Total Loss prompts review of disclosure obligations
The Nancy [2013] EWHC 2116 (Comm.) Blair J.

By Russell Harling and Maria Borg Barthet

This case delves into a number of topical areas of law and practice which will be of keen interest to marine underwriters, brokers and their customers.

In bare outline the facts were simple. The vessel was insured under a marine hull policy on ITC Hulls 1/11/95. It suffered a total loss by fire. The underwriters denied cover on five grounds.

1. Misrepresentation or non-disclosure as to the true technical management of the vessel.

The underwriter was told that the Managers were Swedish Management ("SM") whereas, they alleged, the actual management was carried out by Blue Fleet ("BF"). BF had been involved as (declared) managers of other ships which had suffered casualties or were found to be in a neglected condition.

The evidence showed that the principals of SM and BF were well acquainted, and that SM drew frequently on BF for support and assistance, in particular in dealings with Class. The approach of the judge was that the hallmarks of management were (1) ultimate authority and (2) absolute discretion. He held that the defence failed, because although BF carried out numerous tasks of a ship-management nature, they did so in co-ordination with SM, and under their ultimate authority and control. SM were the true managers, and BF merely their agents or delegates. The judge further held (on the basis of expert underwriting evidence) that the partial involvement of BF in management functions did not go so far as to be material and disclosable. But even if it did, the evidence showed that the underwriters continued to underwrite vessels related to BF after they knew of the alleged record of BF, therefore any non-disclosure did not induce them to write the policy. The underwriter was not helped by being unable to produce any documentary records of underwriting guidelines, policies and risk assessments.

2. Non-disclosure of Port State Control detentions

The vessel had been detained four times in four years by Port State Control ("PSC"): some of the deficiencies relating to fire fighting. The detentions were not disclosed at the time of renewal. The judge considered, on expert evidence, that only the detentions within 18 months of renewal would be material to a prudent underwriter.

The assured argued that details of such detentions are available online and are therefore within the presumed knowledge of underwriters, so that, under s.18 (3)(b) of the Marine Insurance Act 1906, they did not have to be disclosed, even if material. The expert evidence was that it is the usual practice of the London market to check such databases. (The actual underwriter was based in Dubai but the policy was subject to English law "*and practice*"). Details of the detentions were to be found on (1) Sea-Web and (2) Lloyd's MIU, but the

entries on Sea-Web were not fully detailed, and only Lloyd's MIU showed the reasons for the detentions. In fact, the underwriters subscribed to Sea-Web but not to Lloyd's MIU, and the judge rejected the argument that, in effect, the underwriter was to be treated as if it subscribed to Lloyd's MIU, when it did not. Therefore the material facts relating to the detentions were not within the presumed knowledge of the underwriter. The practical conclusion seems to be that underwriters should check at least one commonly available database, but are not obliged to check several or to subscribe to any particular service.

It was consequently held that there was material non-disclosure in relation to certain PSC detentions for fire fighting deficiencies. But these were found not to have induced the making of the policy, for two reasons. First, the judge held that if the detentions had been disclosed, the assured would also have disclosed the ensuing outcome – that the deficiencies were quickly rectified. This point is legally controversial and until this case, undecided, although there are non-binding, and conflicting, *dicta* in certain cases. The judge's approach favours the assured, because it means that if there is a material fact which should have been disclosed and which makes the risk look worse, such as a PSC detention for fire fighting items, the assured can argue that if he had disclosed the detention, he would also have disclosed other facts, such as the quick rectification of the items, which would have made the underwriter think that in fact the risk was not worse. In other words, an undisclosed material fact cannot be viewed in isolation, but must be viewed against other background or mitigating facts which the assured, if the assured had complied with the duty of disclosure, would probably have disclosed at the same time.

It was also found that the actual practice of the underwriter demonstrated that disclosure of the detentions would have made no difference to their decision to renew cover.

3. Non-disclosure of a conflict of interest, in that the Designated Person Ashore was alleged to carry out work for the Certification Organisation that provided ISM certificates for the vessel and the managers.

This failed on the facts.

4. Breach of a warranty which read "Vessels ISM Compliant"

The major and interesting point here was whether the warranty required only documentary compliance – i.e. (1) that there should be a valid Document of Compliance ("DOC") and Safety Management Certificate ("SMC")? Or (2) whether actual, substantive compliance with the ISM Code (the "Code") was required?

Yet more expert evidence was given, both sides calling an ISM Code expert. The judge took note of the fact that the Code is not prescriptive, and that there is a considerable degree of judgment involved in determining questions of compliance. He accepted that the Code cannot be equated to a technical standard for the condition of a vessel, and that even well run ships may not be in full compliance or in compliance the whole time. Essentially for these reasons, he held that the warranty was only of documentary compliance, and not of substantive compliance with the Code.

The warranty was construed as continuous throughout the policy: it did not merely apply at the time of inception as argued by the assured.

It is notable that the International Hull Clauses 2003 contain, in clause 13, an ISM warranty which clearly requires only documentary compliance. But where warranties of "*ISM compliance*" or similar have been added to other policy wordings, this case makes clear that what is required is only documentary compliance – a valid DOC and a valid SMC – throughout the policy period.

5. Illegality, by reason of payment of freight in US dollars in relation to the carriage of sulphur from Iran to China

On a voyage unconnected with the fire, the assured had voyage-chartered the vessel to a (non-Iranian) entity to carry sulphur from Iran to China. A freight invoice in US dollars was issued and paid via a correspondent bank in New York. Having heard (inevitably) expert evidence from both sides on US law as it stood in late 2008, the judge found that this caused the correspondent bank to violate US law and that the assured had also thereby violated US law and could be subject to civil, but not criminal, penalties. It was accepted that the assured was not aware of a recent (in 2008) change of US law which had rendered the method of payment illegal.

The underwriter relied, first, on the warranty in section 41 of the Marine Insurance Act that the "*adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner*". This was rejected because "*the adventure under a* [time] *policy is that the ship is exposed to maritime perils*" and "*the payment of freight is not within the insured adventure*" . The reasoning on this point is very brief and no authority is cited. The underlying thought seems to be that it was not the voyage that was illegal, but the payment of freight for it in that particular manner. In many cases it may be difficult to distinguish between a feature which is integral to the adventure and one that is outside of it. Pending a more detailed authority on the topic, it would be unwise to place excessive reliance on this distinction.

In any event, the defence was rejected for a second and more sweeping reason: that section 41 is only concerned with illegality under English law. This point had never been finally decided before, although there is a first instance decision and non-binding *dicta* in the Court of Appeal in *Boskalis v Mountain* [1999] QB 674 in support of the judge's view. From the assured's point of view the judge's decision has much to commend it, as otherwise the assured risks automatically losing his cover for inadvertent breach of a foreign law of which he may have no knowledge and which may be entirely unrelated to the cause of the loss.

The underwriter finally sought to rely on a defence of illegality at common law. This also failed, on the grounds that (1) there was no causative connection between the illegality and the loss, and (2) the assured did not need to rely on any illegal act in order to prove its claim. This brings out that illegality under foreign law is unlikely to bring about complete and automatic loss of cover, in contrast to the section 41 defence. Interestingly, however, the judge would apparently have decided that if "*at the time the policy was entered into*" the assured had intended to perform "*the adventure*" in a manner which involved a breach of US law, the defence would have succeeded. The precise reasoning for this conclusion is not spelled out, but both assureds and underwriters would be well advised to bear in mind that an intention to violate foreign law at the time the policy is entered into may give rise to a defence.

Conclusions

Although the defences raised by the underwriters failed in this instance, the case highlights the possibility that misrepresentation as to the identity of the manager, particularly the technical manager, could on different facts enable the underwriters to avoid the policy. It also establishes that although, under English law and practice, underwriters are expected to make use of databases to check public information about vessels, which may include the fact of PSC detentions, assureds cannot assume that the most detailed database will be used, nor that full information about PSC detentions will be obtained. It seems that it would be good practice for assureds to disclose PSC detentions and associated details at least for the 18 months before placement. The rulings in this case also clarify the meaning of "*warranted ISM compliant*" or similar – that it is a continuing warranty of documentary compliance, that is, having the right certificates in place, not of actual compliance with the ISM Code. Finally the case sheds light on the possibility of a defence based on breach of foreign law, which will be of continuing importance given the modern prevalence of complex sanctions regimes.

If you would like more information about any of the topics covered in this update, please contact:

Russell Harling

Email: Russell@CJCLaw.com

Office: +44 (0) 207 855 9669
Fax: +44 (0) 207 855 9666
Mobile: +44 (0) 7823 447 113

or

Maria Borg Barthet

Email: Maria@CJCLaw.com

Office: +44 (0) 207 855 9669
Fax: +44 (0) 207 855 9666
Mobile: +44 (0) 7817 859 496