

MARINE INSURANCE
CLAIMS AND PRACTICE

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“If there were no claims, there would be no premiums.” Thomas Caldecot Chubb

Insurance permeates virtually every maritime transaction. Whether it is insurance for a particular vessel, a particular voyage, the cargo being shipped or the liabilities that result from operating in the marine environment, there is a policy for it. They run the gamut from hull, P&I, and cargo to marine employer’s liability, tower’s liability and ship repairer’s liability. It is indeed a part of every aspect of maritime commerce. Only fools and frauds operate without it.

In the marine claims business, questions regarding insurance are at the forefront of every casualty. Is there insurance coverage for the loss? What are the limits of coverage? Is someone else also responsible for the loss, either by virtue of contract or as a co-actor in causing the loss? Somewhat related are the questions about the adequacy of the insurance as security: does the insurer have a good rating? What is the insurer’s approach to payment of claims?

1. WHO’S YOUR BROKER?

For those in the marine claims business, Mr. Chubb was correct: underwriters cannot sell policies of insurance without the risk of claims. Thus, before the first claim ever arises, the insured needs to consider what risks he faces and make certain that his policy provides coverage for them. Given the large sums often involved in marine casualties, it is essential to for the insured to make sure there is coverage for every conceivable (and sometimes inconceivable) risk. Finding out about a problem with coverage after the claim arises is a leading cause of premature baldness (and bankruptcy!).

The advice of an experienced marine insurance broker is invaluable to the insured. Not only will the broker help you understand the sometimes convoluted policy language, but he will know which companies are reputable. In addition, good brokers have E&O coverage, providing the insured with an additional important protection in the event that the coverage turns out not to be as agreed with the broker.

2. REPORTING LOSSES

The instant he becomes aware of any loss, the insured should notify the insurer in writing. For the insured, a fax, with a confirmation report, is very nice to have in the file just in case the insurer ever decides to deny the claim due to late notice. Remember when Reliance went into receivership several years ago? Lots of folks thought they had properly notified Reliance of losses. But once Reliance was in receivership, the folks handling the run-off took a careful look to see if notice had really been given. The ones that had a file copy of what they submitted did not have problems.

Under the laws of many states, compliance with a “notice-of-occurrence” provision of an insurance policy is a condition precedent to an insurer’s liability under the policy. In *Dan River, Inc. v. Commercial Union Ins. Co.*, 227 Va. 485, 317 S.E.2d 485 (1984), the Virginia Supreme Court held that policy language requiring notice when “an occurrence takes place which, in the opinion of the insured, involves liability on the part of the insurer” should be examined under an objective standard to determine timeliness.

The excess or umbrella insurer, if different from the primary insurer, also needs to be given notice. “The duty to notify an excess insurer accrues when the circumstances known to the insured would have suggested a reasonable *possibility* of a claim that would trigger that excess

insurer's coverage.” *Red Apple Supermarkets, Inc. v. North River Insurance Company*, 1999 U.S. App. LEXIS 11807 (2d Cir. 1999) (applying New York law). Courts recognize that notice of an occurrence serves the important function of furnishing an excess carrier with an opportunity to participate in settlement discussions at a time when its input is most likely to be meaningful and to protect its contractual right to decide for itself whether and how extensively to investigate a claim.

The question occasionally arises whether the insured should give notice of small claims, especially those that seem close to (or even below) the deductible. For those tempted not to give notice in such circumstances, it should be kept in mind that the size of a claim rarely diminishes. In addition, giving notice will result in having the insurer's claims staff looking into the underlying facts of the claim to verify whether it is legitimate. They will hire investigators, surveyors and other professionals as necessary. Since virtually all policies include the cost of defending claims, it is wise to promptly notify the insurer.

What if there is a real question of whether the loss is covered by the policy? Notify anyway. Let the insurer make the decision and, if coverage is denied, justify it. While many involved in the marine claims business believe they know what is covered and what is not, there is no penalty for notifying of claims that turn out not to be covered. However, the penalty for not notifying and finding out later that there was in fact coverage can be quite severe: late notice can be a valid reason for denying coverage.

It is also a good idea to notify the broker. Assuming the broker is experienced in the marine insurance business, his advice can be very helpful. His contacts and reputation may help in obtaining a decision in favor of coverage for perhaps an otherwise questionable loss.

3. CONTRACTUAL LIABILITY

Most marine liability insurance policies today are written to provide coverage when a claim is made against the insured under a written contract of indemnity, sometimes referred to as an “incidental contract.” The typical scenario is that, in order for the insured to perform work for one of its customers, the insured is required to sign an agreement that it will indemnify and defend if the customer gets sued by one of the insured’s employees or other third-party claims arising out of the insured’s work. *See e.g. St. Paul Surplus Lines Ins. Co. v. Halliburton Energy Services*, 2006 A.M.C. 919 (5th Cir. 2006). Virtually every shipyard operating today requires its subcontractors to sign these types of agreements. These indemnity agreements are also often found in leases or equipment rental contracts. Want to rent a piece of equipment from Hertz? Take a look at the contract as it requires the lessee to defend Hertz when one of the insured’s employees gets hurt (or killed) and sues Hertz. This incidental contract coverage is essential in today’s business environment.

4. EXCLUSIONS FROM COVERAGE

Exclusions are often written in language that does not make much sense to the average person. The insured should make sure he understands the exclusions from coverage and can live with the consequences of not having coverage for excluded risks. Nothing is worse than finding out that the policy does not provide coverage for what would seem to be a foreseeable loss.

5. WARRANTIES

Warranties can have the same effect as exclusions. In marine insurance, they are written to place certain affirmative duties on the insured or limitations on the location where the vessel is

permitted to operate, size of the crew, dates of sailing, etc., and still be covered by insurance.

There are also implied warranties, most prominently seaworthiness of the vessel. As a general rule, strict compliance by the insured with any warranty is required or the insurer is discharged of his obligation to pay under the policy. *Lexington Ins. Co. v. Cooke's Seafood*, 835 F.2d 1364 (11th Cir. 1988); *Certain Underwriters at Lloyds v. Montford*, 52 F3d 219 (9th Cir. 1995).

In recreational boat policies, there is often a lay up warranty that requires the insured to winterize or take his vessel out of the water for the winter to avoid damage caused by freezing temperatures. Thus, the failure to close the sea cocks and winterize the engines during the lay up period may constitute a breach of the lay-up warranty. *See Goodman v. Fireman's Fund Ins. Co.*, 1979 A.M.C. 2534 (4th Cir. 1979). Whether a vessel is properly laid up during the time warranted in a marine insurance policy depends upon local custom. *Id.* at 2537-38. *See also Campbell v. Hartford Fire Ins. Co.*, 533 F.2d. 496 (9th Cir. 1976) (compliance with lay-up warranty depends on whether vessel has been secured according to local custom in a manner which will protect her from perils of inclement weather); *Poulos v. Fireman's Fund Ins. Co.*, 231 N.Y.S.2d 206, 207 (Sup. Ct. 1962) (same); *Gelb v. Automobile Ins. Co.*, 168 F.2d. 774, 775 (2nd Cir. 1948) (same).

There can also be geographic restrictions on where the vessel can operate, referred to as "trading warranties." Some may express the limitation as a specific distance from the coast; others state it as a geographic region, such as the Caribbean Sea. In either event, it requires the insured to keep the vessel within those limits since any casualty outside the limits will not be covered under the policy. The insured must scrupulously abide by the policy warranties or risk loss of coverage.

5. RESERVATION OF RIGHTS

If the insurer determines that there is no coverage under the policy, it must explain the reason for its decision. In most states, if the insurer does not explain in writing within a reasonable period of time why it believes there is no coverage under the policy, then it has waived its rights to deny coverage later. *McLaughlin v. Connecticut General*, 565 F.Supp. 434 (N.D. Cal. 1983). Many states also have unfair trade practices laws which may regulate the practices of insurers regarding claims. Often, an insurer will issue a reservation of rights letter but nonetheless defend any lawsuit subject to a later determination of whether it may have to pay a judgment. The most common way to determine whether there is insurance for the loss is by means of a declaratory judgment action. For the insured, the downside to this form of resolution is the need to hire counsel to litigate the declaratory judgment action.

6. LIMITS OF COVERAGE

The amount of coverage stated in the policy (sometimes in the Declarations) may not always be what it seems to be. Some policies require that any costs of defending a claim are part of the total amount of coverage. These policies are often called “cannibalizing” policies. The expenses made in connection with claims erode the available limit of coverage. In cases involving substantial attorney’s fees, this type of policy can provide far less coverage than what the insured thought he was purchasing.

Another reduction in policies can occur for certain types of claims. It has become common in recreational yacht policies for the insurer to provide substantially less coverage when the claim is made by a family member, such as a spouse or child. *See Continental Ins. Co. v.*

Roberts, 410 F3d 1331 (11th Cir. 2005). If this is a concern, find another insurer or negotiate better limits of coverage.

7. “OTHER INSURANCE” CLAUSES

Most liability insurance policies today have an “other insurance” clause that seems to make what everyone thought was the primary policy into an excess or umbrella policy. For this reason, it important to find out what other policies of insurance are applicable to see if the underwriter forgot to include such a clause and so may have to pay first. The rule applied in most jurisdictions where the insured has two (or more) policies which each have an excess or “other insurance” clause, is that the insurers must share in the loss. *Reliance Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, 753 F.2d 1288 (4th Cir. 1985).

8. WHAT YOU NEED TO KNOW ABOUT WILBURN BOAT

Over fifty years ago, the United States Supreme Court decided a marine insurance case that astounded the admiralty bar and the marine insurance industry. In *Wilburn Boat Co. v. Fireman’s Fund Ins. Co.*, 348 U.S. 310 (1955), the Court reminded everyone that hard cases can make bad law. Fireman’s Fund insured a small houseboat that was used to carry passengers on Lake Texoma, a navigable lake between Texas and Oklahoma. The owners sold the boat to a corporation in which they were the sole stockholders and then took out a mortgage on it. The policy precluded the use of the vessel for anything other than private pleasure purposes and also specified that the boat could not be sold or pledged as security without the consent of Fireman’s Fund. The boat was then destroyed by fire.

When the new corporate owner made a claim, Fireman's denied it on the basis of the violation of the anti-sale clause and the breach of the warranty of use only as a private pleasure boat. The company filed suit, claiming that, under Texas law, the anti-sale clause was invalid and that the breach of the pleasure use warranty did not contribute to the fire loss. Both the trial court and the court of appeals denied recovery to the insured. The Supreme Court reversed on the grounds that Texas law should be applied because there was no federal admiralty rule which governed the effect of breach of warranty in a marine insurance policy and, therefore, state law should be applied to fill the gap.

Thus, *Wilburn Boat* stands for the proposition that marine insurance law in the United States will be largely controlled by state law. Whether the insured's failure to comply with the obligations in the insurance agreement voids the policy will be subject to the varying laws of the 50 states. Even the question of which state law to apply can be complicated because of the choice of law issues that often arise in marine insurance coverage disputes. The decision in *Wilburn Boat* virtually guarantees that insurers will have to hire lawyers to tell them what the outcome will be in coverage disputes on a state-by-state basis.

9. INSURANCE QUALITY

Will the insurer be able to pay the claim? What is the attitude of the claims department in handling claims? These are questions that need to be answered before the policy is issued and the insured starts paying premium.

You get what you pay for. If the premium is ridiculously low, the insured should ask what the catch is. Does the company have a good rating from A.M. Best? How long has it been writing marine insurance? Who is the claims supervisor that will be handling the insured's

claims? Does his or her philosophy match the insured's? There are claims that ought to be quickly and efficiently settled but does the insurer have a reputation of fighting about everything? Maybe the insured's risk manager is the one who wants to fight about every claim; will a claim department that has a reputation of just rolling over and paying every claim be to the insured's liking?

What if the insured is a vessel operator? Will the insurer be quick to help out with a letter of undertaking in the event of a vessel arrest or attachment? Is the insurer sufficiently capitalized that the other side will take such a letter from it? These are questions that need to be answered before the problems arise, not after the insured's vessel is tied up for a week because it cannot come up with satisfactory security to get it released from an arrest.

10. UBERRIMA FIDES – THE DUTY OF UTMOST GOOD FAITH

Contracts of marine insurance require the utmost good faith by both parties to the contract. This is considered a bedrock principle of marine insurance, whether under federal law, state law, or both. *New York Marine & Gen. Ins. Co. v. Tradeline*, 266 F.3d 112 (2d Cir. 2001). In practice, this generally works to the detriment of the insured because it requires the insured to affirmatively disclose every fact within his knowledge that is material to the risk insured. A failure to disclose allows the insurer to avoid the policy. *Sun Mutual Ins. Co. v. Ocean Ins. Co.*, 107 U.S. 485, 509-510 (1883). Most courts, though not all, hold that even an innocent failure to disclose or misrepresentation of such a material fact will discharge the insurer. Compare *Gulfstream Cargo, Ltd. v. Reliance Ins. Co.*, 409 F.2d 974 (5th Cir. 1969)(innocent non-disclosure voids coverage at option of insurer) with *Albany Ins. Co. v. Anh Thi Kieu*, 927 F.2d 882 (5th Cir. 1991)(requiring intent to deceive).

The battles over non-disclosure usually revolve around just how material the information would have been to underwriting the risk. The test in the United States is whether the omitted information, if known by the insurer, would have controlled the decision to insure the risk for the specific premium. *McLanahan v. The Universal Ins. Co.*, 26 U.S. 170 (1828). The decisions are as varied as the facts of every case. Valuation of the vessel is one of the most frequent concerns with non-disclosure, though other non-disclosures that have been found to be material include previous losses/claims, port risks, criminal convictions and qualifications of the captain. *New Hampshire Ins. Co. v. C'est Moi, Inc.*, 2006 A.M.C. 25 (C.D. Cal. 2005)(value; lack of prior insurance; prior undisclosed claims) However, where the underwriter is presumed to know the information, a failure to disclose will not provide a basis to avoid the policy.

CONCLUSION

The foregoing present a few of the many considerations and problems that can arise in marine insurance. From the perspective of the insured, nothing is more important than having a highly qualified broker assisting in obtaining insurance coverage and in the claims process when they inevitably arise. For the insurer, it is a two-fold process involving the expertise of the underwriter on the front end to effectively analyze and price the risk and on the back end a savvy claims department to handle the liabilities once they materialize. In the vast majority of insurance transactions and claims the system works beautifully. And for the ones that do not, just make sure you have an experienced maritime lawyer who understands marine insurance on your side!