INSTITUTE CARGO CLAUSES – SOME UNDERLYING ISSUES

JOHN McKELVIE
MARINE UNDERWRITER
INTERNATIONAL MARINE INSURANCE
AGENCIES LIMITED
AUCKLAND

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John McKelvie[1]

Introduction

The "Institute Clauses" are London market clauses. They are used throughout much of the Commonwealth, and are known in the rest of the world. This is principally because London was the primary world marine insurance market before the growth of indigenous insurance markets. Now the situation is reversing: London is looked to more as a reinsurance centre.

The Institute of London Underwriters (ILU) was formed in 1884 as an organisation of marine insurance underwriters, drawn from the companies' and Lloyd's markets. Changing times brought with them the need to produce new standard clauses to supplement the wording of the S.G. Policy (Ships & Goods) form[2] where that wording was inappropriate or inadequate for contemporary needs. The first Institute Cargo Clauses were published in 1912. The Clauses have been the work of the ILU Technical and Clauses Committee, which included representatives of both Lloyd's and marine insurance company underwriters.

In November I978 the Legal Secretariat of the United Nations Conference on Trade and Development (UNCTAD) published a report on marine insurance contracts throughout the world, and in particular the London system[3]. This Report gave an international impetus to some scathing judicial criticisms, particularly concerning the area of policy coverage. UNCTAD proposed the establishment of an ad hoc group of experts to examine the existing arrangements for national marine insurance with the aim of getting conditions, practice and legislation standardised on an international basis as far as possible, as had the participants at the Warsaw Convention sought to do 50 years earlier in the context of international contracts for carriage by air. The old language was to be removed, and new policies devised in intelligible terms, preferably in an international forum. This no doubt was part of the wider geo-political movements afoot of that time which delivered the Hamburg Rules. UNCTAD sensibly suggested reforms that would convert the London clauses for international use, rather than draft an entirely new set. At that time it was thought that a set of new international cargo and hull clauses would not be accepted by the established marine insurance markets. The UNCTAD Model Clauses were the result, and they still have yet to achieve any great degree of usage.[4]

The response of the Institute and the Corporation of Lloyd's to the criticism and the United Nations Report was to publish a new simple form of policy and a new set of Clauses.[5] A new type of policy form called the MAR[6] form was introduced with effect

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[1] Operations Manager, International Marine Insurance Agency Ltd. - Royal & Sun Alliance New Zealand Ltd.

[2] originally introduced in 1779.

[3] Report into the Legal & Documentary Aspects of the Marine Insurance Contract - TB/B/C4/ISL/27 20th Nov 78

[4] The London market assisted in this process: the Technical & Clauses Committee of the ILU worked with the International Shipping & Legislation Working Group of UNCTAD in the preparation of the UNCTAD Model Clauses.

[5] It should be noted here that the UNCTAD pressure was less noticed by the US marine insurance industry, who still continue with some arcane wordings.

from 1 January 1982. Instead of a policy form with pre-typed clauses, the MAR form was more modular shell, with 'units' of clauses that could be added. After a transitional period of 15 months when both the old form or the new form of policy were used, the new policy form and clauses were recommended for use from 1 April 1983.

These 1982 Cargo Clauses have not been revised since. In contrast, Incoterms have a much more recent history and significance, and have an accepted tradition that they are revised by the International Chamber of Commerce every ten years, to match new commercial realities. In a similar fashion, an international and public review of a series of established Cargo Clauses could be a healthy mechanism for cargo insurers throughout the world. The major distinguishing features between Incoterms and Cargo Clauses are that Incoterms are not the absolute core commercial contract but more of an expression of common ground; and there is a willing international body fostering their usage.

There are now definite signs of the Cargo Clauses' age. As an example, the Institute Frozen Food Clauses (A) (Excluding Frozen Meat) 1/1/86 seem geared only for machinery breakdown in the hold of a dedicated refrigerated vessel. There is are no dedicated clauses for goods carried in containers. The level of temperature variance cover given due to the "breakdown of refrigerating machinery resulting in its stoppage for a period of not less than 24 consecutive hours" is overtly restrictive for product in refrigerated shipping containers.[7] The containerisation of frozen and chilled product has increased dramatically since the 1980s. Reefer containers more commonly malfunction by a few degrees or so, are failed to be plugged into a supply of either cold air or electricity, or are set incorrectly by third parties. Today we live in a world of much tougher food regulations.

The London insurance market has previously answered outsiders' criticism of the Institute Clauses by stating that these clauses are London clauses. They are subject to English law & practice.[8] They are intended for the use of London insurance practitioners. The London market, like many other insurance markets, is subject to severe competition and has been for many years. Currently the power of intermediaries is such that revision, if it took place, might not be accepted. We have already seen this with the less than wholesome uptake of the newer 1995 Institute Time Clauses Hulls.[9] The Cargo Clauses form an admirable base for scripting specific wordings, and there has never been any strong suggestion from London that to do so is breaking some sort of faith, nor any serious suggestion that anyone outside of London should not be using their clauses.

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[6] MAR is short for MARINE.

[7] Entire holds of vessels are able to maintain a colder temperature for longer in the absence of active refrigeration. The severe curtailment of cover for containerised cargo was recognised at the outset by the scripting of the non-Institute Frozen Food Extension Clauses 1/1/86.

[8] Apparently the intention is not that "any dispute arising out of this insurance must be decided by an English judge or arbitrator sitting in England. What it does mean is that if any such dispute arises the judge or arbitrator will be bound to apply principles of English law to the resolution of the dispute and the parties will be entitled to call in aid evidence of English market practice if an English Court would admit such evidence as an aid to resolving the dispute." - "The Institute Cargo Clauses (Air) - Henry Brooke, QC MA, Inner Temple, Barrister - 1st edition, Witherbys, 1986.

[9] These newer clauses introduced an exclusion for a lack of due diligence by onshore staff, who are often the root cause of poor maintenance and other claims.

London is now less of a direct insurance market. In time, any worldwide cargo clauses should be the creation of their wider audience. Developing new clauses for the facilitation of world trade will be a difficult exercise given the competitive insurance market structures today. In particular, the growing storm clouds above the various Commonwealth Marine Insurance Acts threaten some of the common ground.[10] It appears that the original UK Act is under less of a spotlight, which does not augur well for Cargo Clause reform.

Indemnity and valued policies

> *"A contract of marine insurance is a contract of indemnity i.e. the amount recoverable is measured by the extent of the assured's pecuniary loss."*[11]

This is a basic but wide definition. What I hope to show is that the always wider judicial use of the word "damage" has now somewhat swamped marine insurers' intention to only cover immediate physical loss or damage.

Valued policies have their origin in insurances on British colonial produce. Invoices could not be produced until the goods had reached their trading market, so a prior valuation was adopted that would indemnify planters in the event of cargo loss. This practice was convenient as it allowed both merchants and their insurers to include in the valuation a fair profit on goods, and the practice expanded from the tobacco and other trades to other classes of goods to which the original reasons for adoption did not apply.

> *"Where the value is stated in the policy in a manner to be conclusive between the two parties, the insurer and the insured, as regards the value, then in respect of all rights and obligations which arise upon the policy of insurance, the parties are estopped..." from disputing the value stated."*[12]

In Goole and Hull Steam Towing Co. Ltd. v Ocean Marine Insurance Co. Ltd. (1927)[13] Mackinnon J. stated that a contract of marine insurance was often said to be a contract of indemnity. In the 4th Edition of *Marine Insurance*[14], the editors commented:

> *"... yet it must always be remembered that it was not a contract of indemnity ideally, but of an indemnity according to the conventional terms of the bargain. When a loss had happened, the question was hardly ever: 'How much is the assured out of pocket?' That might appear to be a proper question if the object of the contract was to provide an ideal indemnity. The real question in any case was: 'What is the measure of indemnity which by the convention of the parties had been promised to the assured?' That might in some cases be less than an ideal pecuniary indemnity, and in some cases it might be more."*

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[10] Marine warranties and insurable interest are two particular issues currently under national law reform scrutiny.

[11] "Marine Insurance", E R Hardy Ivamy, 4th Edition, p4.

[12] Cockburn CJ, North of England Ins. Assoc. v. Armstrong (1870) LR 5 QB at p248 - as quoted by Arnould, Marine Insurance 16th Edition vol. 1 p 292.

[13] Goole and Hull Steam Towing Co. Ltd. v Ocean Marine Insurance Co. Ltd. (1927) (1927) 29 LIL Rep 242, KBD.

[14] "Marine Insurance", E R Hardy Ivamy, 4th Edition, p7.

An example of this imperfect indemnity due to valued policies was given by MacKinnon J. in relation to the partial loss of goods:

> *"When a partial loss occurs, there are various conventional bases for ascertaining the measure of indemnity that is promised. In the case of goods, you have to find the proportion of the damaged value to the sound value of the goods and apply that to the insured value, or the insurable value. That again may well result in an artificial indemnity differing from the real pecuniary loss to the assured, as for instance, supposing, as well may be, the valuation includes freight payable at the destination and the particular average loss of goods in question is a total loss of part of the insured goods in the course of a voyage; upon them no freight would have to paid, and to that extent in recovering the insured value of those goods the assured would be making an actual profit; that is to say, there is an artificial measure of indemnity which differs from the real."*

Perhaps there was a comfortable assumption for insurers in these older English cases: that indemnity, valued policies and the *prior* intention of the parties as concerns damage or loss were inextricably bound together.

The widening of "All Risks"

The perils which were identified in the S.G. Policy went back to the days of eighteenth century sailing ships. In 1912 the Institute's first Cargo Clauses included "all risks" cover, subject to defined exceptions in the wording or in the then new Marine Insurance Act 1906. The principle behind this "all risks" cover was that if goods were shipped in good condition and arrived damaged there was prima facie evidence of loss by an insured peril. If the underwriter wished to avoid liability, the burden of proof lay on him to prove that the loss in fact occurred in some way for which he was not liable under the terms of the policy.

Lord Sumner gave an exposition of the meaning of the term "all risks" in 1921:[15]

> *"All risks" has the same effect as if all insurable risks were separately enumerated; for example, it includes the risk that when it happens to be raining the men who ought to use the tarpaulins to protect the wool may happen to be neglecting their duty. This concurrence is fortuitous; it is also the cause of the loss by wetting. It appears to be what happened. For wool to get wet in the rain is a casualty, though not a grave one; it is not a thing intended but is accidental; it is something which injures the wool from without; it does not develop from within. It would not happen at all if the men employed attended to their duty."*
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> *"There are, of course, limits to "all risks". They are risks and risks insured against. Accordingly the expression does not cover inherent vice or mere wear and tear...It covers a risk, not a certainty; it is something which happens to the subject-matter from without, not the natural behaviour of that subject-matter, being what it is, in the circumstances under which it is carried. Nor is it a loss which the assured brings about by his own act, for then he has not merely exposed the goods to the chance of injury, he has injured them himself. Finally the description "all risks" does not alter the general law; only risks are covered which it is lawful to cover, and the onus of proof remains where it would have*

[15] British & Foreign Marine Insurance Co Ltd v Gaunt (1921) 2 AC 41 at pp.57-8.

been on a policy against ordinary sea perils."

Some of the types of loss which, as Lord Sumner explained, will not be covered by an "all risks" policy, are now express exclusion clauses in the Institute Cargo Clauses (A). While insurers can avoid liability by relying on one of these exclusions, with the burden resting on them to prove that the loss or damage was caused by an excluded event, Lord Sumner described the assured's onus of proof:

> *"I think, however, that the quasi-universality of the description does affect the onus of proof in one way. The claimant insured against and averring a loss by fire must prove loss by fire, which involves proving that it is not by something else. When he avers loss by some risk coming within "all risks", as used in this policy, he need only give evidence reasonably showing that the loss was due to a casualty, not to a certainty or to inherent vice or to wear and tear. That is easily done. I do not think he has to go further and pick out one of the multitude of risks covered, so as to show exactly how his loss was caused. If he did so, he would not bring it any the more within the policy."*

The 1963 Cargo Clauses actually had "All Risks" in the title of their widest set of clauses. However, the 1982 revision conformed to a more structured A, B, and C format which replaced the "All Risks", "With Average" and "Free of Particular Average" Clauses.[16]

Apparently the use of "All Risks" in the actual title was deemed (and criticised by UNCTAD as such) as too 'confusing'. Nevertheless, the 1982 Institute Cargo Clauses (A) continued with the all risks formula by stating in clause 1:

> *"This insurance covers all risks of loss of or damage to the subject-matter insured except as provided in Clauses 4, 5, 6 and 7 below."*

Clause 4 details the main exclusions such as delay, inherent vice and insufficiency of packing. Clause 5 excludes unseaworthiness of the carrying vessel. Clauses 6 and 7 exclude war and strikes damage respectively. [17]

This formula of an inclusive cover with a set of exclusions such as the 1982 clauses, with insurers having to prove one of those exclusions to escape liability, still achieves a fair balance of risk, which in itself is no mean feat.

World trade and world trade patterns have expanded significantly since 1982. It is now more commonplace in more countries to trade internationally as well as service local markets. International trade is now just more international. Both Australia and New Zealand have changed their trading patterns away from Europe, and, in particular Britain. There is a much wider international merchant community. The transportation and trade finance industries are larger and more diverse. All less inclined to take the time to research a market's insurance jargon.

The phrase "all risks of loss of or damage to the subject-matter insured" to many without a knowledge of insurance terminology means all and any unhappy circumstance that can befall a cargo. The phrase itself does not make the London underwriters' clear intention to others (at least who are not privy to their market

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[16] "Average" is the old term for damage; and "Particular Average" means partial damage.

[17] These specific risks can be covered by separate Institute Clauses. War damage whilst the cargo is on land is still excluded.

practices or "rules of thumb") that the cover is limited to only the consequences of accidental and external risks. One example of the London interpretation is:

> *The "loss" covered by the policy is simply the loss of the "subject-matter", i.e. the insured goods: the expression "loss" does not include any loss of profits or other consequential loss resulting from their loss or damage.*[18]

Similarly, in "The Institute Clauses Handbook"[19], when discussing *"loss or damage to"* of ICC(A):

> *"This expression comprehends all physical loss or damage to the goods. It does not include financial loss unaccompanied by any physical loss or damage, such as loss of market, even though the cause of the financial loss was a peril insured against."*

Clause 1 of the Institute Cargo Clauses (Air) has the same phraseology to the ICC(A):

> *"This insurance covers all risks of loss or damage to the subject-matter insured except as provided in Clauses 2, 3 and 4 below"*

These textbooks were written by experienced London market practitioners. Based no doubt on their market practice, it is unnecessary to define "damage" any further, as it is their insurers' intention at least that this word is so limited. This insurer intention does not appear to have been that obvious to judges, and in particular to judges outside the United Kingdom.

It should be noted here that the UNCTAD Model Clauses (Geneva 1987) have "All Risks" in their title; but in Section A Coverage, the wording is as follows:

> *"This insurance covers all risks of <u>physical</u> loss of or damage to the insured cargo, unless the insurer proves that one of the exclusions in Part B applies."* [20]

An example of this gradual judicial widening of the scope of "all risks" has been the treatment of the word "damage" in the Institute Clauses is the judgement of the Supreme Court of Tasmania in <u>Ranicar v Frigmobile & Royal Insurance (1983)</u>.[21]

The facts of this case are worth stating because these are common circumstances, in particular for many Australian and New Zealand produce exporters. The Institute clauses in question were the predecessors to the 1982 clause, but the 'all risks" formula was the same and the phraseology of damage was similar:

> *"This insurance is against all risks of loss of or damage to the subject-matter insured but shall in no case be deemed to extend to cover loss damage or expense proximately caused by delay or inherent vice or nature of the subject-matter insured ..."* [22]

Ranicar were fish processors and exporters, who contracted to export frozen scallops to a Canadian importer. Frigmobile were transport operators who took the scallops to

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[18] "The Institute Cargo Clauses (Air)" - Henry Brooke.
[19] Hudson & Allen, Lloyd's of London Press, 1986.
[20] Underlining added
[21] <u>Ranicar v Frigmobile & Royal Insurance (1983)</u> 2 ANZ Insurance Cases p60-525.
[22] Institute Cargo Clauses (All Risks) 1963

Melbourne to load for export to Canada. Whilst on the wharf in Melbourne, they were examined by an official who found that the scallops were at a temperature of between -6°C and -12°C. The fish export regulations however required the temperature to be no higher than -18°C. The cargo was rejected for export. Ranicar were able to sell the scallops on the local Australian market, but for a lesser amount than they would have received from the export sale.

Ranicar sought damages for a breach of a term in their contract with Frigmobile. One of the conditions of carriage was that Frigmobile would transport the scallops from Tasmania at -21°C or lower. Condition 3 of the Conditions of Carriage stated:

> *"The Carrier is not a common carrier and will accept no liability as such. The goods are carried at the risk of the owner and not the Carrier. The Carrier shall not be liable in respect of the loss of any damage whatsoever to any goods while the goods are in the custody or under the control of the Carrier or its sub contractor. The Carrier shall not be liable for any consequential loss or damage which may be sustained by the owner of the goods. The loss referred to shall mean and include without limiting the foregoing loss or damage caused by the negligence or wilful act or default of the Carrier or others whether or not such loss or damage is foreseeable or contemplated by the Carrier."*

Ranicar, in a second action, sought indemnity under their insurance policy for "loss of or damage to" the scallops.

In both actions, the central issue was whether there had been any damage to the scallops, within the meaning of both the contract with Frigmobile *("any damage whatsoever to any goods")* and the insurance contract *("damage to the subject-matter insured")*.

Expert microbiological evidence was accepted by the Court that, although damage due to enzyme activity and the chemical oxidation of fats in the scallops would have been greater at -6°C than -18°C, storage at -6°C would not have resulted in any significant difference in the edibility, taste, smell, texture or appearance of the scallops.

The Court considered the ordinary meaning of the phrase "damage to."[23] When used in relation to goods, "damage to" means a physical alteration or change, which is not necessarily permanent or irreparable. That damage impairs a value or the usefulness of the thing said to be damaged. What amounts to damage therefore depends on the nature of the goods - so a change in temperature would not amount to damage in every case.

Green C.J. considered that the heightened enzymic activity and the chemical oxidation in the scallop fat were clearly physical changes, but did not constitute damage ...

> *"... they were not such as to significantly affect the marketability, edibility or any other material qualities of the scallops."*

However even although the physical changes did not themselves constitute damage, the very fact that there had been storage above -18°C disallowed the scallops for export. This exportability was the value or quality of the scallops that had been

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[23] Green C.J. referred to the Oxford English Dictionary.

damaged. Other examples of similar damage to goods were given: the way in which food was handled might violate the religious dietary laws of an importing country, or handling contrary to quarantine regulations of an importing country, even although there was no contamination.

There is one obvious insurance implication arising from this judgement. Insurers need to recognise that the London Institute clauses do not qualify the word "damage" in any way, and this allows the widest interpretation - at least outside of the United Kingdom. No doubt the British judiciary pays a little more attention to the intentions of their underwriters when forming standard form contracts, marine insurance being such an important UK export industry. Green C.J. in Australia in the Ranicar case found for Frigmobile and against the insurers. The *obiter* comments are quite instructive:

> *"In my view, there are no considerations which are peculiar to these particular contracts or to the relationship between the parties which are such as to persuade me that I should depart from the ordinary meaning of the word "damage". Further, although I recognise that the way in which a Court should approach the construction of a clause in a contract of insurance which defines the ambit of an insurer's liability may well differ from the way in which a Court should approach the construction of an exclusion in a commercial contract, subject to one reservation, I can see no reason in this case for giving the expression a different meaning in the two contracts..."*

This reservation is quite important to this particular thread on "all risks" cover I am attempting to develop: Green C.J. appears to reason that he might not have found against the insurer if the Institute Cargo Clauses (All Risks) had qualified "damage" in some way, as had the contract for carriage:

> *"The reservation arises from the fact that it is arguable that the addition of the words "any" and "whatsoever" in the contract with Frigmobile has the effect of giving the words "damage to" in that context a wider ambit than they have in the contract with Royal Insurance. In the circumstances of the case it is not necessary for me to express an opinion about that question."*

I am aware that there has not been a stampede following this legal case, at least not in the northern hemisphere[24]. However, the Ranicar case has been followed more recently in the Victorian Court of Appeal where it was used outside the marine context. In Switzerland Insurance Australia v Dundean Distributors Pty. Ltd.,[25] where damage had occurred to a computer system and to stored accounting data held on a hard disk. The data was not destroyed but scattered by an electrical 'brown-out'. Brown-outs occur when lower than normal power line voltage is supplied. The accounting data was not destroyed but, because of the scattering, was not easily accessible and was recovered at considerable cost. Dundean argued that as soon as the hard disk was corrupted by the brown-out, there was a physical change to the computer system. The accounting program had to be reloaded and the scattered data recovered in a format that allowed the same prior efficient operation. The Court rejected the insurer's argument that no damage had been suffered as no part had been irreparably damaged and because it was possible to restore the system to full

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[24] Contemporary cargo clauses, e.g. Dutch, also do not refer to physical loss or damage - Tables of Practical Equivalents, IUMI & Intl. Chamber of Commerce, English Edition no. 3, Aug. 1969.

[25] Switzerland Insurance Australia v Dundean Distributors Pty. Ltd 1998 10 ANZ Ins. Cas. 61-388.

working order. The Court adopted the Ranicar interpretation of damage as not having to be permanent or irreparable.
That damage is equated with "physical alteration or change, not necessarily permanent or irreparable, which impairs the value or usefulness of the thing said to have been damaged" has great implications in general liability and products liability, in particular with regards to personal injury. Non-physical injury typically manifests itself in a claim for mental anguish or stress, and successful claims to date have been limited. Liability for economic loss is expanding and this has implications for marine insurers.[26] As a marine insurer who deals with exporters every day, I know the economic loss in Ranicar is as real in impact to them as physical loss or damage.

The principle of indemnity and "damage"

The traditional basis of a contract of marine insurance is contained in the opening section of the Marine Insurance Act 1906.[27]

> *"A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure."*

The operative word is 'indemnify'. A contract of marine insurance is still intended by insurers to be a contract of indemnity, within the broad scope allowed by valued policies. For much of the 1900s, it was the cardinal principle upon which the whole contract is founded, and from which the rules relating to the right to claim under a policy arise. The amount recoverable by the assured is measured by the extent of his pecuniary loss, and the broad purpose is to return the assured to a pre-loss position.

> *"The object of both the legislature and of the courts have been to give effect to the idea of indemnity, which is the basic principle of insurance, and to apply in the diverse complications of fact and law in respect of which it has to operate. In this way, the law merchant has solved, or sought to solve, the manifold problems which have been presented by insurances of maritime adventures."*[28]

One practical problem confronting marine insurers these days is the thorny issue of manufacturer's new machinery guarantees, or warranties.[29] This may be more of an insurance issue in Australia and New Zealand where much of our major machinery has to be imported from far afield. In the event of damage, a competent local repair is usually much cheaper than a return to original manufacturer.

The Marine Insurance Act 1906 s.16 provides that the insurable value of insured cargo is:

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[26] My thanks to Phillips Fox Auckland for bringing these subsequent cases and developments to my attention.
[27] I will use the original UK Act (rather than our NZ or Australian 'derivatives').
[28] Lord Wright, in Rickards v. Forestal Land, Timber and Railways Co. (1941) 3 All ER 62 at p76, HL.
[29] For this discussion on machinery warranties, I am indebted to my colleagues Willum Richards, Nick Blake and Ken Lowe, all of Royal & SunAlliance.

"the prime[30] cost of the property insured, plus the expenses of and incidental to shipping and the charges of insurance..." [31]

As such, the purchase cost of a new machine would be the major component of its insured value. The cost of providing a warranty is built into the pricing structure of most manufactured goods, and this is obviously reflected in the price.

However, s.16 of the MIA 1906 refers principally to unvalued policies. The warranty rarely forms part of the declaration to the insurers - it will simply state something like "injection-moulding machines". Insurers are rarely advised of the terms and conditions of a manufacturer's warranty. Insurers rarely inquire about product warranties at this stage of the transaction, which is either indicative of constructive knowledge or an indication that insurers consider that this aspect is not within the scope of the insurance. The First Schedule of the MIA 1906 has a section called "Rules For Construction of Policy" which, by Rule 17 states:

"The term 'goods' means goods in the nature of merchandise, and does not include personal effects or provisions and stores for use on board ..."

To call a manufacturer's warranty "merchandise" might be stretching traditional definitions a bit far. After all, a manufacturer, in supplying replacement parts for a new machine damaged in transit on the way to its purchaser, has rarely given a discount for the cost of warranty lost but not used on the original components. To return a large item of machinery half way around the world to the original manufacturer to repair minor damage (so that the warranty remains intact) when local repairs would be physically more than sufficient, is likely to be beyond a marine insurer's intention. Insurers feel they are opening themselves up to paying large claims for economic losses arising from relatively minor physical losses. [32]

A warranty specifically encapsulates the manufacturer's production and materials quality standards, and the backup and service reputation. There is no doubt that the warranty is an intrinsic cost of the machine, along with goodwill and advertising. Whether a warranty is part of the prime cost as regards insurance is another matter i.e. whether the warranty is part of that core value when considering physical transit damage. A guarantee or warranty is usually activated when the machinery is put into use after arrival. It lies as a latent property until then.

Although the cost of providing the warranty may indirectly form part of the machine's insured value (which would be paid in the event of a total loss) the warranty itself may be a different and separate interest. Most marine insurers take the position that a warranty *per se* is not insured, but where the cargo's perceived value is specifically one of high quality (e.g. specialised optics), and particularly for issues of safety (e.g.

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[30] Prime cost, in s16(3) of the MIA 1906 is generally evidenced by the invoice price, but not conclusively fixed by it. Prime cost means the prime cost to the assured at or about the time of shipment, or at any rate at some time when the prime cost can be reasonably deemed to their owner a the date of shipment - Williams v Atlantic Assurance Co (1993) 1 KB 81, per Lord Greer at p102; Berger and Light Diffusers Pty. Ltd v Pollock (1973) 2 Lloyd's Rep. 442 at 455 - as per Arnould - "Law of Marine Insurance and Average" 14th edition, vol. 1.

[31] s16(3) of the Marine Insurance Act 1906.

[32] The Institute Replacement Clause is almost invariably included on policies covering new machinery. It states that " in the event of loss or damage to any part or parts of an insured machine caused by a peril covered by the policy the sum recoverable shall not exceed the cost of replacement or repair of such part or parts plus charges for forwarding or refitting, if incurred ... " The Institute Replacement Clause's primary purpose is to preserve specie, but is quite helpful to insurers in these circumstances.

medical equipment) then insurers will usually return the items to the original manufacturer for repair.

This issue is not too distant from the established cases concerning whether packing materials form part of the subject-matter insured. Traditionally (i.e. London market) the rule of thumb is that unless the description of the subject-matter of the insurance is so clearly worded as to include the packing materials, insurers will not respond to claims for their damage or loss.
However, it may be that this practice is not wholly justified. In Brown v. Fleming 1902[33] the insurance was expressed as upon "228 cases whisky". Survey at destination disclosed that in a large number of cases the straw in which the bottles were packed was sodden and discoloured by sea water and that many of the labels on the bottles had been damaged. There was nothing wrong with the whisky. The damaged cases were sold but the claim was declined by the underwriters on the ground that the damage to the straw and labels was not covered by the policy. Bigham J., giving judgment for the assured, said:

> *"The straw in which the bottles were packed and the labels upon the bottles are part of the subject of the insurance just as are the bottles and corks. Damage to the labels affects the selling value of the whisky on the market just as much as damage to the corks would."*

In Berk v. Style 1955[34] the policy was on a quantity of kieselguhr[35] which was carried in heavy paper bags on a voyage from North Africa to London. On arrival a number of bags had split and so it was necessary to rebag a quantity of kieselguhr in order to enable it to be discharged by lighters. A claim for the cost of rebagging was denied by the underwriters as the bags were inadequate, and this inadequacy amounted to inherent vice. Underwriters' counsel conceded that "if this had been a loss by a peril insured against, what the plaintiffs did would have been suing and labouring within the clause in the policy". In relation to the argument whether or not the rebagging was done in order to avert loss or damage to the goods, Sellers J. said:

> *"I prefer the view accepted and alleged by the underwriters that the subject-matter of the insurance was kieselguhr packed in paper bags ... I think it must be taken that both parties to the insurance contemplated that the goods would be packed for carriage and would not be carried in bulk."*

It appears fairly well established that, in the absence of clear words to describe the subject-matter of insurance, evidencing the insurers commitment to insuring the packaging, the packing will not form part of the subject-matter where the goods can, and commonly do, travel unprotected. In Lysaght v. Colemain 1895,[36] where the policy was on galvanised iron, Lord Esher said:

> *"I think I ought to say also that it is clear that the insurance was on the iron, so*

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[33] Brown v. Fleming (1902) 7 Com.Cas. 245
[34] Berk v Style (1955) 2 Lloyds Rep. 383
[35] Diatomaceous earth. It is a form of silica composed of the siliceous shells of unicellular aquatic plants of microscopic size (ancient plankton). Kieselguhr is heat resistant and has been used as an insulator, a component in toothpaste, an abrasive in metal polishes and in explosive manufacture. In the chemical industry, it is also used as a filter to clarify syrups and sugar and as a filling material in paper, paints, ceramics, soap and detergents. Diatomite is a more compact, chalky, light-weight rock. German *kiesel* = *flint* and *guhr* = *earthy sediment deposited in water.*
[36] Lysaght v Coleman (1895) 7 Asp. MLC 552.

that no claim could arise in respect of damaged packing cases."

Berk v. Style suggests that where good commercial practice requires a certain standard of packaging for the transit, such packing does form part of the subject-matter insured, even if not specifically mentioned. However, one caveat should be mentioned here - many of these older cases hark back to days where insurance policies or insurance certificates were individually negotiated and issued for every voyage. Today we have a rather more efficient annual review or renewal process based on an advised sales turnover, and it would be hard to glean the insurer's intention from a phrase used by a freight forwarder's clerk typed on a standard form insurance certificate. However, insurers usually accept that retail packaging forms part of the product itself.

I believe the common view amongst marine insurers is that, unless information is given to the contrary, when asked to insure machinery that by nature is repairable, then the principle of indemnity is satisfied in the event of damage by paying the reasonable costs of repairs. If for contractual reasons an assured cannot accept a repaired machine and requires a new replacement in the event of any damage, then this constitutes a material fact which should be disclosed to the insurers at the outset.

Nevertheless, given the comments in the Ranicar case, a value or attribute of the machine has been damaged - its "saleability". This is no different to "exportability" which was the damaged attribute of the frozen scallops. Insurers who provide a competent local repair - even with a local guarantee matching the original, for the work done - may be satisfying the narrower and traditional understanding of indemnity, but could be found wanting in terms of indemnifying for "damage" in the eyes of a court.

The wording of "All Risks Clause" in the Institute Cargo Clauses

I hope I have provided some evidence why insurers should seriously consider revising how they project their "usual" or "traditional" intention to cover only direct and immediate physical damage. I believe that many insurers do not intend to cover attributes of "exportability" or "saleability". If they do, they script special additional clauses covering these specific aspects. Many probably have to deal with these individual claims on a "without prejudice basis".

Insurers talk often in terms of "loss" and "fear of loss". This - using the example of the Ranicar scallops - is based exclusively on whether the cargo is actually physically and permanently damaged. The scallops were not, in the finding of the Court, physically damaged: the extra microbiological activity was marginal and the scallops could still be quite safely eaten. The insurers in Ranicar no doubt talked in terms of "fear of loss". They were no doubt taken aback when their intention (based on London market practice, no doubt) to cover their concept of cargo damage was definitely put in second place to a wider meaning of "damage" in law.

And therein is the issue: it seems insurers use London "all risks" clauses outside of the United Kingdom at extra peril. London market insurers may be quite happy with this situation. Perhaps they believe that, if the business was placed in London, they have a better chance that their courts will apply their "native" intended meaning and

there is competitive advantage in this. However, London might see their clauses having a sustained international future if they allowed for more regular revision.

I fully realise that there is danger that this whole issue of revision for the benefit of world trade can be overblown, or be mistaken, or be near-impossible to achieve because of competition. There is sometimes, I fear, an element of "London-bashing" by other national markets as we come out from behind mother's skirts.

The UNCTAD clauses have not been seriously considered for use even although they come from an impartial international body.[37] National markets and reinsurers, it seems, 'make do' with national clauses sets without too much disruption. The French marine insurance system ("the 1967 law") provides a comprehensive legal regime for insurance contracts that cover marine cargo risks. UNCTAD, in its review of marine insurance, also undertook a review of marine insurance in Latin America. The conclusion was that there was no single source of influence. The study found the French and Spanish Codes being actively utilised, and even a strong influence of the English Marine Insurance Act 1906 within the civil code of Colombia.

The current trend, already well underway, of fragmentation into scripted "plain English" or broker cargo wordings is not attractive. Insurers still remain comfortable with keeping the Institute Cargo Clauses *as a base.* As they see more evidence of confusion and different interpretations this may change.

There have been recent previous attempts to nudge London into revising the Institute Cargo Clauses. It has been suggested[38] that dropping the "all" in "all risks"; or even the whole phrase "all risks" itself might achieve a simpler and less confusing result:

> *This insurance covers (the risks of) loss of or damage to the subject-matter insured except as provided ...."*

Such constructive criticism has as yet to be heeded.

Insurable interest, the Duration Clause and Incoterms

The Institute Cargo Clauses Clause 8 is the Transit Clause, and is often dubbed the 'warehouse to warehouse clause' because of its history. Essentially cover can commence once the goods leave the warehouse on the export journey and cease after a maximum 60 days once discharged if they remain in the ordinary course of transit.
Prior to the introduction of the 'warehouse to warehouse' clause, the cargo policy cover attached and terminated in accordance with the provisions of the S.G. policy form. There was no cover during transit to the loading port, nor during loading, nor in craft at the loading port. Cover attached as the goods were loaded onto the overseas vessel. Cover terminated as the goods were discharged onto the quay at the port of discharge. No cover was provided for inland transit to the intended destination of the

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[37] Impartial, that is, in terms of underwriter and broker. Perhaps not so in terms of developed world and developing world, though the main reason for the UNCTAD Clauses was not overtly political - it was to simplify the phrasing and delivery of units of insurance cover.

[38] I am indebted to Michael Hill of Associated Marine, Australia, for providing me with a copy of his paper he presented on behalf of the Insurance Council of Australia to the Tokyo Conference of the International Union of Marine Insurance, September 1995, entitled "Beyond All Risks".

goods. Cover was only active whilst the cargo was in the craft at the port of discharge.

The 'warehouse to warehouse' clause was introduced towards the end of the 19th century, and was included in the first Institute cargo clauses of 1912. No time limit had been imposed by the previous S.G. policy form. It was impossible then to forecast the time a voyage would take. No time limit was placed on the sea voyage in the original 'warehouse to warehouse' clauses, nor was any time limit applied to the period prior to loading onto the overseas vessel. This freedom remains, still subject to reasonable despatch. To encourage the assured to move the goods quickly after discharge, a time limit was imposed. This limit was found to be impractical during the 1939/45 war, and was increased to 60 days, by a clause called the 'wartime extension' clause. Underwriters in London continued with the 60 days limit in the 'extended cover' clause. This became the standard and was incorporated in the Institute's cargo clauses. In the 1963 Institute Cargo Clauses the 'Transit Clause' replaced both 'warehouse to warehouse' and 'extended cover' clauses. The 'Transit Clause' was only slightly amended in 1982.

Cover under the 1982 Institute Cargo Clauses is designed to commence when the goods physically pass through the gates of the exporter's factory:

> *8.1 This insurance attaches from the time the goods leave the warehouse or place of storage at the place named herein for the commencement of the transit, continues during the ordinary course of transit....*

The main motivation for this is that a marine underwriter does not want to insure the static risk prior to transit. The material damage (i.e. property) underwriters are supposed to cover the goods as "stock" until this time.

However, this has always been a somewhat clumsy solution, although it may be the only possible 'default' position in the absence of any other agreement.[39] The moment of the truck driving past the warehouse gates has never really been a decisive moment for dry goods such as machinery in either insurance time, or transfer of risk, or Incoterm. In the world of insurance, there is such a proliferation of clauses in insurance contracts that imply an amendment to commencement and termination at 'warehouse gates' that there is usually some confusion as to the exact start and finish. Many open covers will have clauses, for example, that provide for loading and unloading damage but are unspecific as whether cover commences at that time.

Belittling this confusion is the cargo owner's consternation that arises from the Transit Clause's seemingly unqualified statement about commencing from the time the goods leave the warehouse. The clause actually needs to be read in the light of Clause 11, the Insurable Interest Clause:

> *11.1 In order to recover under this insurance the assured must have an insurable interest in the subject-matter insured at the time of the loss.*
>
> *11.2 Subject to 11.1 above, the assured shall be entitled to recover for insured loss occurring during the period covered by this insurance, notwithstanding that the loss occurred before the contract of insurance was concluded, unless the assured were aware of the loss and the Underwriters were not.*

[39] Almost all codes of marine cargo clause throughout the world use the "warehouse gate" point for the commencement of cover.

Underwriters almost invariably demand that they receive the commercial invoice prior to settling a claim, and can decline a claim where the risk in the goods has transferred (as per the Incoterms) after the loss has occurred. A simple example of this is a FCL export from a northern hemisphere country that is trucked from some inland location to a port. The sale is a FOB sale so the seller:

> *"bear(s) all risks of loss of or damage to the goods until such time as they have passed the ship's rail at the port of shipment."*

During the course of that journey to the port, the container is flooded with fresh water during a storm. The goods move on to New Zealand where the importer discovers the damage. As the container was carried under deck but not on bottom stow in the vessel and there were no transhipments, the surveyors quite rightly conclude with the aid of a silver nitrate test[40] that the damage occurred prior to the ship's rail. The claim could be declined.

There are three aspects that need some comment.

Firstly, current insurance practice is that insurers take the Incoterms' "all risks of loss or damage to the goods" to mean only physical loss or physical damage, and equate this in a similar fashion to their intention to only cover physical loss in the Risks Clause in the Institute Cargo Clauses (A). The thought process is something along the lines that, as only physical damage is being insured i.e. that is the insurable interest, and the Incoterms state this specific risk falls into the seller's lap on this occasion, in the absence of any other ameliorating insurance clauses the importer's insurance does not respond.

Second, insurers may not ask or may not be given the information on the commercial terms of sale before binding cover. Quite often the insurance is based on quite basic information. For example the information is simply the cargo is being imported from Europe to New Zealand. Obviously, a cargo trucked by road from northern Italy to the load port of Hamburg presents a different risk than a machine built locally in Hamburg. However, the insurance pricing for a FOB insurance import will commonly be no different to an ex works purchase. Where that is the case, it would be unfair to decline a claim.

Third, the cargo importer has an insurable interest that is much wider than just physical loss or damage. This topic has been well discussed before and needs little more than re-introducing. The NSW Court of Appeal's decision in New South Wales Leather Co. Pty. Ltd v Vanguard Insurance Co Ltd.(1991) [41] demonstrates some of the difficulties where claimants must have an insurable interest at the time of the loss even although they effectively bear the risk of the goods not arriving as expected throughout the entire transit. In that case leather being exported had most probably been pilfered prior to crossing the ship's rail, but as the containers were supposedly sealed the loss was only discovered on arrival. Interestingly, one of the arguments raised in that case was that, following US practice, a container is functionally part of a ship and goods can be deemed to be shipped (I assume across a nominal ship's rail) when a container is sealed.

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[40] A commonly used chemical reaction that tests for salts. Wetting by salt water turns the clouds the silver nitrate solution; fresh water does not. However, the test is not entirely foolproof as the testing solution needs to be of a certain strength and some forms of packaging contain salts.

[41] New South Wales Leather Co. Pty. Ltd v Vanguard Insurance Co Ltd.(1991) 25 NSWLR 699.

From an insurer's point of view, the time of sealing inside a shipping container is a workable alternative to the warehouse point, providing the requirement for reasonable despatch still applies. Any of the transfer of risk points in the Incoterms 2000 could be equally suitable. Possibly, from the aspect of possible insurance clause revision, there could be a reference just to the commercial contract. There is an obvious and real danger in this, which was probably considered by the draftsmen of the 1982 clauses. That danger is that there is no 'default' position.

The importers are, of course, distraught when they open the container. They have paid for the goods, so the seller doesn't really sympathise. The importer holds an "all risks" Institute Cargo Clauses (A) policy document that states he has cover for (unqualified) "loss of or damage to" his goods from the time they left the overseas warehouse. There is a reference to "insurable interest" elsewhere in the insurance clauses but that too is not defined - unless there's some serious research that involves an obscure statute that is almost 100 years old. The insurance clauses also do not refer to the terms of sale as regards the all-important transfer of risk.

Conclusion

I hope that a new common worldwide initiative emerges, although I do not by any means see that as a certainty. The current issues around the Institute Cargo Clauses are not individual court decisions on particular aspects. The issues are broader and concern the age of the current set of clauses and their absolute reliance on a much older statute that encoded British marine insurance practice of almost a century ago. And that is much of the issue with the Institute Clauses. National insurance industries and particularly the Commonwealth have grown in independence. We began as pure satellites. We used London clauses as much of the business was referred to London. Revision of the most commonly used insurance clauses is the prerogative of an authoritative world body. I would have to say that there is no obvious willing candidate. Insurance practitioners in the established marine insurance world have largely ignored the UNCTAD model clauses.

There is still a need for a common set of cargo clauses that are interpreted in a homogeneous way, although that need may not be perceived as absolutely compelling. The most obvious need is for certainty - particularly with letters of credit. E-commerce is about to blur national boundaries. Reinsurers - even in London - require an acceptable common base and this might become a more difficult translation exercise as there is an increasing trend away from the ICC as plain English wordings and broker wordings become standard market practices[42]. Whether individual markets' practices and wordings become more diverse through growing independence or less diverse because of globalisation is as yet uncertain.

Whilst the Institute Cargo Clauses now deserve some constructive criticism, they have served well. As they age, and Marine Insurance Acts erode, they become less valued. Revision with the aim of a single code for world trade may well be impossible without a common approach to marine insurance. Marine Insurance Acts are under an increasing scrutiny, but these calls for reform are not afforded a high priority amongst legislators. Clause revision against this changeable backdrop will be difficult.

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[42] Excess of Loss insurers may have less of an issue with this, because large claims tend to be from the same traditional causes. Nevertheless, standard insuring clauses are an efficient way of capturing the scope of cover.

It is easy to forget that these clauses were produced for the use by insurance practitioners within a particular market. We have used these clauses in Australia and New Zealand as if they were our own. We also sometimes forget that there are other sets of insurance clauses used in the world.

Economic loss appears to be blending into the mainstream of "loss of or damage to" goods. Perhaps the changes to the Cargo Clauses do not have to be too drastic. That may be one ray of hope in these competitive times. However, the issues concerning the Marine Insurance Acts need to be resolved first, even although the issue of economic loss is not as such under review. We will continue to live in interesting times.