REFORM OF THE MARINE INSURANCE ACT – OPTIONS AND CONSTRAINTS

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And down in fathoms many went the captain and the crew;
Down went the owners — greedy men whom hope of gain allured:
Oh, dry the starting tear, for they were heavily insured.[1]

Review of marine insurance

It is wrong to say that the Australian *Marine Insurance Act 1909* ("MIA") has remained immune from amendment in the nine decades since its enactment. In 1966 the Second Schedule (which sets out the text of the antique Lloyd's SG policy) was amended as a result of the introduction of decimal currency[2] and in 1973 s 2, which set out an index to the Act, was repealed.[3] The biggest change to its operation occurred in 1998 by reason of amendments to other legislation which removed the insurance of pleasure craft from the MIA.[4] The mere fact that the MIA has escaped review for so long is reason enough for it to be reconsidered in detail now. This comes as the latest of a series of insurance and shipping reviews by the Australian Law Reform Commission[5] and coincides with the

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1 WS Gilbert, "Etiquette" from *The "Bab" Ballads*, 1866-1871.
2 The *Statute Law Revision (Decimal Currency) Act 1966* (Cth) replaced the words "Five pounds per cent" and "Three pounds per cent" with the more modern formulations "five per centum" and "three per centum" respectively.
3 By the *Statute Law Revision Act 1973* (Cth).
4 Section 9A of the *Insurance Contracts Act 1984* (Cth) came into effect in April 1998.
5 The ALRC reviewed the role of insurance agents and brokers and the content of contracts of non-marine general insurance in its reports *Insurance Agents and Brokers* (ALRC 16) and *Insurance Contracts* (ALRC 20) respectively. The ALRC has also considered both civil and criminal admiralty jurisdiction and the law of prize in its reports *Civil Admiralty Jurisdiction* (ALRC 33) and *Criminal Admiralty Jurisdiction and Prize* (ALRC 48).

Commonwealth Department of Transport and Regional Affairs' review of the *Navigation Act 1912* (Cth).

The Commission is committed to seeking advice and comment from as a wide a range of sources as resources and time permit. The key group of commentators consists of the principal stakeholders: the insurers and brokers in the marine insurance market, their customers, and lawyers experienced in that line of work. To date they have been generous with their time and comments. In addition, there are quite a number of articles and other writings on the shortcomings of the present regime, suggestions on how to fix it and advice on possible reforms that should be avoided. Others in the insurance industry not involved in marine insurance may well have a valuable perspective on the issues raised in the Discussion Paper. The Commission is very conscious of the need to ensure that all sectors are involved in its consultations, not only in a representative capacity but also as individuals with experience of the functioning of the industry and the Act. It is a major concern that the consumers of marine insurance services should have the opportunity to put their views forward.

The Terms of Reference make it quite clear that this review takes place in the context of the concern of the Australian government that the effectiveness of, and competition within, the marine insurance industry within Australia be maintained or enhanced, and that the Australian industry as a whole retain or enhance its competitive position in the world market. A reform proposal that is theoretically flawless and drafted with immaculate clarity serves no-one if it fails in this fundamental respect.

Of particular interest is the current review by the Comité Maritime International of marine insurance law and practice around the world. The Commission anticipates that this will assist it in understanding the degree to which law and practice have become standardised around the law and practice of England and, perhaps more importantly, the extent to which there is variation either on fundamental points or on matters of detail. The CMI is due to report on the outcome of its international survey at its conference in February 2001, and the Commission has accordingly been granted an extension of time to complete its recommendations until the end of April 2001.

The Australian marine insurance industry does not operate in isolation. Unilateral radical reform of marine insurance law may put the Australian market's position with overseas co-insurers and reinsurers at risk. That is of itself no basis to recoil from the idea of change, even radical change, if there is good reason for it. However, in the Commission's consultations to date the response from insurers generally is not to shudder at the thought of change or to rally the forces to protect an entrenched and possibly untenable position. Rather, there has been a mature acceptance of the fact that the world has changed since 1905 when this legislation first passed through the Parliament at Westminster. This is in large part reflected by modern commercial marine insurance practices which are in some respects a far cry from the position that the MIA would allow insurers to adopt in the absence of the contrary terms in their policies. By the same token, the consumers who might

benefit from a softening of the more stringent provisions of the Act will lose that benefit if the reforms are so pro-consumer that insurers are discouraged from entering or remaining in the market, or if the reforms can be sidestepped by a contractual choice of non-Australian law.

The Commission's task, therefore, is to strike a workable and widely accepted balance between conflicting pressures:

- A desire that Australian insurance law have a streamlined and consistent statutory regime.
- A desire to retain a separate marine insurance regime for various pragmatic reasons arising out of commercial factors peculiar to marine (as distinct from non-marine) insurance.
- An apprehension that radical unilateral reform in Australia could imperil the ability of Australian marine insurers to obtain reinsurance or co-insurance from overseas sources, or the prices at which they can do so.
- A recognition that, although there is apparently a broad consistency of marine insurance law and practice internationally, there are differences, even among common law nations, in areas where it has been suggested that reform should occur. Of itself, international consistency should not dictate that the status quo be retained if there are better alternatives and there is no reason that Australia should not advance those alternatives.
- Ultimately, however, a reformed MIA that does not balance the legitimate legal and commercial concerns of insurers and their customers alike will not serve them or Australia well.

The Commission's Discussion Paper published last week[6] identifies quite a number of areas where the available literature and preliminary consultations with lawyers, insurers, brokers and some insureds have suggested that change is required. The desired degree of change and the urgency with which it is advocated vary considerably. At one extreme there are gentle suggestions that some of the MIA's more outmoded provisions should be either repealed or reworded to bring them up to date. The references to bottomry and respondentia in section 16, for example, have been branded as obsolete and ripe for removal. Some more senior practitioners, by contrast, have exhorted us, facetiously perhaps, to retain them even if only for their links with a past that now seems more romantic and adventuresome. Those pressing for modern efficiency in the legislation must, however, ensure that the removal of any apparently obsolete provision without replacement does not inadvertently leave a gap. It has been suggested that the reference to

[6] Australian Law Reform Commission Discussion Paper 63, *Review of the Marine Insurance Act 1909*, ALRC, Sydney, 2000 (ALRC DP 63).

rats and vermin in section 61(2)(c) also falls into this category, although no-one could suggest that rats and vermin are no longer a feature of shipping.[7]

Most venerable of all the Act's provisions is the suggested policy wording — the wording of the old Lloyd's SG policy — found in the Second Schedule. It is not warmly regarded and has at various times been described as

> A strange, very peculiar, absurd, incoherent, clumsy, imperfect, obscure, incomprehensible, tortuous document, drawn up with much laxity, by a lunatic with a very private sense of humour, in a form which is past praying for.[8]

But it too contains a poetry that modern texts so often lack. If it does no harm, can it not remain? A wistful nostalgia for exotic verbiage is not a valid reason to abandon reform but perhaps there is room for a Jack Mundey in the world of marine insurance terminology. More seriously, the wholesale removal of the Second Schedule would delete definitions of various expressions which may still have some effect, though subject to any contrary meaning required by the policy. These expressions range from the much debated "perils of the seas" to the more archaic "barratry" and "arrest, &c., of kings, princes and people"; the Second Schedule also helpfully defines that tricky word "from" in a particular context. In the idiom of modern statutory drafting, these provisions would find themselves in a definitions section or glossary, and perhaps that is where they should be at the end of the Commission's review.[9]

One might also ask why it is that, according to the MIA at least, all participants in marine insurance are male except the ships themselves. That might have been true when the wording of the marine insurance legislation first passed through a parliament consisting entirely of men (as, no doubt, did the world of commerce at the time) elected solely by men, but that usage does not withstand much scrutiny today. In support of the current wording, one might cite Oliver Wendell Holmes, who observed that

> A ship is the most living of inanimate things. Servants sometimes say "she" of a clock, but everyone gives a gender to vessels.[10]

Diverting as they may be, these issues do not strike at the heart of the debate about the need for reform. The Discussion Paper focuses on three principal areas where reform must be considered:

- Warranties and, in particular, the harsh impact of minor breaches, breaches irrelevant to the loss, and breaches remedied before loss.[11]
- The doctrine of utmost good faith, which finds expression most often in the insured's obligations of full disclosure and in the penalties for misrepresentation.

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7 ALRC DP 63, ch 9.
8 D O'May, *Marine Insurance – Law and Policy*, Sweet & Maxwell, London, 1993, 8, amalgamating epithets drawn from English case law.
9 See ALRC DP 63, ch 9.
10 OW Holmes, *the Common Law*, Little Brown & Co, Boston, 1881, 26.
11 ALRC DP 63, ch 5.

The scope of the doctrine itself could well be the subject of more explicit definition in the MIA.[12]

- The requirement for an insurable interest. Although this area seems to generate some heat, it may well be that the occasions where the Act appears to work unfairly are few and rather discreet. If that is so, these problems might be solved by a modest expansion of the interests that are defined to be insurable.[13]

A fourth specific area of concern is the confusion over the demarcation between contracts of insurance covered by the MIA and those covered by the *Insurance Contracts Act 1984* ("ICA"). This is a problem that arises in any jurisdiction which affords marine insurance a legal regime of its own, but its impact is exacerbated in Australia by the existence of the ICA and the major differences in the ways in which various areas of law are handled by the two Acts, not least the three areas highlighted above.

History

The legislation that we are concerned with, for all its good points, represents the commerce of an earlier time. Maritime commerce is ancient but documentary evidence of contracts of insurance or similar risk-sharing is hard to come by before the early 17th century. It is reasonable to assume that merchants in northern Italy in the early 12th century adopted some form of insurance over their property[14] and it has been conjectured that its roots can be found in the practices of the ancient Phoenicians. Its consolidation into a body of law that we would recognise may have started around the time of an Act of Parliament of 1601 by which time marine insurance was understood from "tyme out of mynde" to have been a system

> by means whereof it cometh to pass that upon the loss or perishing of any ship there followeth not the undoing of any man, but the loss lighteth rather easily upon many than heavy upon few, and rather upon them that adventure not than upon those who do adventure; whereby all merchants, especially those of the younger sort, are allured to venture more willingly and more freely.[15]

Somewhat more recently, the Australian MIA was enacted in 1909 as a more or less identical replica of the UK legislation of 1906. [16] As is well known, the UK Act distilled the common law into a single comprehensive source. Although it is said to have codified the

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12 ALRC DP 63, ch 6.
13 ALRC DP 63, ch 7.
14 W Gow, *Marine Insurance, A Handbook*, MacMillan & Co, London, 1917, 3–4.
15 43 Elizabeth, c 12. See W Gow, *Marine Insurance, A Handbook*, MacMillan & Co, London, 1917, 7–8.
16 The corresponding section numbers in the UK Marine Insurance Act 1906 can be found by deducting six from the Australian section number. The numerical difference in section numbering between the Australian MIA and the New Zealand Marine Insurance Act 1908 varies between five and six due to amendments to the NZ legislation. Although closely based on the UK Act, the Canadian Marine Insurance Act 1993, which is the most modern version of the original, has drafting changes that rule out such a purely arithmetical formula.

law of marine insurance, this is not strictly true as it expressly allows the common law to persist except to the extent that it is inconsistent with the Act's express provisions.[17]

Although the English Act has been amended, for example in 1959 to remove the invalidity of time policies for periods longer than 12 months and modifying the required content of marine policies,[18] none of these changes have been taken up in Australia. There have also been changes in similar legislation in other common law countries that have not filtered through to the Australian equivalent. Notably, the New Zealand Insurance Law Reform Act 1977 significantly modified, apart from other things, insurers' ability to rely on breaches of warranties in both marine and non-marine policies.[19] The Canadian Marine Insurance Act was enacted in 1993 in response to a Canadian Supreme Court decision that left the status of provincial marine insurance legislation uncertain.[20] The intention of the new Canadian Act was to preserve the substance of the British model while modifying its form to meet contemporary drafting standards.[21] Canadian case law also diverges in relation to warranties, perils of the sea and insurable interests.[22]

In 1976 the Attorney-General of Australia referred the matter of general insurance contracts to the ALRC but specifically excluded from that review several areas of insurance, including marine insurance.[23] The Commission reported in 1982, making numerous recommendations for reform. This resulted in the enactment of the ICA two years later.[24] The ALRC had previously reported on insurance intermediaries in its 1980 report *Insurance Agents and Brokers*,[25] which also resulted in federal legislation, the *Insurance (Agents and Brokers) Act 1984*. As insurance is a head of power expressly, though not exclusively, given to the Commonwealth Parliament by section 51(xiv) of the Australian *Constitution*, the ICA, as with the MIA, is federal legislation and provides a uniform regime throughout Australia.

The purpose of the ICA, as stated in its preamble, is to

> reform and modernise the law relating to certain contracts of insurance so that a fair balance is struck between the interests of insurers, insureds and other members of the public and so that the provisions included in such contracts, and the practices of insurers in relation to such contracts, operate fairly ...

The MIA does not have such an explicit statement of its purpose but there is no reason that the MIA should not have the same objective in its particular field of operation.

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17 MIA, s 4.

18 By the Finance Act 1959 (UK), repealing s 23(2)–(5) and 25(2) of the Marine Insurance Act 1906 (UK).

19 See s 5, 6, 11 and 14.

20 *Zararolvalna Skupnost Triglav v Terrasses Jewellers Inc and Bank of Montreal* [1983] 1 RCS 283.

21 Parliament of Canada, *Commons Debates*, 23 March 1993, 1025.

22 See ALRC DP 63, para 5.15–5.18, 5.119 and 7.10.

23 The other areas excluded were workers compensation and compulsory third party insurance. See the Terms of Reference found in Australian Law Reform Commission, *Insurance Contracts*, Report no. 20 (ALRC 20), AGPS 1982, p xv.

24 In addition to marine insurance, the ICA also excludes from its operation contracts of reinsurance, health benefits insurance, insurance effected by a friendly society or the Export Finance & Insurance Corporation, State and Northern Territory insurance, and insurance under State and Territory laws relating to workers compensation or death or injury from motor vehicle accidents. Some sections of the ICA do not apply to insurance covering the loss of or damage to aircraft during war: see s 9.

25 Australian Law Reform Commission, *Insurance Agents and Brokers*, Report no. 16 (ALRC 16), AGPS 1980.

The MIA remained unaffected by the major reforms enacted, or perpetrated, by the ICA in other areas of insurance. Almost a quarter of a century since the start of these reviews, the ALRC has the opportunity to take the torch of reform to marine insurance. The present inquiry by the ALRC is the successor to an inquiry by the Attorney-General's Department which resulted in the publication of an Issues Paper in 1997. The concerns that prompted that exercise are still alive and have been considerably expanded.

The rationale for the exclusion of marine insurance from the earlier review is not stated in ALRC 20 or in the Explanatory Memorandum to the ICA. Marine insurance was excluded presumably because it was felt that the its own statutory scheme and practice should be retained and that they should not be disturbed. The concern to maintain international consistency was no doubt an element of the thinking that left the MIA inviolate.

The MIA was violated to some extent, however, in 1998 when the ICA was amended by the insertion of s 9A, which moved non-commercial pleasure craft insurance from the MIA to the ICA. This can be seen as consistent with an overall understanding that the pro-consumer ICA is appropriate for non-commercial insurance (though many forms of commercial insurance are covered by it as well) while ***commercial*** marine insurance still warrants its traditional special status.

The basic question facing the ALRC is whether commercial marine insurance still warrants that status, whether it should be covered by the ICA (as is aviation and land transport insurance, with the exceptions noted above), or whether there is a more appropriate median position where the MIA is retained as a separate legislative scheme but with amendments that may, for example, incorporate provisions from the ICA or at least in some way bridge the gap between the two.

If it is felt that marine insurance warrants a special scheme that retains for marine insurers certain benefits and protections not available to their non-marine colleagues — and that may well be so — that position must ultimately be defensible by sound rational argument supported where possible by empirical evidence, as should any reform that the Commission might ultimately recommend. The conclusion that marine insurance warrants special consideration is not self-evident, at least not to those unconnected with marine insurance, and the ALRC is mindful of the fact that its constituency is the whole of the Australian public.

Warranties

Of the three principal areas in which the ALRC is contemplating reform, the first is warranties. In a warranty, the insured undertakes that something will be done or not done, that certain conditions will be fulfilled, or that a certain state of facts exists or does not exist.[26] A warranty must be complied with exactly. If it is not, the insurer is automatically dis-

[26] MIA, s 39(1).

charged from liability from the date of the breach although without any prejudice to any liability incurred by the insurer before that date.[27] The discharge from liability is automatic and does not require an election, express or implied, by the insurer. Furthermore, a breach of warranty cannot be remedied with the effect that the insurer's liability is revived upon the completion of the remedial activity.[28] This statutory position may be varied either by the policy or by waiver by the insurer.[29] Warranties may be express or implied; an express warranty will supplant any implied warranty to the extent of any inconsistency.[30] The Act goes on to imply in every policy of marine insurance, subject to any contrary express provision in the policy, two warranties: those of seaworthiness and legality.[31] The Act interprets certain other warranties if they are expressed in the policy, namely those of neutrality and good safety,[32] and states that there is no implied warranty in relation to nationality and seaworthiness of goods.[33]

Major criticism in this area has focussed on the harsh operation of warranties, especially the fact that a trivial breach, or one that is irrelevant to any claim under the policy, gives rise to an automatic discharge of liability on the part of the insurer irrespective of the insured's state of mind and any attempts by it to remedy the breach, an outcome that could be entirely disproportionate to the scale and effect of the breach. Suggested and actual reforms in this area seek to soften this harshness by introducing notions of proportionality or causation. These require a causal link between the breach and the insurer's discharge from liability, or limit the remedies available to the insurer to a degree that reflects the prejudice actually suffered by it as a result of the breach. In either case, a trivial breach or one irrelevant to an insured loss would result in no or minimal diminution of the insurer's liability.

A further possible amendment would be to allow the insured to remedy the breach and thus revive the insurer's liability under the policy, though that may be unnecessary if either or both of the elements of causation and proportionality are introduced. The policy could be treated as being suspended for the duration of the breach but reactivated when the breach is remedied. This is similar to an approach adopted by courts in Canada and the USA where the harsh impact of a breach of warranty has led to a construction of these clauses that is not necessarily in keeping with the clear wording of the statutes and the policies in question. It has been said that on occasion Canadian courts have disregarded the statute and "the plain words" of the policy, including clauses that commenced with the words "warranted", to do "what it perceived as fair".[34]

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27 MIA, s 39(3).
28 MIA, s 40(2).
29 MIA, s 39(3) and 40(3).
30 MIA, s 39(2) and 41(3).
31 MIA, s 45 and 47 respectively.
32 MIA, s 42 and 44 respectively.
33 MIA, s 43 and 46 respectively.
34 C Giaschi, 'Warranties in Marine Insurance', *Paper*, Association of Marine Underwriters of British Columbia, Vancouver, 10 April 1997, discussing *Century Insurance Co of Canada v Case Existological Laboratory Ltd (The Bamcell II)* [1984] 1 WWR 97. See also the other cases and articles referred to in ALRC DP 63, para 5.17–5.20.

In addition to the innovative approach of North American courts there have been several statutory approaches to reform in this area. Most notably, s 11 of the Insurance Law Reform Act 1977 (NZ) provides that the insured remains entitled to be indemnified if there is a breach of warranty if he or she proves on the balance of probabilities that the loss was not caused or contributed to by the breach. This section introduces an element of causation but puts the onus on the insured to demonstrate that there was none. Although this provision is not to be read down by anything in the Marine Insurance Act 1908 (NZ),[35] I understand that recent cases have now read down the impact of this provision significantly in the context of marine insurance. An approach similar to s 11 received the endorsement of the Insurance Council of Australia in its submission to the Attorney-General's Department in 1997.

An alternative approach is found in s 18 of the *Insurance Act 1902* (NSW). This section permits a court to excuse a breach by an insured of a term or condition of a contract of insurance if it appears to the court that the failure may reasonably be excused on the ground that the insurer was not prejudiced by it. However, that provision, being found in State legislation, cannot apply to contracts of insurance subject to Commonwealth legislation and is, therefore, of limited effect overall and almost none in the area of our present enquiry. There has been some support for an approach along these lines in preference to the more complex and problematic reforms effected by s 54 of the ICA.

Under s 54, an insurer cannot refuse to pay a claim by reason of an act of the insured or somebody else after the contract was entered into, but its liability is reduced by the amount that fairly represents the extent to which its interests were prejudiced as a result, provided that the act could not reasonably be regarded as capable of causing or contributing to the loss. An insurer's liability can be reduced to zero if it can prove that it would not have entered into or persisted with the contract had the breach not occurred.[36] Acts necessary to protect a person's safety, to preserve property or which could not reasonably be avoided are excused by s 54(5). By way of contrast, s 40 of the MIA only excuses non-compliance where the warranty ceases to be applicable to the circumstances of the contract or where compliance is subsequently rendered unlawful. Section 54 introduces an element of proportionality but is rather complex and has been the subject of much litigation.

Alternative approaches include a suggestion that the concept of warranty be dispensed with and replaced by an obligation on the insured to notify the insurer of any change in the circumstances which form the basis of the contract of insurance and which would alter the risk.[37] The UK Law Commission recommended in 1980 that the insurer should be entitled *prima facie* to reject a claim for breach of warranty but that the insured

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35 Insurance Law Reform Act 1977 (NZ), s 14.

36 See *Ferrcom Pty Ltd v Commercial Union Assurance Co of Australia Ltd* (1993) 176 CLR 332 and other cases referred to in ALRC DP 63, para 5.45–5.54.

37 S Derrington, 'The Law Relating to Non-Disclosure, Misrepresentation and Breach of Warranty in Contracts of Marine Insurance: A Case for Reform', *Ph D Thesis*, University of Queensland, November 1998, 336-338.

be entitled to recover the loss if it can prove either that the warranty was intended to reduce the risk of a particular class of loss of which the actual loss was not a member, or that the breach could not have increased the risk of the loss in the way in which it occurred.

Irrespective of the manner in which warranties generally might be reformed, there is a body of opinion that the statutorily implied warranties of seaworthiness and legality should be handled differently.

The warranty of seaworthiness is expressed differently in relation to voyage and time policies and policies on goods.[38] This distinction and the concept of seaworthiness in stages are said to be out of date.[39] The distinction between different types of policies is certainly not essential, appears to have no relevance in any other context and may have lost whatever practical utility it had with the abolition of stamp duty on marine insurance policies. The Norwegian Marine Insurance Plan does not make the distinction.

The warranty of legality is two-fold: it requires the adventure to be lawful and to be carried out in a lawful manner, so far as the insured can control it. This distinction does not, however, appear to have any practical effect and does not lead to any difference in penalty in the event of breach. One suggested change is to provide for different penalties to flow from the pursuit of an illegal voyage and from its conduct in a manner which breaches technical or other regulations. For example, a loss resulting from the ship's use for illegal purposes discharges the insurer from liability under the Norwegian Marine Insurance Plan but a breach of a technical regulation does not.[40] One variation may be to discharge the insurer from all liability in relation to a voyage conducted for an illegal purpose but otherwise to allow the warranty to be handled in the same way as other warranties if elements of causation or proportionality are introduced generally.

As a brake on reform in this area, a number of commentators have expressed concern that the two statutorily implied warranties should be retained because they support the public interest in the observance of a multitude of safety, technical and anti-pollution conventions. Their argument is that the threat of a severe and immediate financial impact on the insured in the event of a breach of any of these codes gives the insured a direct, strong and effective incentive to observe them. This incentive arises without the need to invoke the authorities of either the port state or flag state.

Utmost good faith

The expression "duty of utmost good faith" is not found in the MIA. Section 23 states that a contract of marine insurance is "based upon the utmost good faith". Some com-

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[38] See MIA, s 45(1), 45(5) and 46(2).
[39] ALRC DP 63, para 5.68, 5.77, Draft Proposal 5.
[40] ALRC DP 63, para 5.84–5.86, Draft Proposals 6–8.

mentators, notably Bennett, have suggested that "doctrine" is a better label than "duty".[41] However it is tagged, this concept manifests itself in a number of duties visited on both parties. The most obvious manifestations fall on the insured and are the insured's duty of full disclosure before the contract is concluded and its duty to refrain from misrepresentation. The remedy available to the underwriter is the avoidance of the contract from its outset with the return of premium (except in the case of fraud).[42] The Act provides for no intermediate position. This can lead to harsh outcomes where the breach was relatively minor.

Much of the modern debate in this area has centred on the test of materiality. Until the 1990s the accepted test was objective: the standard of materiality was determined by reference to a notional prudent insurer and without reference to the state of mind of the actual insurer. This allowed inept insurers to avoid all liability under their contract, even in relation to claims that were otherwise valid and had no connection with the misrepresentation or non-disclosure. In extreme cases, the law would have allowed them to underwrite anything, accept the premium and then avoid those contracts they wished to avoid when this opportunity presented itself without bearing the consequences of their own ineptitude.

The House of Lords in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*[43] added a second element to the test. In addition to an assessment of the impact of the non-disclosure or misrepresentation on the mind of a hypothetical prudent insurer, the House of Lords now requires the court to determine whether the non-disclosure or misrepresentation in fact induced the actual underwriter to issue the policy.

The second aspect of materiality is the extent to which the material circumstance influenced or would have influenced the prudent or actual underwriter. There is dispute as to whether the requisite degree of materiality is reached if the circumstance in question would have influenced the insurer's mind to some extent or whether that influence must have been decisive. The House of Lords rejected the decisive influence test in *Pan Atlantic* though a somewhat different test was applied by the English Court of Appeal in *St Paul Fire and Marine Insurance Co (UK) v McConnell Dowell Constructors Ltd.*[44] That test was rejected by Justice Byrne in the Victorian Supreme Court in *Akedian Co Ltd v Royal Insurance Australia Ltd.*[45] Justice Byrne followed the test formulated by Justice Samuels in the NSW Supreme Court in *Mayne Nickless v Pegler*[46] and followed elsewhere.[47] Justice Samuels determined that a fact is material "if it would have reasonably affected the mind of the prudent insurer in determining whether he will accept the insurance, and if so, at what premium and at what conditions". This is broadly consistent with the decision of the New Zealand High Court in *Quinby Enterprises (in liq) v General Accident Fire and Life*

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41 H Bennett, "Mapping the Doctrine of Utmost Good Faith in Insurance Contract Law", [1999] LMCLQ 165, 166. See ALRC DP 63, para 6.4 and the other reference cited in fn 3.
42 MIA, s 90.
43 [1995] 1 AC 501.
44 [1995] 2 Lloyd's Rep 116, 112-4.
45 (1997) 148 ALR 480.
46 [1974] 1 NSWLR 228, 239.
47 See ALRC DP 63, para 6.19.

Assurance Corporation Public Ltd,[48] where the Court held that the relevant test since *Pan Atlantic* is "whether the relevant information would have had an effect on the mind of a prudent insurer in weighing up the risks".

The ICA has altered the law in this area for non-marine general insurance in a number of ways. Firstly, although the ICA uses the word "duty" (rather than "doctrine") albeit only in the heading to s 13, the text of that section simply states that a contract of insurance "is based on the utmost good faith", reflecting s 23 of the MIA. But s 13 goes further, implying into the contract a provision requiring each party to act towards the other with the utmost good faith in respect of any matter arising under or in relation to the contract. This is expanded in s 14: the parties cannot rely on the provisions of the policy if to do so would be to fail to act with the utmost good faith. The characterisation of the duty as a contractual term presumably makes damages and other contractual remedies available to the parties (at least to the extent permitted by the ICA), which of itself offers more flexibility than the current regime under the MIA.

The original formulation of the duty of disclosure in s 21 of the ICA when it was first enacted was amended in 1998 by the introduction of s 21A. Section 21 required the insured to disclose every matter known to it that it knew to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms or that a reasonable person in the circumstances could be expected to know to be relevant in that way. Although regarded by some as a compromise between an objective and a subjective test, it nonetheless placed a burden on the insured to determine what might be relevant to an insurer's (ie, someone else's) decision. Section 21A now requires an insurer to put to an insured specific questions that the insurer feels are relevant to the risk and to request expressly that the insured disclose each "exceptional circumstance" that the insured knows or could be expected to know to be relevant to the insurer's decision. Proper replies to these questions discharge the duty of disclosure.

Section 18A of the *Insurance Act 1902* (NSW) similarly modifies the position but puts a similar burden on the insured (or a reasonable person in the insured's position) and is subject to the same criticism in that respect as s 21 of the ICA. Under s 18A a contract of insurance is not void or voidable because of a false or misleading statement unless it was fraudulent or the insured knew (or reasonable person in its position ought to have known) that the statement was material to the insurer in relation to the contract of insurance or, if there is an omission, if the omission was deliberate or the insured knew (or a reasonable person in its position ought to have known) that it was material to the insurer in relation to the contract.[49]

The Law Commission of New Zealand reviewed this issue in 1998.[50] It declined to adopt s 21 of the ICA but it nonetheless considered abolishing the duty of disclosure and

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[48] [1995] 1 NZLR 736, 740.
[49] As this is State law only, note the restriction on its operation referred to on page 9 above.
[50] Law Commission, *Some Insurance Problems* (Report 46), Wellington, 1998, 1–18.

replacing it with an obligation to answer questions correctly.[51] However, it concluded that this was an inappropriate avenue for reform because it would interfere unduly with existing commercial practices that make it impractical for insurers always to obtain answers to questions before they take on a risk.

Finally in relation to the doctrine of good faith, there is uncertainty as to the extent that the doctrine imposes duties on the parties after the formation of the contract and, if it does, to what point.

Insurable Interests

The distinction between insurance and gambling has long been seen as a rather fine one. Prior to the Marine Insurance Act 1745 (UK) there was no legal requirement that the insured have any connection to the insured adventure and, therefore, the distinction effectively did not exist. Since then, however, insurable interests have been the defining factor between these two forms of speculation. An insurable interest, or an expectation of acquiring one, is necessary for the contract to be valid.[52] Section 11(2) of the MIA specifies that an insurable interest exists when the insured has a legal or equitable relationship to the insured adventure such that he will benefit from its safe arrival or suffer from its loss, damage or detention or may incur a liability to a third party as a result of its loss, damage or detention. It is not necessary to be an owner to have an equitable interest. Mortgagees, lessees, trustees, the lenders of money on bottomry or respondentia bonds, mortgagors and a number of others have an insurable interests as determined either by the courts or the statute. The definition nonetheless has two elements, both of which must be satisfied. There must be a legal or equitable connection and the insured must suffer or lose a benefit as a result of the insured incident. The mere suffering of financial loss is insufficient.

Contrast this with the position under s 16 and 17 of the ICA. Under s 16, an insurable interest is not required when the contract is entered into. This reflects the position in the MIA to a certain extent; the MIA requires an expectation that the insured will acquire such an interest if it does not have one when the contract is concluded.[53] Nonetheless, the insured must hold that interest at the time of the loss under s 12(1) of the MIA. Under the ICA, however, that is not required: it is sufficient that the insured suffers a pecuniary or economic loss because of the damage to or destruction of the subject matter of the contract.[54] Accordingly, by virtue of these differences, there are cases where insureds may recover under the ICA but not under the MIA. One such group are cargo owners who contract on FOB terms but find that in fact the cargo was never loaded aboard the vessel although they paid for it. Because they do not take a legal or equitable interest in the

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[51] The Law Commission of NZ did not consider s 21A of the Australian ICA, which had apparently not yet been enacted when the Law Commission was preparing its report.
[52] MIA, s 10(1) and (2).
[53] MIA, s 10(2)(a).
[54] Section 17.

goods until the time of loading, they do not have the appropriate connection with the insured property when the loss occurs before loading, but suffer financially nonetheless.[55]

This position may be remedied by the inclusion in the policy of "lost or not lost" clause, which is specifically permitted by the MIA[56], or by the inclusion of warehouse-to-warehouse or FOB or C & F preshipment clauses in the policy. It has been argued that the nature of commerce involving goods carried by sea makes the strict requirement for insurable interest necessary in marine insurance. For example, the repeated on-sale of goods and the assignment of the policy while the goods are in transit necessitate its retention to ensure that only appropriate insureds who both suffer loss ***and*** have the appropriate interest when the loss occurs recover under the policy. The same importance is apparently not attached to this requirement in relation to the insurance of goods carried by other means (which in Australia is governed by the ICA or the common law) though it is possible that the length of transit in sea carriage and the practice of the repeated assignment of goods and policies during transit may account for the particular importance attached to it in the marine context.

The mere fact that the ICA exists adds a dimension to the ALRC's present enquiry that does not arise in other common law countries, at least not to the same extent. The Commission must deal with an argument that it is desirable that all general insurance be governed by the same regime. If the differences between marine and non-marine insurance law are to be maintained into the 21st century, those differences need to be strongly supported in theory and in practice by the way in which maritime commerce and insurance are transacted both within and outside Australia. Because the bases of the exclusion of marine insurance from the earlier reviews of non-marine insurance in the 1970s and 1980s were never stated, it is important that these differences be considered in detail in this enquiry. If its research demonstrates that there is a significant difference in the commercial background of the two regimes, the Commission should advocate the retention of separate regimes where this will legitimately further and balance the interests of all parties. Any perceived neatness or theoretical simplicity in having a single statutory scheme can only ever be a subsidiary objective and must be secondary to the conclusions determined by detailed pragmatic and empirical analysis of the business of marine insurance.

This enquiry also raises the question of the extent to which it is appropriate for government to interfere in the detail of private commercial contracts. It may well be that the 1998 amendments by which the insurance of the largest single identifiable group of non-commercial vessel interests (pleasure craft) was placed into the ICA achieves an overall objective of consumer protection. If what is left to be governed by the MIA is essentially commercial insurance only, a different philosophy might be validly applied.

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[55] The most important Australian case on this point is *NSW Leather Co Pty Ltd v Vanguard Insurance Co Ltd* (1990) 103 FLR 70 (Carruthers J); (1991) 25 NSWLR 699 (NSW Court of Appeal).

[56] Section 12(1). On this basis the insured ultimately succeeded on appeal in *NSW Leather* (1991) 25 NSWLR 699.

How far then should government intervene in the content of private commercial transactions? If the Commission's review reveals no evidence of systematic profiteering from an apparently one-sided regime, and if it is demonstrated that marine insurers are in practice subject to market forces and are as a result often unable or unwilling to take advantage of some of the benefits given to them by the MIA, can it not be argued that wholesale reform is inappropriate and that market forces and self-regulation already achieve a largely satisfactory outcome? That is not to say that there cannot be some improvement, but in this scenario those improvements would be minor and still leave Australia with a familiar regime but one in which certain provisions were softened to avoid unfairness in certain circumstances.

Conclusion

The issue is one of balance. Few have argued that there should be no change to the MIA. However, there has been a strong statement that the MIA should not be transformed into an alien creature that none of us recognise. Rather, it is suggested that it should be morphed into a finer version of its familiar self. It is clear that the international marine insurance market already tolerates a fair margin of divergence from a standard marine insurance contract and there is no need to shy away from change simply on the basis of an attachment to a British norm.

It is premature for the Commission to state a view as to the course that it thinks reform should follow. The Commission intends to canvass the spectrum of possible changes to ensure that broad public debate is encouraged and that its recommendations next year will take into account and balance as a wide a range of opinion as possible. Where appropriate, Australia should not be afraid to take a lead on reform to marine insurance law where that change is seen to be right. The question for judgment is to assess the extent to which Australia should move ahead of, or away from, an international norm, to the extent that any such creature can be identified.