

Protection and Indemnity Insurance: Conduct, Intent and Punitive Damages

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**PROTECTION AND INDEMNITY INSURANCE:
CONDUCT, INTENT AND PUNITIVE DAMAGES**

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Ninety percent or more of the world's trading tonnage is insured by the mutual Protection and Indemnity Clubs which, together, make up what is known as the **International Group of P&I Clubs**. Insurance is based upon the policies underwritten by those Clubs, all which are fundamentally the same, and English law.

PRINCIPLES OF MUTUALITY

Mutual members of the club are both insureds and insurers. In their capacity as the insurers, they assume risks to which the insureds, - all other members,- are exposed. They share risks with many who are engaged in quite different operations, and with some in direct competition. These risks must therefore be mutual to the membership as a whole, in the sense that each member is prepared to underwrite them on behalf of all others.

Club rules define liabilities against this background. Although statutes and common law impose external limits upon the boundaries of club cover, the kinds of risk insured are determined by those who insure them, - the members, and from whom, the Directors of the Club (who represent them) are drawn.

Mutual risks include, amongst others, specified liabilities in respect of:

- Cargo;
- Illness, injury or death of crew, stevedores, and others;
- Threatened or actual pollution;
- Collision;

- Damage to fixed and floating objects;
- Fines for specified infringements; and
- Passengers

To each of these, and to every other insured risk, the assured's knowledge and intent (or lack of it) is highly relevant. A member is only indemnified against liability in respect of a defined risk if its *cause* is "mutual". For example, a member's liability for damage to cargo will usually be covered if the damage results from his negligence or other unintended or inadvertent act, but not if caused by his intentional or reckless misconduct. A fine which might, on the surface, appear to be the consequence of intentional wrongdoing may be covered if in fact it arises from a negligent, but nevertheless unintentional, infringement of law.

The general rules of the club reflect the fact that members who have invested in quality, and who are committed to proper standards of operation, should not assume and insure liabilities incurred by those who have no such commitment. The fair sharing of defined and acceptable risks is one thing, the exploitation of mutual insurance to subsidise reckless or otherwise substandard operations is another. Hence the need to safeguard members against potential abuse of the mutual system, largely through conditions – the Club Rules) requiring adherence to proper standards, and excluding cover if such standards are not met.

These principles can be stated quite briefly. Whilst inadvertent errors and mistakes (negligence) and the inevitable risks of ship-owning operations are insured, the consequences of intentional wrongdoing and of reckless or cynical disregard for the rights of other are not.

OBJECTIVE REQUIREMENTS

The club rules include terms concerning the condition, management, maintenance, and operation of entered vessels. They require that vessels be, and remain, classed by an

approved classification society and maintained at an acceptable standard. The recommendations of club surveyors concerning repair must be implemented and vessels and their operators must comply with statutory requirements ,including those of the flag state and, when applicable, the International Safety Management Code.

Failure to comply with these general requirements may result in, or contribute to, liability which otherwise would not arise, and which will not therefore be covered by club entry. But these rules concerning classification, compliance with statutory requirements, repair and maintenance, and condition surveys are not dependent upon knowledge or intent; they apply regardless of such matters. It is other conditions and statutory provisions that focus upon the member's state of mind or intention, in terms of knowledge or "privity" and the like.

A. Statutory Prvisions Concerning Intent

The club rules are subject to the English Marine Insurance Act 1906. A typical contract of P&I insurance is a time policy, in accordance with section 25 of the Act, and thus is subject to the following provisions:

Section 39(5)

In a time policy there is no implied warranty that the ship shall be seaworthy at any stage of the adventure, but where, with the privity of the assured, the ship is sent to sea in an unseaworthy state, the insurer is not liable for any loss attributable to unseaworthiness.

Section 55(2)(a)

The insurer is not liable for any loss attributable to the wilful misconduct of the assured, but, unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew.

Section 78(4)

It is the duty of the assured and his agents, in all cases, to take such measures as may be reasonable for the purpose of averting or minimising loss (Sue and labour).

Section 17

A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

These statutory provisions, are to a greater or lesser extent, reflected in the rules of all Group Clubs, whether subject to English law or not. They make knowledge and intent essential factors when determining rights of coverage. And the policy terms – the club rules – overlap and in some instances go further. For examples, Steamship Mutual’s rules require that members act as “prudent uninsureds”.

Contractual provisions concerning intent (Club Rules)

27(i) – Prudent Uninsured

The Member shall take such proper steps as in the opinion of the Directors are appropriate to protect its interests from the time when a vessel is entered in the Club and throughout the period the vessel’s entry as it should or would have done if not protected by the club. Compliance with this provision shall be a condition precedent to a Member’s right of recovery from the Club, provided that the Directors shall have power in their absolute discretion to admit in whole or in part a claim, notwithstanding a breach of such condition. The exercise of their discretion by the Directors shall be final and conclusive for all purposes.

These kinds of rules and statutory provisions can be contrasted with other general policy conditions under which the assured’s state of mind is, strictly speaking, irrelevant; for example, the rule required that entered vessels be in class, a condition of cover affected by knowledge or intent.

That there is some overlap between club rules and statutory law is evident from Steamship Mutual's Rule 27(ii).

Rule 27(ii) – Wilful Misconduct

There shall be no recovery in respect of any liabilities, costs or expenses arising out of or constituted by wilful misconduct on the part of the Member (being an act, intentionally done, or a deliberate omission by the Member, with knowledge that the performance or omission will probably result in injury, or an act done or omitted in such a way as to allow an inference of a reckless disregard of the probable consequences).

B. Discretionary Cover

The mutual clubs adapt their rules to meet changing circumstances and the changing needs of their members. They also have the flexibility to cover risks which are not contemplated in the written policy terms, or which are excluded. The directors of the club (who represent the membership as a whole) have a broad discretion, expressed in the Steamship Mutual's rules as follows:

Rule 25(xix) – Expenses Incidental to Shipowning

Liabilities, costs and expenses incidental to the business of owning, operating or managing ships which the Directors may decide to be within the scope of the Club. Claims under this paragraph shall be recoverable to such extent only as the Directors in their absolute discretion may determine without having to give reasons for their decision

Some rules also exclude cover for one reason or another *unless* the directors agree otherwise, in their absolute discretion.

Can the directors' general discretion be exercised to admit claims arising from the assured's breach of statutory provisions or of policy conditions concerning knowledge and intent?

Is it consistent with principles of mutuality that club directors can agree, for example, to cover liabilities arising from a member's failure to act as a "prudent uninsured"?

The answer is yes ,to both questions, and as a result there appears to be some contradiction. But that is resolved by looking at the differing ways in which knowledge, intent, and failure are attributed to an insured company. In short, the fact that misconduct of one kind or another may be legally attributed to a company, through corporate vicarious responsibility, does not necessarily mean that the company itself – those who control and guide it – acted with wrongful intent or acquiescence. The extent to which breach of contract or negligence, recklessness or deliberate malfeasance, are legally attributable (in the sense that the company is liable) varies according to circumstance. The discretion vested in club directors reflects the fact that a member may be held liable for substandard behaviour and for certain types of misconduct, which those who actually control and manage the company (and are thus identified with it for these purposes) neither promote, endorse, nor ignore.

The attribution of recklessness or other failure to a company, purely through vicarious responsibility for such conduct by its junior employees, is one of the many difficulties in justifying some awards of punitive or exemplary damages. It is also one reason why P&I club directors should have discretion to allow cover even for claims arising from intentional misconduct, if the member is liable only because of its vicarious responsibility for such misconduct.

This does not mean that the actions of those who guide the company, its directors, and most senior executives are irrelevant, or may be treated as irrelevant, merely because its shareholders do not control day-to-day operations or are unaware of such actions. On the contrary, the knowledge and intent of those who are actually entrusted with ultimate

management and operational responsibility will usually be equated with that of the company, regardless of whether such individuals happen to be its shareholders.

C. Knowledge and Privity

Section 39(5) of the English Marine Insurance Act excludes cover where, with the privity of the assured, a ship is sent to sea in an unseaworthy state. “Seaworthiness” as defined by Lord Justice Scrutton in the Court of Appeal in *Bradley v. Federal Steam Navigation Co.*, is:

That degree of fitness which an ordinary careful owner would require his vessel to have at the commencement of her voyage having regard to all the probable circumstances of it. Would a prudent owner have required that it (the defect) should be made good before sending his ship to sea, had he known of it?

But a failure to exercise due diligence to make the ship seaworthy at the beginning of the voyage (as in Hague and Hague-Visby Rules) does not in itself amount to recklessness or wilful misconduct, nor for that matter to “privity” within the meaning of section 39(5) of the Marine Insurance Act. “Privity is personal, in that it relates to the knowledge of those identified with the owners, the company’s “alter egos”, and not to the knowledge of employees and subcontractors who are not in any sense the company’s directing minds. It encompasses actual knowledge of unseaworthiness and so-called “blind-eye” knowledge, imputed to an assured who has well-grounded suspicions that his vessel is unseaworthy but who refrains from making further enquiry in order *not* to obtain confirmation of that fact – i.e. “in the hope that he will not know for certain that which any enquiry would have made plain beyond possibility of doubt.”

In circumstances such as these, where the company’s directing minds are in breach of section 39(5), the directors of a P&I club are unlikely to exercise their discretion to grant cover. Nor can a company disclaim or avoid such consequences merely by delegation. If the directors of a company place full and ultimate responsibility for the repair and

maintenance of a vessel into the hands of one individual, and if that individual is “privy” to the vessel’s unseaworthiness, his knowledge will in fact be that of the company itself.

D. Duties

The duty under Steamship’s rules to act as a “prudent uninsured” and the statutory duty to “sue and labour” incorporate obligations to which knowledge and intent are relevant. But they are different from the other rules and statutory provisions concerning conduct because their purpose is to impose positive standards, rather than to exclude cover for certain degrees of misconduct. It is not always easy, however, to define these duties.

1. Sue and Labour

In the context of a marine P&I liability policy, the extent of the duty to sue and labour, imposed under the Marine Insurance Act section 78(4), is limited. It does not require the owner to take every reasonable measure to avoid loss, because if it did there would then, in many cases, be no cover for liabilities resulting from negligence, and liability resulting from negligence, i.e. inadvertent error or oversight, is a core entitlement under P&I insurance. In *State of Netherlands v Youell*, the court held that the duty to sue and labour only arises after the occurrence of an insured peril, and that a failure to “sue and labour” only bars recovery if it is so significant as to displace the prior insured peril as the proximate cause of loss. In other words, if the assured’s failure to sue and labour is the dominant and effective cause of liability (breaking the chain of causation), the resulting claims will not be covered.

The duty to “sue and labour” often arises in casualties involving (or giving rise to the imminent threat of) major cargo damage: for example, complete engine failure, the vessel laden with perishable or timesensitive cargo, the voyage interrupted, the cargo stowage partly collapsed. In such a case, assuming that his breach has caused the breakdown, the owner might “sue and labour” in a variety of ways: separating sound cargo from damaged, repacking where necessary, fixing another vessel and transhipping cargo onto it for carriage to destination, or arranging for towage of his disabled vessel to destination.

If he were to incur any of these expenses, in order to minimise actual or imminent liability for cargo loss/damage (an insured risk under P&I entry), the costs would in principle be covered by the club.

However, if he declines to take such steps, and having abandoned the voyage then invites cargo to collect the goods instead of arranging for transshipment himself, is he in breach of his duty to “sue and labour”? And, would the club decline to cover the ensuing cargo liabilities, which will now be greater because of additional handling and on-carriage costs borne by the consignees?

The answer depends first upon whether the failure to take any such steps constitutes the dominant and effective cause of liability. In the example given, this is unlikely. Second, it depends upon whether, by virtue of any transshipment liberty in the bill of lading, the owner is not only entitled but also obliged to tranship. Does the liberty to tranship (or to tow) involve a correlative duty to do so? The answer, according to Mr. Justice Moore-Bick in *the Fjord Wind*, is *no*, following *Kulukundis v Norwich Union*. Thus the owner may well have no contractual obligation to tranship. But is he required to do so, however, because of his duty to “sue and labour”?

Once a casualty has occurred (as in this example), and assuming an inadvertent and/or unintended breach by the owner, the duty to “sue and labour”, and the possibility that cover may be declined because of the member’s failure to do so, is usually moot. This is because all P&I club rules contain extensive requirements concerning notification, liaison, investigation, and cooperation in the management of claims. Members are required to involve the club at the earliest possible stage of a casualty, so that decisions concerning the handling of a casualty (essentially containment and mitigation of potential liability) are then made with the club’s consent, in the light of legal and other expert advice. *Assuming compliance* with these requirements, and with the club’s rules generally, there is no question of failing to “sue and labour”. Costs incurred with the club’s approval to mitigate liability or imminent risk of liability are covered in principle.

2. The “Prudent Uninsured” Rule

The so-called “prudent uninsured” rule is not common to all clubs in the International Group. But it is a familiar feature of marine P&I policies, and is included in Steamship Mutual’s terms.

Each member is required to “take such proper steps to protect its interestsas (the member) should or would have done if not protected by the Club.

Is there a distinction to be drawn between how the Rule applies before and after an incident?

(i) Before a Casualty or Other Event

While the Rule does not exclude cover in cases of pure negligence or oversight, it nevertheless encompasses substandard conduct falling short of wilful misconduct. It means that if an owner can take steps to avoid or minimise the risk of liability, but chooses not to do so knowing or expecting that the result will be greater exposure, he cannot expect the club to indemnify him. Mr. Justice Donaldson in *The Eurythenes* defined it as

The concept of acting as would a prudent uninsured owner is well known to the law of insurance and imposes a duty which is less onerous than that imposed by a due diligence provision. Ignoring the thought that in this context a prudent uninsured owner is a contradiction in terms, such owners would be neither more nor less lacking in due diligence than an insured owner. What the cause is aimed at is the owner who lowers his standards simply because he thinks that he can look at to the association to pick up the bill.

The Rule is subject to similar qualifications as the “sue and labour” clause in section 78(4) of the Marine Insurance Act; it does not necessarily mean that the member is

uninsured if he has acted negligently before the casualty, because that could negate the cost protection afforded by P&I insurance. In many cases, the obligation to act as a prudent uninsured overlaps with other more specific club rules such as the requirements that vessels be classified, that they comply with statutory flag state and ISM requirements, etc. i.e. no “prudent uninsured” would permit any lapse in such compliance.

Does the club cover costs incurred by a member who acts as a “prudent uninsured” in the course of his ordinary operations?

The answer is no, since he must incur such costs in order to fulfil his statutory and contractual obligations diligently and to reduce or eliminate the risk of injury, damage and loss. Unless such expenditure relates to actual or imminent liability, resulting from the member’s breach (which then blends into “sue and labour”), the cost of acting prudently is no more than operational expenses, for which P&I club membership provides no subsidy.

ii) During or After a Casualty or Other Event Resulting in Liability

Once again, there is a parallel between the Rule and the duty to “sue and labour” under section 78(4) of the Marine Insurance Act. In practice, if the member has complied with his other Rules obligations, (to report forthwith and to co-operate with the club in the investigation and handling of the casualty) the duty to act as “prudent uninsured” is generally fulfilled and questions of breach are moot.

E. Exclusions and Limitations

1. The Distinction between Exclusions based upon the Definitions of Specific Risks, and those based upon Breach of General Conditions.

Amongst the most familiar of club rules are those requiring incorporation of the Hague or Hague-Visby defences (or equivalent – for example COGSA) in all bills of lading and other contracts of carriage under which cargo claims may be brought. The rules also

exclude liability which would not have been incurred but for the member's voluntary agreement to waive Hague and Hague-Visby defences. But it would be wrong to categorise a member who has agreed to carry cargo without the benefit of Hague defences as being in "breach" of club rules in some way, or as courting liability through "misconduct". Cover is not excluded for those reasons, but rather because the definition of mutual risks, as far as cargo liability is concerned, is aligned with the responsibilities and rights set out in these International Conventions. Where those rights can be preserved and invoked, they should be.

2. Delivery of Cargo Without Presentation of the Relevant Bill of Lading.

Specific club rules define and limit the types of cargo liability insured by the clubs membership. They include the following:

Rule 25 [viii]

Unless the Directors shall in their absolute discretion or otherwise determine, there shall be no recovery in respect of the Member's liability arising out of

(b) the delivery of cargo carried on an entered ship without production of the relevant Bill of Lading.

This Rule does not depend upon the member's intent or misconduct. The circumstances may be such that it is quite reasonable for the master to think that he should deliver cargo without production of an original bill of lading. It is not a question of misconduct, but rather whether the mutual clubs should insure such risks.

Delivery of cargo without presentation of an original bill of lading constitutes a breach of the contract as evidenced by the bill:

"A shipowner who delivers without production of the bill of lading does so at his peril. The contract is to deliver, on production of the bill of lading, to the person entitled under

the bill of lading..... The shipping company did not deliver the goods to any such person. They are therefore liable for breach of contract unless there is some term in the bill of lading protecting them and they delivered the goods, without production of the bill of lading to a person who was not entitled to receive them. They are therefore liable in conversion unless likewise so protected.” [Sze Hai Tong Bank Ltd v Rambler Cycle Co]

In *The Houda* the Court of Appeal reemphasised this principle, and in *Motis Exports* (at first instance) Justice Rix expanded upon it. In *Motis Exports*, the owners of the vessel were presented with forged bills of lading, which the master had no reason to suspect were fraudulent. The master was deceived, and in reliance upon the forged documents, issued delivery orders for the cargo. The goods had been discharged and were in the custody of the owner’s agents. After their delivery to the perpetrators of the fraud, the true owners of the cargo, who held the genuine bills, sued the owners for breach of the bill of lading contract and in tort for conversion.

The owners were held liable, notwithstanding the finding that the master, without fault, was deceived by the forgery. The rationale of this decision was that the owner could not be obliged to deliver against forged bills of lading, and thus was not entitled, as a matter of contract, to do so. Nor was it appropriate to imply a term protecting the innocent shipowner in such circumstances.

In the context of the club rules, *Motis Exports* underlines the point made earlier that this risk is excluded, not because of a member’s wrongful intent or otherwise, because there was not such wrongful intent in *Motis Exports*, but rather because the tort of conversion in such circumstances is not regarded as mutual. It follows that delivery of cargo without presentation of bills of lading, against an indemnity provided by charterers or consignees, remains in the same category of excluded risk. Even if, as is usually the case, such delivery occurs in innocent circumstances, reflecting normal commercial arrangements (particularly in the carriage of oil cargoes), the member’s cover is not “reinstated” when he obtains an indemnity or Letter of Indemnity in exchange for his agreement to release, or authorised the release of, the cargo. Whether any such indemnity is sufficient in fact

to replace club cover depends upon its terms and the financial standing of those providing it.

In cases such as *Motis Exports*, the question whether cover should be provided to the member is thus for the directors of the club to decide, in the exercise of their absolute discretion. Cases of this kind are, fortunately, rare

3. Antedating of, and Misdescription in, Bills of Lading

The club rules also exclude cover for liability arising from the antedating of a bill of lading and from an incorrect description of cargo which is known to the member or master. Both define the type of cargo liability insured by the club and relate the nonavailability of cover to what in many circumstances must amount to wilful misconduct.

The rationale for excluding liability under antedated bills of lading can, however, be explained on grounds that are independent of intent or conduct. Club cover for cargo liabilities is predicated upon physical risks encountered during the performance of carriage. Even conversion of cargo, by misdelivery without presentation of the bills of lading, amounts to a physical risk of total loss (to the consignees) and thus, although an excluded risk, constitutes a liability resulting from breach of familiar Hague and Hague-Visby duties.

The antedating of bills of lading involves a quite different assumption of risk, which is not contemplated in any event under the P&I club rules providing cover for cargo liabilities. A member is indemnified against liability resulting from breach of his duties to “load, handle, stow, carry, keep, care for, discharge and deliver cargo, or out of unseaworthiness or unfitness of the entered ship.” It thus appears that even without an express exclusion of liability resulting from antedating, the risk would not be covered, because it does not in any event result from any breach of the duties set out above.

The exclusion in club rules is thus a reflection of objective limits which define the type of cargo liability covered by mutual entry, regardless of the members' knowledge or intent. (The exclusion does not depend upon the member's or master's knowledge of antedating). But it is also a reflection of that fact that, in cases where the point arises, a bill of lading may well have been antedated with the knowledge of the owners or master. That knowledge will probably constitute a conspiracy to defraud the buyers and the banks acting on their behalf. For this reason the rule is a hybrid, reflecting both the limits upon the types of cargo liability insured, and the general principle which excludes cover for any liability resulting from wilful misconduct.

4. Misdescription of Cargo

By contrast, the rule excluding cover for liabilities arising from misdescription of cargo in the bill of lading is dependent upon knowledge; it operates only if the member or his master knows that the cargo has been misdescribed, or its condition or its quantity misrepresented. It follows that when the master and member are each unaware of the fact of any such misdescription, liabilities arising under such a bill of lading are covered in principle.

In what circumstances may the owners or master accept a letter of indemnity from the shippers, in exchange for issuing a clean (unclauses) bill of lading?

The club rule, excluding cover, applies when the owners or master know that the bill of lading contains a misdescription. If, however, there is an honest difference of opinion between the shippers, on the one hand, and the owners/master on the other (for example, when light surface rust on a cargo of steel is said by the master to be "damage", and by the shippers to be no such thing), the owners will not necessarily prejudice their cover if they agree to issue unclauses bills. As always, it depends upon the circumstances.

5. Punitive Damages

On the face of it, and certainly in most cases, the P & I policy conditions concerning conduct, privity, and so forth exclude punitive damages from cover.

Although the definition of what kind of conduct may lead to such damages varies considerably from country to country, and in America from state to state, it seems reasonably clear that a high degree of recklessness, at the very least, is required to justify an award. That alone, given the club rules relating to wilful misconduct (which includes recklessness) and the duty to act as a prudent uninsured, is sufficient to answer the question: Are members of the club insured against their liability for punitive damages?

From the perspective of the club member, however, it may not always be as simple as that. An owner will agree, that the club's funds (to which he is a contributor) should not cover damages resulting from the deliberate and wrongful acts of a fellow member, which are so outrageous as to require separate punishment over and above any compensatory award. He might conclude, as it seems a number of U.S. state courts have concluded, that whilst liability insurance covers inadvertent acts causing injury, cargo damage, pollution and the like, it does not cover reckless and intentional misconduct "causing" awards of punitive damages, a quite separate risk, and one that is simply not in the "list" of insured liabilities under a P&I policy.

These conclusions are perhaps obvious whenever it is apparent that an award of punitive damages is *actually justified* by the misconduct of the insured club member. To decline cover in such circumstances is consistent with principles of mutuality and in accordance with the rules which preserve those principles.

For most members, however, the question does not end there. The difficulty arises when an award of punitive damages appears on any objective analysis to be wholly unsubstantiated by the facts; and when allegations, which if proven, might result in punitive damages but which the owner strongly denies, are included in an otherwise ordinary P&I claim, denied they must be, but at considerable additional cost. There is, furthermore, the problem of punitive damages for misconduct which is attributed to a company purely through vicarious liability.

a. Can Liability for Punitive Damages be Insured?

Certainly as far as *insurability* is concerned, which involves different considerations than those relating to whether an award of punitive damages is actually covered under a particular marine policy, the fact that a company may be held vicariously liable for the misdeeds of its employees (without the involvement or acquiescence of its directing minds) has assisted the conclusion, in England, that punitive damages are insurable.

In 1997, the English Law Commission published its report upon aggravated, exemplary, and restitutionary damages. In considering the question whether insurance against civil liability for exemplary (i.e. punitive) damages is contrary to public policy (the argument against being that such insurance would frustrate the punitive or deterrent effect of such damages upon the defendant), the Commissioners focused upon *Lancashire County Council v Municipal Mutual Insurance Ltd.*, the leading English case authority. Both at first instance and in the Court of Appeal, it was held that public policy did not prevent insurance against the consequences of a company's vicarious liability. But the Court of Appeal appears to have gone further than this, leading the Commissioners to conclude that:

The key distinction in the existing law may not be between personal and vicarious liability. Rather, it may lie between insurance against the personal or vicarious liability of defendants where their conduct would amount to criminal conduct, and insurance against personal or vicarious liability for conduct not amounting to criminal conduct.

Having examined existing case law, both in England and elsewhere, the Commissioners concluded in favour of insurability, recommending that “insurance against punitive damages awards is in all cases permitted by legislation”. Their reasons were:

(i) The need for plaintiffs to have a financial reason for claiming punitive damages.

There is a clear public interest in punishing and deterring bad conduct of a nature which merits a punitive damages award, as well as in offering appeasement to the victims

thereof. Nevertheless, it is futile to discuss the pursuit of these aims through civil litigation if plaintiffs will not claim punitive damages because the defendant cannot pay them. Plaintiffs are unlikely to claim punitive damages where defendants do not have the financial capacity to pay any substantial damages and costs which may be awards against them. Such capacity may be afforded, however, by liability insurance.

(ii) The efficacy of the pursuit of the aims of punitive damages

We do not believe that the aims of punitive damages will be either wholly or substantially frustrated by generally permitting insurance against awards. Although we recognise that any retributive and deterrent purposes of this category of damages may be diluted by our proposed approach to insurance, we do not anticipate that they will be wholly frustrated: in particular, the insurance industry, in controlling the availability and cost of such insurance, is in a position to exert significant pressure on present or potential insured parties.

(iii) Sanctity of Contract

There is a general policy underlying the law of contract that commercial contracts ought not to be lightly interfered with by courts or even legislation. In *Printing and Numerical Registering Co. v Sampson* for example, Sir George Jessel MR offered a powerful entreaty to courts considering the application of any doctrine of public policy;

“ If there is one thing which Public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice. Therefore, you have this paramount public policy to consider – that you are not lightly to interfere with this freedom of contract ”

(iv) ‘Self-insurance’ and ‘gifts’: comparisons

We are also impressed by two arguments put forward by consultees to the effect that a bar on insurance would be inconsistent or unfair in its effects, owing to some alternative

ways in which a liability to pay punitive damages could be met without the need to insure, and even if insurance against such liability was to be barred. The first argument was that a bar on insurance is objectionable because it produces inequality between the impact of punitive damages awards on organisations which are able to 'self-insure' and those which cannot. The second was that no objection is made to allowing another person or organisation to meet a defendant's liability to punitive damages by way of a gift.

“ It is interesting that under the English legal system, which is regarded as more conservative and restrained than its American counterpart, the principled position relating to insurability, that there is no public policy restraint, is considerably wider than that of some American State courts. Insurance is certainly permitted in most states. But in a minority, the courts adhere to arguments rejected by the Law Commission, citing the goal of effective deterrence as a reason for avoiding such coverage. Or permitting it only in cases of vicarious liability without personal fault on the part of the insured.”

The second quoted passage above, from the Law Commission's report, anticipates the response of the insurance industry to the fact that in England, and in the majority of states, there is thus no bar upon the insurance of liability for punitive damages. The P&I Clubs, as we have seen, specifically exclude cover for liabilities resulting from the kind of conduct which may lead to an award of punitive damages. It remains the case, however, that insurers whose policies are subject to English law *can*, if they wish, insure punitive damages, at least in cases of pure vicarious liability.

b. Unfair Awards: Juries

Jury awards – especially in the USA, are frequently excessive, of course, but as *Exxon v. Baker* implies, juries are also very willing, often too willing, to conclude that a defendant's conduct should be punished by punitive damages in the first place.

There is a certain irony too. Awards of punitive damages condemn outrageous and oppressive conduct, and yet all too often, in the hands of a jury, are themselves the very instruments of such oppression. In short, the numerous objections to juries – including inconsistency, arbitrariness, prejudice, the absence of any stated reasons – relate to both stages of the process- first, as to the fact, and secondly, to their proper assessment. It is juries on the whole, and not judges, whose decisions are most likely to be susceptible to the criticism of unfairness.

The objections to allowing juries to go beyond compensatory damages are overwhelming. To allow pure punishment in this way contravenes almost every principle which has been evolved for the protection of offenders. There is no definition of the offence except that the conduct punished must be oppressive, high-handed, malicious, wanton or its like – terms far too vague to be admitted to any criminal code worthy of the name. There is no limit to the punishment except that it must not be unreasonable. The punishment is not inflicted by a judge who has experience and at least tries not to be influenced by emotion: it is inflicted by a jury without experience of law or punishment and often swayed by considerations which every judge would put out of his mind. It is no excuse to say that we need not waste sympathy on people who behave outrageously. Are we wasting sympathy on vicious criminals when we insist on proper legal safeguards for them? But the right to give punitive damages is so firmly embedded in our law that only Parliament can remove it.

c. What sort of Misconduct Justifies Punitive Damages?

The availability of punitive damages is very much more restricted under English law than in the United States. In England, punitive damages can only be awarded against defendants within one of two recognised categories.

These categories are limited, allowing awards only against government agencies or authorities, and otherwise only against individuals or privately owned companies if their oppressive and outrageous conduct has been calculated to produce a greater financial benefit than any compensatory damages payable for such misconduct.

The right to jury trial in the UK is also far more limited than in the USA. But the test for determining what type of conduct actually justifies an award of punitive damages is essentially the same. So far as English law reform is concerned, the Commissioners would abolish the limited “categories”, and permit awards in any appropriate case of tort, negligence or equitable wrongdoing e.g., malicious breach of trust:

“The minimum threshold is that the defendant has been subjectively reckless –[to use criminal law terminology.] The notion of “outrage” imports the element of judicial discretion that is believed to be inevitable and essential in this area. Factors that will no doubt be relevant in deciding whether conduct is not merely reckless but outrageous would include whether the wrong was intentionally committed, the extent and type of the potential harm to the plaintiff, and the motive of the defendant.”

[Law Commission Report]

The Commissioners also concluded:

Particularly helpful is the Restatement (Second) of Torts, section 908, which reads:

(1) Punitive damages are damages, other than compensatory or nominal damages, awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future.

(2) Punitive damages may be awarded for conduct that is outrageous, because of the defendant’s evil motive or his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of the defendant’s act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant.

The justification for awards of punitive damages is thus in theory at least the same, what is different is the apparent absence of consistent and reliable control over awards in the United States.

This presumed lack of control, in a civil law system dominated by jury trial, permits a constant stream of irrational and unjust decisions (even if the US appellate courts recently seem inclined to exercise a more demanding standard of review when jury awards get really out of hand – reviewing “de novo” rather than merely for abuse of discretion). Thus, the Law Commission concluded that the “judge and not a jury, should determine whether punitive damages should be awarded, and if so, what their amounts should be.”

d- Controlling Excessive Awards

The English viewpoint is that moderation and proportionality can be maintained only if juries are excluded. Nor is the problem simply one of jury trials. One of many other arguments against permitting punitive damages altogether is that “large awards produce incentives to unfounded litigation.”

In England the counterargument is that the cost of litigation, together with the fact that the unsuccessful plaintiff will have to bear the successful defendant’s legal costs, is a significant deterrent to those who may otherwise be inclined to launch unfounded claims. These are controlling factors, neither of which appears to be the norm in the United States because (1) much litigation is conducted on a contingency fee basis and (2) awards of costs against the losing party are rare. Furthermore, the United States Supreme Court appears to have set its face against a pure tariff-based approach towards punitive damages, whilst by contrast in England there is a clear and increasing trend towards providing fixed quantum guidelines. They are no more than that – guidelines, not rules – but they are highly influential, and the Court of Appeal has, for example, indicated that sums should be minima and maxima in actions against the police for false imprisonment and malicious prosecution.

The English Courts have in the past been more inclined than their American counterparts to exert appellate court control over jury-assessed awards. Recently, however, United States Supreme Court and United States Court of Appeals for the ninth Circuit decisions suggest that in the United States there is now less reluctance to intervene. Indeed, if

American State Courts follow the latest Supreme Court decision, punitive damages should never exceed nine times the compensatory award, and in most cases should not exceed three times.

e. Punitive Damages in Maritime Cases

To many American maritime lawyers whose practices are largely concerned with claims for personal injury, it may seem strange to be focusing on these issues now. In the wake of *Miles v Apex Marine Corp.*, [498 U.S. 19, 1991 AMC 1 [1990]] the right of seafarers and of others to claim punitive damages for maritime injury and death is no longer recognised by many courts. But as in cases of pollution, and environmental claims generally (which may well include an injury component), punitive damages are still sought in personal injury claims. Unless and until it becomes clear that all such awards have been excluded by *Miles*, these claims will continue to feature in U.S. maritime injury and death claims.

If juries, or judges are unable to express their disapproval and condemnation through awards of punitive damages, they are more likely to do so under the cloak of compensatory awards, allowing damages for various recognised heads of claim at higher levels than would otherwise be justified (or required) if outrageous misconduct permitted a separate award of punitive damages. Such liabilities, even if inflated in this way, will normally be covered under marine P&I policies.

g. Club Cover

Can punitive damages be covered under a marine protection and indemnity policy if the allegation or award is unfounded or unfair, or if such liability arises purely because of vicarious responsibility? There are various replies:

- a) There is no prohibition against recovery per se, at least under policies subject to English law.

- (b) However, the clubs cover defacto liabilities, and these liabilities are defined in the Rules. Whether “fair” or not, justified or otherwise, punitive damages are not included under the terms of their policies (damages awarded by way of punishment for wilful misconduct are entirely different from, for example, compensation for loss of life or personal injury. The latter is included in club policies, the former not).
- (c) It may be easy to say that an award is unfair or driven by prejudice, and that the decisions of juries are notoriously suspect. It is quite another to say that club managers should substitute their own view of liability in place of a binding court decision in order to justify cover which is otherwise excluded. This highlights the difficulty in second guessing such awards, how does one distinguish fair from unfair?
- (d) Club rules concerning conduct and so forth apply regardless whether liability is incurred “vicariously” or otherwise.
- (e) Nevertheless, club boards have a broad discretion to admit claims in order to serve the needs and expectations of the membership as a whole, a discretion exercised against the background of “mutuality”. Even if they are disinclined to cover claims involving punitive damages, and even if no member would assume such cover, it seems that club boards are in principle entitled to allow cover and might be prepared to do so in the case of a member’s pure vicarious liability for misconduct leading to such an award.
- (f) When an allegation of entitlement to punitive damages is included in proceedings, the clubs can and in some cases will cover the costs of defence, upon the basis inter alia that it is appropriate to do so in order to resist the main i.e. non-punitive) allegations of liability.

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