

THE MARINE INSURANCE ACT: OUT OF WARRANTY?

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The Marine Insurance Act provides that an insurer is discharged from liability from the date that the insured breaches a warranty in the policy, even when the breach of warranty is not causative of the loss. Not surprisingly, insureds have tried to prevent insurers playing this trump card and after centuries of losing case-after-case, insureds appear to finally be turning the tide. This article explores the judicial decisions of superior courts that exemplify this recent trend and questions whether a deviation from the centuries old legal position is wise judicial policymaking. Interventions by parliaments are briefly discussed.

The *Insurance Contracts Act*¹ (*ICA*) and the *Marine Insurance Act*² (*MIA*) are the two main statutes governing insurance contracts in trade and transport in Australia.³ The *MIA* has traditionally allowed insurers to escape liability if there is a breach of warranty (for example, the insured warranting a ship will be in survey throughout the policy), regardless of whether the breach of that warranty was causative of the loss claimed. The *ICA*, however, has traditionally not allowed insurers to rely on warranty breaches to deny indemnity where the breach was not causative of the loss.

Not surprisingly, in these situations, insurers often attempt to prove that the *MIA* applies to the policy and the insured tries to prove the *ICA* applies. However, this is not always straightforward. Neither is the question of whether the traditional rule, as summarised above, actually holds nowadays. This brief paper will address first the question of when the *MIA* applies to an insurance policy, and second when the *MIA* will permit insurers to deny liability for breach of warranty where it does apply.

When does the Marine Insurance Act Apply?

The *MIA* applies to ‘contracts of marine insurance’.⁴ Section 7 of the *MIA* defines this as insurance which covers losses incidental to marine adventures. What is a marine adventure? An adventure with marine perils.⁵ What is a marine peril? A peril related to the navigation of the sea.⁶ To understand what perils are related to the navigation of the sea, one must first define what ‘the sea’ is.

What is ‘the Sea’?

Most, but not all, Australian Acts defining the ‘sea’, state that it is a body of water affected by the ‘ebb and flow of the tide’. Such Acts include the *Admiralty Act*⁷ and the *Navigation Act*.⁸

Obviously, ‘the sea’ does not include inland waters, unless they are affected by the ebb and flow of the tide. Clearly this distinction creates problems where the sea meets inland waters. The High Court of Australia encountered this difficulty in its decision in *Gibbs v Mercantile Mutual Insurance*,⁹ in which the Court split 3:2.

In this case, a woman was seriously injured when paraflaying on the Swan River, near where the river meets the Indian Ocean. The question was whether the Swan River estuary was ‘the sea’. Gleeson CJ (in the majority) said that he saw no reason why the ‘sea’ must be limited to the open ocean, and stated that, since the area under which the paraflayer flew was affected by the ebb and flow of the tide, it must have been on ‘the sea’. McHugh J (in the minority) disagreed with this on a legal level and on a common-sense practical level, stating: ‘I doubt that any Perth resident who had spent a day picnicking by the shores of the Swan River would regard him or herself as having spent a day at the sea-side.’

In fairness to the picnicker, they probably were not thinking of the sea’s legal definition under the *Marine Insurance Act* at the time of their imagined contemplation. Important to that legal definition is that interpretation

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¹ *Insurance Contracts Act 1984* (Cth).

² *Marine Insurance Act 1909* (Cth).

³ The New Zealand position will be discussed later in this article, as its legislative structure is substantively different.

⁴ *Marine Insurance Act 1909* (Cth), s 7.

⁵ *Ibid*, s 9.

⁶ *Ibid*.

⁷ *Admiralty Act 1988* (Cth).

⁸ *Navigation Act 1912* (Cth).

⁹ *Gibbs v Mercantile Mutual Insurance* (2003) 214 CLR 604.

of the *MIA* has traditionally been by the letter, not by the common-sense understanding. For example, to ‘navigate’ the sea, as is required, one assumes one needs a ship or something resembling a ship. Yet, in *Promet v Nicholas*,¹⁰ Hobhouse LJ stated that a floating oil platform qualified as a ship, because it could up anchor and be navigated to a new location; and in the process of being on the sea it was, of course, subjected to the usual marine perils.

This leads to the important point that marine insurance is made to protect policy holders from perils of the sea, not perils that can occur on any water; and although extraordinary tidal waves may topple a boat at Port Kembla, it is doubtful that they would do so in Kakadu National Park’s Yellow Water Billabong. Accordingly, the *MIA* applies to vessels that navigate waters affected by the ebb and flow of the tide, which are subject to marine perils. Otherwise the *ICA* applies to the policy.¹¹ The remainder of this article is dedicated to the status of warranties under the *MIA*.

Has the Marine Insurer’s ‘Warranty Shield’ Buckled?

A warranty... is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him or her before that date.¹²

The ‘sorry, you breached a warranty’ statement has always been the insurer’s ‘get out of gaol free’ card under the *Marine Insurance Act*; the Australian Law Reform Commission *Report 91*¹³ referred to it as the ‘ace up the sleeve’.¹⁴ Insurers, on receiving what they believed to be a junk claim, have often called upon its protection. However, some recent decisions seem to have weakened the strength of this old rule.

Is the Marine Warranty Shield still Generally Effective?

‘A warranty... is a condition which must be exactly complied with, whether it be material to the risk or not.’¹⁵

This rule comes from the old English cases. A good example is *Kenyon v Berthon*¹⁶ where a ship was warranted as ‘in Port 20th July, 1776’. In fact, she had sailed two days earlier. Lord Mansfield declared that ‘though the difference of two days may not make any material difference in the risk, yet as the condition has not been complied with, the underwriter is not liable’. This position was codified in the Act, quoted above. The question is whether this holds true today.

In 2006, the Western Australian Supreme Court heard the case of the *Pilbara Pilot*.¹⁷ In this case, a cyclone was on course to hit a moored vessel. The captain of that vessel, on sound advice, decided to move it out of the expected path of the cyclone. This particular action was a direct breach of an express warranty. The cyclone caught the vessel and the owner claimed under the marine insurance policy. The insurer denied indemnity. The Court ordered that the insured should have been indemnified. Heenan J stated four reasons why the insured should have been indemnified:

- 1) the plaintiff’s actions were reasonable;
- 2) the loss was caused by the same cyclonic peril from which the plaintiff was escaping;
- 3) the plaintiff was acting to avoid damage and protect the insured property; and
- 4) the loss was caused by a peril of the sea and not by the breach of warranty regarding the mooring.

¹⁰ *Promet Engineering (Singapore) Pte Ltd (Formerly Self-Elevating Platform Management Pte Ltd) v Nicholas Colwyn Sturge* [1997] EWCA Civ 1358.

¹¹ *Insurance Contracts Act 1984* (Cth), s 9, cf also s 9A; *Marine Insurance Act 1909* (Cth), ss 5-9.

¹² *Marine Insurance Act 1909* (Cth), s39.

¹³ Australian Law Reform Commission *Review of the Marine Insurance Act 1909 (Cth)* (ALRC Report 91: 2001).

¹⁴ *Ibid*, [9.27].

¹⁵ *Marine Insurance Act 1909* (Cth), s39.

¹⁶ *Kenyon v Berthon* (1779) Park Ins. (6th Ed), 426 (SC, I Doug, 12, n).

¹⁷ *Allison Pty Ltd v Lumley General Insurance Ltd* (2006) 200 FLR 394, 14 ANZ Insurance Cases 61-708, [2006] WASC 104.

Essentially, the Judge ruled that the legislation stating ‘a warranty... is a condition which must be exactly complied with, whether it be material to the risk or not’ was not to be taken too literally.

What Happens when Marine Warranties and Other Provisions Conflict?

Australia is not alone in its deviation from the traditional rule.¹⁸ In the Hong Kong High Court case of *Nylon v QBE Insurance*,¹⁹ it was ‘warranted that this is a container load shipment’, but in fact, there were no such containers shipped and the containers that were to be shipped were instead devanned and their contents carried break bulk. Clause 8.3 of the Institute Cargo Clauses (A) was incorporated into the policy, stating relevantly:

This insurance shall remain in force ... during delay beyond the control of the Assured, any deviation, forced discharge, reshipment or transshipment and during any variation of the adventure arising from the exercise of a liberty granted to shipowners or charterers under the contract of affreightment.

Stone J, reading the warranty and the Institute Cargo Clauses together, effectively made inoperative the former in favour of the latter, despite the *MIA*’s application to this policy. His Honour stated:²⁰

I accept the contention that the breach of warranty, which took place *without* the knowledge or instruction of the 1st Plaintiff, occurred pursuant to the exercise of liberty granted to the shipowner, and that the insurance thus remained in place as the breach was one within the parameters contemplated by Clause 8.3 of the ICC(A).

It should be noted that it is unusual to give a general clause (Clause 8.3 of the Institute Cargo Clauses (A)) precedence over a specific one (the warranty) in construing a contract, as specific clauses tend to be read as exceptions, not the other way around, especially where the *MIA* gives warranties such a powerful position in the contract, treating them as a ‘condition’.²¹ However, as we have seen before, the insurer here was attempting to rely on a warranty unrelated to the loss, which they should be able to do under the *MIA*’s explicit wording, though there is an intuitive persuasiveness in the other direction.

Can Marine Insurance Coverage be Suspended while a Warranty is being Breached and be Resumed Thereafter?

The insurer is discharged from liability as from the date of the breach of warranty.²²

Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied.²³

The High Court of England and Wales (in Admiralty) has allowed breaches of warranty to not interfere with the insured’s indemnification, where that breach was remedied before the loss claimed had happened, and where that loss was unrelated to the breach: see *The Newfoundland Explorer*.²⁴ In this case the policy clause stated ‘warranted vessel fully crewed at all times’. Gross J stated (in obiter dicta) that the ‘warranty’ was not promissory in character, only delimiting. This meant that the insurer would be off risk in the event that a casualty occurred during the time period that the warranty was not complied with. His Honour stated: ‘I would accordingly have been reluctant to go further and hold this was a promissory warranty, so that any breach would discharge the insurer from liability automatically, as from the date of the breach.’²⁵

The same outcome occurred in the Canadian case of *Ocean Masters Inc v AGF*.²⁶ In this case, there was a warranty that the ship *MV Northern Challenge II* have a Canadian Steamship Inspection (CSI) Certification. The ship held a CSI Class II certificate, which is valid only for travel 120 miles offshore. The Supreme Court of Newfoundland and the Labrador Court of Appeal found that that was a warranty to stay within a 120 mile zone. In this case the vessel had retrieved crabs from outside the 120 mile zone, but on its return it caught fire 40 miles

¹⁸ As enunciated in *Kenyon v Berthon* (1779) Park Ins (6th Ed), 426 (SC, I Doug, 12, n).

¹⁹ *Hong Kong Nylon Enterprises Ltd v QBE Insurance (Hong Kong) Ltd* (2002) HCCL 46/1999.

²⁰ *Ibid*, 60.

²¹ *Marine Insurance Act 1909* (Cth), s 39.

²² *Ibid*.

²³ *Ibid*, s 40(2).

²⁴ *GE Frankona Reinsurance Limited v. CMM Trust 1440* [2006] Lloyd’s Rep IR 704.

²⁵ *Ibid*, 708.

²⁶ *AGF MAT v Ocean Masters Inc* [2007] NLCA 35.

out and sank. The Court said that when the ship left that 120 mile zone the insurance contract was suspended, but in this case became operative again when the ship re-entered the 120 mile zone; the clause was not held to be an all-out warranty. Welsh JA stated that the insurer could have obtained a different outcome through better policy wording:

If the Insurer had intended something other than this result, it was open to the Insurer to state its intention clearly in the policy. In the absence of such clarity, the *contra proferentem* principle applies with the result that the provision, drafted by the Insurer, will be construed in the insured's favour.

However, this case has often been read too broadly. It is important that in this case Clause 8 of the policy stated:

If any breach of a clause or condition of insurance shall occur prior to a loss under this insurance, such breach shall not void the coverage nor avail the Underwriters to avoid liability, unless such breach shall exist at the time of such loss.

Clause 8 therefore substantially watered down the Canadian equivalent of s 39 of the *MIA*.

The same outcome occurred in an earlier Canadian decision. In *Staples v Great American Insurance Co NY*²⁷ the insurance contract stated '[w]arranted by the insured that the within named yacht shall be used solely for private pleasure purposes and not to be hired or chartered unless approved and permission endorsed hereon'. The boat had been used by someone other than the owner to ferry employees for work purposes before a fire sank it. Kerwin J stated:²⁸

In the case at bar, I cannot read the statement in the margin of the policy as a condition that upon the yacht being used for other than private pleasure purposes the policy would be avoided even though at the time a loss was suffered the yacht was not being so used.

In the United States, the case law appears to also state that the insurance contract can be suspended while there is a breach of warranty, or while there is increased risk due to the breach of warranty: see *Employer's Insurance v Trotters Towing*²⁹ and *Henjes v Aetna*.³⁰ In *Trotters*, the insurance policy expressly stated 'any deviation beyond the navigation limits provided therein shall void this policy'. In relation to this provision, Clark CJ stated that 'breach of an express warranty regarding location of a vessel in a marine insurance policy suspends coverage under Federal admiralty law and Mississippi law'. This approach is similar to the Canadian approach. In *Henjes*, the approach was expressed slightly differently. The Court stated that 'the insured may not by breach of warranty increase the risk and put that added burden on the insurer'. During that time of elevated risk, the insurer was off risk. Accordingly, the focus in *Henjes* was on the change in risk, and not the breach itself.

What the United States position is today, or if there is a unified position among the Circuit Courts, is not certain, though the 1st Circuit should hand down on a decision on this point by year-end in *Northern Assurance v Keefe*.³¹ Whether the other Circuits will follow the decision of the 1st Circuit, however, is not known.

When is a Marine Warranty a Mere 'Limitation of Risk Clause'?

The cases discussed above raise an interesting question: when is a warranty not a warranty? This idea was explored in a 1983 Canadian case, *The Bamcell II*.³² The clause at issue stated 'WARRANTED that a watchman is stationed on board the BAMCELL II each night from 2200 hours to 0600 hours with instructions for shutting down all equipment in an emergency'. Ritchie J said:

[I]t is significant that, although there was no watchman stationed on board *Bamcell II* during the hours prescribed in that clause, this had absolutely no bearing whatever on the loss of the vessel which occurred in mid-afternoon. The clause would only have been effective if the loss had occurred between 2200 hours and 0600 hours, and it was proved that there was no watchman stationed aboard during those hours. To this

²⁷ *Staples v Great American Ins Co, New York*, [1941] SCR 213.

²⁸ *Ibid*, 222.

²⁹ *Employers Ins of Wausau v Trotter Towing Corp*, 834 F.2d 1206 (5th Cir, 1988).

³⁰ *Henjes v Aetna Ins Co*, 132 F 2d 715 (2d Cir, 1943).

³¹ Case ID: 12-1330, on Appeal from *Northern Assurance Co v Keefe*, 2012 WL 603579 (D Mass, Feb 23, 2012) Civil Action Number 10-11998-DPW.

³² *Century Insurance Company of Canada v Case Existological Laboratories Ltd (The 'BAMCELL II')*, [1984] 1 WWR 97.

extent the condition contained in the clause constituted a limitation of the risk insured against but it was not a warranty.

Accordingly, the Court seems to be saying that eking out the metes and bounds of a warranty destroys its status as a warranty, and turns it into some other animal; ie a mere 'limitation of risk' clause. Thus it is best for insurers to draft warranties broadly.

Watering Down of the *Marine Insurance Act* by Courts

It appears that there is a difference between what is said to be 'warranted' and what is, in effect, a 'warranty'. The ambiguity leads to five possibilities for clauses in *MIA* contracts described as warranties.

First, the 'warranted' thing, even if not done, is irrelevant to indemnity, as long as the breach of warranty does not cause the loss: *Pilbara*.

Second, the 'warranted' thing is a promise, capable of being suspended, so that when the promise is being kept, the insurer is on risk; but, when it is not being kept, regardless of whether the loss and breach are connected, the insurer is off risk: *Bamcell II*, *Ocean Masters*, *The Newfoundland Explorer*, *Trotters* and *Northern Challenge II*.

Third, when the 'warranted' thing is not complied with, and this increases the risk on the insurer, the insurer will be off risk until that excess risk is eliminated: *Henjes*.

Fourth, the 'warranted' thing is a condition precedent to both having and keeping the insurance. If the warranty is not complied with at the commencement of coverage, then the insurance is never effective (and thus the insurer is never on risk); and if it is complied with and then subsequently not complied with, the insurance is ineffective from the point of breach onwards: *Kenyon*.

Warranties are not just avoidable in those first four instances. The effect of breach of those warranties can also be avoided by insureds if those warranties conflict with other contractual provisions: *Nylon* and *Ocean Masters*.

Some of the ambiguities mentioned above can be cured by proper contract wording, as when such proper wording is not used, courts can apply the *contra proferentem* principle against the insurer: *Ocean Masters*.

Watering Down of the *Marine Insurance Act* by Parliaments

In New Zealand s 11 of the *Insurance Law Reform Act* 1977 states that, where any warranty in a contract of insurance is not complied with by the insured and the breach of that warranty is not a factor that increases the risk of the damage claimed, the insurer may not rely on that warranty's breach to deny indemnity (contrary to New Zealand's equivalent of s 39 of the *MIA*).³³ Section 11 has been said twice (in obiter dicta) by the High Court of New Zealand³⁴ to apply to express warranties only, rather than to those implied by statute (for example, the warranty as to legality).³⁵

In the UK the Law Commission published a report in June 2012 entitled *Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties*.³⁶ Despite almost every country in the Common Law world using an unmodified (or almost unmodified) form of the UK *Marine Insurance Act 1906*, the Commission stated at page 167 of their report that '[t]hese provisions bring the law in the UK into disrepute in the international market place'. It further criticised the harshness of the law by stating '[t]he consequences [of the UK's equivalent of s 39 of the *MIA*]³⁷ lack 'logical reason' and cannot be explained in terms of either legal fairness or economic efficiency'.

Accordingly, in an attempt to make the law more certain and 'just', the Law Commission proposed that the law take the suspension rule (see *Bamcell II*, *Ocean Masters*, *The Newfoundland Explorer*, *Trotters* and *Northern Challenge II*). This gives the effect that, for as long as a warranty is not exactly complied with, the insurer's

³³ Being s 42 of the *Marine Insurance Act 1908* (NZ).

³⁴ *Harbour Inn Seafoods Ltd v Switzerland General Insurance Co Ltd* (High Court, Auckland, CL 77/89, 25 September 1990, Fisher J) 39; *Womersley v Peacock* (High Court, Christchurch, CP 24/98, 8 September 1999, Panckhurst J) 29.

³⁵ *Marine Insurance Act 1908* (NZ), s 34

³⁶ The Law Commission wrote this report in partnership with the Scottish Law Commission.

³⁷ Being s 33 of the *Marine Insurance Act 1906* (UK).

liability is suspended for only the duration of the breach. Where the breach is then remedied, the insurer would be once again on risk.³⁸

It was further recommended that, where the risk guarded against by the warranty is not the cause of the loss, the breach of that warranty could not be a basis of denying indemnity.³⁹

In March 2013, the Law Commission published the result of its consultation⁴⁰ with 27 ‘consultees’. All but three agreed that marine warranties should not be able to be relied upon by insurers to deny indemnity to their insureds where the breach of those warranties is not causative of the loss claimed. Regarding the proposal that insurance coverage should be suspended whilst a warranty is not being complied with, of the 23 ‘consultees’, 18 agreed with the suggestion of the Commission.

Conclusion and Implications for Insurers

Insurers have two general reasons they ask insureds to disclose facts to them.⁴¹ The first is correlation, the second is causation. Correlation can be quite important in pricing risk. For example, it is often said that people who drive white cars drive more safely. Few would say that the colour yellow causes accidents. Rather, it is the people who pick that colour who are more likely to crash. The second reason is causation, where the roadworthiness of a car will directly influence its ability to handle adverse conditions, eg faulty headlights will cause accidents, not merely correlate with them.

As a public policy decision the Courts, as we have seen above, are imposing their own regulation on how insurers price risk and are limiting the effect of the statutory words to the effect that ‘[a] warranty... is a condition which must be exactly complied with’. The New Zealand Parliament (and perhaps soon the UK Parliament) has also made febrile the marine insurance warranty. Ultimately, with fewer methods to differentiate different categories of risk and the inability to use their ‘get out of gaol free card’ to avoid paying bogus claims, insurers will need to increase their premiums on their entire base of insureds. This will essentially mean that these above decisions will influence the pricing of marine insurance policies, possibly worldwide. As the US Supreme Court once said, ‘the whole judicial and legislative history of insurance regulation in the United States warns us against the judicial creations of admiralty rules to govern marine policy terms and warranties’.⁴²

Whether courts (and Parliaments) worldwide decide to take a more cautious approach in future, or continue on the trend above is not yet known. If courts (and Parliaments) do continue this trend, insurers in Australia, and indeed the rest of the Common Law world, should start finding another ‘get out of gaol free’ card. If insurers do not, they may be able to insure only on the basis of causative warranties and not correlative warranties. That will increase costs, which will then, in turn, increase prices to the consumer.

³⁸ UK Law Commission *Insurance Contract Law: The Business Insured’s Duty of Disclosure and the Law of Warranties* (2012), [15.16].

³⁹ *Ibid.*, 190.

⁴⁰ *Insurance Contract Law: Summary of Responses — Law of Warranties* (2013) 22-26.

⁴¹ Australian Law Reform Commission, above n 13, [9.66]. The same sentiment was stated in almost exactly the same words in Australian Law Reform Commission, *Insurance Contracts* (ALRC Report 20: 1982) [288].

⁴² *Wilburn Boat Co v Fireman’s Fund Ins Co*, 348 US 310 (1955).