

Warranty: The Hidden Shield and Sword for the Insurer to Retain Profit under Marine Insurance

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ABSTRACT

Marine insurance is the medium to safeguard and protect the interest of the assured for any damage suffered during the valid policy. It will restore the insured to the same financial position enjoyed before the loss. However, the insurer is only obliged to indemnify the insured based on the damage suffered. An issue arises when the insurer tries to escape payment by adding terms and conditions known as warranty. This is different from the warranty under the contract of a charter party as it refers to a promissory warranty. It is an embedded shield-and-sword under the law for the insurer to deny payment of claim. The warranty is either used for defence in a denial claim or to initiate the stand to escape liability to pay. The concept of suspensive effect adopted under the Insurance Act 2015 was proposed by jurists and scholars to deviate from the strict compliance of warranty. It is hoped that it will bring justice for both insurer and insured. This is doctrinal research which is qualitative in nature. The paper will discuss this matter by referring to the main sources of law under the law of marine insurance.

Keywords: Marine insurance, suspensive effect, warranty

INTRODUCTION

Marine insurance is a contract whereby the insurer undertakes to indemnify the insured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure (Hodges, 1996, p. 1). It is a promise or agreement of compensation for specific potential future losses in exchange for

ARTICLE INFO

Article history:

Received: 24 January 2017

Accepted: 30 May 2017

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a periodic payment known as premium. Marine insurance is designed to safeguard and protect the financial well-being of an individual, company or other entity in the case of unexpected marine losses. However, in all cases the insurer will control the risks and perils by negotiating and inserting limitations i.e. a warranty before the contract is concluded (Hodges, 1996, p. 95).

Warranty is originated from English law drafted in the 17th century and has been adopted by other countries influenced by English law (Dover, 1982, p. 1). Warranty according to marine insurance 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 negates the existence of a particular state of facts (Hodges, 1999, p. 269).

When the warranty is introduced, the element of materiality signifies nothing. It means that the insurer has full autonomy to decide the terms and conditions to be part of written policy even though there is no connection with the risks. In *Newcastle Fire Insurance Co v Macmorran & Co.* it was given:-

It is a first principle of the law of insurance, on all occasion, that where a representation is material it must be complied with- if immaterial, that immateriality may be inquired into and shown; but if there is a warranty it is part of the contract that the matter is such as it is represented to be. Therefore,

the materiality signifies nothing. (Soyer, 2001, p. 8)

The concept of warranty has become the binding precedent and has been adopted in every case. For instance, in the *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* breach of warranty put risk to an end automatically as from the time of breach. This rule has been held appropriate to both marine and non-marine insurance contracts. The unique distinctive of warranty is that materiality and causation are irrelevant. Once the warranty has been made part of policy, it must be exactly complied with. There is no defence and no act of restoration if the breach is acceptable. The rationale of warranty is that the insurer only accepts the risk provided that the warranty is fulfilled. It means that even though the undertaking is made by the insurer, the insurer will only accept the risk and agree to insure the subject matter after the warranty is agreed by the insurer. The warranty will be used as a defence for the insurer in rejecting the claim either during the defence of claim by the assured or commencing the stand that the contract is void (Soyer, 2001, p.11).

The Attempt to Reform Promissory Warranty

The issue of marine insurance warranty has been a main topic of discussion from the beginning of its establishment. The direct effect on the valid contract was the insurer's intention to avoid liability. In all cases, the insurer will discharge from any liability

automatically even for the slightest breach of the warranty. It is due to the nature of warranty as a promise (Hodges, 1996, p. 96). In other words, it must be exactly complied with without any defence and opportunity to restore the breach even for the breach of promise which has no causal connection with the loss. In addition, the insurer is free to introduce any subject of promise to be undertaken by the assurer even though it is immaterial to the risk. This hardship has led to several attempts made by the scholar and judges via their verdict (Hodges, 1996 p. 95).

For instance, Soyer (2001) proposed the reformation to amend S. 33(3) of the Marine Insurance Act 1906, which states that breach of warranty that does not lead to loss or damage will not repudiate the contract. In addition, the assurer must prove that the breach has not caused or contributed to loss in order to enjoy the policy coverage. The second suggestion by the writer was to repeal S. 34(2) of the Marine Insurance Act 1906, which states that in a case where the breach is remedied before the loss, the assurer will be able to recover loss in the absence of a causal link between remedied breach and loss. The suggested reformation was to amend the promissory warranty that caused conflict to the concept of warranty (Soyer, 2001, p. 293).

The literature shows that many efforts have been made by scholars and judges during the process of delivery of judgement to reform or amend the concept of promissory warranty. However, the attempt was technically parallel or similar.

For example, in the case of *Allison Pty Ltd t/as Pilbara Marine Port Services v Lumley General Insurance Ltd* [2006] WASC 104 (Pilbara Pilot), Justice EM Heenan specified four reasons why the insured should have been indemnified: 1) the Plaintiff's actions were reasonable, 2) the loss was caused by the same cyclonic peril the Plaintiff was escaping from, 3) the Plaintiff was acting to avoid damage and protect the insured property and 4) the loss was caused by a peril of the sea and not by the breach of warranty regarding the mooring. The judge ruled that the legislation was not to be taken too literally, stating "a warranty... is a condition which must be exactly complied with, whether it be material to the risk or not." It is merely a trend based on the discretion of judges. It clearly breached the Marine Insurance Act 1906 since it was a promissory warranty and it had to be exactly complied with without defence for the breach to have been automatically discharged from liability. Ruling based on the trend of rulings past by justifying the existing rule in terms of the application is not a credible solution. This approach is simply by way of interpretation, which is open to disagreement and divergence.

The ruling in *Hong Kong Nylon Enterprises Ltd v QBE Insurance (Hong Kong) Ltd* (2002) HCCL 46/1999 suggested that when there is conflict between policy and warranties, then the former will prevail. The insured "warranted that this is a container load shipment." However, it was actually a bulk shipment. As it turned out, the cargo was damaged, but the insurer

refused indemnity. The insured claimed that the Institute Cargo Clause (A) 8.3 overrode the warranty. Clause 8.3 states, “this insurance shall remain in force ... during delay beyond the control of the Assured, any deviation, forced discharge, reshipment or transshipment and during any variation of the adventure arising from the exercise of a liberty granted to ship-owners or charterers under the contract of affreightment.” Justice Stone agreed with the insured. His Honour stated that the general Clause 8.3 made an exception to the specific warranty. However, to respond to the matter, once mentioned expressly, it is considered an express warranty. Since it is a promissory warranty, it must be complied with exactly and enforced as promised.

In the case of *The Newfoundland Explorer, GE Frankona Reinsurance Limited v. CMM Trust 1440* [2006] Lloyd’s Rep IR 704, the High Court of England and Wales (in Admiralty) allowed breaches of warranty to not interfere with the insured’s indemnification, where that breach was remedied before the loss claimed had happened, and where that loss was unrelated to the breach. The reformation only involved some element of warranty that was not a new concept. In addition, eventually the concept of promissory warranty would have prevailed as it was the main concept of warranty under the Marine Insurance Act 1906 (Hodges, 1996, p. 95). The reformation cannot simply be made by changing the element without considering the whole concept of promissory warranties.

With reference to the case of *Staples v Great American Inc Co, New York*, [1941] SCR 213, Kerwin J said:

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

According to the case, the breach of warranty without being linked to the loss was permissible and was not considered a breach of promissory warranty. The judge tried to eliminate the element of the promissory warranty, whereby the causal connection between the breach and loss did not need to be established. However, it was the same attempt to reform that had been taken by others.

The UK Law Commission Insurance, in a report written with the Scottish Law Commission, “Contract Law: The Business Insured’s Duty of Disclosure and the Law of Warranties” (2012), stated that almost every country in the Common Law world using an unmodified (or almost unmodified) form of the UK Marine Insurance Act 1906, brought disrepute to UK law “in the international market place” (p. 167). It further criticised the harshness of the law by stating that “the consequences [of the UK’s equivalent of s. 39 of the MIA] 37 lack[ed] logical reason and [could] not be explained in terms of

either legal fairness or economic efficiency” (Law Commission, 2011, p. 1-245).

Bind by law Marine Insurance Act 1906. The solution is by creating a new concept of warranty. To abolished “promissory warranty”.

Insurers should not be able to rely upon marine warranty to deny indemnity to their insured where the breach of warranty is not causative of the loss claimed i.e. the suspensive effect. However, an issue arises when it involves the classification of promissory warranty according to the time of undertaking i.e. “warranted that there must be 3 crew at all time” (Law Commission, 2011, p. 22-26). Therefore, it is the breach of the concept of promise.

Later on, in the case of *ICS v West Bromwich Building Society* [1998] 1WLR, 897, Lord Hoffman attempted to modify the concept by interpreting the wording according to the audience:

The meaning which a document would convey to a reasonable man is not the same as the meaning of its words. The meaning of words is a matter of dictionaries and grammar; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean.

However, this is a matter of interpretation. After it was clearly interpreted, the concept of exact compliance under the marine insurance was applied.

A further attempt to reform the warranty via judgement was in the case of *The Milasan* [2002] Lloyds Rep 458, where Mr Justice Aitkens, speaking about “warranted professional skippers and crew” said that they had to be in charge “at all times.” He ruled that, “The warranty obliged the defendant to keep at least one crew member on board the vessel 24 hours a day, subject to (i) emergencies rendering his departure necessary or (ii) necessary temporary departures for the purposes of performing his crewing duties or other related activities.” The judges further explained in order to assist the exact content of marine insurance. The explanation was used as justification when exact compliance with the express warranty stipulated by the insurer in the policy was not met.

The same approach of considering it a matter of interpretation was made in the case of *The Newfoundland Explorer* [2006] EWHC 429 by Mr Justice Gross and in the case of *Pratt v Aigaion Insurance* [2008] EWCA Civ.1314 by Lord Justice Clarke and Lord Justice Burnton. However, the moment the cases concluded, the parties were subject to the concept of promissory warranty. According to the case, the insurance policy had a warranty express term that mentioned that stipulated: “Warranted owner and/or owner’s experienced skipper on board and in charge at all times and one experienced crew member.”

It was found that, “It cannot have been thought that the vessel would be crewed while she was aground or at a place of storage ashore, while being dismantled

etc. It follows that the warranty...cannot be read literally. Some qualification to the term 'at all times' must have been intended." Burnton LJ further explained that, "In the circumstances, the clause should be construed *contra proferentem*...At the time the crew left, the vessel was safely tied up alongside as must happen very often. I would hold that that the insurer has not established that there was a breach of warranty."

Warranties in Marine Insurance

Christopher J. Giaschi, presented to the Association of Marine Underwriters of British Columbia at Vancouver on 10 April, 1997, introduced judicial amendment on the element of warranty. Recent developments in the law in relation to warranty in policies of marine insurance indicate that there is judicial amendment, if not complete revocation, of the Marine Insurance Act. It is only in very rare circumstances that a Canadian court will find a policy to contain a true warranty. These circumstances will essentially be limited, where the warranty is material to the risk and the breach has a bearing on the loss. However, the amendment will jeopardise the concept of promissory warranty under the Marine Insurance Act 1906 (Giashi, 1997).

Suspensive Effect

Shearwater Marine Ltd. v Guardian Insurance Co. (February 28, 1997) No. C935887 (B.C.S.C.) was illustrative of a restrictive approach to warranty. The

policy in this case provided: "Warranted vessel inspected daily basis and pumped as necessary." Although the court found that this condition had been complied with it did consider whether the condition was a true warranty or merely a suspensive condition and held that it was a suspensive condition.

Suspensive effect was mentioned in "The Prospective Reform of Marine Insurance Law in the UK", a study by Professor D. Rhidian Thomas, Emeritus Professor of Maritime Law Founder Director of the Institute of International Shipping and Trade Law at Swansea University. He proposed that breach of warranty was to be treated as 'suspensive' i.e. the insurer should not be liable for the period the assured is in breach of a warranty that is designed to decrease a particular risk (e.g. fire), in which case, the insurer is entitled to reject only claims relating to that risk. Suspensive condition is technically an amendment to element, where 1) the insurer is automatically discharged from liability; 2) the breach can be remedied; and 3) the warranty must be material to the risk (<https://www.swansea.ac.uk/media/IISTL%20Report%202013-30jan-2.pdf>).

Even though there were attempts made by scholars and jurists to reform the warranty, such reformation involved only alteration or amendment of the element of warranty without change being made to the wider concept of warranty. The reformation was to create balance between the parties involved in the insurance agreement in order to uphold the core concept of protection and indemnity.

Insurance Act 2015

In 2006 the Law Commission was asked to think through the existing insurance law regime in the UK to consider whether it was still fit for perseverance in the modern insurance market (Law Commission, 2011). The Commission's decision was that the current law is obsolete, being inconsonant with the realities of 21st century commercial practice. As a result, the Law Commission published The Insurance Bill 2014, which was first put before Parliament in July 2014. The Bill received Royal Assent on 12 February, 2015 to become the Insurance Act 2015 but will only enter into force on 12 August, 2016 to allow the market time to regulate its practices. The Act seeks to extend reforms made in 2009 to consumer contracts of insurance. It will make it more difficult for insurers to avoid claims as a result of technical breaches by the insured (Law Commission, 2011).

The current position as stated in the Marine Insurance Act 1906 is that the warranty is a promissory warranty. The insurer claim will be rejected due to non-strict compliance on express or implied warranty regardless of the materiality of the promise. Unless the insurer waives his right, the insured in no circumstances will be entitled to make a claim (Hodges, 1996 p. 95-106; Wilson, 2010).

Under sections 9 to 11 of the Act the effect of a breach of warranty will be less severe. Any warranty breach by an insured now merely suspends the insurer's liability until the breach is remedied. The insurer will have no liability for any claim arising

if the policy is suspended but once the breach has been remedied then the policy resumes in full force. The Act also stops an insurer from avoiding an insurance contract if a warranty ceases to be applicable to the circumstances of the contract due to a change of circumstances or if it is rendered unlawful or is waived by the insurer.

A further amendment to the existing law under the Act arises from the Law Commission's proposal. Section 11 states that the element of materiality of warranty must be taken into account. This means that non-compliance of the warranty, which has no connection with the risk and does not increase the frequency of risks, is permissible.

CONCLUSION

The introduction of new rules on warranty pursuant to the legislation of Insurance Act 2015 will offer balance between the parties. The insurer has absolute right upon breach of warranty to reject the claim of the insured (shield); however, this requires justification and explanation. In addition, to allege that the claim is void due to breach should be limited to specific circumstances.

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