THE ONLY GLOBAL ASSOCIATION OF YOUNG LAWYERS

53RD ANNUAL CONGRESS IN LONDON
2-5 SEPTEMBER 2015

MARINE INSURANCE
DENYING COVER AS A MARINE INSURER: PLAIN SAILING OR DEAD IN THE WATER?

A WORKSHOP ORGANIZED BY
THE TRANSPORT LAW COMMISSION

QUESTIONNAIRE

Traditionally, marine insurance may cover a broad range of perils, damage and losses related to ships and watercrafts sailing on the high seas or inland waterways, and the cargoes they carry.

For vessel owners and charterers, marine insurance covers risks, which allows them to avoid losses and run their business with the certainty that their exposure to the risks insured is covered. However, marine insurance is not meant to cover all risks, and there are obligations which the insured must fulfil to be able to make a claim. Accordingly, certain express or implied warranties or other terms limit the scope of exposure for marine insurers, and a breach of such warranties or terms may allow the insurers to escape liability.

In continuation of the pre-congress seminar “Marine Insurance: Covering the Vessel’s Life from Cradle to Grave”, the Transport Law Commission will organize a workshop at the 53rd annual congress in London on 2-5 September 2015, which will focus on of hull & machinery (H&M) and protection & indemnity (P&I) insurers’ grounds for denying coverage, in the event of a breach of an express or implied warranty in the policy, or other objectionable conduct by the insured.

This questionnaire will form the basis for the national reports, which are to be prepared by each national reporter in accordance with the laws of her or his country in preparation for the workshop.

The questions are:

1. Which laws and rules govern contracts of insurance, including H&M and P&I insurance, in your jurisdiction?

The United States has a bifurcated legal system. The Constitution creates a federal system of government whereby power is shared between the jurisdictions of the federal government and, in turn, the separate state governments of the fifty states (and various U.S. territories). In this fashion, there are generally two basic categories of laws and rules applied within the United States: **federal law**, and **state law**. Both sets of laws are comprised of codified statutory and common “judge made” law. Generally, federal law uniformly applies to the *entire* nation as a whole (i.e., the fifty states and territories), whereas state law separately applies within the jurisdictional confines of the particular state at issue.

In contrast to the United Kingdom, the law of marine insurance in the United States has never been codified into federal statutory law. To the contrary, in the seminal case of *Wilburn Boat Co. V. Fireman’s Fund Ins. Co.*, 348 U.S. 310 (1955), the United States Supreme Court (the highest court in the nation) held that marine insurance is governed by both federal maritime law and state law. Pursuant to *Wilburn Boat*, in resolving a particular marine insurance issue a court must initially determine if an established federal maritime law rule associated with marine insurance should be followed. In the absence of such a rule, a court must determine if it should create a “new” federal rule to apply to the dispute. If not, then a court must apply the applicable state law rule to the marine insurance

dispute. There is a general presumption against creating a federal admiralty rule in such instances, and in favour of the application of state law insurance principles to the marine insurance dispute. Accordingly, in practical terms the law of marine insurance in the United States is largely controlled by state law insurance rules, and as a result, *Wilburn Boat* can lead to conflicts of law between the states *vis a vis* a particular marine insurance dispute. The state with the greatest interest in the dispute typically is chosen to provide the law to be applied, although the parties are free to (and often) include a contractual "choice of law" clause in their insurance agreement that will generally be enforceable unless that clause is found to be unjust or unreasonable.

An overarching principle running throughout the American law of marine insurance (both at the state and federal levels) is the duty of "utmost good faith," or *uberrimae fidei*. The duty of utmost good faith requires the assured to voluntarily disclose to the insurer every circumstance and fact known to the assured that would be material to affecting the underwriter's decision to insure against the risk at issue. If the assured fails to disclose all material information known to him at the time of underwriting, then the insurer may be allowed to later avoid the policy. Of course, the assured's alleged material misrepresentation and/or nondisclosure is an issue that is often analyzed under state law as a result of *Wilburn Boat*.

2. **Do the laws and rules governing contracts of H&M and P&I insurance prescribe any post-inception warranties or other terms, which – if breached by the insured – may allow the insurer to deny or limit coverage of an insured event?**

If so, please identify such warranties and terms and state specifically whether (i) unseaworthiness, (ii) deviation from the agreed vessel trading area or route, (iii) violation of safety rules and/or (iv) negligence, gross negligence or wilful misconduct of the insured may cause loss or limitation of coverage.

American maritime law provides for various post-inception common law warranties (in addition to any express warranties contained within the insurance agreement) which - if breached - may allow an insurer to deny or limit coverage of an insured event, depending on the facts at issue. An implied warranty of seaworthiness exists in every hull insurance policy (both voyage and time), with two aspects: first, an absolute warranty by the assured that the vessel is seaworthy at the start of the insurance policy, and second, a "negative burden" that an owner will not knowingly (or in some instances, negligently) allow a vessel to "break ground" at the start of a voyage in an unseaworthy condition. In contrast, U.S. maritime law does *not* recognize an implied warranty of seaworthiness in a P & I policy, as such policies are *per se* designed to cover the shipowner's own negligence.

The second major implied marine insurance warranty recognized under American law is the doctrine of deviation. In general terms, and with respect to voyage policies, the marine insurer will only accept the risk of a particular voyage via the customary trade route. If a vessel deviates from the generally accepted

commercial route, the insurer may potentially be discharged from liability with respect to events which occur during the deviation (which were arguably not contemplated by the insurer in the first instance).

3. Under which conditions may a breach of the warranties or other terms identified in reply to question 2 cause loss or limitation of coverage? As part of your answer, please describe how the burden of proof is allocated.

The analysis of a breach of warranty dispute is always a very fact intensive inquiry that will necessarily turn upon the specific circumstances of each case, as well as the precise terms of the marine insurance policy in question. In general, U.S. maritime law distinguishes between voyage and time policies with respect to evaluating the implied warranty of seaworthiness. In voyage policies, the implied warranty of seaworthiness is connected to the particular voyage at issue – the vessel must be seaworthy for the transit in question (i.e., a vessel that is seaworthy for a voyage in the U.S. Gulf of Mexico in July may very well be *unseaworthy* for a voyage in the Bering Sea in December). With respect to time policies, the assured's obligation is more curtailed, and a breach occurs only if he had knowledge 1) of the facts constituting the unseaworthiness and 2) knowledge that such facts rendered the vessel unreasonably unfit to encounter "the perils of the sea." As the implied warranty of seaworthiness assumes that the vessel is seaworthy at the outset, the burden of proving to the contrary is placed upon the insurer.

With respect to the doctrine of deviation, the issue of whether a bona fide "deviation" has occurred is determined by reference to the terms of marine insurance policy in question, the facts at issue, and also the usages and customs of the particular maritime trade. Because it is implied that the vessel will *not* deviate from its intended or customary course, the burden of proof is on the insurer to prove deviation.

4. Are the warranties or other terms identified in reply to question 2 mandatory, or may they be deviated from by contract either to the advantage of the insurer or to the advantage of the insured, or both. Is the insurer allowed to incorporate additional warranties or terms in contracts of H&M and P&I insurance, a breach of which may cause loss or limitation of coverage?

As noted above, the "seaworthiness" and "deviation" warranties are implied into the insurance agreement under United States general maritime law. Of course, there are various additional express warranties (for example, warranties as to crew, nationality, trading limits, and even warranties that concern high water bilge alarms) which are often contained as *contractual* undertakings in the underlying marine insurance agreement. The advantage of such a warranty may flow to either party to the marine insurance agreement, as long as the term is not unconscionable. A breach of an express warranty in a marine insurance agreement may result in a loss or limitation of coverage, depending on the facts and the precise language used.

5. Will a choice of law clause in the H&M policy or P&I club's rules be recognised in your jurisdiction to the effect that the existence of such warranties and terms as are mentioned in question 2 and the consequences of their breach will be governed by the law chosen?

In general terms, forum selection and choice of law clauses which are contained within a marine insurance agreement are enforceable in the United States, assuming the express terms are clear and unambiguous. Such clauses will be upheld unless enforcement of the clause would be unjust or unreasonable.

6. Unless covered by your replies above, is there any case law in your jurisdiction which considers an H&M insurer's or P&I club's right to deny coverage, in accordance with the H&M policy or the P&I club's rules or otherwise, as a result of an insurance event having been caused by (i) unseaworthiness, (ii) deviation from the agreed vessel trading area or route, (iii) violation of safety rules or (iv) negligence, gross negligence or wilful misconduct of the insured?

There is a long established and well-developed jurisprudence of marine insurance law in the United States spanning back to the early 19th century, both by way of state and federal court opinions and arbitration panel decisions. These opinions span the entire range of marine insurance legal issues, particularly the right of a H&M insurer or P&I Club's right to deny coverage for the various examples listed above.

National reporter are requested to complete their reports and submit them to the President of the Transport Law Commission, Niels Jørn Friborg, e-mail njf@hafnialaw.com, in accordance with the instructions given in the cover e-mail.