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Overview over content

Director's preface

2015 was a challenging year for the institute. The Nordic Council of Ministers signalled in 2014 that the funding arrangement for the institute that had existed since 1963 would end in 2016 and that future funding would be organized by NordForsk by a new financial instrument and offered through competition. In order to decide how this instrument should be designed, the institute was, together with the 4 other institutions under the same type of financing, evaluated by an international panel. This took place during the spring of 2015. The result of the evaluation and the design of the new financial instrument will be known in 2016. As this process took much longer time than envisaged, the contract with NMR will continue through 2017.

The research at the institute has followed the same lines as previous years. The traditional core area contracts in the shipping-, offshore- and energy sectors is maintained and developed. The research on maritime contracts has included the so-called "green transport" aspect where environmental issues are analysed as a part of the analysis of contract law.

The focus on energy and environment is further strengthened through the cooperation with the University of Oslo's energy initiative, UiO:Energy. Ocean law is a new area of research where academic staff from both the maritime and the petroleum/energy departments and the Center for European law participate. The institute also has the leadership of the University's Arctic initiative.

Ivar Alvik and Henrik Bjørnebye were both assessed and found eligible for the position as Professor of Law. The promotion was granted retroactively from September 2014.

In terms of publications and activities 2015 has been a most productive year. Researchers at the Institute have contributed to thirteen issues of MarIus, covering topics within EU law, energy law, maritime law and other topics. The Institute has hosted fourteen events of varying size throughout 2015. Among the most notable events was that the Department of petroleum and energy law hosted an anniversary seminar 13

April 2015 with the topic "Licencing rounds during 50 years", and that the Department of maritime law hosted the yearly Colloquium in Maritime Law Research arranged by Oslo/Southampton/Tulane 23-24 September with the topic "Organizing shipping".

The Institute was also co-host at several events. Together with CEFOR and the Norwegian Shipowner Association the institute hosted a seminar on Insurance and Arctic 15. April, and together with UiO:Energy and Energy Norway, a seminar on "the Energy market in the EØS-area – new legal and political developments", 6 May 2015. Further, members of the academic staff are, as in previous years, active participants and partly co-hosts in an array of legal seminars hosted by other institutions (e.g. the "Kiel seminar" on energy law, the Petroleum Law Seminar and the Solstrand seminar on oil and gas law).

The Institute has maintained its portfolio of taught courses in 2015. This includes elective courses in petroleum law, maritime law, marine insurance, insurance law and EU substantive law within the study programme Master of Law (in addition to courses taught in Norwegian). The Institute also provides the complete study programme, Master of Maritime Law. The courses maintain their popularity within the student body. In 2015 there were 130 applicants competing for 20 places on the Master of Maritime Law programme, and accepted candidates have been recruited from thirteen countries. Further, the first round of the North Sea Energy Law Program (NSLP) as accredited master program as a joint venture between 4 participating institutions was held in Oslo two weeks in January 2015.

Approximately fifty percent of the Institutes funding in 2015 has been through external project funding. Our main sponsors and collaborators are:

- The Nordic Council of Ministers
- Research Council of Norway
- the Norwegian Oil and Gas Association
- the Ministry of Petroleum and Energy/the Research Council of Norway
- Energy Norway
- Anders Jahres Foundation

We are very grateful to all our sponsors.

We would also like to express our gratitude to the numerous practitioners who help us year after year with lectures, student advice, information and examinations, in most cases without charging any fee. Their contribution is important in making the Institute what it is: a meeting place for young as well as established researchers, practitioners and students, all of whom combine open-minded enthusiasm for new knowledge with penetrating analysis. In particular, we are delighted with the way in which practitioners as well as researchers from other institutions have contributed to our elective courses and the Master of Maritime Law programme.

Trine-Lise Wilhelmsen

Editor's preface

This issue of SIMPLY – unfortunately somewhat delayed – contains contributions from scholars employed at and associated with the Institute.

First there is Erik Røsæg's article analyzing the scope and effect of the Norwegian Maritime Code Section 45 which provides that mortgages of a registered ship also encompass the ship's appurtenances, something which poses potential difficulties if such appurtenances are owned by third parties, for example a charterer.

Next is Kristina Siig's article which, under Danish law, discusses legal and strategical aspects involving securities, liens and mortgages in situations where shipowners are in financial distress – seen from the perspectives of the various parties involved; shipowners, charterers and ship financiers.

Then follows Trond Solvang's article dealing with the operation of a knock-for-knock liability and indemnity scheme in situations where such contractual indemnity becomes intertwined with indemnity rules of general tort law – due to a third party tortfeasor operating in tandem with a tortfeasor within the contractual regime.

Next is Alla Pozdnakova's article discussing the relevant rules of the law of the seas relating to the protection and exploration of underwater cultural heritage.

Finally we have our former LLM student Daria Romanova with an article based on her LLM thesis covering the recent legislative development of English marine insurance law, particularly on the topic of insurance warranties, and with a comparative view to its pendant under Norwegian marine insurance law.

Trond Solvang

Liens and mortgages on the ship – their relation to the charterer's equipment on board

By professor Erik Røsæg

Content

1 The problem

As a starting point, when a ship is mortgaged, it is easy to ascertain what the mortgaged object is: the ship. Doubts arise, however, in respect to appurtenances,[1] particularly if they do not belong to the mortgagor shipowner, or if someone has a security interest in them, or if they are not permanently attached to the vessel. In this paper, the relationship between the various physical appurtenances belonging to the charterer (or another third party) and the ship mortgagee and holders of liens will be discussed.

The basis will be Norwegian law, which has proven problematic in this respect. The Norwegian flag is still relatively important, and two of the three largest banks for ship financing are Norwegian.

The rule in Norwegian law is based on a rather idealistic notion that a ship with appurtenances should be considered as one single object for the purpose of a mortgage, so that a sale enforcing the mortgage can offer a complete and running ship to the market, for the benefit of those interested in a high price:

> Mortgages and other encumbrances upon any ship which has been or can be entered in the Ship Register, cf. Section 11, shall also attach to each separate part of the ship, and to anything belonging to the ship which is on board or has been temporarily removed. No separate right can be established to such parts or appurtenances.

[1] On the terminology, see Christian Von Bar and Eric M. Clive, *Principles, definitions and model rules of European private law: Draft Common Frame of Reference (DCFR)* (Oxford: Oxford University Press, 2010) p. 5404 (Vol. VI). I adopt the terminology used in the translation of the Norwegian Maritime Code (NMC), 1994 (http://folk.uio.no/erikro/WWW/NMC.pdf (2014, last accessed October 2016)).

The rule was introduced in 1979,[2] but had some roots in the Ship Registry Act, 1901, as amended in 1929.[3] It is now found in the Norwegian Maritime Code (NMC) recast of 1994.[4]

The rule cannot be departed from by agreement.[5] It is not a matter of priority of claims, and the good faith rule of the NMC § 24 is therefore irrelevant.

The uncontroversial aspect of the rule is that a mortgage should not exclude any parts of the vessel, or limit itself to parts such as boilers or engines. There may have been a tradition for such limited pledges, particularly for as long as bottomry still existed in Norwegian law.[6] It does definitely make sense that those parts of the ship that cannot be removed without causing damage to other parts of the ship, should not be sold separately by a forced sale, and therefore should not be mortgaged separately.

The situation is quite different where the ship, for example, has the charterer's computer equipment installed on board in connection with seismic surveys of potential petroleum fields. The equipment can be worth as much as the vessel, and can be easily removed. It would be rather strange if the integration into the vessel should lead to the attachment of the ship's mortgage on that equipment, in possible conflict with ownership interests in the equipment and the interests of others having security interests in them, such as seller's liens. In particular, this is the case where the holders of the conflicting interests did not clearly consent to the equipment being taken aboard, or did not understand the legal niceties.

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2 Norwegian Maritime Code, 1893 § 260.

3 Norwegian Ship Registry Act 4 May 1901 No. 2 § 20.

4 NMC 1994 (footnote 1) § 45.

5 Thor Falkanger and Aage Thor Falkanger, *Tingsrett* (Oslo: Universitetsforlaget, 2013) p. 94 footnote 153; Thor Falkanger, Hans Jacob Bull, and Lasse A. Brautaset, *Scandinavian Maritime Law: The Norwegian Perspective* (Oslo: Universitetsforl., 2011) p. 47; Thor Falkanger and Hans Jacob Bull, *Sjørett* (Oslo: Sjørettsfondet akademisk, 2010) p. 28.

6 The rules on bottomry in §§ 174-185 of the NMC 1893 (footnote 2) were abolished by Norwegian Act 31 May 1929 No. 4, at the same time as § 20 of the Norwegian Ship Registry Act (footnote 3) in respect of prohibition of pledges in parts of the vessel was being considered.

A similar situation arises if the equipment is moved aboard when the ship is under foreign flag, and the ship is later on reflagged to the Norwegian flag (which the owner of the appurtenance cannot prevent or may not even know about), so that § 45 of the Maritime Code starts to apply.

In the following, I will discuss how far the rule in NMC § 45 goes, with a particular emphasis on the definition of appurtenances and on third party ownership in the appurtenances. Thereafter, solutions in foreign law will be discussed.

2 Initial remarks on § 45

2.1 The exceptions

2.1.1 General

The principle in § 45(1) has two stated exceptions.

First, there is an exception for certain equipment on board small ships:

> In regards to any ship with a length overall not exceeding 10 meters, the provisions of paragraph one do not preclude the establishment by agreement of a seller's lien on any engines, radio equipment or electronic equipment (for navigation or similar use) for the ship.[7]

Presumably, the regulators did not wish to impose fully an unpopular rule on the fishing fleet.[8]

Second, there is an exception for short-term hire agreements:

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7 NMC 1994 (footnote 1) § 45(3).

8 See, on the debate leading up to the special rule, Sjur Brækhus, 'Eiendomsforbehold i tilbehør, særlig i tilbehør til fast eiendom eller skib', *Lov og rett,* (1966), 242–264 at pp. 254–255.

The provisions of paragraph one do not apply to any appurtenance belonging to a third party, and which has been hired by the shipowner on a contract which the shipowner can terminate at no more than six months' notice.[9]

This is an exception for short-term hire agreements, regardless of the size of the vessel and the type of equipment hired. The regulators have not wanted to extend this exception to hire-purchase agreements (financial leasing), as opposed to operational leasing. The only way to prove that the leasing is operational and not financial is by proving the short period of the hire, as well as having an option for the shipowner to terminate the contract.

2.1.2 Mortgages Act, § 3-18

There is no indication of it in § 45, but the rule is later supplemented by registration requirements in the Mortgages Act, 1980,[10] § 3-18.[11] Certain rights akin to a seller's lien must be registered in order to be protected against later purchasers in good faith, later creditors' liens and the shipowner's bankruptcy.

The registration rule obviously applies to sellers' liens allowed under § 45(3), even if called by other names. It also applies to leasing in some cases:

> A lease contract or similar agreement which in reality serves to secure a sales price will be regarded as a sales and sales lien agreement, if it is the intention that the lessee shall become the owner of the object after having paid a certain number of instalments. Even where the lessee does

9 NMC 1994 (footnote 1) § 45(2).

10 Norwegian Mortgages and Liens Act No. 2/1980 (translation by Jørgen Sandberg at http://www.ub.uio.no/ujur/ulovdata/lov-19800208-002-eng.pdf (without date, last accessed October 2016)).

11 The rules were originally proposed by the Maritime Law Commission, see Sjur Brækhus and Borgar Høgetveit Berg, *Omsetning og kreditt 2: Pant og annen realsikkerhet* (Oslo: Universitetsforlaget, 2005) p. 125 (para 212.78).

> not have the right to acquire ownership, the provisions of §§ 3-15 to 3-20 will similarly apply.[12]

The Norwegian Supreme Court has decided that so-called residual value leasing is not subject to this definition, so that the registration (and other) requirements of the Mortgages Act therefore do not apply.[13] In other cases, the registration requirement will apply, according to the wording, if the agreement in reality serves to secure a sales price, even on the assumption that there is no sale or potential sale! There is no indication which reality is referred to, or the details of it; most likely this is a virtual or even fictional reality. In any event, the only safe strategy for a lessor is to register his right in the Ship Registry pursuant to § 3-18 of the Mortgages Act.

Even if registered, it follows from §§ 3-19 and 3-20 of the Mortgages Act that the separate rights allowed under § 45 of the Maritime Code and registered pursuant to § 3-18 of the Mortgages Act can be lost by commixture[14] and refinement.[15]

2.2 Application to rights other than mortgages

An oddity of NMC § 45 is that it is placed in the chapter on registered pledges, which mainly deals with registered mortgages.[16] The rule has, however, a wider scope.

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12 Mortgages Act (footnote 10) § 3-22(2).

13 Rt-2001-232.

14 This is different terminology from that in DCFR (footnote 1) p. 5026 (Vol V), where "combination" and "commingling" are used.

15 Brækhus, pant (footnote 11) p. 113 *et seq.* (paras 212.74-212.75). Compare the scepticism towards these kinds of rules in Laila Zackariasson, *Borgenärsskydd och specialitet: om identitet, individuell bestämning och individualisering som förutsättningar för borgenärsskydd vid anspråk som har uppstått och fått sitt innehåll med borgenärens samtycke* (Uppsala: Juridiska fakulteten i Uppsala, 2012) pp. 729 and 736 (Swedish law), and even the Norwegian Supreme Court in Rt-1974-879.

16 NMC 1994 (footnote 1) Chapter 3 I.

The rule does, admittedly, say something about mortgages: they cannot be limited to or exclude certain parts of the vessel. In this respect the provision is well placed.

However, by its wording, the provision in NMC § 45 extends to all kinds of rights in parts of the vessel, for example a creditor's lien, a maritime lien,[17] ownership and a right of first refusal, and it also applies when there are no mortgages or other registered pledges on the ship.[18] In this respect the rule operates without any relation to mortgages or other registered pledges, and is misplaced. A better placement of the rule would perhaps be § 20, which deals with which rights can be established in and registered in a vessel.

2.3 The definition of appurtenances

2.3.1 Scope

Any problem arising from the impact of NMC § 45 would be reduced by a narrow scope of the appurtenances to which it applies. However, from the text of the provision and from the examples in the *travaux préparatoires*, one can deduce that the scope is rather wide.

It is clearly stated that § 45 not only applies to parts of the vessel, but also equipment on board. Even equipment temporarily removed from the vessel – such as a lifeboat removed for repair – is considered an appurtenance for this purpose.[19] The idea clearly goes much further than preventing loss by the removal of appurtenances.

If the appurtenances are used on several vessels, they can hardly be considered an appurtenance on any one of them, even when on board.

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17 Sjørett (footnote 5) p. 107; Scandinavian Maritime Law (footnote 5) p. 129.

18 Report VIII of the Norwegian Maritime Law Commission (1969) pp. 90–91; Report VI of the Norwegian Maritime Law Commission (1966) p. 92. Thor Falkanger, 'Tilbehør til skib: Nooen refleksjoner omkring sjølovens § 260', in Thor Falkanger et al. (eds.), *Lov, dom og bok: festskrift til Sjur Brækhus* (Oslo: Universitetsforlaget, 1988) p. 144, does not accept the wording at face value here.

19 This may prevent a repairer's lien, see ND-1984-281 (arbitration) and Peter Strömgren, *Tillbehör och accession* (Uppsala: Juridiska fakulteten, 2012) p. 309.

The fact that the equipment could be used on several ships is irrelevant provided it is, in fact, used only on one ship.[20]

There is no basis in the wording or in the *travaux préparatoires* for limiting the scope of § 45 to appurtenances strictly necessary for the running of the ship.[21] Even though all of the examples mentioned in the provision itself are appurtenances that are more or less necessary for the running of the ship, this is no indication of the extent of the rule.[22] Thus, fishing gear forms part of the vessel for these purposes.[23]

The Mortgages Act § 3-10 allows the mortgaging of fishery equipment that is not an appurtenance to a vessel. The idea is apparently that fishery equipment may be an appurtenance to a vessel. The exception (to which § 3-10 applies) is fishing gear shared by several vessels.

The appurtenances included in a sale of the vessel could form the outer limit of application of § 45. This would make sense in a way, since the idea of the provision is to preserve the totality of the ship as an attractive sales unit. However, a sale may or may not include special equipment, such as fishing gear. Then the reference to the sale situation would give little guidance.

Consumables are expressly defined to be outside the scope of the appurtenances to which § 45 applies. Consumables, such as bunker fuel oil, often belong to the (time) charterer, so it is wise to exclude them from § 45.

Lifeboats and tenders are often mentioned as examples of appurtenances. Presumably, this does not apply if they are registered as separate ships.

In conclusion, the concept of appurtenances as used in § 45 is rather wide, and does not alleviate any conflicts between the mortgagee of the ship and the owners of appurtenances other than the mortgagor.

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20 *Contra* Sjørett (footnote 5) p. 28; Scandinavian Maritime Law (footnote 5) p. 47.

21 Sjørett (footnote 5) p. 28; Scandinavian Maritime Law (footnote 5) p. 47.

22 Falkanger, tilbehør (footnote 18) p. 146.

23 Hålogaland Court of Appeal in ND-1979-206.

2.3.2 Cease

When movables are lawfully and permanently moved ashore, they obviously cease to be appurtenances. By its own wording, § 45 then no longer applies. However, the situation does not necessarily return to how it was before the item became an appurtenance.[24]

The same applies if the appurtenance lawfully loses some of the other characteristics that make it an appurtenance. Such a situation could in practice be where the shipowner and the charterer no longer make use of the appurtenance.

Even if an appurtenance is unlawfully and permanently brought ashore, it retains its characteristic as an appurtenance, and § 45 continues to apply. The right to lawfully bring it ashore is therefore discussed below.[25] However, it may be that the removal from the vessel – even unlawfully – can be so definite that the character of appurtenance ceases.[26] Certainly this must be so if the item is commixed with another item or becomes the appurtenance of another vessel.

The appurtenances will not lose their character as such just because they are transferred to a purchaser or pledgee in good faith after having been removed from the vessel.[27] The ordinary rule, that an acquirer who has possession in good faith obtains a good title does not apply. This follows explicitly from the legislation if the appurtenances are pledged.[28] But further, if the appurtenances are sold and not pledged, the same seems to follow from the less clear provisions in the legislation, if nothing else so as to align the law of pledges and the general rules.[29]

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24 See below 3.3–3.4.

25 See below 3.3 *et seq*.

26 Brækhus, pant (footnote 11) p. 68 (para 212.0).

27 Unclear in this respect, Brækhus, pant (footnote 11) p. 68 (para 212.0). *Contra* Falkanger, tingsrett (footnote 5) p. 665.

28 Mortgages Act (footnote 10) § 3-3, cf. § 1-2(2).

29 Norwegian Act No. 37/1978 on title to moveables based on good faith § 4 No. 1.

3 The position of the owner of the accessories

3.1 Introduction

I will now consider the position of an owner of the accessories who is neither the owner of the vessel, a non-financial lessor recognised under § 45(2), nor a creditor who has retained his title when this is allowed under § 45(3). § 45 then states that mortgages, *etc.* on the vessel encompass the appurtenances, and that no separate rights can be established to parts of the vessel or its appurtenances. Seemingly, then, the right of the owner of the appurtenances becomes valueless.

Arguably, there is a difference between, on the one hand, the existing property rights of others than the shipowner in parts and appurtenances, and on the other hand, rights originating from the shipowner. The ban on "establishing" separate rights fits better within the latter than in the former situation. But from both legislative history, the context and also the fact that the provision pursuant to the wording clearly applies to parts and appurtenances owned by a third party,[30] this distinction appears to be irrelevant.[31]

3.2 The significance of ownership

It could seem logical to exclude appurtenances not owned by the mortgagor shipowner from the scope of the ship mortgage. However, that would not tally well with the stated purpose of the rule, which is to ensure that a forced sale on the basis of a mortgage includes a fully functional ship.[32]

There are also positive indications that it has been the intent of the legislator to let the ship mortgage include appurtenances, even if they are not owned by the mortgagor shipowner.

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30 See below 3.2.

31 Strömgren, tillbehör (footnote 19) p. 278.

32 See below 4.1.

Thus, subsection 2 of § 45 provides that the section does not apply in some cases where the appurtenances are owned by a third party; namely, when they are rented for a period not exceeding 6 months. This provision is clearly based on the assumption that in other cases of appurtenances owned by a third party, these appurtenances are subject to the ship mortgage.

Subsection 3 of § 45 deals with retention of ownership, and juxtaposed with subsection 2, is a clear indication that the wording of subsection 2 really is intended to include operational leasing,[33] and not only the retention of ownership as a security interest. This reading fits well with subsection 1 second sentence, which provides that separate rights – presumably separate rights of any kind, including ownership, and not only security rights – cannot be established in parts of or appurtenances to a vessel.

In line with this, the *travaux préparatoires* indicate that stolen goods placed unlawfully on board as appurtenances should not be included in the right of the ship mortgagee.[34] The basis for this exception is perhaps not clear.[35] But the statement assumes the main rule that goods belonging to a third party that have been placed on board are included in the right of the ship mortgagee.

The enactment replaced by § 45 also explicitly applied to third party property.[36] There is no indication that a change was intended.

[33] This was written before the Mortgages Act (footnote 10) § 3-21 attempted to clarify the relationship between the retention of title, seller's liens and operational leasing.

[34] Norwegian Maritime Law Commission VI (footnote 18) p. 65; Proposal to the Parliament Ot.prp. nr. 32 (1970–71) p. 56.

[35] At the time this was written and § 45 enacted, the owner could, as a main rule, vindicate his goods, and § 45 was obviously an exception to this, although it does not require good faith. In 1978, the main rule was reversed from vindication to extinction in good faith (by the Good Faith Act (footnote 29)). In relation to § 45, that did not matter, as the mortgagee could not rely on this act anyway (he does not pay for the appurtenance and does not get possession; apparently *contra* Falkanger, tilbehør (footnote 18) p. 141). However, in the 1978 Act the right of vindication was maintained for stolen goods (Good Faith Act (footnote 29) § 2). This may have been based on similar thinking as the stolen goods exception mentioned in the *travaux préparatoires* to § 45. – Stolen goods as appurtenances is a classic discussion, see Strömgren, tillbehör (footnote 19) p. 341.

[36] Norwegian Ship Registry Act (footnote 3) § 20(2).

In connection with a discussion on the seller's liens that should be allowed, the Maritime Law Commission notes that the property of third parties should be respected in that specific context.[37] *A contrario*, the Commission must have intended that the property of third parties should *not* be respected in other contexts.

At a later stage, the Maritime Law Commission considered rules for offshore drilling units similar to § 45. That was rejected, because no clear customary practice as to who owns the appurtenances could be proven.[38] That would, of course, have been irrelevant if § 45 only applied to appurtenances owned by the shipowner. The Maritime Law Commission therefore assumed that § 45 applies, regardless of the ownership of the appurtenances.

The conclusion is inevitable[39] that the ownership of the appurtenances is irrelevant for the application of § 45. In the following, the effects of this will be further analysed.

3.3 Security interests

The clearest situation is when the ownership interest of the third party is only a security interest. In these cases, the *travaux préparatoires* advise that the ownership interest is null and void.[40] This is in line with the general rule in the law of mortgages and pledges that a security interest that cannot be perfected[41] is also null and void between the parties who agreed on it.

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37 Maritime Law Commission VIII (footnote 18) p. 91.

38 NOU 1976: 59 Privatrettslige regler for borefartøyer p. 24.

39 *Contra* Falkanger, tilbehør (footnote 18) p. 142. Falkanger suggests that the property of a subcontractor of the shipowner would not be subject to the mortgage. If so, § 45 would be reduced to a meaningless rule on organising the shipping enterprise. This view is not maintained in Sjørett (footnote 5) p. 28 or Scandinavian Maritime Law (footnote 5) p. 47.

40 Proposal from the Parliamentary Committee Innst. O. VIII (1971–72) p. 11. Still, the shipowner and his mortgagee can apparently rely on agreements making them appurtenances.

41 This is an unusual instance of *numerus clausus* in Norwegian law, now reflected in the Mortgages Act (footnote 10) § 1-2.

A creditor's lien on property that becomes an appurtenance to a vessel will be void in the same way. NMC § 45 does not allow for any special rights in relation to the appurtenance parts of a vessel.[42]

It follows from this that the rights of the appurtenance owner who only has a security interest are not resurrected if the item ceases to be an appurtenance.

The security interest mentioned in § 45 is retention of ownership. But later on, the law in this field was codified, and a number of clauses were defined as being clauses for a seller's lien, including the retention of title clause. It is likely that this will define the scope of § 45(3) as well.

The clauses that are considered merely clauses for security interests are clauses providing for:

- Seller's lien,
- Retention of title,
- Right to cancel a sales contract on the default of the purchaser, and
- Leasing, if the ownership "in reality" secures purchase money, and the intention (of whom?) is that the lessee shall become the owner after a certain number of installments.

An appurtenance owner, who has retained property, *etc.*, can still claim his debt, even when the retention of the property is null and void. But he would perhaps not have accepted this credit risk without the security, at least not on the same terms.

The moral is that anyone who relies on a retention of title clause must check the law first. This may justify the general rules that make such clauses void unless the laws advise a route to achieving perfection.

However, even a very prudent seller can be fooled by the provision in § 45 of the Maritime Code. If one sells a forklift, a retention of title clause is usually valid if registered.[43] The purchaser is then free to place

[42] Falkanger, tilbehør (footnote 18) p. 141 seems to allow the creditor's lien to survive if the ship mortgage is not in good faith, but the basis for this is not discussed. Strömgren, tillbehör (footnote 19) p. 286 supports the proposition here that good faith is irrelevant.

[43] Mortgages Act (footnote 10) § 3-17.

it permanently on board a ship.[44] This would render the retention of the lien clause null and void, and there is nothing the seller can do to protect himself.

3.4 Real ownership

3.4.1 The general rules

If the owner of the appurtenance has more than a security interest in the item brought on board, the situation is different. This owner's interest may reach far wider than the value of the item or the claim for the purchase money; his continued business may, for example be dependent on the return of the item. And unlike the seller with a seller's lien/retention of title, he has no claim to enforce in addition to his property right. In some cases, it may even be illegal for him to give up his title, for example if he bought the goods from a seller who retained the title or the equipment is subject to export restrictions.

Perhaps because of this, making an item an appurtenance does not, in itself, invalidate ownership. The statement on invalidity in the *travaux préparatoires* referred to above expressly only deals with the retention of ownership/seller's liens.[45]

This means that when an item ceases to be an appurtenance, the appurtenance owner regains his full ownership.[46] However, if the appurtenance owner has induced the shipowner to put the appurtenance on shore unlawfully, he may be liable in damages to the shipowner's bankruptcy estate, equal to its loss.[47]

44 The Mortgages Act only prohibits sales, *etc*., see §§ 3-16 and 1-7.

45 Brækhus, eiendomsforbehold (footnote 8) p. 254 argues for a similar distinction.

46 This is dissimilar from the situation where the appurtenance owner only has a security interest in the appurtenance, see above 3.3.

47 This is based on the general negligence rule. The majority view is that the Norwegian Satisfaction of Claims Act No. 59/1984 § 5-9 is not applicable in such situations, as it only deals with legal dispositions and not factual dispositions (Mads Henry Andenæs, *Konkurs* (Oslo: M.H. Andenæs, 2009) pp. 353–354). The legal effects are similar under the two rules, except that under the Satisfaction of Claims Act § 5-12, the bankruptcy estate can claim the appurtenance back in specie, and therefore has a preferred right in the appurtenance owner's bankruptcy.

While the appurtenance is on board (or temporarily removed), the appurtenance owner has no more than a hope that his right does not conflict with the rights of others, and that the shipowner can therefore return the items to him. In line with this, the creditors of the appurtenance owner cannot register a creditor's lien on the appurtenances (that would conflict with § 45); they can only get a lien on the claim against the shipowner to have them returned.[48]

In the running of the ship, it is the pledgees' interests – including the mortgagees, as well as the holders of the creditors' liens and maritime liens – that conflict with those of the appurtenance owners. It then becomes crucial to determine to what extent the ship pledgees can prevent the appurtenances from being brought ashore. If the pledgee succeeds in preventing appurtenances from being released from the ship, he will secure the value of the appurtenances for himself.

In order to prevent appurtenances from being released from the ship, the pledgee must know what is going on and succeed in perhaps cumbersome procedures to get an injunction. That would be difficult. Alternatively, the pledgee can rely on the mortgagor shipowner's wish to avoid breaching the mortgage conditions.

In any event, the pledgees do not necessarily have the right to insist that appurtenances should remain on board. In the general law of mortgages, there are rules of this kind, as follows:[49]

The appurtenances of a ship are pledged as a set ("tingsinnbegrep"); obviously, the idea is that the individual items can be replaced and changed.[50] Under the law of mortgages, when a set of property is mortgaged, the mortgagor can replace the individual items of the set and reduce its value, at least to some extent. The freedom in this respect is determined by the law, and not by the contract.[51]

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48 In line with this, see Strömgren, tillbehör (footnote 19) p. 237.

49 See Brækhus, pant (footnote 11) p. 369 *et seq.* (para 241.3).

50 In line with this, the standard mortgage document of the Norwegian Ship Registries only requires notice to the mortgagee for breaking up the vessel or making major modifications or expenditures in respect thereof. See *Materialsamling i sjørett* (Oslo: Sjørettsfondet, 2010) pp. 116–117.

51 See the Norwegian Supreme Court in Rt-2000-1360 at p. 1363.

Since the mortgagee is obliged to accept that the mortgagor may replace items in or even diminish the value of the set of appurtenances owned by the mortgagor, he must also accept this if the items in the set of appurtenances belong to a third party. There is no reason why the mortgagee should be in a better position in relation to these, than to the appurtenances owned by the mortgagor shipowner. On the contrary, these appurtenances are windfalls for him, where he may even know that the shipowner had no right to mortgage them to him.

If the mortgagee is required to accept this, the same applies to holders of maritime liens and creditors' liens. It would not make sense to first create a rule in § 45 that provides that all pledges must extend to the entire vessel with appurtenances, and then allow the scope of the rule to vary according to the type of pledge.

The extent of the mortgagor's right to alter the set of appurtenances with respect to ships is, however, unclear. Some years after § 45 was introduced by an amendment to the Maritime Code, 1893, The Mortgages Act, 1990, introduced quite standardised rules on this *jus tollendi*.[52] The provisions are not directly applicable to the ship's appurtenances (unlike some other provisions in the Mortgages Act, such as § 3-18). But it makes sense to use them as an analogy.

The starting point is that appurtenances can be replaced or removed in the ordinary course of business.[53] This means that the rights in the appurtenances granted to the ship mortgagee pursuant to § 45 are rather fragile.

There is no rule that one must continue to use an item as an appurtenance. Therefore, appurtenances that are no longer needed can be returned to their owner, as they are no longer appurtenances.

Some – but not all – of the rules of *jus tollendi* in the Mortgages Act prohibit removing items of mortgaged sets of property (without replacing them) if the value of the set is thereby substantially diminished. This is

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[52] There were also some scattered rules before that, see Norwegian Acts 8 June 1895 No. 1 § 3; 8 March 1946 No. 1 § 4.

[53] Mortgages Act (footnote 10) §§ 3-7 (which is referred to in the subsequent rules) and 3-13.

typically the case for manufacturing equipment, but not for stores. Even if a ship's appurtenances are more akin to manufacturing equipment than stores, it is submitted that the shipowner may remove appurtenances, even to the extent that the value of them is diminished. If not, the pledgees in the vessel – including the holders of maritime liens – would have to consent to the removal of, for example fishing gear, if the vessel is to be used as a freighter, or to the removal of specialised computer equipment, if the vessel is no longer to be used for surveys. That would be rather cumbersome.

There is also a rule in the Mortgages Act that the set of appurtenances cannot be changed after the mortgagee has taken steps to enforce his claim.[54] This seems appropriate as an analogy for a ship's appurtenances.[55] This would fit well with the rule in the Enforcement of Claims Act that there is no general right to make changes to the set of appurtenances subject to an enforcement lien.[56]

The consequence of these rules is that the owner will preserve his rights in relation to the mortgagee if the appurtenances are returned to him before there is an enforcement lien on the vessel or the mortgagee has taken steps to enforce his lien. However, there may be other problems.

3.4.2 Extinction

The owner's right in the appurtenances may be extinguished.[57] The appurtenance owner's rights cannot be registered, but the appurtenances are defined as a part of the vessel. A purchaser in good faith[58] of the vessel

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54 *Ibid*.

55 The steps are defined in the act as a notice under the Norwegian Enforcement of Claims Act No. 86/1992, for example § 4-18. For a maritime lien, where enforcement starts with the arrest of the vessel (NMC 1994 (footnote 1) § 55), the request for an arrest probably has the same effect.

56 Enforcement of Claims Act (footnote 55) § 7-19. Another matter is that a creditor's lien can be governed in relation to an entire set of movable property, see Thor Falkanger, Hans Flock, and Thorleif Waaler, *Tvangsfullbyrdelsesloven kommentarutgave* (Oslo: Universitetsforl., 2008) pp. 422 and 427.

57 See Brækhus, eiendomsforbehold (footnote 8) p. 255 *et seq*.

58 The sale contract will often list appurtenances owned by third parties, so the purchaser will not be in good faith, see, for example Norwegian Saleform 2012 cl. 7 and Singapore

or a creditor will therefore acquire good title to them. Equally, creditors seizing the ship would not have to respect the rights of a third party appurtenance owner.[59]

A ship mortgagee[60] will also acquire a right in the third party appurtenances by registration in good faith, regardless of the shipowner's right to mortgage them. But his right does not go further than the rights pursuant to the mortgage. Therefore, a mortgagee who can rely on the rules of extinction must also respect the *jus tollendi*.

Rights in appurtenances that are extinguished by new rights in the ship are the rights existing at the time of extinction.[61] The crucial times are:

- In the case of a new voluntary right in the vessel (such as a purchase), the time of the registration of that right in good faith[62]
- In the case of a creditor's lien, the time of the registration (good faith is irrelevant)[63]
- In the case of bankruptcy seizure, the opening of the bankruptcy (registration of the opening and good faith are irrelevant)[64]

Rights in appurtenances created at a later point of time are not affected by the extinction. Most probably, the supplier of the appurtenances will not supply the new owner or the former owner's bankruptcy estate with new appurtenances, but changes to the set of appurtenances may nonetheless happen. This is so, for example if the delivery of the vessel is later than the registration of the sale. In such cases, § 45 applies. A mortgagor must then respect *jus tollendi* (as always), and the new owner of the vessel and the bankruptcy estate seizing it must respect the ownership

Ship Sale Form (SSF) 2011 cl. 7.

59 NMC 1994 (footnote 1) §§ 23 and 25.

60 Also, a purchaser of a limited right may extinguish rights, but this is not very practical. Charterparties cannot be registered under Norwegian law, see NMC 1994 (footnote 1) § 20.

61 Norwegian Maritime Law Commission VI (footnote 18) p. 64.

62 NMC 1994 (footnote 1) §§ 23-24.

63 NMC 1994 § 23.

64 NMC 1994 § 25.

in the appurtenances of the third party, provided they have not (on the assumptions) extinguished his ownership.

We have seen that the appurtenances are pledged as a set, where the individual items can be replaced or removed. The purchaser of a ship could then either extinguish the third party rights in the set as such, so that continued replacement and removal would be possible, or he could extinguish the right in the individual items, so that continued replacement and removal would not be possible. The better view is probably that it is the right in the individual items that has been extinguished, since the concept of property in a set has, until now, only been recognised in the law of mortgages. This would mean that the seller of the vessel could not replace or remove appurtenances between the time of the registration of the sale and the time of the delivery of the ship. It follows that items removed after the registration of the sale would remain appurtenances, and could be claimed back by the third party supplier of the appurtenances. In other words, the set of appurtenances freezes from the time of extinction until the time the new owner starts to manage them.

This would probably fit quite well with the terms of the sales agreement.[65] In practice, it could be difficult to ascertain exactly which appurtenances existed at the time of registration, as the appurtenances are not registered and may have been temporarily removed from the vessel at that time.

The idea that a right in appurtenances in the ship is better protected against older competing rights than against newer ones is also found in the Mortgages Act, § 3-18.[66] The ideological or philosophical rationales for these rules are not clear:

- There is an element of first in time, better in right. But on a closer look, there can be no doubt that the owner of the appurtenance is first in right.

[65] Saleform 2012 (footnote 58) cl. 7 and (implicitly) SFF 2011 (footnote 58) cl. 7 generally freeze the set of appurtenances from the time of the inspection of the vessel. The inspection may be before or after finalizing the agreement and registration, see Saleform 2012 cl. 4 and SFF 2011 cl. 3.

[66] See above 2.1.2.

- There is an element of making the registers reliable by declaring that the rights follow what is registered, rather than rights established by other means. But it is a general consensus in Norwegian law that creditors should not be allowed to rely on such arguments.[67] And even for buyers who can rely on their good faith, the principle does not have to apply to the entire physical extent of the registered object.[68]
- Finally, there may be an element of demanding that the holder of a right (in an appurtenance) should register his right or suffer the consequences. This may be the thinking behind § 3-18, although it would be plainly contradicting the first in time, better in right, principle. However, in respect of § 45, this point of view fails, as the possibility for the appurtenance owner to register has been removed.

The thinking is thus rather obscure.

3.4.3 Commixture

Arguably, the ownership of a ship's appurtenances can also get lost by commixture, meaning that the appurtenance owner's rights are lost because the appurtenances have become too intermingled with the shipowner's property to separate them. This could be detrimental for the rights of the appurtenance owner.[69] But for the mortgagee, who on the other bases (as described above) has the same rights against the appurtenance owner as against the shipowner, commixture does not change anything. The effect of commixture is that the appurtenance owner cannot insist that the shipowner removes all appurtenances from

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67 Sjur Brækhus, *Omsetning og kreditt 3 & 4: Omsetningskollisjoner* (Oslo: Universitetsforlaget, 1998) p. 34 *et seq.*; Emil Eriksrud, 'Eiendomsforbehold i inventar og tilbehør til skib', *2 Arkiv for sjørett,* (1955), 493–508 at pp. 507–508 in the Norwegian Ship Registry Act (footnote 3).

68 See, for example NOU 1982: 17 Ny tinglysingslov p. 158 *et seq.* on the physical extent of real property (borders) and Falkanger, tingsrett (footnote 5) p. 660 on unregistered buildings.

69 Maritime Law Commission VIII (footnote 18) p. 91.

the vessel, even if the shipowner would otherwise have had the right to do so in relation to the mortgagee and therefore the duty to do so.

The above-mentioned rule on commixture in the Mortgages Act (§ 3-19) does not apply, as it only applies to the retention of title/seller's liens.

There is a special Act on Incidental Property Relations[70] that provides that if an item is merged with a "main item", the owner of the "main item" will become the owner of it all.[71] There can be no doubt that the vessel is always the "main item" and that the Act applies. However, the Act is not mandatory.[72] And even if the *travaux préparatoires* suggest that the Act should be used to clarify incomplete agreements,[73] it must be fairly clear that the intention of the parties is that the supplier of the ship's short-term appurtenances should be allowed to claim them back.

The general rules of commixture are thus not very important here. It is a question of whether § 45 goes further than this.

The wording does not expressly say so. This makes it difficult to assume such a rule, as depriving someone of his property requires a clear rule under the The European Convention on Human Rights Protocol 1-1.[74]

The possible rationales of the rule[75] – and particularly not those that make sense – do not call for an extended use of the commixture rules, and the *travaux préparatoires* do not call for the use of this doctrine.

Therefore, the doctrine of commixture plays little or no role in this context.

3.4.4 Conclusion

In conclusion, then, the appurtenance owner has some rights left even after the appurtenances are brought on board. He may, however lose his

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70 Norwegian Act on Incidental Property Relations No. 17/1969.

71 *L.c.* § 3.

72 *L.c.* § 1.

73 Proposal to the Parliament Ot.prp. nr. 30 (1967–1968) p. 10.

74 See, for example Lithgow and others v. The United Kingdom [1986] ECHR 8 paras 108 *et seq*.

75 See below 4.

rights if the vessel is sold to a purchaser in good faith or the shipowner's creditors pursue their claims against the vessel. The only way for him to protect himself is by making sure that the purchasers are aware of his position and by paying off the creditors of the shipowner to the extent necessary.

3.5 Non-financial leasing

For property leased to the shipowner, as opposed to appurtenances, which the charterer has brought on board for his use, special rules apply. The rules are somewhat confusing, because there are definitions of leasing both in the Mortgages Act and in the Maritime Code, that are not co-ordinated,[76] and because the legislator has focused on the relationship between operational and financial leasing, rather than on the borderline between the lessor's interests and other ownership interests. The latter obscurity may be due to the Scandinavian reluctance to think in terms of ownership.

Financial leasing is defined and discussed above. Leasing that is not financial is often called operational. However, since none of the definitions here mention a real operational element in the leasing agreements, the term non-financial will be used.

The following special rules apply for the non-financial leasing of ship appurtenances:

- If the contract is (binding on the shipowner) for less than 6 months, the lessor's rights are not affected at all by § 45. Thus, the right to remove an item is wider than the *jus tollendi*.[77]
- If the contract is (binding on the shipowner) for less than 6 months, the right to the appurtenance must be registered in the Ship Registry, and will then be protected in the shipowner's bankruptcy against subsequent creditor attachments and purchasers/ mortgagees in good faith.[78] If the lease is for a longer

[76] Mortgages Act (footnote 10) § 3-21; NMC 1994 (footnote 1) § 45(2).

[77] NMC § 45(2).

[78] Mortgages Act § 3-18.

period of time, it cannot obtain protection by registration, apparently because the NMC then does not consider it as non-financial leasing.

- The lessee shipowner and the lessor cannot be part owners in the appurtenance such that only a share of the property is leased.[79] This could be practical when shipowners use equipment from a jointly owned pool.[80] If this rule is overlooked, the shipowner will probably obtain full ownership, as the lease is invalidated.[81]
- The leasing contract must be confirmed in writing or electronically without unjustified delay after the delivery of the leased object, in order for the lessor to invoke his rights in the shipowner's bankruptcy.[82]
- If the leased object is a vehicle, such as a forklift, the lease must be registered in the Register of Mortgaged Moveable Property in order for the lessor to be able to invoke his rights in the shipowner's bankruptcy.[83] This registration is additional to the registration in the Ship Registry (above) and in the Vehicle Register.
- The leasing contract must specify the individual leased objects, the time of the lease and the instalments (scheduled lease payments).[84] If these are not specified, the lessor cannot invoke his rights in the shipowner's bankruptcy. A side effect of this is that individual items cannot be replaced without paperwork and, perhaps, registration.

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79 Mortgages Act § 3-15(1).

80 If an individual item of equipment is used on board several ships, it is not an appurtenance, and therefore not subject to NMC § 45 (see above 2.3.1). But the rules on leasing in the Mortgages Act still apply.

81 Mortgages Act § 1-2(2).

82 Mortgages Act § 3-17(2). The section heading clarifies that this is a condition for perfection in bankruptcy.

83 Mortgages Act § 3-17(3).

84 Mortgages Act § 3-17(4).

- Commixture leads to the loss of the lessor's right.[85]

There are even a few additional rules of minor practical importance that are not mentioned here.

My general impression is that the rules are overly complicated and generally without a strong rationale in relation to non-financial leasing, and that the sanctions are rather harsh. The reason why the rules look like this is perhaps that some rules on financial leasing have been applied to non-financial leasing without a detailed analysis.

3.6 Monetary compensation

If the appurtenance owner loses his rights pursuant to any of the rules discussed above, the question arises of whether he will get a monetary claim instead.

3.6.1 Analogy from the Act on Incidental Property Relations

The Act on Incidental Property Relations provides for compensation when a person loses his ownership due to commixture. Even if the conclusion above were that commixture would rarely cause the appurtenance owner to lose his property, the compensation system could perhaps be used by analogy when the owner of appurtenances loses his property pursuant to § 45.

The main points of the compensation rules under the Act on Incidental Property Relations are as follows, applied to our situation:

- Anyone losing his property rights due to commixture has a right to compensation, limited to the value that originated from him;[86] this is a claim limited to such enrichment. Appurtenances left on board that cannot be used, for example due to software licensing restrictions, add no value to the vessel and thus do not

[85] Mortgages Act §§ 3-19 and 3-20.

[86] Act on Property Relations (footnote 70) § 5.

trigger liability. But in some cases, the appurtenances will add value to the vessel and trigger liability.

- The compensation is payable by those having an interest in the main object, akin to a lien.[87] Thus a purchaser or a mortgagee in the ship may have to pay compensation to the former owner of the appurtenance to be able to enjoy the increased value of the appurtenance, which has become inseparable from the ship.[88]
- The "lien" apparently cannot be registered and may be extinguished by a purchaser in good faith.[89] There is no mechanism to protect this lien in the shipowner's bankruptcy. In such cases, compensation is not payable under the Act (but see the next bullet point).
- If the vessel is sold, the wording of the Act indicates that the old owner is not liable to pay compensation, apparently even if the lien is extinguished and the new owner does not become liable. If so, the old owner would be able to sell the ship with the appurtenances for a good price in bad faith and get rid of the liability altogether. But this was not the intention of the legislators.[90] The former owner will be liable in such cases. The basis for liability is not specified. Perhaps he is also liable on contractual grounds in other cases – the Act, with its rule that the former owner is free, only applies when the relationship between the parties does not prevent a different rule from being implied.
- The Act does not apply when a seller's lien or the rights of a non-financial lessor to appurtenances are lost due to commixture (Mortgages Act § 3-20).[91] The idea here is perhaps that the identity of the goods is lost, and that the privilege in the buyer's/lessee's bankruptcy is lost with it. This is different from the

87 Ot.prp. nr. 30 (1967–1968) (footnote 73) p. 17.
88 Report 7 of the Civil Law Commission (NUT 1969:4) p. 13.
89 NMC 1994 (footnote 1) §§ 23-24.
90 Ot.prp. nr. 30 (1967–1968) (footnote 73) p. 17.
91 Brækhus, pant (footnote 11) p. 567 (para 265).

> plain idea of commixture, where the problem is to find a way to preserve the values. Therefore, a lien or a lessor's right under § 3-20 is not subject to compensation. In cases of non-financial leases, however, it is difficult to find a rationale for this.

As a starting point, these rules seem apt for analogy. However NMC § 45 may be justified, there is no justification for the enrichment of the shipowner or his mortgagee. The exception is when the Mortgages Act § 3-20 is applicable; the choice of the legislator must be respected even if it is ill-founded in respect to non-financial leasing.

There is a problem with this analogy. The *travaux préparatoires* to the Act advise that there should "probably" be no compensation if a ship appurtenance owner has lost his right to have the appurtenances returned.[92] No reasons are given for this. The idea is perhaps that making the shipowner liable would induce him to allow the removal of the appurtenances, thus causing loss to society as a whole rather than to the appurtenance owner. However, the advice does not make sense when the Act can be departed from by contract, and should be ignored. In any event, such a rationale for the exception does not apply when § 45 prevents the return of appurtenances that are not physically incorporated into the ship.[93]

3.6.2 The rules of common pledge

An alternative way of reasoning in respect of compensation to the appurtenance owner who loses his right, could be based on the rule of common pledge.

The rule of common pledge in Norwegian law is the principle that if two properties, A and B, are pledged for the same debt, and pledgee P chooses to pursue his claims over one of them (A), his choice shall not affect the subsequent pledgees of that property. Thus the subsequent pledgees in A will be subrogated in P's pledge on property B if necessary.

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92 Report 7 (footnote 88) pp. 16–17.

93 The Act on Property Relations (footnote 70) is older than (the predecessor of) § 45, so the *travaux préparatoires* did not take a stand on this.

The rule is now found in § 1-14 of the Mortgages Act. At the time when the rule now found in Maritime Code, 1994, § 45 was enacted in the Maritime Code, 1893, the rule of common pledge was found in § 261 of the 1993 Maritime Code.

For a number of reasons,[94] the rule is not directly applicable in situations where NMC § 45 operates. But a similar idea that could be applied in these situations is that because the ship mortgagee has executed the appurtenances owned by a third party for a value exceeding what he has bargained for (that is, nothing at all), the third party appurtenance owner should be entitled to a corresponding share of the proceeds from the sale of the ship with the appurtenances. Obviously, such a rule could not be applied if the third party only had a security interest in the appurtenances which § 45 had rendered void.

A pledge over a vessel in this way would certainly not be unfair, and would not lead to a separation of the ship and the appurtenances.

A rule like this would be quite similar to what follows from (an analogy of) the Act on Incidental Property Relations.[95] However, in this Act, the legislators chose not to put in place a pledge to protect the party who lost his right, even if this was recommended by influential authors at the time.[96] When the legislator makes a choice, that choice should be respected.

The Supreme Court has considered an extension of the rule of common pledge in one case.[97] In that case, the issue was whether the bankruptcy estate of the pledgor should be protected in the same way as subordinate pledgees. The majority would not approve extending the scope of the rule, leaving such consideration to the legislators. Therefore, this calls for a similar reluctance to extend the rule of common pledge to situations where § 45 applies.

Altogether, the rule of common pledge is of no use in this context.

94 One of them is that there is only one property: the ship with appurtenances.

95 It would also be quite similar to the rule on the distribution of the proceeds of a forced sale outlined below 4.3.

96 Sjur Brækhus and Axel Hærem, *Norsk tingsrett* (Oslo: Universitetsforlaget, 1964) p. 559.

97 Rt-1997-645.

4 Rationale

A good question to ask is: which problem or problems is § 45 there to resolve?

4.1 Preferential treatment of mortgagees

The *travaux préparatoires* to § 45 point to the need to maintain a good basis for mortgages and, presumably, creditors' liens.[98] However, this can hardly warrant the mortgagee taking advantage of property not belonging to the mortgagor. There may be a need for the mortgagee to safeguard himself against the mortgagor selling out the appurtenances of the vessel, just as there is a need for him to safeguard himself against poor maintenance, *etc.* But the appurtenance owner has a similar need to be safeguarded against losing his property.[99]

It is hardly possible to justify the idea that mortgagees should be prioritised over other interests, or that liens on the entire ship should be prioritised over liens on parts.[100] Similarly, the interest of shipowners and mortgagees, in perhaps obtaining a better price for a ship in operating shape with appurtenances, has to be weighed against other interests.

4.2 Quiet enjoyment

When no special right can be attached to appurtenances or parts of the vessel, the vessel will not be hindered by the enforcement of claims against others than the shipowner.[101] Of course, creditors of the owners of appurtenances or parts of the vessel cannot attach a creditor's lien to the entire vessel, which their debtor does not own.[102] Because of this, the

98 Maritime Law Commission VIII (footnote 18) p. 90; Norwegian Maritime Law Commission VI (footnote 18) pp. 61 and 63; Brækhus, eiendomsforbehold (footnote 8) p. 249 *et seq.* and generally Brækhus, pant (footnote 11) p. 220 *et seq.* (para 217.14).

99 Strömgren, tillbehör (footnote 19) pp. 91 and 203.

100 Strömgren, tillbehör (footnote 19) p. 309.

101 See above 3.4.1.

102 Satisfaction of Claims Act (footnote 47) § 2-2.

shipowner will avoid the risk of delay, for example because a vital part was removed by the creditors of the part's owners. Creditors of owners of appurtenances and parts in the vessel run a corresponding risk of loss.

As a starting point, in Norway, an arrest can only be made if "the debtor's conduct gives grounds to fear that enforcement of the claim would otherwise be evaded or considerably impeded or would have to take place outside the realm".[103] However, there is an exception for ships, which can be arrested "if the petitioner holds a lien on the ship … that has fallen due for payment".[104] There is probably no requirement for the lien to attach to the entire vessel, since the creditor has a similar need for protection in either case. But in so far that there is no possibility to establish a (creditor's) lien on the ship but against the owner, the risk of arrest is correspondingly reduced for the shipowner, while other interested parties have their chances of loss increased.

These rules fit well with the restricted possibility of making an arrest in a vessel under NMC Chapter 4, which is based on the Arrest Convention, 1952.[105] An arrest can only be made for maritime claims, which do not include claims which are only in relation to appurtenances or parts of the vessel, and in many cases, arrest can only be made for claims against the owner of the vessel.

4.3 Priority issues

If some mortgages on the ship include appurtenances, and some not, that could cause a problem in distributing the revenue if the ship is sold in a forced sale.[106] But § 45 is a rather crude way of dealing with this problem. Alternatively, one could either provide detailed rules on the distribution of the revenue or sell the appurtenances separately, perhaps

[103] Norwegian Act No. 90/2005 Relating to Mediation and Procedure in Civil Disputes (The Dispute Act) (translated at http://www.ub.uio.no/ujur/ulovdata/lov-20050617-090-eng.pdf (without date, last accessed October 2016)) § 33-2(1).

[104] *L.c.* § 33-2(3).

[105] International Convention Relating to the Arrest of Sea-Going Ships, 1952.

[106] The sale should, of course, include appurtenances, see Brækhus, pant (footnote 11) p. 418 (para 251.54).

allowing offers for the ship on condition that the offeror also gets the appurtenances or *vice versa*.[107]

4.4 Clarifying registration issues

§ 45 also resolves two technical registration issues.

First, it clearly defines what nature of the unit registered in the Ship Registry and what is subject to the rules applicable to registered units: i.e. the ship with appurtenances.

Second, it addresses the almost unresolvable, fairly general issue of reconciling several separate systems for the perfection of claims. Should the appurtenances of a vessel be subject to the vessel registration system, or should the rules of the perfection of rights applicable to unregistered movable property? However good each system might be, the parties may experience loss of rights if the perfection system changes in respect to an item, for example (from another area of life[108]) if an IOU changes into a fully negotiable debt certificate.[109] And if the perfection system does not change, it may be misleading, such as if a person believes that he has got a pledge in a painting by possession, but his right is not really perfected because the painting is usually hanging on board a vessel. § 45 clarifies the law by extending the scope of the Ship Registry. Alternatively, movable

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[107] There is already a right to require that appurtenances are sold with real property (Enforcement of Claims Act (footnote 55) § 11-18), which may raise similar issues on the distribution of the revenue.

[108] Other examples are ships moving into the Ship Registry. The choice of law rules may create a similar risk: even if appurtenances on board a vessel would be treated like movable property for perfection purposes under Norwegian law, foreign law may apply if the ship is in a foreign port, and that foreign law may have other rules for perfection (see, for example Crans Berend and Ravi Nath, *Aircraft repossession and enforcement: practical aspects* (Austin: Wolters Kluwer, 2009) pp. 618–619 on air law). It is unlikely that § 45 would prevent foreign law from using *lex rei sitae,* but the foreign law may recognise the need for a perfection system that does not change as the ship moves. Francesco Berlingieri, *Berlingieri on arrest of ships: a commentary on the 1952 and 1999 arrest conventions* (London: Informa, 2011) p. 203 submits that the law of the ship's registry governs these matters in Dutch law.

[109] In Norwegian law, the method of perfection is notification of the *debitor cessus* in the former case (Mortgages Act (footnote 10) § 4-5), but delivery of the document in the latter (*ibid.* § 4-1).

property could be treated as such even if used on board a vessel, as long as it was not commixed with the vessel.

4.5 Avoiding losses

It is an intriguing thought – underlying NMC § 45 and the common rules of the commixture of movable property – that one should avoid losses caused by separating items that have been joined to a ship. There are, however, several reasons why this thought cannot justify the rule in § 45.

First of all, the rule goes much further than this justification. Also, property that can be removed without cost – such as a forklift – is treated as appurtenances that are considered a part of the vessel for the purposes of mortgages, *etc*.

Second, the rule does not go far enough. Items can be removed by agreement, and this is done regularly.

Third, the fact that the appurtenances are on board is no indication that it is wise to let them remain on board. The use of the vessel changes, and so should the appurtenances. Typically this is the case if the charter ceases and the appurtenances were brought on board by the charterer for his special purposes.

Fourth, even if the appurtenances remain on board, it may not be possible to make use of them. An example is an electronic chart display, which may be rendered useless if a continued licence for the maps is not granted and paid for. In such cases, retaining the appurtenances on board would be a problem rather than an advantage, and it would represent a loss of common resources.

Fifth, the appurtenances may be used more efficiently elsewhere. It may not be a wise use of the resources if the appurtenance owner's firm cannot continue its business because a vital instrument has been incorporated into a vessel and cannot be taken back.

Given all this, the better rule is probably that appurtenances should be allowed to be removed by anyone who would have the right to do so on the

basis of ownership,[110] *etc.*, and who will pay for the cost of removal and the damage to the ship. This will prevent removal unless the remover believes he can get the expenses back by his alternative use of the appurtenances.[111] This more or less corresponds to when the appurtenances would be used more efficiently off the ship than on the ship.[112]

5 Workarounds

If the owner of the appurtenances, the shipowner, or his mortgagee, does not like the above rules, they cannot simply contract out of them. The rule was considered by the legislators to represent such pivotal societal interests that the matter could not be left in the hands of the parties. There is no indication that the idea was to protect a presumably weaker party. On the contrary, the rule works for the benefit of the bank mortgagee, which is generally believed to have relatively good bargaining power.

Even if it is not possible to contract out of the rule, some workarounds may be possible to protect appurtenances owned by third parties (leased or borrowed) or the charterer's equipment on board.[113]

First, a right to take the appurtenances back, even if registered in the Ship Registry, will certainly not work, since the appurtenances by § 45 are considered parts of the ship, and special rights in the appurtenances and parts of the ship are void pursuant to the provision.

Second, a third party owner may prohibit putting his property on board ships, for example in a leasing agreement. If the equipment is typically used as ship appurtenances, the courts are likely to ignore such

[110] In this context, it is not possible to discuss whether it is wise to let ownership play the role it generally does in property law.

[111] In this direction, see Strömgren, tillbehör (footnote 19) p. 205.

[112] Depending on transaction costs, see Strömgren, tillbehör (footnote 19) p. 251 *et seq.*

[113] See Nasreen Desai and Rob Murphy, *Aircraft financing* (London: Euromoney, 2011) pp. 198–199 on the corresponding problems relating to aircraft engines. The Dutch legislation implicitly referred to is Dutch Civil Code, 1992 (translated at http://www.dutchcivillaw.com/civilcodebook088.htm (no date, last accessed October 2016)) article 8:3a(2).

clauses as unsuccessful circumventions of § 45.[114] And for other groups of equipment, for example a forklift, the appurtenance owner is unlikely to think of it. But there may be cases where the clauses are included and considered at face value.

At the outset, one would think that a clause like this would not be relevant. It does not effectively prevent the placement on board or – on the face of the provisions in the NMC – the legal consequences of its placement on board. This is so even though the placement on board under these circumstances is a criminal offence under § 386 of the Criminal Code,[115] as the violation of the contract makes the placement on board unlawful.

However, the *travaux préparatoires* of § 45 refer to an example of stolen goods being brought on board without the consent of the appurtenance owner; for such goods, § 45 does not apply.[116] Apparently then, it is relevant whether the appurtenance owner has consented to the goods being brought on board. But most likely, this is only imprecise writing. It is farfetched that the owner of stolen goods should need to consent to them being brought on board rather than vindicating them, and had the consent been crucial, it would not have been necessary to mention that the goods were also stolen. Clauses stating that goods should not be brought on board ships are therefore not effective ways of preventing the operation of § 45.

Third, a mortgage to secure the potential loss of the owner of the appurtenances could be registered.[117] The compensation could even be at an agreed level, set so high that it would be preferable to return the appurtenances rather than to pay the compensation, since penalty clauses are not void in Norwegian law.

114 Norwegian Maritime Law Commission VI (footnote 18) p. 65.

115 Norwegian Criminal Code No. 28/2005.

116 Norwegian Maritime Law Commission VI (footnote 18) p. 65; Ot.prp. nr. 32 (1970–71) (footnote 34) p. 56.

117 Rights in the ship (as opposed to rights against the shipowner) must be registered, NMC 1994 (footnote 1) § 23. Even if this security right should be a term of a charterparty, it must be separately registered, as a charterparty cannot be registered in the Norwegian Ship Registry (NMC 1994 § 20). Eriksrud (footnote 67) pp. 500–501 finds this solution impractical for small creditors.

A security like this may conflict with the bank mortgage financing the purchase of the ship. If it has a higher priority than the bank's mortgage, the bank may increase the interest rate to compensate, and if it has priority after the bank's mortgage, the value of the ship may not suffice to satisfy it.

A better solution then might be to agree with the other security interests on the distribution of proceeds of an eventual forced sale. However, banks are reportedly reluctant to enter into such agreements, and holders of maritime liens and creditors' liens cannot be identified and approached in advance.

Some registers allows the parties to specify the appurtenances that shall be considered parts of the ship for the purpose of, for example a mortgage.[118] Such specifications are not offered by the Norwegian Ship Registers and would not overrule NMC § 45.

Altogether, then, there are some workarounds. However, they require effort and advance planning, and are perhaps not viable in practice.

6 Foreign law

6.1 Introduction

The Norwegian provision (NMC § 45) stands and falls on its own merits and demerits. Still, it would be interesting to see whether other states have found it necessary to implement similar provisions, or if they have included ideas that could be worthwhile to adopt.

6.2 DCFR

The Draft Common Frame of Reference (DCFR) is not legislation, but an academic recommendation founded on a restatement of the current

[118] See, for example Cayman Islands Shipping Registry Form CISR 857 Rev 01/14, Application for Miscellaneous Services.

European law. For the purposes of this review, it is at least as useful as national legislation. However, its coverage is limited, and the overlap is mainly regarding commixture.

The starting point of the DCFR is freedom for the involved to determine the effects of commixture ("combination" and "commingling").[119] This freedom even extends to the proprietary effects.[120] In this respect, it resembles the Norwegian Act on Incidental Property Relations referred to above, and is dissimilar to § 45 of the Maritime Code.

Even if goods subject to a security right become an accessory to a movable or an immovable object, the security right continues to exist.[121] The idea of not allowing special rights in accessories is not recognised, or even discussed, in the commentary.

6.3 Scandinavian law

The Scandinavian Maritime Codes are written and revised in cooperation among the Scandinavian countries.[122] It is therefore of particular interest to see whether the problematic parts of the Norwegian provision are also adopted in these states.

The Danish Maritime Code[123] § 47 reads:

> In the absence of other agreements, a registered right in a ship shall include machinery, boilers, motors, radio equipment, echo sounders, fishing equipment, instruments and other accessories which are procured at the cost of the owner of the ship for installation on the ship, even in the event they are temporarily detached from the ship. ...

[119] DCFR (footnote 1) VIII 5:101(1) and p. 5026 *et serq*.

[120] DCFR (footnote 1) VIII 5:101(2).

[121] DCFR (footnote 1) IX 2:305(2).

[122] See, in particular, the attempts to harmonise the law on appurtenances in ships in Eriksrud (footnote 67) p. 502.

[123] Danish Maritime Code (No. 75 of 17/01/2014). Translates by the Danish Maritime Authority (http://www.dma.dk/SiteCollectionDocuments/Legislation/Acts/2014/LBK-75-17012014-merchant%20shipping%20act.pdf, last accessed October 2016).

> *Subsection 3.* Special rights shall not be established or reserved in the components of a ship or the accessories mentioned, except for fishing equipment.

The corresponding rule exists, but is clearly limited to accessories financed by the owner. Most of the problems of the Norwegian provision have therefore been avoided.[124]

In the Swedish Maritime Code, the rule is found in section 1:5:

> Rights to appurtenances to vessels … may not be exercised separately, even against the owner of the vessel …[125]

This is an even stricter rule than the Norwegian Code, as rights in accessories cannot be invoked against the owner. However, the rule does not apply to the charterer's equipment on board,[126] as accessories are defined so that they exclude items not brought there in the interest of the owner:

> To a vessel, including her hull and steering gear, belong fixed fittings and other equipment for the lasting use of the vessel as well as such spare parts as are permanently kept on board, always provided that the vessel is fitted therewith in her owner's interest.[127]

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[124] In Denmark, there has been some litigation on appurtenances in aircraft. An appeal of the latest decision of the Court of Appeal (U.2015.3495V) was recently rejected by the Supreme Court for procedural reasons (U.2016.1868H). The Court of Appeal was concerned with matters relating to the special pooling arrangements for aircraft engines.

[125] Translation from *Swedish Maritime Code (SMC) 1994* (Stockholm: Juristförlaget, 2006). There is a corresponding rule for creditor's liens in the Swedish Enforecemt of Claims Act (1981:774) 4:6.

[126] Christer Rune, *Rätt till skepp* (Göteborg: Sjörättsföreningen, 1991) p. 30; Strömgren, tillbehör (footnote 19) pp. 46 and 322. Older doctrine goes even further in support of the third party appurtenance owner, see Hugo Tiberg, *Kreditsäkerhet i fartyg* (Stockholm: Norstedt, 1968) p. 63 *et seq*.

[127] SMC 1994 (footnote 125) 1:3. On this clause, see Strömgren, tillbehör (footnote 19) pp. 317–318.

The fact that the equipment is hired does not, however, in itself prevent it being considered as appurtenances.[128]

The corresponding Finnish[129] provisions are not clear in respect to their application to accessories owned by a third party, and the literature and the cases do not (to my knowledge) clarify the matter.[130]

6.4 England

In England, there is no legislation akin to § 45 of the Norwegian Maritime Code. But in *Hull Ropes*,[131] the issue was the protection of a third party seller who had reserved a security interest in a trawl rope (Adams) against the ship mortgagee (confusingly, that was Hull Ropes). The rope was purchased on hire purchase terms. After the mortgagee Hull Ropes had taken the ship and the rope in possession, the seller of the rope (Adams) removed it by force. It was held that the ship mortgagee could demand that the rope be redelivered, as

> … the hirer had agreed to buy the rope within the meaning of the Factors Act, 1889, and … the addition of the rope to the equipment of the mortgaged ship was a sufficient delivery or transfer to the mortgagee …

The rope had become a part of the mortgaged property. However, it was emphasised that the mortgagor shipowner really had bought the rope. Had there been a right for him to terminate and redeliver the rope, the matter would have been different.[132] Thus English law also rejects

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128 Strömgren, tillbehör (footnote 19) p. 46.

129 Finnish Ship Rights Registration Act (1927:211) § 30.

130 Rudolf Beckman, *Handbok i sjörätt* (Helsingfors: Akademiska bokhandeln, 1971) p. 12.

131 *The Hull Ropes Company v. Adam* (1895) 65 L.J.Q.B. 114; compare Iwan Davies, *Security interests in mobile equipment* (Aldershot, Hants: Ashgate, 2002) p. 179 (Gotthard Gauchi); Nigel Meeson, *Ship and aircraft mortgages* (London: Lloyd's of London Press, 1989) p. 55.

132 *Helby v Matthews* [1895] A.C. 471.

including third party property in the mortgage, even if it is an accessory to the mortgaged ship.

In this case, the seller retained property until the ropes were fully paid (p. 115). This clause was not respected when finding for the ship mortgagee. In this way the English decision resembles Norwegian law, which does not recognise the retention of title in ship accessories except for a few, limited cases.

6.5 US

In US federal law,[133] a "preferred mortgage"[134] in a vessel is defined as a mortgage that, *i.a.,* "includes the whole of the vessel".[135] Accessories have been subjected to such mortgages even if a third party had an ownership or security interest in them, rather than letting the mortgages fall outside the definition of preferred mortgages.[136] Accessories have, however, been construed narrowly, only including items necessary for the navigation of the vessel.[137] The idea is apparently to maintain the vessel as an operating and easily saleable unit.

The position in US law in respect to subjecting the property of third parties to ship mortgages has been heavily criticised:

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133 For state law, see Richard Gyory, 'Security at Sea: A Review of The Preferred Ship Mortgage', *31 Fordham L. Rev. 231* (1962–1963) p. 245 *et seq.*

134 About this term, see Gyory (footnote 133) p. 234. This is the type of ship mortgage in widespread practical use.

135 46 United States Code 31322 (a)(1).

136 The cases are not consistent, see Grant Gilmore and Charles Black, *The Law of admiralty* (Mineola, N.Y.: Foundation Press, 1975) p. 729, Bruce A. King, 'Ships as property: Maritime transactions in state and federal law', *79 Tul. L. Rev. 1259,* (2005) p. 1304 *et seq, Stewart F. Peck and David B. Sharpe, 'What is a Vessel?: Implications for Marine Finance, Marine Insurance, and Admiralty Jurisdiction', 89 Tul. L. Rev. 1103, (2015)* at footnote 133. J. Bond Smith Jr., 'Ship Mortgages', *47 Tul. L. Rev. 608,* (1972-1973) p. 618 *et seq.* suggests a distinction between security interests and true property interests.

137 *The Hope* 191 F. 243 (DC Massachusetts 1911). In respect to maritime liens, the concept of accessories is apparently wider, see Lance P. Martin, 'Leased Equipment on Board Vessels and Preferred Maritime Wage Liens: Kesselring v. F/T Arctic Hero', *19 Tul. Mar. L.J. 199,* (1994).

> The result in cases like the Air Brant is indefensible. The mortgagee received as a windfall the value of subsequent improvements in the vessel, for which he had paid nothing. If the law is that equipment installed on a vessel always and under all circumstances feeds the lien of a pre-existing mortgage, then the law is an ass.[138]

6.6 Germany

In German law, it is clarified that a ship mortgage does not encompass accessories belonging to a third party:

> Die Schiffshypothek erstreckt sich auf das Zubehör des Schiffs mit Ausnahme der Zubehörstücke, die nicht in das Eigentum des Schiffseigentümers gelangt sind.[139]

In addition, the owner of the appurtenances can protect himself in the event that the ship is repossessed by a right of redemption.[140]

Accessories are defined as not including parts of the ship or items that are usually not regarded as accessories to the ship.[141] The latter point makes it even clearer that the equipment that a charterer has taken on board for his purposes will not be regarded as accessories at all, and will certainly not be subject to the ship's mortgage.

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138 Gilmore & Black (footnote 136) p. 729. The case referred to is *First Suffolk National Bank of Huntington v. the Air Brant* 125 F.Supp. 709 (ED New York 1954).

139 § 31(1) Gesetz über Rechte an eingetragenen Schiffen und Schiffsbauwerken vom 15. November 1940 (SchiffRG) (RGBl. I p. 1499). The rule is mandatory, Hans-Heinrich Nöll, 'Gesetz über Rechte an eingetragenen Schiffen und Schiffsbauwerken', *J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen* (Berlin: Beck, 2004), and there is no presumption that appurtenances belong to the shipowner, see Hans Jürgen Abraham, *Die Schiffshypothek im deutschen und ausländischen Recht* (Stuttgart: Kohlhammer, 1950) p. 148.

140 SchiffRG (footnote 139) § 50; Abraham (footnote 139) p. 237.

141 § 97 BGB and § 4 SchRG; Norbert Krause, *Praxishandbuch Schiffsregister* (Berlin: de Gruyter, 2012) p. 306.

6.7 France

The starting point in French law is that the mortgagee also has a right in the accessories of the vessel:

> L'hypothèque consentie sur un bâtiment de mer ou sur une part indivise du bâtiment s'étend, sauf convention contraire, au corps du bâtiment et à tous les accessoires, machine, agrès et apparaux.[142]

However, this does not apply to accessories owned by third parties.[143] In any event, the rule is not mandatory, pursuant to the wording.

There is some discussion as to whether the exception for third party ownership extends to hire-purchase agreements; probably not.[144]

The solution in French law seems to create fewer problems than the Norwegian rule.

6.8 The Netherlands

In the Netherlands, a ship mortgage covers appurtenances. The Civil Code provides:

> Article 8:203 Things covered by a mortgage.
>
> Except in the event of derogating stipulations (clauses) that appear from the public registers, the mortgage shall cover all things that on account of their intended use are continuously attached to the ship and that belong to the

[142] Loi n° 67-5 du 3 janvier 1967 relative au statut des navires et autres bâtiments de mer, article 46; René Rodière and Emmanuel Du Pontavice, *Droit maritime* (Paris: Dalloz, 1997) p. 100 para 108.

[143] J. P. Beurier, *Droits maritimes* (Paris: Dalloz, 2008) p. 336 (para 334.41) with references, *i.a.,* to Com. 15 mars 1994, n° 91-1 4.375, Bull. civ. IV, n° 11 0; JCP G 1994, Il, 22277, note by Larroumet; CA Montpellier, 10 févr. 1961, O. 1962, 647, note by Calais-Auloy.

[144] See Beurier (footnote 143) p. 336 footnote 6.

> owner of the ship. Article 266 of Book 3 of the Civil Code is not applicable.[145]

Appurtenances owned by third parties are thus protected against the ship mortgagee. Indeed, even separate rights in appurtenances owned by the shipowner can be registered.

The registration of separate rights in the vessel is excluded by article 8:197. However, the registration of third party interests in appurtenances is not necessary when they are not subject to charges, for example the mortgage, in the first place.

The provision in Article 8:203 (above) that Article 3:266 does not apply even excludes the right of the mortgagor – and a third party – to remove accessories, even if they were added as extras after the mortgage was attached or if the ship was brought back to its original state. The owner's right to remove and replace his own accessories is thereby more restricted than in Norwegian law.

The same rules apply to maritime liens[146] and "privileged debt-claims related to the commercial operation of the ship".[147] The rules also apply to inland waterway vessels.[148]

Dutch law also avoids the problems of the Norwegian provision.

6.9 Italy

In Italy, ownership of appurtenances apparently can be proven against the mortgagee and owner unless they have acquired a better right in good faith.[149]

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145 The quote is from DCC (footnote 113). Berlingieri, arrest (footnote 108) p. 203 maintains (somewhat in contradiction to the wording) that "[t]he owner of the ship is always owner of the component parts of the ship, whereas he is deemed owner of the ship's appurtenances except in the case of a different entry in the ships' registry."

146 DCC article 8:214(a).

147 DCC article 8:217(3).

148 DCC articles 8:793, 8:788, 8:824 and 8:827.

149 Giorgio Berlingieri, *Understanding Ship Mortgage Law* (http://www.maritimeadvocate.com/mortgage/understanding_ship_mortgage_law.htm (without date, accessed

6.10 Summary

This short survey of foreign law does not indicate that it is common, or indeed necessary, to extend the rights of ship mortgagees to appurtenances owned by third parties.

7 Conclusion

It appears that NMC § 45 should be amended so that there is an explicit exception for a charterer's equipment on board and appurtenances owned by third parties for purposes other than securing a debt. With these exceptions, it may not be worthwhile to maintain the remainder of the provision.

October 2016)) with reference to Francesco Berlingieri, *I diritti reali di garanzia* (Padova: Cedam, 1965) pp. 115–118.

Danish rules on securities and other protective rights in the charterparty trade – an appraisal

By associate professor Kristina Siig

Content

1 Introduction

The costs of buying tonnage – whether new built or second hand – are so high that most Owners will need the assistance of Financers in order to be able to make the purchase. This raises several legal questions regarding ships' finance. This article will provide a discussion of certain aspects of ships' finance under Danish Law which are relevant to the charterparty trade.

The factual starting point for this article is that a vessel is working in or intended to work in the charterparty trade, in particular under long term time charterparties or Contracts of Affreightment.[1] In such a situation, there will be a tri-party relationship between the Financers, the Owners and the Charterers. When things are going well, the interests of these three parties are on a par. The Charterers wish to use the vessel in order to make a profit, enabling them to pay the Owners. The Owners, receiving the hire or freight, are able to pay the crew, maintain the vessel and pay the Financers. However, the moment the financial stability of the Owner or the Charterer is threatened, the three parties will tend to have conflicting interests. Below it will be assumed, where relevant, that the Owners have found themselves in financial difficulties. The Financers, if unpaid, may wish to sell the vessel in order to cover at least some of their losses. The Charterers may wish to continue the use of the vessel, which may be inconsistent with a (forced) sale. Alternatively, the Charterers may wish to be freed of their obligations under the charterparty if the Owner enters into receivership or other types of insolvency proceedings. They may not be comfortable with e.g. having the Owner's estate in bankruptcy running the vessel. And ultimately the Owner's estate may wish to reconstruct the company in order to stay in business, for which end keeping the vessel as an asset and the income flowing from a (continued) charterparty may be a precondition.

[1] The article will not discuss the situation with bareboat chartering as such. Danish Law has a bareboat register and allows for parallel registering of a vessel making the Owners by Demise the actual Owners in the eyes of Danish law. However, the purpose of this article is to investigate the more traditional situations where the opposing interests of the traditional Financier – Owner – Charterer relationship present themselves.

The article will discuss the problem from two main angles. In section 3, the Financers' point of view is mainly applied, and the use of the vessel and the income flowing from the vessel as a security for a Financier's claim against the Owner is considered. Thus, in this respect the issue will be around what types of security the Owner may offer, as well as the pros and cons of these types of security seen from both the Owner's and the Financers' perspective. In point 4, the focus is placed on the Charterers. Amongst other things we will consider how the Charterers' interest in maintaining their right of use of the vessel in the event of the Owner having financial difficulties is also protected under Danish Law. Finally, in section 5, an evaluation is made of the aptness of Danish law in relation to securing an adequate balancing of the parties' interests in case of the Owners' financial distress is made. Before that, however, some general points will be considered in Section 2 on the regulation of this issue under Danish Law.

2 The regulation

From the point of view of Danish law, a vessel is a form of chattel and may be used as collateral in the same way as other forms of chattel. However, certain special rules exist regarding vessels, most prominently the rules in the Danish Maritime Code regarding a ship's mortgages and pledges etc. In addition, claims arising under charterparties, in particular claims for freight and hire, are considered no different from other unsecured claims regarding the rendering of services. Likewise, the right to use a vessel as defined by the charterparty is also not under special regulation, but is instead viewed in the same way as other rights to make use of chattels in return for payment, combined with certain features of a service contract.[2]

[2] Apart from in case of a bareboat charterparty such right of use is not considered a traditional lease and the general rules in the Laws of Obligations regarding the lease of chattels are not particularly to the point here.

In this way, apart from the rules on registering rights and claims in the Ships' Register, and the rules on maritime lien on vessel and/or cargo, the special rules in the Danish Maritime Code concern the rights and obligations *giving rise to the claim* and *not the consequences of having the claim as such*. For this, the general rules of the Law of obligation and Laws of Property must be consulted.

Unfortunately, however, Danish Law has no comprehensive "Securities Code" or suchlike. Instead, the rules on the issue are dispersed and found e.g. in the Promissory Notes Act,[3] the Code of Procedure,[4] the Registration Act,[5] the Bankruptcy Act,[6] and, notably, in case law. As indicated, these rules are further supplemented by certain rules in the Danish Maritime Code[7] as *lex specialis*; however, the interaction between the general rules and the regulation in the Danish Maritime Code is not clear. Thus, the regulation is quite inaccessible and does not lend itself particularly well to first time users.

Danish law contains no black letter rules as to what may be used as security. As a point of departure any *transferable asset* which the parties reasonably consider to be of *value* may be pledged or mortgaged as long as it is sufficiently described, allowing the asset to be identified.[8] Likewise, as a starting point any claim for payment may be assigned to a third party.[9] Still, there are binding rules as to what may be registered in the Ships' Register and the Land Register and thus obtain this form of preferential status in competition with other claims and charges, and there are binding rules on e.g. the requirement to give notice to the debtor when assigning a claim in order to ensure that the assigned

3 Promulgation of the Act on Promissory Notes No. 333 of 31 March 2014 (Gældsbrevsloven).

4 Promulgation of the Code of Procedure No. 1255 of 16 November 2015 (Retsplejeloven).

5 Promulgation of the Registration Act No. 1075 of 30 September 2014 (Tinglysningsloven).

6 Promulgation of the Bankruptcy Act No. 11 of 6 January 2014 (Konkursloven).

7 Promulgation of the Maritime Code No. 75 of 17 January 2014 (Søloven).

8 Rørdam/Carstensen, Pant, 7th rev. ed., Cph. 2002, p. 53 f.

9 See e.g. von Eyben, Mortensen and Sørensen, Lærebog i obligationsret II, 4th ed., Cph. 2014 p. 39, Gomard, Iversen, Obligationsret, 4th ed., Cph. 2011, p. 71.

claim is protected from the assignee's other creditors.[10] Finally, it is a general feature of the Danish regulation of this area of Property Law and the Laws of Obligation that it often distinguishes between how a creditor may obtain a preferential status in competition with other creditors and how to obtain such status in competition with the debtor's other contract partners. Unfortunately, therefore, in addition to being rather inaccessible, the regulation is also reasonably complex. Finally, it should be noted that, contrary to what is often the case when dealing with Maritime Law, the laws of the Scandinavian states on Ships' Finance, and especially the regulation of pledges and mortgages, are not analogous. An exception is the Promissory Notes Acts, which were drafted as a part of the Scandinavian Law cooperation at the start of the 20th century. The Danish and Norwegian Registration Acts do also have certain similar features, however not enough to warrant the regulations being described as "Scandinavian". Consequently, readers of this article should not simply assume that the following discussion of the law also applies to the other Scandinavian jurisdictions. For example it is directly prohibited to register a charterparty on the vessel in the Norwegian Ships' Register,[11] so the discussion below in Section 4 on that issue is only relevant to Danish law.

As regards the vocabulary, the reader should note that strictly speaking, the definition of mortgages under Danish Law is more akin to a pledge than to a "mortgage" under English Law. However, in the following discussion the word "mortgage" is kept, but is reserved for security rights in the vessel *registered on the vessel in the Ships' Register by a Financer.* For other types of securities, the terms pledge or charge is used.

[10] See the principle of the Promissory Notes Act sec. 31, sub-sec. 1.

[11] See directly the Norwegian Maritime Code sec. 20.

3 The Financers' point of view: obtaining the best possible security in the Owners' assets

3.1 In general

The first asset that lends itself as security for a Financer is the vessel. In case of a new-build, the vessel will normally be free from encumbrances once the workshop has been paid, and the Financers may simply register a ship's mortgage with the Ships' Register. Second hand tonnage may already be mortgaged or pledged; , such mortgages or pledges are normally paid out in connection with the sale, making a ship's mortgage equally interesting for the Financers. Other assets belonging to the Owner may also be of interest. The Financers may also wish to have a mortgage on other vessels belonging to the Owner, in situations where the Owners do not have a one-ship company structure. However, other assets such as any real estate belonging to the Owners may also be relevant. Further, the Financers may wish to obtain security over the Owners' receivables. In the charterparty trade the major receivables are the freight or hire under the charterparties, but other income may also serve. Finally, albeit it is not a security as such, the Financers may demand that the whole debt falls due in the event of the Owner encountering/having/running into financial difficulties. Under Danish law such clauses are not necessarily valid. These options will be examined in more detail below. Unless otherwise stated, the Financers in the following discussion are considered to be the main, original financers, providing the bulk of the finance for the purchase of the vessel.

3.2 Registering a ship's mortgage with the Danish Ships' Register

The rules on registration of mortgages, pledges and other charges on the vessel are found in the Danish Maritime Code Chapters 2 and 3. To a large

extent, the provisions mirror the relevant provisions of the Registration Act. Consequently, where relevant, the two legislations supplement each other and case law under the Registration Act may also be used as a guide regarding registration of mortgages etc. of vessels under the Danish Maritime Code.

According to the Danish Maritime Code sec. 29, documents may be registered in the Danish Ships' Register if they "confirm, establish, change or terminate a right of ownership, a right of pledge, a right of use, or a right which limits the Owner's right to dispose of the vessel in one or more given ways."[12] Competing rights are prioritised according to the time at which they are entered into the registry.[13] This is in keeping with the general fall back rule of the Danish Laws of Property and Obligation, that the right or claim which is first to arise has precedence.

Consequently, the Financers may – and will – register a ship's mortgage on the vessel as a condition for financing the Owner's purchase of the vessel. It is the wording of the mortgage which defines what is mortgaged; however, unless otherwise agreed between the parties, the mortgage will encompass not only the hull of the vessel as such, but also its fittings, e.g. radios, fishing or other equipment, engines etc.[14] Indeed, apart from fishing equipment, such items may not be independently pledged or otherwise serve as the basis for an independent security interest, such as a retention of title clause.[15] In this way, it is the vessel as a working unit which serves as security for the mortgagee. Thus, the legislators have sought to ensure that the vessel will not be stripped before a (forced)

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12 Writer's translation.

13 Danish Maritime Code sec. 36, sub-sec. 1.

14 Danish Maritime Code sec. 47, sub-sec. 1. Falkanger/Bull/Overby, Søret, 4th ed., Cph. 2013, p. 131.

15 Danish Maritime Code, sec. 47, sub-sec. 3. It is possible to lease e.g. radio equipment or engines, but the Courts will examine whether it is a real lease or rather a disguised pledge. If the latter, the pledge will be set aside and the equipment will be available for [changed since "serve" just sounds very strange here – perhaps it could be altered instead to say e.g. "serve the purposes of…"]the Financers/mortgagee. Falkanger/Bull/Overby, Søret, 4th ed., Cph. 2013, p. 132. Se similarly the Registration Act sec. 37, regarding the registration of a mortgage in real estate used and equipped for business-purposes.

sale; the intention being that the mortgaged vessel maintains a realistic market value.

It is uncertain whether the ship's mortgage may be worded so as to encompass also accessories to the pledged asset in the form of receipts of the vessel, such as freight or hire under the charterparties to which the vessel is fixed. From the Financers' point of view this would be interesting, as it would provide for a registered security in the freight and hire, which would have a preferential status in competition with the Owners' other creditors, such as e.g. a supplier who has had the hire assigned to him as payment for deliveries to the vessel. Such pledges have been accepted by the courts regarding other types of chattels. Thus, in U 1984.1009 Western Court of Appeal, the court accepted quite an extensive inclusion of accessories to the pledged asset in the Land Register registration. In that case, an agreement to pledge a computer facility was worded so as to include also the proceeds flowing from the computer, including rental and potential damages from a third party. Similarly, in U 1996.316 Western Court of Appeal, the court accepted that the operating fixtures and equipment, as well as the economic value of the professional footballers' contracts, could be pledged by a football club. These rulings of the courts have been based on the reasoning that the pledged accessories form an important, transferable, asset for the pledgor, and that it is in the interest of the pledgor's creditors that such assets may be used as security and, consequently, that such security may also be registered so as to protect the pledgee against competing creditors.[16] These features are also present regarding the Owners' claim for freight or hire, and as such there seem to be no policy reasons precluding a similar approach regarding registration in the Ships' Register. However, this is apparently not common practice.

The Financers will normally structure/negotiate their loan on the presumption that they are entered with first priority into the registry and thus that they will hold a preferential position towards other claimants regarding the proceeds in the event of a sale of the vessel (forced or otherwise). Due to the rules on maritime liens and on the preferential

[16] Clausen/Jensen, Sikkerhed i fordringer, 7th ed., Cph. 2014, p. 43 f. See also U 2004.960 Eastern Court of Appeal.

position of certain public law claims, such as port dues and the costs and fees connected with a forced sale, the Financers can never be certain that they will have the best priority, but if they are the main financers, they will be protected against most claims.

The Owners may offer a ship's mortgage over other vessels as security, rather than over the vessel for which the loan has been granted.[17] Such vessels will tend to be mortgaged already and the Financers will have to respect such registered mortgages and charges; however, it is common practice to provide such secondary mortgages.

3.3 Obtaining a floating company charge either in general or on receivables?

Generally, under Danish Law, the requirement that the pledged asset should be identifiable has been seen as precluding floating charges.[18] However, the Registration Act contains certain exceptions to this. Thus, according to the Registration Act sec. 47c, the owner of a company may register a letter of indemnity in the Land Register, providing the creditor under the letter of indemnity with a floating company charge over the company's present and future assets.[19] Such a floating charge will encompass assets which are not already subject to registration according to other rules. Consequently, the Owner's vessels or real estate are not covered by the charge.[20] In particular, the charge will encompass, for example, the Owner's equipment, operating fixtures, goodwill, stores and unsecured claims from the sale of services,[21] such as claims for hire or freight. The charge will cover the assets which belong to the Owner at the time of the registration of the charge, as well as later assets. Assets which are intended

17 In Danish named "fleet-mortgage" (flådepant). However, it is not a floating charge on the fleet (although the term may so indicate), instead it is a collection of individual mortgages over the different vessels.

18 Registration Act sec. 47b.

19 Clausen/Jensen, Sikkerhed i fordringer, 7th ed., Cph. 2014, p. 96 ff.

20 Registration Act sec. 47c, sub-sec. 4, No. 5.

21 Registration Act sec. 47c, sub-sec. 3.

to be transferred to third parties, or e.g. used in production, will cease to be part of the charge as and when such transfer of use takes place.

Given that the Owner's principal assets and production facilities – the vessels – are not included in the floating company charge, the charge is generally not seen as particularly relevant by the Financers; however, the option exists.

According to the Registration Act sec. 47d, the owner of the company may also opt to accept a floating charge solely over unsecured claims, leaving the rest of the company's assets unencumbered. The charge would encompass all unsecured claims at the time of registration of the letter of indemnity in the Land Register, and future unsecured claims are then included as and when they are incurred.[22] Thus, the Owner may propose to the Financers that they accept a floating company charge over the Owner's unsecured claims. In the case of a one-ship company structure, this would realistically imply the freight or hire under the charterparty, but in any case the parties may limit the floating charge so that it only relates to specific unsecured claims.[23]

Both the floating company charge and the floating charge over unsecured claims are security rights. Thus, they do not provide a right for the Financers to receive the freight or hire directly from Charterers, unless the Owner defaults on the loan. In this way, the floating charge on unsecured claims serves much the same purpose as the assignment of receivables for security mentioned in Section 3.5 below. The main difference, however, is that the Financers need not notify the debtors individually, as the charge is already apparent from the Land Register entry.

3.4 Assignment of hire

It is a general starting point of the Danish Laws of Obligation that unsecured claims may be transferred to a third party.[24] Thus, the Owner may assign his claim against the Charterers for freight or hire under

22 Clausen/Jensen, Sikkerhed i fordringer, 7th ed., Cph. 2014, p. 94.

23 Clausen/Jensen, Sikkerhed i fordringer, 7th ed., Cph. 2014, p. 102 f.

24 See e.g. von Eyben, Mortensen and Sørensen, Lærebog i obligationsret II, 4th ed., Cph. 2014 p. 39, Gomard, Iversen, Obligationsret, 4th ed., Cph. 2011, p. 71.

the charterparty to the Financers. In order to ensure, however, that the Charterers do not instead pay the Owner, the Financers must notify the Charterers that the claim has been assigned to them, or otherwise make sure that the Charterers cannot be unaware that the freight or hire is payable to the Financers instead of to the Owner.[25] If notification is made, the Financers are also protected against the Owner's general creditors wishing to seek enforcement of their claims in the freight or hire.[26] The notification may be made by either the Financers or the Owner; however, the Financers will often insist on doing it themselves, so as to ensure that it is actually done.[27]

Assignment of hire involves the Charterers directly, as it imposes a duty on the Charterers to pay to the Financers instead of the Owners. The Charterers may not find this acceptable/attractive. Firstly, regarding the practicalities, currency restrictions might make it more cumbersome for the Charterers to pay into the Financers' account, if it is held in a different country from that of the Owner. Such risks are for the Financers, and they may, as a starting point, be prohibited from demanding payment in another country. However, the Charterers' misgivings may be of another nature. Given all these concerns, it follows from the principle expressed in the Code of Procedure sec. 511, sub-sec. 3, that the Charterer may insist on paying directly to the Owner, if the Charterer would otherwise be subject to a clear risk of loss or significant inconvenience.[28] It follows from Supreme Court case law in construction cases that in such a situation, the debtor will be at liberty to pay to the creditor what is necessary in order to ensure that the creditor is able to fulfil its obligations vis-à-vis the debtor.[29] The policy reasons for allowing the payment in construction

25 See the principle in the Promissory Notes Act sec. 29.

26 See the principle in the Promissory Notes Act sec. 31, sub-sec. 1. Gomard, Iversen, Obligationsret, 4th ed., Cph. 2011, p. 87 f.

27 Compare e.g. the Maritime Code § 391, sub-sec. 4, according to which the owner under a time charterparty may demand that the time charterer assigns the freight to the owner if the time charterer is in default regarding payment of hire.

28 von Eyben, Mortensen and Sørensen, Lærebog i obligationsret II, 4th ed., Cph. 2014 p. 50 ff., Vagner, Entrepriseret, 4th rev. ed. by Iversen, Cph. 2005, p. 309 f.

29 U 1913.90 Supreme Court. See for further discussion Gomard, Iversen, Obligationsret, 4th ed., Cph. 2011, p. 110f.

work cases (the high level of expenses on the creditor potentially causing such a strain on the creditor's cash flow as to frustrate the purpose of the enterprise) also present themselves in charterparty cases – particularly so under time charterparties. Assuming, for example, that there is a real risk that the Owner will not be able to pay the crew's salaries or for the maintenance of the vessel unless he receives at least some of the time charter hire, it must be assumed that the Danish courts will allow the Charterer to pay at least a part of the hire directly to the Owner, despite a notification that the claim had been assigned to the Financers. Unfortunately, in a one-vessel company structure, such a scenario is not inconceivable.

3.5 Assignment of receivables under the charterparty as security

Instead of assigning the receivables under the charterparty to the Financers outright, the Owner may pledge the receivables to the Financers. From the Owner's point of view this has the advantage of not requiring the Charterers to change their payment arrangements. Also, a point which should probably not be overlooked, the message regarding the Owner's financial stability sent to the Charterers is a less bleak one. As with the outright assignment of receivables, the Financers should ensure that a notification of the assignment for security is made to the Charterers.[30] Also, should the Owner default on the loan from the Financers, they must again notify the Charterers that the conditions for which the security was given have presented themselves and that the Charterers must now pay to the Financers rather than the Owner. The above considerations regarding the Charterers' right to pay directly to the Owner despite such notification, in the event this becomes necessary in order to avoid serious risk of loss or significant inconvenience, as allowed for in the Code of Procedure sec. 511, sub-sec. 3, will apply.

[30] As per the principles expressed in the Promissory Notes Act sec. 29 and sec. 31, sub-sec. 1.

3.6 Financial hardship and change of control provisions

Most loan agreements will contain a change of control provision, stating that unless the Financers specifically accept otherwise, the loan will fall due if the vessel is sold or e.g. if the company undergoes a significant change of ownership structure. It is also quite common for these provisions to contain phrasing according to which the loan will fall due if the Owner enters into insolvency proceedings – either because this is seen as a change of control, or because the proceedings in themselves are considered breach of an obligation to be "financially sound". However, the Financers should be aware that the latter part of such a clause is not necessarily acceptable under Danish law.

It follows from the Bankruptcy Act Chapter 7, and in particular from sec. 55, that the debtor's (in this case the Owner's) estate in bankruptcy may opt to step into the debtor's "bilateral" contracts.[31] The consequence of the estate stepping in is that the contract will have to be satisfied in full, and thus that any claim which the creditor may have will obtain a preferential status. The provisions aim to make it possible for the estate to reconstruct the company in order to make it survive, or at least ensure the highest possible dividend, which is generally considered to be in the best interest of the creditors as such.[32]

So, the question is, should the Financers expect that they will notsimply be able to declare the mortgage forfeited and demand that the vessel is sold to satisfy their claim?

If the Owner has already defaulted on the Financers' loan, the Owner is in breach of the loan agreement. In that case, the whole amount will normally be due according to the provisions of the loan agreement, and in any case failure to repay a mortgage on time is considered a substantial breach of contract, allowing a lender to call the full loan immediately.

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31 As per the wording of the Bankruptcy Act sec. 55, sub-sec. 1: The estate may become a party to the bilateral agreements entered into by the debtor.

32 Ørgaard, Konkursret, 11th ed., Cph. 2014, p. 64.

Such a right is not extinguished by the debtor's bankruptcy.[33] If the full amount is not paid, the Financers may cash in on their securities, such as the vessel or e.g. assigned hire. However, it is not necessarily the Financers' loan that is defaulted on. It may be secondary mortgagees, suppliers, port states or other unpaid creditors, or indeed the Owners themselves, who have initiated the bankruptcy proceedings.

The position regarding whether the estate may step into loan agreements is somewhat unclear. Firstly, the wording of sec. 55, sub-sec. 1, indicates that "bilateral" contracts are the focus of this section. Loan agreements are indeed bilateral, and presuppose a quid pro quo; however, it is generally other types of contracts, such as contracts for sales or services, that are considered. Also, the estate will generally have little interest in stepping into the Owner's loan agreements, since the estate would then have to honour subsequent repayments in full after stepping in, rather than paying a dividend on the whole loan amount. However, this presumption fails when the loan is secured on the Owner's main/principal asset and production facility – in case of a one-ship company set-up, indeed the only production facility. If the vessel is sold out from underneath the Owner, any hope of reconstructing the company will generally be lost. This has been recognised regarding mortgages on real estate. Thus, it follows specifically from sec. 42b of the Registration Act that clauses according to which insolvency proceedings trigger the repayment of the loan in full are prohibited. However, this provision is not repeated in the Danish Maritime Code, nor does it apply to registered pledges on chattels.

Considering that realistically it will be impossible for the estate to reconstruct the company if the vessels are not at the estate's disposal, the Financers should expect the courts to be restrictive towards these clauses and allow the estate to step into secured loan agreements which are not (yet) defaulted on. However, there seems to be no published case law specifically on this issue and the legal position remains uncertain.

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[33] See directly sec. 58, sub-sec. 2 of the Bankruptcy Act and further in Munch, Konkursloven med kommentarer, 12th ed. by Lindencrone Petersen and Ørgaard, Cph. 2013, p. 381 f.

4 The Charterers' point of view – keeping the charterparty or getting out quickly?

4.1 The Charterers' dilemma

Depending on the circumstances, the Charterers may wish to keep the charterparty despite the Owner's financial difficulties, even if ultimately the vessel is sold to a third party (by forced sale or otherwise). This may be due to the fact that the value of the hire or freight is low compared to the market level or maybe that the vessel is non-standard. Maybe the vessel was originally bought and refitted by the Owner with the Charterers' needs in view. This is not unusual. Indeed, in situations where it is the existence of the charterparty with Charterers that enables the Owner to raise the finance required to buy the vessel, the specifics of the vessel will often be discussed in detail with the Charterers before the Charterparty commits. Conversely, the Owners may wish to tie the Charterers to the vessel for the length of the Charterparty – despite a possible change of control or e.g. the Owners entering into bankruptcy. The vessel's market value will simply tend to be greater with the charterparty.[34] This is especially the case if the Owners have had the vessel fitted for the Charterers' particular needs. The vessel might not be of much use to other charterers. Alternatively, market fluctuations may cause the Charterers to wish to be released from the charterparty. In a rapidly dropping market, Charterers will tend to look for excuses to get out of the charter, and the Owner's financial difficulties will suffice for this. On the other hand, in a rising market, the Owner's estate may wish to be freed from its obligations towards the Charterers, in order to achieve greater profits from the vessel after a company reconstruction. These scenarios will be developed further below.

[34] In second-hand sales of vessels it is common practice in the Danish market for the charterparties to continue.

4.2 Protecting the Charterers' interest by registration in the Ships' Register

4.2.1 Registering the charterparty as a right of use of the vessel

As with the Financers, the starting point for the Charterers is the Danish Maritime Code section 29. According to this provision, a *right of use* of a vessel may be registered directly in the Ships' Register, including also the rights of use under a Charterparty. Indeed, it is standard practice in the Ships' Register for the charterparties to be registered there, normally with reference to the type and duration of the charterparty (e.g. Baltime 2011, with "Charterers", from X-date to Y-date). The possibility of registering the charterparty as both a limitation over the Owner's right to dispose of the vessel, and as a charge on the vessel that should be respected by competing claimants, is seemingly a rather unique feature of the Danish Ships' Register,[35] and one which protects the Charterers from unknowingly ending up having the vessel sold from under them.

The Charterers' right of use will be protected from the time of registration[36] and will have to respect already registered claims, as well as already existing rights against the vessel of which the Charterers knew or ought to have been aware.[37] If the vessel is sold voluntarily, the buyer must respect the charterparty; however, if the Charterers have insisted on a change of control provision in the charterparty, the Charterers will normally be allowed to refuse to continue with the charterparty under a new ownership.[38] This state of affairs would also follow without a change of control provision, since the starting point of the Danish Law of Obligations is that rights but not obligations are freely transferable

35 Goldschmidt, Søfart og pengevæsen, Cph. 2014, p. 101.

36 Danish Maritime Code sec. 36, sub-sec. 1.

37 Danish Maritime Code sec. 28, sub-sec. 2.

38 The wording sometimes used in practice in such clauses normally indicates that the vessel may not be sold, or the Owner may not undergo significant changes in company ownership or structure, without the prior written consent of the Charterers "which may not be unreasonably withheld".

to a third party.[39] However, the Charterers' right might be extinguished at a force sale if the final bid is not sufficient to cover the right of use. It follows that if the right of use signified by charterparty is only registered with a secondary priority, it may not survive a forced sale.[40]

In this way, Danish law offers similar possibilities to the ones normally connected with the quiet enjoyment clause, but with the added advantage for the Charterers that it may also survive the Owner's bankruptcy – at least in cases where the charterparty has been entered into the Ships' Register at an early stage and thus holds a preferential position and the bid at auction is sufficient to cover the priority held by the registered right of use. Naturally, the Charterers may also enter a traditional quiet enjoyment-clause into the charterparty as a rider-clause; however, under Danish law, simply registering the charterparty on the vessel will normally prove the better option.

4.2.2 Registering a letter of indemnity from the Owner covering the Charterers' interest in the charterparty

Depending on their bargaining powers, both the parties under the charterparty may demand that the other party provides e.g. a bank guarantee for the fulfilment of their obligations. As an alternative to a bank guarantee, the Owner may provide a letter of indemnity towards the Charterers for the Charterers' interest in the Owner's obligations under the charterparty. Such a letter of indemnity may be registered on the vessel in the Ships' Register. It will tend to have a secondary priority compared to the main financers, but will, according to the rule in sec. 36, have preferential priority compared to later claimants.

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39 von Eyben, Mortensen and Sørensen, Lærebog i obligationsret II, 4th ed., Cph. 2014 p. 17 ff.; Clausen, Jensen, Sikkerhed i fordringer, 6th ed., Cph. 2011, p. 13 f.; Gomard, Iversen, Obligationsret, 4th ed., Cph. 2011, p. 153.

40 See further on this issue Goldschmidt, Søfart og pengevæsen, Cph. 2014, p. 130 ff.

4.3 Financial hardship and change of control-provisions in the charterparty

It has already been indicated above, in Section 4.2.1, that the Owner and Charterers may agree to include a change of control provision in the charterparty. Such clauses are, as a starting point, seen as unproblematic in Danish law, because they also tally with what would apply as the fall back rule. Still, as seen above in Section 3.6, if the change of control provision includes wording to indicate that the Owner's insolvency allows the Charterers to cancel the charterparty, such a clause might be seen as invalid under the Bankruptcy Act sec. 55, sub-sec. 1.

It follows from the Bankruptcy Act sec. 53, that the rules in Part VII of the Bankruptcy Act, including sec. 55 on the right of the estate to become party to the debtor's bilateral contracts, do not apply if this is contrary to "the nature of the legal relationship in question".[41] The provision aims at excluding the estate's right to become party to the debtor's contracts in situations where this would be unreasonable either for the debtor or for the creditor. For example, if the obligation which the debtor has to deliver is considered to be a "personal" one, the estate may not step in. Scandinavian legal literature has debated whether or not the Owner's obligation under a charterparty is personal.[42] Indeed, the reason for the Norwegian Maritime Code not allowing the Charterers to register the charterparty on the vessel in the Norwegian Ships' Register, is that Norwegian law considers the Owne'rs obligations under a charterparty to be personal, and thus that they cannot be transferred to third parties. When following that reasoning, the obligations equally cannot be transferred to the Owner's estate.

However, contrary to the Norwegian approach, by including rights of use of the vessel in sec. 29 of the Danish Maritime Code as something which may be registered on the vessel, the Charterers' rights under a charterparty are transferable assets must be considered as the starting

41 Bankruptcy Act sec. 53, first sentence: the provisions of this part are only applied if a contrary intention does not follow from other statutory provisions or from the nature of the legal relationship in question.

42 Goldschmidt, Søfart og pengevæsen, Cph. 2014, p. 104 ff

point under Danish Law. As a point of departure, therefore, the Owner's estate will be at liberty to step into the charterparty. Still, this can only be a point of departure. It must be decided upon an analysis of the charterparty in question, whether the existence of the charterparty is specifically tied to the Owner "personally" or whether the obligations which are due to the Charterers under the charterparty are more generic and may be fulfilled by other parties, such as the Owner's estate or subsequent buyers of the vessel.

4.4 Untimely cancellation of the charterparty by the Charterers in case of the Owners' bankruptcy

As mentioned above in point 1, this article focuses on long term time charterparties and long term Contracts of Affreightment. In the event of the Owner entering into bankruptcy proceedings, both the Owner's estate and the Charterers may wish to be released from their obligations under the charterparty. This possibility is provided for in the Bankruptcy Act sec. 61, according to which the parties to a long-term contractual relationship may terminate the contract if they provide a usual or reasonable notice thereof. This applies even if the contract itself provides for a longer period of notice or for non-terminability.

At first glance this provision seems to allow both the Owner and the Charterer a mutual right to cancel the charterparty. However, in reality, this is not the case.

Firstly, the Owner's estate may not avail itself of the provision if the Charterers have secured the right to a longer period of notice or indeed have secured non-terminability by "registration in the Land Register or other similar registration in public registers."[43] Consequently, if the Charterers have registered the charterparty on the vessel in the Ships' Register, they will be protected against having to suffer the untimely termination of the charterparty. Especially in situations where e.g. the Charterers are a NVOCC, operating its fleet based on long-term time charterparties, such premature termination may be very unfortunate

[43] Bankruptcy Act sec. 61, sub-sec. 1, 2nd sentence.

and the Charterers should make sure, for that reason alone, that the time charterparties are registered on the vessel in the Ships' Register.

Secondly, the Charterers may not be entitled to terminate the charterparty if the Owner has the ability to transfer its rights under the Charterparty to a third party. As has been discussed in Sections 3.4. and 3.5. above, the Owner's rights under the charterparty are mainly the claim for freight or hire. This is normally considered an unsecured claim andas such is freely transferable. Consequently, the Charterers equally/also cannot terminate the charterparty prematurely.

Summing up this point, theoretically the parties should consider in some detail whether they wish the charterparty to be non-terminable for the duration of the charter or whether the possibility of termination of the charter upon reasonable notice should be included in its terms. If it is, the charter may also be terminated upon that notice also in the event of the Owner's bankruptcy. However, such clauses are not only a contradiction in terms in long-term charterparties, they will also tend to be contraindicated for business purposes. Fortunately, most Owners do not go bankrupt during the duration of the charter and the parties' interest in securing a long-term binding obligation on both parties for the duration of the charter, so allowing both parties to assess their position for at least some time to come, should provide for the main focus.

5 Summing up: Is the Danish regulation apt to cater for the parties' needs?

Although not particularly accessible, the Danish regulation on ships' finance does, when put together, provide for a comprehensive regulation of securities and other protective rights. The general access to pledge or mortgage over virtually any transferable asset of financial value enables the Financers to obtain relevant securities with comparative ease. This is an advantage for Owners who will be able to offer a variety of different

assets as security to the Financers, which – everything else being equal – ought to promote lending.

Still, on this point Danish law shares many features with the regulations in other jurisdictions. Nonetheless, the protection of the Charterers' rights and interests by registering the charterparty directly on the vessel in the Ships' Register provides for a distinct feature of Danish law. The possibility of registration provides, firstly, publicity as to the existence of the charterparty. It is simply impossible for anyone to be unaware of and thereby in good faith as regards the existence of the charterparty, and the vessel cannot be sold from under the Charterers unless the priority of the charterparty is not covered at a forced sale. Without getting into technical details regarding how a forced sale is conducted by the Danish Bailiffs' Court, it means that if the charterparty is registered first on the vessel, the Charterers rights will stand as long as the vessel achieves a bid of one (1) crown.

Having said that, Danish law does provide for inconsistencies. The mixed features of a vessel, being a chattel but with many of the traits normally connected with real estate fitted particularly for business purposes is not well catered for, and e.g. regarding the issue of what is actually included in the Financers' mortgage, the ships' mortgage does seem to sit between two stools, so to speak. Given that the standard practice in Danish law is for the vessel to be mortgaged to the Financers with a standard ships' mortgage, and that hire or freight is assigned to Financers either outright or as a security, this inconsistency may not appear a first glance to create problems in practice., However, the uncertainty of the law will tend to make the Financers and their advisers hold back on exploring some of the options available if the vessel were clearly defined as either a production facility or a (real) chattel.

Furthermore, Danish law accepts that that a charterparty is a transferable asset of financial value and therefore that it makes sense to register it on the vessel's page in the Ships' Register, sicne it does not "die" if the Owners go out of business or sell the vessel voluntarily. This does not tally well with the uncertainty found under the regulation in the Bankruptcy Act Part VII, regarding whether or not the rights and obligations under

a charterparty are so "personal" that they may be excluded from the Owner's estate's right to step into the Owner's contracts. This is not so much a problem for Charterers (a voluntary sale "with" the charterparty presupposes Charterers' acceptance, and the Owner's estate may only step in if they fulfil the Owner's obligations under the charterparty), however the uncertainty is problematic for the director of the Owners' estate in his assessment of whether or not it is possible to reconstruct the company.

On a final note, one must not overlook the fact that the rules on ships' finance in Danish law are incomplete unless account is also taken of the importance of being potentially able to register an Owner by Demise as a parallel registration in the Danish Ships' Register. When used to the full, the bareboat charter provides a way for the buyer and seller of tonnage to carry out their transaction without the need for external financers, as long as the seller's cash flow is strong enough to survive that sales price being paid in instalments. As mentioned above in the introduction, however, these issues are not dealt with here.

Having noted all that, it is this writer's view that the Danish regulation is apt for its purpose and that the flexible approach it promotes is desirable. Not least for Charterers, which – considering that Denmark considers itself primarily a shipowners' nation – may be somewhat surprising.

Meeting points between recourse (indemnity) rights in contract and tort

– illustrated by knock-for-knock and ship collision both-to-blame clauses

By professor Trond Solvang

Content

1 Introduction

Where joint tortfeasors are liable in damages under tort law, the general rule is that each tortfeasor is jointly and severally liable towards the claimant,[1] with the corollary that the tortfeasor thus sued is thereby entitled to a pro rata contribution (recourse) from its joint tortfeasor.[2] This set of rules may be said to bestow a privilege on the claimant, in that he does not have to claim against each of the joint tortfeasors in order to recover his full losses, while the recourse rules secure a just end result, in that liability is distributed fairly among those liable.

Moreover, it is generally recognised that the said rule of joint and several liability among joint tortfeasors, applies equally to situations where one tortfeasor is liable in tort and the other in contract.[3] However, complications may arise in these situations if the tortfeasor liable in contract is contractually exempted from liability. This may be illustrated by ship collision cases: ship A collides with ship B and they are both to blame, for example 50% each, and the cargo onboard ship A suffers damage. However, as part of the contractual terms between the cargo claimant and ship A, ship A is exempted from liability in cases of cargo damage caused by navigational fault.[4] Assuming the collision is caused by navigational fault (which is often the case), the cargo claimant would therefore obtain no recovery from ship A, and would instead seek tortious recovery against ship B. If ship B were to be held liable on a joint and several basis, ship B would then look to ship A for a pro rata contribution to the damages thus paid to the cargo claimant. However, if ship B were to obtain such pro rata recovery from ship A, a tension or "asymmetry" would ensue between tortious and contractual liability rules: ship A would indirectly – via tort rules and the recourse claim from ship B – be liable

1 The Tort Act section 5-3 first paragraph.

2 The Tort Act section 5-3 second paragraph.

3 See e.g. Rt. 2005.870 and the general account given in Hagstrøm/Stenvik, Erstatningsrett, p 534–35.

4 As sanctioned in legislation through the Maritime Code section 276 second para.

for (a portion of) the cargo damage for which liability is contractually excluded.

Under Norwegian law, this tension between tortious and contractual rules is resolved in ship collision cases by a cargo claimant being given merely a pro rata right of recovery against each joint tortfeasor.[5] This generally disposes of the need for recourse rights among joint tortfeasors: if, in our example, the cargo claimant could only claim against ship B on a pro rata basis (recovering say 50 % of its losses), there would be nothing for ship B to claim in contribution from ship A. However, this solution entails the perhaps unfortunate effect of depriving a cargo claimant of its otherwise tortious remedy[6] of obtaining full recovery from joint tortfeasors, in our example meaning 100% from ship B.

There is one further twist to this issue: if the general tort rule were to be upheld so that a cargo claimant could, in our example, claim for its entire losses against ship B, with ship B then being entitled to a pro rata contribution from ship A, ship A might then wish to contractually regulate such a situation in its favour by way of a right of indemnity. In other words, since ship A has contractually excluded its liability towards the cargo owner, ship A may wish to obtain the same result by contracting for a right of indemnity if (a portion of) a cargo claim ends up with ship A, via tortious rules and claims having been made against ship B. This type of contractual indemnity right is contained in the so called both-to-blame collision clauses. Under US law, such clauses are held to be invalid on grounds of public policy, a topic to which we shall return later.

The point thus far has been to illustrate the type of tension which may arise between contractual and tortious remedies in certain situations involving joint tortfeasors. And if we return to Norwegian law, it is clear that the said ship collision rules of prorata liability constitute an exception to the otherwise general rule of joint and several liability. Moreover, there may be maritime law cases with similar constellations of joint tortfeasors

5 The Maritime Code section 161 third para, as based on the Collision Convention (Convention for the Unification of Certain Rules of Law with respect to Collisions between Vessels, Brussels, 23 September 1910), see Falkanger/Bull, Sjørett, 7. ed., p 203.

6 As this would follow from the Tort Act section 5-3 first paragraph.

as described above which fall outside the scope of the ship collision rules but nevertheless involve contractual indemnity provisions similar to the mentioned both-to-blame collision clauses. One such example could be offshore supply services contracted on the basis of the knock-for-knock liability system, as contained for example in the Supplytime 2005.

In the following, we shall therefore have a further look at such a potential situation. Through the use of a test case[7], we shall explore, as it were, the destiny of a damages claim made by a claimant charterer against a third party joint tortfeasor which, via tortious recourse rules and contractual indemnity rights, might circle back to the charterer claimant, thus creating the said tension between contractual and tortious remedies – which could also be described as the dilemma of a "recourse roundabout".

After some initial remarks on knock-for-knock clauses in this context (chapter 2), we shall explore the various alternatives for halting the said "recourse roundabout" (chapter 3). Thereafter we shall pay a visit to U.S. law to look at its policy considerations for invalidating both-to-blame clauses (chapter 4), while finally providing some remarks on whether those U.S. law considerations bear weight in a Norwegian law perspective (chapter 5).

2 Knock-for-knock and indemnity for third party claims

As will be known, the essence of a knock-for-knock system is that damage caused to either contracting party remains where it strikes. For reasons of cost efficiency and saving of time and resources otherwise spent in litigation over damages claims, each party bears the risk of damage to

[7] Inspired by a real-life case which ended up being settled amicably.

its property or personnel, as covered by their appropriate insurance arrangements.[8]

This system requires contractual provision for exclusion of that liability which would otherwise follow from the law of damages in contract. It also requires provision for indemnity, in case either of the parties is sued in tort by parties belonging to the other party's sphere of risk (the party's "group"[9]), such third party not being privy to the knock-for-knock agreement between parties A and B. This could involve claims for personal injury suffered by employees of the other party, or claims for property damage suffered by the other party's subcontractors, etc. The aim of such indemnity is therefore to achieve the end result of knock-for-knock, as agreed between A and B. Hence this type of third party claims is unproblematic, in that they form part of what is intended to be covered by the contractual liability regime between A and B. In that sense contract "trumps" potential tortious claims.

This system is however not all-embracing. There may well be third parties involved who are not intended to be covered by the knock-for-knock regime. One example may be fairly obvious: if a third party, not belonging to any of the contracting parties' "groups", suffers damage caused by one of the parties, the ensuing liability is clearly not covered by the knock-for-knock indemnity right. It could for example be the case that a shipowner who performs offshore services under Supplytime, causes damage to fishing gear in the vicinity of the oil rig to which the services are rendered. If held liable by such unrelated third party owner of the fishing gear, the shipowner can clearly not claim to be held indemnified by the charterer under the relevant knock-for-knock provision in Supplytime.

Another situation may involve a third party – not belonging to any of the contracting parties' "groups" – causing damage to one of the contracting parties' property or personnel. It could, for example, be the

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8 See e.g. Trine-Lise Wilhelmsen, Liability and insurance in contracts for vessel services in the Norwegian offshore sector – the knock for knock principle, SIMPLY/MarIus no. 419, 2013.

9 See the definition of "groups" in Supplytime 2005 clause 14 a).

case that a charterer's seismic equipment, being towed under Supplytime, is damaged by a third party ship. This situation would clearly have to be resolved by ordinary tort rules as applicable between the charterer and such third party tortfeasor, with no remedy available for anyone under the knock-for-knock regime of Supplytime.

Yet another situation might involve such a third party tortfeasor causing damage to the property of a contracting party (the charterer), however this time with the other contracting party (the shipowner) being a joint tortfeasor. This is the situation we shall dwell on in the following, as it entails the abovementioned tension between contractual and tortious liability rules.

3 A case study – the potential dilemma of a "recourse roundabout"

a) The problem

As mentioned above, the following is a test case scenario inspired by a real-life case:

A shipowner (party "A") undertakes a seismic tow for a charterer who is also the owner of the tow (party "B"), based on Supplytime 2005. During the course of this tow, a cargo ship belonging to a third party shipowner (party "T") causes damage to the tow by negligently sailing over the seismic equipment. B sues T in tort claiming damages for the ensuing loss. T then joins A into the proceedings, claiming contribution on the alleged basis that A negligently failed to warn T (over the vhf-radio or similar) of the location of the tow. A then claims indemnity against B under Supplytime covering A's potential liability towards T. B in turn claims this potential liability towards A as an item of B's recoverable losses against T.

If we assume that A and T were both guilty of negligence, assessed either in tort or contract,[10] there is in principle a situation of "recourse roundabout" which would somehow have to be halted. The following is a tentative consideration of the various claims involved:

b) B's claim in tort against T

B would clearly not be interested in claiming against A in contract, as A's liability would here be excluded.[11] B would instead want to claim its entire loss against T in tort and would, as a starting point, be entitled to do so on the normal basis of joint and several liability among joint tortfeasors.[12]

c) T's claim against A for pro rata contribution

When sued by B, T would, as a starting point, be entitled to claim pro rata contribution from A under ordinary tort rules of contribution among joint tortfeasors.[13] There are however potential counterarguments to that solution:

First, the position may be affected by whether or not B, after becoming subject to a contractual indemnity claim from A (see below), could in turn claim this as part of B's losses against T. If so, there would be little point in holding A liable for contribution, since A's liability would, via B, end up with T.[14]

Second, an argument might be raised to the effect that the tortious rule of contribution presupposes that A is liable towards B, whereas in this case A is not liable, by virtue of the contractual liability exclusion. A might

[10] A separate point is that the test of what constitutes negligence may turn out differently in tort and contract, see e.g. Selvig, Det såkalte husbondsansvar, 1968, pp 82–84. Those types of nuance are however immaterial for the present purpose.

[11] Supplytime clause 14 b) (ii).

[12] The Tort Act section 5-3 first paragraph.

[13] The Tort Act section 5-3 second paragraph.

[14] In principle it might be said that if this kind of roundabout were allowed to take place, T's claim for contribution against A would gradually diminish, so that it should perhaps be allowed to succeed. If T's initial recourse claim is for say 50% of T's liability towards B, and this 50% in turn ends up with T via B's duty to indemnify A etc., the "second round" of recourse claim would then be for 50% contribution of 50% of the initial claim, i.e. 25%, and the "third round" for 12,5%, etc., until approximating zero. That is however clearly not how the legal thinking would run.

in this respect argue that T ought to bear the risk of such non-liability of A, on the same footing as if the co-existing cause of T's liability was some fortuitous event to which no liability attached. To this argument, T would probably counter that since A was in fact negligent, and since liability in tort attaches to negligence, T should not bear the risk of A and B making contractual arrangements relieving A of liability. Such a contractual arrangement may perhaps be likened to a situation subsequent to the event, whereby the loss suffering party waives its claim against one of two tortfeasors and promises to keep him indemnified if he is sued for contribution by the other – an arrangement which would clearly have no effect to the legal position of the tortfeasor not being subject to such an arrangement.

At a more theoretical level, T might perhaps also argue that the tortious remedy of entitlement to contribution from a joint tortfeasor is itself a reflection of tort. Depending on the circumstances, it could be the case that if A had not acted negligently (by giving improper warning of the seismic tow, or similar), T would not have committed his tortious act against B. Thus one of several tortfeasors, in our example A, may through its negligence be said to have caused losses to a joint tortfeasor T, consisting in causing T's negligent action towards (and thus being held liable by) the claimant B.[15] Another factor to the same effect may involve the degree of negligence on the part of each tortfeasor. If, in our example, A were to have acted with gross negligence, whereas T had not (the distribution among them being say 80% blame attributable to A and 20% to T), it might seem inequitable if T were to be barred from claiming contribution from A, by virtue of A's contractual arrangement with the claimant B.[16]

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15 See Hagstrøm/Stenvig, Erstatningsrett, 2014, pp 536–37 with general comments on the relationship between joint tortfeasors.

16 It could even be that gross negligence on A's part would lead to contractual exclusion from liability being held invalid or – to the same effect – that A would be deprived of invoking an otherwise contractual right of indemnity against B. Such matters belonging to the contractual sphere between A and B should arguably not be allowed to affect the non-contractual position of T.

The point here is not to render a final view on this type of arguments – which could well be more extensive than those raised here – but to illustrate what might be open to discussion, and perhaps with an indication that T's claim for contribution against A would have fairly good prospects of success.[17]

d) A's claim for contractual indemnity against B

Assuming that A is held liable for a pro rata contribution towards T's liability to B, A would seek to be held contractually indemnified by B. The outcome of this would of course depend on the construction of the relevant provision. Generally, however, it should be noted that this type of indemnity for liability towards a joint tortfeasor, is not what is typically contemplated by knock-for-knock indemnity provisions. As mentioned in chapter 2 above, the typical situation would consist of A being sued for having caused damage to parties within the charterer's – B's – group (his personnel or subcontractors) who are not privy to the knock-for-knock agreement. Whether the relevant provision is wide enough to also cover our type of indemnity for A's contribution to a joint tortfeasor relating to damage to B's property, would depend on the relevant term. Presumably the wording in Supplytime clause 14 would be wide enough in this respect.[18] However, there may be policy reasons for adopting a

[17] This would however again depend on the outcome of d) below: there would be little point in allowing T to claim contribution from A if this claim were in the end to end up with T via B.

[18] Under the clause the charterer (B) is obliged to indemnify the shipowner (A) in respect of *"all claims costs, expenses, actions … demands, and liabilities"* (lines 416–417). "Liabilities" is here probably not intended to cover liabilities incurred by A by reason of B's claim for damages against a third party tortfeasor but the wording may nevertheless be deemed wide enough to allow such a recourse claim, in that the stated indemnity is granted for: *"... all claims ... actions ... demands, and liabilities whatsoever arising out of or in connection with such loss, damage, .."* (line 417–18), that is: *".. loss of or damage to ... anything towed ..., the property of the charterers or their contractors .."* (lines 403–6). Other knock-for-knock contracts may have slightly different wording but lead to the same type of question of construction, see for example Towcon 2008 clause 25 (ii) which, firstly, sets out what claims may not be directed by the Hirer against the Tugowner: *"(1) Loss or damage of whatsoever nature, howsoever caused to or sustained by the Tow, (2) Loss or damage of whatsoever nature, howsoever caused to or suffered by third parties or their property by reason of contact with the Tow or obstructions created*

restrictive construction, by taking into account the potential negative effects on B's tortious rights against T, as illustrated under U.S. law, below.

e) B's claim for recovery against T of B's costs in indemnifying A

Assuming A were to succeed with his contractual indemnity claim against B, B may seek to recover this liability/loss as part his overall recoverable losses against T. In that respect, B may argue along the lines that it follows from recognised principles of tort law that a tortfeasor will have to take the claimant as he is, that is to say, with his loss suffering propensity, restricted only by the ordinary principles of foreseeability and remoteness.[19] B might in this respect argue that the fact that an injured party (B) is bound up in a contractual position – through knock-for-knock provisions or the like – requiring him to indemnify a (contractual) joint tortfeasor (A), is not unforeseeable to such an extent that T should not have to cover it as part of the overall losses suffered by B.

T would probably disagree and argue that this type of indirect loss incurred by B is part of B's contractual arrangement, for which B himself must bear the risk. The argument would be similar to those discussed above: in the same way as it would not be open to A and B, subsequent to an event, to enter into an agreement whereby the entire liability is thrown upon one of several tortfeasors, so must the situation also be assessed when this type of agreement is made beforehand. T would probably also point to the fact that the doctrine of having to accept a claimant "as he is", is intended to apply to the assessment of losses caused to a claimant in the first place, and not to whatever knock-on effects which may depend on the construction of contractual provisions for indemnity rights, etc.[20]

by the presence of the Tow. …." – and, secondly, provides for recourse rights, in that: "*The Hirer will indemnify the Tugowner in respect of any liability adjudged due to a third party … arising out of any such loss or damage …*".

19 See a general account of so called financial fragility (økonomisk sårbarhet), Hagstrøm/Stenvig, Erstatningsrett, pp 416–19. See also Falkanger/Bull, Sjørett, pp 212–13 raising the question of how to assess a claimant's recoverable consequential losses involving contractual positions pertaining to his ship.

20 For example A and B would probably be minded to "agree" to a construction of an indemnity provision in A's favour if the consequence of it were to transfer the burden to a third party T.

Moreover, if B were to succeed with claiming this type of loss against T, it would not mean an end to the mentioned "recourse roundabout"; T would in turn presumably claim that his liability for this loss is subject to his right of pro rata recourse against his joint tortfeasor A, as discussed in a) above.

f) Some procedural aspects

So far the discussion has revolved around a case in which the various claims and recourse claims are made part of one and the same legal proceeding, involving a tension between contractual and tortious recourse rules which lead to a potential "recourse roundabout" with no obvious solution. In this respect it may be worth adding a procedural aspect which, depending on the circumstances, would prevent this type of dilemma from occurring. Hence, if T were to be held liable for B's entire losses in an ordinary bi-partite proceeding between B and T,[21] and T in a subsequent proceeding were to successfully claim pro rata contribution against A, and A in a still subsequent proceeding were to successfully claim contractual indemnity against B, B would normally not be in a position to reopen his case against T to claim additional damages consisting in those for which he has had to indemnify A.[22]

To what extent such procedural considerations should be capable of affecting the outcome of the substantive question relating to the said "recourse roundabout" in a tri-partite dispute, is perhaps an open question. Little seems to have been discussed general in legal doctrine.[23] If anything, such procedural considerations do seem to point in the direction of not allowing B's claim (consisting in his indemnification of A) to succeed against T.

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21 Such splitting up of the proceedings may have several reasons, for example that the various claims are subject to different jurisdictions, or that relevant evidentiary aspects are revealed too late to have all parties joined in the same proceedings.

22 At least this appears to be so under Norwegian law, see the Civil Procedural Code section 31-5, cf. section 19-15. See also considerations by Brækhus, Tvister i flerleddede ansvarsforhold, published in Sjørett, voldgift og lovvalg. Artkler 1978–1988, Oslo 1988, pp 180–181.

23 Apart from Brækhus, ibid.

4 A detour with a look to U.S. law

The point of the above case study was to illustrate a dilemma resulting from a situation of asymmetry between liability rules in tort and contract, and the need to somehow put an end to what may be labeled a "recourse roundabout". We mentioned initially that within the area of collision between ships, the said dilemma has been resolved by providing a cargo claimant with a mere pro rata claim for damages against joint tortfeasors. In our case study, the assumption has however been that we are outside the scope of the collision rules and that there are not sufficient grounds for applying these rules by analogy.[24] We have presented the dilemma in a way which may be formulated: What set of rules is to prevail – those of contract or of tort?

When put in this way, it may be of interest to look to U.S. law. The U.S. has not ratified the Collision Convention, hence U.S. law operates with ordinary tort rules of joint and several liability in both-to-blame ship collision cases, allowing a cargo claimant to recover his full losses against the noncarrying ship.[25] The question of recourse rights under U.S. law has however created a fair amount of controversy which may be worth equally considering under Norwegian law.

When the exception for navigational fault was introduced in the Harter Act of 1897, this entailed a statutory exception to the common law position of strict liability for cargo damage on the part of the carrier. Moreover, case law pre-dating the Harter Act had to a large extent in-

[24] A separate topic is to what extent there is room to apply the ship collision rules by analogy to cases with factual aspects resembling those of a collision. There may be a fine line between e.g.: a) situations of collision without contact (uegentlig sammenstøt) falling within Maritime Code section 161; see the examples from case law referred to in Falkanger/Bull Sjørett p 203, and b) situations of towage of ships where the tow (which may be a "dead ship") comes into contact with a third party ship, and c) our case of a tow consisting of seismic equipment coming into contact with a third party ship. In this latter respect, see the Norwegian Supreme Court case the Uthaug (ND 1973.1268) where submerged gear of a fishing trawler was damaged by a submarine but with no indication that the ship collision rules were applicable.

[25] The carrying ship would, also under U.S. law, be protected by liability exception for navigational fault, hence cargo would want to claim against the non-carrying ship.

validated, on grounds of public policy, contractual provisions in cargo documents (bills of lading) purporting to exclude the carrier's liability for negligent acts by his servants, such as negligent navigation by the officers onboard. The Harter Act, and later the U.S. Carriage of Goods Act (COGSA), implementing the Hague Rules, formed a compromise between the interests of the cargo side and the carrier side: the carrier was exempt from liability for navigational fault by the ship's officers and crew, while the obligation to exercise due diligence in procuring a seaworthy ship could not be derogated from by contract.[26]

This background is of some importance, since in the earliest U.S. cases of both-to-blame collisions, the non-carrying ship – having under regular tort rules paid full damages to the cargo onboard the carrying ship – was held entitled to recover a pro rata contribution from the carrying ship, irrespective of the fact that the carrying ship was thereby put at a detriment as compared to his contractual (and statutory[27]) position vis-à-vis the cargo. In that way, the tort rules "trumped" the contractual (and statutory) rules providing for the carrying ship's exclusion from liability for navigational fault.

Moreover, there seems to be no U.S. case law in which shipowners of a carrying ship even attempted to claim indemnity from cargo covering the shipowner's pro rata liability towards the non-carrying ship, for example on the grounds that such indemnity should be contractually implied in order to mirror the contractual (and statutory) position of the carrying ship not being liable towards the cargo in case of navigational fault. In other words, the privilege of exception from liability by navigational fault by the carrying ship was considered "a shield, not a sword".[28]

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26 See the general account given in Falkanger/Bull, Sjørett, pp 253 et seq.

27 Through the Harter Act / U.S. COGSA.

28 There is some parallel here to the Norwegian Supreme Court case the Vestkyst I (ND 1961.325). In the Vestkyst I the shipowner had paid damages for cargo shortage to third party bill of lading holders, by virtue of the mandatory provisions of the Maritime Code. The shipowner tried, unsuccessfully, to claim indemnity for this third party liability against the voyage charterer, on the basis that had the charterer suffered this kind of cargo damage, the shipowner would not have been liable by virtue of an exclusion clause in the relevant voyage charter; the exclusion clause was thus considered to be "a shield, not a sword". The Vestkyst has been criticised on this point, see e.g.

Unsurprisingly, this legal position prompted the shipowners to introduce standard terms in their cargo documents (bills of lading) providing for an express right of indemnity towards cargo, covering whatever pro rata liability the carrier had had to incur towards a non-carrying ship in both-to-blame collision cases. The validity of this type of contractual indemnity provision was tested before the courts and eventually held to be invalid by the U.S. Supreme Court in the Esso Belgium case of 1952.[29] The case is of interest since it was essentially decided on the basis of policy consideration. In response to the shipowner's argument that a provision for indemnity ought to be allowed as the mirror image of the shipowner's right under the Harter Act (and the US COGSA) to exclude its liability for navigational fault, the majority stated:

"It is said to be 'anomalous' to hold a carrier not liable at all if it alone is guilty of negligent navigation but at the same time to hold it indirectly liable for one-half the cargo damage if another ship is jointly negligent with it. Assuming for the moment that all rules of law must be symmetrical, we think it would be 'anomalous' to hold that a cargo owner, who has an unquestioned right under the law to recover full damages from a noncarrying vessel, can be compelled to give up a portion of that recovery to his carrier because of a stipulation exacted in a bill of lading.

Falkanger/Bull Sjørett p 383, referring to the Jobst Oldendorff (ND 1979.364) in support of the view that the Supreme Court in the Vestkyst placed too high a demand on the explicit nature of a shipowner's contractual indemnity right, and indicating that such an indemnity right may impliedly follow from the doctrine of "liability following function", as applied in the Jobst Oldendorff. However this parallel between the two cases seems somewhat misplaced: in the Jobst Oldendorff the said doctrine applied since the relevant event – personal injury suffered by a longshoreman – occurred during the "function" (responsibility) of the time charterer in discharging the ship's cargo. Hence the (arbitrary) fact that the shipowner was held liable in the first instance towards the third party longshoreman, should not bar the shipowner from claiming such liability indemnified by the charterer, based on implied terms of "liability following function". In the Vestkyst, on the other hand, the cargo claim was clearly occasioned by the shipowner's "function" (responsibility) of carrying the goods; there being a mere question of contractual exclusion from liability of what followed from such "function". Moreover, the Vestkyst decision as analysed in the Jobst Oldendorff does not seem to lend support to the doctrine of "liability following function" being applied to cases involving contractual exclusions from liability.

[29] 1952 AMC 659.

Moreover, there is no indication that either the Harter Act or the Carriage of Goods by Sea Act was designed to alter the long-established rule that the full burden of the losses sustained by both ships in a both-to-blame collision is to be shared equally.30 Yet the very purpose of exacting this bill of lading stipulation is to enable one ship to escape its equal share of such losses by shifting a part of its burden to its cargo owners. […] If that rule [of sharing the burden equally] is to be changed, the Congress, not the shipowners, should change it."31

The dissenting vote disagreed that there was any justifiable need to set aside such an indemnity provision which was agreed between professional parties, and favoured instead an expansive reading of the Harter Act and COGSA liability exceptions to allow for contractual indemnity addressing situations of navigational fault – in order to achieve the stated symmetry of law:

"*To revive notions of public policy which Congress rejected in 1893 [the Harter Act liability exception for navigational fault], disregards the appropriate considerations that governed application of the Harter Act in the earlier decisions. To derive from a statute, which relieves a ship entirely of liability to cargo when the ship is wholly to blame for the loss, an implied restriction against a voluntary arrangement for relief from liability when the ship is only half to blame, is surely an odd use to which to put such a statute. When this Court does fashion a rule of public policy it ought to be less perverse and illogical than that in its operation*."[32]

Consequently, the essence of the U.S. law position, following the reasoning of the majority in the Esso Belgium, is that the tortious privilege of cargo to hold the noncarrying ship liable for the entire losses, should not be allowed to be curtailed by a portion of those losses coming back to cargo via tortious recourse actions and contractual indemnities. The minority, on the other hand, took as a starting point the already existing liability exception of the carrying ship vis-a-vis cargo, and found no

30 By tortious rights of contribution on a pro rata basis.

31 P. 662–63 of the judgment.

32 P. 668 of the judgment.

policy considerations militating against the carrying ship being allowed a corresponding right of indemnity.

5 Comments on the U.S. law position from a Norwegian perspective

From a Norwegian perspective, the above detour into U.S. law may perhaps be said to be of limited value, since we do not share the U.S. starting point of joint and several liability in both-to-blame collision cases. Nonetheless, as a means of illustrating the issue of a tension between tortious and contractual liability rules and the dilemma of recourse "roundabout", the detour is of some value. In the following paragraphs, we shall comment on the U.S. considerations from a Norwegian perspective, first by looking at the position within the law on ship collision cases, and then at the position outside of it.

Since Norway has adopted the Ship Collision Convention providing cargo with a mere pro rata claim for damages in both-to-blame situations, the considerations of public policy which motivated the majority decision in the Esso Belgium, have no parallel under Norwegian law. With such a pro rata remedy, cargo is deprived of the right to claim its full loss from the non-carrying ship. Moreover, the potential pro rata remedy against the carrying ship under Norwegian law usually leads to this portion of the loss having to be borne by cargo, due to the carrying ship's liability exclusion for navigational fault. If, exceptionally, a both-to-blame situation were not to involve navigational fault, for example where the fault of the carrying ship is attributable to initial unseaworthiness, the effect of the pro rata rule would not be to avoid an otherwise difficult recourse round, but merely to deprive cargo of its right otherwise to claim against each tortfeasor for its full losses.[33] The considerations by the majority in

[33] This situation does however entail some complicating aspects. As a starting point cargo may perhaps be entitled to claim its entire loss based on *contractual* liability rules against the carrying ship: if there are concurrent causes for which different

the Esso Belgium would therefore not apply under Norwegian law, and this could well have the effect that a U.S. law invalid indemnity provision in a both-to-blame clause becomes enforceable under Norwegian law, if jurisdiction for such indemnity claim were to be found here.[34]

Outside of the ship collision rules, Norwegian law takes the same starting point as U.S. law: the claimant – B in our above example – may claim on the basis of joint and several liability. If in such a situation B recovers its full losses from T based on tort, and T recovers pro rata contribution from A as joint tortfeasor, and A in turn has a contractual right of indemnity against B, there should be no reason to strike down such a contractual indemnity right as being invalid. There are several factors which here depart from the above finding of invalidity under U.S. law.

First, there is no similar pre-Harter Act doctrine of invalidity of contractual exclusions from liability as under U.S. law. Instead, the question of invalidity of a contractual indemnity right would, under Norwegian

tortfeasors are liable, a claimant is generally entitled to consider each tortfeasor as having caused the damage, subject to reservations of "de minimis" causal contribution (uvesentlighetsreservasjonen), see e.g. Hagstrøm/Stenvik, Erstatningsrett, p 363–64. In our example of cargo damage, there is on the other hand the special causation rule in the Maritime Code section 275 third paragraph, allowing the carrier to exculpate himself for that portion of damage not attributable to his fault. This rule is however aimed at situations where discernable parts of cargo damage can be traced back to separate causes, rather than our type of both-to-blame collision where separate causes have contributed to one and the same damage, see the discussion in Falkanger/Bull, Sjørett, p 274. Moreover, assuming that the owner of the carrying ship were to be held *contractually* liable for the entire cargo damage (due to exclusion from liability for navigational fault not being applicable and the said considerations of causation), he would presumably be entitled to claim pro rata contribution from the noncarrying ship, irrespective of the fact that a claimant who suffers the initial/direct loss has a mere pro rata remedy against each joint tortfeasor, see Maritime Code section 161 fourth paragraph, cf. third paragraph.

[34] Falkanger/Bull Sjørett p 208, with reference to ND 1974.155 Simba. Similar questions have arisen under insurance law, see ND 1936.237 Terje, as commented on in Falkanger/Bull Sjørett p 514: Following a both-to-blame collision in U.S. waters, cargo onboard the carrying ship successfully claimed its entire loss against the noncarrying ship and the latter was, under U.S. law, awarded pro rata contribution against the carrying ship. The terms of the carrying ship's H&M insurance did not cover cargo claims and such lack of cover was held to apply also to "indirect cargo claims" coming via the noncarrying ship's tortious claim for contribution under U.S. law.

law, have to be testeed against general censoring standards against unfair contract terms.[35] And in that respect, there should be no policy reason for rendering such an indemnity provision invalid, since the Norwegian legislator has acknowledged that a cargo claimant's (B's) tortious rights may be curtailed by a mere pro rata remedy (in both-to-blame situations). Such curtailment combined with a recognition of a shipowner's (A's) right to exclude his liability for nautical fault, may lead to the very result which the majority in the Esso Belgium held to be untenable. Although we here test out the reasonableness of A's contractual indemnity rights outside the scope of ship collision rules, the fact that such indemnity rights are recognised within the scope of those rules, clearly means that they are not as such in conflict with considerations of public policy.

Second, and to the same effect: since a shipowner's (A's) right to contractually exclude himself from liability for navigational fault is recognised under Norwegian law,[36] there would be no policy consideration against applying the same thinking to a contractual indemnity right mirroring such a result.[37] The thinking from a Norwegian perspective would therefore be in line with that of the dissenting vote in the Esso Belgium.

Moreover, a right of indemnity combined with a right of exclusion from liability in a knock-for-knock provision, such as that of Supplytime, would arguably be even less prone to criticism from a public policy perspective than the corresponding set of rights within the scope of the Maritime Code / Hague Visby Rules. The knock-for-knock liability regime is designed to operate equally in favour (or to the disfavour) of either party, as opposed to the unilateral liability exclusion in the shipowner's favour under the Maritime Code / Hague Visby Rules.[38]

35 As in the Formation of Agreement Act section 36.

36 Maritime Code section 276, implementing the Hague Visby Rules.

37 That is however a different topic from what is discussed in footnote 27 above concerning whether such indemnity right should be implied from the mere fact that there is an express liability exclusion right.

38 The fact that the knock-for-knock regime is designed to operate mutually does of course not exclude its unilateral effect when applied to a given set of facts; hence there may be a questions around setting aside its exclusionary/indemnifying effect, for example if damage is caused by gross negligence, see e.g. the discussion in Monika

6 Concluding remarks

If we now return to our case study of seismic tow and the dilemma of a "recourse roundabout", the following reflections may be made after this detour into U.S. law:

Assuming that our case lies outside the scope of the ship collision rules, there would be a right of joint and several liability under general tort rules, meaning that B could claim his full losses against T. T would in turn be entitled under tort rules to claim pro rata contribution from A. A would then – unlike under U.S. law and the Esso Belgium case – be entitled to claim contractual indemnity from B.[39] We then again end up with the question of whether B – having been obliged to bear a pro rata part of his own losses – can claim this as part of his overall losses against T. We have intimated that this would not be the case, and on this point it seems that our visit to U.S. law would not change the position. It could perhaps be said that the policy considerations of not curtailing B's tortious privilege against T should lead to a different result. However, the U.S. law position does not aim to resolve this type of question. Rather it aims at resolving the "roundabout dilemma" by refusing A a right of contractual indemnity against B by invalidating such indemnity provision, an alternative which is not viable under Norwegian law.

Magdalena Zakk, Ansvarsregulering i borekontrakter, MarIus no. 415 2013, pp 46 et. seq. with further references. Moreover, the Hague Visby Rules may perhaps be said to be balanced if viewed against their historical background of striking a balance between shipowners' strict liability for unseaworthiness under common law, and the earlier prevailing use of shipowner-friendly liability exclusion clauses.

[39] Another issue is that such indemnity provisions could well subjected to restrictive construction, on the basis that this type of indemnity is not what is primarily contemplated by the provision, see chapter 3 d) above.

Historic shipwrecks – contemporary challenges:

Protection of the underwater cultural heritage

By professor Alla Pozdnakova

Content

Significance of UCH and the need for international protection

This paper discusses legal issues pertaining to the international protection of the underwater cultural heritage ("UCH") against activities directed at the exploration and recovery of such heritage from the seabed, especially historic shipwrecks and artefacts on board such shipwrecks. This so-called treasure hunting or other, not mercantile but nonetheless harmful activities aimed at recovery of historic objects from the seabed, are not necessarily unauthorized or illegal. As we shall see, in many cases such activities can, at most, be defined as undesirable from the perspective of the need to preserve UCH for the mankind, but they remain legal from both a national and international law perspective.

The pace of law-making and enforcement in the field of UCH has not kept up with the development of technology facilitating recovery of UCH from the seabed, starting with the invention of the aqualung in the 1940s. As a result, an unknown number of historic shipwrecks, lying in waters accessible for divers, have become subject to unregulated recovery by private individuals or organisations. Unfortunately, the Baltic Sea has not been an exception in this regard.

This paper gives special attention to protection of UCH in the Baltic and Scandinavian region[1]. Baltic and Scandinavian States have a rich maritime history, both as maritime nations and also as coastal States in whose waters active commercial and naval navigation has been taking place for a long time. This history is evidenced by numerous finds of shipwrecks and related artefacts, dating back to the Vikings. These objects need to be appropriately protected, due to their historical, cultural and, as the case may be, material value.

It should be mentioned that UCH can be located, not only on the seabed, but also in inland waters. Lakes, rivers and coastal waters of the

[1] The paper is based on my presentation at the Summer School in Riga, 2016, organized by the Riga Graduate School of Law (the host), in cooperation with universities in the Baltic and Scandinavian States, including Norway (University of Oslo).

Baltic and Scandinavian States hide not only shipwrecks but also other types of archaeological heritage in their depths, such as lake dwellings and remains of now submerged coastal sites dating back to the Stone Age. For example, in Lithuania and Latvia some of such pre-historic sites have been discovered and restored.[2] An unknown number of submerged historic objects lie as yet undiscovered under the sea and risk being collaterally destroyed by human activities if no adequate research is conducted before launching any major works on the seabed.

Since the underwater cultural heritage faces many of the same threats as its counterparts located on land, general UNESCO instruments may provide in part for a protection mechanism. Thus, the "*UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property*" (1970), the "*UNESCO Convention for the Protection of the World Cultural and Natural Heritage*" (1972) and the "*European Convention on the Protection of Archaeological Heritage*", 1992 (Valletta Convention) by the European Council may also be deemed to apply to underwater objects. However, they do not set up a comprehensive regulatory framework for UCH, which would address specific challenges pertaining to the protection of UCH.

Different States have very different approaches to the protection of UCH from such activities as treasure hunting. International law does not, in principle, lay down an absolute prohibition on exploring the seabed in search of historic objects, and does not totally outlaw recovering and taking possession of such objects. As examined in this paper, the existing international restrictions on such activities mainly arise from the exercise of sovereign rights by States: thus, coastal States exercise such rights in their maritime zones (as a rule within the limits of territorial waters) and flag States with respect to shipwrecks which flew their flag, especially

[2] See, e.g.,F. Menotti, Z. Baubonis, D. Brazaitis, T. Higham, M. Kvedaravicius, H. Lewis, G. Motuzaite Ande Pranckenaite, "The first lake –dwellers of Lithuania: late bronze age pile settlements on lake Luokesas". Oxford Journal of Archaeology 24(4) 381–403 2005(available at academia.eu). Araishu lake in Latvia is yet another example. See also Ø.Hammer, S.Planke, A.Hafeez, B.O. Hjelstuen, J.I. Faleide & F.Kvalø, Agderia – a postglacial lost land in the southern Norwegian North Sea, Norwegian Journal of Geology, Vol 96 Nr. 1 (2016).

sunken naval and governmental vessels. However, international law is not fully codified on this matter, and States do not always share the same view on the customary international law in the field of UCH.

In the absence of a comprehensive international mechanism, national laws are, in practice, very important. States' approaches to historic shipwrecks are not uniform. At the domestic level, some States prohibit or limit the recovery (finding, salvage) of historic shipwrecks by private persons, and commercial exploitation of the UCH, whereas other States allow private persons to 'salvage' historic shipwrecks, or at least do not provide for an outright prohibition of such activities.

Such diversity of national approaches may be explained by several factors, including different national interests in the field of UCH. Thus, dominant maritime States may claim title to many shipwrecks around the world and would object to coastal States claiming sovereign rights to all wrecks which sank near their coasts. Coastal States, including former colonies, may have other, or even directly opposite, interests from those of the flag States of the sunken vessels. A good example of the variety of interests in a historic shipwreck and its cargo is the case involving a Spanish frigate *Nuestra Senora de las Mercedes*. In this case, the historic flag State of this ship (Spain) and the State of origin of treasures on board (Peru) had quite different perspectives on the rights to these objects.[3]

General distinctions between legal systems may also influence the way that different States treat the protection of UCH in their domestic maritime and private law systems. Thus, common law countries have traditionally strong admiralty laws and are generally more sympathetic towards the application of salvage rules to UCH than continental legal systems. It may be possible for a private enterprise to claim a salvor's reward for a find and recovery of a historic shipwrecks and artefacts from the seabed. However, several cases in the US courts, such as those related to the find of RMS *Titanic,* illustrate that the traditional maritime law approach does not take sufficient account of the need for special regulation of the historic shipwrecks. The inappropriate legal framework has caused many problems in relation to the preservation of important

[3] See footnote 14.

historic objects, especially those located in international waters open to free navigation.

The dissimilarities between national approaches may also be explained by varying degrees of awareness, experience and financial resources in the field of protection of UCH, which accordingly influences national legislative initiative and enforcement in this field.

In any case, a purely domestic approach to the protection of the historic shipwrecks is not sufficient. The international character of the problem requires a correspondingly international and even global approach to its regulation. The insufficiency of a domestic approach can be illustrated by the following example: a company based in a State with strong maritime salvage traditions may search for historic objects on the seabed of the high seas and place a claim for reward in that State, irrespective of the fact that rights to the shipwreck may be asserted by a (third) flag State which did not authorise recovery of the shipwreck. The rights to treasures on board may be claimed by yet another State – the State of origin of these treasures. In such cases, it would make sense to have an international framework in place, instead of leaving it to national law to determine the rights of the parties involved.

Furthermore, it would also be beneficial to adopt a uniform view on what kind of protection should be applied to UCH and to harmonise the concept of UCH by agreeing on the principal rules as to which objects are of sufficient value to be preserved as cultural heritage.

It has taken several decades of internationally unregulated recovery of UCH for international multilateral regulation to be adopted.

The *"UN Convention on the Law of the Sea"* adopted in 1982 (UNCLOS) lays down only two provisions addressing the duty to protect UCH, but it remains the most important international instrument for the protection of the UCH, due to its wide acceptance by the States. Still, UNCLOS has not been ratified by some of the countries which play a significant role in the field. These are: the USA, which is a forum for salvage claims, as well as Colombia and Peru, i.e. coastal States in whose waters there may be historic shipwrecks and artefacts originated in those States.

As discussed in more detail below, the general character of obligations laid down in UNCLOS leaves too great a margin of flexibility to the State Parties and does not resolve issues surrounding the uncontrolled recovery of UCH from the seabed.

The "Convention on the Protection of the Underwater Cultural Heritage" adopted by UNESCO in 2001 (hereinafter the 2001 UNESCO Convention) entered into force in 2009, but to date has not gained broad acceptance in the Baltic and Scandinavian region. At the time of writing, only Lithuania has ratified this convention.[4] In addition, other States around the world have not ratified the 2001 UNESCO Convention, including, remarkably, such States as the USA, Australia, Colombia as well as the UK and the Netherlands (the latter are important "market" States for UCH). By comparison, UNCLOS has been ratified by all Baltic and Nordic States and by many States around the world, so that in practice UNCLOS remains more important for the regulation of UCH than the 2001 UNESCO convention.

It should be pointed out that the 2001 UNESCO Convention is more important for regulating activities relating to UCH than may appear from its ratification status. For example, some non-party States such as Norway have unilaterally applied UNESCO's "*Rules on the Activities Directed at the Underwater Cultural Heritage*" laid down in the Annex of the 2001 Convention.

The 2001 UNESCO Convention goes much further than UNCLOS in the development of the protection framework, and pays particular attention to the protection of UCH located in seas and oceans, where specific issues arise of an international character. This convention targets activities directed at the UCH, including recovery and preservation of such objects[5].

Although some "general" cultural heritage instrument conventions explicitly refer to the "underwater cultural heritage", they do not define

[4] i.e. in the Baltic and Scandinavian region. For ratification status, see UNESCO website: http://www.unesco.org/eri/la/convention.asp?KO=13520&language=E&order=alpha

[5] Some of the principles laid down in the 2001 UNESCO Convention were developed by the International Council of Monuments and Sites in its Charter on the Protection and Management of Underwater Cultural Heritage (1996).

UCH. UNCLOS also only refers to "archaeologic, historic and cultural objects at sea". The 2001 UNESCO Convention lays down a definition of UCH. Article 1(1)(a) thereof defines UCH as follows:

> "1. (a) "Underwater cultural heritage" means all traces of human existence having a cultural, historical or archaeological character which have been partially or totally under water, periodically or continuously, for at least 100 years such as:
>
> (i) sites, structures, buildings, artefacts and human remains, together with their archaeological and natural context;
>
> (ii) vessels, aircraft, other vehicles or any part thereof, their cargo or other contents, together with their archaeological and natural context; and
>
> (iii) objects of prehistoric character."
>
> Article 1(1)(b) and (c) excludes pipelines and cables placed on the seabed, as well as installations other than pipelines and cables, where placed on the seabed and still in use, from the definition of UCH.

The UNESCO definition has been criticised for being too broad and unclear, in particular because it does not differentiate sufficiently between objects older than 100 years which are worthy of special protection and those which are not (which could be done by introducing additional criteria, for example, "significance"). Such criticism is, in my view, not entirely justified. The UCH is actually defined relatively precisely, while leaving considerable discretion for individual States Parties. These States are also free to extend their protection to the objects not meeting the criteria in Article 1, which is designed as a minimum provision. States are thus free to introduce stricter requirements, provided these are compatible with the UNESCO Convention and other obligations of international law[6].

[6] Operational Guidelines for the Convention on the Protection of the Underwater Cultural Heritage.

Several important implications for State Parties follow from the fact that a shipwreck or another submerged object falls within the UNESCO definition. As a general note, State Parties must ensure that any such object comes under the protection of the 2001 UNESCO Convention regime, which is set out in both the further provisions of the 2001 Convention and in its Annex (Rules Concerning Activities Directed at Underwater Cultural Heritage).

Importantly, the Convention aims at preserving the UCH for the benefit of the mankind. It follows from this that States Parties have a duty to cooperate to protect UCH, to take all necessary measures in compliance with the Convention and international law to protect UCH by the best practicable means, and a duty to protect against activities directed against UCH, as well as from collaterally damaging activities.

Although this may sound like a noble objective to pursue, not all States share the same views on the common heritage of mankind, since in practice implementing this objective means that States undertake to restrict their own national interests in several significant ways.

The 2001 UNESCO Convention requires that *in situ* preservation is to be applied as the first (albeit not exclusive) option. Imposing such an option may lead to objections being raised for a number of reasons, including financial ones, as well as causing problems due to lack of adequate knowledge and experience, and limitations on the commercial use of the UCH implied by such approach. For example, Colombia does not agree with the approach of the UNESCO Convention, arguing that the Convention "*makes the recovery of artifacts from historic wrecks virtually impossible for developing nations*" because it does away with traditional maritime law concepts of finds and salvage.[7] In the Baltic Sea, the Swedish battleship *Wasa* is one of few examples of lifted shipwrecks. Many others are preserved *in situ*.

[7] Daniel De Narvaez, "The UNESCO Convention for Protecting Underwater Cultural Heritage: a Colombian Perspective" in Stemm, Greg and Kingsley, Sean (eds), *Oceans Odyssey 2. Underwater Heritage Management&Deep-Sea Shipwrecks in the English Channel&Atlantic Ocean*, at p.24.

Importantly, the UNESCO Convention imposes a prohibition on the commercial exploitation of UCH, which includes sales and purchase, barter of UCH. Another very significant limitation introduced by the Convention applies to salvage and finds of UCH. As explained further in this article, application of salvage and finds law to UCH is precluded unless undertaken in accordance with certain conditions specified in the Convention. Thus, the litigations in *Mercedes (Odyssey Marine Exploration)* and the *Titanic* cases (see next section) would not be possible for a State party to the 2001 UNESCO Convention.

In addition, the 2001 Convention also imposes a duty on States Parties to take measures to prevent entry, dealing, possession of illicitly exported UCH and UCH recovered in a way contrary to the Convention. The latter requirement also has major practical implications for States which are not Parties to this Convention, because it apparently includes also those objects defined as UCH, which are found or salvaged under 'traditional' find and salvage rules in non-Party States.

States Parties must also prohibit using their territories for unlawful activities directed at UCH. As discussed further, a range of obligations are imposed on nationals and vessels flagged in a State Party, and breach of such obligations will result in the imposition of proportionate sanctions.

Last but not the least, the 2001 UNESCO Convention establishes a dispute settlement mechanism for cases involving the UCH which complements the comprehensive dispute settlement mechanism set up in UNCLOS (the latter not addressing UCH).

The above discussion gives a general idea of why many States have chosen not to become parties to the 2001 UNESCO Convention. In the next sections I will take a closer look at the issues raised by the 2001 UNESCO Convention, in light of the international and the Baltic-Nordic perspective on the protection of UCH.

Historic shipwrecks – implications of law of salvage and finds

It is easy to imagine the excitement of finding an ancient shipwreck full of gold or other precious artefacts, but are private persons permitted to search for historic objects on the seabed and take possession of them? Can one claim finder's reward or assert property rights to historic objects, as could generally be the case with lost or abandoned property? Is it generally appropriate to apply private law concepts such as possession and ownership to the case of UCH? Furthermore, should marine salvage law apply to the recovery of historic shipwrecks and artefacts?

There is no common position among States on these questions and, as yet, no uniform international regulation of these aspects of the legal status of UCH.

The application of marine salvage law to UCH raises a number of complicated issues. On the one hand, marine salvage is a recognised business and this may encourage companies to invest into expensive and technologically advanced equipment necessary to explore and recover UCH from the seabed. The costs pertaining to underwater activities are high and not all States (or private owners, as the case may be) are willing or able to cover them.

On the other hand, it is highly questionable whether salvage law should apply to historic shipwrecks and UCH generally, as it may motivate "treasure-hunters", encourage the unnecessary or dangerous recovery of historic objects from the seabed (instead of preserving *in situ*) and disregard the special importance of the UCH as a heritage of the mankind. An understanding that traditional maritime law concepts may not take sufficient account of the special situation of UCH has arisen from several litigations, illustrating the tension existing between private interests of finders such as financial reward and the need to protect UCH for the common interest.

The 1989 International Convention on Salvage allows States to exclude application of this Convention to property which is "*maritime cultural*

property of prehistoric, archaeological or historic interest and is situated on the sea-bed"[8]. Some States have made use of this option to ensure that UCH is not subject to general marine salvage rules[9].

UNCLOS addresses the protection of cultural heritage at sea, but emphasises that it does not interfere with the rights of identifiable owners as well, or with the rights of salvors of such heritage: "*Nothing in this article affects the rights of identifiable owners, the law of salvage or other rules of admiralty, or laws and practices with respect to cultural exchanges*" (Article 303(3)).

Article 303(3) of UNCLOS can only be understood as leaving it to the domestic law to resolve the question of property rights and, as the case may be, the claim of reward by the finder of UCH.

The 2001 UNESCO Convention introduces provisions limiting the application of the law on salvage and finds to UCH (i.e. it imposes a positive obligation on States Parties to enact corresponding provisions in their national laws)[10]. This Convention in practice precludes application of finder's rights and traditional marine salvage of UCH, by imposing very stringent requirements on such activities. Thus, Article 4 requires that any salvage or find of UCH must be authorised by competent (national) authorities, performed in full conformity with the UNESCO Convention requirements and maximum protection must be ensured for the recovery of UCH.

Even if the State authorises such activities as the 2001 Convention requires, it may not be economically feasible for private persons or commercial salvors to comply at least with the second requirement of Article 4, since the Convention and the Annex containing Rules set the standards very high. Among others, the Rules require the development

8 Article 30(1)(d).

9 For example, Latvia has done so: Maritime Code Article 254(4) excludes application of salvage law to "ships and objects which have cultural historic value".

10 The law of marine salvage regulates the rescue of property in danger at sea. The law of finds regulates rights to lost or abandoned property (i.e. shipwreck and objects on board) which has been found. For a more detailed discussion on the law of salvage and finds in the context of UCH (in the common law countries) see Sarah Droomgole, Underwater Cultural Heritage and International Law, Cambridge University Press (2013), p.167 et seq.

of a project design for the activity which is to be authorised and for it to receive appropriate peer review. Furthermore, an appropriate funding base must be secured in advance of the activity, sufficient to complete all stages of project design. In this way, the UNESCO Convention in fact precludes private salvage activities, by requiring States to enact legislation that would arguably make it unfeasible for salvors to engage into the exploration and recovery activities.

As pointed out earlier, the 2001 UNESCO Convention has not so far gained wide acceptance. Some States, including common law systems with a strong marine tradition, have a more supportive approach towards salvors' and finders' rights to salvage than the Convention allows. Several litigations in the common law jurisdictions illustrate that private companies may rely on the law of marine salvage in order to claim the salvor's award and, as the case may be, assert the finder's rights to the shipwreck and to artefacts on board which they have succeeded in locating and recovering.

Other States which also did not ratify the Convention, including Baltic and Scandinavian States, restrict the application of salvage and finds law to the UCH in their maritime zones, by prohibiting unauthorised activities directed at historic shipwrecks and artefacts on board, under a national law of cultural heritage or other *lex specialis*.[11]

A case in point from the Baltic Sea region is the *Vrouw Maria* case in Finland, in which private individuals claimed the salvor's reward as well as ownership by possession, to the shipwreck of *Vrouw Maria* and the objects which they recovered from the wreck. Their claim was dismissed, in particular because the ship, now wrecked, was in no further danger of sinking and did not need to be salvaged. The Court of Appeal in Turku concluded that both the Maritime Act and Antiquities Act applied but that the latter prevented the finders from having control and accordingly possession of the wreck.[12]

[11] E.g., Section 19(2)(1) of the Latvian Marine Environment Protection and Management Law requires that a licence or permit to be acquired before exploration of underwater cultural and historical heritage, shipwrecks and other sunken property.

[12] See Nordiske Domme (2005) p. 67 and Maija Mattika in S.Droomgole (ed.), The Protection of the Underwater Cultural Heritage. National Perspectives in Light of

In any case, such national restrictions, even if enacted, may only apply in the waters subject to the jurisdiction of the State, i.e. within the contiguous zone of maximum 24 nautical miles. Since a considerable proportion of UCH lies in the waters beyond coastal States' jurisdiction, it would also be necessary for flag States to adopt corresponding provisions regulating the conduct of their ships on the high seas. The jurisdiction of States under international law to regulate UCH is discussed in more detail further on in this paper.

In principle, the owner of the historic shipwreck or objects on board may restrict the salvage of objects for which the owner did not give consent or authorisation. The owners, or rather the successors of the original owners, may in some cases be known, but often this is no longer possible to trace. In practice, UCH has often been treated as *res nullius*, which could be freely taken into possession by its finder, without necessarily having consulted any authorities. The legal vacuum, poor enforcement or, as the case may be, little awareness, resulted in many UCH objects disappearing from their location and from the source State. The example of the Dodington coins illustrates how difficult, or even impossible, it can be to return these objects to the source State.[13]

However, it is possible in some cases to identify the owner, or at least a State which may hold a title to the shipwreck, notably a flag State. It is not certain that the objections of such an owner will trump the salvor's and finder's right to reward, even if a prior authorisation to recover the wreck was not granted to the salvor. The case of the Spanish frigate *Nuestra Senora de las Mercedes* in the US court illustrates the fact that the sovereign immunity enjoyed by naval ships precludes US courts from asserting jurisdiction over cases involving the wrecks of such ships, including salvage reward claims to objects recovered from these wrecks.[14] This case involved a shipwreck outside US waters (on the

UNESCO Convention 2001, 2nd ed. (2006), p.52, for a description of this case.

13 Craig J. Forrest, John Gribble, "The Illicit Movement of Underwater Cultural Heritage: The Case of the Dodington Coins", International Journal of Cultural Property, Vol. 11, No. 2, 2002, pp. 267–293.

14 Odyssey Marine Exploration, Inc. v. The Unidentified Shipwrecked Vessel, 657 F.3d 1159 (11th Cir. 2011) [2011 BL 240845].

Spanish continental shelf); nevertheless, the location of the shipwreck did not change the US court's position on the applicability of sovereign immunity to naval and other State shipwrecks[15].

It appears that States have a duty to protect UCH, irrespective of whether the owners are identifiable. This duty of protection held by the State does not mean that owners will be deprived of their title to UCH. In cases where there are no longer known owners, a *res nullius* situation will require a legislative solution to avoid the UCH falling into the possession of a random finder. One possible solution is for the State itself (i.e. the coastal State) both to assert ownership rights and prescribe that authorisation is necessary for any activities involving UCH. For example, Norwegian law provides for the State to acquire ownership of shipwrecks and objects on board over 100 years old, where there is no longer a reasonable possibility of finding the owner. The cargo on board historic shipwrecks was not included in the Law of Cultural Heritage (kulturminneloven) at the time of the find of the shipwreck *Ankerendam*, so the law was subsequently amended to preclude finders' claims[16].

The *Vrouw Maria* case mentioned earlier also illustrates the fact that State ownership can preclude claims arising from unauthorised recovery of the historic shipwrecks, since the State as owner can prohibit anybody from starting salvage operations.

State Jurisdiction over shipwrecks in territorial sea and beyond

The rights arising from a private law title to the UCH, such as the right of ownership or possession, should not be confused with the concept of jurisdiction over UCH, which can be asserted by a State under interna-

[15] Earlier cases involved Spanish battleships sunk in the US waters: see the Juno and La Galga cases discussed in Mariano J. Aznar-Gómez, The International Journal of Marine and Coastal Law 25 (2010) 209–236.

[16] In Latvia, the State also claims ownership to cultural heritage which is over three hundred years old, without singling out underwater objects.

tional law. The jurisdiction over UCH is basically the State's power to control the UCH located within its territory (maritime zones), including the power to regulate activities directed at UCH. Such jurisdiction may be exercised by the State through legislative, executive and judicial actions.

There is an important interplay between jurisdiction and ownership, which should be kept in mind. A State may decide to exercise jurisdiction over UCH in different ways, including regulating the issues pertaining to property rights to UCH. However, this does not mean that the State having such jurisdiction over UCH will automatically assert ownership rights over it, although examples mentioned earlier show that this is possible.

Another related issue is the duty to protect UCH located at sea. In international law, jurisdiction is generally a privilege, not an obligation, and States are not required to exercise their jurisdiction. However, UNCLOS contains Article 303: "*Archaeological and historical objects found at sea*", which provides for a general duty on States to protect historical and archaeological objects at sea and to cooperate for this purpose. In order to be able to perform this duty, States must have appropriate jurisdiction over UCH. This generally formulated obligation laid down in UNCLOS is spelled out in more detail in the 2001 UNESCO Convention.

This section examines UNCLOS provisions which shed some light on the question of State jurisdiction over historic shipwrecks and compares these provisions with the 2001 UNESCO Convention. Is it the coastal State which has jurisdiction, i.e. the State in whose maritime zones the objects are located? Or is it the State where the ship was flagged? What about States with other types of connection to the shipwreck or artefacts, such as the successor State of the historic shipowner (Dutch East India company (VOC) or the State from which the treasures on board originated (e.g. former colonies such as Peru or Columbia)?

In practice, coastal States usually assert jurisdiction over shipwrecks lying in their territorial waters. It is in any case far from certain that the flag State of a historic shipwreck could trump the coastal State's jurisdiction, in whose waters the wreck lies. A special case is sunken naval and other State ships: flag States are unwilling to yield any rights to

coastal or third States and consistently claim full title to such shipwrecks, irrespective of their location or how old they may be.

UNCLOS is a central, but not exhaustive, source of international rules of jurisdiction in the law of the sea. Importantly, UNCLOS lays down the rules on the breadth of territorial sea, exclusive economic zone and continental shelf, and regulates jurisdiction and sovereign rights of coastal States in these zones, as well as laying down rules applying to the high seas, freedoms of the high seas, international seabed, and dispute settlement mechanisms.

UNCLOS envisages the following maritime zones:

- territorial sea (up to 12 nautical miles from the baselines),
- contiguous zone (24 nm from the baselines),
- Exclusive Economic Zone (up to 200 nm from the baselines),
- Continental shelf (200 nm from the baselines, as a general rule).

In the territorial sea, foreign vessels enjoy the right of innocent passage. In the Exclusive Economic Zone (EEZ) the freedom of navigation applies, subject to the condition that the coastal State's interests must be duly respected. (As to internal waters, i.e. waters on the landward side of the baselines, States generally retain full territorial sovereignty, such that the exercise of jurisdiction is not limited by the general international law or UNCLOS.)

The Continental Shelf stretches 200 nm from the baselines.[17] Some States have claimed rights to an extended Continental Shelf beyond 200 nm in accordance with Article 76 UNCLOS. Ships enjoy freedom of the high seas on the continental shelf, limited by the relevant coastal State's rights to the natural resources of the shelf.

The seabed beyond the Continental Shelf (or the extended continental shelf) is the international seabed over which no State has jurisdiction. The international seabed (the "Area") is a common heritage of mankind and is supervised by the International Seabed Authority (ISA), established

[17] In practice, the outer limits of the EEZ and continental shelf often coincide. An important nuance must be kept in mind: not all coastal States have claimed (established) EEZ but all coastal States have continental shelf ab initio.

according to UNCLOS Part XI.[18] In the Baltic Sea, there is no international seabed at all and most coastal States have established a 12nm territorial sea and corresponding contiguous zones as well as an (200-nm) EEZ and Continental Shelf.

UNCLOS does not establish any particular jurisdictional regime for UCH in the territorial sea, EEZ and continental shelf, as UCH is not a "natural" resource. However in Article 303, UNCLOS provides for the coastal State's rights to regulate UCH in the contiguous zone, which stretches 24 nautical miles from the baselines and provides coastal States with certain jurisdiction (Article 33)[19]:

"In order to control traffic in such objects, the coastal State may, in applying article 33, presume that their removal from the seabed in the zone referred to in that article without its approval would result in an infringement within its territory or territorial sea of the laws and regulations referred to in that article."

The wording of Article 303(2) is quite confusing. In general, it does not appear to give coastal States unlimited jurisdiction over UCH located in their territorial seas and contiguous zones. It only authorises coastal States to regulate (approve) removal of UCH from the seabed in the contiguous zone and to apply enforcement powers laid down in Article 33 (Contiguous zone). Such enforcement may be undertaken to the extent it is necessary "to control traffic" in UCH.

What about other activities, not aimed at the removal of UCH from the seabed as such, e.g. the search for UCH within the contiguous zone, or underwater study visits to UCH discovered within the contiguous zone of the coastal State? Is there a difference between coastal State jurisdiction over UCH in the territorial sea (up to 12 nm) and in the contiguous zone beyond the territorial sea limit?

If Article 303(2) is read in light of the provisions on innocent passage through territorial sea, it would be logical to understand it as precluding

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[18] However, States who are not parties to UNCLOS are not members of ISA and do not generally accept the Area provisions of UNCLOS as customary law. This is important to note because the USA (a forum for salvage claims) is one of such States.

[19] So-called as being a "24-nautical mile archaeological zone".

unauthorised search and study of shipwrecks on the seabed (not just removal from the seabed), as the passage must in any case be expeditious and uninterrupted.

At the same time, jurisdiction over UCH located beyond the limit of territorial sea up to the limit of the contiguous zone seems to be narrower, as foreign ships are not subject to the conditions of the innocent passage mentioned above and the wording of Article 303(2) refers only to the removal of historic objects and to the unlawful traffic in such objects. Article 33 regulates the jurisdiction of the coastal State within the 24 nm area and opens up the ability to take certain enforcement steps against foreign ships, among others those necessary to prevent the infringement of customs law or to punish infringements committed in the territorial sea.

By contrast to UNCLOS, the 2001 UNESCO Convention expressly clarifies that States have "*the exclusive right to regulate and authorize activities directed at underwater cultural heritage in their internal waters, archipelagic waters and territorial sea*." (Article 7(1)).

Jurisdiction over sunken naval and State vessels, including submarines and aircrafts, is a complicated question which is not dealt with by UNCLOS and is also left open in the 2001 UNESCO Convention.

It can be briefly pointed out that international customary law does not contain clear cut and generally accepted rules, and that there is no full agreement between States on the allocation of jurisdiction. The 2001 UNESCO Convention takes as a starting point the sovereignty of the coastal State over territorial and archipelagic waters. Other States must only be informed by the coastal State if a find of a State or naval vessel has been made:

"*Within their archipelagic waters and territorial sea, in the exercise of their sovereignty and in recognition of general practice among States, States Parties, with a view to cooperating on the best methods of protecting State vessels and aircraft, should inform the flag State Party to this Convention and, if applicable, other States with a verifiable link, especially a cultural, historical or archaeological link, with respect to the discovery of such identifiable State vessels and aircraft*".

Such an approach was rejected by maritime powers such as the USA, Russia and Norway.

As to the contiguous zone, Article 8 of the 2001 UNESCO Convention says that:

"*Without prejudice to and in addition to Articles 9 and 10, and in accordance with Article 303, paragraph 2, of the United Nations Convention on the Law of the Sea, States Parties may regulate and authorize activities directed at underwater cultural heritage within their contiguous zone. In so doing, they shall require that the Rules be applied.*"

According to Article 1(6) of the Convention, such activities have UCH as "*their primary object and (…) may directly or indirectly, physically disturb or otherwise damage*" UCH. Apparently, the wording of the UNESCO Convention only insignificantly changes the rule laid down in Article 303(2), if the wording of the former is understood as going beyond "control of traffic" and "removal from the seabed".

Let us now examine how UNCLOS addresses the jurisdiction over the UCH located on the seabed beyond the 24-nm limit and compare that with the corresponding provisions in the 2001 UNESCO Convention.

Beyond the 24-nautical mile limit, UNCLOS does not contain specific provisions granting coastal States jurisdiction over UCH. UNCLOS recognises freedom of navigation if exercised with due regard to coastal States' sovereign rights to natural resources, on the seabed (continental shelf) and in the superjacent water column (EEZ). Since UCH is not a natural resource, UNCLOS does not address the question of whether coastal States may preclude other States from exploring the seabed beyond the contiguous zone and recovering UCH. Several well-known litigations, including the cases of *Nuestra Senora de la Mercedes* and the *Titanic*, deal with shipwrecks found beyond this limit, i.e. on the seabed of the continental shelf, in the exercise of freedom of navigation by the exploring ships (and within the EEZ limits, if such limits are established by the coastal State; if not, the high seas regime applies).

Under UNCLOS, it is, therefore up to the flag States (of ships conducting exploration and recovery of historic shipwrecks from the seabed beyond the 24 nautical mile limit) to regulate such activities. Article 94

provides for a duty on flag States to effectively exercise jurisdiction and control over their ships, in compliance with international regulation. No specific mention is made of a flag State's duties over UCH at sea in Article 94, but such a general obligation for all States to protect UCH and cooperate for this purpose is laid down in Article 303(1) UNCLOS. In the absence of specific provisions enabling the enforcement of this duty, it is unlikely that Article 303(1) will have any noticeable impact on the actual conduct of States in this field.

All in all, under UNCLOS, historic shipwrecks located on the seabed beyond the coastal State's contiguous zone can be accessed and recovered freely by any State. Indeed, activities directed at UCH on the continental shelf beyond the 24-nautical mile limit do not usually (to this author's knowledge) result in any objections from the coastal State. Such objections may rather come from States with a historic or cultural link to the objects, such as the historic flag State, or States of origin for artefacts on board such shipwrecks[20].

The 2001 UNESCO Convention spells out the rights and obligations of coastal and flag (as well as nationality) States in a much more detailed way than UNCLOS. As a starting point, this UNESCO Convention expands the responsibility of States for protecting UCH, irrespective of where it is located. Furthermore, the Convention imposes *active* obligations and rights to regulate activities directed at UCH on the seabed beyond the 24-nautical mile limit, on both the flag and nationality, as well as the coastal States.

Firstly, both the flag State of the ship and nationality State of any person involved in activities directed at UCH must require that the discovery of UCH, or any intention to engage in the activities directed at UCH in their own maritime zones, are reported to the relevant State's authorities (Article 9(1)(a)). As for cases where activities directed at UCH take place in another State Party's EEZ and continental shelf, notification is to be sent to both the flag States and the coastal State involved. Alternatively, the national who made the discovery or the master of the vessel may be required to report such discovery or activity to the flag (or

[20] See the case of frigate *Nuestra Senora de la Mercedes* cited in footnote 14.

nationality) State, which must ensure the rapid and effective transmission of such reports to all other States Parties (Article 9(1)(b))[21].

Article 9 of the 2001 UNESCO Convention expands on the previously mentioned Article 94 UNCLOS provisions, relating to the additional duties of the flag States to include obligations with respect to UCH. Interestingly, by including nationals within its scheme, Article 9 helps to avoid situations where citizens use ships flagged in a non-Party to circumvent the requirements of the Convention. If Article 9 only covered flag States, it would be easy for citizens of State Parties to circumvent the requirements of the Convention, by deploying vessels flagged in non-Parties such as the USA.[22]

Obviously, in order to become effective, State Parties must introduce appropriate reporting and notification rules and enforcement mechanisms in their national legal systems. To this end, Article 16 requires that States Parties shall take all practicable measures to ensure that their nationals, as well as vessels flying their flag, do not engage in any activity directed at UCH in a manner not conforming with this Convention. The 2001 UNESCO Convention backs up these obligations by introducing provisions on adequately severe sanctions and duty to cooperate to ensure the enforcement of sanctions (Article 17).

Secondly, a significant change to coastal States' rights and obligations with respect to UCH located on the seabed of their EEZ and continental shelves is found in Article 10 of the 2001 UNESCO Convention.

Coastal States have a duty imposed on them to protect UCH and the right to authorise activities directed at UCH in the State's Exclusive Economic Zone and Continental Shelf. According to Article 10(2), the coastal State "has the right to prohibit or authorize any activity directed at [UCH located on its continental shelf] to prevent interference with its sovereign rights or jurisdiction as provided for by international law including [UNCLOS]".

[21] What if both the nationality State and the flag State are involved? It is not entirely clear whether Article 9 gives rise to "competition" between these States as to which one is to be reported to and report further to the coastal State.

[22] Many other States offering flags of convenience are also not Parties to the 2001 UNESCO Convention.

The question is: what does international law provide in this respect? UNCLOS is in any event silent on the coastal State's jurisdiction over UCH located beyond the 24 nautical mile limit. As to customary international law, it is far from certain as to whether coastal States can claim any sovereign rights or jurisdiction over UCH located beyond territorial waters. The more coherent interpretation of UNCLOS is that beyond the contiguous zone the coastal State may not regulate activities by foreign-flagged ships aimed at the discovery and exploitation of UCH in these maritime territories, as the freedom of the high seas will apply.

A certain restriction on such freedom under international law could generally be considered in cases where a coastal State has some particular link to the shipwreck other than simply from its location on its continental shelf. For example, this could apply if the coastal State is also a historic flag State, or a State of origin for artefacts on board. (However, UNCLOS only mentions such historic and cultural links in Article 149 which applies on the international seabed (the Area).

According to Article 10(3), the coastal State may act as a Coordinating State in cases where there is a discovery of the UCH or there is an intention to direct activities at UCH located on its seabed. In this capacity, the coastal State may *inter alia* take "all practicable measures" to prevent immediate danger to UCH arising from human activities, including looting (Article 10(4)). Apparently, such measures may include the stopping of foreign vessels, if necessary in a specific case. Such interference beyond the contiguous zone is only permitted in exceptional cases by UNCLOS, which does not include protection of UCH.

Another significant change introduced by the UNESCO Convention with respect to the protection of UCH relates to the imposition of the specific duty on the coastal State to act not in its own interests but in the general interests of States Parties. This duty is manifested in the Convention in a number of ways.

For example, Article 10(1) provides that "[*n]o authorization shall be granted for an activity directed at underwater cultural heritage located in the exclusive economic zone or on the continental shelf except in conformity with the provisions of this Article*". Article 10(3) requires the coastal State

to conduct consultations with all other States parties which have a verifiable link to the UCH. In addition, the coastal State acting in the capacity of Coordinating State must "*act on behalf of the States Parties as a whole and not in its own interest*". In addition, actions by the coastal State may "*not constitute a basis for assertion of any preferential or jurisdictional rights not provided for in international law, including the UNCLOS*" (Article 10(6)). In other words, the coastal State should only exercise jurisdiction on the basis of general interests and not to protect its own interests, as is the case when the coastal State protects its sovereign rights to the natural resources of the EEZ and continental shelf.

In many ways, the UNESCO regime for EEZ and the continental shelf is the same as for the international seabed in Article 149 UNCLOS "Archaeological and historical objects on the international seabed". According to this provision, all objects of an archaeological and historical nature found in the Area (i.e. the seabed beyond any State's jurisdiction) are to be preserved or disposed of for the benefit of mankind as a whole.

Generally, UNCLOS does not lay down any duty for States to act in common interests in relation to UCH located on the seabed of the continental shelf. Provisions of the 2001 UNESCO Convention mentioned above (Article 10) can result in objections being raised both by those coastal States which assert sovereign rights to UCH located on their continental shelf and also by those States which have a historic or other link to such UCH and do not wish to share their heritage with other States or with the whole mankind.

Cases such as those involving Spanish frigate *Mercedes* illustrate the insufficient regulation in the international conventions with respect to the protection of interests of States which have some historic or cultural link to the shipwreck or artefacts, but which are not coastal States or flag States. Such States are recognized by UNCLOS as having preferential rights (subject to the common heritage of mankind) with respect to UCH in the Area, i.e. beyond the outer limits of the continental shelf. As for the 2001 UNESCO Convention, it does not do more than give a right to such States to "*declare their interest in being consulted by the coastal State (In whose EEZ/CS UCH is found) on how to ensure the effective protection*

of that underwater cultural heritage (Art 9(5)). Such declaration shall be based on a verifiable link, especially a cultural, historical or archaeological link, to the underwater cultural heritage concerned".

To sum up the above discussion, Article 10 of the 2001 UNESCO Convention changes the "rules of the game" laid down in UNCLOS quite remarkably, with respect to the freedom of navigation in the waters superjacent to the continental shelf of the coastal States. Article 10 creates a far-reaching new regulation of UCH. For example, considering Article 4 which restricts application of salvage and finds law to UCH, if the 2001 UNESCO Convention Article 10 applied to the continental shelf of Canada, the litigations involving the shipwreck of the *Titanic* would not have been possible.[23]

At the same time, the coastal States' competences in the field of UCH is one of the most controversial issues of the 2001 UNESCO Convention. The UNESCO approach was considered unacceptable by several maritime nations, including Norway, because it obviously gives coastal States more rights and competences in their maritime zones than follow from the law of the sea generally and from the UNCLOS provisions (the "creeping jurisdiction" problem). This precludes other (i.e. flag) States from exercising the freedom of navigation they generally enjoy under the law of the sea, in the case of activities directed at UCH on the seabed of the EEZ.

Baltic and Scandinavian perspective on the protection of UCH

In this section I will take a brief look at the issues pertaining to the protection of UCH from the perspective of the Baltic and Scandinavian countries.[24]

[23] On the *Titanic* in more detail, see Garabello & Scovazzi; M.J.Aznar, O.Varmer The *Titanic* as Underwater Cultural Heritage: Challenges to its Legal International Protection, *Ocean Development & International Law*, 44:96–112, 2013.

[24] The Baltic and Scandinavian dimension definitely deserves a more comprehensive examination than is undertaken in this paper. For a useful and more complete discus-

The Baltic and Scandinavian countries have a lot in common – the coastline in the Baltic Sea (except for Norway), naval and maritime history, common geopolitical concerns and common trade. Many historic shipwrecks lie on the bottom of the Baltic Sea, and several important finds of such objects have already been made. Shipwrecks discovered on the seabed such as *Wasa*, *Svardet*, and *Vrouw Maria* are well-known; some wrecks were also washed ashore (*Kolka wreck I* in Latvia) or found on land (*Salma* ships in Estonia).

The Baltic Sea is shallow (around 45 m maximum depth), has low salinity and no shipworms, which assists in better preservation of the wrecks. As a result, there will be probably more discoveries made in the future. Being a relatively shallow sea, the Baltic Sea has been compared to an "enormous underwater maritime museum in which most underwater cultural heritage sites are accessible by divers"[25].

At the same time, there is intense maritime traffic and other activities in the Baltic Sea, which may lead to conflicting uses, potentially endangering UCH and so requiring an effective mechanism for protection of historic objects on the seabed, not only against activities directed at such objects (looting and similar) but also other activities and circumstances which can cause damage (construction works, natural impact). A harmonised regulatory framework adopted in the Baltic region would be of considerable help in ensuring that the protection measures are effective.

In light of these common challenges, do States with a coastline in the Baltic Sea also have a common approach to the protection of UCH?

We have seen that at the international level, the 2001 UNESCO Convention has not so far gained acceptance in the Scandinavian and Baltic region, and has so far only been ratified by Lithuania. The international instruments which in practice regulate UCH in the Baltic Sea are UNCLOS (1982), the Valletta Convention (1992) and the International Council of Monuments and Sites in its "Charter on the Protection and

sion (published in 2006) see Varenius, Björn. 2006. Rutilus: strategies for a sustainable development of the underwater cultural heritage in the Baltic Sea Region. Report dnr 1267/03-51,2006. [København]: Nordic Coucil of Ministers.

[25] See above.

Management of Underwater Cultural Heritage" (1996). In addition, the Baltic Sea States have excluded UCH from marine salvage rules, as the 1989 International Salvage Convention opens for.[26]

As discussed earlier in this paper, UNCLOS does not explicitly regulate UCH located in the EEZ and the continental shelf, but it does allow States to take measures to protect UCH located in their contiguous zones (i.e. up to 24 nautical miles from the baselines). It has been reported that national jurisdiction is mostly exercised with respect to the territorial sea (12 nm) but not in the rest of the 24 nm "archaeological zone" provided for in Article 303 UNCLOS.[27]

There are also differences between the scope of protection of UCH under the domestic laws on cultural heritage, with respect to the age and cultural significance of the historic underwater objects. For example, in Latvia, no definition of UCH (comparable to the definition laid down in the 2001 UNESCO Convention) is laid down in the law whatsoever.

One of the reasons for rejecting the 2001 Convention could be its approach to jurisdiction of the coastal States, as well as possible implications for the status of State and naval vessels, which is unacceptable for some maritime nations.[28] Additionally, flag States have quite far-reaching obligations imposed upon them to regulate their ships, which may be viewed as too burdensome by many flag States, since it exceeds their minimum international obligations.

Furthermore, the 2001 Convention and the Annex with Rules sets a high standard for the protection of UCH, including the relatively broad definition of UCH, providing for *in situ* preservation as the primary option, and imposing very significant restrictions on the application of marine salvage and the law of finds to UCH. It also requires States Parties to enact appropriate domestic legislation on the protection of UCH and to introduce an enforcement system, including sanctions, preventing

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[26] This author does not have a complete overview over such national exceptions in this region.

[27] As reported in 2006 by Rutilus (see footnote 23 above).

[28] However, some States from other regions in Europe have ratified this Convention (Spain, Portugal and France).

the unauthorised recovery and commercial exploitation of UCH. These are far-reaching requirements imposing a significant financial burden on State Parties, which need to set up a mechanism to give effect to the Convention's requirement and to establish a system for coordination and exchange of information with other State Parties. It does appear that some of the Baltic Sea countries already perform some of the activities encouraged by the 2001 UNESCO Convention, whereas other countries, for many reasons, including financial ones, are still at an the early stage in this field.[29]

An alternative solution to the 2001 UNESCO Convention could be creating a Baltic regional instrument for the protection of the UCH, which would address the issues pertaining to UCH in such a way as to tailor for the special interests and experiences of the Baltic States. Such an idea was presented some years ago in the shape of the "*Resolution on the Maritime Cultural Heritage in Estonia, Latvia and Lithuania*" (2003), which *inter alia* encouraged adoption of the UNESCO Convention and defining the maritime cultural heritage. The Resolution was followed up on a piecemeal basis, as the Baltic States have not yet achieved all the goals declared in it.

The "*Code of Good Practice for the Management of UCH in the Baltic region*" (2008) refers, generally, to the Baltic Sea region and seeks to establish a "common ground for the protection and management of UCH in the Baltic Sea region, and among other things provides for a definition of UCH (based on the 100-year threshold or, alternatively, historic significance criteria) and *in situ* preservation as the first option. It is, however, necessary to follow this work up with by achieving a better harmonisation of the legal regulation of UCH by the Baltic and Scandinavian States.

[29] On the pro and contra arguments for joining the 2001 UNESCO Convention see the report by A. Sne, A. Vilka and E.Plankajis (Riga, 2014). Original title: UNESCO Konvencija par zemūdens kultūras mantojuma aizsardzību Latvijas kultūras mantojuma aizsardzības un pārvaldes sistēmas kontekstā. English summary.

Concluding remarks

This paper discusses the issues pertaining to the international legal framework for the protection of Underwater Cultural Heritage, especially historic shipwrecks. The main international instrument is UNCLOS, although it only contains two provisions explicitly regulating UCH. However, it is nonetheless important due to a significant number of ratifications, to which the 2001 UNESCO Convention has not come close. The Baltic and Scandinavian States have generally ratified UNCLOS but not the UNESCO Convention. As a result, the international protection regime for UCH is mainly rooted in UNCLOS, the Valletta Convention and international law in general. This article did not examine the general cultural heritage conventions which may also apply to UCH.

UNCLOS' provisions on Underwater Cultural Heritage are useful, since they require all States to protect heritage at sea (irrespective of location) while vesting the coastal States with certain jurisdiction in the territorial sea and contiguous zone. In addition, a provision addresses UCH located on the international seabed, i.e. beyond all States' jurisdiction.

As for such questions as the title to historic naval and governmental shipwrecks, jurisdiction over UCH located on the continental shelf beyond the 24-nautical mile zone and the rights of owners, salvors and finders, UNCLOS leaves these to be resolved by international law in general and national legal systems. UNCLOS also does not provide for a uniform definition of the "objects of historic and archaeological nature" found at sea.

There is no consensus between States as to how to treat UCH located on the seabed. In addition to salvage laws, States disagree as to whether the *in situ* approach as the first option is necessarily appropriate. The application of the common heritage of mankind to UCH is also a point of disagreement for some States (especially developing States), since it involves putting the national interests of the particular State controlling UCH below the interests of all States taken as a whole.

The 2001 UNESCO Convention contributes to the harmonisation of the aspects mentioned above which are essential for the effective international protection framework. It also provides for relatively specific obligations for States Parties. The benefits of the 2001 UNESCO Convention are a better legal protection of UCH in the seabed beyond the contiguous zone than those of UNCLOS.

By contrast to UNCLOS, the 2001 UNESCO Convention contains a number of explicit obligations for States with respect to UCH located on the seabed within the EEZ and Continental Shelf. As we have seen, the UNESCO regime expands coastal State's jurisdiction in comparison to UNCLOS and at the same time imposes additional obligations on other States (flag States), thereby restricting their freedoms to explore and recover UCH on the seabed beyond the 24 nm. In addition, the 2001 UNESCO Convention takes a very strict approach to the law of salvage and finds, making it in practice inapplicable to recoveries of UCH.

Comparison between the UNCLOS provisions, the UNESCO approach and the national approaches to the legal regulation of UCH illuminate the differences in the various regulatory approaches, as well as the existing gaps in the international regulation. The international regulation of UCH is still quite fragmentary. This means that many important issues pertaining to the legal status of UCH remain in the international customary law domain. Unfortunately, this opens up a lot of uncertainty for States as to what rights they hold under international law and how to protect those rights. It is possible that some of the grounds for States to refuse the 2001 UNESCO Convention are rooted in this uncertainty and their position would change if international law were clearer on the questions important to them. Since this Convention expressly confirms that States must act in accordance with UNCLOS and general international law when exercising jurisdiction over UCH, it is possible that at least some of these concerns are not well-founded.

These include such questions as sovereign rights of the historic flag States to wrecks of naval and governmental vessels, as well as rights of non-flag and non-coastal States to artefacts which have some historic and cultural connection to such States (e.g. in whose territory the values

on board originated, notably former colonies). As the above discussion shows, neither UNCLOS nor the 2001 UNESCO Convention lays down more or less specific criteria to determine what kind of link will provide States with legal title to UCH and how the disputes arising from conflict of legal titles may be resolved.

Uncontrolled and unauthorised recovery of UCH from the seabed in international waters also poses a significant threat to the interests of States holding a historic or cultural link to the shipwrecks and sunken artefacts and to the protection of such objects as the common heritage of mankind. Given the significant diversity in the national approaches to salvage of UCH, the unilateral prohibition by a State of salvage of UCH would not be effective to prevent such activities beyond the 24 nautical mile limit.

Although a multilateral, global agreement on UCH has been hard to achieve, bilateral agreements have sometimes been entered into by States to regulate the question of title and other issues in specific cases. An example of such a bilateral agreement is the Agreement between Australia and the Netherlands (1972) concerning old Dutch shipwrecks (of the Dutch East India Company). Although the Netherlands (successor of the Company) claims in principle to retain title over the Company's shipwrecks irrespective of their location, in this case the bilateral agreement was reached, transferring all titles to the four shipwrecks in Australian waters to Australia (the Netherlands preserving the "continuing interest" in the articles recovered from the wrecks). This may have been a much better option for the Netherlands than having no such agreement at all, as the case with the shipwreck *Geldermalsen* illustrates, being a wreck of the Company's ship from which artefacts were salvaged off Indonesian coast without consulting the Netherlands.

A more recent example is the arrangement between UK and Canada (1997) involving the then undiscovered wrecks of Sir John Franklin's ships *Erebus* and *Terror*, found in 2014 and 2016 in the Northwest Passage. Under the arrangement UK agreed to limit some of its rights as an owner without waiving sovereign immunity and agreed that Canada would have discretion to take appropriate actions with respect to the shipwrecks.

This arrangement appears to preclude the risk that commercial salvors may avail themselves of salvor's or finder's rights[30].

Another well-known agreement regulates the shipwreck of the *Titanic* located on the continental shelf of Canada. To this author's best knowledge, the "Agreement Concerning the Shipwrecked Vessel RMS Titanic" has not yet entered into force[31].

States with a link to a historic shipwreck located outside their jurisdiction may choose to enter into agreements with salvage companies, and in this way avoid the unpredictable impact of an unauthorised recovery on their interests, as well as ensuring that the exploration and recovery takes place in an appropriate way[32]. However, the 2001 UNESCO Convention (if applicable) may significantly limit the margin of discretion for States entering into such agreements.

30 GarabelloScovazzi (2003), p. 22.

31 On issues pertaining to the *Titanic* see Garabello & Scovazzi; M.J.Aznar, O.Varmer The *Titanic* as Underwater Cultural Heritage: Challenges to its Legal International Protection, *Ocean Development & International Law*, 44:96–112, 2013.

32 E.g., Partnering Agreement Memorandum concerning the Shipwreck of *HMS Sussex* (2002) between the UK and Odyssey Marine Exploration, Inc.

Marine insurance warranties

Development in England, by comparison with other countries[1]

By Daria Romanova

[1] This article is based on an extended version of a master's thesis submitted to the Scandinavian Institute of Maritime Law in November 2015.

Content

1 Introduction

1.1 Marine insurance warranties in English law

The warranty regime in English marine insurance law has for a long time been at the centre of attention for courts, academics and practitioners. The reason for this lies in those distinctive characteristics of insurance warranties that make them a unique type of contractual term, sometimes described as "draconian".[2] Namely, an attribution of warranty status to the assured's undertaking to act in a particular way (to fulfill certain conditions, etc.) turns strict compliance with that undertaking into a condition precedent to the insurer's liability; in the case of non-compliance, issues of fault, materiality of a breach, or presence of a causal connection between the breach and the loss are all disregarded. Furthermore, a specific remedy of "automatic discharge of liability" makes the warranty regime especially severe for the assured. At the beginning of the XXth century, all these traits were reflected in the English Marine Insurance Act 1906 (the MIA 1906) and remained unchanged for many years.

However, it has been widely recognised that warranties constitute a source of potential injustice, as they entitle the insurer to rely on minor and non-causative breaches to avoid liability under the policy. Moreover, as the warranty regime is strikingly different from the general civil law approach to alteration of risk, its maintenance may hinder the process of internationalisation of English insurance law and, from a practical perspective, make the London market less attractive for new clients. Therefore, both the English courts and the insurance industry have endeavored to mitigate the harsh effects of the MIA 1906 provisions. Various measures of amelioration were adopted, but none of them could be described as a final solution. The need for legislative reform was gradually becoming apparent.

In 2006, the UK Law Commission, a statutory body created for the purpose of reviewing and reforming the law, working jointly with the Scottish Law Commission, started the project "Insurance Contract Law".

[2] *Hussain v Brown* [1996] 1 Lloyd's Rep 627, per Saville LJ, 630

The project concluded with the adoption of the Insurance Act 2015, which envisages significant changes to the warranty regime. **The recent reform has raised a number of issues of both theoretical and practical significance:**

1) What particular problems of the "classical" warranty regime were the legislators trying to solve?

2) What are the differences between the warranty regime under the MIA 1906 and the regime established by the Insurance Act 2015? Additionally, does the new regime give rise to potential problems?

3) Has the reform brought the English warranty regime closer to the practices of other common law countries and/or to the civil law approach to alteration of risk?

Overall, the aim of this thesis is to examine these questions and to analyse the process of development of the marine insurance warranty regime in England, by comparison to its international context.

1.2 Structure of the thesis

The main body of this thesis is divided into four parts:

(1) Chapter 2 outlines the historical stages of the establishment of the concept of warranties in English marine insurance law;

(2) Chapter 3 is devoted to the nuances of the warranty regime under the MIA 1906, with the main focus/emphasis on the distinctive characteristics of warranties (the "strict compliance" doctrine, the "automatic discharge" rule, *etc.*). The special status/position of warranties among the other types of insurance contract terms and their internal classification are also discussed;

(3) Chapter 4 examines the Norwegian approach to general alterations to the risk insured and to warranty-resembling clauses, as an example of the civil law solution;

(4) Chapter 5 provides an overview of previous attempts to mitigate the warranty regime in England and other common law countries, and a detailed analysis of the recent legislative reform.

The final chapter provides a conclusion on the questions of the present development of, and future perspectives for marine insurance warranties in English law.

1.3 Legal sources

Due to the fact that marine insurance warranties are a common law concept, the majority of the sources used in the preparation of this thesis are of English origin. They include: statutes (the MIA 1906, the Insurance Act 2015), preparatory works (papers of the Law Commission, draft bills, etc.), standard documents, case law and legal literature. Since the concept of warranties is common to marine and non-marine insurance in England, examples from non-marine insurance are used where relevant. Furthermore, the thesis includes references to the legislation, case law, reform projects and legal literature from other common law jurisdictions, such as Australia, New Zealand, the USA and Canada. The provisions of the Nordic Marine Insurance Plan 2013 and the Commentary relating to it are used to illustrate the civil law approach. In addition, reference is made to some cases heard before the Norwegian courts.

1.4 Method

The main method adopted for this research is a comparative analysis of the "classical" warranty regime in England (Chapter 2), alterations to it, introduced by the recent reform (Chapter 4), and the experience, where relevant, of the other common and civil law countries (Chapters 3, 4). However, it would be impossible to embrace all the varieties of problems relating to marine insurance warranties. Thus, without diminishing the significance of such issues, some of them are left beyond the scope of this work: for example, a status of the "navigation" conditions in the MIA 1906[3] or the problem of the "basis of the contract" clauses.

[3] The MIA 1906, ss 42, 43, 54, 46, 48 and 49.

2 Warranties in a historical perspective

2.1 The XVIIth century. First reported cases on warranties

English and civil marine insurance law have common roots. Marine insurance contracts, which were intended to provide an indemnity against marine risks upon payment of the premium, originated with the Lombard merchants in Northern Italy in the XIIth – XIIIth centuries. Later, these continental practices were brought to England with the establishment of the Hanseatic League of Lombard trading houses in London in the XIVth century.[4] However, the unity broke down in the XVIIth century, when the English courts began to acknowledge that some of the assured's contractual undertakings might constitute a condition precedent (*i.e.*, a prerequisite) to the insurer's promise of cover. Breach of these terms, referred to as "warranties", gave the insurer the unconditional right to repudiate the policy.

Although continental policies also contained provisions requiring the assured to act in a particular way, in civil law jurisdictions a breach of any such provision was treated in the same way as a breach of any other contractual term. Namely, the insurer was entitled to repudiate only if the breach went to the root of the contract and was causative to the loss. To quote Professor John Hare, "if the breach went to the root of the contract, repudiation was possible, but in the marine insurance context, only if it caused the loss[…] if a breach is sufficiently serious as to cause the loss it must surely go to the root of the contract – which is the Roman-Dutch law yardstick for repudiation by the aggrieved party".[5]

This divergence between the English and the continental approaches was originally reflected in decisions adopted by the English courts in

[4] Baris Soyer, *"Warranties in Marine Insurance"*, 2nd edition (London: Cavendish Publishing Limited, 2006), 5

[5] John Hare, *"The omnipotent warranty: England v the world"*, compendium *"Marine insurance at the turn of the millennium"*, vol.2 (Antwerp, Groningen, Oxford: Intersentia, 2000), 43

the late XVIIth century. The first reported cases on marine insurance warranties were concerned with the question of what consequences a breach of a "warranty of convoy" implied. In all three cases, the courts upheld the underwriters' argument that compliance with that warranty constituted **a condition precedent** to their liability under the policy.

However, it seems that in the XVII century the English courts, while defining what constituted such "compliance", were prepared to take into consideration the issues of fault and materiality. For instance, in *Jeffries v Legandra*[6], the earliest of three relevant cases, the ship began sailing with the convoy, but later became separated from it by adverse weather. The court did not find any fault on the side of the master of the ship; hence, the warranty was deemed not to have been breached by the purely accidental separation. Notably, the underwriter unsuccessfully argued that, if the policy was a conditional contract, the promise of cover was dependent on a strict and literal/exact compliance with the warranty:

"[A]n executory promise upon an act done, and to be done to, or by a stranger: and in such a case it is not enough to say it was endeavored, or that the circumstance was rendered impossible to be observed by the act of God[…] The full intent is to be performed, and not bare words".[7]

In the subsequent two cases,[8] the courts held that the warranty of convoy was not breached by minor discrepancies. Consequently, it could be argued that originally a materiality test was applicable to breach of warranty. Nevertheless, in the XVIIIth century English judicial authorities moved towards implementation of the strict (literal) compliance doctrine and affirmation of the absolute character of marine insurance warranties.

2.2 The XVIIIth century. Lord Mansfield's cases

The appointment of Sir William Murray, Lord Mansfield as Lord Chief Justice in 1756 led to a breakthrough in English marine insurance law.

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6 *Jeffries v Legandra* (1692) 4 Mod. 58

7 *Ibid*.

8 *Lethulier's case* (1692), 91 Eng Rep 384; *Gordon v Morley* 93 Eng Rep 1171

Due to his work, this field of law gained many of its unique characteristics, which remain intact to this day. This is true for the warranty regime as well. The first warranty case decided by Lord Mansfield was *Woolmer v Muilman*,[9] where the insured ship and the cargo were warranted to be neutral, but in fact were not. Lord Mansfield commented on that fact as follows:

"There was a falsehood, in respect to the condition of the thing assured; therefore, it was no contract. [...]False warranty in a policy of insurance will vitiate it, though the loss happens in a mode not affected by that falsity".

In this quotation, a clear departure from the previous, more gracious approach of the XVII century could already be seen. The bare fact of the breach, however immaterial to the loss, was enough to vitiate the policy. In subsequent decisions, Lord Mansfield set out further principles to govern the status of marine insurance warranties:

(1) First, Lord Mansfield made a clear distinction between a warranty and a representation, stating that the first constituted a part of the contract, while the latter was a mere/bare collateral statement.

For example, in *Pawson v Watson*,[10] the insured vessel was required to have 12 guns and 20 men on board; these instructions, however, were not inserted or written into the policy. The court ruled that the said requirement amounted only to a [mis]representation, not a warranty, and thus in the absence of fraud the insurer was held liable for the loss of the ship. Lord Mansfield stated, *i.a.*:

"[pp 787–788] There is no distinction better known to those who are at all conversant in the law of insurance, than that which exists, between a warranty or condition which makes part of a written policy, and a representation of the state of the case".

(2) Next, a revolutionary conclusion followed: while a representation might be substantially complied with, a warranty required strict (literal) compliance with what had been written in the policy. In his much-quoted

9 *Woolmer v Muilman* (1746) 3 Burr 1419

10 *Pawson v Watson* (1778) 2 Cowp 785

speech in *De Hahn v Hartley*[11], Lord Mansfield formulated this principle as follows:

"There is a material distinction between a warranty and a representation. A representation may be equitably and substantially answered: but a warranty must be strictly complied with […] A warranty in a policy of insurance is a condition or a contingency, and unless that be performed, there is no contract. It is perfectly immaterial for what purpose a warranty is introduced; but, being inserted, the contract does not exist unless it be literally complied with".

In the quoted case, a ship warranted to sail "from Liverpool with […] 50 hands or upwards", in fact left Liverpool with only 46 hands. Only six hours later, this breach was remedied by picking up a further six men. However, the underwriter was held free from liability for the later loss of the ship. Hence, Lord Mansfield's understanding of the "strict compliance" doctrine implied that any immaterial, non-causative, and even rectified breach of warranty entitled the insurer to refuse to pay. What is more, non-compliance with the warranty could not be excused if the breach was due to an occurrence out of the assured's control[12], which was in contrast to the earlier *Jeffries v Legandra* case. Thus, the departure of English marine insurance law from its continental roots was finalised.

2.3 The XIXth century. The Marine Insurance Act 1906

In the late XVIIIth century, a process began of codifying the rules laid down by Lord Mansfield and subsequent case law. Eventually, the efforts of the then Parliamentary draftsman, Sir Mackenzie Chalmers, resulted in the adoption of the Marine Insurance Act (MIA) 1906, with Sections 33–41 devoted to different aspects of the warranty regime. It is recognised that the objective of this Act was retrospective: "It has to be appreciated at the outset that the 1906 Act[…] was not a civil law code designed to

[11] *De Hahn v Hartley* (1786) 1 T.R. 343, 345. See also *Pawson v Watson* (1778) 2 Cowp 785

[12] *Bond v Nutt* (1777) 2 Cowp 601; *Hore v Whitmore* (1778) 3 Cowp 784

provide answers to future problems, but rather a snapshot of how the law stood in 1906".[13]

Analogous statutes were implemented throughout the common law world, including: the Australian MIA 1909, the New Zealand MIA 1908 and the Canadian Federal MIA 1993. Although this led to a certain unification of the warranty regime, the majority of the common law countries eventually amended it by various legislative and non-legislative measures.[14] To understand the aims and content of these alterations, the "classical" warranty regime under the MIA 1906 should be addressed first.

3 The warranty regime under the MIA 1906

3.1 Warranties and alteration of risk

During the formation of the insurance contract, an assessment of the risk insured must be made on the basis of presumptions about particular past or present facts, or future events. Consequently, these presumptions constitute a fundamental of the policy; if these fundamental presumptions fail, the principle of a fair balance of interests between the insurer and the assured may require the amendment, or even the termination, of the policy. In order to help the insurer to regulate the risk insured, English law adopted, *i.a.,* the notion of **"warranty".**

This solution, however, is quite unique; many other legal systems deal with the same problem without introducing the exhaustive warranty regime. As Professor John Hare puts it, "it is thus anathema to continental lawyers to be told that Anglo-American insurance law knows a number of different types of warranty".[15] The majority of civil law jurisdictions provide the insurer with an opportunity to control the risk insured

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13 Robert Merkin, "Australia: still a nation of Chalmers?", *University of Queensland Law Journal* (2011), 195

14 For a further discussion, see Chapter 5, ss 5.2.1.3 and 5.3.2.

15 Professor John Hare, *"The Omnipotent Warranty: England v The World"*, 44

through general provisions on **alteration of risk.** Professor Trine-Lise Wilhelmsen of the Scandinavian Institute of Maritime Law, has undertaken a comprehensive study of several legal systems and concluded that the various definitions of "alteration of risk" seem to be based on four main approaches. Those are, as follows:

(1) The risk being insured must have increased compared to the written or implied conditions of the insurance contract (Norway);

(2) The risk must have altered or increased in such a way that the insurer would not have accepted the insurance at all (Belgium) or would not have accepted the insurance on the same conditions if he had known about the increase (Italy, Greece);

(3) The risk is "substantially" altered (Japan, Slovenia, Croatia); and

(4) Finally, to connect the sanction (*i.e.,* particular negative legal consequences) to circumstances affecting or altering the risk after the contract is concluded without any further definition (France).[16]

Despite the differences in these approaches and in the effects of particular provisions, they are all governed by a basic requirement of "subjective materiality".[17] This means that the insurer has a right to vitiate the contract only if there has been an alteration of those circumstances that were in some way material to him when the contract was entered into. What is more, a logical conclusion follows that the civil law jurisdictions recognise a corresponding duty of the assured not to alter the circumstances that had a material bearing on the risk insured.

English law is also acquainted with a concept of **change of risk**; however, it differs in its implications from the continental concept. Two types of changes of risk are recognised: (1) alteration of risk; (2) and increase of risk.

"Alteration of risk" takes place when the subject matter being insured is substantially changed, *i.e.*, the insured risk is substituted by a new one. In this case, the general principle of common law is that the insurer is automatically discharged from liability: "There would be no cover

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16 Professor Trine-Lise Wilhelmsen, *"Issues of Marine Insurance"* (Oslo: MarIus, 2001), 113–115

17 *Ibid,* 115

where the circumstances had so changed that it could properly be said by the insurers that the new situation was something which, on the true construction of the policy, they had not agreed to cover".[18] Other cases, where the risk remains the same in essence, but a loss is more likely to occur – for example, if a ship insured under a war policy sails into an area of enhanced military activity – are referred to as "**increase of risk".**

The civil law concept of alteration of risk embraces both types of situations; hence, the assured's duty not to alter the risk applies to both equally. The striking feature of English law is that there is no general duty of the assured to prevent an increase of the risk during the insurance period. Such an increase is deemed to be taken into account by insurers, "since the insurance bargain is one where, in return for the premium, they take upon themselves the risk that an insured peril will operate".[19] Therefore, the insurer cannot claim that the increased risk goes beyond what it has agreed to cover. As Pollock CB observed in *Baxendale v Harvey*[20]:

"An insured may light as many candles as he please in his house, though each additional candle increases the danger of setting the house on fire".

In the absence of the implied duty of the assured not to increase the risk, English marine insurance law was in need of another way to secure the insurer's position. Hence, the warranty regime was implemented. Parallel to provisions on alteration of risk in civil law, warranties serve as an instrument to administer the risk insured: they circumscribe it, oblige the assured to take suitable precautions, etc.[21] However, despite the similarity of goals, a closer look at the English warranty regime reveals its substantial differences from the civil law approach.

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18 *Kausar v Eagle Star Insurance Co Ltd* [2000] Lloyds Rep IR 154

19 *Ibid.* See also *Swiss Reinsurance Company and others v United India Insurance Company Limited* [2005] EWHC 237 (Comm)

20 *Baxendale v Harvey* (1859) 4 H & N 445, 449

21 On the purpose of warranties, see the Law Commission Consultation paper No182 (2007) ss 2.1–2.2

3.2 The definition of a warranty

3.2.1 The statutory definition

Section 33(1) of the MIA 1906 provides that:

"Warranty […] 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".

According to this definition, a warranty's status can be attributed to a huge variety of undertakings: (1) as to past or present facts (affirmative warranties); (2) as to the future conduct of the assured (continuing/promissory warranties); or (3) that some condition shall be fulfilled, although the inclusion of this middle category was argued to be rather open-ended and creating a basis for litigation.[22] Indeed, the courts occasionally have problems with deciding whether a particular statement is or is not a warranty.

An affirmation of fact, for instance, can constitute either a warranty or a representation, an instrument with its own legal regime.[23] In the XVIIIth century, Lord Mansfield endeavored to separate these concepts, stating that warranties form part of the written policy, whereas representations are made outside of the written contract; and that representations may be equally or substantially answered, while warranties must be strictly complied with.[24] The third criterion of distinction is that the test of materiality is applicable only to representations. As Lord Eldon LC put it in *Newcastle Fire Insurance v Macmorran & Co*[25]:

"It is a first principle of the law of insurance, on all occasions, that where a representation is material it must be complied with – if immaterial, that immateriality may be inquired into and shown; but that if there is a warranty… the materiality or immateriality signifies nothing".

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22 The Law Commission Consultation paper No 204 (2012), s 12.6. See, for example, *Switzerland Insurance Australia v Movie Fisheries Pty Ltd* (1997) 144 ALR 234

23 See the MIA 1906 s 20

24 *Pawson v Watson* (1778) 2 Cowp 785; *De Hahn v Hartley* (1786) 1 T.R. 343

25 *Newcastle Fire Insurance v Macmorran & Co* (1815) 3 Dow 255, 262

Aside from the broadness of the MIA s 33(1), problems in defining warranties are numerous. To begin with, the very process of creation of warranties fuels potential uncertainty.

3.2.2 Creation of a warranty

According to the MIA s 33(2), a warranty may be either express or implied. Warranties may be implied by statute. The MIA specifies four implied warranties: the warranties of seaworthiness (s 39(1)), portworthiness (s 39(2)), cargoworthiness (s 40(2)), and legality (s 41). In theory, warranties may be implied into a contract of insurance by courts, as with any other contract, for example, for reasons of business efficacy. However, in practice this possibility is of little importance to insurance contracts.[26]

The majority of warranties are created expressly by the contracting parties: *i.e.,* they are either written into the policy, or incorporated into it by reference. The MIA s 35(1) states that an express warranty may be in any form of words from which the intention to warrant is to be inferred. Consequently, there is no single verbal construction to indicate a warranty. Even the use of the word "warranty" is not decisive. Here, Arnould provides the following example: "The fact that the word "warranted" is used in a policy does not always prove that the term to which it refers amounts to a warranty. Thus, the clause "warranted free from particular average" is not a warranty; it is an exception from the risk undertaken by the underwriter".[27]

The courts in England and other common law countries are sometimes prepared to find a clause that is labeled as a "warranty", not to be one, in order to mitigate the harshness of the warranty regime.[28] For instance, in *Roberts v Anglo-Saxon Insurance Ltd*[29], the statement "warranted: use only for commercial travelling" was held not to be a "true" warranty, because "[…] the parties had used that language as words descriptive of

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26 As noted in the Consultation paper No 204 (2012), s 12.13

27 Arnould, *"On the Law of Marine Insurance and Average"*, 11th ed. (London: Law Publishers, 1924), 829

28 For a further discussion, see Chapter 5, ss 5.2.1.2–5.2.1.3.

29 *Roberts v Anglo-Saxon Insurance Ltd* (1927) 27 LI L Rep 313, *per* Bankes LJ 314

the risk". Therefore, even if a term apparently seems to be a warranty, it can be construed otherwise by the court.

On the other hand, a warranty may be inferred from any words demonstrating an intention to warrant. The courts have tried not to push this doctrine to extremes[30], yet sometimes it is applicable. In *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co*[31], the Court of Appeal held that the undertaking to produce six films in the "pecuniary loss indemnity" policy must be construed as a warranty, because the essence of the risk insured was the generation of a certain revenue, and the films could generate it only if completed. Furthermore, Lord Justice Rix listed several tests for identifying a warranty:

"[para 101] It is a question of construction, and the presence or absence of the word "warranty" or "warranted" is not conclusive. One test is whether it is a term which goes to the root of the transaction; a second, whether it is descriptive or bears materially on the risk of loss; a third, whether damages would be an unsatisfactory or inadequate remedy".

Overall, the approach to the creation of warranties is very flexible. For instance, the Law Commission's report in 1980 summarised possible ways of creating warranties as follows[32]:

(1) by the use of the word "warranty". It is to be recalled that the word "warranty" is indicative, but not decisive;

(2) by the use of "basis of the contract" clauses – a legal device, typically a statement on a proposal form, that converts the assured's answers and declarations into contractual warranties;

(3) by the expression of a requirement for strict compliance and a right to repudiate for a breach[33];

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30 See *Clapham v Cologan* (1813) 3 Camp. 382, where the court rejected an argument that a mere description of the ship by an English name constituted a warranty of nationality.

31 *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co* [2001] 2Lloyd's Rep 161

32 *"Insurance Law: Non-Disclosure and Breach of Warranty"* (1980) Law Com No104, s 6.3

33 After *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1991] 2 Lloyd's Rep 191; [1992] 1 A.C 233, it is more correct to speak of the "automatic termination" of the insurer's liability.

(4) by the use of phrases such as "condition precedent", from which the court can infer that the parties intended strict compliance and a right to repudiate for a breach[34];

(5) by the use of any other words such that the court concludes that, on a true construction of the whole document containing the term, the parties intended the term to possess the attributes of a warranty.

Overall, in order to determine if the term is a "true" warranty, one must consider the intentions of the parties as revealed by the contract as a whole. Warranties are "an elusive target", to quote the Law Commission[35]; the difficulties in defining them lead to significant uncertainty in insurance relationships and provide grounds for a vast amount of litigation. The problem is enhanced by the fact that the same term may be drawn in different ways – as a definition of risk, an exclusion from liability, or a warranty. Each of these options may lead to different consequences for the insurer and the assured. For that reason, it is important to draw a line between warranties and other provisions of the insurance contract.

3.2.3 Warranties in the hierarchy of contractual terms

Lord Greene MR described the term "warranty" as "one of the most ill-used expressions in the legal dictionary".[36] Indeed, it has a number of meanings: for instance, a warranty in insurance law is a very different thing from a warranty in general contract law. In the latter, the word "warranty" usually describes a term of minor importance, as opposed to "condition" – a term that "goes to the root of the contract".[37] If a condition is breached, the non-breaching party may repudiate the contract going forward in addition to damages. If a warranty is breached, damages are the only remedy available. For example, Section 11(3) of the Sale of Goods Act 1979 states:

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34 *Ibid.*

35 The Consultation paper No 204 (2012), s 11.19

36 *Finnegan v Allen* (1943) 1 KB 425, 430

37 For a further discussion, see Jill Poole, "Textbook on Contract Law", 12th ed. (Oxford University press, 2014), 301–302

"Whether a stipulation in a contract of sale is a condition, the breach of which gives rise to the right to treat the contract as repudiated, or a warranty, the breach of which may give rise to a claim for damages but not to a right to reject the goods [...]"

By contrast, under English insurance law warranties have a "dominant" position. According to the hierarchy of contractual terms, presented by the Law Commission in the 2006 Issues paper[38]:

(1) Warranties carry the most severe consequences for the assured, because their breach leads to the insurer's automatic discharge from liability (*i.e.,* the insurer does not need to elect to repudiate the policy). This unique feature of warranties was acknowledged in *The Good Luck* case.[39]

(2) Conditions precedent to a claim are mostly procedural requirements, such as to give notice of a claim, etc. Similarly to warranties, the insurer may refuse to pay a particular claim even if a breach of such condition is not material or causative to the loss. However, other claims under the policy will remain unaffected.

(3) Clauses "descriptive of the risk" and "excluding the liability" indicate under which circumstances the insurer shall or shall not cover the loss. These clauses are also known as "suspensive" conditions, because in case of a breach the insurer's liability is only suspended until this breach is remedied.

(4) Innominate terms are qualified by the fact that the remedy for their breach depends on their seriousness: the remedy may be either a right to repudiate the contract and damages, or only damages.[40] Notably, in the *Alfred McAlpine* case[41] it was suggested that a breach of such term might be serious enough to justify a rejection of a particular claim, but not the whole contract. However, the idea of a "partial repudiatory breach" was criticised by the Court of Appeal in *Friends Provident Life*

38 The Issues paper 2 *"Warranties"* (2006), ss 2.12–2.13

39 *The Good Luck* [1991] 2 Lloyd's Rep 191

40 See *Hongkong Fir Shipping Co. Ltd v Kawasaki Kisen Kaisha Ltd* (1962) 2 QB 26. Existence of innominate terms in insurance contracts was acknowledged in *Phoenix General Insurance Co v Greece SA v Halvanon Insurance Co Ltd* [1985]2 Lloyd's Rep.599

41 *Alfred McAlpine Plc v BAI (Run-Off) Ltd* [2000] 1 Lloyd's Rep 437

and Pensions v Sirius International Insurance[42] as creating a completely new and unknown doctrine. Thus, the law is inconsistent on this point.

(5) Mere terms are equal to "warranties" in general contract law; their breach has no bearing on the insurer's liability, as it is adequately remedied by damages.

Overall, marine insurance warranties have a unique place among other policy terms, as they envisage the harshest consequences of non-compliance for the assured. A detailed examination of the main characteristics of warranties, which make them one of the most powerful and criticised instruments in English insurance law, is provided below.

3.3 Characteristics of warranties

The following characteristics can be attributed to a marine insurance warranty on the basis of the MIA 1906 provisions and relevant case law:

(1) It must be strictly complied with;

(2) It need not be material to the risk;

(3) A causal link between the particular breach of a warranty and the loss is irrelevant;

(4) The absolute character of a warranty: *i.e.*, there is no excuse (no defence) in case of breach;

(5) Specific consequences of breach: the "automatic discharge" of the insurer from liability;

(6) There is no remedy for breach.

Taken together, these features constitute the traditional warranty regime in English insurance law. Clearly, such severe rules can lead to striking injustice towards the assured. For that reason, recent legislative reform has reviewed a number of them to various extents. However, in order to understand the modern amendments, the original approach should first be analysed.

[42] *Friends Provident Life and Pensions v Sirius International Insurance* [2005] EWCA Civ. 601

3.3.1 The strict compliance rule

Warranties in insurance contracts have occasionally been characterised as "conditions precedent" to attachment of the risk, or to the liability of the insurer. In *Thomson v Weems*[43], Lord Blackburn stated: "In policies of marine insurance […] the compliance with that warranty is a condition precedent to the attaching of the risk". In *The Good Luck*[44], Lord Goff affirmed: "[…] fulfillment of the warranty is a condition precedent to the liability of the insurer". The word "condition" here is used in a contingent sense, as "a stipulation of a state of affairs that must be achieved before any contractual liability, or possibly any further contractual liability, will be incurred".[45] The rationale behind this is that warranties are indicators of the risk, which the insurer has originally agreed to indemnify.

Yet what constitutes a "compliance" with a warranty? From Lord Mansfield's time up until now, it has never been challenged that warranties require the strict (literal) compliance: "[…] nothing tantamount will do, or answer the purpose; it must be strictly performed, as being part of the agreement".[46] In *De Hahn v Hartley*[47], Ashhurst J reaffirmed: "The very meaning of warranty is to preclude all questions whether it has been substantially complied with; it must be literally so".

This approach was reflected in the MIA 1906 s 33(3):

"A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not".

The strict compliance rule has two aspects. On the one hand, the insurer cannot demand anything greater than the warranted undertaking: in *Hide v Bruce*[48], the warranty to have 20 guns did not imply sufficiency of the ship's crew to man them. On the other hand, nothing less than literal performance will suffice. The only potential escape may be offered

43 *Thomson v Weems* (1884) 11 R (HL) 48, 51
44 *The Good Luck* [1991] 2 Lloyd's Rep 191, 202
45 Jill Poole, "*Textbook on Contract Law*", 301
46 *Pawson v Watson* (1778) 2 Cowp 785, 787
47 *De Hahn v Hartley* (1786) 1 T.R. 343, 346
48 *Hide v Bruce* (1783) 3 Doug K B 213

by the *de minimis non curat lex* rule, formulated in *The "Reward"49* case as follows: "If the deviation were a mere trifle, which, if continued in practice, would weigh little or nothing on the public interest, it might properly be overlooked". Applicability of this rule to a breach of a marine insurance warranty was discussed in *Overseas Commodities Ltd v Style.*[50] In this case, the shipped tins of pork were warranted to be specifically marked by the manufacturers; in fact, some of the tins lacked such marks. McNair J mentioned in his reasoning:

"[p 558] Being satisfied that, as regards both policies, a substantial number of tins – well exceeding any tolerance that could be disregarded under the *de minimis* rule – were not marked[…] I have no option but to hold that the breach of the express warranty affords the underwriters a complete defence in this action".

Professor Baris Soyer argues that the language adopted makes it clear that had only one tin out of thousands been defective, McNair J would have sidestepped the strict compliance doctrine by applying the *de minimis* rule.[51] It is hard not to agree. However, the rule is of limited help, as the breach in question must concern only a trivial part of the whole undertaking.

3.3.2 No requirement of materiality

The MIA 1906 s 33(3) prescribes that a warranty must be complied with, whether or not it is material to the risk. The essence of this principle was formulated by Lord Eldon LC in *Newcastle Fire Insurance*[52]: "[…]when a thing is warranted to be of a particular nature or description, it must be exactly what it is stated to be. It is no matter whether material or not; the only question is, is this the thing *de facto* I have signed?"

"Immateriality" of a warranty can take two forms. First, the warranty may concern a thing so random that it could not affect the risk in prin-

49 *The "Reward"* (1818) 165 BR 1482

50 *Overseas Commodities Ltd v Style* [1958] 1 Lloyds Rep 546

51 Baris Soyer, "*Warranties in Marine Insurance*", 134

52 *Newcastle Fire Insurance v Macmorran & Co* (1815) 3 Dow 255

ciple, "however absurd it may appear".[53] In *Thomson v Weems54*, Lord Blackburn explained this ambiguous approach by reference to contractual freedom of the parties:

"It is competent to the contracting parties, if both agree to it and sufficiently express their intention so to agree, to make the actual existence of anything a condition precedent to the inception of any contract […]. And it is not of any importance whether the existence of that thing was or was not material; the parties would not have made it a part of the contract of they had not thought it material, and they have a right to determine for themselves what they shall deem material".

Next, even if the warranty concerns something that could theoretically affect the risk, whether it does so in fact, is irrelevant. For example, in *Yorkshire Insurance Co Ltd v Campbell*[55], the shipped horse was warranted to be of a certain pedigree. Lord Summer noted that the pedigree of the horse might affect the risk one way or another (thus, being material to the risk in a general way), but no evidence were required that it in fact did. The same principle could be traced in *Abbott v Shawmut Mutual*[56], where a warranty that a mortgage on the property insured constituted £6,600 was held to be breached because the real figure was £6,684.

3.3.3 No requirement of causation

A general approach to the problem of causation in English insurance law is expressed in "the proximate cause" (*causa proxima*) rule; see, for example, the MIA s 55(1):

"Subject to the provisions of this Act, and unless the policy otherwise provides, the insurer is liable for any loss **proximately caused** by a peril insured against […]".

Previously, there was doubt about the content of this doctrine. One school of thought advocated that "only the *causa proxima* or immediate

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53 *Farr Motor Traders Mutual Insurance Society Ltd* [1920] 3 KB 669, 673

54 *Thomson v Weems* (1884) 9 App Cas 671, 683

55 *Yorkshire Insurance Co Ltd v Campbell* [1917] AC 218, 255.

56 *Abbott v Shawmut Mutual* (1861) 85 Mass 213. See also *Allen v Universal Automobile Insurance Co Ltd* (1933) 45 Ll L Rep 55.

cause of the loss must be regarded"; due to the fact that the test of the last event in a chain was well known at the time, "people must be taken to have contracted on that footing".[57] Another view was adopted in *Reischer v Borwick58*, where the tug sustained damage in a collision, but afterwards was abandoned due to a flood; here, the collision was held to be the *causa proxima*, despite not being the last event on the timescale. The law remained unclear until the *Leyland Shipping* case[59], where Lord Shaw said: "causation is not a chain, but a net […] the cause which is truly proximate is that which is proximate in efficiency". Courts were therefore invited to weigh up the influence of different causes on the particular loss.

In contrast, a causal link between the breach of a warranty and the loss has never been relevant in insurance cases. In *Hibbert v Pigou*[60], the ship was lost in a storm, but the underwriter avoided the liability due to the breach of the warranty of convoy. In the non-marine case *Dawsons Ltd v Bonnin61*, the lorry was warranted to park at one address, when in fact it parked at another. Although the misstatement about the address did not increase the insured risk, and arguably even reduced it, the House of Lords held that the insurer was discharged from liability.

Therefore, as Arnould puts it, "although the loss may not have been in the remotest degree connected with the breach of the warranty, the underwriter is none the less discharged on that account from all liability for the loss if the warranty have been in fact broken".[62] This peculiar feature of insurance warranties is a direct consequence of the strict compliance doctrine and the absence of the materiality requirement; indeed, if an undertaking is not material to the risk, it could hardly become the *causa proxima* for the loss. Such disregard for the causal element can lead to

57 Susan Hodges, "Cases and Materials on Marine Insurance Law", (London, Sydney: Cavendish Publishing Limited, 1999), 336, with reference to Pink v Fleming (1890) 25 QBD 396

58 *Reischer v Borwick* (1894) 2 QB 548 CA

59 *Leyland Shipping Co Ltd v Norwich Union Fire Insurance Society Ltd* [1918] AC 350, 369

60 *Hibbert v Pigou* (1783) 3 Doug KB 213

61 *Dawsons Ltd v Bonnin* [1922] 2 AC 413. For a more recent case, see *Sugar Hut v Great Lakes Reinsurance (UK) Plc* [2010] EWHC 2636, [2011] Lloyd's Rep IR 198

62 Arnould, "On the Law of Marine Insurance and Average", 833

results unjustifiable from the viewpoint of civil law. Not surprisingly, in *Forsikringsaktielselskapet Vesta v Butcher*[63] it was called "one of the less attractive features of English insurance law".

3.3.4 The absolute character of warranties

Although the XVIIth century courts viewed an absence of fault as an excuse for non-compliance with a warranty[64], in the next century an about turn occurred on this point. In *Bond v Nutt65*, the ship warranted to sail on a particular day was detained in port by an embargo – a circumstance clearly outside the assured's control. Lord Mansfield stated rigidly that the question of compliance: "[…] is a matter of fact; and one that admits of no latitude, no equity of construction, or excuse. Had she or had she not sailed on or before that day? No matter what cause prevented her; if the fact is, that she had not sailed, though she staid behind for the best reasons, the policy was void: the contingency had not happened; and the party interested had a right to say, there was no contract between them".[66]

Since then, it is a general rule that "[n]o cause, however sufficient; no motive, however good; no necessity, however irresistible, will excuse non-compliance" with a warranty.[67] Neither fault, nor knowledge, nor even control of the assured matters. This is sometimes described as the "absolute character" of warranties.

However, the MIA s 34(1) does provide for two exceptions:

(1) A warranty ceases to be applicable to circumstances of the contract: this provision seems to be quite broad and, at first sight, even resembles the materiality requirement. The principle here, however, is *cessante ratione, cessat lex*: in the event that the reason for a law ceases, the law itself ceases. Hence, to claim this exception, the assured must prove that a specific state of things, which had **exclusively** led to introduction

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63 *Forsikringsaktielselskapet Vesta v Butcher* [1989] AC 852, 893

64 *Jefferies v Legandra* (1692) 4 Mod. 58

65 *Bond v Nutt* (1777) 2 Cowp 601, 606. See also *Hore v Whitmore* (1778), 2 Cowp. 784: even the operation of a peril expressly insured against is no excuse for non-compliance.

66 *Bond v Nutt* (1777) 2 Cowp 601, 606

67 Arnould,*"On the Law of Marine Insurance and Average"*, 834

of the warranty, has ceased.[68] An example provided by Sir Chalmers, the drafter of the MIA 1906, demonstrates that the statute implies a very limited application of this principle: namely, an intervention of peace depreciates renders inappropriate a wartime warranty to sail with convoy.

(2) A warranty is rendered unlawful by any subsequent law: it is apparent that a warranty, as any contractual term, should not contradict public policy. Consequently, if it is rendered unlawful after the formation of the contract, non-compliance is excused.

3.3.5 The remedy of "automatic discharge from liability"

The strict compliance doctrine, discussed above, is not restricted to warranties. Conditions of general contractual law also require exact compliance and cannot be only substantially performed.[69] Hence, for a long time the English courts equated insurance warranties to such conditions.[70] However, warranties possess one feature, which distinguishes them from all other types of contractual terms – the remedy of "automatic discharge", contained in the MIA 1906 s 33(3):

"[…] 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".

This rule has two applications:

(1) If a warranty relates in time to circumstances at the inception of the risk, a breach will result in the contract never coming into existence. Here, the warranty is a condition precedent to attachment of the risk under the whole policy; if "[t]here was a falsehood, in respect to the condition of the thing assured; therefore, it was no contract".[71] The premium then is, arguably, refundable due to total failure of consideration under the MIA s 84(1).

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68 See *Agapitos v Agnew (the Aegeon)* (No2) [2002] EWHC 1558, [2003] Lloyd's Rep IR 54

69 As illustrated by *Hoening v Isaacs* [1952] 2 All ER 176 and *Bolton v Mahadeva* [1972] 1 WLR 1009

70 *Pawson v Watson* (1778) 2 Cowp 785; *De Hahn v Hartley* (1786) 1 T.R. 343, etc.

71 *Woolmer v Muliman* (1763) 3 Burr 1419

(2) If a warranty relates to the assured's future conduct, a consequent breach has no effect on the formation of the contract. The risk under the policy has already attached; under s 33(3), the insurer will be discharged from the liability only from the date of the breach. The question is, what does the word "discharged" mean?

Lord Mansfield equated marine warranties to conditions in general contract law, following the earlier cases in this regard.[72] Arguably, the drafter of the MIA 1906, Sir Chalmers intended to uphold this approach, as the following commentary appears in his publications: "[…] a breach warranty in insurance law appears to stand on the same footing as the breach of a condition in other branches of contract".[73] Following this lead, the Law Commission in the 1980 Report stated that a breach of warranty, similarly to a breach of condition in general contract law, entitled the insurer to repudiate the policy: *i.e.,* to choose whether to continue with the contract or terminate it.[74]

However, some years later the House of Lords altered direction with its clarification on this point in *The Good Luck*.[75] In this case, the insurer undertook to advise the mortgagee (bank) promptly if the insurance of the ship were to cease. The ship, in breach of a warranty, sailed to the Arabian Gulf, but the bank was not notified. Without any further investigation, the bank provided loans to the shipowner and afterwards sued the insurer for the failure to provide prompt notification. In its defence, the insurer claimed that it had not exercised the right to repudiate at the time the loans were made – hence, the insurance was intact. Lord Goff disapproved this conclusion:

"[p 202] So it is laid down in s 33(3) that, subject to any express provision in the policy, the insurer is discharged from liability as from the date of breach of warranty. Those words are clear, they show that discharge of the insurer from liability is automatic and is not dependent

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72 *Pordage v Cole* (1669) 83 Eng. Rep. 403. The position of the common law courts on this issue changed following *The Good Luck* case, see *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Good Luck)* [1992] 1 A.C 233.

73 Baris Soyer, "Warranties in Marine Insurance", 8

74 *"Insurance Law"* (1980) Law Com No104, s 6.3 and others.

75 *The Good Luck* [1991] 2 Lloyd's Rep 1

upon any decision by the insurer to treat the contract or the insurance as at an end […]

What it does is (as section 33(3) makes plain) is to discharge the insurer from liability as from the date of breach. Certainly, it does not have the effect of avoiding the contract ab initio. Nor, strictly speaking, does it have the effect of bringing the contract to an end. It is possible that there may be obligations of the assured under the contract which will survive the discharge of the insurer from liability, as for example a continuing liability to pay a premium".

The Good Luck **acknowledged the existence of the remedy exclusively for a breach of an insurance warranty.** In contrast with repudiation, which requires the non-breaching party to make an election about the fate of the contract and then communicate it, this remedy operates automatically. Neither party needs to take any steps in relation to it: "the former policyholder is suddenly without cover and often quite unaware of it".[76] The insurer, however, remains liable for losses incurred before the breach, see the MIA 1906 s 34(1). Notably, this also differs from the remedy for breach of utmost faith obligations, where the contract is voided *ab initio*.

Lord Goff underlined that in the case of automatic termination of the insurer's liability, it is not correct "to speak of the contract being brought to an end, though that may be the practical effect".[77] This conclusion has especially notable consequences in relation to the obligation to pay a premium. In English insurance law, the premium sum is deemed to be earned at the commencement of the policy and, is normally not returnable, because: "[…] if it [adventure] has commenced, though it be only

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[76] M. A. Clarke, *"Insurance Warranties: The Absolute End?"* (2007) *LMCLQ* 474.
The US solution is somewhat different: the majority view holds that breach merely suspends the coverage (*Aguirre v Citizens Casualty Co. of New York* 441 F.2d 142, 1971 A.M.C. 1134 (5th Cir.1971)). A second line of American cases declares that the insurer is 'discharged' or the policy is 'void' without going into detail as to what this means. Shoenbaum presumes that the insurer has the right to repudiate; thus, there is no automatic termination rule in American cases.
For a further discussion, see Thomas J. Schoenbaum, *"Key divergences between English and American law of marine insurance"* (Centreville, Maryland: Cornell Maritime Press, 1999), 148–150

[77] *The Good Luck* [1991] 2 Lloyd's Rep 191, 202

for twenty four hours or less, the risk is run; the contract is for the whole entire risk, and no part of the consideration is returned".[78] Therefore, the assured is not only automatically left without the insurance cover in the event of the slightest breach, but may still be obliged to pay consequent installments of the premium.

It is clear that, even though the onus of proof of non-compliance rests on the insurer[79], a breach of warranty defence is one of the mightiest weapons in its arsenal. The MIA 1906 envisaged three ways of mitigating the severity of the "automatic discharge" doctrine:

(1) S 33(3) provides that the parties can contract out of the "default" statutory regime: for instance, by introducing "held covered" clauses into the policy;

(2) S 34(1) provides that non-compliance with a warranty is excused when, by reason of a change of circumstances, the warranty ceases to be applicable, or when compliance with the warranty is rendered unlawful by any subsequent law;

(3) S 34(3) provides insurers with the right to waive a breach of warranty.

This option has been a topic of considerable academic debates.[80] *In brevi*, English law recognises two types of waiver: by election (1) and by estoppel (2). After *The Good Luck*, the common view is that there is no place for election in the automatic discharge doctrine: "It follows that waiver by election can have no application in such a case and the waiver, therefore, referred to in section 34(3) of the MIA 1906 must encompass waiver by estoppel".[81]

Essentially, waiver by estoppel is a promise not to rely on a breach of warranty as a defence; the representation to that effect must be unequiv-

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78 *Tyrie v Fletcher* (1777) 2 Cowp666. For recent example, see *JA Chapman & Co Ltd v Kadigra Denizcilik ve Ticaret* [1998] Lloyd's Rep IR 377

79 *Barret v Jermy* (1849) 3 Exch 535; *Bonney v Cotnhill Insurance Co* (1931) 40 L1L Rep 39, etc.

80 For extensive analysis of a concept of waiver in the marine insurance warranty regime, see: Baris Soyer, *"Warranties in Marine Insurance"*, 155–177.

81 *HIH Casualty and General Insurance Ltd v New Hampshire Insurance Co* [2001] 2Lloyd's Rep 161

ocal, and relied upon in circumstances "where it would be inequitable for the insurer to go back on his representation".[82] This representation may be either by words or by conduct, but not by silence, as "an automatic discharge which is not required to be perfected by the insurer and inactivity can only favour preservation of that discharge".[83] From a practical point of view, waiver by estoppel puts a heavier burden of proof on the assured. Furthermore, being an equitable remedy, it introduces an element of discretion into the already complicated warranty regime.

3.3.6 Subsequent remedy is irrelevant

The MIA 1906 s 34(2) states:

"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".

Previously, doubts were expressed about the general applicability of this rule in marine insurance. The majority of cases recognised the irrelevance of the later remedy; for instance, in *Forshaw v Chabert*[84], the vessel under a voyage policy at and from Cuba to Liverpool was warranted to have 10 men onboard. It in fact did so; but two men were contracted to sail only to Jamaica, where they were replaced. The warranty was held to be breached at the time the ship sailed from Cuba, despite the subsequent remedy. However, in *Weir v Aberdeen85*, Abbot CJ stated: "I confess that I was a little surprised at that proposition, because, if true in point of law, I fear we should find many cases indeed where it would turn out that the assured could have no claim upon underwrites […]". This inconsistency was brought to an end by *Quebec Marine Insurance Co v Commercial Bank of Canada*[86], which criticized the *Weir v Aberdeen* approach as "a

82 *Kosmar Villa Holidays Plc v Trustees of Syndicate 1243* [2008] EWCA Civ 147

83 Sarah Derrington, *"The law relating to non-disclosure, misrepresentation and breach of warranty in contracts of marine insurance. A case for reform"* (The University of Queensland, 1998), 308

84 *Forshaw v Chabert* (1821) 3 Br&B 159. See also *DeHahn v Hartley* (1786) 1 T.R. 343, etc.

85 *Weir v Aberdeen* (1819) 2 B.& Ald. 320

86 *Quebec Marine Insurance Co v Commercial Bank of Canada* (1870) LR 3 PC 234

proposition of perilous latitude" and confirmed that once a warranty is breached, the later remedy is irrelevant.

From the assured's perspective, this principle may lead to a number of unjustifiable results. First, too much depends on a formal construction of a particular clause: if the provision is construed as a descriptive condition, the later remedy of the breach reinstates the insurer's liability; but if essentially the same provision is construed as a warranty, the breach results in irreversible discharge. For example, in *Farr v Motor Traders Mutual Insurance*[87], an obligation to drive the taxi for one shift only was held to be a description of the risk; hence, when the owner ceased using the cab twice per day, the insurer's liability resumed – but had it been construed as a warranty, the owner would have been left without cover. Moreover, if the policy includes a "premium warranty" – an undertaking that premium installments shall be paid at the specified time or rate, and a payment is late, the assured remains without cover, but still liable to pay each future instalment required by the policy.

To draw a conclusion, the warranty regime under the MIA 1906 is based on: (1) the "strict compliance" doctrine, which disregards the issues of materiality, causation or fault; and (2) the "automatic discharge" doctrine, which provides the insurer with the exclusive remedy of automatic termination of liability from the moment when a breach of a warranty occurs. Furthermore, the assured is deprived of any possibility of remedying the breach, once it has occurred.

3.4 Implied and express warranties

3.4.1 Implied warranties

Warranties may be classified differently[88]; the MIA 1906 s 33(2) distinguishes between implied and express warranties in accordance with their structure. The MIA 1906 names four implied warranties: seaworthiness (s 39(1)), portworthiness (s 39(2)), cargoworthiness (s 40(2)) and legality

[87] *Farr v Motor Traders Mutual Insurance* [1920] 3 KB 669

[88] For a further discussion, see Baris Soyer, "*Warranties in Marine Insurance*", 8–10

(s 41), as well as six "navigation" conditions of similar effect.[89] Due to the limits of this article's scope, only two implied warranties (of seaworthiness and legality) are briefly discussed below, in order to demonstrate how their regulation deviates from the general warranty regime.

3.4.1.1 Seaworthiness

The MIA 1906 s 39(1) provides that:

"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".

Seaworthiness is a complex category. In case law, it is defined either through the reasonable fitness of the vessel to encounter the ordinary perils of the voyage insured[90]; or through what the ordinary, careful and prudent owner would require[91]; or both.[92] According to the MIA s 39(4), a ship is deemed seaworthy "when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure insured".

Requirement to be fit in "all respects" is far reaching, but does not stand for a pure perfection; the degree of seaworthiness: "[…] varies with the place, the voyage, the class of ship, or even the nature of the cargo"[93], as well as other factors. Moreover, the warranty of seaworthiness does not impose a continuing duty on the assured. As Arnould puts it, "it is enough to satisfy this warranty that the ship be originally seaworthy for the voyage insured when she sails on it".[94]

The noteworthy restriction is that this warranty does not apply to time policies. As explained by *Gibson v Small*[95], it would be too problematic to identify a appropriate/reasonable moment for attachment of the warranty; under time policies, the shipowner on many occasions may have no

89 See the MIA ss 42, 43, 54, 46, 48 and 49 respectively.
90 *Dixon v Sadler* (1839) 5 M&W 40,414
91 *McFadden v Blue Star Line* [1905] 1 K.B. 696
92 *Gibson v Small* (1853) 4 HLC 353
93 *Foley v Tabor* (1861) 2 F&F 663
94 Arnould, *"On the Law of Marine Insurance and Average"*, 901
95 *Gibson v Small* (1853) 4 HLC 353

knowledge or control over the state of the vessel. However, the MIA s 39(5) contains the special provision for **time policies:**

"[…] 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".

Notably, the quoted rule is closer to the civil law approach on the issue of seaworthiness, as it has regard both to culpability of the assured[96] and causation; the question is, could these principles be further extrapolated? For instance, the so-called "American rule" applies both to **voyage and time** policies, and consists of two parts: one absolute warranty of seaworthiness at the commencement of the voyage and one continuing "negative warranty", similar in operation to the MIA 39(5).[97]

3.4.1.2 Legality

The MIA 1906 s 41 provides that:

"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".

Hence, the warranty of legality may be separated into two parts:

(1) Illegality of the adventure insured relates to the inception of the contract. Activities may be rendered illegal, for example, by public policy[98]; yet more often they are rendered illegal by statute – either by an express prohibition of a certain type of activity[99], or impliedly. In order to find an implied prohibition, courts must decide: does the statute have an objective to prohibit a particular action? As explained in *Redmond v.*

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96 Privity here includes actual knowledge and "turning a blind eye" on truth; see *Companania Maritima San Basilio S.A. v Oceanus Mutual Underwriting Association (Bermuda), Eurysthenes* [1976] 2 Lloyd's Rep 171

97 See Trine-Lise Wilhelmsen, *"Issues of Marine Insurance"*, 149; Thomas J. Schoenbaum, *"Key divergences[…]"*, 167

98 See *Masefield AG v. Amlin Corporate Member Ltd.* [2010] EWHC (Comm) 280, where the Court of Appeal held that it is not contrary to public policy to ransom a vessel from pirates

99 *Darby v. Newton* (1816) 128 Eng. Rep. 1146; *Wainhouse v. Cowie*, (1811) 128 Eng. Rep. 297, etc.

Smith[100], non-compliance with the statute "passed for a collateral purpose only" does not lead to illegality of the activity.

(2) Illegality during the performance of the activity insured refers to subsequent misconducts of the assured. It is not that any illegal action constitutes a breach of the warranty of legality: if the misconduct is completely accidental to the marine activity itself, the said breach cannot be claimed.*101* However, there are hundreds of relevant maritime safety regulations; does a violation of any one of them constitute a breach of the warranty? It seems that Australian law gives an affirmative answer[102], by contrast with English law, which applies here the same test of an "implied prohibition" as for establishing the initial illegality.[103] Arguably, the English approach is preferable, as it limits a further expansion of the warranty regime.

It is worth noting that in relation to the continuous warranty of legality, the MIA 1906 s 41 envisages a deviation from the general warranty regime. Namely, it denies the absolute character of this warranty: if the activity/action was beyond the control of the assured, a breach is excused. In *Cunard v. Hyde*[104], the assured in such a position was granted the recovery despite his knowledge of the illegal actions of the carrier.

Overall, the special rules on seaworthiness and legality modify the general warranty regime to a certain extent, *by* reference to the issues of causation, privity or control of the assured. Presumably, this demonstrates that the English courts and the drafters of the MIA understood that, at least in some circumstances, the general warranty regime was capable of producing unfair outcomes and, thus, should have been voided not have been applied.

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100 *Redmond v. Smith* (1844) 135 Eng. Rep. 183. See also *St. John Shipping Corp. v. Joseph Rank Ltd.* [1957] 1 Q.B. 267.

101 *Bird v. Appleton* (1800) 8 TR 562; *Royal Boskalis Westminster N. V. v. Mountain* [1999] Q.B. 674

102 *Doak v. Weekes* (1986) 82 FLR 334; *Switzerland Insurance Australia v Movie Fisheries Pty Ltd* (1997) 144 ALR 234

103 *St. John Shippimg Corp v Joseph Rank Ltd* [1957] 1 QB 267. For a further discussion, see Baris Soyer, *"Warranties in Marine Insurance"*, 127

104 *Cunard v. Hyde* [1860] 121 Eng. Rep. 1

3.4.2 Express warranties

The MIA 1906 s 35(2) provides that in marine insurance, an express warranty must be included in, or written on, the policy, or must be contained in some document incorporated by reference into the policy. There is a plethora of various types of express warranties: the MIA 1906 mentions the warranties of neutrality (s 36) and good safety (s 38); the Institute Warranties 1/7/76 establish geographical warranties; Institute Time Clauses – Hulls (ITCH) 1/11/95 identify:

- the towage and salvage warranty (ITCH(95) cl.1.);
- the disbursements warranty (ITCH(95) cl.22); and
- the classification clause (ITCH(95) cl.4.1), which imposes on the assured a duty to ensure that the ship possesses and maintains her class.

Although the Classification Clause is not expressly referred to as a "warranty", the ITCH (95) cl.4.2 implies that conclusion, by providing a remedy of automatic termination of liability in case of breach, in full accordance with the MIA s 33(3) and *The Good Luck*[105] doctrine; although "if the Vessel is at sea at such date the Underwriters' discharge from liability is deferred until arrival at her next port". In addition, cl.5.1 refers to automatic termination of the contract in case of breach of duties under cl.4.1; cl.5.2 envisages the same effect for any change of ownership, flag, management, charter on a bareboat basis, or requisition of the Vessel. Notably, the issues of classification and materiality are so fundamental for insurance contracts that even some civil law countries have introduced a warranty-like regime to handle them.[106]

Overall, after considering the main characteristics of the warranty regime under the MIA 1906, it is safe to conclude that warranties are a powerful instrument of risk administration for the insurer. The severity of the warranty regime can even be superfluous, as it does not allow the considerations of materiality, causation or culpability to improve the assured's position. Although there are some exemptions and deviations

[105] *The Good Luck* [1991] 2 Lloyd's Rep 191

[106] For a further discussion, see Chapter 4, s 4.3.

from the general rules (for example, the MIA s 39(5) and s 41), as well as mitigation instruments (waiver, "held covered" clauses, etc.), outcomes of individual cases may still be unjustifiable. However, is it possible to avoid the use of warranties completely? Here, experience from the civil law countries could be relevant. A perfect example is Norway, where a comprehensive set of marine insurance rules is embodied in the agreed policy document, with a balanced approach to interests of assureds and insurers – the Nordic Marine Insurance Plan.

4 Norwegian approach to alteration of risk

Insurance relationships in Norway are primarily regulated by the general Insurance Contracts Act (ICA) 1989. However, the ICA is not mandatory for insurance relating either to ships, which are subject to registration according to the Norwegian Maritime Code 1994, or to goods in international transit.[107] Hence, the most significant role in marine insurance is left to marine insurance plans: standardised conditions drafted jointly by representatives of insurers, assureds and other interested parties. The latest version of these conditions is the Nordic Marine Insurance Plan (NMIP) 2013, based on the Norwegian Marine Insurance Plan 1996. Although the NMIP is not binding for parties until incorporated into contract, it explicitly illustrates the common practices of the Norwegian insurance market.

4.1 General provisions on alteration of risk

Norway, as in the majority of the civil law countries, has adopted the doctrine of alteration of risk to regulate a continuing duty of the assured not to undermine the fundamental estimations behind the insurance contract. Provisions on alteration of risk in the NMIP are divided into two groups: general regulations, § 3-8 to 3-13, and special rules, § 3-14

[107] See the ICA 1989, ss 13(c), (e)

to § 3-21. A conceptual definition of alteration of risk is provided by the NMIP, § 3-8, first paragraph:

"An alteration of the risk occurs when there is a change in the circumstances which, according to the contract, are to form the basis of the insurance, and the risk is thereby altered contrary to the implied conditions of the contract".

Therefore, a "true" alteration of the risk insured is distinguished from irrelevant changes of circumstances by two criteria[108]:

(1) There must have been a change of a fortuitous nature. Such "change" may include both an alteration of the subject matter insured, and a pure increase of the risk; however, similarly to the English approach, a mere increase of intensity of a peril insured will not constitute an alteration of risk;

(2) The said change must amount to frustration of the fundamental expectations upon which the contract has been based. Here, a construction of the policy in accordance with the general principles of insurance and contract law is needed in order to decide whether it would be reasonable to give the insurer an opportunity to apply the sanctions provided by the NMIP.

Speaking about the sanctions for alteration of risk, Professor Trine-Lise Wilhelmsen argues that in civil law jurisdictions they are normally connected with the following issues[109]:

(1) Culpability of the assured;

(2) How the insurer would have reacted had he known about the alteration of risk when the contract was entered into;

(3) How the alteration of risk has influenced the casualty or the extent of the loss.

Hence, the questions of culpability, materiality and causation are taken into account in different proportions, in contrast with the English warranty regime. The civil law approach is reflected in the NMIP § 3-9, which provides that if the assured **intentionally caused or agreed** to

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108 See the Commentary to the NMIP § 3-8

109 Trine-Lise Wilhelmsen, *"Issues of Marine Insurance"*, 117

an alteration of the risk, further sanctions will depend on the degree of **subjective materiality** of the alteration to the insurer:

(a) If the insurer would not have accepted the insurance, had he known of alteration in advance, the contract is not binding for him. The Commentary to the NMIP § 3-9, with reference to § 3-3, further clarifies that there is no need for the insurer to additionally cancel the contract to avoid the future liability[110];

(b) If the insurer would have accepted the risk, but on different terms, then it is possible for him to avoid the liability only if there is a **causal link** between the loss and the alteration.

Furthermore, the NMIP § 3-10 provides that if an alteration of the risk occurs, the insurer has a right to cancel the insurance for any future period by giving fourteen days' notice, whenever the alteration was caused by the assured or by circumstances outside of his control.[111] Nevertheless, the NMIP 3-12 first paragraph precludes the insurer from invoking both § 3-9 and § 3-10 if the alteration of the risk has ceased to be material to him. Consequently, the Norwegian approach, as opposed to the English one, generally does not allow reliance on immaterial changes to the risk.

4.2 Special provisions on alteration of risk and the concept of safety regulations

As mentioned above, the NMIP contains special provisions for certain types of alterations of the risk insured in § 3-14 to § 3-21. Previously, § 3-22 of the Norwegian Plan 1996 regulated the duty of the assured to ensure the ship's seaworthiness. Parallel to the English approach, the concept of seaworthiness was understood as being a relative one. For instance, the Commentary to the NMIP 1996, citing Section 2 of the Seaworthiness Act 1903 and the case ND 1973.450 *NH RAMFLØY*, concluded with the following: "The ship is seaworthy if it maintains a certain minimum technical (hull, equipment, machinery) and operational

[110] The NMIP § 3-13, however, requires the insurer to give notice of his intentions to invoke § 3-9

[111] Trine-Lise Wilhelmsen, Hans J. Bull, *"Handbook in Hull Insurance"* (Gyldendal Akademisk, 2007), 156

(crew, loading) standard. The standard is a function of the navigation for which the ship is intended […] The decisive factor is the risk associated with sending the ship out to sea".

In case of unseaworthiness, the insurer was not liable for the loss: (1) if the assured **knew or ought to have known** of the defects in the ship's condition at such a time that it would have been **possible for him to intervene**; and (2) the loss was **a consequence** of the ship not being in a seaworthy condition. This provision strongly resembled the special rule for time policies contained in the MIA s 39(5). The latter similarly takes into account the issues of the assured's control over the state of the ship, his privity and a causal connection between the state of unseaworthiness and the loss. However, in 2007, in accordance with the newly adopted Ship Safety and Security Act, the notion of seaworthiness and the corresponding rule were removed from the NMIP 1996 § 3-22.

Instead, the legislation concentrated on defining "which requirements the ship must fulfill at any point in time"[112], or, in other words, on the notion of **safety regulations** – "rules concerning measures for the prevention of loss".[113] Notably, the category of safety regulations is defined as having this objective; otherwise, "if the requirement is linked to an entirely different purpose[…] Cases like this must come under the rule against illegal undertakings in Cl. 3-16".[114] Hence, those defects that previously would have rendered the ship unseaworthy, will nowadays normally represent a breach of some safety regulations. As Professor Trine-Lise Wilhelmsen states: "Compared to the regulation of seaworthiness, the advantage of safety regulation is that it is much easier to document a breach of safety regulation than to prove that the ship was unseaworthy".[115]

It is worth recalling that views vary on the problem of breach of safety regulations in the common law world. While the Australian approach

[112] *Ibid*, 138

[113] See the NMIP § 3-22

[114] See the category of safety regulations is limited by the aim; as the Commentary explains. This footnote feels like half a sentence? I'm also not sure what "aim" is referring to?

[115] Trine-Lise Wilhelmsen, *"Issues of Marine Insurance"*, 159

tends to treat even technical breaches of the shipping safety legislation as a breach of the warranty of legality, without inquiring into the intent behind the statute[116], the English approach is based on the principle that "it is important to consider, in each instance, the objective of the legislation which has been contravened".[117] It follows that, generally, a breach of a safety regulation will not render the whole activity illegal; "[t]hus, if breach of safety regulations does not make a ship unseaworthy, in the absence of express warranties (as in IHC 2003) there's no breach of warranty"[118].

Therefore, the English approach is closer to the Norwegian one in the sense that it underlines a correlation between the categories of safety regulations and seaworthiness. However, the English solution implies that breach of safety regulations in some, though not all, situations may constitute breach of warranty and, thus, lead to automatic discharge of the insurer's liability regardless of the issues of materiality, causation or fault of the assured. In contrast, the general rule of the NMIP § 3-25, first subparagraph, first sentence, requires both the fault of the assured in breaching the safety regulation and the causal connection between the breach and the loss for the insurer to avoid liability. Arguably, there is also an implied requirement of materiality, as a minor or irrelevant breach is not likely to cause the loss. Therefore, it could be said that the exclusion of the seaworthiness provision from the NMIP in 2007 did not have a detrimental effect on the assured's position.

Speaking of the **special provisions** on alteration of risk included in the current version of the NMIP, it must be mentioned that the NMIP § 3-16, which addresses illegal activities, also requires culpability of the assured as well as causal connection between breach and loss, in order to free the insurer from liability. However, the NMIP recognises exceptions to these general requirements. First, there are three provisions with a

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116 See *Doak v. Weekes* (1986) 82 FLR 334; *Switzerland Insurance Australia v Movie Fisheries Pty Ltd* (1997) 144 ALR 234

117 Susan Hodges, "Cases and Materials on Marine Insurance Law", 329

118 Baris Soyer, "*Warranties in Marine Insurance*", 126

suspensive effect that resemble "conditions descriptive of the risk" in English insurance law:

(1) Sailing in excluded trading areas (§ 3-15, 3rd par.);

(2) Suspension of the insurance in the event of requisition (§ 3-17);

(3) Removal of the ship to a repair yard (§ 3-20, 2nd par.).

Furthermore, there are two provisions on loss of main class (§ 3-14) and change of ownership (§ 3-21), which provide a remedy of automatic termination of the insurance without regard to elements of causation or fault. Although they are not expressly called "warranties", there is little doubt that these provisions were designed under the influence of the warranty regime.

4.3 Warranty-like provisions

A reason for the introduction of the warranty-like provisions on loss of the main class and change of ownership in the NMIP § 3-14 and § 3-21 rests in the fundamental character of these issues to marine policies. Presumably, loss of the class and change of the vessel's owner affect the essence of the insurance so significantly that, even if the assured were not blameworthy for such alteration[119], it would be unfair to keep the insurer to his original promise.

(1) The NMIP § 3-14 provision on loss of the main class, analogous to the ITCH (95) cl.4.1.1, envisages both:

- An affirmative warranty that the vessel has the main class at the inception of insurance (§ 3-14 1st paragraph). In case of breach, the insurer never becomes at risk under the policy;
- A continuous duty of the assured to maintain the main class (§ 3-14 2nd paragraph). In case of breach, the policy automatically terminates, *cf.* the ITCH (95) cl.5.1.

(2) The NMIP § 3-21 provides that "the insurance terminates if the ownership of the ship changes by sale or in any other manner". The assured's continuous undertaking to maintain the ownership is significantly narrower than the ITCH (95) cl.5.2, and does not embrace situations of

[119] *Cf.* The general rule in the NMIP § 3-9

requisition (the NMIP § 3-18), change of flag or management (the NMIP § 3-8 2nd paragraph), and so on.

It should be underlined that neither the NMIP § 3-14, nor the NMIP § 3-21 make a distinction between "termination of the insurance [contract]" and "discharge from liability", which is the true remedy for breach of warranty in English insurance law.[120] The distinction may be relevant in relation to surviving duties of the assured: for example, to pay the premium. Nevertheless, some aspects of these provisions, such as disregard to causation and culpability of the assured, resemble the English warranty regime and represent a huge departure from the general system of the NMIP.

In the *traveaux preparatoires* for the ICA, the legislators expressed a considerable scepticism about the place of warranties in the Norwegian insurance; it was noted that in individual cases the Norwegian courts might apply Section 36 of the Contracts Act (Avtaleloven), regarding unreasonable contracts, to set aside warranty clauses.[121] However, such an outcome seems rather unlikely: first, the courts are reluctant to apply Section 36 to contracts between professional parties, which are the majority of marine insurance policies. Next, the NMIP § 3-14 and § 3-21 in particular are the provisions of the agreed document, and the courts may not want to disturb its inner balance. The fact that analogous warranties exist in other jurisdictions may also be relevant.

A breach of a warranty provision has not been frequently claimed before the Norwegian courts. In ND 1981.347 *Vall Sun*, the P&I insurer argued that it was an implied condition for membership in the insurance group – hence, a condition precedent to the insurance cover (warranty) – that the ship had the class. As *Vall Sun* was deprived of her class at the time of the casualty, the insurer was discharged from liability, regardless of a causal link between the loss of class and the casualty. The court disagreed, on following grounds:

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120 *The Good Luck* [1991] 2 Lloyd's Rep 191; cf. the ITCH (95) cl.4.2 and 5.1

121 "*The use of warranties in Norwegian marine insurance*", Wikborg Rein's Shipping Offshore Update 1/2009, 6–7

(1) In this particular case, the cancelation of the class occurred from a pure misunderstanding between the assured and the classification society, so that the court found it more just to disregard it completely.[122] Arguably, a position of the English courts would be stricter in this respect[123];

(2) Even if the class was lost, the Norwegian Plan 1964, § 31 2nd sub-paragraph, expressly stated that such loss was a general alteration of the risk, which only entitled the insurer to cancel the insurance after giving notice (§ 33). Since the NMIP 2013 § 3-21 provides another solution, nowadays the insurer presumably might have been more successful. For instance, in *Tor Hollandia*[124], the court not only construed a contractual provision as a warranty, but also confirmed that in order to trigger legal effects of its breach, a causal link between the breach and the loss was not required. This could be a step towards the recognition of the utility of warranties in Norwegian insurance.

Overall, apart from a few exceptions, the Norwegian approach to alteration of risk is based on the notions of materiality, causation and, to some extent, culpability of the assured. This demonstrates that the insurer can be provided with sufficient legal protection without the shelter of the extensive warranty regime. Hence, many academics have focused on the Norwegian experience when seeking an impetus for reform of marine insurance in the common law countries.[125]

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122 ND 1981.347, 361

123 See Chapter 3, s 3.4.4

124 *Tor Hollandia* (2008) Oslo City Court (Tingrett) 07-139941TVI-OTIR/06

125 See: Baris Soyer, *"Warranties in Marine Insurance"*, Chapter 7.V; Sarah Derrington, *"The law relating to non-disclosure[…]"*, Chapter 9.3; The Consultation paper No182 (2007) s 7.62, etc.

5 Reform of the warranty regime

5.1 Critique and support of warranties

5.1.1 Drawbacks of warranties

Historically, the excessive severity of the warranty regime in insurance law could not pass unnoticed. For a long time, it drew the critique of academics, market players, and even judicial authorities. In *Hussain v Brown*[126], Saville LJ described warranties as "draconian terms", because "[t]he breach of such a warranty produces an automatic cancellation of cover, and the fact that a loss may have no connection with that breach is irrelevant".

In the 1980 Report, the Law Commission concluded that the law relating to non-disclosure and breach of warranty was "undoubtedly in need of reform". In particular, it appeared unjust that[127]:

(1) The insurer could demand a strict compliance with a warranty, which was immaterial to the risk **(no materiality requirement)**;

(2) The insurer could reject a claim for any breach, no matter how irrelevant that breach was to the loss **(no causation requirement)**;

(3) In respect of "basis of the contract" clauses, the insurer could avoid liability upon purely technical grounds.

In the 2006 Issues paper, the Law Commission referred mainly to the same flaws of the warranty regime, adding that it seems unjust that[128]:

(1) The insurer may refuse to pay a claim, though the breach has been remedied **(irrelevance of the later subsequent remedy)**;

(2) The insurer is entitled to a whole amount of the premium despite the termination of cover, which appears especially unfair in cases of breach of so-called "premium warranties".[129]

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126 *Hussain v Brown* [1996] 1 Lloyd's Rep 627, 630

127 *"Insurance Law"* (1980) Law Com No104, ss 6.9(a), 6.9(b) and 7.2 respectively

128 The Issues paper 2 *"Warranties"* (2006), ss 5.3 and 7.77 respectively

129 See discussion in Chapter 3, s 3.4.5

Therefore, the typical characteristics of insurance warranties may turn them into a source of a striking injustice to the assured, "technical traps for the benefit of the insurer written into the fine print of policies which are "*not worth the paper upon which they are written*".[130] The problem is not merely theoretical: Mactavish, the British research group on insurance governance, reported in 2014 that warranties were the third most common ground for insurance disputes.[131]

Another reason for concern rests in the process of internationalisation of the insurance market. It is generally viewed as a distant perspective, but the Law Commission agrees that there are some European initiatives, which may eventually influence the framework of insurance law. However, many English practices are perceived in the civil law countries as both "unfair and unusual".[132] The warranty regime is especially problematic, as the prospect of leaving the assured without cover for a minor and/or non-causative breach appears rather peculiar to the continental systems. Even the common law countries have revised the traditional approach to a certain extent.[133] Hence, the warranty regime, as codified by the MIA 1906, creates a hindrance to the harmonisation of insurance law.

A perfect illustration of the collision between the English and the civil law approaches is the *Vesta v Butcher*[134] case, where a Norwegian fish farm was insured against loss of fish under Norwegian law, but the risk was reinsured in London. The policy contained a condition of keeping a constant watch, which was never complied with; however, there was no causation between the non-compliance and the subsequent loss of fish in the storm. The Norwegian insurer paid, while the English underwriters claimed a breach of warranty. Remarkably, the House of Lords was able to sidestep this defence only by stating that, in this particular case, the

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130 John Hare, *"The Omnipotent Warranty: England v The World"*, 53, with reference to *Zurich Insurance Company v Morrison* [1942] 1 ER 529 and *Anderson v Fitzgerald* (1853) 10 ER 551

131 The Law Commission Report No 353 (2014), s 14.5

132 The Consultation paper No182 (2007) ss 1.84–1.85

133 See, for example, New Zealand's Insurance Law Reform Act 1977, s 11; Australian ICA 1984, s 54

134 *Forsikringsaktieselkapet Vesta v Butcher* [1989] AC 852

reinsurers had agreed to cover all the risks embraced by the original policy.

Finally, English insurance companies should also be interested in keeping the London market in accord with international standards, in order to preserve its attractiveness for new clients. For instance, the Association of British Insurers (ABI) confirmed that a reform in respect of the consequences of breach of warranty was necessary, though "in business insurance the guiding principle should be freedom of contract".[135]

5.1.2 Benefits of warranties

Nevertheless, some respondents advocated before the Law Commissions in the UK and Australia that warranties were a necessary feature of insurance contracts. The arguments presented on this point were[136]:

(1) Safety: warranties serve as a measure to promote high standards of the assured's performance in respect of seaworthiness, legality, compliance with class recommendations, and so on. Hence, an abolition of warranties could lead to an unwanted relaxation in these areas. **As counterargument,** it may be said that these public policy issues should not be dealt with through the regulation of private contractual relationships.

(2) Simplicity: warranties help to avoid a burdensome process of proving the presence of elements of causation and culpability. However, this advantage has a rather one-sided character, as it primarily benefits the insurer.

(3) Contractual freedom: the MIA s 33(3) allows the parties to contract out of the consequences of breach of warranty, envisaged by the statute. Yet it should be remembered that shipowners and even brokers have different levels of expertise: they may simply miss the true meaning of a policy clause, especially if it is drafted without the use of the word "warranty".

(4) Industry self-regulation: insurers frequently claim that a legislative interference into the warranty regime is not needed, because

135 The Report No 353 (2014), s 14.13

136 *Ibid*, ss 14.17–14.22; *"Review of the Marine Insurance Act 1909"*, ALRC Report 91 (2001), ss 9.23–9.37

they already tend to avoid reliance on minor or non-causative breaches. Indeed, such practice exists[137], but its non-obligatory character exposes the assured to the insurer's discretion.

However, there are a number of other methods adopted by the courts and by the participants in the insurance industry in England and other common law countries in order to ameliorate the warranty regime. It is worth examining them prior to a discussion of legislative reforms.

5.2 Attempts to mitigate the warranty regime in the UK and other common law countries by judicial interpretation of policy and introduction of special policy provisions

5.2.1 Construction of policy by courts

There are two main methods available to mitigate the harsh consequences of breach of warranty: the policy itself may contain special provisions to this effect, or it could be done through judicial interpretation of contractual clauses. For that purpose, the common law courts have adopted two approaches:

(1) Restrictive construction of a warranty;

(2) Construction of a warranty as another contractual term.

5.2.1.1 Restrictive construction of warranty

For a long time the common law courts have recognised that, due to the severity of the warranty regime, its applicability must be restricted by judicial interpretation: *i.e.*, any ambiguity in a warranty should be construed in accordance with the *contra proferentum* rule. The essence of this rule in the marine insurance context was explicitly formulated in *Winter v Employers Fire Insurance Co*[138]: "[…] marine contracts are strictly construed against the insurer and favorably to the insured, and

[137] For a further discussion, see Chapter 5, s 5.2.2.3.

[138] *Winter v Employers Fire Insurance Co* [1962] 2 Lloyd's Rep 320, 323

where two interpretations are possible, that which will indemnify the insured will be adopted".

Supportive principles of restrictive construction may be summarised as follows[139]:

(1) If insurers wish a warranty to have draconian consequences, "then it is up to them to stipulate for it in clear terms"[140];

(2) If the literal wording of a warranty is inconsistent with a reasonable and businesslike interpretation, it is likely that the parties have not intended such a result;

(3) A literal interpretation of a warranty must not be inconsistent with other policy terms;

(4) Furthermore, a warranty may be construed as being relevant to only some risks covered in the policy. For example, in *Printpak v AGF Insurance Ltd*[141], the policy was divided into different sections; the court found that a warranty to install a burglar alarm referred only to the theft section, but not to the fire risks. However, this principle has a limited application: in *Sugar Hut*[142], the policy covered four nightclubs. The court stated, *obiter*, that as these four places were the subject matter of the same insurance, a breach of warranty in one club would leave all of them uncovered. Therefore, even restrictive construction of warranty clauses may not always help the assured.

5.2.1.2 Construction of a warranty as a suspensive condition

The second method of mitigation adopted by the courts is that a clause may be construed not as a warranty, but as another contractual term – namely, a condition descriptive of the risk. Non-compliance with such a condition only suspends the insurance cover, which provides the assured with an opportunity to remedy the breach. The English courts have

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139 Based on the Consultation paper No204 (2012), s 12.46

140 *Hussain v Brown* [1996] 1 Lloyd's Rep 627, 630

141 *Printpak v AGF Insurance Ltd* [1999] Lloyd's Rep IR 542

142 *Sugar Hut v Great Lakes Reinsurance (UK) Plc* [2010] EWHC 2636, [2011] Lloyd's Rep IR 198

applied this reasoning in a number of non-marine insurance cases.[143] In *Provincial Insurance Company Ltd v Morgan & Foxton Coal*[144], the House of Lords held that on "a strict but reasonable construction" a statement that the insured lorry would be used for transportation of coal was only a description of a normal use of the vehicle; hence, the carriage of other goods did not terminate the policy.

In the recent case *Kler Knitwear v Lombard General Insurance Co Ltd*[145], the contract expressly stated that an undertaking to have a sprinkler system inspected in 30 days was a warranty; non-compliance was described as terminating the cover "whether it increases the risk or not". In fact, the inspection was carried in 60 days; later the insured factory suffered the storm damage. Despite the fact that the wording of the policy was so precise, Mr Justice Morland held that the term was a suspensive condition, because it would "be utterly absurd and make no rational business sense" to construe it as a warranty.

The *Kler Knitwear* decision aroused considerable criticism.[146] If the clearest language of the policy may be viewed as not indicative of the parties' intentions, an uncertainty about the legal effects of contractual provisions is created. Moreover, the limits of applirrcation of this method of judicial interpretation are blurred, as demonstrated by two cases: *The Newfoundland Explorer*[147] and *The Resolute148*. In both cases, the vessels were warranted crewed "at all times"; the loss occurred while they were either berthed or safely tied up. In *The Newfoundland Explorer*, the court construed the clause in question literally, including time at berth; in *The Resolute*, the warranty was held to refer only to navigation time. Hence, although the courts have benevolent intentions and try to reach

[143] See *Farr v Motor Traders' Mutual Insurance Society Ltd* [1920] 3 KB 669; Roberts v Anglo Saxon Insurance (1927) 27 Lloyd' List Rep. 313, Dawson v Mercantile Mutual Insurance Co Ltd [1932] VR 380; CTN Cash & Carry v General Accident Fire and Life Assurance Corporation [1989] 1 Lloyd's Rep. 299

[144] *Provincial Insurance Company Ltd v Morgan & Foxton Coal* [1933] AC 240 [1933] AC 240

[145] *Kler Knitwear v Lombard General Insurance Co Ltd* [2000] Lloyd's Rep IR 47

[146] See, for example, the Consultation paper No204 (2012), s 12.50

[147] *GE Frankona Reinsurance Ltd v CMM Trust No 1400 (The Newfoundland Explorer)* [2006] EWHC 429

[148] *Pratt v Aigion Insurance (The Resolute)* [2008] EWCA Civ 1314

fair outcomes in individual cases, they introduce inconsistency into insurance law.

5.2.1.3 The role of courts in other common law jurisdictions

The majority of the common law countries share a tendency of "[…] increasingly discarding the more extreme features of English law which allow an insurer to avoid liability on grounds which do not relate to the occurrence of the loss".[149] Partially, it is due to attempts of the local courts to ameliorate the "classical" warranty regime.

In Canada, the courts are inclined to find a term to be a "true warranty" only in "situations where the warranty is material to the risk and the breach has a bearing on the loss".[150] This is illustrated by *The Bamcell II* case[151], where the policy contained a clause "warranted that a watchman is stationed on board the Bamcell II each night". The court construed it as a suspensive condition, applicable only at night; so, despite of a breach, the insurer was liable for the loss, which occurred during the daytime. This practice, however, is criticised on the same footing as *Kler Knitwear*: as harming a fine line between warranties and other types of policy terms.[152]

In the USA, a break with the English approach began with the *Wilburn Boat* case[153], where the Supreme Court held that marine insurance contracts were governed by state law. As the result, nowadays the status of warranties differs from state to state. For instance, in Texas a causal connection test is adopted, while in New York it is required that warranties must materially affect the risk.[154]

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149 *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd and others (The Star Sea)* [2001]1 All ER 743, para 79

150 Christopher Giaschi, *"Warranties in Marine Insurance"*, Association of Marine Underwriters of British Columbia, Vancouver, 10.04.1997

151 *Century Insurance Company of Canada v Case Existological Laboratories Ltd (The Bamcell II)* (1980) 133 DLR (3d) 727

152 Baris Soyer, *"Warranties in Marine Insurance"*, 205

153 *Wilburn Boat Co v Fireman's Fund Ins* [1955] AMC 467

154 For a further discussion, see Thomas J. Schoenbaum, *"Key divergences[…]"*, Chapters 2, 6

Overall, the judicial authorities throughout the common law world have supported the idea of taking into consideration an immaterial and non-causative character of a breach. It allows them to provide justice in individual cases, but on a greater scale, the law becomes more uncertain and unpredictable. Therefore, other means of amelioration of the warranty regime are required.

5.2.2 Self-regulation of the industry

5.2.2.1 "Held covered" clauses

The harsh outcomes of the warranty regime may be avoided at the stage of formation of policy. One option for those who wish to contract out of the statutory envisaged consequences of breach is to use "held covered" clauses.[155] A typical effect of such a provision is that, in the case of a breach of a specified warranty, the insurance cover will continue under two conditions: (1) a notice must be given to the insurer; (2) essential variations to the contract (*i.a.,* concerning the premium) must be renegotiated. If there is disagreement between the parties on the latter point, the assured may end up uncovered.[156] Hence, the mitigation offered by "held covered" clauses has certain limits.

5.2.2.2 The International Hull Clauses 2003

In the attempt to ameliorate marine insurance practices, the London market has produced the International Hull Clauses (IHC) 2003. One of the objectives of these Clauses is a more balanced approach to the warranty regime. Primarily, the navigation provisions are not construed as warranties, in contrast with the ITCH(95) cl.1 and the Institute Warranties 1/7/76. Under the IHC 2003 (cl.10–11), navigating outside of the permitted areas leads only to **suspension of cover**. Moreover, **restriction of cover** is envisaged for a failure to comply with the specified statutory

[155] For example, Clause 3 of the ITCH (95)

[156] For a further discussion, see Baris Soyer, *"Warranties in Marine Insurance"*, 165–166

or Class requirements (cl.14.4.1 –14.4.2): *i.e.,* the insurer shall not be liable for any loss "attributable to such breach".

The reduction of a number of warranties and the limited introduction of a causation element were welcomed among academics.[157] Nevertheless, it should be remembered that the Clauses are not obligatory; their incorporation into insurance policies depends on free will of the parties.

5.2.2.3 Non-marine insurance: the Statement of General Insurance Practice 1986

Notably, the Association of British Insurers (ABI) in Section 2(b)(iii) of the Statement of General Insurance Practice (SGIP) 1986 indicated that the insurer should not appeal to a breach of warranty "where the circumstances of the loss are unconnected with the breach unless fraud is involved". Therefore, insurers were recommended not to rely on technical (non-causative) breaches, except for situations when "they suspect fraud but are unable to prove it".[158]

Non-compliance with the SGIP 1986 could be detrimental to the insurer's reputation; however, this document is not supported by legal enforcement. Furthermore, the SGIP 1986 does not concern marine insurance: here, the assured depends on the insurer's decision to adopt a similar practice independently and adhere to it.[159]

In sum, the fact that marine insurance warranties allow the insurer to rely on any breach, regardless of its relation to the loss, is a widely acknowledged problem. Both the judicial authorities and the participants in the insurance industry have developed various instruments for amelioration of the warranty regime codified in the MIA 1906. Among them are: mitigating interpretation of policies by the courts, adaptation of special provisions by the contracting parties, and even the insurers' self-implied restrictions. However, neither of these solutions seem final,

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157 Andrew Longmore, "Good faith and breach of warranty: are we moving forwards or backwards?", *LMCLQ* (2004), 162

158 *"Insurance Law"* (1980) Law Com No104, s 6.10

159 *Switzerland Insurance Australia v Movie Fisheries Pty Ltd* (1997) 144 ALR 234

as they leave too much to the discretion of the courts, or the insurers. Therefore, the need for legislative reform has been recognised in the UK.

5.3 The legislative reform of the warranty regime in the UK

5.3.1 Previous proposals for reform in the UK

In 1980, the Law Commission introduced an ambitious project of revision of English insurance law. One of its main concerns was unjustified use of warranties to deny cover: (1) when a warranty was not material to the risk; or (2) when a breach of even a material warranty was irrelevant (non-causative) to the loss.[160] For that reason, the Law Commission recommended that the assured should be able to raise the following defences against a claim that the warranty was breached:[161]

(1) The warranty in question was **not material** to the risk: *i.e.,* it would not have influenced a prudent underwriter's assessment of the risk;

(2) The warranty had **another commercial purpose**: *i.e.*, it was introduced against a risk "which does not include the event which gave rise to the claim";

(3) The breach of the warranty **could not have increased the risk** that an event, which gave rise to the claim, would occur in the way in which it did in fact occur. Although this proposal is sometimes referred to as a "causation test", it may be more correct to describe it as an extended materiality requirement. There may be a number of situations where the breach increases the risk in general without causing or contributing to the particular loss.[162]

These proposals were not implemented in practice due to resistance of the industry; but even if they had been, neither of them related to marine, aviation and transport (MAT) insurance. The Law Commission was of the view that the long-established rules worked satisfactorily for MAT

160 *"Insurance Law"* (1980) Law Com No104, ss 6.9(a), 6.9(b)

161 *Ibid*. The Draft Bill, clauses 8(1), 10(5)(a) and 10(5)(b) respectively

162 See, for example, the Issues paper 2 *"Warranties"* (2006), ss. 7.72 – 7.73; *cf.* the Report No 353 (2014), s 14.23

and created "a context of certainty of law and practice".[163] However, the situation has changed since 1980. The share of the London insurance market on the international scale has decreased, while other markets, such as the Norwegian one, have gained attractiveness, partially due to more balanced solutions for the problem of alteration of risk. For instance, Baris Soyer argues that "[…] it is fair to say that Norwegian hull clauses provide a more equitable solution than English law, which helped Norwegian marine insurance to increase its market share dramatically and retain it over the years".[164] Hence, a demand for a thorough revision of the warranty regime was acknowledged, at least in order to bring English law "closer in line with international standards".[165]

5.3.2 Legislative reforms in other common law countries

Although the common law world inherited the English approach to insurance warranties, in New Zealand and Australia it was revised with the help of legislative reforms. The experience of these counties, as well as various attitudes to the issues of materiality and causation, were taken into account by the UK legislators during the recent reform.

5.3.2.1 New Zealand

In New Zealand, the warranty regime has been reformed by Section 11 of the Insurance Law Reform Act 1977. It is a complicated provision, which relates not only to warranties, but also to conditions descriptive of the risk or excluding liability. In brief, if there is an event or a change in circumstances of **subjective materiality** to the insurer, he remains liable, "if the insured proves on the balance of probability that the loss in respect of which the insured seeks to be indemnified was not caused or contributed to by the happening of such events or the existence of such circumstances".

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163 *"Insurance Law"* (1980) Law Com No104, s 2.8

164 Baris Soyer, *"Warranties in Marine Insurance"*, 205

165 The Consultation paper No204 (2012), s 16.3

This formula is broader than a mere causation requirement, especially in the light of the *causa proxima* doctrine, and more lenient towards the insurer. However, Section 11 has drawn criticism as being too insured-friendly: in 1998, the New Zealand Law Reform Commission (NZLRC) proposed that the causal connection test should not apply to a provision which:

(1) defines the age, identity, qualifications or experience of a driver, a pilot, or an operator of a chattel;

(2) defines the permitted geographical area;

(3) excludes the loss for use of a vehicle, an aircraft or other chattel for commercial purposes.[166]

The possible rationale behind this proposal is that the listed circumstances actually mark the scope of the risk indemnified under the policy, so that every change of them equals going outside of this scope. Even the civil law countries know examples of special provisions, comparable in effect: see, for instance, the NMIP 3-15, third paragraph, on suspension of cover during the sail in the excluded trading areas. The question is, however, what exceptions from the causation test are justified? Some of the proposals of the NZLRC might seem rather arbitrary; this problem was taken into account during the recent reform in the UK.[167]

5.3.2.2 Australia

In contrast with the NZ Act 1977, the Australian Insurance Contract Act (ICA) 1984 does not govern marine insurance. Nevertheless, it is worth mentioning that Section 54 of the ICA 1984 introduces both the materiality and causation requirements for non-compliance with terms that exclude or restrict cover. The insurer may not refuse to pay if:

(1) The insured's act could not **reasonably be regarded** as **being capable of causing or contributing to the loss** (Section 54(2)); or

(2) The insured proves that the loss (the isolated part of it) **was not caused** by its act (Sections 54(3) and 54(4)).

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166 *"Some problems of insurance law"* (1998) NZLRC No 46, Ch1

167 See Chapter 5, s 5.3.3.1.

The Australian Law Reform Commission (ALRC) found Section 54 generally unsuitable for marine insurance, but acknowledged that "[i]t is not equitable to allow an insurer the right to avoid liability where there is only a minor or immaterial breach"; hence, a causal link between the loss and the breach of warranty should be required in form of the *causa proxima*, "a well understood insurance law concept".[168] Although this proposal was not applied in practice, it demonstrates the willingness of the Australian market to introduce the element of causation into the warranty regime.

5.3.3 2006–2015 reform process in the UK

Despite extensive non-legislative and legislative attempts to mitigate the warranty regime, for a long time the relevant MIA 1906 provisions have remained a source of potential injustice.[169] Therefore, in January 2006, the UK Law Commission and the Scottish Law Commission started a joint project devoted to the reformation of English insurance law. Their aim was to review its most unfair and outdated traits, including the status of warranties. According to the content of the Commissions' proposals, these can be separated into two groups:

5.3.3.1 2006–2007 proposals

At the first stage of work, the UK Law Commission prepared the Issues Paper 2 "Warranties" (November 2006) and the Consultation Paper No. 182 "Misrepresentation, Non-disclosure and Breach of Warranty by the Insured" (July 2007). Their distinguishing feature was the proposal to introduce **a causation element** into the warranty regime. That, according to the Law Commission, was the necessary step to defeat "the greatest and most obvious problem with the law on warranties" – *i.e.,* termination of cover "for technical breaches that have nothing to do with the loss in question".[170]

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168 *"Review of the Marine Insurance Act 1909"*, ALRC Report 91 (2001), ss 9.120–9.127

169 See discussion in Chapter 5, s 5.1.1.

170 The Issues paper 2 *"Warranties"* (2006), ss 7.66–7.67

Originally, the Law Commission was prepared to adopt the New Zealand "purposive approach" and introduce the causation test not only for warranties, but also for other terms "that enable the insurer to refuse to pay a claim for events or circumstances that add to the risk of loss" (descriptive conditions).[171] However, in 2007 the proposal was limited to warranties "in the narrow sense".[172] This decision was partly inspired by the above mentioned New Zealand theory that the causation element is unsuited to/inappropriate for terms defining the age, identity, experience of a driver, etc. Therefore, it was feared that the causation test, common to both types of terms, would require a blurry list of exclusions.

The other question was, what degree of causation must be sufficient to discharge the insurer from liability? Again, the Law Commission considered experience from the UK and other common law countries. The 1980 Report's proposal that a relevant breach of warranty should **"increase the risk"**, was considered to be too unfavourable to the assured. In contrast, the Australian approach that required the loss to be **"caused"** by a breach was considered too generous, because it implied that the breach must be "a dominant or major cause of the loss".[173]

The Law Commission stated that to discharge the insurer from liability, it should be enough that the breach contributed "in any way to the accident"; hence, it adopted the following formula, which was closer to the New Zealand approach:

"[T]he policyholder should be entitled to be paid a claim if it can prove on the balance of probability that the event or circumstances constituting the breach of warranty **did not contribute** to the loss".[174]

By comparison, the NMIP, in cases where there is a combination of perils, distinguishes between relevant and non-relevant causes; as the Commentary to § 2-13 1st par. indicates, the lower limit required for the effect of a cause to be "relevant" is circa 10–15%. Apparently, the rule envisaged by the Law Commission sets a lower limit: from the literal

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171 *Ibid*, s 7.88

172 The Consultation paper No182 (2007) ss 8.4, 8.39

173 *Ibid*, ss 7.71–7.75

174 The Consultation paper No182 (2007) s 8.45

wording of the Papers, it follows that even the breach of warranty with a 1% contribution to the loss terminates insurance cover. However, those are only theoretical speculations, as the English courts did not have the chance to apply the rule in practice.

The 2006–2007 proposal to introduce the causation test into the warranty regime triggered a mixed reaction. In academic circles, this idea received extensive support; as Sir Longmore (Lord Justice of Appeal) noted, "most commentators appear to think that it would be sufficient if the law were reformed to allow insurers only to rely on breach of warranty if the breach is a cause of the loss".[175] Several consultees related to the industry were also supportive: for instance, AIRMIC (the UK association for risk and insurance management professionals) called such reform an "essential change to insurance contract law".[176]

On the other hand, many respondents presented arguments against the proposal, namely[177]:

(1) Causation is a difficult principle to apply in practice, because it requires a closer assessment of a chain of events. What is more, insurers might try to compensate for increased investigation costs through higher premiums;

(2) The causation test is not appropriate for all terms, because some warranties may be relevant to the risk without being causative to the loss (for example, those that concern past claims to the assured, where relevant to assessment of possibility of future claims);

(3) Undue formalism. As mentioned above, the Law Commission proposed the causal connection test only for warranties, but in practice, a similar term may be formulated as a descriptive condition. Hence, the effect of a particular provision would depend only on the formalistic approach to its construction.

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[175] Andrew Longmore, *"Good faith and breach of warranty"*, 163. See also Baris Soyer, *"Warranties in Marine Insurance"*, 215; Sarah Derrington, *"The law relating to non-disclosure[…]"*, 346

[176] The Consultation paper No 204 (2012), ss 14.20–14.58, s 14.37

[177] *Ibid*, 14.39–14.50

These arguments do not seem fully persuasive. First, the experience of civil law countries evidences that it is possible to apply the causation test in practice, without disproportionate escalation of costs or premiums. Second, in situations where an undertaking generally affects the risk, but a particular breach is purely completely irrelevant, the causation test could allow fairer results to be achieved.[178] Third, it is certainly preferable to treat warranties in the same way as suspensive conditions; yet it does not necessarily mean a complete abandonment of the causation test. In 2006, the Law Commission was prepared to introduce it for both types of terms; although the industry and the courts would have required a longer time to adapt to that solution, it seemed as a huge step would be taken towards a modernisation of English insurance law.

However, the heavy critique of the causation requirement demonstrated that the industry was not prepared for such a striking reform. The concerns about complexity of investigation and proof, as well as uncertainty and potential formalism of outcomes *en masse* persuaded the Law Commission to abandon the causal connection test. Hence, other instruments were needed to ameliorate the warranty regime.

5.3.3.2 2012–2014 proposals

On the next stage of work, the Law Commission prepared the Consultation paper "Insurance Contract Law: The Business Insured's Duty of Disclosure and the Law of Warranties" (June 2012) and the Report "Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment" (July 2014). Both documents named three main proposals in relation to the warranty regime[179]:

(1) To treat warranties as suspensive conditions. This proposal goes to the root of the warranty regime, as it abolishes the "automatic discharge" doctrine, established by the MIA 1906 s 33(3);

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[178] Cf. *Abbott v Shawmut Mutual* (1861) 85 Mass 213, discussed in Chapter 3 s 3.4.2

[179] The Consultation paper No204 (2012), s 11.22; The Report No 353 (2014), s 12.6

(2) To introduce the rule that terms designed to reduce the risk of loss of a particular type (or at a particular time or place) should not affect losses of a different kind. Notably, this proposal was designed as an alternative for the causal connection test;

(3) To abolish "basis of the contract" clauses. This measure was envisaged primarily for non-marine commercial policies, where such clauses allowed the insurer to rely on a minor mistake in the proposal form. Due to the fact that the MIA s 35(2) sets out strict requirements for introduction of express warranties into marine policies, such clauses are of minor relevance for marine insurance.[180]

In July 2014, the Insurance Bill, based on the previous works of the Law Commission, was introduced into the Parliament; it received the Royal Assent on 12 February 2015 and became the Insurance Act 2015.[181] The Act reflects all the above mentioned proposals (Sections 9 – 11); therefore, it embodies the cardinal reform of the "classical" warranty regime.

5.3.3.3 The Insurance Act 2015

A few points about application of the Insurance Act 2015 should be mentioned. First, the majority of the provisions of the Act, including those relevant to warranties, enter into effect from August 2016.[182] Until that time, the MIA 1906 continues to apply. Next, the Insurance Act 2015 provides that **in non-consumer insurance the parties may contract out** of statutory provisions and introduce a term "which would put the insured in a worse position" (for instance, a warranty clause with a remedy of automatic termination of liability), if the requirement of transparency is satisfied. Namely:

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[180] See, for example, Arnould, *"On the Law of Marine Insurance and Average"*, 827. For that reason, Section 9 of the Insurance Act 2015, abolishing "basis of the contract" clauses, is not discussed further.

[181] See the official site of the UK Parliament (as of 23.10.2015): http://services.parliament.uk/bills/2014-15/insurance/documents.html

[182] The Insurance Act 2015, s 22(3)

(1) The insurer must take sufficient steps to draw the disadvantageous term to the assured's attention before its incorporation into the contract. Alternatively, the insured must have actual knowledge of the term;

(2) The disadvantageous term must be clear and unambiguous as to its effect.[183]

Thus, the use of warranties in their present form will not be completely abolished, but restricted to situations where the parties have implemented express and unequivocal provisions to that effect into the policy. For instance, standard clauses frequently include terms with the effect of automatic termination of liability and/or contract.[184] Nevertheless, the "default" warranty regime is significantly amended.

5.3.3.3.1 Suspensive character of warranties

Section 10 of the Insurance Act 2015[185] provides that insurance warranties will no longer possess the specific remedy of "automatic discharge from liability".[186] Henceforth, breach of warranty will have the effect of **suspension of liability,** which means that the insurer will not cover two types of losses:

(1) Occurring in the period between a breach and its rectification;

(2) Attributable to something happening during that period, even if the loss occurred later.

At the moment of **rectification of the breach**, the insurer's liability will reattach. The rationale behind this rule is clear: if warranties are instruments for circumscribing the risk the insurer agreed to indemnify, and this risk remains/becomes the same, the insurer cannot deny cover. In particular, Section 10 envisages the following situations:

(1) Subsection 10(5)(b) refers to breaches of **"general warranties"**, which are deemed remedied "if the insured ceases to be in breach";

(2) Subsection 10(5)(a) refers to breaches of **"time-specific warranties"**: undertakings to do something or to fulfill specified conditions

183 The Insurance Act 2015, ss 16, 17(2), (3) and (5)

184 For example, ITCH (95) cl.4.1–4.2 and cl.5.1

185 For the full text of Section 10, see Appendix I

186 The MIA 1906, s 33(3); *The Good Luck* [1991] 2 Lloyd's Rep 191

"by an ascertainable time". Such breaches cannot "cease" if a deadline is already missed, but they can be "functionally" remedied[187], which means that the risk insured must "become essentially the same as that originally contemplated by the parties";

(3) Subsection 10(4)(b) recognises a third situation, **when a breach of warranty is incapable of remedy** (for example, when a statement under a warranty of past or present facts was inaccurate). In such a case, the insurance cover either never commences, or remains indefinitely suspended after the breach.[188]

Notably, the practice of construing warranties as suspensive conditions is already familiar to the English courts[189]: despite being helpful in individual cases, it has also led to uncertainty about the status and effect of particular contractual terms. The recent reform will not only make it easier for the courts to reach fairer outcomes, but also to reduce the number of disputes concerning construction of policies. Furthermore, assureds will get a new stimulus to keep the marine activities under control and rectify any discrepancies as promptly as possible.

5.3.3.3.2 Terms designed to reduce a particular risk

Section 11 of the Insurance Act 2015[190] provides that, if **a term tends to reduce a particular risk** (loss of a particular kind, or at a particular time or place), a breach of that term should not release the insurer from liability for loss caused by other types of the risk. To determine whether a policy provision fits this description, an **objective construction** is required: *i.e.,* a normal effect of compliance with the term should be assessed, not what the parties subjectively intended it to be.[191]

On the one hand, Section 11 embraces not only warranties, but also other types of terms: conditions precedent, definitions of the risk and exclusion clauses. On the other hand, not all warranties relate to

187 The Report No 353 (2014), s 17.43. For a further discussion, see ss 17.30–17.50

188 *Ibid*, s 17.50

189 See discussion in Chapter 5, s 5.2.1.2.

190 For the full text of Section 11, see Appendix I

191 The Report No 353 (2014) ss 18.12–18.17

particular risks. They may: (1) address more general issues, as warranties concerned with the assured's criminal record; (2) have no bearing on the risk at all, as premium warranties; or (3) define the whole risk insured under the policy, as warranties of (non)commercial use of a vehicle.[192] Hence, an objective of each warranty should be analysed individually.

It should be underlined that Section 11 **does not introduce a causation test:** for the insurer to rely on a breach of warranty defence, it is not required that the breach actually caused or contributed to the loss. It is sufficient that the warranty in principle relates to the risk, which resulted in the loss. Consequently, the causation test prevents reliance on **irrelevant breaches**, while rule in Section 11 prevents reliance on **irrelevant warranties**, "where the type of loss which occurred is not one which compliance with the warranty or condition could have had any chance of preventing".[193] Undoubtedly, this approach is more favourable for the insurer than the causation test.

According to Section 11(4), if the term in question is a warranty, Section 10 of the Insurance Act 2015 applies jointly. It means that in case of breach of a warranty that tends to reduce a particular risk, liability of the insurer will be suspended only in relation to losses caused by that risk. It is a major improvement of the assured's position in comparison with the situation under the MIA 1906.

Nevertheless, a number of possible problems with a practical application of Section 11 have already been noted[194]:

(1) It might be challenging to identify whether a warranty tends to reduce a particular risk. As mentioned above, some warranties have a more general implication;

(2) Even when it is evident that a warranty is not of a general character, identifying its precise objective may be problematic.

Therefore, Section 11 may become a source of extensive litigation concerning objectives of warranties. The Law Commission recognised

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192 *Ibid*, s 18.6

193 *Ibid*, ss 18.7, 18.38–18.40

194 Baris Soyer, "Beginning of a new era for insurance warranties?", *Lloyds Maritime and Commercial Law Quarterly*, Issue 3 (August, 2013), 392–394

this problem, stating that: "There is undoubtedly a degree of uncertainty relating to how the courts will interpret a "type of loss", a "loss at a particular place" and "a loss at a particular time" […] Often the questions will have common sense answers, but we are aware that sometimes they will not".[195] It is argued that "in determining what particular risk the warranty aims at, it will be inevitable to be drawn into an inquiry involving causation"; hence, "the proposed change to a certain extent introduces causation by the back door".[196] This is especially striking, as the legislators intended to avoid the causation test. Moreover, the reform may lead to a costly review of standard clauses in order to contract out of the default statutory regime, or to specify the aims of warranties.

Overall, the Insurance Act 2015 introduces a significant reform of the "classical" warranty regime, embodied in the MIA 1906. First, Section 10 abolishes the remedy of "automatic termination of liability", which was a unique feature of warranties. From 2016, warranties will be equal in effect to suspensive conditions. As a result, the second amendment follows: the assured will normally have an opportunity to remedy a breach of warranty, so that the insurer's liability will reattach. Furthermore, Section 11 has introduced a new requirement for the insurer's reliance on a breach, which could be characterized as the test of "objective materiality of a term to a particular risk". Together, Sections 10 and 11 of the Insurance Act 2015 provide the assured with significant protection from the insurer's discretion. However, the Insurance Act 2015 still leaves a room for situations where the non-causative breach of warranty will allow the insurer to avoid the liability. What is more, concerns were expressed about potential difficulties of interpretation of Section 11 by courts.

[195] The Report No 353 (2014) ss 18.49–18.67

[196] Baris Soyer, "Beginning of a new era for insurance warranties?", 394

6 Conclusion

6.1 Summary of the development process. Potential future perspectives

In conclusion, it must be said that the development of the status of marine insurance warranties in English law has been a lengthy process. From the XVIIIth century, the warranty regime was governed by rigid rules, such as: the "strict compliance" doctrine, the absolute character of warranties, disregard for materiality or the causative character of breach and irrelevance of future rectification. The unique remedy of "automatic discharge of liability", introduced by the MIA 1906 s33(3), made the warranty regime even more beneficial to the insurer and detrimental to the assured. In practice, this disproportion resulted in **the following problems:**

The insurer could refuse to pay a claim for any breach of warranty, no matter how irrelevant (minor or non-causative) that breach was to the loss;

The insurer could refuse to pay a claim, even though the breach had already been remedied;

However, the insurer generally was entitled for a whole amount of the premium.

Another reason for concern with the warranty regime under the MIA 1906 was that international practices were inclined towards a more balanced solution. The civil law approach to alteration of risk normally implies the requirements of subjective materiality and a causative character of an alteration, as well as some degree of culpability of the assured. What is more, even common law countries have departed from the traditional warranty regime to various extents.

Although there were attempts to mitigate the harshness of the warranty regime either through judicial interpretation of warranties, or through drafting of insurance contracts, these solutions were not sufficient. In order to keep in line with international standards, and to provide fairer

outcomes for assureds, English marine insurance law was demanding legislative reform. As the result, the new Insurance Act 2015 was adopted. **The main differences** between the marine insurance warranty regime under the MIA 1906 and the 2015 Act are that:

The remedy of "automatic termination of liability" is abolished. Under Section 10 of the 2015 Act, warranties are given a suspensive character: *i.e.,* if a breach of warranty is remedied, the insurer's liability reattaches;

Section 11 of the 2015 Act introduces a new rule that if a term (*i.a.,* a warranty) tends to reduce a particular risk, the insurer is not entitled to rely on a breach of that term to deny liability for the loss caused by another risk.

The recent reform has significantly mitigated the default warranty regime in English marine insurance law. However, there is still **one major difference** from approaches adopted in the civil law countries, New Zealand, Canada and, to some extent, Australia and the USA: namely, this reform has **not introduced the causation test.** Although the rule in Section 11 of the Insurance Act 2015 may sometimes provide similar results, it still allows the insurer to rely on non-causative breaches. Moreover, the complexity of the rule in Section 11 is likely to lead to disputes about objectives of a particular warranty. Hence, a significant element of uncertainty is introduced into English marine insurance law.

Therefore, the question arises – was it really a justified step to avoid the causation test? Not only is it familiar to the English courts; its introduction would have been a huge step towards internationalisation of the English marine insurance market. It is possible that the upcoming development of the marine insurance warranty regime in English law will be focused on a further recognition of elements of causation, in order to avoid the limits set out by the Insurance Act 2105. Overall, the reaction of the courts and the industry on the recent reform remains to be seen.

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7.5 Table of abbreviations

ABI Association of British Insurers
AC Appeal Cases
AIRMIC Association of Insurance and Risk Managers
All ER All England Law Reports
ALR Australian Law Reports (1983 –)
ALRC Australian Law Reform Commission
AMC American Maritime Cases
App Cas Appeal Cases
B & Ald Barnewall & Alderson's King's Bench Reports (1817–22)
Br & B Broderip & Bingman's Common Pleas (1819–22)
B & S Best & Smith's Queens Bench Report (1861–65)
Bur Burrows' King's Bench Reports (1757–71)
Camp Campbell's Reports
Cowp Cowper's King's Bench Reports (1774–78)
DLR Dominion Law Reports (Canada)
Dougl KB Douglas' King's Bench Reports (1778–85)
Dow Dow's House of Lords Cases
Eng Rep English Reports Full Print (1210–1865)
EWCA Civ Court of Appeal Civil (England & Wales)
EWHC (Comm) High Court of England and Wales Decisions (Commercial Court)
Exch Exchequer Law Reports (1865–1875)
F&F Foster & Finlanson's Nisi Prius Reports (1858–67)
FLR Federal Law Reports (Australia)
HLC House of Lords Cases (Clarke's) (1847–66)
H & N Hurlstone and Norman's Exchequer Reports
IHC International Hull Clauses (2003)
ICA Insurance Contract Act
ITCH Institute Time Clauses – Hulls (1995)
KB King's Bench Law Reports (1866-78)
LR PC Law Reports, Privy Council Appeal Cases
Lloyd's Rep Lloyd's List Law Reports (1951–)

LMCLQ Lloyds Maritime and Commercial Law Quarterly
MAT Marine, Aviation & Transport
MIA Marine Insurance Act
Mod Modern Reports
ND Nordiske Domme I Sjøfartsanliggender (law report containing maritime law decisions from the Scandinavian countries). (Oslo 1900–)
NMIP Nordic Marine Insurance Plan (2013)
NZLRC New Zealand Law Reform Commission
P&I Protection & Indemnity
QB Queen's Bench Law Reports
R (HL) Rettie, Crawford and Melville Session Cases (Scotland)
SGIP Statement of General Insurance Practice (1986)
TR Durnford & East's Term Reports (1775–1800)
WLR Weekly Law Reports

APPENDIX I

Insurance Act 2015
2015 CHAPTER 4

An Act to make new provision about insurance contracts; to amend the Third Parties (Rights against Insurers) Act 2010 in relation to the insured persons to whom that Act applies; and for connected purposes. [12th February 2015]

(EXTRACTS)

PART 3

Warranties and other terms

9 Warranties and representations

(1)This section applies to representations made by the insured in connection with—

(a) a proposed non-consumer insurance contract, or

(b) a proposed variation to a non-consumer insurance contract.

(2) Such a representation is not capable of being converted into a warranty by means of any provision of the non-consumer insurance contract (or of the terms of the variation), or of any other contract (and whether by declaring the representation to form the basis of the contract or otherwise).

10 Breach of warranty

(1) Any rule of law that breach of a warranty (express or implied) in a contract of insurance results in the discharge of the insurer's liability under the contract is abolished.

(2) An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied.

(3) But subsection (2) does not apply if—

(a) because of a change of circumstances, the warranty ceases to be applicable to the circumstances of the contract,

(b) compliance with the warranty is rendered unlawful by any subsequent law, or

(c) the insurer waives the breach of warranty.

(4) Subsection (2) does not affect the liability of the insurer in respect of losses occurring, or attributable to something happening—

(a) before the breach of warranty, or

(b) if the breach can be remedied, after it has been remedied.

(5) For the purposes of this section, a breach of warranty is to be taken as remedied—

(a) in a case falling within subsection (6), if the risk to which the warranty relates later becomes essentially the same as that originally contemplated by the parties,

(b) in any other case, if the insured ceases to be in breach of the warranty.

(6) A case falls within this subsection if—

(a) the warranty in question requires that by an ascertainable time something is to be done (or not done), or a condition is to be fulfilled, or something is (or is not) to be the case, and

(b) that requirement is not complied with.

(7) In the Marine Insurance Act 1906—

(a) in section 33 (nature of warranty), in subsection (3), the second sentence is omitted,

(b) section 34 (when breach of warranty excused) is omitted.

11 Terms not relevant to the actual loss

(1) This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following—

(a) loss of a particular kind,

(b) loss at a particular location,

(c) loss at a particular time.

(2) If a loss occurs, and the term has not been complied with, the insurer may not rely on the non-compliance to exclude, limit or dis-

charge its liability under the contract for the loss if the insured satisfies subsection (3).

(3) The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

(4) This section may apply in addition to section 10.

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