured also promises, subject to any express terms the parties may agree, to pay a reasonable additional premium and/or to agree reasonable amended terms, and in so doing provides consideration.

[266] D. Rhi dian Thomas, *The Modern Law of Marine Insurance VII,* (LLP Publishing, 2002) at p 52.

Adopting the above analysis, the effect of a held covered clause is that the underwriter undertakes a contractual obligation to provide additional cover if the assured demands by giving notice. It does not become an obligation requiring performance until notice is given, and if notice is not given it never becomes an active obligation. Until notice is given, the assured is under no obligation whatsoever. But once notice is given, both parties are subject to immediate obligation. The underwriter is obliged to provide the promised additional cover. There is no option in the matter and failure to do so amounts to breach of contract. The assured is obliged to agree any specified conditions precedent, usually relating to additional premium and amended terms of cover.

4.4.4 Whether the Additional Cover is an Option for the Assured

It is quite clear that the additional cover provided by held covered clauses is only available when notice is given by the assured. Thus, the assured's notice is the trigger to activate the held covered clause. When the assured gives notice to the underwriter, the underwriter is obliged to hold the assured covered, although the underwriters' obligation is usually subject to the right to the payment of additional premium or amended conditions of cover. Here, the relevant question is whether the assured is entitled to choose not to give the notice. In other words it needs to be considered whether giving notice is an option for the assured.

Professor Rhidian Thomas's approach to that issue is as follows:[267] "There is, of course, no obligation on an assured to invoke a held covered clause; the clause merely gives the assured the right to election." However, Hamilton J took a different view in the case of *Mentz, Decker & Co v. Maritime Insurance Co.*[268] The clause in

[267] D. Rhi dian Thomas, *The Modern Law of Marine Insurance VII,* (LLP Publishing, 2002) at p 4.

[268] [1910] KB 132.

this case stated: "in the event of the vessel making any deviation or change of voyage [the assured] shall be held covered at a premium to be arranged provided due notice be given by the assured on receipt of advice of such deviation or change of voyage." *Obiter*, Hamilton J agreed with counsel for the insurers that "it is impossible to construe the clause as giving an option to the assured to be covered or not as he chooses"[269]

In my opinion, the answer to the question whether there is an option for the assured to be held covered or not should depend on the wording of the particular clause and on the relevant intention of the parties. In *Mentz, Decker & Co v. Maritime Insurance Co.*[270] the wording of the clause stated that "it is mutually agreed that such deviation or change of voyage shall be held covered". This could be read as meaning that the assured had already agreed that deviations and changes of voyage were to be covered. According to the true intention of the parties, if the assured failed to give notice as required, the result will be that the assured is deprived of cover. In contrast, clause 9 of the Modern Institute Cargo Clauses provides that, where the contract of carriage or transit terminates in certain circumstances, the insurance "shall also terminate unless prompt notice is given to the underwriter and continuation of cover is requested." The wording used in this clause can hardly be interpreted as an obligation to give notice. The two parties' intention should be read as affording the assured the opportunity in the relevant circumstances, to assess its needs and determine whether or not they are best served by continuation of the insurance.

[269] *Ibi d,* at p 135.

[270] *Ibid..*

4.4.5 Difficulties that may Arise in the Case of Co-insurance

It is a common practice that, during the formation of marine insurance contracts, a policy is subscribed by a number of underwriters. When there is a held covered clause in the insurance policy, the invocation of such a clause may give rise to some difficulties. Several issues arise. For example, it may be asked, to whom should the assured give the notice; is the assured required to give notice to every underwriter; if the assured gives notice to different underwriters at different times, will this action still be considered as a valid invocation of the held covered clause; and can it be said that different underwriters may request different levels of the additional premium? A common and effective method of avoiding these potential difficulties is by agreeing a "leading underwriter agreement", whereby the leading underwriter receives notice and agrees the level of additional premium and/or new terms of cover on behalf of the following co-insurers.[271]

4.4.6 The Importance of the Notice

There is a consideration that is relevant and common to all held covered clauses. It may argued that, under held covered clauses, an assured may give notice and pay an additional premium only in the event of a loss, and this can cause inequity to the insurer. The inequity may be said to arise here because the insurers will take a different and greater risk without either the knowledge necessary to permit the seeking of reinsurance or the certain benefit of an appropriately enhanced premium. However, the law has responded by rendering the benefit of a held covered clause to be conditional upon the giving of notice at least within a reasonable time of discovery by the assured of the alteration of risk. Accordingly, central to the concept of a held covered clause is the requirement of notice. How it is to be given may be governed by the terms of the held covered clause itself. In contemporary practice it is almost a universal requirement that the notice be prompt, but otherwise little, if any,

[271] A leading underwriter clause is discussed in Chapter 2 at p 47.

is stipulated as to the form of the notice.

4.4.6.1 The Time within Which Notice is to be Given

In contemporary practice held covered clauses usually make express provision for the time within which notice must be given. The standard obligation is to require notice to be given "promptly"[272] or "immediately"[273] after receipt of the held covered events. Words such as "promptly" and "immediately" indicate clearly that once an assured is aware that a held covered event has occurred or will or may occur, notice must be communicated at once. The notice must be given without delay, at the first practicable moment, to the underwriters if additional cover is required.

In the absence of such an express provision, the courts will imply a term to the effect that the benefit of a held covered clause is conditional upon the giving of notice within a reasonable time.

Thames & Mersey Marine Insurance Co Ltd v HT van Laun & Co[274] concerned two differently worded cargo policies. The "Liverpool policy" held the assured covered in case of deviation or change of voyage "provided notice be given and any additional premium required be agreed immediately after receipt of advice". The "London policy" contained a held covered clause confined to deviations but silent with respect to notifying the insurer. The insured's adventure involved the transportation of a cargo of cattle and sheep to a Chinese port, the bill of lading specifying Taku. After the vessel had sailed, the consignees repudiated the contract of sale and, on 16 December, the master found Taku blocked by ice, a fact known to the assured on 17 December. That same day, and repeatedly during the following week,

[272] For example, Institute Cargo Clause (a) (b)(c) clause 10.

[273] For example, Institute Time Clauses Hulls, Port Riskd incl. Limited Navigation (20.7.87) Clause 1.2.

[274] [1917] 2 KB 48N.

the assured directed the master to hold his position. Appalling conditions on board, however, compelled the master to depart from a different port on 25 December, the entire cargo ultimately being destroyed at sea for health reasons. The House of Lords held that such delay in communication infringed both the express immediate notification requirement of the Liverpool policy and a requirement of notification within a reasonable time to be implied into the London policy.

4.4.6.2 What is a Reasonable Time?

As discussed above, when there is no express provision in the contract terms as to the giving of notice, the law will imply that the notice must be given within a reasonable time. However, can the reasonable time be fixed within a certain period of time, for example one day or one week? The appropriate approach has been enunciated in the following terms in *Liberian Insurance Agency Inc v Mosse*[275] by Donaldson J:

> "What time is reasonable will depend on all the circumstances. Thus if the assured learns the true facts while the risk is still current, a reasonable time will usually be a shorter period than if this occurs when the adventure has already ended. If the assured learns the true facts when the insured property is in the grip of a peril, which is likely to cause loss or damage, a reasonable time will be very short indeed."

So, what constitutes a reasonable time is a question of fact to be decided according to the circumstances of each case.

4.4.6.3 Whether the Implied Term Protects the Assured More Than the Expressed Term?

From the wording, there would seem to be a clear distinction between an obligation to give "prompt" or "immediate" notice and an obligation to give notice within a reasonable period of time. It seems that the assured can get more protection from the

[275] [1977] 2 Lloyd's Rep 560 at p 566.

implied obligation, because a longer period of time may be considered as reasonable under the implied term than would be permitted when the obligation is defined in terms of the former words. However, in *Liberian Insurance Agency Inc v Mosse*,[276] Donaldson J appears to suggest that there is no difference between the two formulations. He said:[277]

> "It may be objected that it is unfortunate to use the words 'prompt notice' when what is meant is notice within a reasonable time. However, in the context of a clause which may impose on underwriters, and indirectly upon reinsuring underwriters, risks which they have never specifically accepted, I do not think that notice which is other than prompt could ever be said to be given within a reasonable time. In my judgment, the use of the word 'prompt' is not only justifiable but also desirable in explanation of the obligation which id implicit in the clause itself."

From the above judgment, it can be said that prompt notice really meant reasonable notice, and that a notice not promptly given would almost inevitably equally amount to a notice not given within a reasonable time.

4.4.6.4 What is Knowledge?

In order to invoke a held covered clause, the assured needs to give notice to the insurer within a reasonable time after he obtains knowledge of the event which is covered under a held covered clause. The question that arises next is what precisely is meant by knowledge? Obviously, there is no difficulty when actual knowledge can be established: but does knowledge extend to categories of constructive knowledge, such as the knowledge an assured has denied to himself by turning a blind eye, or the knowledge the assured would have acquired had he acted with reasonable competence in the management of his affairs? The answer can be found from the judgment of Lord Denning in *The Eurysthenes,*[278] where he states:

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[276] *Ibi d.*

[277] *Ibi d,* at p 566.

[278] [1977] Q.B. 49 at p 68.

"If a man, suspicious of the truth, turns a blind eye to it, and refrains from inquiry-so that he should not know it for certain- then he is to be regarded as knowing the truth."

4.4.7 The Additional Premium

When notification of the event held covered by the clause is given by the assured, on theone hand the underwriter is obliged to provide the promised additional cover, on the other hand, the assured is obliged to agree any specified conditions precedent. These conditions usually relate to the additional premium. In establishing the obligation to pay the additional premium the drafting of held covered clauses may vary and much will depend on the proper construction of the wording used.

For example, in Institute Cargo Clause (A) (B) (C), clause 9 states that "...this insurance shall also terminate unless prompt notice is given to the underwriters and continuation of cover is requested when the insurance shall remain in force, subject to an additional premium if required by the underwriter..." Here the phrase "if required" makes it clear that the conditional obligation of the assured in respect of the additional premium only becomes operative where the underwriters actually demand the premium in question.

In Institute Cargo Clause (A) (B) (C), clause 10 states "...held covered at a premium and on conditions to be arranged subject to prompt notice being given to the Underwriter". Here the wording appears to suggest that the additional premium *will* be demanded, and therefore that the assured is under an obligation to pay additional premium.

4.4.7.1 A Reasonable Additional Premium

Following the invocation of a held covered clause, in most instances, the amount of the additional premium payable will be settled by negotiation between the parties. However, when the parties' negotiation fails, what is the additional premium to be paid by the assured? Section 31 (2) of Marine Insurance Act 1906 provides the answer:

> "Where an insurance is effected on the terms that an additional premium is be arranged in any given event, and that event happens but no arrangement is made, then a reasonable additional premium is payable."

The impact of s. 31 (2) is to introduce into every held covered clause a conditional implied statutory term to the effect that where the parties fail to agree an additional premium, the assured is under an obligation to pay a reasonable additional premium.

The question which naturally comes to be considered is what is meant by a reasonable premium? This question should be answered primarily by reference to market practice at the relevant point in time.

4.4.7.2 What is the Relevant Time to Assess the Additional Premium

The issue of the point at which the additional premium should be assessed is referred to in *Mentz, Decker & Co v. Maritime Insurance Co.*[279] On the facts of the case the insured vessel was lost following a deviation, which was a held covered event in the voyage policy. The assured gave notice to be held covered following the loss. One question which came to be considered related to the basis on which the additional premium was to be assessed where the assessment did not take place until after the insured vessel was lost. Hamilton J answered the question by indicating, "the premium is to be calculated as it would have been calculated by the parties if they

[279] [1910] 1 KB 132.

had known of the deviation at the time that it happened."[280]

4.4.7.3 How to Assess the Reasonable Additional Premium

The decision in *Greenock Steamship Co. Ltd v Maritime Insurance Co Ltd*[281] is instructive in determining what a reasonable additional premium may require. In this case an insured vessel embarked on a voyage stage inadequately coaled and therefore in an unseaworthy condition. This amounted to breach of warranty with cover terminated, save that there was also a held covered clause which stipulated breach of warranty to be a "held covered" event. The parties failed to agree an additional premium and the question was referred to the court for determination. In the abstract, Bigham J[282] considered the question before the court to be "what is a reasonable premium for the added risk?" Applying the question to the factual context of the case, Bigham J formulated the question, "What might an underwriter fairly require as a premium for insuring a steamer which starts on a voyage short of coal?"

Responding to the question, Bigham J considered that an underwriter confronted by such a risk would be justified in taking into account two material considerations. First, the probable losses that would occur. Because the insured vessel was inadequately coaled, alternative sources of fuel would be required, which of necessity must come from the ship's fittings or spars, and from the cargo. These losses, in turn, would be general average losses which the underwriter would be entitled to take into account in assessing a reasonable premium. Second, and additionally, Bigham J considered that the underwriter could take into account the increased risk of the total loss of the ship as a result of her being sent on a voyage inadequately bunkered.

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280 *Ibi d,* at pp.134,135.

281 [1903] 1 KB 367.

282 *Ibi d,* at p 375.

Applying these two principles to the facts of the case, Bigham J concluded that the underwriter was entitled to charge an additional premium at least equal to the average loss claimed by the assured owner for ship's fittings and spars burnt, and the sum paid for cargo needed as fuel. In the event the claim under the policy was equalled by the entitlement of the underwriter to the additional premium, and the claim of the assured, therefore, failed.

Liberian Insurance Agency Inc. v. Mosse[283] is also instructive on the point. Here Donaldson J set out the approach in the following terms:

> "the clause only applies if the assured on the basis of an accurate declaration of all the facts affecting the risk but excluding knowledge of what was to happen in the event, could have obtained a quotation in the market at a premium which could properly be described as 'a reasonable commercial rate' ".

Accordingly, the answer to the question raised earlier, ('what is a reasonable additional premium?'), depends on the facts and circumstances of each individual case. The additional premium should be assessed by reference to market practice and evidence of such market practice should be sought from those within the market with the appropriate knowledge, expertise and experience.

[283] [1977] 2 Lloyd's Rep 560 at p 568.

4.4.8 The Application of the Duty of Utmost Good Faith in Held Covered Clauses

It has been judicially confirmed on several occasions that an assured who seeks to invoke a held covered clause must conduct himself with the utmost good faith in his dealings with underwriters. There are two principal cases dealing with this issue which should be noted.

The decision in *Overseas Commodities Limited v. Style*[284] concerned a claim under two policies of marine insurance in respect of damage to two consignments of canned pork. The policies provided that the tins of pork would be marked in a particular manner. Certain of the tins were incorrectly marked. Each policy contained a "held covered" clause in the event of omission or error in description of the insured cargo, upon which the assured sought to rely. The assured obtained two letters from the manufacturers' agents containing inconsistent explanations for the incorrect markings. Only the letter containing the most favourable explanation was presented to the insurers. Mc Nair J held that,

> "To obtain the protection of the 'held covered' clause, the assured must act with the utmost good faith towards the underwriters, this being an obligation which rests upon them throughout the currency of the policy."[285]

The assured's failure to provide insurers with both explanations for the incorrect markings was a breach of that duty, thereby preventing the assured from relying upon the "held covered" clause.

The same "held covered" clause was considered in *Liberian Insurance Agency Inc v.*

[284] [1958] 1 Lloyd's Rep 546.

[285] *Ibi d,* at p 559.

Mosse.[286] The facts of that case are a little unusual. The plaintiff, acting as broker, arranged all cargo insurance on behalf of African Trading Company with the defendant insurers. A claim was made on the policy, which the insurers declined. The assured successfully sued the plaintiff brokers in Liberia on the basis that they claimed to be agents for Lloyd's (which they were not). The plaintiff brokers commenced English proceedings against the insurers seeking restitution. In order to recover an indemnity from the insurers, the brokers had to prove that the insurers were liable under the policy to the assured. The insurers denied liability because there had been a misrepresentation concerning the cargo of enamelware. The brokers argued that the assured could rely upon the "held covered" provision. Donaldson, J in considering the judgment in Style, remarked[287] that observance of the utmost good faith was a condition precedent to the application of the held covered clause. He went on to say that the clause required an accurate declaration of all the facts affecting the risk. The assured was in breach of that duty by not advising the insurers promptly of the true nature and quality of the cargo. On the facts of the case, the "held covered" clause could not be relied upon and the brokers' claim failed.

Accordingly, when an additional premium, or other terms, is to be agreed pursuant to such a clause, it is established that the assured will owe a duty of good faith to the insurer to inform him of all details relating to the risk, or at least the manner in which the risk has changed by virtue of the scope of cover being extended.[288] However, the scope of such a duty is not entirely clear. The issues of how "materiality" will be judged under held covered clauses and the effect of the breach of duty of utmost good faith need to be discussed further.

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[286] [1977] 2 Lloyd's Rep 560.

[287] *Ibi d,* at p 567.

[288] *Overseas Commodities Lt d v. Style* [1958] 1 Lloyd's Rep 546 at p 559, per McNair, J; *Liberian Insurance Agency Inc v. Mosse* [1977] 2 Lloyd's Rep 560 at p 568, per Donaldson, J; *The Litsion Pride* [1985] 1 Lloyd's Rep 437 at p 511, per Hirst, J; *New Hampshire Insurance Company v. MGN Ltd* [1997] LRLR 24 at p 28, per Potter, J; *k/s Merc-Scandia XXXXII v. Certain Lloyd's Underwriters* [2001] 2 Lloyd's Rep 563, per Longmore LJ.

4.4.8.1 How to Define "Materiality" under Held Covered Clauses?

The concept of materiality must be adapted to this specific context. Thus, it is clear, for example, that a circumstance that has arisen since the conclusion of the contract that would be material were the risk being placed for the first time or being renewed but that is not material to the amendment does not require disclosure under a held covered clause.

In *Iron Trades Mutual Insurance Co. Ltd. v. Companhia De Seguros Imperio*,[289] the need to tailor 'materiality' to its context was cogently articulated by Hobhouse, J:

> "Where there is an addition to a contract, as where it is varied, there can be a further duty of disclosure but only to the extent that it is material to the variation being proposed. If the addition does not alter the contractual rights there will be no fact that it is material to disclose and the same will apply if variation is favourable to the insurer. It will only be when the insurer is being asked to take on some additional risk and/or needing to reassess the premium or terms of cover that disclosure of further facts could be material and, even then, the facts to be disclosed are only those which are material to what the insurer is being asked to do...Any other conclusion would lead to an absurdity; the duty of utmost good faith does not include giving the insurer an opportunity, after he has accepted the risk and become bound, to escape from his commitment."

In *The Litsion Pride*,[290] Hirst J,. stated that

> "a circumstance is material if it would influence the judgement of a prudent underwriter in making the relevant decision to which the misrepresentation or non-disclosure relates".

Moreover, the House of Lords has since ruled in *Pan Atlantic Insurance Co. Ltd v.*

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[289] [1991] 1 Lloyd's Rep 213.

[290] [1985] 1 Lloyd's Rep 437 at p 511.

Pine Top Insurance Co.Ltd[291] that breach of the pre-formation duty of utmost good faith requires subjective inducement of the actual insurer in question and there is no reason to distinguish the post-formation duty on this point. Consequently, the scope of the duty attaching to held covered clauses is confined to circumstances that are both material to the alteration of risk in question and that induce the actual insurer into agreeing to that alteration.

4.4.8.2 What is the Remedy for Breach of the Duty of Utmost Good Faith under Held Covered Clauses?

An important issue which arises in relation to the application of the duty of utmost good faith under held covered clauses is the question of the appropriate remedy. If the duty arises out of s. 17 of the MIA 1906, the only remedy is avoidance. The next question that may arise is whether avoidance is a universal remedy or one that exists alongside alternatives. Does avoidance always allude to the original contract of insurance or can it relate to a severable part of the original contract?

The question was considered in *Fraser Shipping Ltd v. Colton.*[292]

Fraser concerned a policy incorporating the Institute Voyage Clauses Hull for a voyage to Shanghai of a vessel being towed for demolition. On 25 May, the assureds decided to send the tow to Huang Pu, where it arrived on 24 June. The tow moored at the quarantine anchorage awaiting passage up river to the delivery berth. On 25 June, notice of this change of voyage was given to and accepted by the insurers. However, the insurers were not told that the tow had already been waiting at anchorage at Huang Pu for 24 hours during which time it had been involved in a minor collision, that the port of Huang Pu was congested so that delivery of the tow was likely to be delayed at the quarantine anchorage, that de-ballasting and work on the anchor were

[291] [1995] 1 AC 501.

[292] [1997] 1 Lloyd's Rep 586.

necessary before the voyage up river, and that a hurricane was threatening the port. The assureds unsuccessfully invoked the Institute Voyage Clauses Hull, cl. 2.

Potter, L.J., sitting as a judge of first insurance, held that the assureds had failed to give timely notice and had not disclosed material circumstances, such non-disclosure inducing the insurers into agreeing the change of voyage. In doing so, he applied the MIA 1906, section18 to the assured's disclosure obligations under cl. 2.

However, it is readily appreciated that the doctrine of utmost good faith has its source in section 17 of the MIA 1906, and that the particular duties established by ss. 18-20 amount to specific applications of the doctrine and not to a definition of the province of the general doctrine. Section 17 is drafted in very wide terms. Beyond making it clear that the general duty of utmost good faith arises as a matter of law and is mutual in its application, and that the remedy for breach of the duty is restricted to avoidance of the contract of marine insurance, all is presented in a very general vein. In contrast, the specific duties recognized in ss. 18-20 are defined with particularity and it is plain that they are restricted to the negotiating and pre-contractual phase.

It follows that the duty of utmost good faith attaching to held covered clauses, or other contractual modifications, does not fall within either section 17 or section 18 of the MIA 1906. As has already been seen, section 18 cannot apply once the contract has been concluded and section 18 (1) provides that in the event of non-disclosure "the insurer may avoid the contract". A similar problem arises with section 17.

Just as the meaning of "materiality" will reflect the operation of utmost good faith in the specific context of held covered clauses so to should the remedy for non-compliance be adapted to fit this same narrow application of the duty. If the duty is tailored to the variation of the contract, the remedy should be limited to that variation and breach of the duty should not affect the entirety of the cover. There is, consequently, no justification for permitting retrospective avoidance of the entire contract in the event of non-compliance with the duty of utmost good faith which applies to held covered clauses. The duty of utmost good faith has previously been properly discharged with respect to any original risks and the insurer should remain liable for prior casualties therefore. The insurer's remedy should be limited to avoidance of any extension of cover granted on the basis of improper presentation of that risk. Put another way, observance of utmost good faith with respect to a held covered clause is condition precedent to the enforceability of the insurer's promise to maintain the cover, not to the insurer's promise to grant cover in the first place.

Accordingly, to the point can be clarified that an implication of the applicability of the duty of utmost faith when invoking a held covered clause is that the assured is under particular obligations to disclose all material information and not to make material misrepresentations. Section 18 and 20 are relevant, but in all likelihood subject to certain qualifications. In the first place the concept of materiality, as defined in sub-section (2) of both sections, is to be restricted to the held covered risk. Second, information is material if it would influence the judgment of a prudent insurer in fixing the additional premium and/or determining the conditions on which the additional cover is to be provided. Third, since the insurer is already obliged to provide the additional cover, if demanded, information relating to whether the additional risk should be accepted is not material, but information which helps the underwriter to decide whether the additional risk falls within the terms of the held cover clauses is material. Fourth, given the circumstances which may prevail an assured gives notice of a held covered event and also the conditions precedent to which the additional cover must be satisfied, it may be that the concept of deemed knowledge pursuant to s. 18(1), which has been developed in the context of the standard pre-contractual application of the doctrine, may require some modification. As for the consequences of breach of the duty of utmost good faith in invoking a held covered clause, it is becoming increasingly certain that it is the additional cover alone which may be avoided.

CHAPTER 5

CONCLUSION

The main conclusion of the thesis is that, most of the practices in the London market in relation to contract formation are in line with general contract law principles and any deviation can be explained by market custom. It is hoped that this thesis analysed and discussed main legal problems arising at this stage and offers solutions to problematic areas.

5.1 LEGAL ISSUES ARISING BEFORE THE CONTRACT IS CONCLUDED

The formation of the marine insurance contract in the London market is quite different from the formation of non-marine insurance contracts. An assured will act through his agent, a broker. The broker will prepare one of the two important documents – the slip - and take the slip around the market seeking subscriptions. The underwriters who are interested in the insurance will initial the slip. Once the broker has obtained the desired level of subscriptions, the slip is closed and the other important document – the policy - will be issued later. In the past, when the broker prepared the slip, he could use different formats for various types of risks which would cause interpretation difficulties and uncertainty. The need for the standard slip format emerged and with the new LMP and LMP BRAT slips much of the interpretive problems were resolved and increased clarity resulted.

During this process, the subscription on the slip should be considered as an acceptance by the underwriter rather than an offer from the underwriter.[293] In the case of partial subscriptions, when one underwriter signs on the slip, the insurance

[293] *Ge neral Reinsurance Corporation and Others v. Forsakeringsaktiebolaget Fennia Patria* [1982] 1 Lloyd's Rep 87 and [1983] 2 Lloyd's Rep 290.

contract between himself and the assured is concluded. Accordingly each subscription constitutes an individual contract and each underwriter may be bound to the assured on different terms. Both the assured and the underwriters are bound to each subscription before full subscription and the underwriter is liable for loss prior to full subscription.

However, when the underwriter subscribes the slip and puts some kind of qualification on it, that subscription is not an acceptance and it should be considered as a counter-offer, which is left to the assured to accept or reject. The assured may accept the response but he may also reject it with a further proposition, in which case the assured makes a further counter-offer. Again the underwriter may accept or reject any counter-offer. This process continues until the counter-offer of one or other is finally accepted or rejected. The court will look at the entirety of the negotiations to determine if there is a point at which the relevant agreement has been reached.[294]

It should be noted that the above offer and acceptance rule operates in a different manner when a reinsurance contract is formed, particularly, where the reinsurance contract is formed before the original insurance contract. In practice, it happens quite often that the underwriter will not participate in the original insurance unless the reinsurance is arranged in advance. In such a case, the signature of the reinsurer on the reinsurance slip will not be considered as an acceptance. It should, instead, be taken as an offer of reinsurance from the reinsurer. The contract of reinsurance is concluded when the reinsured accepts this offer. Subsequently, the duty of disclosure will not come to an end at the moment when the reinsurer signs on the slip, rather it will be exhausted when the reinsured signs on the slip.[295]

At the formation stage, it is common to incorporate a leading underwriter clause into

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[294] *CTI I nc v. Oceanus Mutual Underwriting Assn (Bermuda) Ltd* [1984] 1 Lloyd's Rep 476.

[295] *Bo nner v. Cox [2005] Lloyd's Rep. I.R. p. 569; The Zephyr* [1984] 1 Lloyd's Rep 58.

the marine insurance contracts. The broker takes the slip to the leading underwriter who has a reputation in the market as an expert in the kind of cover required and whose lead is likely to be followed by other insurers in the market. The broker and the leading underwriter go through the slip together. They agree on any amendments to the broker's draft and fix the premium. Under a leading underwriter agreement, the underwriters who follow the lead may agree to accept any minor amendments or additions to the policy without the need for their specific approval or authority. However, the leading underwriter cannot agree to a material alteration of the risk.[296] As to the nature of this clause, whether the leading underwriter should be considered as the "agent"[297] of the following market or only as the "trigger"[298] actually depends upon the scope and terminology of the clause itself.[299] The judicial view is divided on the legal nature of such clauses but the writer believes that there is practical advantage of adopting "trigger" approach.

Signing down is a common practice in Lloyd's market at the formation stage. Signing-down plays two important functions. First, it enables brokers to show their business to more underwriters and these larger lines make the risk appear more attractive to following underwriters Secondly, if the assured wishes to increase the value insured, the initial commitment of underwriters to a larger percentage than ultimately obtained provides an indication of where some spare capacity may be found. In this practice, the broker is generally asked to provide a "signing indication" which amounts to a promise given by the broker. When the broker can not reach the indicated level of subscription, his liability to the underwriter can be analysed in terms of contract since he is in breach of an implied undertaking to use his best endeavours to ensure that there would be a certain level of subscription on the slip

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[296] *Barlee Marine C orporation v Mountain (The "Leegas")* [1987] 1 Lloyd's Rep 471.

[297] *Ro adworks Ltd v Charman* [1994] 2 Lloyd's Rep 99.

[298] *Man der v Commercial Union Assurance Co plc* [1998] Lloyd's Rep IR 93; *The Tiburon* [1990] 2 Lloyd's Rep 418 at p 422.

[299] *Barlee Marine C orporation v Mountain* [1987] 1 Lloyd's Rep 471; *Unum Life Insurance Co of America v Israel Phoenix Assurance Co Ltd.* [2002] Lloyd's Rep IR 374.

and the lack of best endeavours could be equated with lack of reasonable care.[300]

5.2 THE ROLE OF INSURANCE BROKERS

In placing insurance at Lloyd's, an insurance broker is one of the key players. The broker is always the agent of his principal, the assured, who employs him to obtain the insurance contract. When the duties of broker to the assured are clearly defined in the contractual terms, the broker must exercise his duties accordingly.[301] When there is no such kind of contractual terms, the broker is under a duty of reasonable care which can be summarized as follows: with his reasonable knowledge of the insurance market place, the broker is under a duty to obtain sufficient cover[302] with the most suitable insurer[303] within a reasonable time.[304] The reasonable time requirement does not of course amount to a fixed pre-determined period, but rather it will be modified on a case by case basis to reflect the range of different circumstances that will have arisen. The broker is also responsible for the policy wording[305] and is under a duty to provide advice and information to the assured; this duty will encompass a requirement to give qualified information in accordance with the inquiries of the assured, to inform the assured of any exemption under the policy and to give advice about what the assured must disclose to the insurer regarding the subject matter of the insurance.[306]

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[300] *The Zephyr* [1984] 1 Lloyd's Rep 58.

[301] *S trong v. S.Allison* [1926] 25 Lloyd's Rep 504; *Talbot Underwriting Ltd v. Nausch Hogan & Murray Inc (The Jason 5)* [2006] Lloyd's Rep IR 531.

[302] *Yuill & Co v. Robson*[1908] 1 KB 270; *Youell v Bland Welch & Co Ltd* [1990]2 Lloyd's Rep 431; *Aneco Reinsurance Underwriting Ltd. (in liquidation) v. Johnson & Higgins Ltd* [2002]1 Lloyd's Rep 157.

[303] *Osman v Moss* [1970] 1 Lloyd's Rep313; *Youell v Bland Welch & Co Ltd* [1990]2 Lloyd's Rep 431.

[304] *Cock, R ussell v. Bray, Gibb*[1920] 3 Lloyd's Rep 71.

[305] *Melik & Co. Ltd. v. Norwich Union Fire Insurance Society Ltd.* [1980] 1 Lloyd's Rep 523; *JW Bollom & Co Ltd v Byas Mosley & Co Ltd* [2000] Lloyd's Rep IR 136; *Grace v Leslie & Godwin Financial Services Ltd*[1995]LRLR 472; *Tudor Jones v Crowley Colosso Ltd* [1996] 2 Lloyd's Rep 619.

[306] *Sar ginson Brothers v. Keith Moulton & Co. Ltd,* [1942] 73 Ll L Rep 104; *McNealy v Pennine Insurance Co*[1978] 2 Lloyd's Rep18; *John Woods (Lisglynn) v. Carroll* [1980] 3 NIJB

In some circumstances, for example in relation to the placing of reinsurance,[307] and in accepting risks under a binding authority,[308] the broker acts in a dual capacity as the agent for both assured and insurer and he also owes duties to the insurer. This is likely to create practical difficulties, but the London market practice of dual agency is very common. The main duties of the broker to the insurer are first, the duty to pay the premium and secondly the duty of utmost good faith.

The rule of law by which it is the broker, but not the assured who is liable to the insurer for the premium is founded on the custom in the London market for more than about a century[309]. This custom is based on the fiction that once the contract is concluded, it is assumed that the insurer loans the amount of premium to the broker so that the broker becomes debtor of that loan. However, this fiction theory was superseded by the wording of "unless otherwise agreed" in s.53(1) of the MIA 1906; this phrase enables policies to be construed in accordance with what is actually *agreed* and therefore either the broker or the assured can be liable for the premium. The MIA, which is intended to regulate payment of premiums, makes it clear that whether the broker or the assured is liable for the premium will depend upon the true construction of the policy.[310]

The duty of utmost good faith on the broker to the insurer is set out at Section 19 and 20 of MIA 1906. However, these sections do not contain any clear reference to the required status of the broker- i.e. it is not clear whether the duties laid out are restricted in their application, to the producing broker. It has been suggested, however, that the placing broker and other sub-brokers also owe such duties to the

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[307] *Ever ett v. Hogg Robinson & Gardner Mountain (Insurance) Ltd* [1973] 2 Lloyd's Rep 217; *Forsikringsaktieselskapet Vesta v. Butcher, Bain Dawes and others* [1988] 1 Lloyd's Rep 19; *European International Reinsurance Co Ltd v Curzon Insurance Ltd* [2003] Lloyd's Rep IR 805.

[308] *Ea gle Star Insurance Co v. Spratt* [1971] 2 Lloyd's Rep 116.

[309] *Power v. Butcher* (1829) 10 B & Cr 329 at p 340; *Universo Insurance Co. of Milan v. Merchants Marine Insurance Co. Ltd.* [1897] 1 QB 205; *Prentis Donegan & Partners Ltd. v. Leeds & Leeds Co. Inc.* [1998] 2 Lloyd's Rep 326.

[310] *Heath Lambert Ltd. v. Sociedad de Corretaje de Seguros* [2005] 1 Lloyd's Rep 597.

assured despite the absence of any contract between them.[311]

One of the key aspects of the duty of utmost good faith is the duty of disclosure. Compared with the assured, this duty on the broker is more extensive, in this respect. The broker is not only under a duty to disclose material circumstances that are known to the assured and himself but also the material circumstances that in the ordinary course of business *ought* to be known by himself. A circumstance is to be regarded as material if it has the capacity to influence the judgment of an insurer in fixing the premium, or determining whether he will take the risk. It is the judgment of a hypothetical prudent insurer that determines whether the undisclosed circumstance is material or not. [312] When the insurer wants to exercise his right against the broker under the duty of disclosure, he must show that he is induced to enter into the contract as result of that non-disclosure.[313] If the insurer cannot prove it, there is a presumption of inducement in favour of him.[314] However, if it could be shown that the insurer has not acted with the required care or skill the presumption of inducement will not apply.[315] According to Section 18(3) of MIA 1906, the broker does not need to disclose the facts or circumstances which reduce the risk[316] or which are presumed to be known to the insurer. The definition of circumstances that the insurer is presumed to know can be briefly summarized as the circumstances an underwriter who insures a risk within a particular industry ought to know or find out, the practices of the industry or trade, and the matters which are in general well

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[311] *BP plc v. Aon Ltd.* [2006] Lloyd's Rep IR 577.

[312] *Con tainer Transport International Inc and Reliance Group Inc v. Oceanus Mutual Underwriting Association Ltd.* [1984] 1 Lloyd's Rep 476; *Pan Atlantic Insurance Co Ltd v. Pine Top Insurance Co Ltd.* [1994] 2 Lloyd's Rep 427 at p 445.

[313] *Pa n Atlantic Insurance Ltd v. Pine Top Ltd* [1994] 2 Lloyd's Rep 427; *St Paul's Fire and Marine Insurance v. McConnell Constructors Ltd* [1995] 2 Lloyd's Rep 116.

[314] *Pa n Atlantic Insurance Ltd v. Pine Top Ltd* [1994] 2 Lloyd's Rep 427.

[315] *Mar c Rich and Co AG v. Portman.* [1996] 1 Lloyd's Rep 430; *Assicurazioni Generali SpA v Arab Insurance Group (BSC)* [2002] CLC 164.

[316] *The D ora* [1989] 1 Lloyd's Rep 69; *The Elena G* [2002] Lloyd's Rep IR 450.

known by persons in that trade.[317] The broker does not need to disclose any circumstance as to which information is waived by the insurer. These circumstances can be waived by either express agreement or through implied waiver.[318] Provided a clause in the contract of insurance is clearly and specifically intended to express what kind of conduct of the assured or broker can be expressly waived, it is even possible to waive fraud on the part of the broker or assured.[319]

Another key aspect of the duty of utmost good faith is the duty not to make misrepresentation. This is specifically developed in Section 20 of MIA 1906. According to this section, a representation could be either a representation of facts[320] or a representation of opinion[321] or a representation of intention.[322] Normally, excessive valuation is a misrepresentation.[323] However, if both parties are aware of the excessive valuation or the insurer is not aware of the excessive valuation, but the excessive valuation can be explained as a part of an ordinary business transaction, this excessive valuation will not be counted as misrepresentation.[324]

A broker is usually employed to obtain insurance for a specific period of a particular risk on the best possible terms for the assured. Therefore, he is entitled to the remuneration when a valid and binding contract of insurance has come into existence. It has been well established that the broker's remuneration is paid by the insurer[325]

[317] *Carter v. Boehm* (1766) 3 Burr 1905; *North British Fishing Boat Insurance Co., Ltd., v. Starr*[1922] 13 Ll L Rep 206.

[318] *Mann Macneal & Steevens Ltd. v. Capital and Counties Insurance Co* [1920] 4 Lloyd's Rep 57.

[319] *HIH Casualty and General Insurance Ltd. v New Hampshire Insurance Co. and Others* [2001] 2 Lloyd's Rep 161.

[320] *Williams v. Atlantic Assurance Company, Limited* [1933] 1 KB 81; *Liberian Insurance Agency Inc. v. Mosse* [1977] 2 Lloyd's Rep 560.

[321] *Anderson v. Pacific Fire and Marine Insurance Co.* [1872] LR 7 CP 65.

[322] *Seismik Sekuritik AG. v. Spere Drake Insurance Co. plc*[1997] 8 CL 351.

[323] *Eagle Star Insurance Co. Ltd. v Games Video Co. (GVC) S.A. (the "Game Boy")* [2004] 1 Lloyd's Rep 238.

[324] *North Star Shipping Ltd v Sphere Drake Insurance Plc* [2006] 2 Lloyd's Rep 183.

[325] *Pryke v. Gibbs Hartley Cooper* [1991] 1 Lloyd's Rep 602.

and the liability of the insurer to pay brokerage to the broker comes into existence when the contract is formed. When the broker breaches his duty to his principal the liabilities arise. However, in some circumstances, the broker may be able to limit or exclude his liabilities when the broker can prove that the assured is responsible for or has contributed to the lack of suitable insurance;[326] or when the broker can prove the existence of an independent ground for the insurer to disclaim liability;[327] or when the broker can show that the assured would not have been insured in the circumstances irrespective of any failure on the part of the broker;[328] or when the broker can prove that the assured is not insurable at the moment the insurance contract is concluded.[329]

5.3 LEGAL ISSUES ARISING AFTER THE CONTRACT IS CONCLUDED

When there is a discrepancy between the two important documents, slip and policy, the question raised is whether the policy can supersede the slip or the slip can prevail over the policy. The narrow approach[330] which asserts that the slip will not be available to assist the true construction of the insurance contract at all has been denied by the liberal approach.[331] The writer is of the opinion that the slip must play a degree in the identification of the parties' intention so the liberal approach should be welcomed. Under the liberal approach the parties' intention will determine the evidential utility of the slip. It may be the case that the parties intended the contract as stated in the policy to supersede the contract as stated in the slip.[332] On

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[326] *JW Bollom & Co Ltd v. Byas Mosley & Co Ltd* [2000] Lloyd's Rep IR 136.

[327] *Fraser v. Furman*[1967] 3 All ER 57.

[328] *Gun ns v. Par Insurance Brokers*[1997] 1 Lloyd's Rep 17.

[329] *Ever ett v Hogg, Robinson & Gardner Mountain (Insurance) Ltd* [1973] 2 Lloyd's Rep 217; *0 & R Jewelers v. Terry & Jardine Insurance Brokers*[1999] Lloyd's Rep IR 436.

[330] *Youell v. Bland Welch & Co Ltd.* [1990] 2 Lloyd's Rep 423.

[331] *HIH Casu alty & General Insurance Ltd v New Hampshire Insurance Co.* [2001] 2 Lloyd's Rep 161.

[332] *Ibi d.*; *The Aikshaw*(1893) 9 TLR 605 ; *Motteux v London Assurance*(1739) 1 Atk 545.

the other hand the parties may have intended the slip to take precedence over the policy.[333] The intention of the parties must inevitably fall upon the wording chosen by them. The interpretation of the words chosen by the parities may be affected by the natural meaning of the words[334] and the business common sense of the words.[335] When there is an ambiguity about the meaning of the wording, the ambiguity entitles the court to invoke the *contra proferentem* rule.[336] Accordingly, where the term that proves ambiguous is one inserted by or on behalf of the assured, the *contra proferentem* rule requires interpretation in favour of the insurer and against the interests of the assured. Where, by contrast, the ambiguity resides in an amendment to the slip introduced by the insurer, the ambiguity will be resolved against the insurer. Where the meaning of the words may lead to an excessively unreasonable result, if the parties have used plain language to express their intentions, that should be the end of it: the court should enforce the contract in accordance with its terms.[337]

Rectification is the equitable remedy by which a court can remedy mistakes in the recording of the parties' agreement. The utility of the slip in any given rectification action will depend on the intention of the parties as to whether the policy should supersede the slip.[338] Where the two parties' intention is that the policy is intended to supersede the slip, the natural assumption is and should be that the wording of the policy has been designed to reflect better the agreement between the parties. To refer to the slip as an aid to the construction of the policy would make little sense in these circumstances. Where the two parties' intention is that the slip is intended to

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[333] *Western Assurance Co v Poole*(1903) 8 Com Cas 108.; *Eagle Star & British Dominion Insurance Co Ltd v AV Reiner*(1927) 27 LIL Rep 173.

[334] *Melanesia n Mission Trust Board v Australian Mutual Provident Society* [1996] UKPC 53.

[335] *Investors Com pensation System Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 p. 913; *Mannai Investments Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749; *Antaors Compania Naviera SA v Salen Rederierna AB* [1985] AC 191; *Quorum v Schramm* [2002] 1 Lloyd's Rep 249.

[336] *M/S Aswan Engineering Establishment Co Ltd v Iron Trades Mutual Insurance Co Ltd* [1989] 1 Lloyd's Rep 289.

[337] *Kuwa it Airways Corp v Kuwait Insurance Co SAK (No 1)* [1999] 1 Lloyd's Rep 803.

[338] *A. G agniere & Co. Ltd v The Eastern Company of Warehouses Insurance* [1921] 8 LIL Rep 365.

supersede the policy, the slip represents the final terms of a binding contract, and in the event of any discrepancy between the slip and the later policy, the slip will prevail and the policy will be rectified accordingly.[339] It should also be mentioned that rectification of both slip and policy is possible.[340]

Held covered clauses are the clauses which are designed to offer protection to the assured, because under such types of clauses, when the situation stated in the term occurs which constitutes an alteration of risk, the insurer's liability is not prospectively discharged. The assured remains covered provided any specified conditions are fulfilled, usually notification of the event by the assured to the insurer and agreement upon any appropriate additional premium and change of terms. Since the held covered clause is one of the terms in the original contract, it is possible to view the held covered clause as an integral part of the initial contract. However, the invocation of this clause, by the assured giving notice,, creates a distinct contract apart from the original one. It is appropriate to analyse held covered clauses in this part as they, if operated, create a new contract during the currency of the original contract.

It is quite clear that the additional cover provided by held covered clauses is only available when notice is given by the assured. Whether the additional cover is an option for the assured should depend on the wording of the particular clause and on the relevant intention of the parties.[341] In contemporary practice held covered clauses usually make express provision for the time within which notice must be given. In the absence of such an express provision, the courts will imply a term to the effect that the benefit of a held covered clause is conditional upon the giving of

[339] *Ba nque Sabbag SAL v Hope* [1972] 1 Lloyd's Rep 253; *Wilson Holgate & Co Ltd v Lancashire & Cheshire Insurance Corp Ltd.* [1922] 13 LILR Rep 486; *Symington & Co v Union Insurance Society of Canton Ltd (No 2)* [1928] 32 LIL Rep 287.

[340] *The Demetra K* [2002] 2 Lloyd's Rep 581.

[341] *Mentz, Decker & Co v. Maritime Insurance Co.* [1910] KB 132.

notice within a "reasonable time". Again, what constitutes a "reasonable time" is a question of fact to be decided according to the circumstances of each case.[342]

When the held covered clause is invoked, the assured is normally obliged to pay additional premium. Following the invocation of a held covered clause, in most instances, the amount of the additional premium payable will be settled by negotiation between the parties. However, when the parties' negotiation fails, the assured is under an obligation to pay a reasonable additional premium. The question of "What is a reasonable additional premium?" depends on the facts and circumstances of each individual case. The additional premium should be assessed by reference to market practice and evidence of such market practice should be sought from those within the market with the appropriate knowledge, expertise and experience.[343]

Since the held covered clause creates a distinct contract apart from the original insurance contract, it is established that the assured will owe a duty of utmost good faith to the insurer.[344] The scope of the duty attaching to held covered clauses is confined to circumstances that are both material to the alteration of risk and that induce the actual insurer into agreeing to that alteration.[345] As for the consequences of breach of the duty of utmost good faith in invoking a held covered clause, it is becoming increasingly certain that it is the additional cover alone which may be avoided but not the original contract.[346]

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[342] *Liberi an Insurance Agency Inc v Mosse* [1977] 2 Lloyd's Rep 560.

[343] *Mentz, Decker & Co v. Maritime Insurance Co.* [1910] 1 KB 132; *Greenock Steamship Co. Ltd v Maritime Insurance Co Ltd* [1903] 1 KB 367; *Liberian Insurance Agency Inc. v. Mosse* [1977] 2 Lloyd's Rep 560.

[344] *Overseas Commodities Limi ted v. Style* [1958] 1 Lloyd's Rep 546; *Liberian Insurance Agency Inc v. Mosse.* [1977] 2 Lloyd's Rep 560.

[345] *Ir on Trades Mutual Insurance Co. Ltd. v. Companhia De Seguros Imperio* [1991] 1 Lloyd's Rep 213; *The Litsion Pride* [1985] 1 Lloyd's Rep 437; *Pan Atlantic Insurance Co. Ltd v. Pine Top Insurance Co.Ltd* [1995] 1 AC 501.

[346] *Fraser S hipping Ltd v. Colton.* [1997] 1 Lloyd's Rep 586.

APPENDIX

Marine Insurance Act 1906

An Act to codify the Law relating to Marine Insurance. [21 December 1906]

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:

MARINE INSURANCE

1. Marine insurance defined

A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure.

2. Mixed sea and land risks

(1)A contract of marine insurance may, by its express terms, or by usage of trade, be extended so as to protect the assured against losses on inland waters or on any land risk which may be incidental to any sea voyage.

(2)Where a ship in course of building, or the launch of a ship, or any adventure analogous to a marine adventure, is covered by a policy in the form of a marine policy, the provisions of this Act, in so far as applicable, shall apply thereto; but, except as by this section provided, nothing in this Act shall alter or affect any rule of law applicable to any contract of insurance other than a contract of marine insurance as by this Act defined.

3. Marine adventure and maritime perils defined

(1)Subject to the provisions of this Act, every lawful marine adventure may be the subject of a contract of marine insurance.

(2)In particular there is a marine adventure where—

(a)Any ship goods or other moveables are exposed to maritime perils. Such property is in this Act referred to as "insurable property";

(b)The earning or acquisition of any freight, passage money, commission, profit, or other pecuniary benefit, or the security for any advances, loan, or disbursements, is endangered by the exposure of insurable property to maritime perils;

(c)Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.

"Maritime perils" means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seisures, restraints, and detainments of princes and peoples, jettisons, barratry, and any other perils, either of the like kind or which may be designated by the policy.

4. Avoidance of wagering or gaming contracts

(1)Every contract of marine insurance by way of gaming or wagering is void.

(2)A contract of marine insurance is deemed to be a gaming or wagering contract—

(a)Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest; or

(b)Where the policy is made "interest or no interest," or "without further proof of interest than the policy itself," or "without benefit of salvage to the insurer," or subject to any other like term:

Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer.

5. Insurable interest defined

(1)Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.

(2)In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

6. When interest must attach

(1)The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected:

Provided that where the subject-matter is insured "lost or not lost," the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.

(2)Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss.

7. Defeasible or contingent interest

(1)A defeasible interest is insurable, as also is a contingent interest.

(2)In particular, where the buyer of goods has insured them, he has an insurable interest, notwithstanding that he might, at his election, have rejected the goods, or have treated them as at the seller's risk, by reason of the latter's delay in making delivery or otherwise.

8. Partial interest

A partial interest of any nature is insurable.

9. Re-insurance

(1)The insurer under a contract of marine insurance has an insurable interest in his risk, and may re-insure in respect of it.

(2)Unless the policy otherwise provides, the original assured has no right or interest in respect of such re-insurance.

10. Bottomry

The lender of money on bottomry or respondentia has an insurable interest in respect of the loan.

11. Master's and seamen's wages

The master or any member of the crew of a ship has an insurable interest in respect of his wages.

12. Advance freight

In the case of advance freight, the person advancing the freight has an insurable interest, in so far as such freight is not repayable in case of loss.

13. Charges of insurance

The assured has an insurable interest in the charges of any insurance which he may effect.

14. Quantum of interest

(1)Where the subject-matter insured is mortgaged, the mortgagor has an insurable interest in the full value thereof, and the mortgagee has an insurable interest in respect of any sum due or to become due under the mortgage.

(2)A mortgagee, consignee, or other person having an interest in the subject-matter insured may insure on behalf and for the benefit of other persons interested as well as for his own benefit.

(3)The owner of insurable property has an insurable interest in respect of the full value thereof, notwithstanding that some third person may have agreed, or be liable, to indemnify him in case of loss.

15. Assignment of interest

Where the assured assigns or otherwise parts with his interest in the subject-matter insured, he does not thereby transfer to the assignee his rights under the contract of insurance, unless there be an express or implied agreement with the assignee to that effect.

But the provisions of this section do not affect a transmission of interest by operation of law.

Insurable Value

16. Measure of insurable value

Subject to any express provision or valuation in the policy, the insurable value of the subject-matter insured must be ascertained as follows:—

(1)In insurance on ship, the insurable value is the value, at the commencement of the risk, of the ship, including her outfit, provisions and stores for the officers and crew, money advanced for seamen's wages, and other disbursements (if any) incurred to make the ship fit for the voyage or adventure contemplated by the policy, plus the charges of insurance upon the whole:The insurable value, in the case of a steamship, includes also the machinery, boilers, and coals and engine stores if owned by the assured, and, in the case of a ship engaged in a special trade, the ordinary fittings requisite for that trade:

(2)In insurance on freight, whether paid in advance or otherwise, the insurable value is the gross amount of the freight at the risk of the assured, plus the charges of insurance:

(3)In insurance on goods or merchandise, the insurable value is the prime cost of the property insured, plus the expenses of and incidental to shipping and the charges of insurance upon the whole:

(4)In insurance on any other subject-matter, the insurable value is the amount at the risk of the assured when the policy attaches, plus the charges of insurance.

Disclosure and Representations

17. Insurance is *uberrimæ fidei*

A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

18. Disclosure by assured

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

(2)Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

(3)In the absence of inquiry the following circumstances need not be disclosed, namely:—

(a)Any circumstance which diminishes the risk;

(b)Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge, and matters which an insurer in the ordinary course of his business, as such, ought to know;

(c)Any circumstance as to which information is waived by the insurer;

(d)Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.

(4)Whether any particular circumstance, which is not disclosed, be material or not is, in each case, a question of fact.

(5)The term "circumstance" includes any communication made to, or information received by, the assured.

19. Disclosure by agent effecting insurance

Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer—

(a)Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and

(b)Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent.

20. Representations pending negotiation of contract

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

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

(3)A representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief.

(4)A representation as to a matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer.

(5)A representation as to a matter of expectation or belief is true if it be made in good faith.

(6)A representation may be withdrawn or corrected before the contract is concluded.

(7)Whether a particular representation be material or not is, in each case, a question of fact.

21. When contract is deemed to be concluded

A contract of marine insurance is deemed to be concluded when the proposal of the assured is accepted by the insurer, whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract . . .

Annotations:

Words repealed as to instruments made or executed after 1.8.1959 by Finance Act 1959 (c. 58), Sch. 8 Pt. II

THE POLICY

22. Contract must be embodied in policy

Subject to the provisions of any statute, a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act. The policy may be executed and issued either at the time when the contract is concluded, or afterwards.

Annotations:

S. 22 excluded by Marine and Aviation Insurance (War Risks) Act 1952 (c. 57), s. 7(1) and Finance Act 1959 (c. 58), s. 30(6)(7)

23. What policy must specify

A marine policy must specify—

(1)The name of the assured, or of some person who effects the insurance on his behalf:

(2)—(5). . .

Annotations:

S. 23(2)–(5) repealed as to instruments made or executed after 1.8.1959 by Finance Act 1959 (c. 58), Sch. 8 Pt. II

24. Signature of insurer

(1)A marine policy must be signed by or on behalf of the insurer, provided that in the case of a corporation the corporate seal may be sufficient, but nothing in this section shall be construed as requiring the subscription of a corporation to be under seal.

(2)Where a policy is subscribed by or on behalf of two or more insurers, each subscription, unless the contrary be expressed, constitutes a distinct contract with the assured.

25. Voyage and time policies

(1)Where the contract is to insure the subject-matter "at and from," or from one place to another or others, the policy is called a "voyage policy," and where the contract is to insure the subject-matter for a definite period of time the policy is called a "time policy." A contract for both voyage and time may be included in the same policy.

(2). . .

Annotations:

S. 25(2) repealed as to instruments made or executed after 1.8.1959 by Finance Act 1959 (c. 58), Sch. 8 Pt. II

26. Designation of subject-matter

(1)The subject-matter insured must be designated in a marine policy with reasonable certainty.

(2)The nature and extent of the interest of the assured in the subject-matter insured need not be specified in the policy.

(3)Where the policy designates the subject-matter insured in general terms, it shall be construed to apply to the interest intended by the assured to be covered.

(4)In the application of this section regard shall be had to any usage regulating the designation of the subject-matter insured.

27. Valued policy

(1)A policy may be either valued or unvalued.

(2)A valued policy is a policy which specifies the agreed value of the subject-matter insured.

(3)Subject to the provisions of this Act, and in the absence of fraud, the value fixed by the policy is, as between the insurer and assured, conclusive of the insurable value of the subject intended to be insured, whether the loss be total or partial.

(4)Unless the policy otherwise provides, the value fixed by the policy is not conclusive for the purpose of determining whether there has been a constructive total loss.

28. Unvalued policy

An unvalued policy is a policy which does not specify the value of the subject-matter insured, but, subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained, in the manner herein-before specified.

29. Floating policy by ship or ships

(1)A floating policy is a policy which describes the insurance in general terms, and leaves the name of the ship or ships and other particulars to be defined by subsequent declaration.

(2)The subsequent declaration or declarations may be made by indorsement on the policy, or in other customary manner.

(3)Unless the policy otherwise provides, the declarations must be made in the order of dispatch or shipment. They must, in the case of goods, comprise all consignments within the terms of the policy, and the value of the goods or other property must be honestly stated, but an omission or erroneous declaration may be rectified even after loss or arrival, provided the omission or declaration was made in good faith.

(4)Unless the policy otherwise provides, where a declaration of value is not made until after notice of loss or arrival, the policy must be treated as an unvalued policy as regards the subject-matter of that declaration.

30. Construction of terms in policy

(1)A policy may be in the form in the First Schedule to this Act.

(2)Subject to the provisions of this Act, and unless the context of the policy otherwise requires, the terms and expressions mentioned in the First Schedule to this Act shall be construed as having the scope and meaning in that schedule assigned to them.

31. Premium to be arranged

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

(2)Where an insurance is effected on the terms that an additional premium is to be arranged in a given event, and that event happens but no arrangement is made, then a reasonable additional premium is payable.

DOUBLE INSURANCE

32. Double insurance

(1)Where two or more policies are effected by or on behalf of the assured on the same adventure and interest or any part thereof, and the sums insured exceed the indemnity allowed by this Act, the assured is said to be over-insured by double insurance.

(2)Where the assured is over-insured by double insurance—

(a)The assured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may think fit, provided that he is not entitled to receive any sum in excess of the indemnity allowed by this Act;

(b)Where the policy under which the assured claims is a valued policy, the assured must give credit as against the valuation for any sum received by him under any other policy without regard to the actual value of the subject-matter insured;

(c)Where the policy under which the assured claims is an unvalued policy he must give credit, as against the full insurable value, for any sum received by him under any other policy:

(d)Where the assured receives any sum in excess of the indemnity allowed by this Act, he is deemed to hold such sum in trust for the insurers, according to their right of contribution among themselves.

33. Nature of warranty

(1)A warranty, in the following sections relating to warranties, means a promissory warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.

(2)A warranty may be express or implied.

(3)A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

34. When breach of warranty excused

(1)Non-compliance with a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract, or when compliance with the warranty is rendered unlawful by any subsequent law.

(2)Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss.

(3)A breach of warranty may be waived by the insurer.

35. Express warranties

(1)An express warranty may be in any form of words from which the intention to warrant is to be inferred.

(2)An express warranty must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy.

(3)An express warranty does not exclude an implied warranty, unless it be inconsistent therewith.

36. Warranty of neutrality

(1)Where insurable property, whether ship or goods, is expressly warranted neutral, there is an implied condition that the property shall have a neutral character at the commencement of the risk, and that, so far as the assured can control the matter, its neutral character shall be preserved during the risk.

(2)Where a ship is expressly warranted "neutral" there is also an implied condition that, so far as the assured can control the matter, she shall be properly documented, that is to say, that she shall carry the necessary papers to establish her neutrality, and that she shall not falsify or suppress her papers, or use simulated papers. If any loss occurs through breach of this condition, the insurer may avoid the contract.

37. No implied warranty of nationality

There is no implied warranty as to the nationality of a ship, or that her nationality shall not be changed during the risk.

38. Warranty of good safety

Where the subject-matter insured is warranted "well" or "in good safety" on a particular day, it is sufficient if it be safe at any time during that day.

39. Warranty of seaworthiness of ship

(1)In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured.

(2)Where the policy attaches while the ship is in port, there is also an implied warranty that she shall, at the commencement of the risk, be reasonably fit to encounter the ordinary perils of the port.

(3)Where the policy relates to a voyage which is performed in different stages, during which the ship requires different kinds of or further preparation or equipment, there is an implied warranty that at the commencement of each stage the ship is seaworthy in respect of such preparation or equipment for the purposes of that stage.

(4)A ship is deemed to be seaworthy when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure insured.

(5)In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness.

40. No implied warranty that goods are seaworthy

(1)In a policy on goods or other moveables there is no implied warranty that the goods or moveables are seaworthy.

(2)In a voyage policy on goods or other moveables there is an implied warranty that at the commencement of the voyage the ship is not only seaworthy as a ship, but also that she is reasonably fit to carry the goods or other moveables to the destination contemplated by the policy.

41. Warranty of legality

There is an implied warranty that the adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

42. Implied condition as to commencement of risk

(1)Where the subject-matter is insured by a voyage policy "at and from" or "from" a particular place, it is not necessary that the ship should be at that place when the contract is concluded, but there is an implied condition that the adventure shall be commenced within a reasonable time, and that if the adventure be not so commenced the insurer may avoid the contract.

(2)The implied condition may be negatived by showing that the delay was caused by circumstances known to the insurer before the contract was concluded, or by showing that he waived the condition.

43. Alteration of port of departure

Where the place of departure is specified by the policy, and the ship instead of sailing from that place sails from any other place, the risk does not attach.

44. Sailing for different destination

Where the destination is specified in the policy, and the ship, instead of sailing for that destination, sails for any other destination, the risk does not attach.

45. Change of voyage

(1)Where, after the commencement of the risk, the destination of the ship is voluntarily changed from the destination contemplated by the policy, there is said to be a change of voyage.

(2)Unless the policy otherwise provides, where there is a change of voyage, the insurer is discharged from liability as from the time of change, that is to say, as from the time when the determination to change it is manifested; and it is immaterial that the ship may not in fact have left the course of voyage contemplated by the policy when the loss occurs.

46. Deviation

(1)Where a ship, without lawful excuse, deviates from the voyage contemplated by the policy, the insurer is discharged from liability as from the time of deviation, and it is immaterial that the ship may have regained her route before any loss occurs.

(2)There is a deviation from the voyage contemplated by the policy—

(a)Where the course of the voyage is specifically designated by the policy, and that course is departed from; or

(b)Where the course of the voyage is not specifically designated by the policy, but the usual and customary course is departed from.

(3)The intention to deviate is immaterial; there must be a deviation in fact to discharge the insurer from his liability under the contract.

47. Several ports of discharge

(1)Where several ports of discharge are specified by the policy, the ship may proceed to all or any of them, but, in the absence of any usage or sufficient cause to the contrary, she must proceed to them, or such of them as she goes to, in the order designated by the policy. If she does not there is a deviation.

(2)Where the policy is to "ports of discharge," within a given area, which are not named, the ship must, in the absence of any usage or sufficient cause to the contrary, proceed to them, or such of them as she goes to, in their geographical order. If she does not there is a deviation.

48. Delay in voyage

In the case of a voyage policy, the adventure insured must be prosecuted throughout its course with reasonable dispatch, and, if without lawful excuse it is not so prosecuted, the insurer is discharged from liability as from the time when the delay became unreasonable.

49. Excuses for deviation or delay

(1)Deviation or delay in prosecuting the voyage contemplated by the policy is excused—

(a)Where authorised by any special term in the policy; or

(b)Where caused by circumstances beyond the control of the master and his employer; or

(c)Where reasonably necessary in order to comply with an express or implied warranty; or

(d)Where reasonably necessary for the safety of the ship or subject-matter insured; or

(e)For the purpose of saving human life, or aiding a ship in distress where human life may be in danger; or

(f)Where reasonably necessary for the purpose of obtaining medical or surgical aid for any person on board the ship; or

(g)Where caused by the barratrous conduct of the master or crew, if barratry be one of the perils insured against.

(2)When the cause excusing the deviation or delay ceases to operate, the ship must resume her course, and prosecute her voyage, with reasonable dispatch.

ASSIGNMENT OF POLICY

50. When and how policy is assignable

(1)A marine policy is assignable unless it contains terms expressly prohibiting assignment. It may be assigned either before or after loss.

(2)Where a marine policy has been assigned so as to pass the beneficial interest in such policy, the assignee of the policy is entitled to sue thereon in his own name; and the defendant is entitled to make any defence arising out of the contract which he would have been entitled to make if the action had been brought in the name of the person by or on behalf of whom the policy was effected.

(3)A marine policy may be assigned by indorsement thereon or in other customary manner.

51. Assured who has no interest cannot assign

Where the assured has parted with or lost his interest in the subject-matter insured, and has not, before or at the time of so doing, expressly or impliedly agreed to assign the policy, any subsequent assignment of the policy is inoperative:

Provided that nothing in this section affects the assignment of a policy after loss.

THE PREMIUM

52. When premium payable

Unless otherwise agreed, the duty of the assured or his agent to pay the premium, and the duty of the insurer to issue the policy to the assured or his agent, are concurrent conditions, and the insurer is not bound to issue the policy until payment or tender of the premium.

53. Policy effected through broker

(1)Unless otherwise agreed, where a marine policy is effected on behalf of the assured by a broker, the broker is directly responsible to the insurer for the premium, and the insurer is directly responsible to the assured for the amount which may be payable in respect of losses, or in respect of returnable premium.

(2)Unless otherwise agreed, the broker has, as against the assured, a lien upon the policy for the amount of the premium and his charges in respect of effecting the policy; and, where he has dealt with the person who employs him as a principal, he has also a lien on the policy in respect of any balance on any insurance account which may be due to him from such person, unless when the debt was incurred he had reason to believe that such person was only an agent.

54. Effect of receipt on policy

Where a marine policy effected on behalf of the assured by a broker acknowledges the receipt of the premium, such acknowledgement is, in the absence of fraud, conclusive as between the insurer and the assured, but not as between the insurer and broker.

55. Included and excluded losses

(1)Subject to the provisions of this Act, and unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against.

(2)In particular—

(a)The insurer is not liable for any loss attributable to the wilful misconduct of the assured, but, unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew;

(b)Unless the policy otherwise provides, the insurer on ship or goods is not liable for any loss proximately caused by delay, although the delay be caused by a peril insured against;

(c)Unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or nature of the subject-matter insured, or for any loss proximately caused by rats or vermin, or for any injury to machinery not proximately caused by maritime perils.

56. Partial and total loss

(1)A loss may be either total or partial. Any loss other than a total loss, as hereinafter defined, is a partial loss.

(2)A total loss may be either an actual total loss, or a constructive total loss.

(3)Unless a different intention appears from the terms of the policy, an insurance against total loss includes a constructive, as well as an actual, total loss.

(4)Where the assured brings an action for a total loss and the evidence proves only a partial loss, he may, unless the policy otherwise provides, recover for a partial loss.

(5)Where goods reach their destination in specie, but by reason of obliteration of marks, or otherwise, they are incapable of identification, the loss, if any, is partial, and not total.

57. Actual total loss

(1)Where the subject-matter insured is destroyed, or so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, there is an actual total loss.

(2)In the case of an actual total loss no notice of abandonment need be given.

58. Missing ship

Where the ship concerned in the adventure is missing, and after the lapse of a reasonable time no news of her has been received, an actual total loss may be presumed.

59. Effect of transhipment, &c

Where, by a peril insured against, the voyage is interrupted at an intermediate port or place, under such circumstances as, apart from any special stipulation in the contract of affreightment, to justify the master in landing and reshipping the goods or other moveables, or in transhipping them, and sending them on to their destination, the liability of the insurer continues, notwithstanding the landing or transhipment.

60. Constructive total loss defined

(1)Subject to any express provision in the policy, there is a constructive total loss where the subject-matter insured is reasonably abandoned on account of its actual total loss appearing to be unavoidable, or because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred.

(2)In particular, there is a constructive total loss—

(i)Where the assured is deprived of the possession of his ship or goods by a peril insured against, and (a) it is unlikely that he can recover the ship or goods, as the case may be, or (b) the cost of recovering the ship or goods, as the case may be, would exceed their value when recovered; or

(ii)In the case of damage to a ship, where she is so damaged by a peril insured against that the cost of repairing the damage would exceed the value of the ship when repaired.

In estimating the cost of repairs, no deduction is to be made in respect of general average contributions to those repairs payable by other interests, but account is to be taken of the expense of future salvage operations and of any future general average contributions to which the ship would be liable if repaired; or

(iii)In the case of damage to goods, where the cost of repairing the damage and forwarding the goods to their destination would exceed their value on arrival.

61. Effect of constructive total loss

Where there is a constructive total loss the assured may either treat the loss as a partial loss, or abandon the subject-matter insured to the insurer and treat the loss as if it were an actual total loss.

62. Notice of abandonment

(1)Subject to the provisions of this section, where the assured elects to abandon the subject-matter insured to the insurer, he must give notice of abandonment. If he fails to do so the loss can only be treated as a partial loss.

(2)Notice of abandonment may be given in writing, or by word of mouth, or partly in writing and partly by word of mouth, and may be given in any terms which indicate the intention of the assured to abandon his insured interest in the subject-matter insured unconditionally to the insurer.

(3)Notice of abandonment must be given with reasonable diligence after the receipt of reliable information of the loss, but where the information is of a doubtful character the assured is entitled to a reasonable time to make inquiry.

(4)Where notice of abandonment is properly given, the rights of the assured are not prejudiced by the fact that the insurer refuses to accept the abandonment.

(5)The acceptance of an abandonment may be either express or implied from the conduct of the insurer. The mere silence of the insurer after notice is not an acceptance.

(6)Where notice of abandonment is accepted the abandonment is irrevocable. The acceptance of the notice conclusively admits liability for the loss and the sufficiency of the notice.

(7)Notice of abandonment is unnecessary where, at the time when the assured receives information of the loss, there would be no possibility of benefit to the insurer if notice were given to him.

(8)Notice of abandonment may be waived by the insurer.

(9)Where an insurer has re-insured his risk, no notice of abandonment need be given by him.

63. Effect of abandonment

(1)Where there is a valid abandonment the insurer is entitled to take over the interest of the assured in whatever may remain of the subject-matter insured, and all proprietary rights incidental thereto.

(2)Upon the abandonment of a ship, the insurer thereof is entitled to any freight in course of being earned, and which is earned by her subsequent to the casualty causing the loss, less the expenses of earning it incurred after the casualty; and, where the ship is carrying the owner's goods, the insurer is entitled to a reasonable remuneration for the carriage of them subsequent to the casualty causing the loss.

PARTIAL LOSSES (INCLUDING SALVAGE AND GENERAL AVERAGE AND PARTICULAR CHARGES)

64. Particular average loss

(1)A particular average loss is a partial loss of the subject-matter insured, caused by a peril insured against, and which is not a general average loss.

(2)Expenses incurred by or on behalf of the assured for the safety or preservation of the subject-matter insured, other than general average and salvage charges, are called particular charges. Particular charges are not included in particular average.

65. Salvage charges

(1)Subject to any express provision in the policy, salvage charges incurred in preventing a loss by perils insured against may be recovered as a loss by those perils.

(2)"Salvage charges" means the charges recoverable under maritime law by a salvor independently of contract. They do not include the expenses of services in the nature of salvage rendered by the assured or his agents, or any person employed for hire by them, for the purpose of averting a peril insured against. Such expenses, where properly incurred, may be recovered as particular charges or as a general average loss, according to the circumstances under which they were incurred.

66. General average loss

(1)A general average loss is a loss caused by or directly consequential on a general average act. It includes a general average expenditure as well as a general average sacrifice.

(2)There is a general average act where any extraordinary sacrifice or expenditure is voluntarily and reasonably made or incurred in time of peril for the purpose of preserving the property imperilled in the common adventure.

(3)Where there is a general average loss, the party on whom it falls is entitled, subject to the conditions imposed by maritime law, to a rateable contribution from the other parties interested, and such contribution is called a general average contribution.

(4)Subject to any express provision in the policy, where the assured has incurred a general average expenditure, he may recover from the insurer in respect of the proportion of the loss which falls upon him; and, in the case of a general average sacrifice, he may recover from the insurer in respect of the whole loss without having enforced his right of contribution from the other parties liable to contribute.

(5)Subject to any express provision in the policy, where the assured has paid, or is liable to pay, a general average contribution in respect of the subject insured, he may recover therefor from the insurer.

(6)In the absence of express stipulation, the insurer is not liable for any general average loss or contribution where the loss was not incurred for the purpose of avoiding, or in connexion with the avoidance of, a peril insured against.

(7)Where ship, freight, and cargo, or any two of those interests, are owned by the same assured, the liability of the insurer in respect of general average losses or contributions is to be determined as if those subjects were owned by different persons.

MEASURE OF INDEMNITY

67. Extent of liability of insurer for loss

(1)The sum which the assured can recover in respect of a loss on a policy by which he is insured, in the case of an unvalued policy to the full extent of the insurable value, or, in the case of a valued policy to the full extent of the value fixed by the policy is called the measure of indemnity.

(2)Where there is a loss recoverable under the policy, the insurer, or each insurer if there be more than one, is liable for such proportion of the measure of indemnity as the amount of his subscription bears to the value fixed by the policy in the case of a valued policy, or to the insurable value in the case of an unvalued policy.

68. Total loss

Subject to the provisions of this Act and to any express provision in the policy, where there is a total loss of the subject-matter insured,—

(1)If the policy be a valued policy, the measure of indemnity is the sum fixed by the policy:

(2)If the policy be an unvalued policy, the measure of indemnity is the insurable value of the subject-matter insured.

69. Partial loss of ship

Where a ship is damaged, but is not totally lost, the measure of indemnity, subject to any express provision in the policy, is as follows:—

(1)Where the ship has been repaired, the assured is entitled to the reasonable cost of the repairs, less the customary deductions, but not exceeding the sum insured in respect of any one casualty:

(2)Where the ship has been only partially repaired, the assured is entitled to the reasonable cost of such repairs, computed as above, and also to be indemnified for the reasonable depreciation, if any, arising from the unrepaired damage, provided that the aggregate amount shall not exceed the cost of repairing the whole damage, computed as above:

(3)Where the ship has not been repaired, and has not been sold in her damaged state during the risk, the assured is entitled to be indemnified for the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage, computed as above.

70. Partial loss of freight

Subject to any express provision in the policy, where there is a partial loss of freight, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the proportion of freight lost by the assured bears to the whole freight at the risk of the assured under the policy.

71. Partial loss of goods, merchandise, &c

Where there is a partial loss of goods, merchandise, or other moveables, the measure of indemnity, subject to any express provision in the policy, is as follows:—

(1)Where part of the goods, merchandise or other moveables insured by a valued policy is totally lost, the measure of indemnity is such proportion of the sum fixed by the policy as the insurable value of the part lost bears to the insurable value of the whole, ascertained as in the case of an unvalued policy:

(2)Where part of the goods, merchandise, or other moveables insured by an unvalued policy is totally lost, the measure of indemnity is the insurable value of the part lost, ascertained as in case of total loss:

(3)Where the whole or any part of the goods or merchandise insured has been delivered damaged at its destination, the measure of indemnity is such proportion of the sum fixed by the policy in the case of a valued policy, or of the insurable value in the case of an unvalued policy, as the difference between the gross sound and damaged values at the place of arrival bears to the gross sound value:

(4)"Gross value" means the wholesale price, or, if there be no such price, the estimated value, with, in either case, freight, landing charges, and duty paid beforehand; provided that, in the case of goods or merchandise customarily sold in bond, the bonded price is deemed to be the gross value. "Gross proceeds" means the actual price obtained at a sale where all charges on sale are paid by the sellers.

72. Apportionment of valuation

(1)Where different species of property are insured under a single valuation, the valuation must be apportioned over the different species in proportion to their respective insurable values, as in the case of an unvalued policy. The insured value of any part of a species is such proportion of the total insured value of the same as the insurable value of the part bears to the insurable value of the whole, ascertained in both cases as provided by this Act.

(2)Where a valuation has to be apportioned, and particulars of the prime cost of each separate species, quality, or description of goods cannot be ascertained, the division of the valuation may be made over the net arrived sound values of the different species, qualities, or descriptions of goods.

73. General average contributions and salvage charges

(1)Subject to any express provision in the policy, where the assured has paid, or is liable for, any general average contribution, the measure of indemnity is the full amount of such contribution, if the subject-matter liable to contribution is insured for its full contributory value; but, if such subject-matter be not insured for its full contributory value, or if only part of it be insured, the indemnity payable by the insurer must be reduced in proportion to the under insurance, and where there has been a particular average loss which constitutes a deduction from the contributory value, and for which the insurer is liable, that amount must be deducted from the insured value in order to ascertain what the insurer is liable to contribute.

(2)Where the insurer is liable for salvage charges the extent of his liability must be determined on the like principle.

74. Liabilities to third parties

Where the assured has effected an insurance in express terms against any liability to a third party, the measure of indemnity, subject to any express provision in the policy, is the amount paid or payable by him to such third party in respect of such liability.

75. General provisions as to measure of indemnity

(1)Where there has been a loss in respect of any subject-matter not expressly provided for in the foregoing provisions of this Act, the measure of indemnity shall be ascertained, as nearly as may be, in accordance with those provisions, in so far as applicable to the particular case.

(2)Nothing in the provisions of this Act relating to the measure of indemnity shall affect the rules relating to double insurance, or prohibit the insurer from disproving interest wholly or in part, or from showing that at the time of the loss the whole or any part of the subject-matter insured was not at risk under the policy.

76. Particular average warranties

(1)Where the subject-matter insured is warranted free from particular average, the assured cannot recover for a loss of part, other than a loss incurred by a general average sacrifice, unless the contract contained in the policy be apportionable; but, if the contract be apportionable, the assured may recover for a total loss of any apportionable part.

(2)Where the subject-matter insured is warranted free from particular average, either wholly or under a certain percentage, the insurer is nevertheless liable for salvage charges, and for particular charges and other expenses properly incurred pursuant to the provisions of the suing and labouring clause in order to avert a loss insured against.

(3)Unless the policy otherwise provides, where the subject-matter insured is warranted free from particular average under a specified percentage, a general average loss cannot be added to a particular average loss to make up the specified percentage.

(4)For the purpose of ascertaining whether the specified percentage has been reached, regard shall be had only to the actual loss suffered by the subject-matter insured. Particular charges and the expenses of and incidental to ascertaining and proving the loss must be excluded.

77. Successive losses

(1)Unless the policy otherwise provides, and subject to the provisions of this Act, the insurer is liable for successive losses, even though the total amount of such losses may exceed the sum insured.

(2)Where, under the same policy, a partial loss, which has not been repaired or otherwise made good, is followed by a total loss, the assured can only recover in respect of the total loss:

Provided that nothing in this section shall affect the liability of the insurer under the suing and labouring clause.

78. Suing and labouring clause

(1)Where the policy contains a suing and labouring clause, the engagement thereby entered into is deemed to be supplementary to the contract of insurance, and the assured may recover from the insurer any expenses properly incurred pursuant to the clause, notwithstanding that the insurer may have paid for a total loss, or that the subject-matter may have been warranted free from particular average, either wholly or under a certain percentage.

(2)General average losses and contributions and salvage charges, as defined by this Act, are not recoverable under the suing and labouring clause.

(3)Expenses incurred for the purpose of averting or diminishing any loss not covered by the policy are not recoverable under the suing and labouring clause.

(4)It is the duty of the assured and his agents, in all cases, to take such measures as may be reasonable for the purpose of averting or minimising a loss.

Rights of Insurer on Payment

79. Right of subrogation

(1)Where the insurer pays for a total loss, either of the whole, or in the case of goods of any apportionable part, of the subject-matter insured, he thereupon becomes entitled to take over the interest of the assured in whatever may remain of the subject-matter so paid for, and he is thereby subrogated to all the rights and remedies of the assured in and in respect of that subject-matter as from the time of the casualty causing the loss.

(2)Subject to the foregoing provisions, where the insurer pays for a partial loss, he acquires no title to the subject-matter insured, or such part of it as may remain, but he is thereupon subrogated to all rights and remedies of the assured in and in respect of the subject-matter insured as from the time of the casualty causing the loss, in so far as the assured has been indemnified, according to this Act, by such payment for the loss.

80. Right of contribution

(1)Where the assured is over-insured by double insurance, each insurer is bound, as between himself and the other insurers, to contribute rateably to the loss in proportion to the amount for which he is liable under his contract.

(2)If any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution against the other insurers, and is entitled to the like remedies as a surety who has paid more than his proportion of the debt.

81. Effect of under insurance

Where the assured is insured for an amount less than the insurable value or, in the case of a valued policy, for an amount less than the policy valuation, he is deemed to be his own insurer in respect of the uninsured balance.

Return of Premium

82. Enforcement of return

Where the premium or a proportionate part thereof is, by this Act, declared to be returnable,—

(a)If already paid, it may be recovered by the assured from the insurer; and

(b)If unpaid, it may be retained by the assured or his agent.

83. Return by agreement

Where the policy contains a stipulation for the return of the premium, or a proportionate part thereof, on the happening of a certain event, and that event happens, the premium, or, as the case may be, the proportionate part thereof, is thereupon returnable to the assured.

84. Return for failure of consideration

(1)Where the consideration for the payment of the premium totally fails, and there has been no fraud or illegality on the part of the assured or his agents, the premium is thereupon returnable to the assured.

(2)Where the consideration for the payment of the premium is apportionable and there is a total failure of any apportionable part of the consideration, a proportionate part of the premium is, under the like conditions, thereupon returnable to the assured.

(3)In particular—

(a)Where the policy is void, or is avoided by the insurer as from the commencement of the risk, the premium is returnable, provided that there has been no fraud or illegality on the part of the assured; but if the risk is not apportionable, and has once attached, the premium is not returnable:

(b)Where the subject-matter insured, or part thereof, has never been imperilled, the premium, or, as the case may be, a proportionate part thereof, is returnable:

Provided that where the subject-matter has been insured "lost or not lost" and has arrived in safety at the time when the contract is concluded, the premium is not returnable unless, at such time, the insurer knew of the safe arrival.

(c)Where the assured has no insurable interest throughout the currency of the risk, the premium is returnable, provided that this rule does not apply to a policy effected by way of gaming or wagering;

(d)Where the assured has a defeasible interest which is terminated during the currency of the risk, the premium is not returnable;

(e)Where the assured has over-insured under an unvalued policy, a proportionate part of the premium is returnable;

(f)Subject to the foregoing provisions, where the assured has over-insured by double insurance, a proportionate part of the several premiums is returnable:

Provided that, if the policies are effected at different times, and any earlier policy has at any time borne the entire risk, or if a claim has been paid on the policy in respect of the full sum insured thereby, no premium is returnable in respect of that policy, and when the double insurance is effected knowingly by the assured no premium is returnable.

MUTUAL INSURANCE

85. Modification of Act in case of mutual insurance

(1)Where two or more persons mutually agree to insure each other against marine losses there is said to be a mutual insurance.

(2)The provisions of this Act relating to the premium do not apply to mutual insurance, but a guarantee, or such other arrangement as may be agreed upon, may be substituted for the premium.

(3)The provisions of this Act, in so far as they may be modified by the agreement of the parties, may in the case of mutual insurance be modified by the terms of the policies issued by the association, or by the rules and regulations of the association.

(4)Subject to the exceptions mentioned in this section, the provisions of this Act apply to a mutual insurance.

86. Ratification by assured

Where a contract of marine insurance is in good faith effected by one person on behalf of another, the person on whose behalf it is effected may ratify the contract even after he is aware of a loss.

87. Implied obligations varied by agreement or usage

(1)Where any right, duty, or liability would arise under a contract of marine insurance by implication of law, it may be negatived or varied by express agreement, or by usage, if the usage be such as to bind both parties to the contract.

(2)The provisions of this section extend to any right, duty, or liability declared by this Act which may be lawfully modified by agreement.

88. Reasonable time, &c. a question of fact

Where by this Act any reference is made to reasonable time, reasonable premium, or reasonable diligence, the question what is reasonable is a question of fact.

89. Slip as evidence

Where there is a duly stamped policy, reference may be made, as heretofore, to the slip or covering note, in any legal proceeding.

90. Interpretation of terms

In this Act, unless the context or subject-matter otherwise requires,—

"Action" includes counter-claim and set off:

"Freight" includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money:

"Moveables" means any moveable tangible property, other than the ship, and includes money, valuable securities, and other documents:

"Policy" means a marine policy.

91. Savings

(1)Nothing in this Act, or in any repeal effected thereby, shall affect—

(a)The provisions of the Stamp Act 1891, or any enactment for the time being in force relating to the revenue;

(b)The provisions of the Companies Act 1862, or any enactment amending or substituted for the same;

(c)The provisions of any statute not expressly repealed by this Act.

(2)The rules of the common law including the law merchant, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts of marine insurance.

92., 93.. .

Annotations:

Ss. 92, 93, Sch. 2 repealed by Statute Law Revision Act 1927 (c. 42)

94. Short title

This Act may be cited as the Marine Insurance Act 1906.

SCHEDULES 1(s.30)

The S.G. Form

FORM OF POLICY

BE IT KNOWN THAT ....as well in ....own name as for and in the name and names of all and every other person or persons to whom the same doth, may, or shall appertain, in part or in all doth make assurance and cause ....and them, and every of them, to be insured lost or not lost, at and from.................

Upon any kind of goods and merchandises, and also upon the body, tackle, apparel, ordnance, munition, artillery, boat, and other furniture, of and in the good ship or vessel called the ....whereof is master under God, for this present voyage, ...or whosoever else shall go for master in the said ship, or by whatsoever other name or names the said ship, or the master thereof, is or shall be named or called; beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship.

upon the said ship, &c.

and so shall continue and endure, during her abode there, upon the said ship, &c. And further, until the said ship, with all her ordnance, tackle, apparel, &c., and goods and merchandises whatsoever shall be arrived at................

upon the said ship, &c., until she hath moored at anchor twenty-four hours in good safety; and upon the goods and merchandises, until the same be there discharged and safely landed. And it shall be lawful for the said ship, &c., in this voyage, to proceed and sail to and touch and stay at any ports or places whatsoever

without prejudice to this insurance. The said ship, &c., goods and merchandises, &c., for so much as concerns the assured by agreement between the assured and assurers in this policy, are and shall be valued at................

Touching the adventures and perils which we the assurers are contented to bear and do take upon us in this voyage: they are of the seas, men of war, fire, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, surprisals, takings at sea, arrests, restraints, and detainments of all kings, princes, and people, of what nation, condition, or quality soever, barratry of the master and mariners, and of all other perils, losses, and misfortunes, that have or shall come to the hurt, detriment, or damage of the said goods and merchandises, and ship, &c., or any part thereof. And in case of any loss or misfortune it shall be lawful to the assured, their factors, servants and assigns, to sue, labour, and travel for, in and about the defence, safeguards, and recovery of the said goods and merchandises, and ship, &c., or any part thereof, without prejudice to this insurance; to the charges whereof we, the assurers, will contribute each one according to the rate and quantity of his sum herein assuredAnd it is especially declared and agreed that no acts of the insurer or insured in recovering, saving, or preserving the property insured shall be considered as a waiver, or acceptance of abandonment. And it is agreed by us, the insurers, that this writing or policy of assurance shall be of as much force and effect as the surest writing or policy of assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London. And so we, the assurers, are contented, and do hereby promise and bind ourselves, each one for his own part, our heirs, executors, and goods to the assured, their executors, administrators, and assigns, for the true performance of the premises, confessing ourselves paid the consideration due unto us for this assurance by the assured, at and after the rate of..................

IN WITNESS whereof we, the assurers, have subscribed our names and sums assured in London.

N.B.—Corn, fish, salt, fruit, flour, and seed are warranted free from average, unless general, or the ship be stranded—sugar, tobacco, hemp, flax, hides and skins are warranted free from average, under five pounds per cent., and all other goods, also the ship and freight, are warranted free from average, under three pounds per cent. unless general, or the ship be stranded.

Rules for construction of policy

The following are the rules referred to by this Act for the construction of a policy in the above or other like form, where the context does not otherwise require:—

1. Lost or not lost

Where the subject-matter is insured "lost or not lost," and the loss has occurred before the contract is concluded, the risk attaches unless, at such time the assured was aware of the loss, and the insurer was not.

2. From

Where the subject-matter is insured "from" a particular place, the risk does not attach until the ship starts on the voyage insured.

3. At and from [Ship]

(a)Where a ship is insured "at and from" a particular place, and she is at that place in good safety when the contract is concluded, the risk attaches immediately.

(b)If she be not at that place when the contract is concluded, the risk attaches as soon as she arrives there in good safety, and, unless the policy otherwise provides, it is immaterial that she is covered by another policy for a specified time after arrival.

(c)Where chartered freight is insured "at and from" a particular place, and the ship is at that place in good safety when the contract is concluded the risk attaches immediately. If she be not there when the contract is concluded, the risk attaches as soon as she arrives there in good safety.

(d)Where freight, other than chartered freight, is payable without special conditions and is insured "at and from" a particular place, the risk attaches pro rata as the goods or merchandise are shipped; provided that if there be cargo in readiness which belongs to the shipowner, or which some other person has contracted with him to ship, the risk attaches as soon as the ship is ready to receive such cargo.

4. From the loading thereof

Where goods or other moveables are insured "from the loading thereof," the risk does not attach until such goods or moveables are actually on board, and the insurer is not liable for them while in transit from the shore to the ship.

5. Safely landed

Where the risk on goods or other moveables continues until they are "safely landed," they must be landed in the customary manner and within a reasonable time after arrival at the port of discharge, and if they are not so landed the risk ceases.

6. Touch and stay

In the absence of any further licence or usage, the liberty to touch and stay "at any port or place whatsoever" does not authorise the ship to depart from the course of her voyage from the port of departure to the port of destination.

7. Perils of the seas

The term "perils of the seas" refers only to fortuitous accidents or casualties of the seas. It does not include the ordinary action of the winds and waves.

8. Pirates

The term "pirates" includes passengers who mutiny and rioters who attack the ship from the shore.

Annotations:
Sch. 1 rules 8, 10 amended by Public Order Act 1986 (c. 64, SIF 39:2), s. 10(2)

9. Thieves

The term "thieves" does not cover clandestine theft or a theft committed by any one of the ship's company, whether crew or passengers.

10. Restraint of princes

The term "arrests, &c., of kings, princes, and people" refers to political or executive acts, and does not include a loss caused by riot or by ordinary judicial process.

Annotations:
Sch. 1 rules 8, 10 amended by Public Order Act 1986 (c. 64, SIF 39:2), s. 10(2)

11. Barratry

The term "barratry" includes every wrongful act wilfully committed by the master or crew to the prejudice of the owner, or, as the case may be, the charterer.

12. All other perils

The term "all other perils" includes only perils similar in kind to the perils specifically mentioned in the policy.

13. Average unless general

The term "average unless general" means a partial loss of the subject-matter insured other than a general average loss, and does not include "particular charges."

14. Stranded

Where the ship has stranded, the insurer is liable for the excepted losses, although the loss is not attributable to the stranding, provided that when the stranding takes place the risk has attached and, if the policy be on goods, that the damaged goods are on board.

15. Ship

The term "ship" includes the hull, materials and outfit, stores and provisions for the officers and crew, and, in the case of vessels engaged in a special trade, the ordinary fittings requisite for the trade, and also, in the case of a steamship, the machinery, boilers, and coals and engine stores, if owned by the assured.

16. Freight

The term "freight" includes the profit derivable by a shipowner from the employment of his ship to carry his own goods or moveables, as well as freight payable by a third party, but does not include passage money.

17. Goods

The term "goods" means goods in the nature of merchandise, and does not include personal effects or provisions and stores for use on board.

In the absence of any usage to the contrary, deck cargo and living animals must be insured specifically, and not under the general denomination of goods.

SCHEDULE 2 (s.92)

Annotations:
Ss. 92, 93, Sch. 2 repealed by Statute Law Revision Act 1927 (c. 42)

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