THE MARINE INSURANCE ACT 1906: REFLECTIONS ON A CENTENARY

In the light of the centennial anniversary of the Marine Insurance Act 1906, this article considers the principal characteristics of the legislation and discusses a number of concerns about more specific provisions in the Act. The strong espousal of commercial certainty as a fundamental principle of marine insurance law is discussed, together with limitations of the degree to which there is and can be adherence to that principle in the modern law. The Act is seen also to be largely facilitative, but, in so far as it has a regulatory function, its focus is questioned.

Howard **BENNETT**[*]
LLB (English and French Law) (King's College London),
Maîtrise en Droit (Paris I),
LLM (Corporate and Commercial Law) (King's College London);
Barrister (UK);
Hind Professor of Commercial Law, University of Nottingham, UK.

1 21 December 2006 is the one hundredth birthday of the Marine Insurance Act 1906,[1] marking 100 years since the Marine Insurance Bill gained royal assent and became the 1906 Act. Whether the centenary attracts attention or whether the deluge of insurance contract law litigation over the past 30 years has exposed points of controversy, questions are being asked about the suitability of the Act for the future. It is appropriate, therefore, to reflect upon the nature of the law enacted by the 1906 statute and, in the light of such reflection, to look to the future and possible concerns that might influence any process of reform.

I. General characteristics of the Marine Insurance Act 1906

2 One may begin by considering the 1906 Act at a certain level of generality, in order to appreciate the nature of the law that it contains. Four key features may be identified.

* This article is a modified version of a lecture given at the invitation of the Maritime Law Association of Singapore while I had the pleasure to be the MPA Distinguished Visitor in Maritime Law, National University of Singapore.

1 1906 (c 41) (UK) ("the 1906 Act" or "the Act").

A. A codifying statute

3 The first key feature of the 1906 Act is its nature as a codifying act. The Act represents the final flowering of the Victorian movement for the codification of English law, of which the other principle results were the Bills of Exchange Act 1882[2] and the Sale of Goods Act 1979.[3] The parliamentary Bills that became these three statutes were, of course, the work of the same draftsman, Sir Mackenzie Chalmers.

4 As is well known, Chalmers' aim in producing his Bills was, as far as possible, restricted to stating established law, departing from this task of faithful record and systematic organisation only, first, to fill the occasional lacuna by reference to commercial practice, comparative law, or logical extension of existing precedent, and, secondly, to resolve any conflict between decided cases. The function of a codifying bill was to state with clarity the law as it then was, neither to improve the existing law through proposing reform nor to extend it by proposing solutions to questions that had not yet generated reported litigation. Such matters were left to be addressed, if at all, by the Legislature as the Bill worked its way through the two Houses of Parliament.

5 This concept of a draft Bill necessarily influenced the choice of area of law for statutory attention. According to Chalmers, "[w]hen the principles of the law are well settled, and when the decided cases that accumulate are in the main mere illustrations of accepted general rules, then the law is ripe for codification".[4] The impression may thereby be created that the Victorians conceived of those areas chosen for codification as comprised of principles carefully and wisely crafted over the generations by intellectual giants so as to produce, subject perhaps to the very occasional Homeric nod, an impeccable and inviolable mosaic. In short, an area of law was ripe for codification because and only once it had attained a state of accomplished perfection. Any such impression, however, would be fundamentally to misunderstand the codification movement. That movement was driven by a desire to serve the commercial community by eliminating, so far as possible, the need in litigation to determine the relevant legal principles before applying those principles to the facts of the dispute, commensurately reducing costs. Better still, clearly articulated legal principles should in some cases

2 1882 (c 61) (UK).
3 1979 (c 54) (UK).
4 M D Chalmers, "Codification of Mercantile Law" (1903) 19 LQR 10 at 11.

obviate the need for the expense of litigation altogether. However, the political reality of the day was that proposed legislation that went beyond existing law was unlikely to be passed by Parliament. Attempts to codify the criminal law and the law of partnership had run into difficulty precisely because they sought to amplify and improve the existing law. Consequently, Sir Farrer (later Lord) Herschell, who was responsible for piloting both the Bills of Exchange and Sale of Goods Bills through the House of Commons and who introduced the Marine Insurance Bill into the House of Lords, insisted on restricting any bill to codifying the existing law on the basis that "[a] Bill which merely improves the form, without altering the substance, of the law creates no opposition, and gives very little room for controversy".[5] Consequently, according to Chalmers, Lord Herschell dictated the following approach:[6]

> Let a codifying Bill in the first instance simply reproduce the existing law, however defective. If the defects are patent and glaring it will be easy to get them amended. If an amendment be opposed, it can be dropped without sacrificing the Bill. The form of the law at any rate is improved, and its substance can always be amended by subsequent legislation. If a Bill when introduced proposes to effect changes in the law, every clause is looked at askance, and it is sure to encounter opposition.

6 The restriction of codification to the reproducing of existing law was, therefore, far from a reflection of a perception of legal perfection but a result of political reality. Subsequent amending legislation to improve the codifying statutes was actively contemplated by the codes' leading proponents.

B. Scope

7 A second feature of the 1906 Act is the scope of the rules it codifies. Officially, of course, the Act is concerned with those principles of law that apply to contracts of marine insurance. The Act is not, however, designed to isolate marine insurance contract law from the general law of contract or the wider common law, which is stated to apply to marine insurance contracts subject only to incompatibility with the provisions of the Act.[7] Moreover, many of the principles applicable to marine insurance contracts are not confined thereto but apply equally to all types of insurance contract, marine or non-marine, direct cover or reinsurance,

5 M D Chalmers, "An Experiment in Codification" (1886) 2 LQR 125 at 126.
6 *Id*, at 128–129.
7 See s 91(2) of the 1906 Act.

commercial or consumer. With respect to such principles, it is more accurate to say that the Act codifies for the purposes of marine insurance contracts principles of general insurance contract law. Non-marine litigation on such principles often takes the formulation of the 1906 Act as authoritative. In practice, therefore, the 1906 Act operates for many important doctrines as a codification of general insurance contract law, and, indeed, much of the post-1906 case law that develops our understanding of the provisions of the Act involves non-marine contracts.

8 A unitary system of insurance contract law, namely one that applies without distinction to all forms of insurance contract, possesses the advantage that the technically correct classification of a contract has no relevance and, therefore, does not consume costs. In English law, however, while it is true to say that the system is largely unitary, it is not entirely so. First, consumer insurance is separated increasingly from commercial insurance. Industry self-regulation has now been supplanted by statutory consumer protection in the form of the Unfair Terms in Consumer Contracts Regulations 1999[8] and the more recent Insurance Conduct of Business Code promulgated by the Financial Services Authority. Secondly, a distinction has to be drawn between direct cover and reinsurance for the purposes, for example, of the Third Party (Rights against Insurers) Act 1930,[9] which applies to the former but not to the latter. Thirdly, certain rules of marine insurance law do not apply to non-marine insurance law.

C. Non-mandatory law

9 The third general feature of the Act is its predominantly non-mandatory nature. Aside from a small number of provisions reflecting public policy, the Act comprises default rules, applicable only in the absence of contrary intention. Many provisions of the Act expressly so provide, but it is clear that the parties are free to derogate even from those provisions that do not so provide and even in respect of doctrines of such centrality to insurance contract law as utmost good faith.[10]

8 SI 1999 No 2083 (UK) ("the 1999 Regulations").
9 1930 (c 25) (UK).
10 *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2001] 1 Lloyd's Rep 30 (HC), at [30], [2001] 2 Lloyd's Rep 483 (CA), at [142].

10 The largely non-mandatory nature of the Act reflects its purpose of assisting the commercial community. According to Chalmers:[11]

> A man of business, in effect, says to the lawyers, 'Leave me free to make my own contracts, but tell me plainly beforehand what you are going to do if I don't make a contract, or if I fail to express it intelligibly. If I know beforehand exactly what you lawyers are going to do in a given case, I can regulate my conduct accordingly. All I want to know is exactly where I am.'

11 As a result, provisions that relate to outdated methods of doing business can simply fall into desuetude while others that prove inconvenient can be overridden by express terms. That is not to say that provisions that reflect outmoded business practices cannot cause difficulty today,[12] but the Act has not, as yet, presented any barrier to innovation and evolution by the insurance markets.

D. Commercial certainty

12 A final general feature of the 1906 Act meriting attention is alluded to also in the words Chalmers places in the businessperson's mouth, namely an unequivocal espousal of commercial certainty. The Act attempts to state clear rules and to provide for clear consequences in the event of transgression. Thus, parties have the right retrospectively to avoid the contract for failure to comply with the doctrine of utmost good faith, and liability is automatically prospectively discharged in the event of any alteration of risk, irrespective of the merits of individual cases. On introducing the Marine Insurance Bill into the House of Lords, Lord Herschell quoted Willes J (as he then was) in *Lockyer v Offley*[13] in 1776 as follows:

> [A]s in all commercial transactions the great object is certainty, it will be necessary for this Court to lay down some rule, and it is of more consequence that the rule should be certain, than whether it is established one way or the other.

The belief is that businesspeople would rather have a clear rule that might operate harshly and against their interests in a particular case than an unclear rule designed to produce a fair and equitable result in each case but that might require a lengthy and costly process to apply.

11 Chalmers, *supra* n 4, at 14.
12 See further below at paras 23–31.
13 (1776) 1 TR 252 at 259; 99 ER 1079 at 1083.

13 The importance of certainty in business and the intense frustration and difficulty that may be caused by legal uncertainty is beyond dispute. An unbridled pursuit of certainty regardless of the merits of the particular case can, however, be counter-productive. Consider, for example, the promissory warranty. It is clear that the promissory warranty of insurance contract law is simply the condition precedent of general contract law in disguise.[14] As such, once it is broken, the consequences brook of no dispute. The insurer's liability is immediately prospectively discharged. This is because the promissory warranty serves to define the insured risk so that breach results in the risk being no longer that which it was agreed to cover or, alternatively, because that is what the parties, in exercising their freedom to conclude the contract they wish, have elected to include as a condition precedent to further cover. Consequently, questions productive of potential uncertainty, such as a causal link between breach and casualty, and proportionality between breach and response, simply do not arise. In their place, however, looms the spectre of considerable injustice on the facts of an individual case. For example, breach of a navigation warranty by one vessel insured under a fleet policy will, subject to contrary intention,[15] afford an insurer an unimpeachable defence in relation to a later casualty sustained by a different vessel that has complied impeccably with all the terms and conditions of the policy. As a result, the courts have exploited the logically prior question of whether a given term of the policy is properly characterised as a promissory warranty in order to ensure that terms operate as promissory warranties only where it is clear from their substance that they do indeed define the risk insured or it is unequivocally clear from the wording that the parties have indeed exercised their contractual freedom to confer such status on the term. The net result is that much of the certainty, and avoidance of litigation cost, gained at the secondary level of the consequences of breach, has been lost at the primary stage of characterisation of the term.

14 A similar point may be made in relation to the doctrine of utmost good faith. According to the relevant provisions of the 1906 Act, the insurer is entitled to avoid the policy in the event of non-disclosure or misrepresentation by the assured of any material circumstance. Certainty is afforded by the irrelevance of the assured's state of mind: the policy is voidable irrespective of whether the failure to disclose or the

14 See s 33(3) of the 1906 Act and *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1990] 1 QB 818.

15 See, for example, International Hull Clauses (01/11/03), cl 26.

misrepresentation was fraudulent, negligent, or innocent. Moreover, any and every non-disclosure or misrepresentation renders the contract voidable, regardless of the seriousness or significance of the non-disclosure or misrepresentation. A contrast may be drawn with the judicial discretion conferred in English law by statute to refuse the remedy of rescission for non-fraudulent misrepresentation in general contract law. However, there can be little doubt that the all or nothing nature of the remedy of avoidance has prompted assureds to explore every conceivable means of controlling the scope of the doctrine and the operation of the remedy. The last 30 years have seen waves of litigation investigating, *inter alia*:

(a) the scope of the objective concept of materiality;

(b) whether subjective inducement of the particular insurer who underwrote the risk, not expressly mentioned by the Act, is required;

(c) given that it was ultimately held that inducement is required, how it is proved;

(d) what, indeed, inducement means;

(e) the extent of limitations on the requirement of disclosure, especially what knowledge the insurer may be presumed to have;

(f) whether the law recognises any innate limitations on the remedy of avoidance; and

(g) under precisely what circumstances the insurer will be held to have affirmed the contract by waiving the remedy of avoidance.

The judicial discretion to refuse rescission for non-fraudulent misrepresentation in general contract law was introduced by the Misrepresentation Act 1967. That discretion does not apply to non-disclosure[16] and may well be inapplicable to the insurance contract law remedy of avoidance for misrepresentation.[17] Suppose, however, that in 1967 a certain measure of apparent certainty in insurance contract law

16 *Banque Keyser Ullmann SA v Skandia (UK) Insurance Co Ltd* [1990] 1 QB 665.
17 Howard Bennett, *Law of Marine Insurance* (Oxford University Press, 2nd Ed, 2006) at paras 4.22, 4.162.

had been sacrificed by drafting the Misrepresentation Act to cover the pre-formation doctrine of utmost good faith. One has to wonder whether a significant amount of the subsequent case law, and attendant cost, would not have been avoided.

15 If it is correct that certainty is desirable but is not to be pursued at all costs, then what is required is an approach that accommodates a balance. An example may be found in the law of sale of goods. Sections 12 to 15 of the Sale of Goods Act 1979 imply a series of terms into contracts for the sale of goods.[18] Most of the terms so implied are classified by the Act as conditions, so that breach by the seller entitles the buyer to reject the goods and elect to treat the contract as discharged.[19] Such clarity at the level of remedies for breach may be regarded as advancing commercial certainty and promoting consumer protection. Commercial parties know exactly where they stand and consumer buyers have enforceable rights. Precisely because the law is unequivocal in conferring rejection and termination rights, a seller is less likely to attempt to deny a consumer the redress the law requires. This certainty is, nevertheless, purchased at the cost of a possible lack of proportionality between breach and remedies, as some well-known case law demonstrates.[20] Consequently, when reforms were introduced, renaming and extending the obligation that goods sold in the course of a business shall be of merchantable (now satisfactory) quality, the opportunity was taken also to modify the remedies for breach through what is now s 15A of the Sale of Goods Act 1979.[21]

16 Section 15A provides that, first, breach of an implied statutory condition entitles rejection, but, secondly, subject to the proviso that rejection is not available where breach is so slight that rejection is unreasonable. Thirdly, however, this proviso is inapplicable in cases of consumer sales, where rejection is always available. The section balances values as follows. First, one starts with the proposition that a remedy of rejection operates in the vast majority of cases of breach of the implied statutory conditions, providing reasonable certainty. It is noteworthy, moreover, that nothing in s 15A affects freedom of contract in terms of

18 Strictly speaking, the implied terms as to quality are reserved for sales in the course of a business: Sale of Goods Act 1979, *supra* n 3, ss 14(2), 14(3).

19 Sale of Goods Act 1979, *supra* n 3, ss 14(6), 11(3), 15(1)(*a*).

20 *Re Moore and Co Ltd and Landauer and Co* [1921] 2 KB 519; *Arcos Ltd v E A Ronaasen and Son* [1933] AC 470. For judicial legerdemain when faced with a similar disparity between breach and apparent consequence, see *Cehave NV v Bremer Handelsgesellschaft mbH (The Hansa Nord)* [1976] QB 44.

21 Reforms effected by the Sale and Supply of Goods Act 1994 (c 35) (UK).

the availability of rejection and termination remedies for breach of expressly agreed terms. Secondly, however, the remedy of rejection for breach of the implied conditions is denied at the margins to guard against manifest injustice. Thirdly, that denial is subject to the overriding policy consideration of consumer protection. The section demonstrates, therefore, that certainty and fairness need not be considered irreconcilable opposites, but can both be accommodated in a balancing exercise.

II. Some concerns about the rules codified in the Marine Insurance Act 1906

17 After considering the general characteristics of the law codified in the 1906 Act, certain specific rules may be addressed in the context of five concerns that may perhaps attract the attention of a law reformer.

A. Divergence between general insurance contract law and marine insurance law

18 Different types of insurance may raise different issues and concerns. However, there is nothing about the maritime subject matter of marine policies that dictates a difference in legal treatment in comparison with non-marine insurance. There is, for example, no material difference between ships and any other income-generating asset or between marine and non-marine liabilities. Nor is there any material difference between the insurance of marine and non-marine risks in terms of the operation of the insurance market. Nevertheless, in certain respects, the rules of marine insurance differ from those of non-marine insurance. Two examples may suffice.

19 First, in the non-marine market, liability for premiums lies with the assured, unless the policy provides to the contrary. In marine insurance, however, the converse applies. Where the risk is placed through a broker, which is invariably the case, then, unless the policy provides to the contrary, liability for the premium rests on the broker and not on the assured.[22] It is difficult to see any justification for this difference. That is not to say that the marine rule is indefensible. Insurers participating in an international market where assureds and their assets may not be readily amenable to the obtaining and enforcing of judgment for premiums may

22 Section 53(1) of the 1906 Act.

legitimately prefer more easily enforceable rights against brokers.[23] However, the absence of any rule of broker liability does not appear to impede the functioning of the non-marine market and insurers can obtain a considerable degree of protection by making payment of premiums by a certain date a condition precedent to liability on the policy. Regardless of the merits of either position, however, what appears undeniable is that the existence of two different premium liability rules is anachronistic.

20 Secondly, marine and non-marine insurance classify losses differently. Marine insurance divides total losses into "actual" and "constructive" total losses. The latter include instances of, for example, damage that would be uneconomic to repair in that the cost of repair would exceed the value of the repaired property and loss of possession where recovery within a reasonable time is unlikely.[24] In cases of constructive total loss, the assured's entitlement to indemnification on a total loss basis is dependent upon service on the insurer of a notice of abandonment within a reasonable time of the property becoming a constructive total loss.[25] Non-marine insurance has no doctrine of constructive total loss[26] and, therefore, never requires service of a notice of abandonment. Moreover, non-marine insurance does not appear to draw the line between total and partial loss in quite the same way as marine insurance, although the picture is not entirely clear.[27] In terms of the substance of each issue, arguments may doubtless be advanced in favour of either the marine or the non-marine approach, but a tenable argument in favour of a difference in treatment is elusive.

B. Otiose rules and doctrines

21 The 1906 Act is 100 years old, but the rules it codifies are of course older still, often much older. A number of them no longer serve any useful purpose. Again, two examples may be offered.

23 Compare the traditional personal liability on a contract of an agent acting for a foreign principal: *Armstrong v Stokes* (1872) LR 7 QB 598 at 605.

24 For the full definition of constructive total loss, see s 60 of the 1906 Act. The definition may be modified by contract: see, for example, Institute Cargo Clauses (A), cl 13.

25 The requirement of a notice of abandonment is considered further below at para 48.

26 *Moore v Evans* [1918] AC 185.

27 Areas of (possible) difference include damage resulting in loss of commercial identity and deprivation of possession.

22 First, there is no reason for marine insurance law to retain any formality requirements. The continuing requirement that a contract of marine insurance must be "embodied in a marine policy in accordance with this Act" and attendant stipulations as to content[28] run counter to the general demise of formalities in commercial contract law.[29] More importantly, it is arguable that the 1906 Act's concept of a policy is confined to a paper document,[30] in which case the requirement of a policy constitutes a barrier to the dematerialisation of commercial documentation and, thereby, to the development of electronic commerce.

23 A second example is the doctrine of insurable interest. In the scheme of the Act, the doctrine purports to serve two functions. It is instrumental in enforcing the public policy prohibition on using contracts of marine insurance by way of gaming or wagering.[31] It also reinforces the indemnity principle in that its existence at the time of any casualty is a pre-condition to the assured's right to recover in respect of the casualty.[32] In truth, however, the doctrine fails to make a useful contribution to insurance contract law in either respect.[33]

24 Turning first to the wager issue, the desirability of a policy prohibition against gambling on the outcome of marine adventures is self-evident. The law should not facilitate the financial overloading of a ship with such a weight of insurance as to increase the risks of casualty beyond those inherent to maritime adventure. Otherwise the law enhances the risk of fraud on insurers while endangering the lives of the crew, the property of cargo owners, and the environment. However, the policy against wagering on maritime adventures does not require cloaking in the doctrine of insurable interest. The question of whether an insurance contract is a wager can be asked without reference to any concept of insurable interest. In so far as the existence of an insurable

28 Sections 22–24 of the 1906 Act.

29 On their connection with, now repealed, stamp duty laws, see Howard N Bennett, "The role of the slip in marine insurance law" [1994] LMCLQ 94.

30 See UK Law Commission, "Electronic Commerce: Formal Requirements in Commercial Transactions" (2001) at para 7.9, relying on the recognition in s 53(2) of the 1906 Act of a broker's lien over the policy and the fact that liens "are exercised over something tangible". The contrary argument would be that the lien simply does not apply to an electronic policy. In other words, a lien may assume that a policy will have a particular substance but the availability of a lien where a tangible policy exists should not be read as requiring that a policy has to be tangible as a matter of law.

31 Section 4 of the 1906 Act.

32 *Id*, s 6.

33 Life insurance may give rise to special issues of public policy. No view is expressed here.

interest is merely legal shorthand for the non-wager quality of the contract, it might be contended that the doctrine does little harm. In reality, the doctrine is more pernicious.

25 The problem is this. The question of whether the policy is a true indemnity policy having been translated into whether there exists an insurable interest, the doctrine of insurable interest then acquired a life of its own independently of the policy it was designed to serve. The definition of insurable interest and its recognition in various types of insurance has generated law of considerable complexity that has lost sight of its origins and purpose. English law currently recognises three types of insurance contract. One would expect non-wager contracts where the assured has an insurable interest and wager policies where the assured lacks an insurable interest. However, the technicality of insurable interest law has generated the non-wager policy that is void because of a lack of insurable interest. This category should not exist, but the highest authority establishes that it does.[34] In other words, not only does the doctrine of insurable interest fulfil no positive function with respect to combating undesirable wagering on maritime adventures, but it has the malign potential to invalidate the occasional policy that is wholly unobjectionable in principle. Moreover, even where an insurable interest defence is unsuccessful,[35] it still has to be contested, leading to expense and delay in settlement.

26 The assured must also have an insurable interest at the time of loss. But why? As just noted, if the concern is gambling, public policy can operate without the insurable interest doctrine. Again, if the concern is that an assured should recover only in respect of the loss it has itself sustained, a rule to that effect does not require a concept of insurable interest.[36]

34 *Macaura v Northern Assurance Co Ltd* [1925] AC 619.

35 The last 20 years have seen insurable interest defences unsuccessfully raised in particular in the context of composite policies. See also *Feasey v Sun Life Assurance Corporation of Canada* [2003] Lloyd's Rep IR 637.

36 A buyer of goods on FOB terms may face difficulty in recovering under a cargo policy that incepts when the goods are safely loaded on board where the cargo is shipped, for example, in a container so that it cannot be established precisely when during the transit the loss occurred. This is sometimes presented as an insurable interest problem, in that the buyer is required to establish an insurable interest at the time of loss. However, even if the insurable interest requirement were abolished, the indemnity principle would still require the buyer to prove a loss in circumstances where the loss may have occurred at a time when risk was on the seller. Currently, protection for the buyer depends on inclusion in the policy of a "lost or not lost" clause, permitting the buyer to recover provided only that a loss occurred during the

27 Ultimately, the doctrine of insurable interest serves only to provide insurers and their lawyers with a technicality they may invoke in order to prevaricate and obfuscate when the bargain concluded otherwise requires a loss to be indemnified.[37] It should be abolished.

C. Compatibility with commercial practice

28 English commercial law has traditionally endeavoured to support commercial practice and facilitate commercial innovation. A third concern, however, is that certain aspects of marine insurance law do not respond to modern commercial practice. The incompatibility between formalities and electronic commerce has already been noted. However, particular mention in this context should be made of cargo insurance, which fails properly to accommodate through, multi-modal transport, a problem only accentuated by containerisation.

29 The fundamental problem is the status within the policy of the sea voyage. The policy may be drafted as insurance primarily on a sea voyage with secondary extensions to incidental inland transit before and after the sea voyage. Such a policy is susceptible to interpretation that cover for the incidental inland transit pre-supposes that the cargo embarks upon the core insured adventure.[38] Just as a branch of a tree cannot exist without a tree trunk, so risk in respect of the incidental land transit cannot incept in the absence of risk incepting in respect of the sea transit to which the land transit is incidental. Such a problem may be a matter of contract drafting.[39] However, the problem of interpretation may be reinforced by the 1906 Act, which may indeed in turn both reflect and influence the common wording of cargo policies. The Act defines a contract of marine insurance as a contract for the indemnification of "losses incident to marine adventure".[40] The concept of "marine adventure" in the context of cargo in turn involves exposure to maritime perils.[41] Absent a marine adventure, there is no contract of marine insurance. Although a contract of marine insurance can be extended to

contractual period of cover irrespective of whether the assured had an insurable interest at that moment: s 6(1) of the 1906 Act; *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1991) 25 NSWLR 699.

37 *Stock v Inglis* (1884) 12 QBD 564 at 571; *Cepheus Shipping Corporation v Guardian Royal Exchange Assurance plc (The Capricorn)* [1995] 1 Lloyd's Rep 622 at 641; *Feasey v Sun Life Assurance Corporation of Canada*, *supra* n 35, at [7], [116], [140].

38 *Simon, Israel & Co v Sedgwick* (1892) 67 LT Rep 352, affirmed [1893] 1 QB 303.

39 [1893] 1 QB 303 at 306.

40 Section 1 of the 1906 Act.

41 *Id*, s 3.

incidental inland transit,[42] it remains a contract of marine insurance. Any such contractual extension, standard in cargo policies, "operates on the assumption that the insured adventure takes place and on that basis addresses the question of the commencement and termination of the risk".[43] If the cargo is never exposed to the maritime perils contemplated by the policy, it never embarks upon the insured marine adventure and risk never incepts.

30 The problem is that the law conceives of a cargo policy as one of marine insurance instead of a policy on goods in transit. Such a legal approach flies in the face of commercial reality. It is, however, further reinforced by s 44 of the 1906 Act. This provides that:

> 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.

The section makes perfect sense in the context of a voyage policy on a ship under which risk is to attach "from" a named port or place. Where the insured ship embarks on a different voyage from that insured, it is at no time engaged on the insured adventure and, logically, the insurer is never at risk. There is, however, nothing in the express wording of the section to confine it to such situations. In particular, where cargo is insured for the whole of a multimodal transit, s 44 ignores the commercially indivisible nature of the transit and focuses artificially upon the sea voyage.

31 Assume, for example, that cargo is insured under a policy incorporating the Institute Cargo Clauses (A). These clauses cover loss caused by all risks except those expressly excluded. Theft is not excluded, even if by an act of piracy. Moreover, the transit clause provides that risk attaches "from the time the goods leave the warehouse or place of storage at the place named herein for the commencement of transit".[44] To the commercial eye, therefore, once the goods embark upon their transit, risk attaches and the assured is covered against all losses, including all thefts, that may occur during the transit unless caused by an excluded peril. In law, however, the result of s 44 appears to be as follows. If the cargo survives the journey to the port of loading and embarks upon the sea

42 *Id*, s 2(1).
43 *Nima SARL v Deves Insurance plc (The Prestrioka)* [2003] 2 Lloyd's Rep 327 at [48] *per* Potter LJ.
44 Institute Cargo Clauses (A) (1/1/82), cl 8.1.

voyage, but is thereafter stolen by piracy or any other form of theft, the assured is covered. If it is stolen at the port of loading through being loaded on to a phantom ship controlled by fraudsters who then sail away with the cargo, the assured is not covered.[45] Moreover, if the cargo is stolen *en route* for the port of loading and never embarks upon the sea voyage, the law's insistence upon the marine adventure as the "trunk" of the insured risk appears to deny cover.[46] This makes no commercial sense whatever and discredits marine insurance law. The 1906 Act needs reform so that the marine character of a policy ceases to have legal conceptual significance.

D. Sub-standard shipping

32 Sub-standard shipping endangers lives, it jeopardises cargo, and it threatens the environment. Its elimination is a central goal of international maritime law, actively pursued through such instruments as the Safety of Life at Sea Convention 1974[47] and such mechanisms as port state control. Sub-standard shipping is also of obvious concern to underwriters. The issue is addressed by the 1906 Act, but in a wholly unsatisfactory manner.

33 Taking the view that the promissory warranty approach to unseaworthiness adopted in the context of voyage policies could not be adapted to time policies, the courts developed a defence requiring both causation and privity, meaning knowledge. An insurer under a time policy would not be liable for any loss caused by unseaworthiness at the time the insured vessel was put to sea to which the assured was privy. This defence is now codified in s 39(5) of the 1906 Act, but the subsection is largely a dead letter because of the difficulty in proving the knowledge requirement. Moreover, the very existence of that requirement, exonerating negligent assureds, is controversial. In *The Star Sea*,[48] the

45 *The Prestrioka*, *supra* n 43. Likewise *Nam Kwong Medicines & Health Products Co Ltd v China Insurance Co Ltd* [2002] 2 Lloyd's Rep 591 (Hong Kong High Court).

46 In *The Prestrioka*, *supra* n 43, Potter LJ was prepared to contemplate that an assured might recover for a total loss on the initial inland element of the transit: at [56]. It is, however, difficult to reconcile with attaching cardinal importance to the sea leg of the voyage. Either embarking upon the sea leg is a condition precedent to attachment of risk, or it is not.

47 International Convention for the Safety of Life at Sea, 1974, adopted on 1 November 1974, entered into force on 25 May 1980.

48 *Manifest Shipping & Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [1995] 1 Lloyd's Rep 651, reversed on other grounds: see [1997] 1 Lloyd's Rep 360 (CA), [2003] 1 AC 469 (HL).

assured shipowner responded to fires in two of its vessels in a manner described by the trial judge as "completely inadequate",[49] failing properly to check either the fire safety equipment on board its vessels or the ability of the master and crew to operate it. A letter relied on by the assured as providing information of the two fires was criticised as "absolutely pathetic".[50] When a fire subsequently broke out in the engine room of the insured vessel, the fire dampers proved defective and the master failed to operate the vessel's carbon dioxide extinguishing system effectively. The vessel was rendered a constructive total loss. The assured was held entitled to recover for a loss caused by the insured peril of fire since the evidence demonstrated negligence but not privity.

34 This is highly regrettable. Insurance is not designed to subsidise negligence with respect to the equipping, crewing, and maintaining of vessels. Hull and machinery policies are designed to spread the risk of maritime and certain other perils, not to subsidise the operating of sub-standard shipping. It is noteworthy that a cargo insurer that seeks to invoke the associated defence of inherent vice need prove only the sub-standard nature of the insured property and a causal link to the loss or damage. Why hull insurance is more indulgent is unclear. It is noteworthy that negligence with respect to unseaworthiness provides a defence under the Norwegian Marine Insurance Plan, further stiffened by the assured carrying the burden of disproving negligence.[51] Although developments such as the advent of the ISM code[52] may assist underwriters in proving privity, it is suggested that reform towards the Norwegian position is in principle desirable both of itself and in support of international maritime law. At the very least, a negligence-based unseaworthiness defence should become the default rule, leaving it for prospective assureds and their brokers to explain to underwriters on what basis a licence to be negligent

49 [1995] 1 Lloyd's Rep 651 at 663, 664.

50 *Id*, at 663.

51 2003 Version available at <http://www.norwegianplan.no/eng/index.htm> (accessed 22 November 2006), §3-22:

> The insurer is not liable for loss that is a consequence of the ship not being in a seaworthy condition, provided that the assured knew or ought to have known of the ship's defects at such a time that it would have been possible for him to intervene. …
>
> … The assured has the burden of proving that he neither knew nor ought to have known of the defects, and that there is no causal connection between the unseaworthiness and the casualty.

52 International Management Code for the Safe Operation of Ships and for Pollution Prevention, incorporated into the Safety of Life at Sea Convention 1974, *supra* n 47, as ch IX.

with respect to the condition of the vessel should be included in the policy.

E. The values of modern commercial contract law

35 A final concern is that some of the doctrines codified in the 1906 Act are no longer compatible with the values of modern commercial contract law. This incompatibility concern may be expressed *a fortiori* in the context of consumer contracts. However, consumer protection legislation applicable to insurance already exists. Without prejudice to the possibility of further reform in consumer insurance and while some reference will be made to existing consumer legislation, this article will focus on the provisions of the 1906 Act that apply without any gloss to commercial insurance.

36 As already indicated, the Act adopts the values of freedom of contract and certainty. Modern commercial contract law accepts that parties should, within very few limits, have the freedom expressly to include such terms as they wish in their contracts. The default rules of contract law, however, increasingly aim at producing a result that is appropriate given the facts of the particular case, any cost in terms of certainty being readily paid. The development of innominate terms,[53] the recognition of an account of profits as a remedy for breach of contract (albeit in rare circumstances),[54] the development of the jurisdiction to award damages in lieu of an injunction,[55] the relaxation of the rules on admissibility of extraneous evidence on the interpretation of contracts,[56] the introduction by statute of a judicial discretion to refuse rescission in cases of non-fraudulent misrepresentation,[57] and s 15A of the Sale of Goods Act 1979, already discussed,[58] all contribute to the evolution of a new commercial contract law.

37 This brings one to those provisions in the 1906 Act that might be regarded as of most concern, namely those that codify the pre-formation doctrine of utmost good faith and the law of promissory warranties.

53 See especially *Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26.
54 *Attorney-General v Blake* [2001] 1 AC 268.
55 See especially *Experience Hendrix llc v PPX Enterprises Inc* [2003] 1 All ER (Comm) 830.
56 Starting in *Prenn v Simmonds* [1971] 1 WLR 1381.
57 Misrepresentation Act 1967 (c 7) (UK), s 2(2).
58 At para 16 of the main text above.

These areas of insurance contract law may be criticised for lacking the responsiveness to the factual nuances of the particular case that we increasingly expect of commercial contract law. The question is then to what extent and how such responsiveness should be introduced.

38 With respect to utmost good faith, it would of course be possible to limit the scope of the disclosure and misrepresentation doctrines. This, for example, is the approach of the Insurance Conduct of Business Code, promulgated in the UK by the Financial Services Authority for policies under which the assured qualifies as a "retail customer", defined as "an individual who is acting for purposes which are outside his trade, profession or business".[59] This would encompass many yacht policies. With respect to non-fraudulent non-disclosure, the test for materiality becomes that which the retail customer could reasonably be expected to disclose. With respect to misrepresentation, the right to avoid for innocent misrepresentation is abolished.[60]

39 With respect, these reforms are puzzling. Why is the definition of materiality changed for non-disclosure but not for misrepresentation? Why is the right to avoid abolished for innocent misrepresentation but not for innocent non-disclosure?[61] What justifies abolition of the right to avoid for innocent misrepresentation in the consumer insurance context when it remains for all other contracts, including consumer contracts? This question is all the more poignant when considering reform in the non-consumer context. More generally, however, it might be asked whether tinkering with the scope of the utmost good faith duties is the best way forward. A parallel alteration to the scope of materiality in the commercial context would require the assured to disclose that which the commercial assured could reasonably be expected to disclose. This is, presumably, the commercial assured with the characteristics of the actual assured, producing a variable and uncertain standard depending on the legal and commercial sophistication of the actual assured. Moreover, given that insurance brokers act as agents for the assured, is the reasonable assured one advised by professional insurance brokers? Ultimately, given that materiality is confined to circumstances that the

59 Financial Services Authority Handbook, Glossary.

60 Insurance Conduct of Business Code, r 7.3.6(2)(a)–(b).

61 A suggestion that the concept of non-disclosure is unitary, not susceptible of classification according to the state of mind in the manner of misrepresentation, was exposed as fallacious by the House of Lords in *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyd's Rep 61.

assured knows or ought to know and that relate to the risk to be insured,[62] would any real difference be produced by tinkering with the definition of materiality, apart from generating significantly increased uncertainty?

40 The real problem with the doctrine of utmost good faith lies not so much with the scope of the doctrine as with the remedy for failure to act in the utmost good faith, namely avoidance of the policy. Were that remedy, outside of cases of fraud, subject to the judicial discretion that applies to rescission for non-fraudulent misrepresentation in the general law of contract, one suspects the heat would disappear from the debate about the scope of the duty. The focus would move to the appropriateness of the remedy on the facts of the case. This would, of course, be a source of uncertainty. However, the existing law already acts as a cause of seemingly constant litigation. A change in the availability of the remedy would be consistent with developments in commercial contract law generally and concentrate minds upon the real issue.

41 With respect to promissory warranties, one should first change the terminology. As already noted, the phrase "promissory warranty" is merely insurance contract law jargon for the condition precedent of general contract law.[63] The question, therefore, is what ought to be done to mitigate the potential harshness of conditions precedent? A common complaint about the current law focuses on the irrelevance of causation. Breach of a condition precedent to liability on the policy generally discharges the insurer from any and all future liability on the policy even in respect of casualties that are in no way causally linked to the breach. Breach of a condition precedent with respect to notifying the insurer of an occurrence generating claims or with respect to claims co-operation discharges the insurer for liability for the relevant claim or claims regardless of whether the breach occasions the insurer serious prejudice or indeed any prejudice at all. It is, therefore, often suggested that reform of the law relating to conditions precedent should confine the insurer's discharge to the extent of prejudice the insurer can prove to have sustained by reason of the breach. For four reasons, it is questionable whether reform should go this far.

62 *North Star Shipping Ltd v Sphere Drake Insurance plc* [2006] Lloyd's Rep IR 519 at [50] (history of non-payment of premium probably not material since it relates to the assured's credit risk rather than the risk to be insured).

63 Moreover, although there is no authority, it appears likely that it is a contingent condition precedent. It has never been suggested that breach of a promissory warranty sounds in damages.

42 First, insurance contract law should not diverge from general contract law without good reason. Any reform to the condition precedent of insurance contract law will introduce some element of divergence, but general contract law shows no signs of wishing to abolish the non-causally relevant condition precedent. Even in the context of the statutory implied conditions under the Sale of Goods Act 1979, s 15A does not go that far, although the absence of a causal link may prove to be significant in determining whether rejection of the goods would be unreasonable.

43 Secondly, requiring a causal link by way of mandatory law would represent a restriction on freedom of contract that is difficult to justify. It may be that conditions precedent have the potential to operate harshly more frequently in the context of insurance contracts, but there is no qualitative difference in the apparent unfairness. Returning to sale of goods law, s 15A has no application to express terms. The clear Parliamentary message is that the parties should retain the freedom to create whatever contractual terms they wish.

44 One possible exception is the "basis clause". The scope of such clauses varies, but their purpose is to make it a condition precedent to cover under the policy that, for example, all information supplied in the course of applying for cover is accurate. This enables the insurer to deny liability on the basis of misrepresentation without proof of either materiality or inducement. Appropriate wording may similarly extend the assured's disclosure obligations. On the one hand, such clauses may again be considered simply to be manifestations of freedom of contract. However, in this context, the law has already considered the appropriate obligations to impose on an assured in the context of risk presentation. The concepts of materiality and inducement serve to strike a balance between the interests of the insurer and the assured. The insurer has a genuine interest in being able to arrive at as informed an appreciation of the risk as possible. However, avoidance of the policy in circumstances where the misrepresentation or non-disclosure could not legitimately and did not in fact make a difference to the decision to offer cover cannot be justified. A basis clause destroys the balance that the law has struck. As such, there is a clear case for invalidating such clauses.

45 Thirdly, the concept of a condition precedent is inherent in the basic doctrine of risk and alteration of risk. According to Blackburn J:[64]

64 *Company of African Merchants, Ltd v British and Foreign Marine Insurance Co Ltd* (1873) LR 8 Ex 154 at 157.

> The underwriter insures a particular risk, and the assured has no right to change it. Whether he increases or diminishes it is immaterial; if he varies it the underwriter is discharged.

Unless the law is to dictate to parties to insurance contracts how the insured risk, the very core of the contract, is to be defined, some idea of automatic discharge of liability divorced from causation or any notion of prejudice to the insurer has to remain. It is noteworthy that contract terms that "relate … to the definition of the main subject matter of the contract" are immune from challenge under the Unfair Terms in Consumer Contracts Regulations 1999.[65] In any reform of insurance contract law, a distinction could be drawn between conditions precedent that relate to the making of claims and those that relate to the attachment and alteration of risk. However, any attempt to distinguish between "genuine" risk definition and some notion of "secondary" conditions precedent to cover would, it is suggested, be unduly productive of uncertainty.[66]

46 Fourthly, the condition precedent can operate as a highly desirable instrument of policy. Reference has already been made to the struggle against sub-standard shipping. To take one specific example, the ISM Code[67] represents a significant attempt to address shortcomings in crewing standards. The Code is a piece of public law, promulgated under and forming part of the Safety of Life at Sea Convention 1974.[68] If, however, failure to implement the Code in no way jeopardised, or was highly unlikely to jeopardise, a shipowner's insurance cover in the private law sphere, the Code might be criticised for lacking teeth. It is noteworthy, therefore, that cl 13 of the International Hull Clauses (01/11/03) requires possession of the two key documents that evidence compliance with the Code and that non-compliance with this requirement is expressly stated automatically to terminate cover. In other words, cl 13 imposes a condition precedent, although the significance of the term is spelt out rather than depending upon the label "condition precedent".

65 *Supra* n 8, reg 6(2).
66 Of course, the 1999 Regulations may, on their true interpretation, require such a distinction to be drawn so that such uncertainty would be injected into insurance contracts within the scope of the 1999 Regulations. However, the fact that consumer protection may prevail over the advantages of certainty is no reason for spreading uncertainty in the non-consumer context.
67 *Supra* n 52.
68 *Supra* n 47.

47 It is, therefore, suggested that the condition precedent should remain within the array of contractual terms available to parties to insurance contracts. Parties should be free to incorporate terms that prompt an automatic prospective discharge irrespective of any prejudicial impact of non-compliance on the insurer if that is what they wish. However, the potentially harsh operation of such terms is undeniable, as is the consequent and understandable judicial reluctance to accept that a given contract term operates harshly on the facts. Consequently, there is a case for changing the default rule as to how such terms operate. The law on conditions precedent in insurance contract law could be amended so that, subject to explicit contrary provision, a breach would deny cover only if the breach caused the casualty generating the claim. The "subject to explicit contrary provision" qualification is critical. This accommodates provisions such as cl 13 in the International Hull Clauses. In the interests of transparency of contract language, the mere use of a label such as "condition precedent" or "promissory warranty" could be decreed insufficient to oust the new default rule. In the context of conditions precedent to the making of claims, there is a case for more radical reform to abolish conditions precedent in favour of rendering all such provisions ordinary promissory terms sounding in damages quantified by reference to such loss, if any, as the insurer can prove was caused by the breach. Alternatively, such a term could be characterised as a matter of law as innominate, so that an insurer could reject liability on the claim if it could prove that breach of the term occasioned it serious prejudice, but would otherwise be confined to damages.[69]

48 In the context of marine insurance, particular criticism may be levelled at the statutory codification of the requirement for a notice of abandonment in cases of constructive total loss.[70] This procedural condition precedent to indemnification on a total loss basis is designed to enable the insurer to exercise rights over what remains of the insured subject matter to which it is entitled by virtue of the substantive doctrine of abandonment on payment for a total loss. While notice of a casualty giving rise to such potential rights on abandonment may be commercially useful, such utility does not justify retention of the procedural condition precedent to total loss indemnification. First, it is undeniable that insurers may legitimately wish to be informed of a casualty that might generate a

69 The analysis advocated as a possibility at common law in *Alfred McAlpine plc v BAI (Run-Off) Ltd* [2000] 1 Lloyd's Rep 437 but rejected in *Friends Provident Life & Pensions Ltd v Sirius International Insurance* [2005] 2 Lloyd's Rep 517.

70 Section 62 of the 1906 Act.

claim at an early stage. The true circumstances behind a casualty may be more readily determined in its immediate aftermath when both physical evidence and witness recollections are fresh. The commercial legitimacy of this desire for notification does not, however, translate into a legal requirement of notification. Insurers that desire notification of a casualty that may give rise to a claim must contract for it. Apart from constructive total loss cases, the default position is that no notification requirement is imposed by law. Secondly, the financial consequence of restriction to indemnification on a partial loss basis ensues irrespective of whether the failure to serve a notice of abandonment occasions the insurer any financial prejudice. This is hard to justify, especially in the hull market where notices of abandonment are routinely rejected for fear of liabilities attaching to the insured vessel. Moreover, the fact that a notice of abandonment must be served within a reasonable time of a constructive total loss occurring coupled with the difficulty of identifying that moment in certain sets of facts combine to produce the unedifying spectacle of the service of a series of notices in the hope that one will fall within the relevant time period.[71] Should none do so, the assured will suffer a financial penalty despite the insurer having been given notice of the occurrence of the casualty, even if not shortly after the precise moment when a constructive total loss arose.[72]

III. Conclusion

49 As an Act drafted with the intention of limiting opportunities for litigation on legal principle, it cannot be said that the Marine Insurance Act 1906 has been particularly successful. The last one hundred years have seen litigation on all the main principles codified in the 1906 Act. The Act has, nevertheless, been adopted with little or no amendment of substance by several other countries, most recently by Canada in 1993, while the law it codifies has been and remains influential in other jurisdictions, such as the US.[73] The Australian Law Reform Commission, in its 2001 *Review of the [Australian] Marine Insurance Act 1909*[74] in a paragraph entitled "Chalmers' Masterpiece", stated that:[75]

71 See, for example, *Panamanian Oriental Steamship Corp v Wright* [1970] 2 Lloyd's Rep 365.

72 The notice may even be ineffective for having been given too early, in which case the insurer receives extra notice but the assured is confined to partial loss indemnification.

73 Although more so at federal than state level.

74 Australian Law Reform Commission Report No 91 (2001).

75 *Ibid*, at para 5.14.

> It is a testament to Sir Mackenzie's drafting skill, and to the stability (and perhaps conservatism) of the system that it underpins, that the Act remains virtually intact today and operates by custom or contractual incorporation in numerous countries, not only those that have inherited the English legal system generally.

If, however, the Act is to retain its influence for the next one hundred years, it may require revisiting. Concerns such as those raised above may indicate a need for substantive reform. Moreover, if the Act is to serve its original purpose, there is scope for the clarification of existing provisions and the addition of new ones in the light of the last one hundred years of jurisprudential development. The centennial birthday of the Marine Insurance Act 1906 merits a celebration, but one can be fairly confident that Chalmers himself would be a proponent of review and reform.