# THE DUTY OF UTMOST GOOD FAITH AND WARRANTIES IN MARINE INSURANCE

**(A comparative analysis)**

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## Abstract

This thesis consists of a comparative analysis of two elements of marine insurance that are the source of divergence between common and civil law jurisdictions: the duty of utmost good faith and warranties. The thorough analysis will show that the two jurisdictions and, presumably, the common and civil law traditions, diverge in the field of marine insurance in the legal concepts as such, but not so much in the substance of the contract.

The duty of utmost good faith permits the insurer to be fully and properly informed about all circumstances material to the assessment of the risk and to making of the contract and its terms. Despite relative coherency of the regulation of the issues of materiality and causality between the breach of the duty of utmost good faith and the loss occurred, the sanctions for the breach vary significantly between the civil and common law jurisdictions. It will be examined how the warranty, a typical common law concept, has been replaced in civil law jurisdictions.

Various methods of harmonization will be examined and discussed in the light of possible application in the field of marine insurance. In the conclusion, it will be argued that reconciling fundamental legal concepts inherent to various legal traditions is a demanding task and may not be as advantageous for the respective field of law as it is expected to.

**Résumé**

Cette thèse consiste en une étude comparative de deux éléments de l'assurance maritime qui représentent la source de divergence entre le droit civil et le "common law": l'obligation de bonne foi et les "warranties". L'analyse détailée permettra de proposer que les deux juridictions examinées ainsi que les deux grand systèmes juridiques divergent en domaine d'assurance maritime sur les concepts fondamentaux eux-mêmes, mais pas autant sur le contenu de la relation contractuelle.

L'obligation de bonne foi permet à l'assureur d'être complétement et adéquatement informé de toutes les circonstances qui soient importantes pour l'évaluation du risque et pour la conclusion du contact et la formulation de ses éléments. Malgré une cohérence relative dans la régulation des questions concernant l'importance des circonstances et la causalité entre la violation de l'obligation de bonne foi et le dommage ou la perte, les sanctions varient considérablement entre le droit civil et le "common law". Il sera analysé comment les "warranties", un concept propre au "common law", ont été remplacés dans le droit civil.

Les moyens différents de l'unification seront examinés et discutés en vue de l'application potentielle dans le domaine d'assurance maritime. En conclusion, il sera avancé que l'unification des concepts juridiques fondamentaux, propres aux différents systèmes juridiques, représente une tache exigeante dont les résultas n'engendront peut-être pas dans le domaine d'assurance maritime d'avantages envisagés.

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# PART ONE: INTRODUCTION

## *A. THE BACKGROUND*

Contractual relationships with an international element are far from being a rarity in the modern world. The mixture of places and people involved in international transactions makes the legal aspect of contractual relationships more complex. Although complexity and variety enrich life, they can also make it very bitter when it comes to a disagreement. And it can be said that the resolution of disagreements is what law is all about.

International contractual relationships are especially critical when contracting parties come from different legal traditions. It is not only the language that makes contractual provisions ambiguous, but most of all, the differences in the legal conceptions. What a "legal rule" means in the civil law tradition does not have the same meaning in common law traditions[1].

The interaction of legal traditions is not new in the modern world. It has been going on for centuries, but with the greatest intensity in the last 50 years. This is due to the phenomena of - globalisation[2].

The growing number of international contractual relationships and the disputes arising out of them have caused legislators and jurists to look for appropriate means for improving the situation. Conflict of laws rules, international conventions, model laws and standard forms are methods by which we try to reconcile legal traditions, usually between the civil and the common law legal traditions. Which method will in a particular case serve best the objective depends on the nature of the legal issue to be reconciled, on the interested parties involved, and on the domain of law. And yet, the success is not guaranteed.

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[1] See W. Tetley, "Mixed jurisdictions: common law vs civil law (codified and uncodified), Part I" (hereafter "Mixed jurisdictions, Part I"), http://tetley.law.mcgill.ca at 17.

The number of domains where reconciliation was attempted or completed has grown. And one of the latest challenges is the field of marine insurance[3].

### *B. THE PURPOSE AND THE PLAN OF THIS THESIS*

The purpose of this thesis is to show that despite the identifiable differences in the field of marine insurance a convention or a model law may not be necessary or useful. The scope of the present text is far too limited to permit a conclusive answer, but I will, nonetheless, try to set forth arguments in support of such a thesis.

The substance of the contract of marine insurance does not vary substantially from one jurisdiction to another. The divergences derive mainly from the legal concepts inherent to each legal tradition. It is not a conflict of substance; it is a conflict of form i.e. of legal traditions. The reconciliation of conceptual differences is a demanding and complex task, but the practice has bridged the differences by creating standard and internationally accepted terms.

The Comite Maritime International has identified a number of elements of the marine insurance where the two western legal traditions seem to diverge. I have focused my research on two aspects of marine insurance: the duty of utmost good faith and warranties.

I chose the duty of utmost good faith because it is not an ordinary obligation, but operates on the level of a legal principle (in the civil law sense). The duty of utmost good faith is a general principle, known in both legal traditions, the content of which is vaguely defined by a moral standard - the good faith. There is no legal definition of good faith while practice has shown that it can have various facets. It is not the content of this obligation

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[2] See R.Goode, *Commercial law in the next millennium* (London: Sweet&Maxwell, 1998) at 81-105.
[3] See J.Hare, "The CMI review initiative", at http://www.comitemaritime.org; see also Lord Mustill, "Convergence and Divergence in Marine Insurance Law" (2000) 31 J.Mar.L. &Com. 1-14; see also Trine-Lise Wilhemsen, "Duty of Disclosure, Duty of Good Faith, Alteration of Risk and Warranties", http://www.comitemaritime.org.

that makes the two legal traditions irreconcilable; what tears them apart is the sanction for its breach.

Warranties are a type of contractual term known in common law jurisdictions only. Their objective is to allocate the risk between the parties to a contract. It is a legal concept that represents one of the fundamental differences between the common and civil contractual law.

These two apparently unrelated legal notions are, in fact, connected in the field of marine insurance by the need of the insurer to be informed as much as possible about the true state of the risk or in other words to create circumstances which allow the insurer to offer the insurance at an appropriate rate.

The thesis is divided in five parts. The first part consists of a description of the thesis and the social context in which the subject of the thesis arose, the method of analysis, the legal sources of the two jurisdiction considered (Slovenia and the UK) and an explanation of the terminological issues. The second part provides an analysis of the duty of utmost good faith, followed in the third part by an analysis of the warranties in general. The discussion about the methods of harmonization and their applicability in the field of marine insurance will be presented in the fourth part. The fifth part consists of the conclusion.

### *C. THE METHOD*

I have based my study on the law of the United Kingdom, the cradle of the modern marine insurance, as an example of the common law jurisdiction and on the law of Slovenia as an example of the civil law jurisdiction. I analysed various aspects of the two legal systems in those jurisdictions, especially in respect of statutory regulations, the case law, and the doctrine.

For the civil law jurisdiction, I relied on the Slovene Marine Code (hereafter the SMC) and the doctrine. The case law is quite modest and very difficult to access. Only the

decisions of the Supreme Court of Slovenia are published and very few of them treat the subject of marine insurance. The reason for that may be found in the practice of the insurance companies who wish to avoid litigation and usually submit their disputes to arbitration. The awards are, of course, not published.

It is not the purpose of my thesis to give an exhaustive list of cases in which the issues addressed are dealt with, but to highlight the legal issues and analyse them in the light of possible harmonization. The *questio facti* will only be addressed when it is necessary for a comprehensive treatment of the subject. From the comparative aspect, questions of facts are interesting only for the analysis of what is considered to be a question of fact.

## *D. THE TERMINOLOGY*

The various legal traditions use various legal terms to describe various legal notions. In addition, differences exist also in the legal concepts found in various legal traditions. Therefore, it is very important to define the meaning of relevant legal notions and terms that will be used throughout the text.

### 1. Legal principle - Civil law

In the civil law system, legal principle is defined as a measure of value which serves to fill in the substantially empty parts of a particular legal provision and which permits the choice between various options. Legal principles determine criteria for behaviour in legal relationships in which we assume various types of conduct and behaviour[4]. It is a sort of an umbrella-rule that encompasses various types of conduct and behaviour.

Legal principles enable courts to participate actively in the process of creation and formulation of legal rules. The court does not merely construe the norm, as it is the usual function of courts in the civil law system, but actually fills in the norm and, hence, participates in the formulation of its content. The judge is not merely an applicant and an interpreter of legal norms, but also a creator of legal norms.

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[4] See M. Pavcnik, "Pomen pravnih nacel" (1991) Podjetje in delo 6/1991) XVII at 653-657; B.Strohsack "Temeljna pravna nacela obligacijskega prava" (1991) Podjetje in delo 6/1991) XVII at 693 - 701.

### 2. Legal principle - Common law

In the common law, the legal principle is an abstract prescription of the envisaged conduct in a particular legal situation. The common law notion of legal principle, in fact, corresponds to the civil law notion of legal rule[5].

### 3. Legal rule - civil law

The legal rule contains an abstract, yet not very broad definition of a type of conduct or behaviour that is expected in a particular legal situation. The courts and practitioners in particular cases apply legal rules[6].

### 4. Legal rule - common law

In the common law, the legal rule is defined as the rule enunciated in the particular case i.e. a particular judicial application[7].

### 5. Legal standard

A legal standard is a flexible legal notion that may have various meaning in various legal relationships. It is counted among the so-called undefined legal notions and represents a substantially empty part of legal provisions[8]. The legal standard may, thus, impose different conduct in different legal situations. The legal standard contains a lower degree of abstraction than the legal principle therefore it may be directly applied by the court. The jurisprudence and courts develop criteria that facilitate the application of legal standards[9].

## *E. JURISDICTIONS*

Legal traditions have various types and hierarchies of legal sources.

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[5] See Tetley, "Mixed jurisdictions, Part I", *supra* note 1 at 17.
[6] See Tetley "Mixed jurisdictions, Part I", *supra* note 1 at 17; see also Pavcnik, *supra* note 4 at 655.
[7] See Tetley, "Mixed jurisdictions, Part I", *supra* note 1 at 17.
[8] See V.Kranjc, "O pravnih standardih pogodbenega prava" (hereafter "Pravni standardi") (1996) 51 Pravnik 493.
[9] *Ibid.* at 494.

## 1. UNITED KINGDOM

### *a) Statutes*

Unlike most of the common law domains, the field of marine insurance is regulated by the statute: the Marine Insurance Act of 1906 (hereafter the MIA). The MIA is the main source of the rights and obligations of the parties to the contract of marine insurance. It represents a partial codification of the law of marine insurance as it was practiced in the 19th century[10].

### *b) Judge-made law*

The core of the common law is the judge-made law. The legal rules are established on the basis of thorough analysis and comparison of various fact patterns (the cases). The rules have a very narrow scope while they may only be applied to the cases with the same or similar fact pattern[11]. The creative role of the courts is limited by the doctrine of *stare decisis*[12] where courts are bound to follow former decisions even if they would like to decide otherwise.

### *c) Doctrine*

The doctrine is an important legal source in the common law. There are many exhaustive and detailed texts concerning various aspects of marine insurance that are also relied on by the British judges[13].

### *d) Contracts*

The contract of marine insurance is primarily governed by the general law of contracts. Since it has developed some principles of its own, we can also speak of the contract law of insurance[14]. The principles developed within the frame of marine insurance have been

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[10] See, below, "2. THE EXISTING SUBSTANTIAL HARMONIZATION".
[11] See Tetley, "Mixed jurisdictions, Part I", *supra* note 1 at 15.
[12] Lat: to stand by that which was decided; see S.H.Gifis, *Law dictionary* (New York: Barron's, 1991).
[13] See generally R. Merkin, ed., *Colinvaux's Law of Insurance*, 7th ed. (London: Sweet&Maxwell, 1997); J.Birds, *Modern Insurance Law*, 4th Ed. (Sweet & Maxwell, London, 1997); R.Merkin, *Annotated Marine Insurance Legislation* (London: LLP, 1997); Arnauld, *Law of Marine Insurance and Average*, M.Mustill & J.Gilman, eds, (16th ed, 1997), and texts referred to in this text.
[14] See J.Birds, *Modern Insurance Law*, 4th Ed. (Sweet & Maxwell, London, 1997) at 1.

applied to other types of insurance subsequently developed. Marine insurance is, therefore, called the mother of all insurances[15].

*e) Lex maritima*[16]

The lex maritime represents another legal source for the contract of marine insurance. It is a *ius commune* or the "general maritime law" which exists in the United States, the United Kingdom, Canada, and in may other "shipping nations"[17]. It consists of the *lex maritima* that is part of the medieval *lex mercatoria*[18] along with the common forms, terms, and practices of the shipping industry.

## 2. SLOVENIA

*a) Statutes*

In civil law countries, the main legal source is the statute. Not all the provisions of a statute have the same legal force, there being a distinction between the provisions that are mandatory and have the force of the public order, on the one hand, and the provisions that are not mandatory and can be changed by the parties, on the other hand.

The hierarchy of the legal sources is, thus, composed of the statutory provisions with the force of the public order on the top of the pyramid, the express contract terms and standard general contract terms which are complemented by the non-mandatory (dispositive) statutory provisions, usages and customs, arbitration and court decisions, and, finally, by the doctrine.

### (1) The Slovene Marine Code

The contract of marine insurance was first regulated by the Napoleon *Code de commerce*, but was later replaced by the rules of the British law. In the time of the Federal Republic of Yugoslavia, marine insurance was regulated by the *Law on the sea and inland*

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[15] See W. Tetley, *International Conflict of Laws - Common, Civil and Maritime*, (Montreal: Les Editions Yvon Blais Inc., 1994) at 335.
[16] See W.Tetley, "The general maritime law - the lex maritima", 20 Syracuse J.Int'l L.& Com.105.
[17] See *ibid.* at 107.
[18] Generally see, below, note 300.

*shipping* [19] which was based on the British Marine Insurance Act of 1906 and the Italian *Codice della Navigazione* from 1942. Today, the contract of marine insurance is regulated by the new Marine Code in chapter 5 (ss.680-743). The provisions are basically the same as in the previous statute[20]. The provisions of the respective chapter are mainly of non-mandatory nature therefore the parties may stipulate otherwise than as provided by the statute.

### (2) The Slovene Civil Code

The Slovene Civil Code (the law on obligations) at chapter 27 defines the contract of insurance, but it does not apply to marine insurance and to other insurance to which the rules of marine insurance apply (s.899)[21].

Since insurance is a contractual relationship, the general rules of contract law shall apply for the issues that have not been expressly regulated by the parties or cannot be subject to a different regulation by the parties, provided, however, that such issues are not regulated by the SMC which is a *lex specialis* in respect to the Civil Code.

### *b) Contract*

Insurance is a highly formable legal branch. Contracts are formed on the basis of non-negotiable terms set out in advance by the insurance companies that cannot be influenced by the persons seeking insurance. It is a typical example of the contract of adhesion where one party sets the terms and the other may only accept or refuse.

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[19] Zakon o pomorski in notranji plovbi, published in Ur.l.SFRJ, no.22/77, ss.689- 752.

[20] Section 680 of the SMC defines the subject of the marine insurance. It covers the insurance of the hull and everything that (it contains) is placed on it (the machinery and cargo), insurance of the expenses, freight and other material rights and benefits which exist or may be justifiably expected to arise in the connection with the voyage and the carriage of goods by the vessel and may be valued in money as well as the insurance of the damage caused to the other parties in connection with the exploitation of the vessel and other items (objects), stated in the subsection (1) of the respective section.

[21] The legislator chose a different, less binding regulation of the marine insurance due to the fact that the parties to this type of contractual relationships are not the physical persons, but mostly legal persons, specialized companies with the deemed equal bargaining power. These subjects do not need the same protection as the unsophisticated individuals that enter into various insurance contracts. Despite the high level of sophistication, some of the rules of the marine insurance have the nature of the public order and cannot be changed or excluded from the contract by the parties.

The general contractual terms, however, may be complemented or altered by specific contractual terms. In practice, the basis for the marine insurance contract is the British marine insurance policy. Its content is complemented by the general Institute Clauses and others (for war, political and other risks) as well as by special clauses for specific goods. The application of statutory provisions will be affected by events that have not been foreseen and, therefore, not defined by the parties in the contract by taking into account the intent of the parties, unless there is a question of public order.

***c) Custom and usage***

In the field of commercial law, custom and usage represent an important legal source. Throughout the years, entrepreneurs have articulated their own rules of behaviour for various contractual relationships. According to the Slovene legal theory, custom is considered to be a certain type of behaviour that is generally accepted or perceived as the correct and usual behaviour in certain circumstances whereas usage is defined as a custom that has been written down[22]. Custom and usage are in general more appropriate for regulation of business contractual relationships, while business requires highly flexible regulation. However, the application of custom and usage is not automatic in the Slovene legal system. According to s.21 and to s.1107 of the SCC the application of usage must be expressly stipulated for or it may be so concluded in respect of the circumstances of the business. General standard contractual terms very often reflect custom and usage of the business branch.

[22] B.Strohsack, *Obligacijska razmerja I* (Ljubljana: Casopisni zavod Uradni list RS, 1995) at 28.

# PART TWO: THE DUTY OF UTMOST GOOD FAITH

## *F. INTRODUCTION*

The duty of utmost good faith is a general legal principle[23]. As such, it differs from a legal rule[24] in that the statute does not define its content in advance. It needs to be "filled in" or completed by the courts. In other words, the statute does not say what kind of conduct by the parties amounts to a breach of the duty of utmost good faith. There is no definition. It is up to the court to decide when dealing with a dispute as to which conduct complies with the duty of utmost good faith and which does not. Therefore, the key question in the analysis of the duty of utmost good faith is: " What conduct of the parties to a contract represents a breach of the duty of utmost good faith?"

The statutes, legal theory, and courts have defined some of the "utmost good faith occasions", namely the duty to disclose and not to misrepresent material circumstances. I believe, however, that the duty of utmost good faith as an overriding principle in the insurance contracts keeps the door open for other good faith occasions to be identified. How wide the door is open may nonetheless vary from one jurisdiction to another.

## *G. THE PLAN AND PURPOSE OF PART TWO*

In the second part of this thesis, I will analyse the duty of utmost good faith as to its content, duration, and the sanction applicable in the event of the breach in both jurisdictions. The analysis is based on relevant statutes as the primary source of information, the case law as the secondary, and the jurisprudence (articles and books) as the third. Most abundant case law has been developed by the courts in the UK, whereas

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[23] The word "principle" is used in its civil law meaning which designates an overriding concept. The adequate common law terms seems to be a "principle of law" while it is used by Lord Hobhouse of Woodborough in the "*Star Sea*"; see the citation under, *infra* note 38.

[24] The word "legal rule" is used in its civil law meaning. According to Tetley the term "legal rule" in English law refers to the rule established in a particular case what is otherwise considered only as a judicial application in the civil law. See Tetley, "Mixed jurisdictions, Part I", *supra* note 1.

the Slovene courts have pronounced few rulings on the issue. Part II is concluded by a synthesis of similarities and divergence between the law of the UK and Slovenia.

## *H. UNITED KINGDOM*

### 1. THE DUTY OF UTMOST GOOD FAITH (*Uberrimae fidei*)

#### *a) The principle of law*

In the UK, the contract of marine insurance is considered to be a contract of the utmost good faith (*uberrimae fidei*)[25]. This general principle is defined in s.17 of the MIA (hereafter s.17):

> 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.

The principle has been applicable to insurance contracts since the decision of Lord Mansfield in *Carter v. Boehm* [26] where it was held:

> Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the insured only; the underwriter trusts to his representation and proceeds upon confidence that he does not keep back any circumstance in his knowledge to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk as if it did not exist.

This citation clarifies the *ratio legis* for the special place that the duty of utmost good faith occupies in the field of insurance. It is one of the fundamental criteria used in the English theory of contract for differentiation between the contract of (marine) insurance and other contracts, namely contracts of sale, which are governed by the principle of

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[25] See also P. J. S. Griggs, "Marine Insurance: Coverage, Warranties, Concealment, Disclosure, Exclusions, Misrepresentations, and Bad Faith" (hereafter "Marine Insurance") (1991) 66 Tul. L. Rev. 423 at 433. Griggs notes, that this principle applies to all contracts of insurance.

[26] See *Carter v. Boehm* [1766] 3 Burr 1905 at 1909; 97 ER 1162 at 1164.

"*caveat emptor*"[27]. The speculation and aleatory nature of the contract demands the highest degree of honesty possible between the parties[28].

***b) When does the principle apply?***

**(1) Pre-contract**

The duty of utmost good faith arises before the contract is concluded. In the common law, the main source of rights and obligations of the parties to the contract is the contract itself. The rights and obligations before the contract is concluded must be established by a statute or the general law.

Sections 18 and 20 of the MIA (hereafter s.18 and s.20) clearly impose a duty to disclose on the assured during the brokering of the contract of insurance, i.e. during the pre-contractual period. In the *"Mercandian Continent"*, Aikens J pinpointed the underlying rationale for the pre-contractual duty of disclosure as follows:

> Because the contract is one of speculation, both must observe the utmost faith in their dealings towards the other in order to judge as best they can the extent of the speculation before they conclude the contract. That is why the issues of materiality of the facts misrepresented or not disclosed (...) are so important at the pre-contract stage and figure so largely in the statutory code at ss.18 to 20 of the MIA.[29]

It should be noted, however, that according to s.18 it is not the general obligation of utmost good faith that applies to the pre-contractual period, but one of its facets termed the duty to disclose every material circumstance to the insurer. Moreover, this obligation is expressly imposed only on the assured, but not on the insurer. Despite the clear

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[27] This observation was made by Lord Hobhouse of Woodborough in the "*Star Sea*" in para. 45. "*Caveat Emptor*- Lat: Let the buyer beware. Expresses the rule of law that the purchaser buys at his own risk." Law Dictionary, *supra* note 12; see also Kirby, *infra* note 64 at 267.

[28] For general discussion about the duty of utmost good faith in USA, see G. S. Staring, "Marine insurance - Is the doctrine of "utmost good faith" out of date?" (1994) CMI Y. 288; G. S. Staring & G.L.Waddell, "Marine insurance" (1999) 73 Tul.L.R. 1647-1662.

[29] See "*Mercandian Continent*", *infra* note 40 para. 42.

wording of the respective section, there are some judicial opinions that this duty should apply to both parties due to the aleatory nature of the contract[30].

The same observation can be made for the provision of s. 20, which regulates representations pending negotiation of contract. Again, the law refers only to the assured and his agent who must make true representations to the insurer during the negotiations for the contract, and before the contract is concluded. Such a one-sided approach is not surprising, while it is the assured who provides material information and make representation as to the circumstances relevant for the proper assessment of risk and creation of terms of insurance, and not the insurer. The duty is needed only on one side.

### (2) During the life of the contract i.e. Post-contract

The construction of s.17 as to the duration of the duty of utmost good faith has been the subject of many judicial decisions and one should doubt if this issue has come to its definite delineation. The problem subsist is the construction of the wording "contract *based upon* the utmost good faith" [*emphasis added*]. The respective wording gave rise to the debate whether the duty of utmost good faith applies by virtue of the statute to the period of negotiating *and* the whole period of the life of the contract of marine insurance, or only to the period before the contract is concluded. The judges and the commentators have been using the expression "post-contract" when referring to application of the duty during the life of the contract as opposed to the "pre-contract" which refers to the period before the contract is concluded.[31]

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[30] In the "*Mercandian Continent*", Aikens J, when referring to the pre-contractual period and describing the underlying rationale for ss.18 and 20 of the MIA, said: "So the practical reason for imposing the duty of utmost good faith on both parties is the aleatory nature of the contract [of insurance]." See *infra* note 40 in para.42; The same could be induced from the decision of Lord Mansfield in *Carter v. Boehm*:" The policy would equally be void against the underwriter if he concealed anything within his own knowledge, as, for example, if he insured a ship on a voyage and he privately knew that she had already arrived, and an action would lie to recover the premium. Good faith *forbids either party*, by concealing what he privately knows, to draw the other party into a bargain, [owing to ] his ignorance of that fact, and his believing the contrary." [*Emphasis added*] The citation is referred to by Griggs, "Marine Insurance", *supra* note 25 at 433.

[31] The expression post-contract has been used, among others, by Justice Aikens in the "*Mercandian Continent*" (see *infra* note 48), by Lord Hobhouse of Woodborough in the "*Star Sea*" (see *infra* note 36), and by Merkin; see Merkin, *supra* note 13 at 11 et ff.

There have been two theoretical approaches regarding the duration of the duty of utmost good faith in the contract of marine insurance[32]:

> 1. The duty of utmost good faith is exhausted when the contract is concluded: this theory is based on a technical argument that s.17 belongs to the chapter entitled "Disclosure and Representations" in which the duty to disclose and the duty not to make material misrepresentations before the contract is concluded are defined;
> 2. The duty of utmost good faith is a continuing duty that applies through out the life of the contract: this approach is supported by a number of dicta[33] and jurisprudence[34].

Although it appears that the second approach is generally accepted by the courts and parties, there seems to be a disagreement as to the legal nature of this obligation. In another words, there are authorities who say that the post - contract duty of utmost good faith is the statutory rule (the same as it's applicable before the contract is concluded) and there are authorities who seek its origin in the express and implied terms of the contract[35]. The legal nature of the duty is crucial for the determination of its scope and the remedies available. This issue will be thoroughly discussed below, under the subtitle "Sanction". At this point, I will only conclude that the duty of utmost good faith applies also post-contract.

### *c) How long does the duty of utmost good faith apply?*

#### (1) Beginning of the (hostile) litigation

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[32] Both approaches are mentioned in the "*Star Sea*" by Lord Clyde (ibid. in para. 6) and Lord Hobhouse of Woodborough in the "*Star Sea*" (*ibid.* in para. 48); see also Griggs "Marine Insurance", *supra* note 25 at 434 et ff.

[33] In the "*Star Sea*" (see *infra* note 36), the House of Lords held that the duty continues to exist after the contract is made. Lord Hobhouse of Woodborough, who gave the principle judgement, *cited Overseas Commodities v Style* ([1958] 1 Lloyd's Rep 546 at 559) in support of his conclusions. In the "*Litsion pride*", it was held by Justice Hirst that the duty of good faith continued during the life of the contract. See *Black King Shipping Corp. v. Massie, the Litsion Pride* [1985] 1 Lloyd's Rep at 515; see also Griggs "Marine Insurance - Is the Doctrine of "Utmost Good Faith" out of date?" *infra* note 54 at 304.

[34] Lord Hobhouse of Woodborough cites, in the "*Star Sea*", the passage from the book *The Marine Insurance Act 1906* (1st ed. 1907), written by Sir MacKenzie Chalmers. See *infra* note 36 in para 48.

[35] In the "*Star Sea*", the House of Lords held that "the lack of good faith during [the performance of the contract] could derive from express or implied terms of the contract and the appropriate remedies were those provided by the law of contract." For the full citation, see *infra* note 36 in para. 1.

In the *Manifest Shipping Co. Ltd v. Uni-Polaris Shipping Co. Ltd and others* (hereafter the "*Star Sea*")[36], the House of Lords established the rule that the duty of good faith and disclosure under s.17 ceases to apply when the litigation starts. The Lords held:

> [T]he obligation of good faith and disclosure did not continue to apply unqualified once the parties to a policy of marine insurance were in hostile litigation before the courts. Before the litigation started, the parties' relationship was purely contractual, subject to the application of the general law, but important changes in the parties' relationship occurred when litigation started. The relationship and their rights were thereafter governed by rules of procedure and order of the court. There was no longer the need for the remedy of avoidance under s.17 as other more appropriate remedies were available, such as orders for disclosure of documents and facts. Once the parties were in litigation, it was the procedural rules that governed the extent of the disclosure which should be given in the litigation, not s.17 as such, though s.17 may influence the court in the exercise of its discretion.[37]

Lord Hobhouse of Woodborough, who gave the principle judgement, saw the main reason for such a decision in the significant change in the relationship between the parties once the litigation has started. There is no longer a community of interest and the hostility arises. New rules, therefore, apply and provide new and more appropriate remedies in the new (adversary) circumstances. The acts of the parties should be evaluated in the light of the procedural rules and not according to the rules of the general contract law and the contract itself. Nonetheless, Lord Hobhouse of Woodborough agrees that there are certain procedural acts of the parties which "may amount to a contractual act"[38].

He goes on saying that "[t]he s.17 is a principle of law and if its rationale no longer applies and if its operation, the conferment of a right of avoidance, ceases to make commercial or legal sense, then it should be treated as having been exhausted or at least

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[36] The "*Star Sea*", [2001] 4 Lloyd's Rep IR 247, [2001] UKHL/1, [2001] 1All ER 743, [2001] 2 WLR 170, [2001] 1 Lloyd's Rep 389; For a brief, general presentation of the decision and comparison with the American law, see M.Davies, "Insured's Post-Contract Duty Uberrimae Fidei: Manifest Shipping Co., Ltd v. Uni-Polaris Shipping Co. Ltd (The Star Sea)", (2001) 32 J. Mar. L. & Com. 501.

[37] See *ibid.* para 2.

[38] Lord Hobhouse of Woodborough gives the example of the delivery of pleadings which could be considered as a termination of a contract and should, therefore, be evaluated and given the effect in the light of the substantive law. See *Ibid.* para. 76.

superseded by the rules of litigation"[39]. One could conclude on the basis of this statement that the duty of utmost good faith and the remedy of avoidance should apply *as long as its underlying rationale exists*. And it may be so even after the litigation started.

### (2) The non-hostile litigation

Bearing in mind a possible conflict of interests, the termination of community of interest, and the notion of hostile litigation, it is interesting to analyse how and if this rule complies with what has been established in the *K/S Merc-Scandia XXXXII v. Certain Lloyd's Underwriters subscribing to Lloyd's policy no 25T 105487 and Ocean Marine Insurance Co. Ltd and Others* (hereafter the "*Mercandian Continent*")[40]. The assured (the ship building and repairing company) and the insurer were sued by the owner of the vessel (Mercandian Continent) that was severely damaged due to the negligent repair. The assured and the insurer were on the same side in the litigation, thus they were not in hostile litigation.

Being on the same side implies a harmony of interest. As it was observed in the preceding paragraphs, the duty of utmost good faith may continue to exist during litigation provided that the need for the remedy of avoidance under s.17 still exists[41]. In the absence of a conflict of interest and hostile litigation on the one hand and the existence of a continuing need for the remedy of avoidance under s.17 on the other hand, one could argue that the beginning of a litigation does not terminate the duty of utmost good faith.

### (3) Property insurance v. Liability insurance

There is, however, one particular difference between the two cases that should be observed and may be relevant in the analysis of the rule. In the "*Mercandian Continent*",[42] the basis of the dispute was the liability insurance (insurance of the ship

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[39] See *ibid.*
[40] The "*Mercandian Continent*", [2000] 2 Lloyd's Rep 357, [2000] Lloyd's Rep IR 694.
[41] See the citation under, *supra* note 39.
[42] For the full citation see *supra* note 40.

repairer against its negligence), whereas in the "*Star Sea*"[43] the dispute arose on the basis of the property insurance (the insurance of the vessel against marine perils). The former involved a tripartite relationship where the third party, the owner of the vessel, claimed damages against the assured, the ship repairer, and the insurer, on the basis of the Third Parties Rights against Insurers Act (1930). The latter case involved a usual bilateral contractual relationship where the litigation took place between the assured, the owner of the vessel, and the insurer.

In the property insurance, there are no third parties involved in the contractual relationship; the loss will be suffered by the contracting party itself (the assured) and the litigation will only take place between the insurer and the assured (i.e. contracting parties). Therefore, in litigation, they will always be on different sides.

This will not be the case in the liability insurance, where the loss is primarily suffered by the third party, which will have a claim against the one who caused the loss (the assured) and the insurer. The assured and the insurer will thus co-operate in the litigation in order to rebut the third party's claims. It seems that there's no conflict of interest.

However, this may only be illusory, while, in fact, both parties are trying to shift the liability for the claim on the other party. The assured will try to show that he was not responsible at all for the loss or at least not negligent to the extent that the insurer might have a claim against him, based on the subrogation. The insurer, on his part, will try to deny its liability under the policy and make the assured to pay the loss. The procedural rules do not provide the insurer and the assured with the remedies against each other when they are on the same side, as in the case of the adversary litigation.

Hence, it could be argued that the procedure does not provide better and more appropriate remedies than those available under the statute, general contract law and the contract itself. For the reasons stated above, I believe that there is a legitimate doubt that the rule

[43] For the full citation, see *supra* note 36.

(i.e. the duty of good faith and disclosure under s.17 ceases to apply when the litigation starts) should be applicable when the assured and the insurer are on the same side in the litigation.[44]

***d) The content of the duty of utmost good faith***

Since s.17 speaks only of the general obligation of utmost good faith, the question to ask is, "What is the content of such an obligation?" Although the cases mostly equate the duty of utmost good faith with the duty to disclose and not to make misrepresentations, it is hard to say that the duty of utmost good faith should only appear in the form of these two particular duties. After all, why would there be a special general provision about the duty of utmost good faith (s.17) and the two special provisions about the duty to disclose and misrepresentations if those two obligations were the only facets of the utmost good faith[45]. There is also authority that refers to the duty of utmost good faith in its generality. In *Bank of Nova Scotia v Hellenic Mutual War Risks Associations (Bermuda) Ltd* (hereafter the "The Good Luck")[46], Justice Hobhouse said that the duty of utmost good faith during the contract was a continuing one.

There is a very exhaustive analysis of the "utmost good faith occasions"[47] considered by the courts in the "*Mercandian Continent*" by Aikens J. He concluded that apart from the claim context and the variation of the risk or speculation there is no other occasion in which the duty of utmost good faith operates post-contract[48]. However, the door for a wider application has not been totally closed. Aikens J also referred to *the Royal Boskalis*

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[44] Such a conclusion would not be in conflict with the decision in the "*Mercandian continent*" (for the full citation, see *supra* note 40) where the court held that the assured did not breach the duty of utmost good faith by submitting a forged document to the insurer during the litigation. The document referred to a collateral matter, the establishment of the jurisdiction, and not to the substance of the claim.

[45] See the text referring to *infra* note 50; In the *Colinvaux's Law of Insurance*, it is noted that the sections of the MIA regarding the duty of disclosure are merely illustrative provisions. The duty of utmost good faith is a wider, general principle that may have independent effect. See R. Merkin, ed., *Colinvaux's Law of Insurance*, 7th ed. (London: Sweet&Maxwell, 1997) at 475.

[46] The "*Good Luck*", [1988] 1 Lloyd's Rep 514 at 546.

[47] This "evocative phrase", as described by Aikens J, was first used by Mr.Lydiard, the counsel of the defendants, in the "*Mercandian Continent*" and took up by the court. It describes situations in which the duty of utmost good faith arises; see *supra* note 40 para.41.

[48] See *supra* note 40 para. 75 (2).

*Westminster NV v. Mountain* (hereafter the "*Boskalis case*")[49] in which it was said that if the duty of utmost good faith was to have a wider scope than in the claim context then the fact non-disclosed or misrepresented must be material and must have had induced the insurer[50]. The issue will be discussed later, under the heading "Claim context"[51].

***e) The duty of utmost good faith is bilateral***

The generality of the principle requires the duty of utmost good faith to be bilateral, that is owed by each contracting party to the counter party. The "father" of the rule is again Lord Mansfield in *Carter v. Boehm*:

> The policy would equally be void against the underwriter if he concealed anything within his own knowledge, as, for example, if he insured a ship on a voyage and he privately knew that she had already arrived, and an action would lie to recover the premium. Good faith forbids either party, by concealing what he privately knows, to draw the other party into a bargain, [owing to] his ignorance of that fact, and his believing the contrary.[52]

The rule has been recently reaffirmed by the House of Lords in *La Banque Financiere de la Cite v. Westgate Insurance Co.* (hereafter *"La Banque financiere")*[53]. The court held that:

(2) [R]*eciprocal duties rested on the insurers* to an insurance contract not only to abstain from bad faith but to observe in a positive sense the utmost good faith by disclosing all material circumstances: the body of rules which were described as the *uberrimae fidei* principle were rules of law developed by the Judges and the relevant duties applied before the contract came into existence and they applied to every contract of insurance." [*emphasis added*]

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[49] The *Boskalis case,* [1997] LRLR 523.
[50] See *supra* note 40 para. 68; for the discussion about the test of materiality, see, below, under the heading "The actual inducement test" at 24.
[51] See, below, at 38.
[52] See *Carter v. Boehm, supra* note 26; reference found in Griggs, "Marine Insurance", *supra* note 25 at 433.
[53] *La Banque financiere* [1990] 2 All ER 947.

Let me now analyse the two "utmost good fait occasions" which are defined by the MIA in ss. 18 and 20.

## 2. DUTY OF DISCLOSURE: PRE-CONTRACT

### *a) General*

Section 18(1) reads:

> Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such a disclosure, the insurer may avoid the contract.

There are two crucial elements in this section that call for a further analysis: material circumstance and "known to the assured".

### *b) What is a material circumstance?*

According to the s.18 (2), the material circumstance is such a circumstance that would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk. Such a definition gave rise to various tests of materiality formulated and applied by courts. The variability of these tests derives from the point of reference: the hypothetical prudent insurer or the actual one. The former test is called *"the hypothetical prudent insurer test"* and the latter *"the actual inducement test"*. There is also a third variation of the test of materiality, called *"the decisive influence test"*, which was omitted very early, but will be briefly discussed later due to its contribution to the development of the doctrine of the utmost good faith in marine insurance[54].

[54] See generally, M.D.Kirby, "Marine insurance - Is the doctrine of "utmost good faith" out of date?" (1994) CMI Y. 266; P.J.Griggs "Marine insurance - Is the doctrine of "utmost good faith" out of date?" (1994) CMI Y. 298; *Colinvaux's Law of Insurance*, *supra* note 45 at 465 - 486.

### *c) The hypothetical prudent insurer test*

In *Container Transport International Inc. v Oceanus Mutual Underwriting Association (Bermuda) Ltd.* (hereafter the *CTI case*)[55] the English Court of Appeal set the test of materiality based on the abstract standard of a hypothetical prudent insurer. The test tended to be purely objective in so far as it did not take into account whether the actual underwriter was actually influenced by the fact that was not disclosed[56]. The Court of Appeal held that,"(a) there is no requirement that the particular underwriter should have been induced to take the risk or to charge a lower premium than he would otherwise have done as a result of the non-disclosure: *the sole yardstick is the impact on the judgement of a hypothetical prudent underwriter*"[57]. [*Emphasis added*]

This test was subject to many criticisms and has been unpopular in theory as well as in the insurance practice, which will be discussed later[58].

### *d) The actual inducement test*

At present the House of Lords is in favour of the "actual inducement test". As explained by Lord Goff of Chieveley, the "actual inducement test" is based on the causal connection between the non-disclosure and the insurer's decision to enter into the contract of insurance under relevant terms[59]. It is for the insurer to prove that it was induced by the non-disclosure to enter into the contract of insurance before it can exercise its right to avoid the contract for the reason of non-disclosure. This approach was first formulated by Justice Kerr J in *Berger v Pollock*[60] and later confirmed in *Pan Atlantic Insurance Co.*

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[55] The CTI case [1994] 1 Lloyd's Rep 476 (CA).
[56] See Merkin, *supra* note 13 at 14.
[57] See headnote of the *CTI case*, *supra* note 55.
[58] See discussion under the headings "Why preferring causal connection over the abstract standard of a hypothetical prudent insurer?" and "Evaluation of the three tests of materiality", below, at 26.
[59] See *Pan Atlantic v. Pine*, *infra* note 61; see also Kirby, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 272; see also Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 301.
[60] *Berger v. Pollock* [1973] 2 Lloyd's Rep 442 (Q.B.) at 463; see also Kirby, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 273.

*Ltd. v. Pine Top Insurance Co. Ltd.* (hereafter *Pan Atlantic v. Pine*)[61] where the House of Lords held:

> (F)or an insurer to be entitled to avoid a policy for misrepresentation or non-disclosure, not only did the misrepresentation or non-disclosure have to be material but *in addition it had to have induced the making of the policy on the relevant terms.* Accordingly, an underwriter who was not induced by misrepresentation or non-disclosure of a material fact to make the contract could not rely on the misrepresentation or non-disclosure to avoid the contract."[62] [*Emphasis added*]

The Lords have emphasised the causal connection between the non-disclosed or misrepresented circumstance and the making of a particular contract. Lord Mustill noted that it is a "question which concerns the need or otherwise, for a causal connection between the misrepresentation or non-disclosure and the making of the contract of insurance"[63]. Lord Lloyd formulated the two-limb test for materiality:

> There are two questions to be asked of an insurer who seeks to avoid a contract of insurance for non-disclosure or misrepresentation:
> 1. Did the misrepresentation or non-disclosure induce the actual insurer to enter into the contract on those terms?
> 2. Would the prudent insurer have entered into the contract on the same terms if he had known of the misrepresentation or non-disclosure immediately before the contract was concluded?[64]

Both questions have to be answered in favour of the insurer so that it will be entitled to avoid the contract. In so holding, the House of Lords overruled in part the decision in the *CTI case*[65] and substituted the hypothetical prudent underwriter with the actual underwriter.

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[61] *Pan Atlantic v. Pine* [1994] 3 WLR 677 (HL).
[62] See *ibid.* in the headnote.
[63] See *ibid.* at 705.
[64] See Kirby, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 272; see also Merkin, *supra* note 13 at 14.
[65] For the full citation, see *supra* note 55; see also Kirby, "Marine insurance - Is the doctrine of "utmost good faith" out of date?" *supra* note 54 at 272.

If the insurer has to prove the causality between the non-disclosed or misrepresented circumstance and the making of the contract, it does not need to prove any causal link between the loss and the non-disclosure or misrepresentation[66]. In this respect, the consequences for non-disclosure remain as merciless as in the event of the breach of warranty[67].

### *e) Why preferring causal connection to the abstract standard of a hypothetical prudent insurer?*

In rejecting the test of a "hypothetical prudent insurer" Lord Mustil summarized the criticisms addressed to this test of materiality and expressed in theory and practice by saying that "(t)he law is too harsh, for it deprives the assured of recovery for a genuine loss by perils insured against even if the misrepresentation or non-disclosure had no bearing on the risk which brought about the loss.[68]" According to Lord Mustill, such an approach would go against the general law of misrepresentation that requires even in the event of a fraudulent misrepresentation to be shown that it has induced the contract.[69] As to the practical side of the matter, Lord Mustill argues that the doctrine of CTI case demands more of the assured than it is feasible in modern trading conditions.

Lord Templeman justified his decision in favour of the "actual inducement test" by saying:

> If this is the result of the judgements of the Court of Appeal in the (CTI) case than I must disapprove of this case. If accepted, this submission would give carte blanche to the avoidance of insurance contracts on vague grounds

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[66] See Merkin, *supra* note 13 at 15; see also Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 299; see also *Pan Atlantic v. Pine*, *supra* note 61.

[67] Here I would like to emphasise that the sanction for the breach of warranty is not the same as in the case of the breach of duty of utmost good faith. Yet both of the sanctions prevent the assured to recover loss under the policy regardless of the causal connection between the occurred loss and the breach.

[68] See *Pan Atlantic v. Pine*; *supra* note 61, under the heading "III. Criticism of the CTI case".

[69] In *Pan Atlantic v. Pine*, Lord Mustill said: " ... [I]t is beyond doubt that even a fraudulent misrepresentation must be shown to have induced the contract before the promisor has a right to avoid, although the task of proof may be made more easy by a presumption of inducement. ", see *ibid.* at 705; see also Merkin, *supra* note 13 at 14.

> of non-disclosure supported by vague evidence even though disclosure would not have made any difference.[70]

To sum up: the objective standard of hypothetical prudent insurer would stimulate the negligence (imprudence) of the underwriters and offer to the insurer a too large and vague ground for avoidance of insurance contracts.

***f) The decisive influence test***

Deciding in favour of the actual inducement test, in *Pan Atlantic v Pine,* the House of Lords also rejected the "decisive influence test" which requires that the full and accurate disclosure should lead the prudent insurer either to reject the risk or at least to have accepted it on more onerous terms[71]. This test was already rejected in the *CTI case* and in this part the judgement was affirmed in *Pan Atlantic v. Pine*. The court held (Lord Templeman and Lord Lloyd dissenting[72]):

> [T]he test of materiality of disclosure for the purposes of both marine insurance under s 18(2) of the 1906 Act and non marine insurance was, whether the relevant circumstance would have had an effect on the mind of a prudent insurer in weighing up the risk, not whether had it been fully and accurately disclosed it would have a decisive effect on the prudent underwriter's decision whether to accept the risk and if so, at what premium[73].

Lord Mustill believes that the meaning of the expression "to influence the judgement" cannot be understood as "to change the mind". He supports his argument by saying that the legislator could have used other expression or words to express the decisive influence of the non-disclosed fact, such as "decisively influence", or "conclusively influence". In the absence of such clear wording, the court should not take into account whether or not

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[70] See *Pan Atlantic v. Pine, supra* note 61 at 680-681.

[71] See also Kirby, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 277.

[72] Lord Templeman argued that a circumstance could not be said to have influence, if disclosed, would not have any impact on the acceptance of the risk or the amount of premium. Lord Lloyd said that the fact must be one that would incline the insurer to refuse the subscription or to increase the premium. The decision in *Pan Atlantic v. Pine* was accepted by 3-2 majority; see Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 302.

[73] See *Pan Atlantic v. Pine*; *supra* note 61 in the headnote.

the non-disclosed circumstance would have been decisive had it been disclosed before the contract was concluded[74].

### *g) Actual inducement v. Decisive influence*

The "actual inducement test" narrowed the chances of escape for the insurer by pinpointing to the actual insurer and making him prove that the non-disclosed circumstance would have made a difference to him when entering into the contract. By so stating, Lord Mustill intended to "discourage the careless and cynical underwriters from seeking to avoid for non-disclosure or misrepresentation in borderline cases"[75] and, consequently, to balance the burden of the duty of utmost good faith between the contracting parties in the pre-contractual period[76]. I agree with the commentators who believe that this test introduced a greater degree of fairness in the pre-contractual relationship[77].

Although the "decisive influence test" was rejected by the majority of the law Lords in *Pan Atlantic v. Pine*[78], its contribution to the balance of the duty of utmost good faith between the parties cannot be disregarded. By limiting the insurer's right to avoid the contract only to the cases of non-disclosure and misrepresentation of circumstances which would *decisively* affect insurer's decisions as to the making of the contract or its terms, the insurance contractual relationship would comply better with the general contractual principle of equality of parties to the contract and fairness. However, there are arguments against the application of the "decisive influence test". Those arguments are of economic nature. As Griggs pointed out[79], the causal connection between the loss and the non-disclosed circumstance, on the one hand, and the option of paying an additional

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[74] See *ibid.* at 721.

[75] See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 303.

[76] Lord Mustill said: "To enable an underwriter to escape liability when he has suffered no harm would be positively unjust and contrary to the spirit of mutual good faith recognised by Section 17 of the Act."; see *Pan Atlantic v. Pine*, *supra* note 61.

[77] See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 301.

[78] Lord Templeman and Lord Lloyd dissenting, see *supra* note 72.

[79] See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 307.

premium, on the other hand, may encourage the assured to conceal certain facts or to be less prudent in disclosing facts that are necessary for correct assessment of the risk. This would result in a consistent underprising of the risk and consequently in a lack of funds which would endanger the insurance industry and its objective i.e. the existence and stability of (capitalistic) economy.

### *h) Examples of material circumstance*

What circumstance need or need not be disclosed is a *questio facti* what is also emphasised by the MIA in s.18 (4). The British courts have considered a number of cases in which this issue was brought up. Merkin divides material facts into three categories[80].

#### (1) Physical hazard

The first category of material facts are the facts that affect directly the risk insured ("physical hazard"): any physical attributes of the insured subject-matter which increase the risk[81], previous losses and claims[82], or making a contract with a third party that was not found in the ordinary course of business[83].

#### (2) Moral hazard

The second category of material facts consist of facts which affect the "moral hazard", such as: information as to other policies on the same risk if it converts the risk from genuine to speculative[84]; information as to previous losses or claims under other policies[85]; the master's past criminal conduct may be material if it increases the risk of the vessel's seizure[86]; the vessel's or shipowner's nationality[87], or the assured's criminal convictions[88].

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[80] See Merkin, *supra* note 13 at 15.
[81] Merkin cites *Inversiones Manria SA v. Sphere Drake Insurance Co. Ltd*, (hereafter "*The Dora*") [1989] 1 Lloyd's Rep 69; see Merkin, *supra* note 13 at 15.
[82] Merkin cites *Sharp v. Sphere Drake Insurance Co. Ltd.* ("*The Moonacre*") [1992] 2 Lloyd's Rep 501; see *ibid.*
[83] Such a fact will be material if it potentially increases the insurer's liability or diminishes its right of subrogation in the event of a loss. Merkin cites *Marc Rich & Co. AG v. Portman* [1996] 1 Lloyd's Rep 430; *ibid.*
[84] Merkin cites *Mathie v. Argonaut Insurance Ltd.* [1925] 21 Ll LR 145; see Merkin, *supra* note 13 at 16.
[85] Merkin refers to the *CTI case* (for the full citation, *supra* note 55 ); *ibid.*
[86] Merkin cites "*The Dora*", (*supra* note 81); *ibid.*

### (3) Facts that affect the premium

The third group of facts consists of facts which cannot be listed neither under the physical nor the moral hazard, but affect the amount of premium paid: the amount of vessels to be declared[89], or the fact that the assured has not personally signed the proposal[90].

There are also some cases where the court held that the information at issue was not material. The assured, thus, needs not disclose rejections of cover by other insurers[91] nor the fact that it was previously guilty of non-disclosure[92]. It has also been held that the identity of the assured is not a material fact as long as it does not affect the moral hazard therefore the doctrine of undisclosed principal does not contravene the duty of disclosure[93]. Moreover, the nature of the assured's interest is not material[94].

#### *i) What is considered to be known by the assured?*

Partly, the answer is given in s.18 (1): "...[T]he assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him."

In *Simner v. New India Insurance Co.* (hereafter *Simner)*[95], Judge Anthony Diamond considered the ambit of this presumption in the light of the agent-principal relationship. In order to answer the question "which fact within the knowledge of an agent of the assured will be deemed to be within knowledge of the assured", he analysed three different situations:

#### (1) The assured relies for information concerning subject matter of the proposed insurance on the agent

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[87] Merkin cites *Demetriades & Co. v. Northern Assurance Co.*, "*The Spathari*" [1926] 21 Ll LR 265; *ibid.*
[88] Merkin cites "*The Dora*" (*supra* note 81); *ibid.*
[89] *Ibid.*
[90] Merkin cites *Sharp v. Sphere Drake Insurance Co. Ltd.* "*The Moonacre*" [1992] 2 Lloyd's Rep 501; *ibid.*
[91] Merkin cites *North British Fishing Boat Insurance Co. v. Starr* [1922] 13 Ll LR 206, *ibid.*
[92] Merkin cites the *CTI case* (for the full citation, see *supra* note 55), *ibid.*
[93] Merkin cites *Siu v. Eastern Insurance Ltd* [1994] 1 Lloyd's Rep 213, *ibid.*
[94] See Merkin, *supra* note 13 at 17.
[95] *The Simner* [1995] LRLR 240.

The information concerned is the information which agents (not the agent to insure, but assured's employees, the master of the ship and his crew) ought to have communicated to the assured in the ordinary course of business. Judge Diamon decided that the test to determine whether or not particular information ought to be communicated to the principal in the ordinary course of business is a subjective one. Hence, the issue to be considered is whether the *actual assured-principal* ought to find the information in question in the ordinary course of business and not some hypothetical principal in hypothetical circumstances[96].

The duty of disclosure does not impose on the assured an obligation to look for information outside the knowledge that he acquired in the ordinary course of business. Judge Diamond justified this rule as follows:

> An assured is under no duty to care not to cause financial loss to the insurer. He is under no duty to advise the insurer whether or not to write the risk. The insurer is presumed to know his own business and to be capable of forming his own judgement as to the risk presented to him. The submission that an assured is under a duty to investigate matters outside his knowledge for the purpose of making a fair representation to the insurer, as it seems to me, conflict with some if not all of these elementary propositions.[97]

The company which seeks insurance or its board of directors is under no duty to investigate the manner in which the company's activities are carried out.[98]

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[96] Judge Diamond cited the following passage from the Arnould on Marine Insurance (*Law of Marine Insurance and Average*, M.Mustill & J.Gilman, eds, (16th ed, 1997)) where the author suggests: "The test of what "ought to be known" by the assured is not, therefore, an objective test of what ought to be known by a reasonable, prudent assured carrying on a business of the kind in question, but a test of what ought to be known by the assured in the ordinary course of carrying on his business in the manner in which he carries on that business; the underwriter takes the risk that the business may be run inefficiently unless the circumstances are such that the assured knows or suspects facts material to be disclosed. To hold otherwise would be a tantamount to saying that underwriters only insure those who conduct their business prudently, whereas it is a commonplace that one of the purposes of insurance is to obtain cover against the consequences of negligence in the management of the assured's affairs."; see the *Simner*, *ibid.*

[97] *Ibid.*

[98] In so stating, Diamond J referred to *Australia & New Zealand Bank v Colonial & Eagle Wharves* ([1960] 2 Lloyd's Rep 241) where McNair J stated that there was no authority "to suggest that the board of a company proposing to insure owe any duty to carry out a detailed investigation as to the manner in which the company's operations are performed.... (t)hough clearly they must not deliberately close their eyes to defects in the system and must disclose any suspicions or misgiving they have". He further argues that "to

**(2) The knowledge of the agent is the knowledge of the principal**

This situation arises where the agent is in a predominant position in relation to the assured. Diamond J refers to *Regina Fur Company Ltd v. Bossom*[99] where the information of criminal conviction of the director was considered as knowledge of the company i.e. the assured.

**(3) The agent to insure is deemed to know every circumstance which ought to be known by, or to have been communicated to him (s.19).**

Judge Diamond also held that suspecting a material circumstance and not enquiring about it, what he calls "turning a blind eye"[100], is to be regarded as *knowing* what would have been discovered by the enquiry and, consequently, falls within the ambit of the presumption under s.19 of the MIA. The same approach was taken by the House of Lords in the "Star Sea" where it was held that the gross negligence as such does not amount to a "blind-eye knowledge"[101]. In addition, it was decided that the test to determine a "blind-eye knowledge" is a subjective one[102].

***j) What does not need to be disclosed?***

Subsection 18(3) complements both preceding subsections by enumerating the circumstances which need not be disclosed: any circumstance which diminishes the

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impose such an obligation upon the proposer is tantamount to holding that insurers only insure persons who conduct their business prudently, whereas it is a commonplace that one of the purposes of insurance is to cover yourself against your own negligence or the negligence of your servants."; *ibid.*

[99] [1957] 2 Lloyd's Rep 466 at 484.

[100] The expression was first used by Lord Denning MR in *Cia Maritima San Basilio SA v. Oceanus Mutual Underwriting Association (Bermuda) Ltd, "The Eurysthenes"* ([1976] 3 All ER 243 at 251, [1977] QB 49 at 68). The case war also referred to in the "*Star Sea*", *supra* note 36 para. 24.

[101] In the "*Star Sea*", the defence was raised under s 39(5) therefore the court considered the question of privity on the side of the assured and it held: "(2) Gross negligence would not suffice to establish an assured's "blind-eye knowledge" of the unseaworthiness of an assured's vessel. The illuminating question was why the assured had not inquired: if the judge was satisfied that it was because the assured did not want to know for certain that the vessel was unseaworthy, a finding that he was privy to the unseaworthiness of the vessel would be made out. If, on the other hand, the assured did not inquire because he was too lazy or grossly negligent or believed that there was nothing wrong, the privity would not have been made out. The test for the establishment of privity was the subjective one of whether the assured had direct knowledge of the unseaworthiness or an actual state of mind which the law treated as equivalent to such knowledge."; see the "Star Sea", *supra* note 36 in the headnote.

[102] See *ibid.* para. 25.

risk[103], any circumstance as to which information is waived by the insurer[104], and any circumstance which it is superfluous to disclose by reason of any express or implied warranty[105].

The assured is also free of obligation to disclose any circumstance that is known or presumed to be known to the insurer. The MIA provides that the insurer is presumed to know matters of common notoriety or knowledge[106] and matters which an insurer ought to know in the ordinary course of his business[107].

## 3. DUTY OF DISCLOSURE: POST-CONTRACT

### *a) General*

Let us now analyse the "utmost good faith occasions" that arise after the contract has been entered into.

The cases to date do not give a definite and exhaustive answer to the question in what circumstances the duty of utmost good faith arises post-contract. It is clear, however, that the duty to disclose and not to misrepresent arises when there is a variation of risk or speculation and in the claim context[108].

Ss.18 and 20 apply expressly to the pre-contract period. None of the MIA provisions addresses the duty to disclose and not to misrepresent after the contract was concluded. Nonetheless, the courts did not hesitate to follow the same definition of the duty to

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[103] Merkin cites "*The Dora*", *supra* note 81; see Merkin, *supra* note 13 at 17.
[104] The court held that disclaimer by the insurer of the relevance of the facts at issue by policy terms (*Cantiere Meccanico Brindisino v. Janson* [1912] 3 KB 452) or by an authorised agent (*Allden v. Raven, "The Kylie"* [1983] 2 Lloyd's Rep 444) amounts to a waiver. Failure by the insurer to seek further information when alerted by existing disclosures has also been considered as a waiver (*Mann, MacNeal and Steeves Ltd v. General Marine Underwriters Ltd* [1921] 2 KB 300); see Merkin, *ibid.*
[105] If a certain circumstance is covered by a warranty, there is no need for sanctioning for the non-disclosure, while the insurer may avoid the contract on the basis of the breach of warranty. ("*The Dora*", supra note 81), *ibid.*
[106] Merkin cites *Schloss Brozhers v. Stevens* [1906] " KB 665; *ibid.*
[107] There are a lot of cases as to various classes of business insured and as to the nature of the subject-matter insured. See cases cited in Merkin, *supra* note 13 at 17.
[108] See also the heading "Content of the duty of utmost good faith", above, at 20.

disclose and of the material circumstance as it is defined for the pre-contractual period in ss.18 and 20. Yet, with some moderation[109].

***b) New circumstances***

It has been firmly established that there is no obligation to disclose circumstances that came to light after the contract has been entered into[110] even if they would be material (except where an additional risk is accepted or otherwise contractually varied[111]). This includes the situation where the insurer has a right, based on the express contractual term, to cancel the contract after it was concluded. The rule is based on the argument that the insurer should not be given a chance to avoid a contract which is a bad deal for him. As it was pointed out by Lord Hobhouse of Woodboroughin the "Star Sea", "the duty of good faith is even-handed and is not to be used by the opposite party as an opportunity for himself acting in bad faith"[112].

***c) Change of risk or speculation***

In the "*Mercandian Continent*", Aikens J pinpointed (on the basis of the existing authorities) four situation in which the duty to disclose arises post-contract: renewal of the policy, variation to extend the terms or cover, an express obligation (under the terms of the policy) of the assured to provide information concerning a proposed risk, and the exercise of the "held-cover" clause. He concluded that the common element of these four situations was the *re-evaluation of the risk*: " In my view all four categories are examples of where the underwriter is being asked to agree to some new speculation, so that he must

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[109] See especially: the "*Mercandian continent*", the "*Star Sea*", the *Boskalis case*; see, below, under the headings "Change of risk or speculation" and "Claim context".

[110] In so establishing, Aikens J refers to *Commercial Union Assurance Co. v Niger Co. Ltd* [1922] 13 L1 L Rep 75; See the "*Mercandian Continent*", *supra* note 29 para. 46.

[111] Lord Hobhouse of Woodborough refers to *Cory v. Patton* [1872] LR 7 QB 304, *Lishman v. Northern Maritime Insurance Co.* [1875] LR 10 CP 179, The "*Good luck*", *New Hampshire Insurance Co. v. MGN Ltd, Maxwell Communication Corp plc v New Hampshire Insurance Co.* [1997] LRLR 24; see the "*Star Sea*", *supra* note 36 para. 56; see especially the heading " Change of risk or speculation", below, for the discussion of this issue.

[112] See the "*Star Sea*", *supra* note 36 para.55.

be entitled to rely upon the utmost good faith of the assured in giving him the information before he's obliged to take on a new risk."[113]

*d) Claim context*

There are many authorities which established that the assured is under the obligation of utmost good faith when presenting its claim to the insurer since the assured is familiar with the circumstances of the loss and the insurer is not[114]. However, not every claim based on misrepresentation or non-disclosure would lead to the right to avoid the policy what is the regular result in the pre-contractual period. The claim must be *fraudulent* which involves deliberate and culpable acting of the assured[115]. An interesting decision was made in the *Boskalis case* where the court held that "the sue and labour" claim, under the insurance policy, by which the assured tried to recover the claims waived in a secret agreement with its debtor (and did not inform the insurer about it) was not fraudulent. The judge distinguished this case from the authorities on fraudulent claims such as claims on deliberately self-inflicted or pretended losses, or claims in recklessly and knowingly exaggerated amounts.

As in the pre-contract situation, the duty to disclose implies two relevant elements: *materiality* and *inducement*. In the *Boskalis case*, Justice Rix defined the test of materiality which should apply when the question of breach of duty to disclose arises *post-contract*. The test of materiality is narrower. He relied on the commentary of prof. MA Clarke in the book The Law of Insurance Contracts that was also considered (and accepted) by Aikens J:

> In particular the duty of disclosure, most prominent prior to contract, revives whenever the insured has an express or implied duty to supply information to enable the insurer to make a decision. Hence it applies if cover is extended or renewed. It also applies when the insured claims insurance

[113] See the "*Mercandian Continent*", *supra* note 29 para. 48; see also cases cited by Merkin, *supra* note 13 at 12.
[114] Aikens J cites: *Insurance Corporation of the Channel Islands Ltd v. McHugh and Royal Hotel Ltd* [ [1997] LRLR 94 at 134, *Firma C Trade SA v. Newcastle P&I Association* [1990] 2 Lloyd's Rep 191 at 202, [1991] 2AC 1 at 35, see the "Mercandian Continent", *supra* note 29 para.44.
[115] See Merkin, *supra* note 13 at 12; see also Griggs, "Marine insurance", *supra* note 25 at 12.

> money.... The degree of disclosure, however, *varies according to the phase in the relationship*. It seems that the level of disclosure appropriate to a claim is different from that at the time of contract; an innocent misrepresentation or non-disclosure in the claim does not defeat a claim; there must be fraud in the sense discussed below... [116] [*emphasis added*]

The misrepresentation or non-disclosure must have legal relevance to the assured's claim on the policy itself[117]. Judge Aikens agreed with Lord Mustill in the *Pan Atlantic v Pine* that there was no "disciplinary element" in the law of marine insurance in relation to the post-contract conduct, which is another argument in support of a narrower interpretation of the materiality.

The narrower view was approved and further developed in the "*Mercandian Continent*"[118]. The court decided that a forged letter, which was relevant for the determination of the jurisdiction over the claim dispute, does not constitute the breach of duty to disclose and, consequently, does not give rise to the right to avoid the contract. The court held that such information was immaterial while it had no relevance for the claim; therefore, there was no inducement:

> (T)he deliberate and culpable misrepresentation that the letter of July 1 was genuine, was immaterial; the July 1 letter only concerned the issue of whether the English Court could maintain jurisdiction over the claim by the claimants against the assured; it had no legal relevance to the assured's claim on the policy itself...even if the misrepresentation by the assured was deliberate and culpable it was to be treated as irrelevant if it did not relate directly to the "risk" of the insurer or the liability of the insurer for a claim under the policy, but only to some collateral matter such as the jurisdiction in which the claim against the insured was to be determined;
> (5)...if facts that it did not concern the legal liability of the insurers on the claims were immaterial, then there could be no relevant inducement of the insurers by an immaterial fact...."[119]

The duty to disclose and not to misrepresent thus does not extend to collateral matters.

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[116] See the "*Mercandian Continent*", *supra* note 29 para.74(3).
[117] See *ibid.* para. 78(2).
[118] See *ibid.* paras. 67(1), 68, 76.
[119] See *ibid.* in the headnote (4) and (5).

## 4. AGENTS

Since the agents are almost always present in the process of concluding the contract of insurance, an abundant case law has been developed on the subject and finally summarised in s.19 of the MIA (hereafter s.19):

> Subject to the provisions of the preceding section as to circumstances that need not be disclosed, where insurance is effected for the assured by an agent, the agent must disclose to the insurer:
> (a) Every material circumstance which is known to himself, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to, him; and
> (b) Every material circumstance which the assured is bound to disclose, unless it come to his knowledge too late to communicate it to the agent."

Merkin refers to the authorities which construe the expression "agent to insure" as the agent who is authorised by the assured to obtain insurance as opposed to a general agent of the assured[120]. The agent to insure has an independent duty of disclosure[121]. The assured in not obliged to disclose circumstance which is known to his agent[122], but the failure of the agent to disclose the information communicated to him by the assured is the failure of the assured[123]. Information in the possession of an agent not authorised to insure the risk in question is not deemed to be known by the assured[124].

## 5. REPRESENTATIONS PENDING NEGOTIATIONS

### *a) General*

Misrepresentations are regulated in s.20 of the MIA (hereafter s.20) that provides:

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[120] Merkin cites: *PCW Syndicates v. PCW Insurers* [1996] 1 Lloyd's Rep 241, *Group Josi Re v. Walbrook Insurance* [1996] 1 Lloyd's Rep 345, the *Simner supra* note 95 .
[121] See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 304.
[122] See *Berger v. Pollock* , *supra* note 60.
[123] Merkin cites *Russel v. Thornton* [1860] 6 H & N 140, see Merkin, *supra* note 13 at 18; see also Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 304.
[124] Merkin cites *PCW Syndicates v. PCW Insurers* [1996] 1 Lloyd's Rep 241, *Group Josi Re v. Walbrook Insurance* [1996] 1 Lloyd's Rep 345, *Kingscroft v. Nissan Fire and Marine Insurance Co. Ltd* [1996] Lloyd's List, May 16; see Merkin, *supra* note 13 at 18.

> 20. - (1) Every material representation made by the assured or his agent to the insurer during the negotiations for the contract, and before the contract is concluded, must be true. If it be untrue the insurer may avoid the contract.
> (2) A representation is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk.
> (3) A representation may be either a representation as to a matter of fact, or as to a matter of expectation or belief.
> (4) A representation as to matter of fact is true, if it be substantially correct, that is to say, if the difference between what is represented and what is actually correct would not be considered material by a prudent insurer.
> (5) A representation as to a matter of expectation or belief is true if it be made in good faith.
> (6) A representation may be withdrawn or corrected before the contract is concluded.
> (7) Whether a particular representation be material or not is, in each case, a question of fact.

The notion of misrepresentation was often mentioned in the present text in connection with the duty to disclose. These two terms are usually both referred to when the issue of utmost good faith is considered by the courts. It could be said that most of what it stands for the non-disclosure goes also for the misrepresentation. The reason for such a package treatment lies probably in the common underlying rationale observed by the courts and stated earlier in this text[125]: the insurer must be properly and fully informed about the facts that are important for the assessment of the risk and the setting of the contractual terms either by way of reporting facts or by way of making statements as to material circumstances of the adventure insured.

***b) Similarities***

Let me first summarize the rules already analysed in the preceding paragraphs treating the duty to disclose which are also applicable to the misrepresentations. The actual inducement test established in *Pan Atlantic v. Pine*[126] applies also to misrepresentations. The misrepresentation must be material in so far that it has influenced the judgement of

[125] See the "*Mercandian Continent*", *supra* note 29; see citation under note 29.

the actual insurer in fixing the premium or in determining whether he will take the risk. In addition, the actual insurer must be induced by the misrepresented fact before he can exercise his right to avoid the contract[127]. No causal connection is required between the misrepresented fact and the occurred loss. The materiality of the misrepresentation is of course the question of fact. Any material misrepresentation, fraudulent or innocent, is sanctioned by the right to avoid the contract[128]. The duty not to misrepresent applies pre- and post-contract in the same extent as it applies for the duty to disclose.

***c) What is particular to misrepresentation?***

Although the sanction for misrepresentation is the same as in the case of non-disclosure, the operation of this draconian remedy appears to be mitigated by the s.2 (2) of the Misrepresentation Act 1976[129]. According to this section, the court may refuse recession of the contract when it would be otherwise available or even reconstitute a contract already rescinded and award damages provided that the misrepresentation was not fraudulent. It should be noted that the recession of the contract for a misrepresentation is a remedy available under the general law of contracts. The MIA as a *lex specialis* provides for a different remedy against the misrepresentation, that is avoidance of the contract. For the purpose of marine insurance, the provision of s.2 (2) of the Misrepresentation Act should, thus, be read:

> Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to [*avoid*] the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been [*avoided*], the court or arbitrator may declare the contract

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[126] See, above, text accompanying note 59.
[127] See, above, text accompanying note 61.
[128] Merkin cites the decision in *Hamilton & Co. v. Eagle Star and British Dominions Insurance Co. Ltd.* [1924] 19 L1 LR 242; see Merkin, *supra* note 13 at 18.
[129] Section 2(2) of the Misrepresentation Act 1976 reads: "Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.", see Merkin, *supra* note 13 at 19.

> subsisting and award damages in lieu of [*avoidance*], if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that [*avoidance*] would cause to the other party. [*Emphasis, change added*]

But before the court may act so, it must consider the loss actually and potentially suffered by each contracting party and how important the representation was in respect of the subject matter of the contract[130].

Merkin notes, that the respective section of the Misrepresentation act is not applicable in reinsurance cases[131].

## 6. SANCTIONS

### *a) General*

The MIA provides for the remedy in the event of the breach of duty of utmost good faith: the avoidance of the contract. This remedy is provided for under s.17 as well as under ss.18 and 20. Despite the clear and consistent language of the MIA, there has long been debate whether this draconian remedy should be the only remedy available or the courts should also permit the use of remedies under the general law of contracts[132].

### *b) Avoidance - the sole remedy*

The answer was sought in the legal nature, i.e. the source of the obligation of the duty of utmost good faith. In the "*Mercandian Continent*" the parties accepted that the duty of utmost good faith and the right to avoid the contract under s.17 is a rule of positive

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[130] Smith argues: "Before exercising its discretion the court must consider: (i) the importance of the representation in relation to the subject matter of the contract, (ii) the loss which would be caused to the misrepresentee by the misrepresentation if rescission were refused; and (iii) the loss which would be caused to the representor by rescission."; see J.C.Smith, *The Law of Contracts*, 3rd ed. (London: Sweet & Maxwell, 1998) at 144.

[131] Merkin cites *Highland Insurance Co. v. Continental Insurance Co.*[1987] 1 Lloyd's Rep 109; see Merkin, *supra* note 13 at 19.

[132] The only remedy available is the avoidance; there is no claim for damages. The same approach is not adopted in the USA. See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 304.

law[133]. Justice Aikens J relied on the decisions in *the Banque Kaiser Ullmann SA v. Skandia (UK) Insurance Co. Ltd* [134](hereafter the "*Keyser Ullman case*") and *the "Good Luck"*[135]. In the latter case the court decided that" there was no reason why the source in law of obligation [of the utmost good faith], or the remedy for its breach should be different after the contract is made, from what it is at the pre-contract stage." The cited authorities lead to the conclusion that the statutory obligation of the utmost good faith applies throughout the contract and that the only remedy available before and after the contract of insurance is concluded is the avoidance of the policy.

This conclusion is somehow disturbed by the decision in the *"Star Sea"* where the Lord Hobhouse of Woodborough, in delivering the principle judgement, proposed a scheme of good faith occasions. He distinguished between a "lack of good faith which is material to the making of the contract itself (or some variation of it) and a lack of good faith during the performance of the contract"[136]. This distinction is based on his belief that the remedy under s.17 is "anomalous and disproportionate". In his opinion, the former obligation derives from "requirements of law" and the latter from "express or implied terms of the contract". Since in the latter case the obligation is of a contractual nature, the remedies available derive from the law of contracts. He believes that the duty of utmost good faith post-contract cannot have the same extent as pre-contract. This would permit the insurer to act in bad faith[137]. He argues that the remedy of avoidance under s.17 in not appropriate because it is "in practical terms wholly one-sided".

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[133] See the "*Mercandian Continent*", *supra* note 29 para. 40(2).
[134] The "*Keyser Ullman case*" (HL) [1990] 2 Lloyd's Rep 377; [1991] 2 AC 249; (CA) [1988] 2 Lloyd's Rep 513; [1990] QB 665.
[135] The "*Good Luck*", *supra* note 46 ; the reference found in the "*Mercandian Continent*", *supra* note 29 para. 63.
[136] See the "*Star Sea*", *supra* note 36 para. 52.
[137] Lord Hobhouse of Woodborough: "Where a fully enforceable contract has been entered into insuring the assured, say, for a period of a year, the premium has been paid, a claim for a loss covered by the insurance has arisen and been paid, but later towards the end of the period, the assured fails in some respect fully to discharge his duty to complete good faith, the insurer is able not only to treat himself as discharged from further liability but can also undo all that has perfectly properly gone before. This cannot be reconciled with principle."; see *ibid.* para. 51.

*c) Remedy of avoidance v. proportionality*

Many criticisms have been addressed to the application of the remedy of avoidance on all or nothing bases. The concurrent principle is that of proportionality which permits to the assured in the event of misrepresentation or non-disclosure to recover a part of the loss in proportion of the premium actually paid to the premium payable had there been full disclosure, or to recover full loss for an additional premium, calculated on the basis of the non-disclosed or misrepresented circumstance[138]. Various commentators[139] and courts expressed arguments in favour of the principle of proportionality, known in many civil law countries, but in the final consequence proportionality has been systematically rejected by the courts. In addition, the Law commission of England and Wales decided to reject it[140].

The fundamental argument against the concept of proportionality is that it does not make part of the English law. In the *CTI case*, the trial judge (Lloyd J) noted that "in England it would not be possible for the assured to enforce its claim by tendering the additional premium when the insurer would have accepted the risk for an additional premium, had it known the non-disclosed circumstance." On the appeal Lord Mustil said that any such "intermediate solution" was not a part of the common law and that it would be inconsistent with the words of the 1906 Act. He believes that the introduction of such a solution should be done by a statutory change.

Later, in *Pan Atlantic v. Pine* the court held: " The insurer has the right to avoid the contract *ab initio* on all or nothing basis. The assured cannot require the insurer to reinstate the contract by proffering an additional premium, as proportionality does not form part of English law."

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[138] This principle has been discussed in *Pan Atlantic v. Pine*, see *supra* note 61.
[139] See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 307.
[140] *Ibid.* at 299.

Apart from the legal argument, there is also an economic argument that was raised against the concept of proportionality. If the assured was aware that the worst that can happen to him in the event of the breach of duty to disclose material information is to pay an additional premium, he will be more tempted or even encouraged not to reveal circumstance that aggravate the risk. This would lead to a constant underpricing of risk and consequent lack of funds which would finally amount in the raise of premiums for all insurance buyers[141].

Regardless of all that was said above, the right to avoid the contract for the breach of duty of utmost good faith could be waived, expressly or tacitly[142]. Moreover, the insurer will be very willing to keep the contract in force while avoiding the contract induces the return of the premium[143].

## *I. SLOVENIA*

### 1. GOOD FAITH IN THE LEGAL SYSTEM

According to the leading Slovene commentator on the general law of contracts, Stojan Cigoj, the duty of good faith protects the party which has unknowingly entered into an unfavourable situation against the party who was aware of the unfavourableness or is even responsable for it. The Slovene legal system does not have a general rule for the protection of the good faith[144]. In other words, there is no provision that would sanction the breach of the duty of good faith as such. There are, however, provisions that refer to some particular contractual situations in which the good faith is expressly referred to and protected, such as in the case of a simulated contract[145] or in the case of termination or

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[141] *Ibid.* at 307.
[142] See *Pan Atlantic v. Pine*, *supra* note 61.
[143] See s.84 of the MIA; see also Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 304.
[144] The respective general provision imposes the duty of good faith to all obligations. See S.Cigoj, *Teorija obligacij* (Ljubljana, Casopisni zavod Uradni list SR Slovenije, 1989) at 20; compare s.1375 of the Quebec Civil Code which reads: "The parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished."
[145] Section 66 of the SCC (*infra* note 149) reads: (1) The simulated contract has no binding effect on the parties. (2) If the simulated contract conceals any other contract, such other contract shall be valid, provided that the necessary conditions for its legal validity have been fulfilled. (3) The simulation of the

limitation of the agency[146]. These situations are best described by the expression "the good faith occasions", articulated by the British courts[147].

### *a) The principle of diligence and fair dealing*

The most general rule[148] that is based on the idea of the good faith is *the principle of diligence and fair dealing*. The principle of diligence and fair dealing is defined in s.12 of the Slovene Civil Code[149](hereafter SCC), and represents one of the fundamental principles of the general law of obligations. Section 12 of the SCC (hereafter s.12) reads:

> The parties to a contractual relationship must observe the principle of diligence and fair dealing when entering into contractual relationships and when executing their rights and performing their obligations which derive from such relationships.

Cigoj describes the principle of diligence and fair dealing as a bunch of moral principles which have developed in business transactions. The aim of these rules is to observe the interests of both contracting parties in the contractual relationship[150]. Not just any interest, but those that comply with the nature of the legal transaction and the interests of the society as a whole.

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contract cannot be used as a defence against *an innocent third party*. [*translation, emphasis added*] Hence, if a third party was in good faith as to the existence of the simulated contract, the contract is considered to be valid in relationship to the third party. For general discussion about the simulated contract, see Cigoj, *ibid.* at 122. The new SCC has the same provision under s.50.

[146] Section 93(1) of the SCC (*infra* note 149) reads: The cancellation of the agency or its limitation have no effect toward a third party which entered into a contract with the agent or performed any other legal transaction while he did not know nor he ought to have known that the agency was cancelled or limited. [*translation*] The contract or the legal transaction is thus legally binding on the principal. In return, the principle has a claim for the refund of the damage so suffered against the agent (s.93(2) of the SCC). The new SCC has the same provision under s.78. For general discussion about the agency, see Cigoj, *supra* note 144 at 68.

[147] See *supra* note 47.

[148] I used the word "rule" not as a legal term, but in the general meaning of the word which is "a principle to which an action, procedure, etc. conforms or is required to conform". See *The Canadian Oxford Dictionary*, Ed.A.Bisset (Oxford: Oxford University Press, 2000).

[149] Zakon o obligacijskih razmerjih, published in Ur.l.SFRJ, no.29/78 on May 25, 1978; Slovenia has recently adopted a new Civil Code which will become in force on the 1st of January, 2002. The new Civil Code was published in the Official Gazette no.83/01 from October 25, 2001. The principle of diligence and fair dealing has also been provided for in the s.5(1) of the new Civil Code without any substantial change.

[150] See Cigoj, *supra* note 144 at 20.

*b) Legal and moral norms*

Usually the difference between a legal and a moral norm is identified in respect to the legal sanction: the sanction for the breach of a legal norm is defined in advance whereas the sanction for the breach of a moral norm is not. Rather than by sanction, Cigoj distinguishes legal and moral norms according to their content. The content of the former is defined in advance whereas the content of the latter is left to be defined on the basis of the fundamental principles of the legal system[151].

The content of a moral norm, which has a legal effect, is defined by the courts. In Slovenia the immoral conduct, as defined by the courts for the purpose of the contract law, is any conduct by which one party puts the other party into a considerably less favourable position, or by which one party acquires considerably more favourable position for which there is no justification.[152]

*c) Legal principles and legal standards*

In the Slovene legal system, the duty of diligence and fair dealing is also considered to be a legal standard and as such directly applicable by courts[153]. It defines "the boundaries of acceptable conduct from the perspective of interests and benefits of the counter party"[154].

## 2. THE DUTY OF UTMOST GOOD FAITH

*a) General*

The general contractual principle of diligence and fair dealing is particularly emphasised in the field of marine insurance. Although this is not expressly stated in the Slovene Marine Code (hereafter the SMC), the importance of this principle is recognized by the theory and practice. Pavliha, the leading Slovene commentator in the field of marine

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[151] See *ibid.* at 25.
[152] See Cigoj, *supra* note 153 at 26; One of the Slovene authors argues that the principle of diligence and fair dealing contains also elements of morality. In that sens, the morality is a broader notion. See "Pravni standard", *infra* note 154 at 495.
[153] For the definition of the "legal standard" see, above, under the heading "The Terminology".
[154] See V.Kranjc "O pravnih standardih pogodbenega prava" (hereafter "Pravni standard") (1996) 51 Pravnik 493 at 499.

insurance, equates the principle of diligence and fair dealing with the principle of utmost good faith or the most thorough respect of the promise[155].

As it was noted earlier, the principle of diligence and fair dealing covers a scale of conduct, from less to utmost diligent and fair conduct. The substantial variability of the principle of diligence and fair dealing permits also variation of terminology.[156] The duty to observe diligence and fair dealing in the contract of marine insurance may, hence, be understood as the duty of *utmost* good faith.

The Marine Code does not contain any general provision about the duty of utmost good faith in the chapter regulating the contract of marine insurance. However, the duty is clearly reflected in certain provisions which define particular contractual obligations of the parties. The role of the respective principle is further emphasised by the dispozitive (non-binding) nature of the statutory rules which define the contract of marine insurance in the SMC.

***b) To whom and when does it apply?***

The principle of diligence and fair dealing is applicable to the pre-contractual period and throughout the life of the contract. This clearly derives from s.12[157] which imposes the duty of diligence and fair dealing on all parties of the contractual relationship at the time when they negotiate and when they exercise their contractual rights or perform their contractual obligations.

As a legal principle and according to the express wording of s.12, the duty of diligence and fair dealing operates bilaterally.

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[155] See M. Pavliha, *Zavarovalno pravo* (Ljubljana: Gospodarski vestnik, 2000) at 259.
[156] As it was noted above, the principle of diligence and fair dealing corresponds also to a legal standard. A legal standard is flexible in its meaning, therefore it may have different meaning in different situations. Hence the duty of diligence and fair dealing may impose various forms and degrees of good faith in various circumstances i.e. contractual relationships. For example, in the contract of sale the level of mutual informing and trust is considerably lower than in the insurance relationship. It is the role of the practice, courts and jurisprudence to define an appropriate level of good faith for each contractual relationship.
[157] For the full text see, above, text accompanying note 149.

*c) The content of the principle*

As it was mentioned earlier, the content of the principle of diligence and fair dealing was not defined by the legislator. The courts will have to estimate in every particular case, if the conduct in dispute complies with the principle or not. This principle can assume various forms of conduct and some of them have already been enacted as contractual right or obligations, such as the duty to disclose material fact, the duty to exercise due diligence in respect of the subject insured during the currency of the policy, the notification about the co-insurers in the case of the double insurance, and others.

## 3. THE DUTY TO DISCLOSE

*a) General*

The insurer depends largely on the information known by or within the reach of the insured therefore it is very likely that the insurer may make an unfavourable decision due to its lack of information. This is one of the typical situations against which the principle of good faith is intended to operate. The duty to disclose is clearly one facet of the principle of good faith in the Slovene legal system[158].

The duty to disclose is defined in ss.685(1) and 686(1) of the SMC (hereafter s.685(1) and s.686(1)). Section 685 (1) reads:

> If the assured or his agent when entering into the contract of insurance does not disclose all circumstances, for which he knows or ought to have known, and which are *important for the assessment of the risk* or he reports them incorrectly, the insurance company have the right to claim from the assured to pay the difference between the premium, which complies with the actual risk and the premium already paid. [*Emphasis added, translation*]

Section 686(1) reads:

> If the assured or his agent when entering into the contract of insurance intentionally or by gross negligence does not disclose to the insurance

[158] For general discussion about the duty to disclose, see Pavliha, *supra* note 155 at 266.

> company all the circumstances of which he knew or ought to have known, and which would *essentially influence the decision about entering into the contract of insurance or its terms*, or if he reports them incorrectly, the insurance company shall have the right to claim the rescission of the so concluded contract, provided that the insurance company has not claimed an additional premium in the sense of the preceding article. [*Emphasis added, translation*]

According to the wording of the two respective sections of the SMC, the duty to disclose is one-sided and does not apply to the insurer.

There are two elements to be taken into account in an analysis of the duty to disclose: (i) the state of mind of the assured regarding the circumstance and (ii) the type of circumstance. Firstly, there is an important difference between innocent, negligent and intentional non-disclosure and misrepresentation. Secondly, a distinction is to be made between the circumstances important for the assessment of the risk on the one hand and circumstances which essentially influence the decision about entering into the contract of insurance and setting its terms on the other hand.

***b) Test of materiality***

As it was noted above, the insurer will assess the risk and determine the premium according to the circumstances of each particular case (such as: destination, type and quantity of the cargo, age of vessel, financial capacity of the shipper, etc.). Which of these circumstances is a material one is a question of fact.

**(1) "Important" v. "Essential influence"**

It would seem that there are two tests of materiality. In s.685(1), the SMC speaks of circumstances that are *important* for the assessment of the risk. In s.686(1), the SMC refers to the circumstances, which would *essentially* influence the decision about making the contract and its terms. The legislator used two different expressions. Therefore the legitimate question to ask is, "Why?". One should never *a priori* exclude a legislative

mistake, nevertheless this should not be the primary approach. It is more likely, that the legislator intended to differentiate the two situations.

**(2) Linguistic interpretation**

I will try to construe the two expressions by the method of linguistic interpretation. In the English language the difference may not be so obvious, but in the Slovene language the word "important" refers to something that needs to be taken into consideration, or to be thought about or something that has an impact on the decision-making[159].

On the other hand, the word "essentially" usually refers to the essence of something or to the most important, the most significant, or the most typical characteristics[160]. It seems that the word "important" has a more general meaning, a larger semantic field whereas the word "essential" implies a higher degree of "significance". One could argue that the word "essential" is a semantic superlative of the word "important".

The difference is, thus, identifiable already in the general, colloquial language. It should be even more obvious in the light of the legal language. I cannot see any particular reason, except for the legislative sloppiness, why two different words are being used if they were intended to carry the same meaning. The legal language avoids the richness in expressively because it tends to be precise and clear. It tends to narrow the semantic field of words, on the one hand, and to create new meanings, on the other[161]. Using a different word habitually means using a different meaning.

This argument is further supported by the fact that the Slovene Legal Terminology Dictionary contains both expressions, but it does not use them as synonyms. The adjective "essential" is defined as something that refers to the essence[162]. The word "important" is defined as something that needs to be taken into consideration and may

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[159] See *Slovar Slovenskega Knjiznjega Jezika* (*Dictionary of Slovene Language* [*translation*]) (Ljubljana, DZS, 1995) at 909.
[160] *Ibid.* at 47.
[161] See Kusej, Pavcnik & Perenic, *Uvod v pravoznanstvo* (Ljubljana: Uradni list, 1989) at 22.

influence certain facts[163]. These two definitions are very broad and not very helpful for a precise identification of the criteria of the tests of materiality, yet they support the hypothesis that there are two tests of materiality.

#### (3) Systematic interpretation

Under the general law of contracts, the party who was mistaken about the essential characteristics of the subject may rescind the contract. The Slovene Civil Code defines what an essential element is: mistake about the person who is a counter party, about the essential characteristic of the subject of the contract, or about any other circumstance that is essential according to custom and for which the party would not entered into the contract had it known about the true state of the things[164]. The recession is, hence, not available for any mistake, but only for the essential ones.

This distinction supports the conclusion that the same differentiation is applicable in the contract of marine insurance. This leads to the conclusion that there are two tests of materiality and that a closer connection between the circumstance and the insurer's decision is required in respect of the entering into the contract and setting of its terms than in respect of the assessment of the risk.

### *c) What does not need to be reported?*

According to ss.685(3) and 686(3), neither the assured nor his agent needs to report the circumstances which are generally known, for which the insurer knew, or it was reasonably presumed that they were known to him.

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[162] See Pravni terminoloski slovar (*Slovene Legal Terminology Dictionary[translation]*) (Ljubljana: ZRC SAZU, 1999) at 30.
[163] See *ibid.* at 293.
[164] See s.61 of the SCC.

*d) To whom and when does it apply?*

According to the express wording of the SMC, the duty to disclose and not to misrepresent applies only to the assured. The insurer is not mentioned in the respective sections[165].

Despite the absence of such an express provision, I believe there should be no obstacle for the courts to recognize in certain situations the existence of the duty to disclose on the side of the insurer through the legal standard of diligence and fair dealing. As it was observed earlier, the legal standard embodies a lower lever of abstraction than legal principle and may consequently be directly applied by courts[166]. As to the sanction, the courts should choose an appropriate one on the basis of the analogy in respect to the objective pursued by the sanction and the purpose of the breached norm of conduct.

## 4. MISREPRESENTATIONS

The general law of contracts in the civil law does not know the notion of "misrepresentation" as a legal principle. However, the legislator did not overlook the possibility that the assured may tell the insurance company something that is not true i.e. misrepresent a fact. Sections 685(1) and 686(1) expressly provide for the same sanction as in the event of the non-disclosure when a circumstance which would be important for the assessment of the risk (s.685(1)) or which would essentially influence the decision about making the contract and its terms (s.686(1)) is reported incorrectly.

## 5. SANCTIONS

*a) General*

At first sight, there is no general sanction for the breach of duty to observe diligence and fair dealing in the contractual relationship since this is a general contractual principle. The law will provide the sanction in each particular case i.e. for each legally defined

[165] Pavliha notes that the comparative judicial practice took a stand that the insurer is also under a duty to disclose material facts. There are no examples of such a practice in the Slovene judicial practice. See Pavliha, *supra* note 155 at 266.
[166] See Kranjc, "Pravni standard", *supra* note 154 at 446.

"good faith occasion". However, it is possible to identify two situations in which the principal duty to observe diligence and fair dealing in the contractual relationship as such may be sanctioned: (i) the party's conduct conflicts with the Constitution, morality, or with mandatory rules and (ii) the insurer imposes unfair and too harsh terms in its standard contract terms.

***b) Conflict with the Constitution, morality, and public order***

According to the SCC, the contract may be avoided if it does not comply with the Constitution, with the rules of public order, or with the morality, unless the legal rationale of the breached rule points to some other sanction or the law provides otherwise (s.103(1) of the SCC)[167]. If the conduct of the party to the contract of marine insurance conflicts with the morality and at the same time it breaches the duty of diligence and fair dealing (which is a moral principle), the contract of insurance may be avoided[168].

The remedy of avoidance is the most radical sanction in the civil law of obligations. If the contract is avoided, each party must return the other party what it has received on the basis of the contract. The contract is void *ab initio*[169]; therefore, the parties must reinstate the situation, as it was before the contract was entered into or as it had never existed[170].

The consequences are even more painful if the avoidance is due to the breach of the principles of morality: the court may defeat the claim to a refund by the defaulting party[171].

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[167] The general law of obligations provides for the avoidance. The new SCC contains the same provision under s.86(1).

[168] Some commentators consider the morality and the principle of diligence and fair dealing as two different legal standards, but the courts do not always fallow this approach. See Kranjc, "Pravni standard", *supra* note 154 at 495; see also Cigoj, *supra* note 144 at 68.

[169] When the conditions to avoid the contract are met, the contract is void *per se* i.e. automatically; the innocent party need not to file an action in order to avoid the contract. See Cigoj, *ibid.* at 105.

[170] For general about the avoidance of the contracts, see Cigoj, *ibid.* at 104 et ff; see also B. Strohsack, *Obligacijska razmerja I* (Ljubljana: Uradni list, 1995) at 164 et ff.

[171] The same consequence is defined in s.87(2) of the new SCC. Under the currently enforceable Civil Code, another option was provided for in the event of the breach of the morality: the court may order the defaulting party to give what it has received on the basis of the avoided contract to the community (s.104(2) of the SCC). This option was omitted in the new Civil Code.

*c) Unfavourable standard contract terms*

The contractual relationship in the field of insurance, and particularly marine insurance, is highly standardized, captured in the standard forms. The forms and the general conditions under which the insurance companies enter into contracts are prepared by one party alone i.e. the insurance company, and the other party can enter into the contractual relationship only on the "take it or leave it" basis. It is a typical contract of adhesion.

However, the law introduced certain mechanisms to control the power of insurance companies. Under s.143 of the SCC, the court may refuse to apply certain provisions of the general terms of the contract which deprive the counter party of its defences, or on the basis of which the counter party is deprived of its rights under the contract or delays, or which are otherwise unfair and too harsh towards the counter party.

*d) Non-disclosure or misrepresentation of a circumstance important for the assessment of the risk*

If the assured or his agent fails to disclose or report a circumstance that is important for the assessment of the risk, the insurer may claim an additional premium (s.685(1))[172]. The right to claim an additional premium is limited in time. The insurer must exercise his right within three months after the insurance coverage has expired. If the loss has already occurred, the insurer may claim so at the latest when the loss is completely paid off[173].

The distinction should be made between on the one hand the innocent and on the other the knowingly or negligently caused non-disclosure or misrepresentation. The remedy of additional premium is only available when the assured *new* or *ought to have known* about the fact which was important for the assessment of the risk (s.685(1)). If the assured or his agent did not know about such a circumstance and he could not have known (i.e. an

[172] For the complete text of the respective section, see, above, at 52.

[173] Section 685(4) of the SMC reads: "The insurance company looses the right under the first paragraph of this article, if it does not claim from the assured to pay an additional premium within three months after the insurance has expired, or, if the loss has already occurred , at the latest when the loss is completely paid off."[*translation*]

innocent assured), the insurer has no such right unless otherwise provided in the contract of marine insurance.

### *e) Non-disclosure or misrepresentation of a circumstance which would essentially influence the decision about making of the contract and its terms*

In the event of non-disclosure or misrepresentation of a circumstance which would have an essential impact on the process of making the contract, the insurer has an option: either he claims an additional premium and keeps the contract in force, or he rescinds the contract. In order to set forth accurately the conditions under which these rights are applicable, a further distinction should be made: (i) the assured's mental state as to the concealed or misrepresented circumstance and (ii) the assured's conduct towards the insurer regarding such a circumstance.

#### (1) Assured's mental state

As in the case of the assessment of the risk, the assured must know or ought to have known of the circumstance which would essentially influence the process of making the contract of marine insurance before the insurer is invested with the rights under s.686(1). The insurer has no such rights against an innocent assured[174].

#### (2) Assured's conduct

The assured's conduct towards the insurer regarding such a material circumstance is of crucial significance when it comes to the awarding of the rights under s.686(1). Both of the rights arise only if the assured concealed material circumstance *intentionally* or by *gross negligence* (*culpa lata*)[175]. The innocent or ordinary negligence (*culpa levis*) will not give rise to any such sanction unless otherwise provided in the contract[176]. To sum

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[174] For definition of an innocent assured, see second paragraph under the heading "Non-disclosure or misrepresentation of a circumstance important for the assessment of the risk", above, at 60.

[175] The Slovene legal system has two forms of negligence. *Culpa lata* (the gross negligence) is the omission of the diligence expected from any ordinary person. *Culpa levis* is the omission of diligence required from a particularly diligent and attentive person. See Cigoj, *supra* note 144 at 186.

[176] The assured's conduct regarding the misrepresented or concealed circumstance towards the insurer is of no significance when such a circumstance is important for the assessment of the risk. This conclusion is induced by the wording of s.685(1). The mere act of reporting incorrectly or concealing suffices to invoke the right to claim an additional premium, provided that the assured is not innocent as to the awareness of the information itself.

up: even if the assured knew about a certain material fact, but failed to disclose it to the insurer by ordinary negligence, the insurer will have no right to rescind the contract or to claim an additional premium.

If the insurer decides to rescind the contract, he has the right to keep the premium already paid, or to claim a refund of the already paid loss (s.686(4) of the SMC).

The right to claim an additional premium and the right to rescind the contract are not complementary. Once the insurer has chosen to claim an additional premium it cannot subsequently cancel the contract if the additional premium is not paid (s.686(1) of the SMC).

***f) Causal connection***

The law does not provide for the requirement of the causal connection between the non-disclosed or misrepresented circumstance and the loss. The insurer may, therefore, claim an additional premium or rescind the contract even if the loss was not caused by the non-disclosed or misrepresented fact.

## 6. OTHER UTMOST GOOD FAITH OCCASIONS IN THE SMC

There are some other provisions that reflect the principle of diligence and fair dealing (i.e. the duty of utmost good faith), in the contract of marine insurance.

***a) Due diligence and mitigation of damage***

Section 714 of the SMC provides for the duty to exercise due diligence in respect of the subject of the contract of marine insurance during the currency of the policy. In my view, this is another facet of the overriding duty of the utmost good faith in the field of marine insurance.

Under s.714(2)1 of the SMC, the assured is also under the duty to undertake all that is wise and necessary to avoid the loss or to mitigate the damage when the loss occurs[177].

If the assured does not comply with the so defined duties or intentionally or by gross negligence does not take care of the insured subject, the insurance company is free of obligation to cover the damage caused by such a conduct of the assured (s.714(3) of the SMC). The insurance company does not have the right to rescind the contract. The contract is valid, but the insurance company is free of its obligation to cover the occurred loss.

***b) Protection of the insurer's right to claim refund***

**(1) From the person liable for the damage**

The one who has caused the loss and can be held liable for it should pay for it. The assured may not do anything that would prevent the exercise of the insurer's right to claim refund from the person who is liable for the loss occurred (s.714 of the SMC).

If the assured undertakes anything intentionally or by gross negligence to that aim the insurance company may deduct from the loss paid (or to be paid) the damage that was due to the conduct of the assured (s.714(4) of the SMC).

**(2) From the co-insurer**

Under specific provision of s.695(1) of the SMC, the subject of the insurance may be insured against the same risk for the benefit of the same assured during the same period of time under two or more contracts of insurance (entered into with different insurance companies) even though the aggregate sum of the insurable values, under all contracts, exceeds the agreed or the actual value of the subject insured. When the loss occurs, the assured may file his claim for the total or partial coverage of the loss with any of these

[177] See also Pavliha, *supra* note 155 at 279.

insurance companies of his choice[178]. The insurance company that has liquidated the damage has the right to claim refund from other insurance companies in proportion to their liabilities under the contracts of marine insurance (s.695(2) of the SMC).

The assured must notify the insurance company, upon the filing of the claim to recover damage, of any other insurance contract covering the same loss (s.695(5) of the SMC). This duty is provided for by a mandatory provision; the parties may, therefore, not agree otherwise.

It is interesting, yet not incomprehensible, that the legislator imposed the duty to notify the existence of parallel insurance contracts by a mandatory rule. If the assured was not under such a duty, the insurance company that paid off the loss might never find out that there were, in fact, more insurance companies receiving premiums but finally not paying for the loss. Permitting the occurrence of such situations would go against the fundamental insurance principle of solidarity and spread of risk, and, finally, against the principle of good faith.

The problem may arise in respect of the sanctioning of the breach of such a duty, while the SMC does not provide for the sanction. Based on the *argumentum a simili ad simile*, I would suggest to apply the sanction from s.714(4) of the SMC which applies when the conduct of the assured prevents the insurer to claim refund from the person who is liable for the loss occurred.

***c) Liquidation of damage***

The insurance company must liquidate the damage within one month after the assured filed a claim and submitted the necessary documentation (s.716 of the MIA)[179].

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[178] The sum claimed and received may, of course, not exceed the actual value of the loss occurred. See s.695(1) of the SMC.
[179] See Pavliha, *supra* note 155 at 279.

*d) Knowingly or negligently caused damage*

The assured may not contribute to the occurrence of the loss. One of the fundamental elements of the risk is the unforseeablness. According to s.704(1) of the SMC, the insurance does not cover the damage caused directly or indirectly by the assured's intentional acting. This provision is of mandatory nature therefore the parties may not stipulate otherwise (s.720 of the SMC). It reflects the basic principles of the tort law as well as the duty of good faith. If the loss was caused by the gross negligence, directly or indirectly, of the assured, the insurance company is under no duty to pay for so caused loss, unless otherwise agreed by the parties (s.704(2)1 of the SMC).

In s.704(2)2 of the SMC, the legislator also excluded from coverage the damage caused directly or indirectly by the intentional or grossly negligent undertakings of the persons for whom the assured is responsible according to the law. The parties may stipulate otherwise. The loss caused intentionally or by gross negligence by the master and his servants is *not excluded* due to a specific provision in s.704(3) of the SMC, unless otherwise provided by the contract of marine insurance.

## *J. ANALYSIS OF THE DIVERGENCE*

### 1. THE PURPOSE AND THE PLAN OF THIS CHAPTER

The objective of this chapter is to make a synthesis of the preceding detailed analysis of the duty of (utmost) good faith in respective jurisdictions and to outline the divergences and similarities.

### 2. THE DEFINITION

The point of departure is the same: there is a general provision, but the duty of (utmost) good faith is not defined. It is a "principle of law" or a "legal principle" that needs to be defined. Not on the abstract level, but by examples of concrete conduct.

In the UK, the duty of utmost good faith is expressly provided for in the MIA 1906 and assumes the role of a distinguishing factor between the contract of (marine) insurance and

other contracts. In Slovenia, the duty of (utmost) good faith is not expressly emphasized in the contract of marine insurance, it is a general principle that applies to all contracts under the general contractual principle of diligence and fair dealing defined in the Civil Code. However, the insurance practice and the jurisprudence insist on the primary role that this principle should play in the insurance relationships.

## 3. THE "UTMOST GOOD FAITH OCCASIONS"

The court practice and the jurisprudence show that there is more than one situation in which the duty of utmost good faith arises. The British courts refer to them as the "utmost good faith occasions" and there is no substantial or formal reason that the same notion could not be used in respect to the Slovene jurisdiction.

At first sight, it could be concluded that in Slovenia there are more "good faith occasions identified" than in the UK. The British case law authorities suggest that the duty of utmost good faith operates only in the form of the duty to disclose and the duty not to misrepresent which are defined by the MIA. To the contrary, the SMC identifies many more occasions, before and after the contract of marine insurance is made, in which the duty of utmost good faith arises. A closer analysis will show that a broader concept of the duty to disclose and not to misrepresent in the UK also includes some of the good faith occasions defined by the SMC.

### *a) Notification of double insurance & fraudulent claim*

The failure to inform the insurance company about double insurance may be regarded as the concealment of a material fact in respect of the claim, provided, however, that such concealment has legal relevance to the assured's claim on the policy and that it has induced the insurer.[180]

The intentional or grossly negligent contribution of the assured to the occurrence of the loss may be sanctioned as a fraudulent claim.[181]

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[180] For the discussion on the duty to disclose and not to misrepresent post-contract, see, above, at 31.
[181] For discussion on the fraudulent claims, see above at 37.

*b) Mitigation of damage & Due diligence as to the subject insured*

The systems become even more overlapping if the concept of the contractual nature of the duty of utmost good faith (as an implied or express term) is accepted. The duty to exercise due diligence as to the subject of insurance during the currency of the policy and to mitigate damage may be seen as implied terms of the contract of insurance. Therefore, it is very likely that such obligations will be introduced into the contract by an express term.

*c) Obstruction of right to claim refund*

As to the duty to abstain from any undertaking that may endanger the insurer's right to claim refund of the loss paid from the person liable for it (under the Slovene law), the British courts do not seem inclined to apply any such duty. In the *Boskalis case*[182], the court decided that the "sue and labour expenses" claim was a valid and good claim under the policy although the assured signed a secret agreement with his debtor in which he waived all outstanding claims. Clearly, the *Boskalis case* cannot be the authority for denying the existence of the respective duty while such a defence was not raised by the defendant.[183]

## 4. IDENTIFYING NEW "UTMOST GOOD FAITH OCCASIONS"

Despite the general and apparently quite open provision of the MIA, the British courts are very reluctant to add new "utmost good occasions" to the list. On the contrary, the law seems less flexible and open for new facets of the duty of good faith in Slovenia, but this may only be illusory. The reason for British resistance and Slovene openness lies in the sanction for the breach of the duty of utmost good faith.

[182] For full citation, see *supra* note 49.

[183] The defendants raised the defence of "deliberate and culpable misrepresentation and non-disclosure" which was rejected by the court.

## 5. SANCTIONS

### *a) Defined & Non-defined*

The MIA provides for the harshest sanction under the law of contract for the breach of duty of utmost good faith: the avoidance of the contract. The courts will, therefore, carefully examine the appropriateness of the sanction in each particular case before identifying a new "utmost good faith occasion".

Seeking contractual sources of the duty of utmost good faith instead of statutory ones[184] shows the willingness of the British courts to reaffirm the importance of the duty of utmost good faith in the field of insurance and, at the same time, not to intervene too radically in the contractual relationships. Only to the extent that is necessary and appropriate.

In Slovenia, the problem is slightly different; there is no sanction provided for on the general (abstract) level and therefore the courts will not be very open for new applications of the abstract legal standard of diligence and fair dealing. The courts could, however, apply sanctions that are foreseen by the SMC for a particular "utmost good faith occasion" on the basis of the *argumentum a simili ad simile,* provided that the similarity between the two occasions is established. In addition, there are other rules of legal interpretation that would help to choose an appropriate sanction.

### *b) Proportionality v. "All or nothing" approach*

The key difference that seems to be incommensurable is the concept of proportionality of the Slovene jurisdiction and the British "all or nothing" concept of the sanctioning.

The Slovene legal system tends to accord the sanction according to the gravity of the breach. When the breach of duty to report a material circumstance is to affect only the insurer's judgement in the assessment of the risk, but would not otherwise influence the

[184] For the discussion on the issue see, above, under the heading "Sanctions".

insurer's decision as to entering into the contract at all, the insurer has no right to rescind the contract, but to claim an additional premium only.

*c) Rescission of the contract*

On the other hand, the insurer may rescind the contract if the information concealed or misrepresented would have influenced its decision about the terms of the contract and the entering into it. Such an approach complies with the general contract law which invests the contracting party with the right to rescind the contract if its consent is vitiated by error. The error of the consent may be caused by fraud[185] of the counter party or by misperception of the person of the counter party, of the essential characteristics of the subject of the contract, or other decisive circumstances of the contract. The misrepresentation or concealment of the facts which would have influenced the insurer's decision about making of the contract, in fact, results in the error of the consent on the side of the insurer about decisive circumstances of the transaction. The sanction under the law of marine insurance, thus, complies with the system of the general law of contracts.

Due to the non-binding nature of the statutory provisions, the parties may, of course, stipulate for a different sanction, but here again, s.143 of the SCC may prevent the application of the contractual term that is too harsh on the assured[186].

As was noted above, the concept of proportionality does not form part of English law[187]. Regardless of the weight of the concealment or misrepresentation, the courts shall apply the remedy of avoidance. They have somehow limited the reach of the draconian remedy by developing the test of materiality, but the adjustment of premium will only be applied if so provided in the contract of insurance. In this respect the difference between the two jurisdictions remains unbridgeable on the statutory level.

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[185] According to s.65(1) of the SCC, the conduct of a contracting party shall amount to a fraud when a contracting party induces an error of the consent of the counter party or keeps it in misbelief in order to make him sign the contract.

[186] See, above, the discussion under the heading "c) Unfavourable standard contract terms".

[187] See, above, the discussion under the heading "c) Remedy of avoidance v. proportionality"

## 6. THE CAUSAL CONNECTION

The causal connection between the non-disclosed or misrepresented fact and the occurrence of the loss is not required in neither of the jurisdictions. I do have a slight of the doubt, that this should also be true in respect to the connection between the non-disclosed or misrepresented fact and the decision about entering the contract or making of its terms in Slovenia.

## 7. THE ASSESSMENT OF THE RISK

In the UK, the "actual inducement" test of materiality assumes that the actual insurer must be induced by the non-disclosed or misrepresented fact when assessing the risk.

Despite the unspecified wording of the SMC when addressing the assessment of the risk, one could argue that the same test is hidden under the word "important" and nothing more. I do not believe that the Slovene courts would be willing to apply the "hypothetical prudent insurer test" due to their traditional emphasis on causality. In other words, it is not very likely that the court would approve the claim for an additional premium if the insurance company had alleged that the concealed or misrepresented circumstance would have actually made no difference in the perception of the risk, but it would be important for some hypothetical, more prudent insurer.

Due to the language and structure of the respective statute, I doubt, however, that the court would recognize in the word "important" aspect of decisiveness.

## 8. THE DECISION ABOUT ENTERING INTO THE CONTRACT OR MAKING OF ITS TERMS

Since the UK legal system does not make a distinction between the two groups of non-disclosed and misrepresented circumstances, the "actual inducement" test applies also to the circumstances that influence the decision about the making of the contract and its terms.

In Slovene law, the wording "essential influence" definitively corresponds to the "actual inducement" test, but it may be argued that it could be more than that. As it was noted above, the misrepresentation or concealment of a fact that would have influenced the insurer's decision about making of the contract is, in fact, an error of the insurer's consent regarding decisive circumstances of the transaction. In s.61 of the SCC[188], the word "decisive" is used, and it is possible that the court will decide to rely on this general provision in the interpretation of the respective provision of the SMC. The "essentially influence" may, hence, be read as "decisively influence". A harsher sanction and a narrower semantic field of the expression "essential influence" would further support this argument.

## 9. FAIRNESS V. SURVIVAL OF THE INSURANCE INDUSTRY

Finally, I would like to address the economic argument that was put forward by Griggs[189]. The possibility to pay an additional premium (the concept of proportionality) and the requirement of the causal connection between the loss and the concealed or misrepresented circumstance or between the latter and the assessment of the risk or making of the contract (the "decisive influence test") would encourage the imprudence of the assured which would result in the constant underpricing of the risk and lack of funds. The lack of funds would, in the final consequence, prevent insurers to successfully "distribute the misfortune of the few amongst the many"[190] and to provide the economic safety. The insurance industry is a "vital element of the capitalistic society"; therefore, the collapse of the insurance industry would lead to the collapse of society. The economic interest should, hence, overpower the tendency to introduce a higher degree of fairness in the (marine) insurance contract relationship.

I have to admit, that this is quite a legitimate argument. I should even add to it by arguing that such an economic interest is, in fact, legally protectable interest while the preservation of society and its economic system is one of the legitimate social interests

[188] See, above, the discussion under the heading "Systematic interpretation".
[189] See, above, the discussion under the heading "Remedy of avoidance v. proportionality".

that the law aims and ought to protect. It is in fact a battle of the two legally protected values or interests: fairness (as a moral value), on the one side, and preservation of the economic social system, on the other. One could clearly see, why the latter should be privileged over the former, but before we make a final decision one should ask why capitalist society may nonetheless exist and function in civil law traditions where the concepts of proportionality and causality are well established.

## 10. CONCLUSION

The above analysis showed that there are not many substantial differences as to the duty of (utmost) good faith in the field of marine insurance in both jurisdictions. In so arguing I refer to the content of the duty. However, the differences do exist in the form in which the duty of good faith is introduced and emphasised in the field of marine insurance. Hence, it is the method and the legal frame, which are the source of divergence between the two jurisdictions.

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[190] See Griggs, "Marine insurance - Is the doctrine of "utmost good faith" out of date?", *supra* note 54 at 305.

# PART THREE: WARRANTIES

## *K. INTRODUCTION*

The legal institute of "warranty" and a "condition", known in the common law, represent another method by which the insurer may achieve a full and appropriate disclosure of all facts material to the assessment of the risk and making of the contract of marine insurance. Their objective, under the general law of contracts, is to allocate the risk between parties to the contract.

## *L. THE PURPOSE AND THE PLAN OF PART THREE*

First, I will briefly define "warranty" and distinguish it from other similar legal terms of the general law of contracts. The analysis of warranties under the British marine insurance law will then be presented, followed by analysis of the corresponding Slovene regulation. The Part III will be concluded by the synthesis of similarities and divergences.

## *M. GENERAL*

### 1. WARRANTIES AND CONDITIONS UNDER THE GENERAL LAW OF CONTRACTS

Under the general law of contracts in common law countries, warranties and conditions are present in two different classes of contractual promises. The classification of a particular term of the contract depends on the nature and effect of its breach. Their distinction is, hence, important from the perspective of the remedy available in the event of the breach.

The distinction between a warranty and a condition should be sought in the nature and effect of the breach: "[T]he condition goes to the heart of the contract and is a ground for non-performance by the innocent party, whereas a warranty is a term of the contract

whose breach gives rise to damages but not to rescission".[191] This distinction has passed into the English Sale of Goods Act. [192]

*a) Conditions*

Conditions form part of the "law of excuses" which governs the party's rights to be excused from the performance of its obligation under the contract[193].

The legal theory distinguishes between the *condition precedent* and the *condition subsequent*. The former refers to the obligation under a bilateral contract that must be completely performed before the obligation of the counter party is invoked[194]. It is, in fact, a device of protection against some risk[195].

By the breach of a condition precedent, the contract never comes into existence[196]. The condition subsequent, on the other hand, provides an excuse for the party who refuses to

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[191] Schoenbaum reports that this rule was first established in the *Street v. Blay* in 1831 and was further elaborated in the subsequent cases. See T.Schoenbaum, "Warranties in the Law of Marine insurance: Some suggestions for Reform of English and American Law" (hereafter "Warranties") (1999) 23 Mar.Law 267 at 270.

[192] This distinction has been complemented by Lord Diplock in *the Hong Kong Fir Shipping Co .Ltd v. Kawasaki Kisen Kaisha Ltd.* ([1962] 1 All E.R.474) by introduction of *intermediate* or *innominate* contract terms: "[T]here are, however, many contractual undertakings of a more complex character which cannot be categorised as being "conditions" or "warranties"...[O]f such undertakings, all that can be predicated is that some breaches will, and others will not, give rise to an event which will deprive the party not in default of substantially the whole benefit which it was intended that he should obtain from the contract; and the legal consequences of a breach of such an undertaking, unless provided for expressly in the contract, depend on the nature of the event to which the breach gives rise and do not fallow automatically from a prior classification of the undertaking as a "condition" or a "warranty"." In this case, the seaworthiness was defined as an innominate term. Seaworthiness is such a state of the vessel when the vessel is fit in every aspect for the voyage contemplated (for the general discussion on the issue of seaworthiness in the carriage of goods, see W.Tetley, *Marine Cargo Claims*, 3rd ed. (Montreal: International Shipping Publications, 1988) c.15) The unseaworthiness may be caused by a trivial default of the vessel, such as a missing nail, or a serious default, such as a rotten bottom of the vessel. The consequences of these two defaults are different therefore the defaults should be treated differently. For the discussion about the case, see Swan, Reiter & Bala, *infra* note 193 at 520 et ff; see also Smith, *supra* note 130 at 125.

[193] J.Swan, B.J.Reiter & N.Bala, *Contracts, Cases, Notes &Materials*, 5th ed. (Toronto: Butterworths, 1997) at 496; for general discussion on the "law of excuses", see c.4.

[194] See Smith, *supra* note 130 at 131.

[195] See Swan, Reiter & Bala, *supra* note 193 at 517.

[196] See *ibid.* at 497; When a party performed its obligation only in part, it will only have the right to the action of "*quantum meruit*" if this is not contradicted by express terms of the contract. The Frustrated Contracts Act 1943 and the doctrine of substantial performance mitigate the defendant's liability and enable him to recover some payment for the obligation performed; see Smith, *supra* note 130 at 131 et ff.

continue performance of its obligation[197]. The contract between the parties did come into existence, but is put to an end due to the breach of a condition[198].

***b) Warranties***

In the contract of sale, a warranty is a promise that the product or a service has certain qualities or characteristics[199]. A warranty may be a term of the contract or may exist outside the contract as a collateral contract, which induced the making of the main contract[200].

The warranty is *promissory* when it consists of a promise that something shall or shall not be done. The warranty is *affirmative* or *negative* when it consists of a declaration that something does or does not exist. A further distinction differentiates between the *continuing* and the *present (factual)* warranty: the continuing warranty consists of a promise or a declaration that must be fulfilled all the time during the life of the contract (refers to the *future* conduct), whereas the present warranty is a promise or a declaration that refers to existing facts or intentions[201].

***c) Representation***

The representation is a statement of fact that has contractual relevance or it is material to the contract, but it is not a term of the contract. The breach of a representation is sanctioned by the remedies available for misrepresentations: award of damages and recession of the contract[202].

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[197] See Swan, Reiter & Bala, *supra* note 193 at 517.
[198] See *ibid.* at 497.
[199] See *ibid.* at 589.
[200] *Ibid.*
[201] See Merkin, *supra* note 13 at 26.
[202] The choice of the remedy depends on the fact whether a misrepresentation is fraudulent or innocent. Generally about misrepresentations, see Smith, *supra* note 130 c.13; see Swan, Reiter & Bala, *supra* note 193 at 589 et ff.

## 2. EXPRESS AND IMPLIED TERMS OF THE CONTRACT

Sometimes a term is imported in the contract although it was not expressly stated by the parties. Those terms are named "implied terms", as opposed to express terms of the contract that have been clearly expressed by the parties (orally or in writing).

The theory and judicial practice distinguish between three situations in which the implied terms are applied by the courts: (i) where it is needed to make the contract work; (ii) where it would be unhesitatingly included by the parties themselves; and (iii) where it is otherwise so necessary[203]. The underlying rationale for such complementation is to provide "business efficacy " to the contract[204].

Since the court is by adding terms to the contract, in fact, implementing the intention of the parties, implied terms may not conflict with express terms.

# *N. UNITED KINGDOM*

## 1. WARRANTIES IN THE CONTRACT OF MARINE INSURANCE

### *a) General*

The distinction between warranties and conditions as established in the general contract law in respect of sale of goods does not apply to the contract of marine insurance. The law of marine insurance has redefined the distinction between warranties and conditions for its own purpose. The doctrine of warranty in marine insurance, developed by Lord

[203] The leading case on the issue is *Liverpool City Council v. Irwin* where the House of Lords listed the three situations when a court may read an implied term into the contract: (i) where the agreement between the parties appears to be a complete bilateral contract, the Court will add to it such terms as the parties would unhesitatingly agree to include, (ii) where there is an apparently complete barging, terms will be added without which the contract would not work; and (iii) where the parties themselves have not fully stated the terms, the Court will read into the contract only such obligations "as the nature of the contract itself implicitly requires, no more, no less: a test, in other words, of necessity." [1976] 2 All E.R. 39, [1977] AC 239 (HL) at 252-256; see Smith, *supra* note 130 at 122.

[204] For general discussion about the implied terms of the contract, see *ibid.* c.11.

Mansfield in the second half of the 18th century[205], was later adopted in the MIA of 1906[206]. Section 33 of the MIA (hereafter s.33) provides for this purpose:

> (1) A warranty, the following sections relating to warranties, means a promissory warranty, that is to say, a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.
>
> (3) A warranty, as above defined, 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 before that date.

***b) The warranty is a condition***

According to the express wording of s.33 (3) and the legal consequences[207] that are foreseen in the event of a breach, a warranty in the marine insurance policy is equated with a condition, more particularly, with a condition precedent.

If the warranty is breached, the insurer will be discharged from his liability as from the day of the breach on. *A contrario*, the warranty must be complied with before the liability arises which qualifies marine insurance warranties as a "condition precedent". This approach was undertaken by the House of Lords in the *Bank of Nova Scotia v. Hellenic Mutual War Risks Association* (the "*Good Luck*")[208].

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[205] According to Schoenbaum, Lord Mansfield set down four key rulings in respect of marine insurance. Firstly, he delineated misrepresentation and warranty by defining a warranty as a part of the contract, while describing a misrepresentation as a collateral statement. Secondly, the standard of materiality is applicable to representations, but not to the warranties which must strictly be complied with.. Thirdly, he equated the warranty with the condition and fourthly, held that warranties should be construed according to merchants' customs and the parties' intentions. See Schoenbaum, "Warranties", *supra* note 191 at 8.

[206] For general presentation of the development of warranties, see *ibid.* at 267 et ff.

[207] For the discussion on sanctions, see, below, under the heading "2. BREACH & SANCTION".

[208] The *"Good luck"* (1991) 3 All E.R. 1.

According to Merkin, the word "promissory" encompasses both present and continuing warranties[209]. Moreover, the warranty is not only promissory but also affirmative while it can embody not only promises, that something shall or shall not be done or that some condition shall be fulfilled, but also affirmations or negations of the existence of a particular state of facts[210].

### *c) Warranty and insured subject-matter*

The distinction between the warranty and the insured subject-matter is important in respect of the consequences induced by each of them. The breach of a warranty puts the insurer's liability under the contract permanently to an end while a temporarily default of the insured subject-matter only suspends the coverage for the time of the default. After a default is repaired, the coverage is reinstated[211].

### *d) The literal compliance rule*

As set forth in s.33 (3), a warranty must strictly be complied with, whether or not it is material to the risk[212]. This rule has been consistently applied by the British courts.[213]

According to the express wording of the s33(3), there need to be no causal connection between the breached warranty and the loss occurred[214]. The mere fact that the warranty was not literally complied with will induce the cancellation of the insurer's liability.

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[209] Merkin also notes that a warranty will not be interpreted as relating to the future conduct, unless so clearly provided for in the contract. In so arguing he relies on Hussain v. Brown [1996] 1 Lloyd's Rep 627; Merkin, *supra* note13 at 26; the same, see Schoenbaum, "Warranties", *supra* note 191 at 10.

[210] See the definition of the warranty in s.33(1) of the MIA.

[211] Merkin refers to *Provincial Insurance co. v. Morgan* [1933] AC 240; see Merkin, *supra* note 13 at 27.

[212] Griggs notes that the literal compliance rule is one of the distinctive features of warranties in the marine insurance in comparison with the representations. Griggs, "Marine Insurance", *supra* note 25 at 429; for the case law on this issue, see Merkin, *supra* note 13 at 27.

[213] The rule has been recently applied in the "Good Luck", *supra* note 208. The American courts have followed the British practice until the *Wilburn Boat Co. v. Fireman's Fund Insurance Co.* (hereafter the *Wilburn Boat case*) 348 U.S.310 (1955). The *Wilburn Boat case* did not overrule the strict compliance rule, yet it caused a great confusion as to the choice of law (state or federal) that should govern the law of warranties. The problem subsists in the fact that not all of the States apply the literal compliance rule, but the federal law does. For detailed discussion, see Schoenbaum, "Warranties", *supra* note 191 at 277-279.

[214] Griggs also notes that the causal connection is required in the field of non-marine insurance and cites *Euro-Diam, Ltd. v. Bathurst* [1988] 1Lloyd's Rep 228(Q.B.); see Griggs, "Marine Insurance", *supra* note 25 at 429; Some commentators in the United States argue that the literal compliance rule should not apply

The assured's contribution to the breach of warranty is of no significance. As Schoenbaum observed, no "pleas of due diligence, good faith, and inevitable accident" are admissible[215].

In order to temper the strict literal compliance rule, the British courts are inclined to construe obligations under warranties as strict and narrow as possible[216].

## 2. BREACH & SANCTION

### *a) Termination of the insurer's obligation*

In the event of a breach, the insurer is discharged from liability, but without prejudice to any liability incurred by him before the date of the breach (s.33(3))[217]. The issue whether the breach of warranty brings the contract to an end has been recently addressed in the "Good Luck" case, where the court (the House of Lords) held that the contract is not void *ab initio* and that the contract is not automatically terminated as of the date of the breach. Some obligations may survive the breach of warranty, but the insurer is automatically discharged.

The court based its decision on the rationale of warranties in the insurance law: the insurer only accepts the risk provided that the warranty is fulfilled. The warranty is a condition precedent to the liability of the insurer. The court preferred to faithfully follow the wording of s.33(3) rather than making the conclusion that the contract is avoided.[218]

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to affirmative warranties. They should be evaluated by the same standard as collateral misrepresentations i.e. the standard of materiality. See Schoenbaum, "Marine Insurance", *supra* note 191 at 12.

[215] See Schoenbaum, "Marine Insurance", see *supra* note 191 at 279; see also N.R.Foster, "The Seaworthiness Trilogy: Carriage of Goods, Insurance, and Personal Injury" (hereafter "The Seaworthiness Trilogy") (2000) 40 Santa Clara L.Rev. 473 at 480.

[216] See Merkin, *supra* note 13 at 27; American courts have developed other means of softening the literal compliance rule, such as: cure of the breach (the breach merely suspends the coverage for as long as the violation lasts), causation (the breach must be proximate cause of the loss), or materiality (the breach of warranty must materially affect the risk). English law rejects most of them; see Schoenbaum, "Warranties", *supra* note 191 at 277-279.

[217] Merkin cites *Simpson SS Co.Ltd. v. Premier Underwriting Association Ltd.* [1905] 92 LT 730; see Merkin, *supra* note 13 at 28.

[218] See the "Good Luck", *supra* note 46 at 263.

The breach must be actual not merely anticipated or intended[219]. The insurer does not need to be aware of the breach at the moment when it occurred; the cancellation of liability will apply automatically.

***b) Waiver of the breach***

Although the discharge of liability on the part of the insurer is an automatic consequence, it is not an inevitable one. Section 34 (3) of the MIA (hereafter s.34(3)) provides that the breach of warranty can be waived by the insurer ("held covered" clauses)[220], but can also be excused when due to the change of circumstances the warranty ceases to be applicable to the circumstances of the contract, or when the compliance with the warranty is rendered unlawful by any subsequent law (s.34(1) of the MIA)[221].

The "held covered" clause shall render the insurer free of his obligation only if the insurer is in full awareness of the breach and its circumstances. As Schoenbaum notes "a waiver is a voluntary and express decision to forego a contract right"[222]. It cannot be tacit. The fact that a defect on the vessel was an obvious one does not *per se* amount to the "knowledge about the breach" of the implied warranty of seaworthiness[223].

Merkin notes that the "held covered" clauses are presently included in the Institute Clauses for hull insurance[224] and enable the assured to uphold the insurer's liability by giving a prompt notice of the breach and by paying an additional premium[225].

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[219] Merkin cites *Simpson SS Co.Ltd. v. Premier Underwriting Association Ltd. (supra note 217)*; see Merkin, *supra* note 13 at 27; see also Griggs, "Marine Insurance", *supra* note 25 at 439.

[220] Merkin notes that the warranty of legality cannot be waived as "the issue is one of public order rather than private contract" and cites *Gedge v. Royal Exchange Assurance Corporation* [1900] 2 QB 214; see Merkin, *supra* note 13 at 28.

[221] Section 34(1) of the MIA reads: "Non-compliance with a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract, or when compliance with the warranty is rendered unlawful by any subsequent law."

[222] See Schoenbaum, "Warranties", *supra* note 191 at 289.

[223] See Foster, "The Seaworthiness Trilogy", *supra* note 215 at 479.

[224] Express warranties are not included neither in the Institute Cargo Clauses nor in the Institute Hull Clauses, but the latter nevertheless contain a "held covered" clause; see Merkin, *supra* note 13 at 27;see Institute Time Clauses Hulls (1/10/83), Institute Cargo Clauses (A), 1/1/82, Institute Cargo Clauses (B), 1/1/82, Institute Cargo Clauses (C), 1/1/82.

*c) The breach cannot be remedied*

It is important to note that the breach of warranty cannot be remedied during the life of the contract (section 34(2) of the MIA)[226]. Once the warranty is breached, the insurer is discharged, unless he has waived the warranty. As it is pointed out in the Colinvaux's Law of Insurance, the risk cannot reattach.[227]

## 3. EXPRESS WARRANTIES

The warranty may be expressed or implied (s.33(2)). The parties to the contract are free to stipulate for any warranty of their choice. However, the mere use of the word "warranty" does not suffice for the court to treat a particular contractual term as a warranty[228].

There are no formal requirements as to the wording of the express warranty clause; the crucial is the *intent of the parties to warrant* which must be understood from the wording of the contractual term[229]. In the absence of such intent, the courts will be reluctant to apply the remedy for the breach of warranty.

The only formal requirement for express warranties is to be written. The express warranty may be included in the policy or written on it, but in could also be written in any other document that is incorporated by reference into the policy.[230]

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[225] The Institute Time Clauses for Hulls contains the following "held covered" clause (cl.3): " Held covered in case of any breach of warranty as to cargo, trade, locality, towage, salvage services or date of sailing, provided notice be given to the Underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed." See also Griggs, "Marine Insurance", *supra* note 25 at 439.

[226] Section 34(2) of the MIA reads: "Where a warranty is broken, the assured cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss." See also Merkin, *supra* note 13 at 28; see also Griggs, "Marine Insurance", *supra* note 25 at 439.

[227] See *Colinvaux's Law of Insurance, supra* note 45 at 492.

[228] Merkin cites *CTN Cash&Carry v. General Accident Fire and Life Assurance Corporation* [1989] 1 Lloyd's Rep 299; see Merkin, *supra* note 13 at 28.

[229] Section 35(1) of MIA reads: "An express warranty may be in any form of words from which the intention to warrant is to be inferred."

[230] Section 35(2) of MIA reads:" An express warranty must be included in, or written upon, the policy, or must be contained in some document incorporated by reference into the policy." Schoenbaum lists several typical kinds of express warranties found in standard clauses, such as warranties establishing geographical

The MIA specifically refers to the express warranty of neutrality (s.36 of the MIA)[231]. There is no implied warranty that the vessel and goods are neutral, but where there is such an express warranty there is also an *implied condition* that the neutrality is established at the commencement of the risk as well as during the risk, so far as the assured may control the matter. The MIA provides for another implied condition where the ship is expressly warranted "neutral": the ship must be properly documented. The breach of such a condition will amount to the right to avoid the contract, which is a harsher sanction as in the case of the breach of warranty[232].

## 4. IMPLIED WARRANTIES

Implied warranties are the contractual terms that are not contained in the written documents constituting the contract of marine insurance, but are defined in the Marine Insurance Act. No other warranty than the ones defined in the Marine Insurance Act will be implied in the contract of marine insurance.[233]

There are two important implied warranties in the contract of marine insurance: the warranty of legality and the warranty of seaworthiness.

According to s.37 of the MIA, there is no implied warranty as to the nationality of a ship, or that her nationality shall not be changed during the risk. Griggs notes, however, that

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(trading) limits, warranties as to number of crew, warranties against towage, warranties as to additional insurance, and others; see Schoenbaum, "Warranties", *supra* note 191 at 269.

[231] For the review of the case law on the issue, see Merkin, *supra* note 13 at 29.

[232] Section 36 of the MIA reads: "(1) Where insurable property, whether ship or goods, is expressly warranted neutral, there is an implied condition that the property shall have a neutral character at the commencement of the risk, and that, so far as the assured can control the matter, its neutral character shall be preserved during the risk. (2) Where a ship is expressly warranted "neutral" there is also an implied condition that, so far as the assured can control the matter, she shall be properly documented, that is to say, that she shall carry the necessary papers to establish her neutrality, and that she shall not falsify or suppress her papers, or use simulated papers. If any loss occurs through breach of this condition, the insurer may *avoid the contract.*" [*emphasis added*]

[233] See *Colinvaux's Law of Insurance*, *supra* note 45 at 491.

the ownership and flag of the vessel are regularly subject of the express warranties in the hull insurance[234].

### *a) Legality*

The adventure must be a lawful one and must be performed in a lawful manner.[235] It is so required by s.41 of the MIA which reads:

> There is an implied warranty that the adventure insured is a lawful one, and that, so far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

According to Griggs, the implied warranty of legality is not really a warranty since its breach cannot be waived[236].

### *b) Seaworthiness*

Seaworthiness is the core of the maritime law, and so it found its place also in the field of marine insurance. As an implied warranty it "serves to protect the insurer against preventable losses"[237].

#### (1) Definition

Section 39(4) of the MIA defines seaworthiness as follows:

> A ship is deemed to be seaworthy when she is reasonably fit in all aspects to encounter the ordinary perils of the seas of the adventure insured.

The seaworthiness is composed of various elements[238]: un-delegable duty of the shipowner[239], fitness of the vessel as such[240] and fitness for the adventure contemplated[241], specific circumstances[242], and reasonableness[243].

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[234] See Griggs, "Marine Insurance", *supra* note 25 at 431; see also Schoenbaum, "Warranties", *supra* note 191 at 269.

[235] Griggs notes that this today commonly accepted principle was not embraced and pleaded for by Lord Mansfield. In *Planche v. Fletcher* (99 Eng.Rep 164 (K.B.1779)), he decided that the insurance on an adventure that was directed to breach foreign revenue laws, involving the fabrication of the ship's papers, was not illegal. See Griggs, *ibid.*

[236] See Griggs, *ibid*; see also *supra* note 220.

Lord Mansfield established that the implied warranty of seaworthiness in a voyage policy was an absolute one[244]. The due diligence or unawareness of the unseaworthy condition are of no relevance[245].

The seaworthiness is an implied warranty only in the voyage policies where the vessel is still in port at the inception of the insurance coverage[246]. Making the vessel seaworthy is still within the power of the shipowner. There is no such implied warranty in the time policy because the shipowner cannot guaranty the seaworthiness at the inception of the risk while the vessel is usually already at the sea. The British jurisprudence took a stand that imposing such an obligation would be inequitable[247]. There is also no implied warranty that the goods or other moveable things, subject of the insurance policy, are seaworthy (s.40(1) of the MIA).

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[237] See Foster, "Seaworthiness Trilogy", *supra* note 215 at 473.

[238] The same complexity is observed also in the contract of carriage of goods by sea; see Tetley, *supra* note 192 at 370; see also Merkin, *supra* note 13 at 30.

[239] The shipowner may not raise the defence that the unseaworthiness was caused by a third party. See Foster, "Seaworthiness Trilogy", *supra* note 215 at 480.

[240] The seaworthiness is threefold: the ship must have a sound hull, proper gear, and competent crew. See Foster, *ibid.*

[241] There are no abstract, absolute standards as to the seaworthiness, it has to be established on a case by case basis, for each particular adventure insured. Circumstances, such as the time of the year, the destination, and the requirements of the port of departure must be taken into account. See Foster, *ibid.* at 481.

[242] The jurisprudence established on the case by case basis some "unsaeworthy conditions": slippery decks, defective or damaged equipment or appliances, failure of navigational equipment, obstructions on deck, the possibility of arrest, and others. See Foster, *ibid.*

[243] Only the reasonableness is required in making the vessel capable of encountering the perils of the sea. See Merkin, *supra* note 13 at 31; see Foster, "Seaworthiness Trilogy", *ibid.*

[244] Hodges reports that this is the traditional stand taken in the British case law, although s.39(1) of the MIA is silent in this respect. See S.Hodges, "Express Warranties of Seaworthiness in Time Policies: A Comparative Analysis of American and English Law" (hereafter "Express Warranties of Seaworthiness") (2001) 32 J.Mar.L.& Com. 95 at 104; Under the Hague and Hague/Visby Rules the obligation to make the vessel seaworthy is not an absolute one. For the shipowner it suffices to exercise *due diligence* to that aim. For the general discussion of the duty to make the vessel seaworthy in the field of carriage of goods by sea; see Tetley, *supra* note 192 c.15.

[245] See also Arnould: "Whether the assured were ignorant of the unseaworthiness of the ship or not makes no difference; if the ship was not in fact, seaworthy at the outset of the adventure, either in the degree commensurate with her then risk, or for the voyage, as the case may be, that state of things never existed which was the foundation for the underwriter's promise, and he consequently can never be bound thereby against his will."; see Arnould, *supra* note 96 at 708.

[246] For comparison between time and voyage policies, see Merkin, *supra* 13 at 30.

### (2) Voyage policy

The MIA provides in respect of the voyage policy as follows:

> 39. - (1) In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure insured.
> (2) Where the policy attaches while the ship is in port, there is also an implied warranty that she shall, at the commencement of the risk, be reasonably fit to encounter the ordinary perils of the port.
> (3) Where the policy relates to a voyage which is performed in different stages, during which the ship requires different kinds of or further preparation or equipment, there is an implied warranty that at the commencement of each stage the ship is seaworthy in respect of such preparation or equipment for the purposes of that stage.

In the voyage policy there is an implied warranty that the vessel shall be seaworthy at the commencement of the voyage for the voyage contemplated and fit to encounter perils of the port when the risk attaches while the vessel is still in port. If the vessel became unseaworthy later during the voyage, the insurer may not relay on the breach of warranty[248]. This will not be the case if the voyage is to be performed in different stages, while the "doctrine of stages" is applicable also in marine insurance[249].

There is a presumption that the vessel was seaworthy at the beginning of the voyage (and of every stage), therefore, the onus of proving the unseaworthiness is on the insurer[250]. The *onus probandi* is shifted on to the assured where the loss is caused by an unascertained or unknown peril of the sea[251].

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[247] See Foster, "Seaworthiness Trilogy", *supra* note 215 at 481; see Griggs, "Marine Insurance", *supra* note 25 at 431.

[248] If the vessel was lost in an unseaworthy state later during the voyage, the insurer will have to show that the vessel was unseaworthy at the beginning of the voyage in order to be excused form its liability under the voyage policy. See Merkin, *supra* note 13 at 31.

[249] See *ibid.* at 31.

[250] See *ibid.* at 30.

[251] Foster mentions "the calm water presumption", which may be rebutted by showing that the vessel was seaworthy prior to the damage and that there was no such condition which could have rendered the vessel unseaworthy. The assured must further prove that there was a reasonable probability that some extraordinary and unascertainable peril of the sea caused the loss; see Foster, "The Seaworthiness Trilogy", *supra* note 215 at 479; see also Griggs, "Marine Insurance", *supra* note 25 at 432.

### (2) Time policy

The equity demanded that no such obligation was to be imposed where the risk attaches while the vessel is already at the sea[252]. Section 39(5) of the MIA provides for that purpose:

> 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.

However, the equity also demanded that the assured may not be entitled to recover damage if he was aware of the unseaworthy state of his vessel, but let it sail off nonetheless. The privity of unseaworthiness includes the actual knowledge of the shipowner as to the unseaworthy condition and the "turning a blind-eye" knowledge[253].

Yet, the mere knowledge of the unseaworthiness will not suffice to put the insurer's liability to an end. Unlike in the event of the breach of a warranty, the unseaworthiness must be "the approximate cause" of the loss[254]. If the assured proves that the vessel was lost due to a peril of the sea, he will be able to recover.[255]

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[252] Griggs cites who has formulated the rationale as follows: "[T]here is nothing to prevent a time policy lapsing and a new one beginning when the vessel is at sea, beyond the knowledge and control of her owner or manager as respects unseaworthiness: that consequently insistence on the warranty in such a case might become inequitable."; see Griggs, "Warranties", *supra* note 25 at 431; the same comentator is referred to by Foster, "The Seaworthiness Trilogy", *supra* note 215 at 481;

[253] The "turning of a blind-eye" knowledge was defined in the "Eurysthenes" (*supra* note 100) by Lord Denning: "If a man suspicious of the truth, turns a blind eye to it, and refrains from inquiring, [...] so that he should not know for certain [..] then he is to be regarded as knowing the truth. This "turning a blind eye" is far more blameworthy than mere negligence. Negligence in not knowing the truth is not equivalent to knowledge of it. [...] The knowledge must also be the knowledge of the shipowner [*assured*] personally, or his alter ego, or, in the case of a company, its head man or whoever may be considered their alter ego."; this citations is also referred to by Griggs, "Warranties", *supra* note 25 at 432, and Foster, "The Seaworthiness Trilogy", *supra* note 215 at 481; for upgrade of the Lord Denning's definition see *supra* note 36.

[254] Compare observations under the heading "d) The literal compliance rule", above.

[255] See Foster, "The Seaworthiness Trilogy", *supra* note 215 at 481.

The seaworthiness may, naturally, be included in the time policy as an express warranty[256].

#### (4) Insurance of goods and moveables

The insurance policy on goods and other moveables does not contain an implied warranty as to their seaworthiness, but the ship must be reasonably fit to carry the goods and other moveables to the destination contemplated by the policy at the commencement of the voyage. It is so warranted under s.40(2) of the MIA[257].

### 5. IMPLIED v. EXPRESS

The relationship between express and implied warranties is determined in s.35(3) of MIA which provides that an express warranty does not exclude an implied warranty, unless the latter is inconsistent with the former[258]. This approach is consistent with the general approach of courts in the event of the conflict between the express and implied contractual terms[259].

## *O. SLOVENIA*

### 1. GENERAL

The Law of Slovenia does not know the legal term of *warranty*, but some authors believe that this common law term is incorporated in the term "specifically agreed conditions", used in s.713 of the SMC (hereafter s.713)[260]. It should be noted that the word "condition" does not have the meaning of the common law legal term, but the ordinary meaning that the respective word carries in the English language[261].

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[256] For thorough discussion of the issue under American and British law, see Hodges, "Express Warranties of Seaworthiness", *supra* note 244.
[257] See Griggs, "Warranties", *supra* note 25 at 433.
[258] See *ibid.* at 429.
[259] See, above, under the heading "2. EXPRESS AND IMPLIED TERMS OF THE CONTRACT".
[260] See Pavliha, *supra* note 155 at 278 et 279; see D.Pavic, *Pomorsko osiguranje*, Vol. 2 (Zagreb: Croatia osiguranje d.d., 1994) at 69.
[261] Condition is something upon the fulfilment of which something else depends; see *The Canadian Oxford Dictionary*, *supra* note 148.

## 2. EXPRESS AND IMPLIED CONTRACTUAL TERMS

In Slovenia, the contractual rights and obligations are primarily defined by the parties themselves in the contract, written or oral. Apart from such express terms, rights and obligations are also defined by the statutes, namely by the Civil Code[262]. The provisions of the general law of obligations and the provisions regulating nominate contracts shall be applied by the court and parties themselves in respect of the issues that have not been expressly addressed by the parties in their contract[263]. What is known as an implied term in the common law, it is, in fact, a statutory provision in the civil law. Hence, in Slovenia, contractual rights and obligations are defined by express terms of the contract and the statutes.

## 3. SPECIFICALLY AGREED CONDITIONS (Express warranties)

The Marine Code does not define the term "specifically agreed conditions" or its content. Moreover, the term as such cannot be found in the Slovene Legal Terminology Dictionary. Hence, the definition of the respective term should be induced from the definition of the legal term "condition".

### *a) Definition of the condition*

Under the general law of contracts, the condition is an uncertain fact on which the establishment or termination of a contract depends[264].

There is no definition as to the content of the condition therefore the condition may embody any kind of undertaking that something shall or shall not be done (a promise) or that a certain fact or circumstance shall or shall not exist (that the object must have certain qualities or must be in a certain condition - statement of facts). The only

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[262] See *supra* note 113.

[263] Section 20 of the SCC (*supra* note 149) reads: "Parties to relationships of obligations may define their contractual relationship otherwise as it is defined in this statute, if it is not otherwise provided by a particular provision of this statute or by the meaning of such a provision." [*translation*] The new SCC contains the same provision in s.2.

[264] See s.74(1) of the SCC (*supra* note 149). The Slovene Legal Terminology Dictionary defines a condition as a "future objectively uncertain fact, on which the creation or termination of a legal transaction depends by the intention of the parties". [*translation*] The same definition of the condition is preserved in the new SCC in s.59(1).

limitation imposed by the law is that the condition may not conflict with the Constitution, with the rules of public order, or with the morality. The contract under such a condition is void[265].

***b) Materiality***

Not every specifically agreed condition is protected under s.713. The SMC distinguishes between two types of conditions: conditions that are essential for the decision about the coverage and conditions that are important for the risk or the extent of the loss. The distinction is relevant in respect to the sanction. Section 713 reads:

> (1) If specifically agreed conditions that were *essential* for the decision about the coverage in general, are not fulfilled, the insurance company may require the insurance contract to be cancelled.
> (2) If specifically agreed conditions which were *important* for the weight of a particular risk and for the extent of the loss, are not fulfilled, the insurance company may deduct from the amount to be paid the part of the loss that was probably caused by the failure to fulfil the condition." [*translation, emphasis added*]

**(1) Decision about the coverage**

The court will have to estimate whether or not the insurer would be willing to provide the coverage if he knew, at the time when he entered the contract, that the condition was not or would not be fulfilled. The burden of proof is on the side of the insurer. If the court found that the insurer would provide the coverage also in the circumstances where the condition was not fulfilled, such a condition would be estimated non-essential and the insurer would not have the right to cancel the contract. It should be noted that the condition must be essential, not merely important, for the decision about the coverage[266].

Section 713(1) invests the insurer with the right to cancel the contract if a specifically agreed condition has not been complied with. The contract will, thus, remain in force

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[265] See s.75 of the SCC (*supra* note 149) and s.60 of the new SCC.
[266] For the discussion about the difference between "important" and "essential", see, above, under the heading (1) "Important" v. "Essential influence".

unless the insurer files a lawsuit for the cancellation of the contract[267]. The specifically agreed conditions under s.713(1) are, hence, of the suspenseful nature while the failure to comply with will lead to the termination of the contract[268].

The consequences of the rescission of contract will further depend on the responsibility of the assured for the failure to comply with the condition. If the assured is not responsible for the non-fulfilment of the condition and the insurer decides to cancel the contract, the insurer will have to return the premium[269]. The lowest level of negligence will suffice for insurer to keep the premium[270]. The insurer may deduct from the premium the costs incurred by making of the contract[271].

**(2) The weight of the risk and the extent of the loss**

Specifically agreed conditions that are merely important for the weight of the risk or for the extent of the loss do not have the same weight in the contract of marine insurance. The sanctions provided for in the event of the breach are less burdensome than those provided for when the condition essential for the decision about the coverage is broken.

If the condition, important for the weight of the risk or for the extent of the loss, is not met, the insurer may deduct from the amount to be paid the amount that was probably induced by the fact that the specifically agreed condition has not been fulfilled

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[267] The insurer can rescind the contract only by filing a lawsuit. A mere declaration of rescission does not suffice. The action must be filed within certain period of time. The right to rescission may not be exercised as a defence in the court proceedings. See Strohsack, *supra* note 170 at 174.

[268] The regulation of the suspenseful conditions in the Slovene Marine Code differs from the one provided for under the general law of obligations (s.74 of the SCC, *supra* note 149) which provides for the automatic rescission of the contract where a suspenseful condition has not been fulfilled. In both cases the contract remain in force as long as the condition is complied with (from the moment of its creation).

[269] Section 697(1) of the SMC reads: " The insurance company must return to the assured the premium, if the subject of the contract of marine insurance has not been exposed at all to the risk insured against, or if the contract of marine insurance has been rescinded without the fault of the assured or the person who signed the contract." [*translation*] In the Slovene legal system, the term "fault" encompasses both, intent and negligence.

[270] The assured must be absolutely faultless in respect of the breach. Even if the assured caused or contributed to the rescission of the contract by *culpa levis*, the ordinary negligence, the insurer may keep the premium. For definition of *culpa levis*, see, above, under note 175.

[271] Section 697(3) of the SMC reads: "When returning the premium, the insurance company may keep a part of the premium, in a customary or agreed amount, in order to cover the costs incurred by the making of the contract." [*translation*]

(s.713(2))[272]. In order to discount the amount to be paid, the insurer will have to show to what extent the loss augmented due to the breach of the condition.

*c) Causality*

According to s.713, no causal connection between the breach of the condition and the occurrence of the loss is required. However, the occurrence of the loss seems to be the prerequisite of the sanction for the breach of condition that is important for the weight of the risk or for the extent of the loss (s.713(2)). The payment of the loss presupposes the occurrence of the loss. In other words, the deduction of the amount would only be possible if there is any amount to be paid at all.

*d) Practice*

The consequences foreseen in ss.713 and 697 of the SMC are applicable only when the parties have not stipulated otherwise. The provisions of the respective two sections are not mandatory therefore the parties are free to stipulate for other consequences as long as they comply with other public order rules, including s.704 of the SMC which excludes from coverage the loss caused by the intent or gross negligence of the assured.

Usually, insurance companies will foresee in their standard general terms the exclusion of coverage as the sanction for the failure to comply with specifically agreed conditions. The contract of marine insurance will stay in force, but the insurer will not pay the loss if the loss was due to the fact that the condition has not been fulfilled. Preferring of this kind of arrangement is understandable from the insurer's perspective which tends to keep the contract in force and consequently to collect premium.

## 4. STATUTORY EXCLUSIONS OF THE LOSS

*a) Seaworthiness*

There is no statutory condition that the vessel should be seaworthy in order to recover loss under the contract of marine insurance[273]. In addition, insurance companies usually

[272] For the full text, see, above, under the heading "b) Materiality".

do not impose such a condition in their general standard terms[274]. Instead, the SMC provides for the exclusion of the coverage where the vessel is in an unseaworthy state. There is no distinction between time and voyage policies. Section 724(1) of the SMC reads:

> The loss caused directly or indirectly by a default or unseaworthiness of the vessel is excluded from the coverage under the contract of hull insurance, provided that the assured knew or ought to have known by the diligence of a good shipowner about such a default or unseaworthiness and could have prevented its consequences. [*Translation*]

In order to exclude the coverage, the loss must be in the causal connection with the default or unseaworthy state of the vessel. Moreover, the assured must be aware of such a fact or could have been aware of it had he exercised the diligence of a good shipowner.

The ambiguity exists as to the required time or moment of the seaworthiness. One commentator believes that the seaworthiness should exist throughout the contract i.e. the coverage[275]. Such a position is based on the wording of the respective section which does not include any time limitation.

The unseaworthiness is defined as a general unfitness of the vessel, or unfitness for a particular voyage and carriage that the vessel is to carry out, due to either technical failures or insufficient equipment, improper crew, overloading and incorrect loading of the cargo, or due to the boarding of too many passengers, or any other reason[276].

***b) Inherent vice***

Under s.729(1) of the SMC, the insurance policy on goods does not cover the loss occurred due to a default or natural characteristics of the goods insured (inherent vice), unless otherwise provided in the contract.

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[273] Pavic notes that this practice comply with the practice in other civil law countries, such as Germany or France. See Pavic, *supra* note 260 at 82.
[274] *Ibid.*
[275] *Ibid.*
[276] See s.724(3) of the SMC.

*c) Deviation*

Under s.724(4) of the SMC, the time policy does not include the coverage of the loss occurred directly or indirectly due to the risks arisen outside the route of the voyage contemplated in the contract of marine insurance.

*d) Legality of the adventure insured*

There is no specific provision in the SMC, which would require the adventure insured to be legal, but such a requirement is imposed by the general contractual principle embodied in s.10 of the SCC[277]:

When participating in transactions, parties shall freely define their relationships of obligations, yet they shall not define them in conflict with the Constitution, the mandatory rules, or with the morality.

If parties to the contract stipulate to the contrary, the contract is void, unless otherwise provided by the statute or by the legal rationale of the breached rule[278].

## *P. ANALYSIS OF THE DIVERGENCE*

### 1. INTRODUCTION

Let me now proceed to the comparative analysis of both statutes. Once again, I may conclude that the same issues are addressed through various methods. The concept of seaworthiness and the lawfulness of the adventure insured as a *condiction sine qua non* do not differ from one jurisdiction to the other. What makes them apparently different is the method by which they are incorporated to the contract of marine insurance.

### 2. WARRANTIES V. EXCLUSION OF COVERAGE

In the UK, the requirement of seaworthiness is embodied in an implied warranty, whereas in Slovenia, the unseaworthiness triggers the exclusion of coverage.

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[277] See *supra* note 149.

In the final consequence, the result will be the same: the termination of the insurer's liability to pay the loss. The exclusion of coverage does not put the contract to an end, but merely suspends the insurer's obligation to pay for the loss. The contract remains valid. Almost the same consequence arises in the event of the breach of an express or implied warranty, except that the coverage is cancelled in whole.

### 3. WARRANTIES V. SPECIFICALLY AGREED CONDITIONS

The same overlapping of the result cannot be induced from the comparison of "warranties" and "specifically agreed conditions", although the latter supposedly reflect the former in civil law jurisdictions[279]. While the breach of an express or implied warranty results in the termination of the insurer's obligation, but not the contract, the non-fulfilment of the specifically agreed condition may lead to the right to rescind the contract. In fact, in Slovenia, two options are offered depending on the importance of the condition breached: either the insurer rescinds the contract or he claims an additional premium and pays the loss. The variability of sanctions is, in my opinion, due to the pondering of the circumstances in which the contract is concluded and performed, inherent to the Slovene contract law[280]. The more important the circumstance for the establishing of the contractual relationship, the harsher and more radical the sanction.

In practice, insurance companies will seldom include "specifically agreed conditions" in contracts of marine insurance. Rather, they will use the exclusion clause in order to bring about the same result. Hence, one should ask, what is the purpose of introducing the legal institute of "specifically agreed conditions". I believe, that this institute was created by the civil law jurisprudence in the process of adoption of the British (common law) marine insurance concept. Although it may not be very useful in the practice, it may be quite

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[278] See s.103(1) of the SCC; see, above, under the heading "b) Conflict with the Constitution, morality, and public order".
[279] See, above, the discussion under the heading "1. GENERAL".
[280] See, above, the discussion under the heading "c) Rescission of the contract".

helpful for the courts where they are to construe a foreign marine insurance policy under the Slovene law[281].

## 4. WARRANTIES AND THE GOOD FAITH

Despite the differences of forms, the aim of warranties and specifically agreed conditions remains the same. They permit the insurer to properly assess the risk and to avoid making bad business decisions due to innocent ignorance of the true circumstances of a case. From that perspective, warranties and specifically agreed conditions may, in fact, be regarded as another method of protecting the utmost good faith in the contract of marine insurance.

[281] This situation is not very likely to arise, while contracts of marine insurance are usually made on the basis of the Institute Clauses forms (cargo and hull insurance) which contain the provision that "the insurance is subject to English law and practice".

# PART FOUR: RECONCILIATION OF DIVERGENCE

## *1. GENERAL*

### 1. INTRODUCTION

The attempts of reconciliation of divergence have been induced by the international co-operation[282]. Unification and harmonization strive to improve the predictability of the legal relationships and, consequently, improve legal safety in the international business transactions. In order to achieve successful reconciliation various factors must be considered[283]. Some of them will be discussed below.

### 2. THE PURPOSE AND THE PLAN OF PART FOUR

This part will first identify different levels on which the reconciliation of divergence between different national regulations may take place. The various methods of reconciliation will then be presented, followed by analysis of the need and possibility of unification in the field of marine insurance.

### 3. LEVELS OF HARMONIZATION

Differences in the national regulations as to a particular legal issue may be neutralized on various levels. The neutralization may occur on the international or trans-national level and on the national, state level[284]. A great deal of conformity is achieved informally,

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[282] One commentator observed that there must be a "valid *raison d'etre*" for harmonization. "Harmonization *de lege lata* and *de lege ferenda* is not an end in itself". H.Honka, "Harmonization of contract law through international trade: A Nordic perspective" (hereafter "A Nordic perspective") (1996) 11 Tul.Eur.&Civ.L.F. at 111.

[283] The method, the procedure for decision-making, the contract issues, and the type of contract are factors that must be considered in the process of reconciliation. See Honka, "A Nordic perspective", *ibid.* at 117.

[284] The level on which the neutralization takes place is, in fact, for some authors the source of distinction between the process of unification and the process of harmonization. While the unification operates on the international or trans-national level, the harmonization is effectuated on the national level i.e. the state level: The most important instrument of unification is the convention. The process of harmonization, usually, starts on the international level by drafting of some model regulation, guidelines, or principles which will serve as the example for by the national legislature bodies; see V.Trstenjak, "Dispozitivnost in kogentnost mednarodnega pogodbenega prava" (hereafter "Dispozitivnost in kogentnost") at 702; yet, other authors apply the notion of "harmonization" to the whole scale of levels: from international level down to

through everyday practice of judiciary, arbitration, and business transactions what may be considered as the third level of reconciliation of differences[285].

## 4. STATE-REGULATORY V. SELF-REGULATORY MECHANISMS

Another distinction is made as to the frame within which the harmonization is performed: the inter-state regulatory activity which results in the so-called "hard law" and the activity of self-regulatory organizations which results in the so-called "soft law". Some commentators notes that the self-regulatory approach is more appropriate for the regulation of the international business transactions while it permits the application of usages and renders the so created rules better applicable[286].

## 5. METHODS OF HARMONIZATION

The reconciliation may be achieved through various methods: conflict of laws rules, conventions, model laws, principles, standard forms, usages, and practice of courts and arbitration.

### *a) Conflict of laws rules/Private international law*

Conflict of laws rules or the private international law[287] consist of the rules which aid to identify the law applicable to the contract if the law has not been chosen by the parties.

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legal doctrine. The unification is only one form of harmonization. Instead, they make a distinction between harmonization *de lege lata* and *de lege ferenda*. See Honka, "A Nordic perspective", *ibid.* at 117-118.

[285] My separation of levels is based on the "regulation - practice" opposition. I differentiate between two levels of regulatory activity (international and state) and the practice which could be further differentiated into business practice on the one hand and arbitration/judiciary practice on the other hand. The latter differentiation is not necessary for the purpose of this chapter. I have not included in this levelisation the modern *lex mercatoria* as a system of supranational legal principles, while its existence is still not generally admitted. Moreover, it is not clear what it consists of. According to the wider concept, the modern *lex mercatoria* consists of international standard form contracts, general commercial practices, trade usages, customary law, etc., as well as international conventions and uniform laws. The narrower view describes it as merely customary, spontaneous law. See G. Baron, "Do the UNIDROIT Principles of International Commercial Contracts Form a new Lex Mercatoria" (hereafter "UNIDROIT Principles") (1999) 15 Arbitration International 115 at 119.

[286] See V.Kranjc "Pravila gospodarskega pogodbenega prava postavlja poslovna praksa" (hereafter "Poslovna praksa") (1998) XXIV Podjetje in delo 604 - 701. The author describes the tendency of achieving harmonization in the field of commercial contracts through self-regulatory rules rather than by ratification of the international conventions. The harmonisation is thus left to the commercial practice via commercial usages and customs and via commercial arbitration.

[287] The "conflict of laws rules " is a common law term, whereas the "private international law" is the civil law term. Both terms are used to describe the rules governing choice of law, choice of jurisdiction, and

They are not of international origin, but make part of the national legal systems. Hence, in order to find the law applicable to the contract at issue, one should first identify the national conflict of laws rules according to which the applicable law is to be found. This is, however, much more complicated, than it seems.

Tetley describes four classic approaches to solving conflicts of laws (in common and civil law jurisdictions): "single concept or principles" approach[288], "multiple numbered rules" approach[289], "general texts, commentaries, and essays" approach[290], and "national legislation and international conventions" approach[291]. He believes, however, that those four methods do not always lead to the right answer. Therefore, he proposed the fifth approach which is, in fact, a methodology rather than a single rule while "the courts, practitioners, and academics require a consistent method and order to apply to those laws and conventions when solving a particular conflicts problem"[292].

Despite its complexity, in the absence of the applicable international regulation, the conflict of laws rules remain the only method by which a potential dispute between parties to the contract may be resolved.

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recognition of foreign judgements. Tetley notes that despite different origins and methods both systems developed similar rules, such as "fraude a la loi" and "no evasion of the law" (common law rule); see W.Tetley, "Mixed jurisdictions: common law vs civil law (codified and uncodified), Part II" (hereafter "Mixed jurisdictions, Part II"), http://tetley.law.mcgill.ca at 2.

[288] The solution to the conflict is found in one or very few concepts or principles, such as *lex fori*, *lex patriae*, "the closest and most real connection", and others; see Tetley, *supra* note 15 at 7-23.

[289] This approach refers to the creation of a compilation of rules for almost every possible legal relationship. Such compilations exist in the UK (Dicey & Morris, The Conflict of Laws), Canada (James g.McLeod compilation of two hundred and five rules based on the English and Canadian jurisprudence), and USA (The First Restatement, 1934; The Restatement Second, 1969); see *ibid.* at 23-25.

[290] In the common law countries, commentaries, general texts, and essays are also the source of conflict of laws rules. Tetley cites, among others, the general commentaries of Cheshire & North (12 Ed., 1992) and J.H.C.Morris ($ Ed., 1993) which are in use in England; see Tetley, *ibid.* at 25-26.

[291] This is the most recent approach to resolving conflicts of laws. Many civil law countries (Germany, Austria, Switzerland, Slovenia) as well as common law countries (the UK, Australia) have codified their conflicts legislation in order to make it more transparent and applicable. The conflicts of laws are also solved by international conventions, such as the Hague Conventions or the Rome Convention on the Law Applicable to Contractual Obligations (80&934 EEC, adopted June 19, 1980); see Tetley, *ibid.* at 27-34.

[292] See Tetley, *ibid.* at 37; for detailed presentation of the Tetley's conflict of laws methodology, see Tetley, *ibid.* at 39 to 43.

*b) Conventions*

The most important instrument of unification is a (bilateral or multilateral) convention. Convention is a binding act of law because it is signed and ratified by the states. One of the disadvantages of conventions is that the process of adopting or amending is very long and complicated. Negotiations between the states may take years, and the compromises are very hard to reach. Every state is occupied with its own national interests and is quite reluctant to give up on its national legal institutes[293]. Hence, when it finally comes to a compromise, it usually results in a very broad rule that is not very helpful in practice. Instead of solving the problem, such a broad solution may even add to the confusion. Moreover, states will often exercise their reservation rights in respect to the compromise solutions that do not comply with their interests.

Conventions are, thus, highly inflexible instruments and as such not very appropriate for the regulation of the commercial transactions[294].

Yet, the law based on conventions is more transparent and predictable. It is also fairer while the interests of both parties are taken into consideration[295].

*c) Model laws*

The model law is a document that is not formally signed by the states, nor it needs to be ratified by them. It is a document prepared in co-operation with many experts from various legal backgrounds within the frame of international (governmental or non-governmental) organisations or professional associations, such as UNCITRAL, UNIDROIT, or others. It has no binding effect and as a complete set of rules serves as a model according to which states may draft their national legislation[296].

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[293] The state "egocentrism" is quite understandable while ratified international conventions become part of the national legal system; therefore, they should comply with it as much as possible.

[294] For general discussion on convention as the method of harmonization of the contract law, see Honka, "A Nordic perspective", *supra* note 282 at 119-121.

[295] Generally about the harmonization in the field of transport law, see M.Pavliha,"Poenotenje transportnega prava", (1998) XXIV Podjetje in delo 726.

[296] One of the most successful examples of model law is the UNCITRAL Model Law on International Arbitration, adopted by United Nations Commission on International Trade Law on June 21 in 1985. It

*d) Principles*

Another method of harmonization of diverging national regulations is the formulation of international principles applicable to a particular domain of law. They are usually prepared by legal experts from various legal backgrounds and, therefore, offer synthetic and compromise solutions to issues of divergence. Unlike model laws, principles consist of more general rules and do not provide answers to particular questions. It is not a complete set of rules, but rather a set of the concepts that are supposed to govern certain domain of law. They are not binding, yet they serve as models to national and international lawmakers[297].

## *R. RECONCILING DIVERGENCE IN THE FIELD OF MARINE INSURANCE*

### 1. INTRODUCTION

In order to give a definite and a well-grounded opinion, a wider research and analysis should be made than the scope and objective of this text permit. I have considered only two issues of divergences in only two jurisdictions. This is far form being sufficient to permit a general answer as to whether the unification or harmonization in the field of marine insurance is possible. It is also not enough to make propositions as to possible compromise solutions while only two jurisdictions cannot provide a complete picture of

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provides to the national legislator a complete set of arbitration rules which could be adopted in national legislation in whole or in part. It has been adopted by almost 30 countries from all over the world, among them Germany, Australia, and Canada. It represents a "collection of the major principles accepted in the industrial and developing world as the international standard for international commercial arbitration" See Introduction to UNCITRAL Model Law on International arbitration .

[297] One of the most successful examples of such transnational principles are the "UNIDROIT Principles of International Commercial Contracts". The objective of the respective document was to lay down principles that were common to the existing national legal systems and/or which seemed best adapted to the particular needs of international commercial contracts. The Principles do not represent a mere compilation of the principles inherent to different legal traditions, namely common and civil legal traditions, but an attempt of synthesis between the different legal systems. They may serve as a model to the national legislator, but they may be more than that. Based on the express will of the parties to a contract, they may be chosen as the governing law of the contract. As such, they constitute "a cornerstone in the *lex mercatoria* debate and may become the heart of the new *lex mercatoria*".See Baron, "UNIDROIT Principles", *supra* note 285 at 123-129; see also K.P.Berger, "International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts", (1998) 46 Am.J.Comp.L. 129; Tetley, "Mixed jurisdictions, Part II", *supra* note 287 at 7; See also P.A.Crepeau, *The UNIDROIT Principles and the Civil Code of Quebec: Shared Values?* (Toronto: Carswell, 1998); Honka, "A nordic perspective", *supra* note 282 at 131-140.

the existing and possible solutions regarding issues in the field of marine insurance. Therefore, let me just briefly explore some options.

## 2. THE EXISTING SUBSTANTIAL HARMONIZATION

The above analysis suffices to say that some level of substantial harmonization already exists in the field of marine insurance[298]. The same utmost good faith occasions are identifiable in both jurisdictions and the seaworthiness, a complex legal standard that needs to be established on the case-by-case basis, is a postulate for the insurer's liability where that is fair and appropriate to require.

The reason for such a substantial harmonization lays in the historical development of the marine insurance[299]. The principles of marine insurance was first developed within the medieval *lex mercatoria*[300], as a part of the civilian tradition, which was later accepted into the English common law as customary law. As such, it was codified in the MIA of 1906[301] that served as the model for many other civil and common law jurisdictions in

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[298] Tetley notes that common and civil law of marine insurance covers both, risk interests and property rights, despite different wording of the definitions of the marine insurance. See Tetley, "Mixed jurisdictions, Part II", *supra* note 287 at 5; for definition of marine insurance in common and civil law, see Tetley, *supra* note 15 at 331-383.

[299] For general discussion about the history of marine insurance see Birds, *supra* 14 at 1618-1623; Tetley, "The general maritime law - the lex maritima", *supra* note 16; A.Franasovic, *Praksa Transportnog Osiguranja* (Zagreb: Croatia osiguranje, 1987) at 1-3; G.S.Staring & G.L.Waddell, "Marine Insurance", *supra* note 28 at 1620 - 1623.

[300] *Lex mercatoria* was a system of law created by merchants in the medieval time for the purpose of regulating their commercial activities from the early ninth century to the sixteenth century. It was a reflection of mercantile customs and transnational in character. See Tetley, "Mixed jurisdictions, Part II", *supra* note 287 at 5; There is a lively debate as to whether a new lex mercatoria is about to emerge. Merchants and their international associations have been creating international legal structures and instruments in order to create a common base for international business co-operation. Their activities aim to establish supranational legal principles that would be applicable to any business transaction regardless of the national legal system in which such a transaction is to take place. The theory have been exposing arguments in favour and arguments against the existence of such a supranational legal systems. The debate remains open. See Baron, "UNIDROIT Principles", *supra* note 285 at 115; Generally see, P.Grilc, "Lex mercatoria in mednarodno gospodarsko pravo", (1998) XXIV Podjetje in delo 685-696.

[301] The medieval *lex mercatoria* was made a part of the common law in England by Lord Mansfield. See J.Oldham, "Reinterpretations of 18th-Century English Contract Theory: The View from Lord Mansfield's Trial Notes" (1989) 76 Geo.L.J.1949; In the 19th century, the most important parts of common law contained in the common law decisions were embodied into various statutes: Bills of Exchange Act 1882, Sale of Goods Act 1893, and Marine Insurance Act 1906; see Baron, "UNIDROIT Principles", *supra* note 285 at 117.

drafting their marine insurance legislations[302]. Therefore, some level of substantial harmonization has been already effectuated on the national statutory level.

It seems that the harmonization occurred also informally through internationally accepted standard forms of marine insurance contracts (the Institute Clauses)[303]. However, this may not be regarded as the harmonization in the proper meaning of the word while the use of the Institute Clauses means, in fact, the application of English law and practice. Each form of the Institute Clauses contains the "choice of law" clause that subjects the interpretation of the contract to the English law and practice that is to the common law legal concepts[304].

### 3. THE DIVERGENCE

Hence, the divergence does not lay in the substance, but in the form i.e. the frame in which the contract of marine insurance is performed. In other words, the civil law with its proportionality and causality, on the one hand, and the common law with its draconian remedy of avoidance without requirement of causality and the system of warranties, on the other. The core of divergences therefore lays in the dissenting fundamental legal concepts of the two legal traditions. The question is not "What?" but "How?"

### 4. MAKING COMPROMISES

In order to achieve a unique solution, the compromise between the two approaches should be created. And this is exactly what the unification in the field of private law aims to achieve. The question is, however, what method of unification or harmonization would be the most appropriate for the field of marine insurance.

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[302] The Marine Insurance Act 1906 is called "the mother of all marine insurance statutes"; see Pavliha, *supra* note 155 at 262.

[303] Pavliha notes that more than 70 percent of all marine insurance contracts is based on the Institute Clause of The Institute of London Underwriters. Pavliha cites other examples of the "soft law" that is accepted in marine insurance practice: The Marine Insurance Policy of Antwerp, put into force on 1st of July 1859, The Norwegian Marine Insurance Plan 1996, Version 1999, DTV Cargo Insurance Conditions 2000 (Germany)); Pavliha, *ibid.* at 262

[304] This argument should only be understood in the light of the general common - civil law opposition. Differences also exist between various common law jurisdictions, for example between the law of the UK and USA. The same contractual term may be construed differently in the UK and USA. The growing

*a) Convention*

When making a convention, the parties involved in the negotiations must find or, more likely, create a middle ground or compromise between common and civil law concepts. This is not impossible and it has been done before. The United Nations Convention on Contracts for the International Sale of Goods is said to be very successful[305]. Yet, there is quite a substantial difference between the field of sale of goods and the one of marine insurance.

The practice of the former is highly telegraphic (economically worded) and informalized while the practice of marine insurance is highly formalized and standardized. Written and oral contracts of sale usually contain only some of the most important elements, such as the price, the quantity, the deadline for delivery, and the type of goods. In consequence, the parties to the contract or the court must look for the law applicable to the contract in order to resolve disputes as to the details of expressly agreed terms or as to issues which have not been addressed by the parties[306].

In marine insurance to the contrary, the answer is very likely to be found in the contract itself. What is missing is the method of interpretation and application. Hence, it is not a question of what, but of how.

Taking into account the subsisting divergence in legal concepts, the convention negotiations would surely take many years before some compromise could be achieved.

*b) Model laws and Principles*

Model law or principles would be, in my opinion, a better choice, yet the work will be as hard as in the case of the convention. Reconciling legal traditions demands a lot of knowledge and vision in order to discover functional solutions that may be integrated in

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divergence between the common law jurisdictions may also serve as indication that some sort of harmonization is needed. For examples of divergence , see Schoenbaum, "Warranties", *supra* note 191.

[305] Generally see M.Ilesic, "Od Rima...do Dunaja...prek Slovenije", (1998) XXIV Podjetje in delo 710-723, see also V.Trstenjak, "Dispozitivnost in kogentnost", *supra* note 284 at 704.

[306] See Ilesic, *ibid.* at 711.

any legal system. The example of UNIDROIT Principles showed that concepts originating in different legal traditions may be reconciled, and this may be the most appropriate method for achieving harmonization in the field of marine insurance.

*c) Standard clauses and customs*

As was observed earlier, the current Institute Clauses contain "choice of law" clauses that refer to the English law and practice. If the business would wish to promulgate concepts and solutions developed in the civil law, the competent professional associations could draft another set of Standard Clauses grounded in the civil law. In the business transactions between the parties from the civil law countries, hence, such more familiar clauses could be used. Some attempts in this direction have been carried out in Norway and Germany[307].

Although such a solution would better fit the needs of some of the participants in the insurance business, it may contribute to a greater differentiation instead of convergence. One should also consider what consequences may such a variation induce as to the reinsurance business.

## 5. AN URGENT NEED OR A REDUNDANT PROBLEM

Another question should be considered before we start the snowball rolling: " Is there a real need for change? What does the insurance industry have to gain from it?"

It is true that the application of the English law and practice may cause some difficulties to civil law judges and consequently induce some doubt as to the outcome of the proceedings. It is also true that there is no particular reason for preferring common law solutions and practice to the detriment of civil law principles. From this perspective, the creation of standard forms based on the civil law principles or new, combined standard forms seems to be an advantageous solution.

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[307] See *supra* note 303.

Creating new, middle ground solutions is a very demanding and long lasting task with no guaranty of success. It represents a challenge for legal experts and scholars, but the result of their work is not always appreciated in the practice. Especially in the field of commercial law, solutions may very quickly fall into oblivion if the practice does not find them usefull and effective. Before a solution is arrived at, a real need must emerge in the practice.

Neutralization may not be as advantageous as it seems. Neutralizing fundamental concepts means neutralizing legal traditions. Yet, traditions are considered to be "agents or factors of change and innovation"[308]. Different approaches to the same issues may reveal new aspects and solutions. Hence, two parallel systems or techniques in performing the contract of marine insurance may also enrich the field of marine insurance. Therefore, it is questionable what the field of marine insurance may gain from such a neutralisation of the concepts[309].

[308] See H.P.Glenn, *Legal traditions of the world* (Oxford: Oxford University press, 2000) at 333.
[309] Glenn argues that "working within the cadre of diverse legal traditions, and knowing how to do so, can provide equal or greater benefits to whatever cause is being advanced"; see *ibid.*

## PART FIVE: CONCLUSION

There are fundamental conceptual divergences in the regulation of the contract of marine insurance in the UK and Slovenia. These very divergences may be the subject of the harmonization that is to take place in the field of marine insurance and is pleaded for by many lawyers. It is very hard to give a definite answer as whether a step forward in the harmonization of the marine insurance contract law is possible. I may only put forward some factors that, in my view, should be taken into account in the process of looking for common solutions: the use of self-regulatory instruments, the use of legal standards and customs, and consideration of the needs of the insurance industry.

Reconciling legal traditions has been one of the principal activities of international society during the past hundred years. The neutralization of differences may bring about many advantages in the process of globalisation, yet we should not forget that differences are also the source of change and innovation.

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