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# MARINE INSURANCE BULLETIN

## Welcome to the February edition of our Marine Insurance Bulletin.

In this edition, we analyse the impact of the Costa Concordia casualty on the marine insurance market. We also cover a recent decision of the English Court of Appeal, which confirms there is no automatic stay of reinsurance proceedings in favour of proceedings in another country on the underlying policy, even where this means insurers are faced with potentially inconsistent decisions.

Where cargo is lost or damaged during a sea passage and the assured attributes this to perils of the seas, insurers may want to use the excluded risk of inherent vice as a defence to liability. We look at whether this is likely to succeed in light of recent case law. As regulators increasingly use restrictions on the availability of insurance to block trade with Iran, insurers and brokers are at risk. We set out how insurers and brokers are exposed, and look at how they can best protect themselves from involvement in prohibited activities.

Finally, we review a recent decision that demonstrates how the English courts will handle cases where multiple insured perils have occurred and insurers argue that multiple deductibles should be applied.

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## *Costa Concordia:* impact on marine insurance market

Almost exactly 100 years after the sinking of the *Titanic*, the *Costa Concordia* disaster has been cited as one of the worst maritime insurance losses ever. The fallout from the *Costa Concordia* is likely to have a worldwide impact, not only on vessel owners and operators, but also on their insurers and reinsurers. According to analysts, the total insured loss could be around US$1 billion, including the salvage and hull costs, and it was initially estimated that the claims from passenger deaths, injuries and loss of property alone would exceed US$8 million. Claims filed to date are understood to seek more than US$1.4 billion in compensation. The size of the claims means that they will potentially resonate throughout the shipping industry and into the wider insurance market.

Claims are still emerging in the aftermath of the incident, with claims for loss of life and personal injuries from passengers and crew alike. Claimants have been flocking to the US, where punitive damages are awarded and the Athens Convention (which limits liability for passenger claims) does not apply, although a recent decision in Florida seems to have put an end to this, finding that Costa can rely on the choice of jurisdiction clause in the booking conditions, and therefore claims (even those brought by US citizens) should be heard in Italy. The major insurance claim, of course, is likely to be the hull claim, and it is understood that the ship's insured hull value was approximately US$513 million.

Following the incident, and the emergence of such claims, predictions of sharp increases in prices in the hull insurance market were not surprising. However, the opposite was, in fact, the case, despite the estimated costs of the disaster reportedly accounting for between 6% and 7% of the world's hull premiums. Overcapacity in the hull market, perhaps as a result of the large number of newer providers, has apparently had the inevitable consequence of driving rates down. As a result, the hull market has continued to suffer from losses for the 16th year running, with no current prospect of this trend reversing.

Larger risks are normally spread across the insurance market and it might therefore be expected that a large disaster would affect the whole market. However, again, this was not the case. The hull value of the *Costa Concordia* was, it seems, spread across 28 underwriters, a very small number in comparison to the large number of insurers currently operating in the hull market (although the four largest insurers account for more than 50% of the risk, and the top ten account for more than 90%). As a result, there is a division in the hull market between the effect on the small number of insurers affected by the incident and who are therefore likely to increase rates, and the majority of insurers, who are not affected and for whom business continues as usual.

The *Costa Concordia* incident illustrates that it takes more than one large claim to affect rates. Taking into consideration the on-going effect of the *Rena* incident, it becomes even more apparent how unreceptive the hull market is to major casualties. However, Willis has cautioned that the *"costs of the Costa Concordia will ultimately depend on the liability settlements"*. This mirrors other insurers' projections that there may be a delay while the loss works its way through to the reinsurance market, before actually having an impact upon the direct market by way of higher premiums.

The reinsurance market was also predicted to see an increase in rates as a result of the *Costa Concordia* incident. Although the total estimated losses are unusually large for the marine market, they are not so large as those caused by natural catastrophes that affect the reinsurance market, such as the Japanese earthquake and tsunami in March 2011, or Superstorm Sandy in the USA in November 2012. It is estimated that the costs of the Japanese earthquake and tsunami, for example, was US$210 billion, of which US$35 to 40 billion is reinsured. It is therefore not surprising that the estimated US$1 billion loss caused by the *Costa Concordia* is not as significant as originally envisaged. However, the combined effect of these incidents has led to a tighter reinsurance market and this is likely to have an effect in due course down the insurance chain.

By contrast, the P&I sector has seen a far greater impact. In particular, those Clubs which write risks for cruise operators are expected to face an increase in the cost of their cover with the International Group, which is seeing one of its biggest claims yet. The International Group is also likely to face an increase in its commercial reinsurance costs, which is likely to be passed on in premium increases and ultimately to shipowners themselves.

More broadly, with vessels increasing in size, particularly increasingly large cruise ships and ultra-large boxships, P&I Clubs seem likely to face further issues in the not-too-distant future when incidents occur with these massive vessels. The effect on the hull market of one of these casualties is also likely to be much more significant than that experienced in relation to the *Costa Concordia*.

It is only a question of time until such a super-container or cruise ship suffers a major casualty and it remains unclear whether the hull market will be able to afford to continue business as usual after such a disaster. With bigger vessels, the high value of cargo (potentially towards US$2 billion on an 18,000 teu container ship) and passenger/crew claims (well over 8,000 people may be on board the largest cruise ships, well in excess of the 4,000 or so on board the *Costa Concordia*), added to the insured value of the hull could lead to claims outstripping the vessel's own value, and potentially exceeding the value of the entire marine insurance market.

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## Insurer in the middle: Court of Appeal confirms no automatic stay of English proceedings brought by reinsurers

It is well known that insurers need to minimise their exposure by ensuring their insurance and reinsurance policies are back to back. Ideally, both policies should be made subject to the same law and jurisdiction, though in practice this will not always be commercially achievable. Insurers agreeing that reinsurance is governed by a law other than the governing law of the underlying policy face the inherent risk that the different courts will reach different decisions on the law and/or facts. A recent decision of the English Court of Appeal[1] has emphasised that where reinsurers bring declaratory non-liability proceedings in the English courts, an insurer "in the middle" will not usually be able to stay these pending resolution of proceedings in the other country under the policy itself.

The Court of Appeal has upheld the Commercial Court's decision not to grant a stay of reinsurance proceedings in the English High Court pending the outcome of the underlying insurance claim in the Philippines. The Court of Appeal held that the risk of inconsistent decisions in the English and Philippine courts was not a "rare and compelling case" such as to justify a stay.

The Princess of the Stars was a roll-on roll-off passenger cargo vessel operating in the Philippines, which was sunk by typhoon Frank in June 2008 with the tragic loss of more than 500 passengers and crew. All the more tragically, the Philippines government had issued a typhoon warning before the vessel left her port of departure, encompassing the ports of both departure and destination and the planned route.

Over 40 cargo claims have been brought in the Philippines against the owners of the vessel (Owners). Further claims in respect of the lost cargo have been brought directly against Owners' cargo liability insurer, Oriental. By the underlying cargo liability policy (the Original Policy), Oriental would indemnify Owners *"for all sums which the insured [Owners] shall become legally obligated to pay as damages for loss or damage of merchandise or goods under his custody."*

Oriental reinsured their potential liability in the London market with reinsurers led by Amlin (the Reinsurance Policy). The Reinsurance Policy contained an English law and jurisdiction clause, and a "follow the settlements" clause.

Importantly, both the Original Policy and the Reinsurance Policy contained a typhoon warranty which stated:

*"[...] it is expressly warranted that the carrying vessel shall not sail or put out of Sheltered Port when there is a typhoon or storm warning at that port nor when her destination or intended route may be within the possible path of the typhoon or storm announced at the port of sailing, port of destination or any intervening point. Violation of this warranty shall render this policy void".*

Reinsurers commenced proceedings in the High Court in England for a declaration of non-liability under the Reinsurance Policy on the grounds that there had been a breach of the typhoon warranty. Reinsurers further sought a declaration of Oriental's non-liability under the Original Policy due to the breach of the typhoon warranty in the Original Policy.

Oriental then applied for the English High Court proceedings to be stayed pending the outcome of the various cargo claims commenced in the Philippines. The High Court

1. *Amlin Corporate Member and Others v Oriental Assurance Corporation ("Princess of the Stars")* [2012] EWCA Civ 1341.

refused to grant the stay and Oriental appealed to the Court of Appeal.

It was well established that a stay of proceedings would only be granted in a *"rare and compelling case"*. Oriental argued that, in order to protect their claim in England under the Reinsurance Policy, they had to argue in the Philippines that there had been a breach of the typhoon warranty in the Original Policy. However, at the same time, in order to make good their reinsurance claim, they had to argue the opposite case under the Reinsurance Policy in the English courts (i.e. that there had been no breach of warranty). They further argued that the circumstances of this case were sufficiently rare and compelling because, without a stay, the Philippine court and the English court might reach inconsistent verdicts.

The Court of Appeal did express some sympathy for Oriental, noting that it was legally correct to refuse the stay despite the *"apparent unfairness"* of Oriental's position. The Court commented that, by commencing declaratory proceedings in London *"[t]hese giants of the London insurance market have placed their reinsured Philippine minnow in a hopeless and invidious position."*

However, the Court of Appeal rejected Oriental's application for a stay. The judgment stated that it was within the Commercial Court's discretion to hold that the risk of different evidence and inconsistent decisions in the two sets of proceedings was *"a relatively modest one"*, particularly because evidence relevant to the reinsurance proceedings would come out in the Philippine proceedings well in advance of the English trial. It had been legitimate to take into account as a factor against a stay that the Philippine proceedings might not be concluded for ten years.

In summary, each application for a stay will be considered on its own merits to determine whether the *"rare and compelling"* case test has been satisfied, but the Court of Appeal's decision makes clear that there can be no argument that reinsurance claims automatically satisfy that test.

Reinsurers will welcome this, as reinsurers can continue to ask the English courts to issue judgment on liability under the reinsurance policy and are unlikely to have to wait for the conclusion of drawn out foreign proceedings on the policy itself. In light of this decision, insurers will need to continue to exercise caution in agreeing to different law and jurisdiction clauses and be aware of the risks where they do so.

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## Perils of the seas v inherent vice: what is the cause?

Marine underwriters are well aware that one of the key risks insured against under a marine policy is the loss of/damage suffered to the subject-matter insured due to accidents deriving from exposure to the effects of the sea. Such risks are generally referred to as perils of the seas, and the MIA[1] has defined them as *"fortuitous accidents or casualties of the seas"* excluding *"the ordinary action of the winds and waves".*

A brief analysis of such definition indicates that there is a positive element required, namely fortuity in an accident or casualty of the seas, along with a negative one, namely that the loss should not have been caused by the ordinary action of the winds and waves.

As far as the negative element is concerned, it should be noted that the word ordinary qualifies the action, and not the wind and waves. The point, therefore, is whether the wind and waves had an extraordinary effect on the subject-matter insured, i.e. the wind and waves were sufficient to cause a fortuitous accident or casualty, and not whether they were extraordinary in themselves. Extraordinary weather, therefore, is not required to trigger coverage for perils of the seas whether under hull or cargo policies.

Taking such principles into account, what would be the position in cases where the losses suffered by the subject-matter insured during a sea passage are a result of its inherent nature?

1. Marine Insurance Act 1906, schedule 7.

The inherent adverse characteristics of the subject-matter insured are generally referred to as inherent vice. A usually accepted definition established by case law[2] is *"the risk of deterioration of the goods shipped as a result of their natural behaviour in the ordinary course of the contemplated voyage without the intervention of a fortuitous external accident or casualty".*

This risk is generally excluded from marine cargo policies either by operation of the MIA[3] or by contractual terms[4].

Having established the legal basis for claims, we will go on to consider the following examples of losses:

1. A cargo which contains a high moisture content is damaged during sea carriage by water, which originates from the evaporation of its own moisture.

2. The legs of a jack-up rig are damaged and lost during sea carriage as their holding mechanism was not designed to withstand the action of the waves during transportation.

On the face of it, both scenarios appear identical as the relevant losses resulted from the subject-matter insured's inherent characteristics. Caselaw, however, has differentiated them on the basis of the existence, or not, of an intervening fortuitous external cause.

In scenario (1), the understanding was that the described loss was solely caused by the inherent vice of the cargo (i.e. excessive moisture content), without the interference of any external cause. The cargo has, in fact, damaged itself, and this would have occurred irrespective of its exposure to perils of the seas[5].

In scenario (2), despite a possible argument that the loss was caused by inherent vice of the subject-matter insured (i.e. the leg's holding design which could not withstand the action of the waves), the understanding was that the loss would not have occurred had the cargo not been exposed to the perils of the sea[6]. The latter was, therefore, a fortuitous cause of the loss, which should be considered its true proximate cause. The proximate cause is not necessarily the cause closest in time to the loss but that which was proximate in efficiency to cause the loss.

There appears to be a conflict between such a conclusion and the generally accepted principle that whenever there are two independent concurrent causes of a loss, one that is insured and the other excluded, the excluded one should take precedence.

This is a difficult conflict to reconcile and the courts have avoided it by establishing that *"the sole question in a case where loss or damage is caused by a combination of the physical condition of the insured goods and conditions of the sea encountered in the course of the insured adventure is whether the loss or damage is proximately caused, at least in part, by perils of the seas (or, more generally, any fortuitous external accident or casualty). If that question is answered in the affirmative, it follows that there was no inherent vice, thereby avoiding the causation issues that arise where there are multiple causes of loss, one of which is an insured risk and one of which is an uninsured or excluded risk".*[7]

This is obviously not an ideal approach as it leaves the overall position unclear. It is known that the Law Commission is currently reviewing the MIA and, amongst other issues, it is possible that section 55 might be amended to clarify, once and for all, the issue of cover in cases where the subject loss has concurrent causes.

The distinction between perils of the seas and inherent vice has always been considered on a case by case basis, and this approach seems set to remain. Recent caselaw has, however, indicated that whenever English law is applicable, marine underwriters should bear in mind that in scenarios where a loss is allegedly caused or contributed to by an inherent vice triggered by a peril of the seas, the courts will consider perils of the seas as the true proximate cause of the subject loss and not the inherent vice.

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## Iran Sanctions: how can insurers and brokers protect themselves?

Insurers and brokers in the EU and US could be forgiven something of a siege mentality, as they continue to find themselves at the sharp edge of sanctions against Iran. Regulators are increasingly using restrictions on the availability of insurance as a way to curtail trade with Iran, and insurers and brokers who have

2. *Soya GmbH Mainz Kommanditgesellschaft v White* [1983] 1 Lloyd's Rep 122.
3. Section 55(2) of the Marine Insurance Act 1906.
4. Clause 4.4 of the Institute Cargo Clauses A.
5. *TM Noten v Harding* [1990] 2 Lloyd's Rep. 283.
6. *Global Process Systems Inc and another v Syarikat Takaful Malaysia Berhad, The Cendor MOPU* [2011] UKSC 5.
7. *The Cendor MOPU*, para. 137.

concerns in this regard will need to conduct detailed due diligence on their assureds, as well as their assureds' trading activities, to ensure that the insurers and brokers are not themselves engaging in prohibited activities.

EU based insurers and brokers need to be aware of a host of specific restrictions. In particular, they need to do the following:

- Check that the assured and any other person who benefits from the insurance is not subject to EU sanctions.
- Check that the assured is not the Government of Iran, its public bodies, corporations and agencies, or an Iranian person, entity or body, other than a natural person.
- Check that no prohibited payments will be made, either by way of premium or payment of claims.
- Check that the underlying transaction is not prohibited.
- Take account of any US restrictions which apply (whether because the insurer or broker is owned or controlled by a US person, or because the sanctions have extra-territorial effect).
- Ensure that the policy has an appropriate sanctions clause.

Some of these requirements can be satisfied by carrying out the usual due diligence and making other enquiries into the assured. Insurers and brokers are in a much more difficult position when it comes to identifying the assured's counterparties (and other entities which may benefit indirectly from the insurance), and the trade which they are engaged in.

In the case of the import, purchase or transport of crude oil and petroleum products, petrochemical products, and/or natural gas (including propane and butane) there is a specific prohibition on the provision of insurance, reinsurance or brokering services related to insurance or reinsurance.

In addition, insurers and brokers in the UK are also potentially exposed where the assured engages in other prohibited trades, or deals with a prohibited person, because the UK legislation which gives effect to and supports the relevant EU regulations includes a wide prohibition on participating intentionally in activities where it is known that the object or effect of them is (whether directly or indirectly) to circumvent any of the prohibitions in the EU sanctions, or to enable or facilitate the contravention of any such prohibition.

Insurers and brokers will want to obtain as much information as possible, to satisfy themselves that their assured is not engaged in a prohibited trade with Iran which could expose insurers and/or brokers.

Insurers and brokers who are concerned about US sanctions will need to obtain detailed advice from US lawyers, but it is worth noting that non-US persons which are owned or controlled by a US person are effectively prohibited from providing any goods or services to or for the benefit of Iran. This is because US legislation makes the US company liable for the activities of companies which it owns or controls, as if the US parent had itself engaged in the activities.

Further US sanctions will also apply, irrespective of ownership or control, where the sanctions have extra-territorial effect, because the punishments which the US can impose for breaching these sanctions will affect non-US companies as well as US companies.

US extra-territorial sanctions include some specific prohibitions on the provision of underwriting services or insurance or reinsurance. These apply, for example, to insurance in connection with the sale to Iran of goods that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. From 1 July 2013, they will also apply to insurance in connection with any other activity which is prohibited by US sanctions against Iran as well as to insurance with respect to or for the benefit of any activity in the energy, shipping or shipbuilding sectors of Iran, for which sanctions are imposed under US sanctions.

However, in each instance there is a defence where the insurer has exercised due diligence in establishing and enforcing official policies, procedures and controls to ensure that the insurer does not provide underwriting services or insurance or reinsurance in connection with any activity which is prohibited by US sanctions against Iran.

Insurers and brokers can feel justifiably aggrieved at the high burden which regulators impose

on them, in circumstances, where, unlike their assureds, they may not have made a conscious decision to continue trading with Iran. However, the simple fact is that, as a result of the restrictions which affect insurers and brokers, they need to ensure that they have procedures and checks in place, so that they are not exposed because of the actions of their assureds.

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## A careful look at causation

When the Owners of the specialist well-drilling vessel *Toisa Pisces* were successful before the English Commercial Court in late 2011 in their claim against their loss of hire insurers, the case centred on issues of non-disclosure and misrepresentation. However, the unsuccessful insurers appealed to the Court of Appeal asking them to consider different issues entirely[1]. Three machinery breakdowns occurred during an off-hire period – did these amount to three separate occurrences each attracting its own deductible? Further, did the subsequent occurrences give rise to a break in the chain of causation?

The loss of hire insurance was on ABS 1/10/83 wording which provided:

*"If in consequence of [...] breakdown of machinery [...] occurring during the period of this insurance the Vessel is prevented from earning hire for a period in excess of [21] days in respect of any accident, then this insurance shall pay [US$70,000] for each 24 hours after the expiration of the said days [...] not exceeding a further [30] days in respect of any one accident or occurrence and not exceeding [30] days in all during the currency of this Insurance..."*

Owners were claiming the maximum US$2.1 million indemnity under the policy, which represented 30 days loss of hire at the insured amount of US$70,000 per day.

The *Toisa Pisces* was propelled by two azimuth thrusters, each of which was driven by an electrical motor. These two motors were referred to in the judgment as the PAM (the port azimuth motor) and the SAM (the starboard azimuth motor). The first and primary incident was the breakdown of the PAM, which occurred on 25 February 2009. The vessel was put off-hire as a result of the breakdown. The PAM did not return to service until 19 May 2009, and it was this period of off-hire which formed the basis of the Owners' claim.

The Owners attempted to mitigate their losses by installing the SAM in place of the PAM and using a Louis Allis motor where the SAM would ordinarily have been. This work enabled easier access for maintenance in areas that were usually difficult to reach. During this maintenance, a hydraulics failure occurred (the second occurrence), with the result that the vessel had to go to drydock for repair. The vessel was in drydock for just over a month.

Did this second occurrence break the chain of causation? If the answer to this question was 'yes', then the Owners' claim would be reduced from US$2.1 million to just over US$1.94 million. However, the Court of Appeal held that the chain of causation had not been broken. Both the reasonableness of the Owners' decision to undertake the maintenance work which was underway at the time of the second occurrence and the close relationship between that maintenance work and Owners' attempts to mitigate their loss pointed against a break in the causal chain. Agreeing with Gross LJ's judgment on the point, Tomlinson LJ noted that the decision to carry out the repairs which gave rise to the second occurrence could be regarded as itself caused by the first occurrence.

However, the second occurrence was not the end of the story. Less than a week after departure from drydock following the second occurrence, the SAM failed (the third occurrence). The vessel proceeded to port for further repairs, during which time the now repaired PAM was reinstalled and the Louis Allis motor installed on the starboard side in place of the SAM. The vessel then went back into charterers' service.

How did this third occurrence affect the position? The third occurrence was relevant to the question of whether one, two or three deductibles should be applied. The Court looked on this as a question of construction of the loss of hire policy, and held that after the application of the 21 day deductible, the first occurrence gave rise to a claim to the policy maximum. There was no need to consider whether further deductibles would have been applied if the Owners' claim had hinged on the second and/or third occurrences. It was irrelevant that the Hull and Machinery cover, which was closely linked to the loss of hire cover, had treated the three occurrences as three separate events. Tomlinson LJ concluded his judgment by describing the insurers' attempt to suggest that a claim based upon the occurrence of a

1. *Valiant Insurance Company v (1) Sealion Shipping Ltd & (2) Toisa Horizon Inc ("The Toisa Pisces")* [2012] EWCA Civ 1625

single insured peril should attract the application of multiple excess periods as “to say the least unorthodox”.

This judgment has re-emphasised that, where multiple insured perils occur, it will be necessary to examine the factual circumstances of the claim carefully to determine whether the chain of causation has been broken by one or more of the perils which followed the first. The parties will also need to take a careful look at the policy wording to determine how many deductibles should apply. In this case, as the Owners’ claim was successfully established on the basis of the first occurrence, the fact that two insured perils occurred after the first was ultimately irrelevant to the claim. In such cases, and subject always to the policy wording, it would seem unlikely that multiple deductibles and/or excess periods could be applied.

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## Conferences & Events

### Lillehammer Energy Claims Conference

Norway
(6-8 March 2013)
Attending: Jonathan Bruce and Nigel Wick

### Marine Insurance Seminar - Brokers Talk

HFW, Friary Court, London
(8 May 2013)
We will be hosting the next in our series of Marine Insurance Seminars on 8 May 2013. More details to be confirmed in due course.



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