

# Ship values: How much will your underwriters pay for a total loss

This article examines the amount (if any) which an assured (usually a shipowner) will be entitled to recover from his H&M underwriters in case of a total loss of a vessel. Given the present escalating ship values, it is essential for a shipowner to ensure that the amount which is paid to him by his underwriters is sufficient to indemnify him for the purchase of a replacement vessel. Conversely, if the market turns and ship values deteriorate, the shipowner must be aware what amount will be recovered from underwriters.

In this lies certain peculiarities of marine insurance. Insurance policies issued to private individuals covering household goods or personal effects are often unvalued. In contrast, policies on vessels and on cargo are usually valued. However, particular attention must be paid to the wording of the policy to avoid any confusion as between a "value" and a "sum insured". Generally, one finds that insurance conditions on vessels would normally be based on the Institute Time Clauses – Hulls and would be subject to English law and practice. In such case the Marine Insurance Act 1906 applies. According to Section 27 of the Act, a policy may be "valued" or "unvalued". A valued policy is one which specifies the agreed value of the subject matter insured. Furthermore, the value fixed by the policy is, as between the insurer and assured, conclusive of the insurable value of the subject matter insured

Two recent cases highlight the following issues:

1. Is the policy in question a valued policy? (Herein lies the trap for the unwary).
2. Even if the policy contains an agreed value, will underwriters be bound by it?

## Valued / Unvalued policies

The recent English Court decision in *Thor Navigation Inc. v Ingosstrakh Insurance Company and SOVAG (2005)* considered the issue whether on its proper interpretation the policy covering the vessel "Thor II" was a valued or unvalued policy. The underwriters, Ingosstrakh (covering 40% of the risk) and SOVAG (covering 60% of the risk) contended that the vessel was insured on unvalued terms. The policy was written on the basis of the Institute Time Clauses - Hulls, clause 280, 1/11/95 and was subject to English jurisdiction. The vessel was covered for a "sum insured" of USD 1,500,000. The vessel broke her intermediate shaft causing further damage to her main engine. The repair quotation indicated that the cost of repairs would exceed USD 2,000,000. Owners, Thor Navigation, claimed for a constructive total loss and gave notice of abandonment which Underwriters declined. Underwriters contended that the policy was an unvalued policy. Owners denied this and asserted that the insurance was on an agreed value basis. Owners alternatively argued that if on its true construction the policy was unvalued,

then the policy ought to be rectified. Mrs. Justice Gloster tried the matter on the basis of certain preliminary issues and Owners failed on all counts. The decision makes clear that it is not essential that the words "agreed value" or "valued at" are used, provided the intention of the parties is clear that there is a specified agreed value, proposed by the assured and



**Imad Elias, Managing Director of Elias Marine Consultants Ltd, examines the amount (if any) which an assured will be entitled to recover from his H&M underwriters in case of a total loss of a vessel.**

accepted by the underwriter. The court went on to hold that simply specifying a "sum insured", without more, does not amount to an agreed value. The sum insured is merely an expression of the limit of insurers' liability, as distinct from the value which the insurer will have to pay if there is a total loss. Therefore, this was an unvalued policy and the assured was only entitled to recover an amount of USD 800,000 which was the market value of the vessel at the time and place of her loss. Owners attempted to have the policy rectified on the basis of either a common mistake by Owners and Underwriters or, alternatively, on the basis of a unilateral mistake by Owners, but both arguments failed. Although in the London market the practice is almost invariably to insure on an agreed value basis, the court found that historically Russian insurers contract on an unvalued basis and that the underwriter in question also intended in the present case to contract on the basis of an unvalued policy.

## Excessive Overvaluation

The second case concerned the issue of excessive overvaluation. Although an agreed value in a valued policy is binding on the underwriters, such value should not exceed what is fair and reasonable. The assured is only intended to have an indemnity and not to make a profit out of the insurance nor for the insurance to be a form of gambling. The courts

would generally be prepared to overlook a margin of error or difference provided that the value fixed in the policy is not excessive. It is a question of fact as to what constitutes an excessive overvaluation. Naturally, if there is fraud then the whole policy, and not just the agreed value, is at risk since a fraud entirely vitiates the contract. However, it is possible to have an excessive overvaluation without it being fraudulent. Indeed, underwriters normally do not plead fraud as it is often difficult to prove, but rely on the overvaluation constituting a material non-disclosure or misrepresentation giving underwriters the right to avoid the whole policy. This is what happened in the recent case of *Eagle Star Insurance Co. v Games Video Co. (2004)*. The vessel "Game Boy" was insured under an H&M policy for an agreed value of USD 1,800,000. The vessel had been laid up at Chalkis, Greece, and had previously operated as a floating bar. Her new owners' intention was to carry out repairs and then trade her as a floating casino. Eagle Star had issued a policy covering the vessel during lay up and repairs. Whilst the vessel was moored, an explosive device was detonated resulting in the vessel listing and partially sinking. The insurers sought to avoid the policy on the basis of material misrepresentations by the assured about the condition and the value of the vessel. In particular, they asserted that the vessel's true value was significantly less than the agreed value of USD 1,800,000 and was more in the region of her scrap value of USD 100,000. Mr. Justice Simon held that the underwriters were entitled to and had validly avoided the policy. He held that the Defendants had no genuine belief that the value of the vessel was USD 1,800,000 but the true value of the vessel at the time that the insurance was effected was in the region of USD 100,000 to USD 150,000. The underwriting experts called by each of the parties before the court both agreed that an insurer relies on the assured being honest. In the opinion of the expert called by the assured an overvaluation was only material if extreme. The expert called by the insurers opined that it was material if the overvaluation was in multiples.

## Conclusion

Therefore, assureds would be well advised to:

1. Ensure that the wording of H&M policies clearly reflects any intention to have an agreed value policy. With more underwriters worldwide writing marine insurance business, this point becomes of even greater importance.
2. Ensure that the agreed values in such policies are always kept under review so as to ensure that such values are fair and reasonable.

No doubt the above considerations will also be of crucial importance to mortgagees who have provided ship finance and in whose favour insurance policies may have been assigned.

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