Introduction to Marine Insurance

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What Is Marine Insurance?

A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent agreed in the contract, against

(*a*) losses that are **incidental to a marine adventure** or an adventure analogous to a marine adventure, including losses arising from a land or air peril incidental to such an adventure if they are provided for in the contract or by usage of the trade; or

(*b*) losses that are incidental to the building, repair or launch of a ship.

(2) Subject to this Act, any lawful marine adventure may be the subject of a contract.

Marine Insurance Act, s. 6

The Marine Adventure

"marine adventure" means any situation where insurable property is **exposed to maritime perils**, and includes any situation where

(*a*) the earning or acquisition of any freight, commission, profit or other pecuniary benefit, or the security for any advance, loan or disbursement, is endangered by the exposure of insurable property to **maritime perils**, and

(*b*) 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

"maritime perils" means the perils consequent on or incidental to navigation, including perils of the seas, fire, war perils, acts of pirates or thieves, captures, seizures, restraints, detainments of princes and peoples, jettisons, barratry and all other perils of a like kind and, in respect of a marine policy, any peril designated by the policy;

Maritime Perils

- The Supreme Court of Canada in 1983:

  The policy which was obtained covering the *Bamcell II* was in the form set out in the schedule to the *Insurance (Marine) Act,* ... The language of the policy is sanctified by long usage in the marine insurance world and the operative words read as follows:

  TOUCHING the Adventures and Perils which the Assurers are contented to bear and do take upon themselves in this Voyage, they are of the Seas, Men-of-War, Fire, Enemies, Pirates, Rovers, Assailing 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 subject matter of this Assurance... And it is agreed by us, the Assurers, 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.

Why is Marine Insurance Important?

- Insurance, as a risk spreading / sharing concept originated in the maritime sector

- It is the linchpin in the international sale of goods
  - Provides assurance to the buyer & seller in the event of cargo damage

- Enables an enormously capital intensive, risk laden and vital industry to survive

Imagine the risks and the costs

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The sheer size of a potential disaster

- Very Large Crude Carrier involved in a total loss of ship and cargo.
- Losses could be:
- Cost of ship: over $60 Million
- Cost of oil cargo: Over 150 Million
- Loss of freight charges: over 3.5 Million
- Pollution Cleanup: Billions
  - Exxon spent over $2 Billion 20 years ago in Valdez.

Origins & History of Marine Insurance

- Maritime trade was (and still is) a risky business that required a lot of capital
- Financing from others is required (equity / debt)
- Need for the sharing of risk
  - Protect investment
  - If a calamity strikes could put shipowner out of business
    - Could happen to anyone
- Risk sharing became a feature of early trade and remains a feature of modern business
- Earliest concepts of insurance: "Bottomry & Respondentia"
  - No longer used, but reflected these principles

Origins & History of Marine Insurance

- Early Greek and Phoenicians had loss sharing and financing schemes
- Italian Merchants in 1300's
- German Merchants, the Hanseatic League, in 1300's
- Migrated to England in the 1400's & 1500's
- First English statute on Marine Insurance in 1601
- Today England remains the epicenter of the marine insurance community and legal system
- Modern law of marine insurance is based on England's *Marine Insurance Act* of 1906.

Lloyd's of London

- Early references as far back as 1688
- Rise of international trade routes
  - Caribbean spices, South American riches, Indian textiles, French wine
- Coincides with rise of English sea power, merchant marines and navy
- England begins it rise to global dominance by trade and colonization – all of which are sea based
- England set out to "rule the waves"
  - And did so from a coffee shop!

Lloyd's of London

- Edward Lloyd's Coffee House in London
- Shipowners, cargo owners, merchants and financiers came together
- Those that had ships and those that wanted to invest in ships could finance and share the risk of a "marine adventure"
- They underwrote the great voyages of trade and exploration of 1700 & 1800's
- England evolved into the central place for marine insurance

Lloyd's of London

- Merchants would want investors to take on some of the risk
- Underwriters would seek out persons of wealth and integrity who could and would pay in the event of a loss – the Lloyd's "name"
- It is a market place where brokers present a risk to underwriters for consideration and subscription to the risk. Still backed by "names" in syndicates.

Modern Marine Insurance

- Lloyd's of London still exists and operates
- Insurance companies around the world
  - Some specialize in marine risks
  - Most are large multi-line insurers that have a marine portfolio
- Protection and Indemnity (P&I) clubs
- Canadian domestic companies

Modern Marine Insurance

- Much greater risks and much more sophisticated shipping industry
- Much larger and more sophisticated insurance industry and products
- Ships are now worth many (or hundreds) of millions
- Cargo worth millions (or more)
- Freight charges
- Environmental risks and others

Early Insurance & Evolution

- Mainly Property related
  - The ship or hull
  - The cargo
- Legal developments gave rise to legal liabilities
- Liabilities for collisions, damage to cargo, death as well as general average and salvage
- Need for expanded types of insurance
- Shipowners need “protection and indemnity”
  - P&I mutual clubs
- Cargo owners need some liability cover for GA and salvage

Brokers

- Play a key role in the marine insurance field
- Intermediary between the Insured and the Insurer
- Presents the risk to the underwriter and assist in adjustment and settlement of claim
- Retail brokers
  - Have the clients and deal with wholesale brokers
- Wholesale brokers
  - Deal with the underwriters
- Lloyd's brokers
  - Based in London and have access to the “floor” to shop the risk

Types of Marine Insurance

- 4 major types – there are many others, but variants
- Cargo Insurance
  - Insures the goods on the vessel. A "property" type policy, with some liability coverage
- Hull & Machinery Insurance
  - Insures the ship or "hull"
  - Total loss only, constructive total loss, or partial loss
  - "property" type insurance with some liability coverage
    - "¾ running down clause"
      - Collision damage to another vessel

Types of Marine Insurance

- Protection & Indemnity Insurance
  - Liability coverage
  - Protection against claims for cargo damage, collisions, personal injuries, pollution
  - Can be written by a company, syndicate or a mutual association known as a P&I club
- Loss of Use / Business Interruption Insurance
  - Vessels are more than assets – they are going concerns and revenue generating objects. If they are out of service due to an incident then shipowner is losing income.

Policy Types

- Voyage
  - Covers a specific voyage
  - Covers a specific cargo
- Time
  - Covers a specific time period
  - Usually for hull or P&I
    - (time policies would not make a lot of sense for cargo insurance)
      - Except for the open cover type policy!

Policy Types

- Valued and Unvalued
  - Valued policy nominates a specific amount of coverage in event of total loss
    - Protects owner and underwriters from fluctuations in market value of object insured
  - Unvalued Policy leaves value of object insured to be determined according to *Marine Insurance Act*

Open or Floating Policies

- Type of Cargo Insurance
  - Very common especially amongst larger shippers, freight forwarders
  - Would be used to insure shipments throughout a year which my fluctuate
- Describes the insurance in general terms and leaves the ship and other particulars to be defined in subsequent declarations
- Premiums charged based on declarations

Role of Cargo Insurance in Facilitating Trade

- Part of the international sale of goods
- Provides stability & assurance to buyers, sellers and bankers in sale of goods contracts
- Goods are insured for losses and carriers are insured for liabilities

Sale Contract

- The transportation contract is part of the sale arrangements and is performed after the sale of goods is completed
- The terms of sale dictate who owns the goods and when. The ownership of the goods changes hands in a sale and thereby the risk of damage to the goods
- There are standardized terms, known as the INCO terms

INCO terms

- A sliding scale as to when the ownership of the goods pass from Buyer to Seller
- Determines who is responsible for arranging transportation, insurance and who bears the risk of damage of transit
- www.iccwbo.org/incoterms

INCO Terms

- Ranges from **All Risk on Buyer** to **All Risk on Seller**

- EXW - "Ex Works" – Buyer has ownership as soon as leaves Seller's loading dock

To

- DDP – "Delivery Duty Paid" – Seller has ownership until delivery by Seller to Buyer at Buyer's location

INCO Terms

- Most commonly used terms are:
  - **F.O.B.** – "Free On Board"

    Seller must deliver the goods to the ship nominated by the buyer. Risk and title to the goods pass to the buyer once in the goods "pass the ship's rail" . The buyer arranges the transportation and should arrange for the transit insurance.

  - **C.I.F.** – "Cost, Insurance, Freight"

    The sale price includes the cost of the goods, the insurance of goods while in transit and the costs of shipping (freight). The Seller arranges transportation and should arrange for the transit insurance.

INCO Terms

- Under both **FOB** and **CIF** terms the buyer is the owner (and at risk) when the goods are in transit.
- The obligation to place insurance on the cargo is different.
  - FOB on the buyer
  - CIF on the Seller
- The insurance is the same – marine cargo insurance

EXAMPLES of the INCO Terms

1. You go to an electronics store and buy a 22" television. You pay for it, and while walking to your car, you drop it.

This is, in effect, an Ex Works sale contract.

Ex Works terms: You owned it as soon as you took possession – your loss

EXAMPLES of the INCO Terms

2. You go to back to the store and buy a 50" large screen TV. It is too large to fit in your car. Your hire a truck, which is waiting in the parking lot. The employees from the store have the TV on a hand cart and it topples over in the parking lot.

   If FOB terms: The store's loss as the goods not yet delivered to the carrier.

   Let's say it gets dropped when unloading the truck at your house

   FOB terms: you owned it – your loss

EXAMPLES of the INCO Terms

3. You go to back to the store and buy a 60" TV and home theatre system with installation. As the delivery guys are unloading the big screen TV from the truck, it is dropped.

   DDP terms – the store's loss – not yet delivered, risk is still on the seller.

Marine Cargo Law

- There is a set of rules and laws that relate to the liabilities and immunities for marine cargo losses
- Canada's *Marine Liability Act*
- The Hague Visby rules
- These govern the law for liabilities of carriers, but it is the insurance on the goods that links the sale contract and the transportation contract all together. The buyer (or seller) knows that if damage occurs when the goods are not in either's possession, there will be compensation.

The "Insurance Linchpin"

- The buyer does not want to release the money to buy the goods until he knows that the goods he bought are in transit.
- The seller does not want to release the cargo until she is knows that payment is available.
- Transaction is conducted by an exchange of documents using the carrier and banks as intermediaries.
  - The "clean" on board bill of lading proves cargo in transit. It is exchanged for payment.

➢ **The insurance protects the parties from loss in transit.**

Canadian Marine Insurance Law

- Insurance, generally, is a matter left to the regulation of the provinces. A matter of "property and civil rights" under the constitution. Thus every province has its own statutes and laws relating to insurance.

- Marine insurance is not a matter of provincial insurance law. It is a federal matter under the constitution as it comes within the federal powers over "Navigation and Shipping".

Zavarovalna Skupnost, (Insurance Community Triglav Ltd.) v. Terrasses Jewellers Inc. (1983)

- "Marine insurance is first and foremost a contract of maritime law. It is not an application of insurance to the maritime area. Rather, it is the other forms of insurance which are applications to other areas of principles borrowed from marine insurance."

- Federal Court of Canada as well as Provincial Courts can hear and determine marine insurance disputes

Marine Insurance Act, 1993

- A Federal Statute which governs the law of marine insurance
  - Modeled after English Marine Insurance Act of 1906
- Provincial Marine Insurance Acts are still on the books, but likely of no effect
- Sets out the framework for the law relating to marine insurance

Policy Requirements

- *Marine Insurance Act* s. 26:
  - Name of the insured
  - Subject matter insured against
  - Perils insured against
  - Voyage or time period, or both
  - Sum insured
  - Name of the insurer
- Policy wordings
  - Standard Clauses – "Institute Cargo Clauses"
  - Manuscript policies – written for a specific insurer or risk

7 Important Principles of Marine Insurance

1. Insurable Interest
   - The insured has to have an interest in the object insured
     - Otherwise it is just gambling
   - May acquire the interest after the contract concluded
   - A person with an interest in the marine adventure has an insurable interest
   - "a person has an interest in a marine adventure if the person has a legal or equitable relation to the adventure, or to any insurable property at risk in the adventure, and may benefit from the safety or due arrival of insurable property, may be prejudiced by its loss, damage or detention or may incur liability in respect of it."

7 Important Principles of Marine Insurance

2. Indemnity

- Insurance indemnifies – puts the insured in the position it was in before the loss. Does not allow the insured to profit on the loss.

- Double Insurance – two policies insuring same risk
  - Cannot collect on both

7 Important Principles of Marine Insurance

3. Duty of Good Faith – *uberrima fides*

- Insured and Insurer must deal with each other with the "utmost good faith"
- Must deal with each other fairly and openly
- *Marine Insurance Act* s. 20:

  A contract is based on the utmost good faith and, if the utmost good faith is not observed by either party, the contract may be avoided by the other party.

Good Faith (Continued)

- Requires disclosure of material circumstances
  - *MIA* s. 21 – 22

- an insured must disclose to the insurer, before the contract is concluded, every material circumstance that is known to the insured
- A circumstance is material if it would influence the judgment of a prudent insurer in fixing the premium or determining whether to take the risk.

Disclosure & Representations

- Whether any circumstance that is not disclosed is material or not is a question of fact.
- The following circumstances do not need to be disclosed:
  - (*a*) any circumstance that diminishes the risk;
  - (*b*) any circumstance that is known to the insurer;
  - (*c*) any circumstance as to which information is waived by the insurer; and
  - (*d*) any circumstance the disclosure of which is superfluous by reason of any express warranty or implied warranty.
- an insured is deemed to know every circumstance that, in the ordinary course of business, ought to be known by the insured;
- an agent is deemed to know every circumstance that, in the ordinary course of business, ought to be known by, or to have been communicated to, the agent; and
- an insurer is presumed to know circumstances of common notoriety and every circumstance that, in the ordinary course of an insurer's business, ought to be known by an insurer.
- If an insured or an agent of an insured fails to make a disclosure as required by this section, the insurer may avoid the contract.

7 Important Principles of Marine Insurance

4. Warranties

- *Marine Insurance Act* s. 32 – s. 39
- A "warranty" is a promise by the insured that a certain state affairs exists, that the insured will do something or will refrain to from doing something. e.g.:
  - "warranted a fire watch is maintained at all times"
  - "warranted that no cargoes of rice will be carried"
- It is a promise consider to be so important to the insurer that it must be *exactly complied* with and if it is not, then the insurer is relieved from any obligations under the policy

Warranties

- A breach of warranty relieves the insurer from any obligation *even if* the loss is not caused by the breach of warranty
- Warranties may be express or implied
  - Express must be written into or included in the contract
  - An implied warranty arises by operation of law
- A breach of warranty can be excused if there is a change in circumstances contemplated by the contract or is unlawful to comply with the warranty

Warranties

- The courts have not been fond of strict interpretations or warranties over the years. They can be harsh on an insured, especially if the breach was minor and unrelated to the loss.
  - A concern for fairness and commercial expectations
- Leniency for the insured unless warranty and breach is clear. Ambiguities resolved in favour of the insured.
- Development of concepts of "description of the risk" and "suspensive conditions"

7 Important Principles of Marine Insurance

5. Subrogation

- ***Marine Insurance Act*, s.81:**

(1) On payment by an insurer for a total loss of the whole of the subject-matter insured or, if the subject-matter insured is goods, for any apportionable part of the subject-matter insured, the insurer becomes entitled to assume the interest of the insured in the whole or part of the subject-matter and is subrogated to all the rights and remedies of the insured in respect of that whole or part from the time of the casualty causing the loss.

(2) On payment by an insurer for a partial loss of the subject-matter insured, the insurer acquires no title to the subject-matter but is subrogated to all the rights and remedies of the insured in respect of the subject-matter from the time of the casualty causing the loss to the extent that the insured is indemnified, in accordance with this Act, by the payment for the loss.

Subrogation

- The right of the insurer to pursue a claim against the at-fault party in respect of a loss.
  - Cargo arrives at destination in damaged state. Believed to be caused by carrier's mis-handling. Insured presents claim on cargo policy and is paid by cargo insurance policy. Cargo insurers sue the carrier in the name of the insured for recovery of the loss.
- The insurer "steps into the shoes" of the insured and becomes a claimant.
  - Insurer has no better rights than insured
- Insured has a duty to cooperate and protect insurer's right of subrogation
- Right of subrogation arises after insurer has paid insured for the claim

7 Important Principles of Marine Insurance

6. Peril of the Seas

- Marine insurance is about the maritime perils to which property is exposed to in the course of maritime adventure
- Loss must due to an insured peril, typically a "peril of the seas"
  - "Maritime peril" defined in the *MIA*
- Insurance is about risk and fortuitity, not inevitability
  - 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.

7 Important Principles of Marine Insurance

7. Proximate Cause

- *Marine Insurance Act*, s.53:

  ...unless a marine policy otherwise provides, an insurer is liable only for a loss that is proximately caused by a peril insured against, including a loss that would not have occurred but for the misconduct or negligence of the master or crew.

- The act or event nearest in time or closest in connection that caused the loss.
  - "The cause" as opposed to "a cause"
  - "But for" X the loss would not have occurred

Proximate Cause

The "*Bamcell II*" Case (Supreme Court of Canada)

- The vessel, a converted barge of unique design, was partially open to the sea on her bottom and kept afloat by an airtight deck. It sank when a member of her crew negligently permitted an air pressure control valve to remain open so that the air no longer supported the platform and the vessel completely submerged.
- The insurance company denied the claim on the hull policy maintaining that the loss did not arise from a "peril of the seas" and therefore was not within the risk insured by the policy.

Proximate Cause

- The issue was whether the negligence in leaving the air valve open was a “peril of the sea” which caused the vessel to sink. The insurer’s position was that there is nothing particularly “marine” about leaving an air valve open. It could happen on land. It was a case of employee negligence not a “peril of the seas”, such as pirates or collisions etc.

The *Bamcell II*

- In order to succeed in a claim under the perils of the seas provision the insured must establish that the proximate cause of the loss was a "fortuitous accident or casualty of the seas", and furthermore, the claim may succeed even though the loss would not have happened "but for the misconduct or negligence of the master or crew."

- The insurer said that in addition to the negligence, there must be an operating peril of the seas of some category peculiar to marine operations,. The insured said that a sinking caused by a negligent act is a sufficient fortuitous accident of the sea.

The *Bamcell II*

- The Supreme Court said that an act is not negligent in itself but only in relation to a foreseeable risk of harm. If that foreseeable risk of harm is a peculiarly marine risk, then the act, coupled with its foreseeable consequence, is a fortuitous accident of the seas and a peril of the seas and the proximate cause of the loss.

- In this case there is no doubt that it was the risk of the *Bamcell II* sinking, and causing loss by that sinking, that made the failure to close the deck valves a negligent omission. When that negligent omission was coupled with its foreseeable consequence, the proximate cause of the loss was a peril of the seas and, as such, covered by the policy.

Resources

- *The Law & Practice of Marine Insurance in Canada*
- *Marine Insurance: The Silent Export*
- Canadian Board of Marine Underwriters
  - www.cbmu.com
- International Union of Marine Insurance
  - www.iumi.com
- Lloyd's of London
  - www.lloyds.com
- Isaacs & Company