

Fraud and sinking ships in marine insurance

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On a fine November afternoon in 1992, Italian coastguards found two inflatable rafts by a sinking 76-foot luxury cruiser. Three Americans on board told them they had managed to escape after their crew had mutinied, left the yacht in a speedboat after holing it, locking up the Americans to perish with the yacht. In spite of the coastguards' attempts to save the yacht, it was eventually lost.

Among the three Americans was Beverly Hills attorney Rex DeGeorge, born Angelos Michael Karageorge on the island of Rhodes. The yacht turned out to be M/Y *Principe*, owned by Polaris Picture Corporation in which DeGeorge had a leading interest and to which he had recently sold the new-built 1.9 million yacht for 3.6 million US dollars, for which amount the yacht was insured with Cigna Insurance Co.

Totally discarding the explanation of the sinking, Cigna refused to pay and was sued by Polaris. As a result of dogged research, Cigna could show the following background to the *Principe* sinking.

In 1970, DeGeorge had been trying to sell his 43 foot yacht *Tutania* to some Peruvian coffee merchants, whom he took out to sea for a nocturnal test-run. Some 35 miles off the shore DeGeorge with a companion were purportedly drugged but managed to escape and return to the shore by the yacht's dingy. The yacht was never seen again, but DeGeorge was well protected by a high insurance cover.

Six years later, DeGeorge was night sailing along the Italian coast with a friend in a new yacht, the *Epinicia*, when suddenly they struck a "low-profile dark object" in the water, which caused the yacht to sink in about twenty minutes, while DeGeorge and his friend escaped in a dinghy which he had fortunately just bought. After a threatened lawsuit his Lloyd's insurers paid the insurance amount in full.

In 1983, De George was sailing with his wife off the Californian coast in their new 47-foot *Sea Crest II*, when he saw a suspicious looking fishing boat circling the yacht, whereupon explosions began to rock the yacht, which sank in about half an hour. DeGeorge and his wife escaped in the dinghy. DeGeorge reported to his insurers that he had had murder threats but did not report the matter to the police. He received the full amount of the insurance.

In addition, Cigna insurance could substantiate eight other cases of claims for various items of valuable property stated to have been lost or stolen as well as twenty-nine insurance disability claims.

Altogether, the circumstances surrounding this new sinking were such that neither the District Court nor, on appeal, the Ninth Circuit Court of Appeals had any difficulty determining that this time there could be no recovery.

– How is that for a fraud story, Bill?

Fraud is rampant in Maritime Law and Insurance. There are a number of reasons for that. Ships and cargoes are comparatively easily disposed of either into the anonymity of the international theatre or by being scuttled into the unfathomable vastness of the ocean depths.

Ships often have considerable value further boosted, in the hands of fraudsters, by the general prevalence of valued policies, under which insurance compensation is paid according to the declared values of the objects.

I shall focus in this presentation mainly on Swedish law, though examples will be taken from various jurisdictions, mainly English law, and other approaches than used in Swedish law will be considered in such relations.

Swedish hull insurance¹

Hull insurance is known in Sweden as kasko insurance, from Spanish casco for hull. It is the shipowner's primary property insurance. In Sweden, it was regulated as early as in the 1667 Maritime Code, and the 1891 Maritime Code had a special chapter on marine and particularly hull insurance. Those provisions were later moved into the Insurance Contracts Act (1927:779, hereinafter ICA), which is due to be replaced by a new Act from January 2006.

In ICA, provisions of importance for hull insurance include the introductory ones in sections 1–34, the special part on indemnity insurance sections 35–58, and the special rules on transport and marine insurance sections 59–76. For commercial insurance the ICA is on the whole declaratory.

The coming Act (2005:104, hereinafter new Act) is based on consumer insurance with only a short introductory Part I of seven sections mainly setting out its application. According to section 6 (1) the Act's provisions are not mandatory for non-consumer marine insurance, but certain general principles in Part III on enterprise insurance have declaratory application.

The ICA is supplemented by contract conditions, for hull insurance the General Swedish Hull Insurance Conditions from 2000 (Swedish Hull Conditions), and these are to be adjusted to the new Act. In addition there is a Marine Insurance Plan from 1957, to which a reference clause is needed but which is to some extent used for fishing vessels and coastal tonnage. The Norwegian Plan from 1996 has reasoned preparatory works that have a certain importance for the construction of the Nordic rules.

Marine Insurance disputes in Sweden have normally been resolved in the first instance by the Swedish Average Adjuster according to a provision in Maritime Code (1994:1009, hereinafter MC) chapter 17 section 9. In a decision from 2000,² the Supreme Court held this provision to be contrary to the European Lugano/Brussels conventions, which holding will be further fortified now that the conventions have been replaced for EU countries by an EC Regulation.³ The new Swedish Hull Conditions have sought to counter this by a provision that the Adjuster undertakes jurisdiction as an arbitrator,⁴ which seems somewhat questionable, as appeal continues to lie to the regular courts.

Recognised precedents in Sweden, usually cited by publication, year and page only, are the Supreme Court cases reported in NJA (New Juridical Archive, Stockholm, current) but partly also from lower courts such as the Appeal Courts (RfH). Even District Court and Average Adjuster opinions are reported in *Nordiske Domme i Sjøfartsanliggender* (Nordic Judgements in Maritime Cases, Oslo, current). Swedish judgements have been published annually in *Lloyds Maritime and Commercial Law Quarterly* but henceforth appear only on the Stockholm Maritime Law Institute's website www.juridicum.su.se/transport.

Ship values

Hull insurance is an indemnity insurance which, contrary to personal insurance, is intended to cover an economic loss. But the prevalence of valued policies tends to modify this for hull insurance.

Basically, for indemnity insurance, the assured must have an insurable interest, that is, an economic advantage from the insured object that is lost upon the insured loss of the object. In English law, the principle is regarded as inherent in the indemnity principle, but it has often been said that the absence of an economic interest would make the insurance into a wagering contract, which is in principle void. In Swedish law, the corresponding principle is known as

¹ In this article I have relied greatly upon Camilla Jerlardtz' book *Taxerad polis vid fartygsförsäkring*, Stockholm 1996, to which a general reference is due throughout.

² ND (see below in text) 2000, p. 1.

³ The Brussels 1 Regulation (EC) No 44/2001 on jurisdiction and recognition and enforcement of judgements in civil and commercial matters.

⁴ Clause 44 on determination of disputes.

the *enrichment prohibition*, expressed in ICA section 39 (1)⁵ but removed in the new Act. The present rule is, however, mandatory against the assured. The assured may not profit from the occurrence of an insured event. This has been considered necessary to prevent unsound practices.

But since long ago, the principle is not fully observed. Examples of situations where the assured may increase his assets through an insured event are new value insurance of buildings and valued policies for ships. Still, unlimited access to insurance of fictitious economic losses or non-pecuniary losses would be conducive to fraud. For valued policies ICA sec. 39 (2) provides that valuations shall be accepted unless the insurer can show that such compensation would be substantially higher than needed to cover the loss.

Why are valued policies so common for ships? It is a practice sprung from the difficulty of evaluating commercial vessels. These may have, first, a *market value*, that is a value that can be realised by sale on the open market. Decisive factors determining the market value are

- technical data, such as size, type, age, and speed,
- the ship's class, and
- other factors, such as the freight market, a favourable charterparty if it can run with the ship, the selling shipowner's reputation.

Understandably, the market value is not necessarily a solid and reliable basis for evaluation of a ship.

For specialised ships it may be hard to find a market, and for ocean going ships the market may be small and not yield such price as the insured needs for his protection. For mercantile goods, ICA sect. 37 and the new Act⁶ uses the *replacement value*, but this has little importance for hull insurance. Another alternative might be the *newbuilding value*, which is of course usually but not necessarily higher than the market value. An entirely different valuation is the *use value* or *profit value*, also called the value of the ship "as a going concern" and which may be directly connected with the value of a time or bareboat charterparty tied to the ship.

It appears that some values are objective and others are subjective in the particular owner's hand. ICA sect. 36 indicates a presumption that objective values and not the special value to the owner are relevant for insurance. This was to be replaced by the contrary presumption in an earlier Indemnity Insurance Act proposal,⁷ but this was finally rejected, and the Minister's proposal⁸ was based on objective values, which is also used in the new Insurance Act.⁹ So in Swedish hull insurance the prima facie value to be covered is still the objective interest, and other interests are covered by various types of special interest insurance.

These prima facie indications for a legal evaluation principle have little importance for ship insurance, though they may become applicable for consumer boat owners. For commercial vessels the owner's need to protect very varying interests has made valued policies the rule. These are accepted as long as the assured's interest is not grossly overvalued or the insurance is invalidated by fraud.

Valued policies

Valued policies have long been used in marine insurance, and they are said to have sprung from a practical need in the time of sailing ships, when an undeveloped market and poor communications made it hard to find a market. Today it is claimed that

- valued policies reduce disputes, since, as we have seen, ships' values are hard to establish,

⁵ The insurer is not bound to pay a higher amount as compensation than is needed to cover the loss.

⁶ Chapter 6(2) as referred to in chapter 8 sect. 18.

⁷ SOU (Sweden's Official Inquiries) 1989:88.

⁸ New Act chapter 6 section 2 as referred to in chapter 8 section 18 paragraph 1.

⁹ Proposal chapter 6 sect. 1 subsect. 2.

- the assured may have difficulties fulfilling his burden of proof of lost values, and
- valued policies satisfy financiers' and shipowners' needs for foreseeability.

But there are clear dangers attending the prevailing practice of valued policies.

Not the most obvious danger is that the assured may *undervalue* the object. In such a situation the assured's compensation for partial losses was traditionally decreased in proportion. But a problem today is that shipowners tend to systematically undervalue their hull insurances, using special interest insurance to top up the missing amount. These are such as freight interest, loss-of-hire and various unspecified insurances payable in the event of the ship's loss or unavailability. Since these insurances are not burdened with costs of partial damage, their premiums can be lower, and hull underwriters complain that such insurance is profiting from the hull insurance, which bears the brunt of insurance costs. The effect is augmented in the present Swedish Hull Conditions which no longer reduce partial loss compensation for underinsurance.

This has important effects for constructive total loss (CTL). The Swedish Hull Conditions provide that constructive total loss may be declared when the vessel cannot be repaired at less than 80% of her hull declared value. If the hull value is 100 mill., the vessel can declare CTL and cash the 100 mill. if it would take 80 mill. or more to repair her. If the vessel has an actual value to its owner of 150 mill. but has covered her top value with special interest insurances, that would enable the owner to declare CTL at just over half of her real total value. In order to stop misuse, the new Hull Conditions provide that if special interest insurances exceed 25% of the hull insurance amount, the total loss indemnity for the hull insurance is reduced by the exceeding amount.¹⁰ Thus in our example, since special interest insurances are 50% above the hull insurance (25% above the norm), the 100 mill. normally cashable in CTL is reduced by 25 mill., so that the assured receives only 75 mill from his hull insurer.

This article will deal, however, with the more dramatic scenario of overvaluations and the obviously attending possibility of the owner profiting from the loss of his vessel.

Revision of overvaluations

For larger tonnage, valued policies are always used, and overvaluations have become common, ships having easily a valuation of more than 200% above market value. The limitation in ICA sec.39 (2) for "substantial" overvaluation has been said for yacht insurance to permit a maximum overvaluation of 30%, but for commercial ships valuations as such are regarded as virtually unassailable.

While the new Insurance Act has formally abolished the enrichment prohibition, the Formation of Contracts Act (1915:218 with amendments) still allows an overvaluation to be challenged if it is substantial and based upon mistaken assumptions on the insurer's part.¹¹ In many cases the assured may be taken to have neglected his disclosure duty, but there may also be cases where the overvaluation was unknown to both parties, such as a sudden drop in ship prices.

In the English Marine Insurance Act, 1907 (MIA), section 27 (3), a mere overvaluation is cause for a revision only in case of fraud:

"Subject to the provisions of this Act, and in the absence of fraud, the value fixed by the policy is, as between the insurer and the assured, conclusive of the insurable value of the subject intended to be insured."

A point of some interest in this connection is that for hull and machinery, insurers have access to other sources of information than the assured's statements.

In *General Shipping & Forwarding Co. v. British Gen. Insurance Co.*¹², the insurers claimed the ship was grossly overvalued, in reality probably twice the real value. Bailhache, J., accepted the valuation, pointing out

¹⁰ Swedish 2,000 Hull Conditions 27.3.

¹¹ Under the doctrine of "mistaken assumptions" generally based on the Act's section 33.

¹² (1923) 15 Ll.L.Rep. 175.

that for hull and machinery the insurer is not, as in cargo insurance, thrown upon the assured's statements, since he has access to classification registers.

The previous Swedish hull conditions provided that a stated value was binding as long as the assured had not given misleading information in respects significant for the valuation. This does not go as far as the English rule, where fraud must be proved with a certainty approaching that required in a criminal case. In the Swedish 2000 Hull Conditions the valuation is binding unless the assured has given misleading information concerning the vessel of importance to the insurer when estimating its value, which seems to be a further clarification of the same intended rule and accords with the Contracts Act.

It is clear that the Swedish Hull Conditions are in formal conflict with the Swedish ICA's enrichment prohibition, while the conflict will be removed with the new Act. In practice the conflict with mandatory ICA has not caused great problems, but the revision question has been raised in four cases.

In ND 1935, 449 *Heddy*, the vessel's market value was 92,000 SEK while the valuation of 180,000 was seen as a substantial overvaluation subject to revision. In ND 1957, 579 *Sea Gull* the insurer could not show that an agreed constructive total loss compensation of 70,000 SEK was "substantial overvaluation" above 40,000 remaining after avoided salvage and repair expenses. In Norwegian ND 1960, 68 *Dyrstad* the valuation of 75,000 NOK was taken to be "unreasonable" under the applicable conditions and therefore unbinding for the insurer when the market and replacement value was 48,000. And in ND 1998, 264 "*Hantverksbåten*" a Norwegian Appeal Court accepted 2 mill. NOK for a lighter bought for 521,000 NOK.

Today, when an evaluation is challenged by the insurer, it is mostly for other reasons than mere overvaluation. The insurers' acceptance of this is probably due to their own influence in framing the conditions. In practice, there is freedom of contract for large tonnage insurance, with only fraud as a "limit".

In the recent English case *Game Boy*¹³ a vessel built in Bulgaria in 1965 as a training ship for the Russian navy had been sold to Greece for use as a floating bar and discotheque, then after bankruptcy resold in 1998 to Russian interests for use as a casino and insured as such for a value of US \$ 1.8 mill., to be raised to 2.5 mill. upon commencement of business. On January 13 1999 an explosive device was detonated below the vessel's waterline, causing an ingress of water and sinking of the vessel. The owners claimed compensation for total loss, asserting that the valuation had been made in good faith and adducing a number of documents supporting it. Justice Simon in the High Court of London found that at least three of the documents adduced as proof of value were not genuine. In that light he found that the assured had no genuine belief in the stated value of US \$ 1.8 mill., that the real value was between US \$ 100,000 and 150,000, that the valuation was a material misrepresentation and the underwriters could avoid the policy.

Similarly in Swedish law there is not much weight given to the enrichment prohibition in ICA sect. 39(2). But neither at present nor under the new Act is it necessary to adduce proof of criminal fraud to avoid an overvaluation supported by misleading statements.

Fraud risk

It may be tempting for shipowners with strained economy to use high valuations to overcompensate the loss of their vessels. As the premium in such cases is correspondingly high, an attendant danger lies in the shipowner's obvious interest in seeing that a loss covered by the insurance occurs before substantial premiums have been incurred. Fraud by the assured or on his account will of course never be covered,¹⁴ but how to cope with it is a harder question, and the first problem is to determine the burden of proof.

¹³ *Eagle Star Insurance v. Games Video Co.* [2004] 1 Lloyd's Rep. 238.

¹⁴ Trine-Lise *Wilhelmsen*, Misconduct of the assured and identification, CMI Yearbook 2003, p. 543.

Burden of proving intentional causation of the loss

While the avoiding of a policy for alleged fraud is a civil action, what is sought to be proved is that the assured has been guilty of a criminal act. The first question is what is required for showing this.

Clearly the burden of showing deliberate destruction of the object of the insurance is borne by the insurer. In English law it is said that this burden – if not quite of the criminal standard – is commensurate with the degree of dishonesty alleged.¹⁵ However, in English as well as in Swedish law, the burden will not lie upon the insurer until the assured has proved his claim.¹⁶

If the insurance claim is in respect of sinking under an “all risks” policy, as is normal in Sweden¹⁷, this primary burden is easily fulfilled. The ship has sunk, and that is it. But it may be that the assured claims compensation not for sinking, but for some other insured event, such as theft. If the ship is then found to have been scuttled or otherwise destroyed, this may throw doubt on the allegation of theft, for which the assured still bears the burden of proof.

Such was the situation with the yacht *Carl II*, which the Swedish navy, while searching for foreign submarine activity, found to be scuttled in the deepest and most inaccessible spot of the Stockholm archipelago more than a year after insurance compensation had been paid for total loss by theft. Having initially disputed his continued burden of proof after receiving payment, the assured was persuaded to stipulate that the burden for retaining improper insurance compensation is the same as for claiming payment, and both the District Court and Appeal Court found that the assured had not been able to discharge it.¹⁸ The assured withdrew an appeal to the Supreme Court.

But if the assured has claimed compensation for sinking, and the vessel is clearly sunk, the assured’s primary burden is discharged, and the same would normally be the case if the vessel has totally disappeared without trace. It is then for the insurer to show that the sinking was due to exempted circumstances, such as scuttling.

In *Svängen*, unreported Particular Average Statement 29 March 1995, no. 2978, the Average Adjuster required the insurer to show preponderant likelihood of intentional causation of the ship’s sinking. The Adjuster found that the alleged opening of the ship’s two “mud boxes” could have caused the sinking but that both of these could not have been deliberately opened simultaneously. The facts that the ship was old, that her valuation has just been raised considerably and that she sank in quiet weather off Gibraltar in a part of the Mediterranean so deep that the vessel could not be investigated were not considered material.

In two cases concerning motor and home insurance respectively,¹⁹ the Swedish Supreme Court has more precisely indicated that in cases involving accusation of crime, preponderant evidence does not suffice, although the required level of proof is not as high as in criminal cases.²⁰ There are Norwegian marine insurance cases to the same effect.

In ND 1992, 292 *Veslekari* the Gulating Appeal Court said the sinking of the vessel did not show the necessary “strong preponderance” of likelihood that someone on board must have opened a bottom valve, while in ND 1993, 197 such intentional opening of a bottom valve on the *Torson* was held by a majority Appeal Court not to be shown by the necessary “qualified preponderance”.

If the policy is for particular risks, as normally in English law, the assured must show a named risk to achieve primary coverage. The normal allegation for a ship that has sunk would be “perils of the seas”, which is understood as a fortuitous circumstances causing the loss.²¹ The ship’s sinking by incursion of sea water is not itself a proof of such perils, but it may be prima facie proof if the vessel was found to have been seaworthy on commencement of the

¹⁵ Merkin, at www.nzila.ort/annualconf/docs/auckland/Prof_Merkin_Fraudulent_Claims.pdf p. 1.

¹⁶ In Sweden, discharge of the primary burden requires convincing proof, though in consumer insurance such as private boat insurance mere preponderance will suffice, see for motor insurance NJA 1954 p. 501.

¹⁷ All risks policies are common in Scandinavia and occur in Germany and France, Wilhelmsen, op cit. p. 542 footnote 10.

¹⁸ Södra Roslags DC (10) DT 426/96 matter T 2394/94, Svea AC 1997 (*Carl II*) [1997] LMCLQ 565,

¹⁹ NJA (Nytt Juridiskt Arkiv, being the Swedish Supreme Court decisions) 1986 p. 470 and NJA 1990 p. 93, also relied on in West Sweden AC 15 Nov. 2004 matter Ö 4502-02 assuming the assured put his vessel on fire.

²⁰ Same for suspected arson, *AC W Sweden 19 Nov. 2004 matter Ö 1081-04 (Vanessa)*, (2004) Sw.Mar.Cas. 25.

²¹ In Australian *Ocean Harvester Holdings Pty v. MMI General Insurance Ltd, the Ocean Harvester* [1003] QSC 262, it was held to make no difference that the cover of the insurance was for “accidents”.

voyage, all of which the insurer may refute by counterproof of some exemption.²² It is when such proof amounts to an accusation of fraud or some other crime that English cases have taken the weight of the burden to be close to the criminal standard.²³

So it appears, when proof of fraud is required, that both Swedish and English law have indicated a strictness of the burden approaching that required of the prosecutor in a criminal case. It seems doubtful whether this is a well-considered solution. The strict burden of proof in criminal cases is justified by considerations of civil rights and protection against unjust punishment. An action for insurance compensation concerns a contractual claim where the assured's right must be weighed against the insurer's objections in a way to admit justified claims but also to prevent fraudulent ones and to keep premiums at a reasonable level.

In RfH 1988:40 *Fontainbleau* a Stockholm restaurant had been blown up in a violent explosion, its two owners being first apprehended on suspicion of insurance fraud but later released for lack of proof. Skandia, the insurer, refused to pay up and was exonerated in the District Court. The Appeal Court, after considering similar happenings in the owners' previous record as well as certain embarrassing circumstances concerning the present case, assessed the insurer's burden of proof in such cases to be not as high as a prosecutor's in a criminal action but that mere preponderance of likelihood for fraud does not suffice; the insurer must show *clearly* greater likelihood of fraud than of innocence. As such likelihood was not found, the insurers must cover the damage.

Similarly, in the English *The Ny-Eeastayr*,²⁴ where technical evidence indicated scuttling, the court "was satisfied to the required standard, indeed beyond any reasonable doubt, that the vessel was deliberately sunk by Mr. Horne" (the master).

In English law, once a substantial fraud is proved, it is taken to defeat the assured's claim whether the fraud was directly causal to the occurrence of the loss or not. Also, if a lesser claim might properly have been made and the assured adds improperly to it, as by overstating his claim, this may defeat the whole claim.²⁵ The logic has been expressed that the fraudulently inclined assured must not be allowed to think: "if the fraud is successful, I will gain; if it is unsuccessful, I will lose nothing".²⁶

Economic motives

An insurance fraud may be incited by a deliberate intention to enrich oneself at the expense of the insurance collective or it may be a desperate attempt to rescue an insolvent or waning business. In the former case the vessel will have to be insured well above its purchase price, and this evaluation must be made not too long before the casualty, since high premiums will otherwise consume the contemplated gain. In the latter case the vessel need not be overinsured nor recently insured, though its real value – to the owner at least – will often be much depreciated. There may also be a combination of incentives, where an impecunious owner may have raised the evaluation shortly before the loss. Planning fraudsters may also have a record of sunken ships that may indicate systematic scuttling.

Naturally, then, a court may be inclined to assume from combinations of such facts that the sinking is fraudulent, but there has been a decided restraint on the part of Nordic tribunals

²² Further the US case *Vanqueur Corp. v. Insurance Companies, The Vanqueur*, reported in [1973] 2 Lloyd's Rep 275. In *The Popi M* [1985] WLR 948 Lord Brandon said the owner always had the burden of proving loss by perils of the sea, though it is open to the court to conclude from the evidence that the proximate cause remains in doubt and the shipowners have failed to discharge their burden. In *Glowrange Ltd v. CGU Insurance, The Moana*, reported by David Martin-Clark www.onlinedmc.co.uk/Glowrange.htm Colman, J refused a summary judgement for the assured where the yacht had taken in water and sunk in quiet weather without an explained reason.

²³ For example, *The Gloria, Compania Naviera Vascongada v. British Foreign Marine Insurance Co.* (1936) 54 Ll.L.R. 35.

²⁴ *R.H. Houghton and Mancon Ltd. v. Sunderland Marine Mutual Insurance Co. Ltd.* [1988] 1 Lloyd's Rep. 60.

²⁵ *Galloway v. Guardian Royal Exchange* [1999] Lloyd's Rep. IR 209, where the addition of an expensive computer equipment to a lesser claim was held to be substantial.

²⁶ From *Manifest Shipping Co. v. Uni.Polaris Shipping Co. and Others*. In *Black King Shipping Corp. v. Massie (The Litsion Pride)* (1985) 1 Lloyd's Law Reports 1, a fraud consisting in retaining a lower premium rate by not declaring the entry into a war area totally defeated the assured's claim.

in accepting such evidence. Thus in *Svangen* (above) the Adjuster refused to make assumptions from the owner's economic embarrassment and his raising of the insurance evaluation; in *Veslekari* (above) the matter was not even considered, and in *Torson* (above) only the minority paid attention to such allegations. In *Carl II* (above) where the owner had tried vainly for over half a year to sell his yacht, the insurer based its repayment claim on the owner's failure to prove the alleged theft rather than on fraud.

English courts may have been more inclined to give weight to such motives, though a definite tendency is hard to perceive.

In *The Arnus*²⁷ a steam vessel had sunk at sea in good weather. The Spanish-owned vessel had a market value of £ 13-14,000 but was insured for £ 160,000, i.e. more than eleven times its market value. The policy was about to expire, and the owner company was insolvent, having assets apart from the vessel worth £ 400. The owners alleged that the ship must have hit wreckage in the water, while the insurers claimed that the master and chief engineer had led in water through certain pipes. The High Court accepted the second mate's testimony of having seen a dark belt in the water, while the Court of Appeal and House of Lords assumed sinking by deliberately leading water into the vessel. Lord Sumner said

"Ships are not cast away out of lightness of heart or sheer animal spirit. There must be some strong motive a work; and this is usually the hope of gain".

In *The Ny-Eesteyr* (above)²⁸ the master was found to have scuttled the vessel, which was insured for £ 135,000. A market value could not be established, but the owner had vainly tried to sell the vessel, which has been causing him economic loss for a period of time. Such circumstances were taken to turn the scale and justify the assumption of the owner's implication. It was stressed, however, that the existence of a motive alone would not be sufficient to justify the assumption.

In *Grecia Express*,²⁹ the ship was undoubtedly scuttled, and the assured had also lost a number of other vessels under unclear circumstances though he had not been sentenced for any fraud. Colman, J, in the High Court, rejecting such circumstances as evidence of particular "moral hazard", and also rejecting the allegation that failure to inform the insurer of the previous sinkings was a breach of the assured's disclosure duty, allowed full recovery. (Incidentally, there was a previous Norwegian case ND 1998 p. 244 about the same vessel where the Appeal Court questioned but accepted the same owner's statements concerning daily loss for repair.)

The procedural matter of expert evidence was discussed at length in *The Ikarian Reefer*,³⁰ where the Court of Appeal in a long judgement changed the High Court's fact evaluation, concluding (1) that the ship was scuttled and put on fire, and (2) that in view of the owner's impaired economy and the on-board officers' disinterest in the matter, the scuttling must have been done at the owner's demand.

Technical evidence

Technical evidence of scuttling may be hard to refute, though it does not necessarily show that the assured was privy to the sinking.

In *Carl II* (above), where it could be shown that vital tubes had been cut off, hatches had been left open, the diesel tank lid had been carefully fastened but the water tank left open, and where the sinking boat had just missed landing on a navy ammunition dump where searches may not be conducted, the owner who had reported the boat lost by theft did not dispute scuttling but suggested that the thief must have done it!

The trawler *Ny-Eeasteyr* (above) sank in perfect conditions off Worthing, and the owner had no explanation except that the vessel had taken in water and sunk for "unexplained reason". The vessel was found, and video and ordinary photographs showed that the cooling water outlet and another tube had been taken apart to admit water into the vessel's engine room. The owner's failing economy and other circumstances were accepted as proof of the owner's privity.

But in the case of the *Torson* fishing vessel,³¹ the court's majority found proof of fraud insufficient. It was shown that the vessel had taken in water through a bottom valve, and the insurer alleged that the valve had been deliberately opened, while the vessel owner said it had suffered a "radical breakdown" through rust. As such

²⁷ *Compania Naviera Martiartu v. Royal Exchange Assurance Corp.* [1924] 19 Ll.L.R. 95.

²⁸ *R.H. Houghton and Mancon Ltd. v. Sunderland Marine Mutual Insurance Co. Ltd.* [1988] 1 Lloyd's Rep. 60.

²⁹ *Strive Shipping Corp. and Royal Bank of Scotland v. Hellenic Mutual War Risks Association* [2002] 2 Lloyd's Rep. 88.

³⁰ *National Justice Compania Naviera v. Prudential Assurance Co. Ltd.* [1995] 1 Lloyd's Rep. 455 (CA).

³¹ ND 1993 p. 197 Norwegian Hålogaland AC. Cf. *West Sw.AC 19 Nov. 2004 matter Ö 1081-04 (Vanessa) (2004) SwMarLaw 25*, where the fuel line on the burnt-out boat was twisted in a manner that should have prevented the engine from running, showing to the court's satisfaction that the owner must have manipulated it after reaching the site of the purported accident.

rusting was not proved, the decision hinged on whether there could be a radical breakdown without rust, on which the parties' experts were disagreed. The majority held that the insurer had not achieved a "qualified preponderance" for the impossibility of such a breakdown, while the minority considered that such a high evidence standard would defeat any possibility of proving the assured's having caused the casualty.

Unseaworthiness

If fraud cannot be shown, and technical evidence is not conclusive, the insurer may try to show lack of seaworthiness, which the assured may meet by proof that he neither knew nor should have known of the deficiency. In clause 12 of the Swedish Hull Conditions, the *insurer* must show (1) unseaworthiness and (2) that it caused the loss, while the *assured* may show (1) that he did not and ought not to have known of the inadequacies, and also (2) that he did not have such knowledge at a time when he could have avoided the loss.

On the other hand, the Swedish Marine Insurance Plan, § 84 (2), provides a special presumption for unseaworthiness if a vessel has "sprung aleak while afloat", which is understood as unexplained leakage in normal weather. The Plan does not permit counterproof for good faith but does allow for the insurer's previous approval of the vessel (§ 84 (3)).³²

In ND 1964, 202 *Marie* the Swedish Supreme Court affirmed the Adjuster's and City Court's finding that the section was applicable to defeat compensation for water damage where the ship had met hard but not exceptional weather.

In ND 1975, 733, where fishing vessel *Blue Bird* had sunk in good weather, the owner invoked the insurer's inspector's approval before commencement of the voyage, but as this had only concerned a specific incident of over deck damage, it was held not to be relevant to the sinking.

Even in the absence of the Plan's special presumption, it may be suggested that a presumption of fact for unseaworthiness might arise from the unexplained sinking of a vessel in good weather conditions. If the vessel sinks in such circumstances without any sound or shock indicating collision with some object in the water or other indication of accident, there seems indeed reason for such a presumption of unseaworthiness. But, under the Swedish Hull Conditions clause 12 and corresponding provisions, the assured may invoke good faith about the lack of seaworthiness.

In *Svängen* (above) the Adjuster considered that a presumption of fact might arise from the sinking, easing the insurer's burden of proving unseaworthiness, but that even if so, the assured was in good faith about this. In *Gloria* (above), the owner's postponing inspections was not seen as a sign of bad faith.

The *Popi M* (above) sank in quiet weather in the Mediterranean after a large aperture had opened in the vessel's shell plating. The assured alleged that the aperture must have resulted from a collision with an unidentified submarine, while the insurer said the vessel had come to the end of her natural life and did not hold together any longer. The House of Lords, clarifying that the solution depended on the construction of "perils of the sea", said that under a specific risks policy the assured must prove that the sinking was due to an event covered by the policy, which required a real showing just why the ship's bottom had opened in good weather. As the idea of the submarine had only been alleged, not proved, the House of Lords held there was no right to insurance compensation.

There may however be a combination of losses in which the assured may be covered by his insurance though the sinking itself was not sufficient proof.

In the *Kastor Too*³³ a vessel with a cargo of phosphate caught fire off Yemen and sank after fifteen hours. It was stipulated that the fire alone should not have caused sinking in such a period, but the owners alleged that there were explosions causing the sinking. However, the principal question came to concern whether the fire, which was covered by the insurance, made the ship a constructive total loss before the sinking, and it became agreed that the test was not whether the ship would have become a constructive total loss had the fire continued without the ship sinking. The CA affirmed the High Court's finding that the ship was a constructive total loss before sinking and must therefore be covered as for total loss.³⁴

³² The 1964 Norwegian Plan had a corresponding presumption, § 45 (2), see ND 1983 p. 204 *Frank Erik*, but it permitted the assured to plead good faith, see further Jerlardtz, *op.cit.*, pp. 46-49,

³³ *Kastor Navigation Co. v. Axa Global Risks* [2003] EWHC 472.

³⁴ Cf. The facts of *Manifest Shipping Co. Ltd. v. Uni-Polaris Insurance Co. Ltd. (the Star Sea)* [1997] 1 Lloyd's Rep. 651, in which the ship never sank but became burnt out and a constructive total loss.

Suspicious action

There are plenty of examples of actions that support the likelihood of intentional sinking. A classical example is the sinking of the infamous tanker *Salem* off Africa in 1977, in which the crew were found in good spirits with all their belongings in lifeboats while the ship was still sinking and the full oil cargo stated to have been on board but actually sold showed no trace on the water surface. The scuttling of the vessel became too obvious for the fraudsters to even press an insurance claim. But the circumstances are seldom so obvious.

The *Tropaiforos* sank in the Bay of Bengal. The insurer alleged that water had been pumped in through bilgelines and ballast lines, while the owner assured that the vessel had hit an unidentified object. The crew's testimonies were highly inconsistent, with different statements as to the side on which the vessel had been leaking, and it appeared that the radio operator had sent a Mayday message before the alleged moment of hitting the purported object. These various statements "did not impress" the judge.³⁵

The *Spathari*³⁶ grounded and sank off the Portuguese coast in such quiet weather that small boats could come out and give assistance. From one of these boats the ship's master had been asked why he had not sent for help, to which he had answered, "It slipped my memory". The *ratio* for refusing compensation was however not the master's behaviour but the assured's failure to disclose that the real owner was Greek.

Neglected sue & labour exertions

The *Spathari* (above) verges on active failure preventing or interfering with the salvage of the vessel, which if proved could be a cause for denied insurance compensation.

In the *Gold Sky*³⁷ prospective salvors testified that the master had bungled the salvage work with the apparent intention of assisting the sinking of the vessel. Compensation was refused.

If a crewmember is suspected of deliberately damaging the ship, it may be tempting to ascribe this to his being hired by the owner for that purpose. But in spite of appearances a court may still feel doubt about proof of fraud.

M/V Zinovia stranded on the Egyptian coast when directed by recently appointed K, who had sent the lookout away and ordered altered course towards the shore, where he called for the ship's master only after it was too late to avoid grounding. In spite of the master and crew doing much to obstruct salvage of the vessel, complicity of the owners was not taken to be proved.³⁸

But in *The Gold Sky* (above) and *The Michael*³⁹ the hiring shortly before loss of the vessel of a Mr. Komiseris referred to in the latter case as a scuttler (but not being the K of the *Zinovia* case), was taken to indicate the assured owner's complicity.

In the absence of reasons to expect collusion by the owner, mere negligence by the crew will not normally disentitle the owner from insurance compensation.

Such might be the situation in the Norwegian *Torson* case,⁴⁰ where a fishing vessel sank in quiet weather on its way back from the fishing area. The vessel's failure to call for efficient pumping assistance led to her foundering, which misjudgement according to the court's majority did not constitute such gross negligence as disqualified the owners from insurance compensation.

In the German Insurance Contract Act, section 62, there is a presumption for gross negligence in case the assured is taken to have objectively failed to minimise damages. The provision may be a difficult obstacle for an assured seeking insurance cover after loss.

The provision proved fatal to a Swedish sailor, whose boat *Kalea* was insured on German terms through the yacht insurance broker Pantænius. His boat *Kalea* having sunk in the Caribbean, and a court expert having declared that he ought to have sailed in the opposite direction to what he had chosen, the court, without any suggestion of wilful misconduct, refused to grant compensation.⁴¹

³⁵ *Compania Naviera Santi v. Indemnity Marine Assurance Co. Ltd* [1960] 2 Ll.L.Rep. 462,

³⁶ *Demetriades & Co. v. Northern Assurance Co.* (1923) 17 Ll.L.R. 327.

³⁷ *Astrovlanis Compania Naviera S.A. v. Linard* (1972) 2 Q.B. 611 (CA).

³⁸ *N. Michalos & Sons Maritime S.A. and Another v. Prudential Assurance Co. and Public Corporation for Sugar Trade v. N. Michalos & Sons Maritime Co. Ltd.* [1984] 2 Lloyd's Rep. 264. Cf also *National Justice Compania Naviera S.A. v. Prudential Assurance Co (The Ikarian Reefer)* [1994] 1 Lloyd's Rep. 68, where negligent navigation was also taken to be the cause of the ship's grounding.

³⁹ *Piernay Shipping v. Chester* (1979) 2 Ll.L.Rep. 1.

⁴⁰ ND 1993, p. 197 Hålogaland AC.

⁴¹ Oberlandesgericht Hamburg 10 Jan. 2003 matter 9U 204/01, unreported.

Lacking custody and exempted use of the vessel

In ND 1998 p. 159 charter sailing vessel Apollo, insured by Finnish Sampo on Institute Yacht clauses (IYC) had been moored in shallow water at Puntarenas, Costa Rica, with her engine and most equipment removed and under casual surveillance only. Under the IYC the insurance was suspended during major repairs. At ebb tide she had stuck in the mud in such a way that water entered into her when the tide returned, whereupon she sank. The Swedish Supreme court, applying English law principles and stressing the importance in English law of conformance to the utmost good faith rule, found that as the assured had not disclosed that the ship was under repair, the insurer was not liable.

In Canadian *Russell v. Canadian General Insurance Co.*⁴² a boat owner covered by an all risks marine policy had left his boat in storage from 1990 to 1993, whereupon she was found to be a constructive total loss due to water inside. The insurer denied cover due to wilful misconduct and assumption of risk in not periodically inspecting the vessel. The court held that there was no duty of periodical inspection and no wilful misconduct as the assured could not be shown to have voluntarily subjected his vessel to damage.

Compare with *Marler v. Royal Insurance Co.*⁴³ where a sailboat was insured on “all risks” conditions subject to being “warranted laid-up and out of commission”. The assured put the boat into the water, where she sank. The court held that putting the vessel into the water was a breach of warranty, and there could be no recovery.

Wilful misconduct and gross negligence

Interference with salvage work and insufficient rescue actions may be ranged under the more general head of negligence defeating the insurance claim. In this respect there is a difference between the Anglo-Saxon legal systems and the rules normally applicable in civil law.

Thus English law excludes damage due to “wilful misconduct” from the cover, and this is basically understood as intentional, though not fraudulent, causation of damage and also reckless assumption of risk.⁴⁴ This is not seen as a matter of negligence but rather as a matter of recklessness or ill will.⁴⁵ Such a concept is rarely used in the civil laws systems, where, apart from fraud, the exemption is for loss through gross negligence.⁴⁶ Although this concept is distinct from intent, it is recognisably used in many cases to exclude compensation where intent may be suspected.

Identification⁴⁷

A technique much used in Scandinavian law is that of identifying the actor with the principal, so that loss of protection may occur as a result of servants’ acts or omissions though the principal may have nothing to do with the matter. The rules differ for the various duties that may have been neglected, but the Swedish Hull Conditions clause 13 clarifies that “wilful misconduct” and negligence by the master and crew is not generally attributed to the assured.

Under the Hull Conditions, clause 11.6, the insurer is free of liability to the extent damage may be assumed to be caused by the disregard of safety rules on the part of the person responsible for the observance of such rules. Apart from non-observed safety rules, the insurer is relieved, under clause 13, only to the extent damage is caused by wilful or negligent acts of the assured or of the managing owner or of any one to whom these have delegated their functions. The Insurance Plan, where it still applies, is stricter against the assured. Under its section 40, the owner’s wilful and negligent (not only grossly negligent) acts defeat the claim, and under section 81 the same applies to intentional acts of the master and other officers.

As we have seen in, for instance, the *Ikarian Reefer* case above⁴⁸, acts or omissions of the master or crew may sometimes raise the inference that the vessel owner must have been

⁴² (1999) 11 CCLI(3rd) 284 (Ont.Ct. Gen.Div).

⁴³ No. C 12405/93 (Ontario Ct. Gen. Div. Oct. 3 1996).

⁴⁴ Marine Insurance Act, 1907, section 55 (2)(a), cf. *Wilhelmsen op.cit.* pp. 546–548, and further on wilful misconduct Malcolm Clarke, *The Law of Insurance Contracts*, 4th ed. 2002, esp. 17-3A3, 19-2A2 and 19-2B.

⁴⁵ *Wilhelmsen op.cit.* p. 545 citing cases.

⁴⁶ *Wilhelmsen, op.cit.* p. 545–547 (France, Italy, the Nordic countries, Greece, Germany, Slovenia, Croatia, Japan and perhaps also Holland). The Swedish Hull Conditions clause 13 exempt “damage caused wilfully or by gross negligence”, adding that “wilful misconduct” by crew members does not implicate the assured.

⁴⁷ For identification in other legal systems than Sweden, reference is made to *Wilhelmsen op.cit.* pp. 551–572.

directly implicated. Such inferences are fact findings and should not be confused with identification.

Importance of disclosure

The intentional sinking of a ship will of course take place during the currency of the insurance contract (*in contractu*), even though it may have been planned before. But breaches in contracting for the insurance (*in contrahendo*) may also be relevant, thus for example the overvaluation of a vessel intended to be scuttled. As we have seen, such circumstances may be taken into account after a sinking as indicating intent. But overvaluation is not as such a breach of contract.

In the absence of sufficient indications of fraud, the common law systems sometimes rely on another kind of fault *in contrahendo* to exclude cover for a dishonest assured. Since long, English law has prescribed a duty for the parties to an insurance contract of observing the “utmost good faith”, which for the assured involves an obligation to disclose all circumstances that may seem relevant for the insurer to know, whether or not they were causal to the actual loss. The idea, expressed by Lord Mansfield in the early case of *Carter v. Boehm*⁴⁹, is that the insurer needs to calculate his risk upon facts lying for the most part in the knowledge of the assured only, and that the transaction depends on the insurer’s confidence in all relevant facts being declared; if not, the policy is void. The principle has been elaborated in a series of cases and in English practice has been given a certain application to supervening circumstances during the performance of the contract.⁵⁰ As we shall see, circumstances that can be relevant to mention include previous losses of the assured’s.

The Scandinavian legal systems do not rely on such an outspoken trust requirement between the parties for combating insurance fraud. In Swedish ICA section 4 and the new Act’s chapter 8 section 9 (1), proof of fraud or dishonesty is needed to avoid the contract for misrepresentation or withholding material information from the insurer. For other consciously incorrect or omitted information, the insurer is free from liability only if correct statements would have caused the insurer to deny insurance, ICA sections 6–7, new Act chapter 8 section 9 (2). Under the present ICA, section 6 (3), the same is true also when the incorrect information has otherwise materially affected the insurer’s risk evaluation, ICA sections 6–7. Corresponding provisions are incorporated in the present Hull Conditions, clause 9. A largely similar regulation exists for supervening circumstances, ICA section 45, Hull Conditions clause 10 and the new Act chapter 8 section 10.

The seemingly laxer attitude of the Swedish law might seem to make it less efficient in combating insurance frauds. A test case might be where an assured has not divulged a previous loss record of vessels in his ownership, which is hardly a requirement in Swedish law. Yet the English case of *The Grecia Express* and the Swedish *Fontainbleau* restaurant, which should be illustrative examples, do not seem to bear out a tangible practical distinction. In the English case,⁵¹ the owner of a ferry actually scuttled at its mooring was confronted with the following non-declared previous losses: the sinking of another ferry in his fleet through an explosive device, a casino vessel in his ownership sunk by opening of sea valves, the disappearance of a luxury powerboat personally conducted by the shipowner and the theft of another powerboat upon its sale to a close relative of his. In the *Fontainbleau* case (above)⁵², owners of an exploded restaurant were shown to have had a number of previously owned restaurants burnt out and covered by insurance. In both cases the assured received full

⁴⁸ Compare similarly the minority judgement in the Norwegian *Torson* case (above).

⁴⁹ *Carter v. Boehm* (1765) 3 Burr. 1905.

⁵⁰ *The Litsion Pride* (supra) and *The Star Sea* (supra). This extension is not recognised in other Anglo-Saxon jurisdictions. N 29 2001

⁵¹ *Strive Shipping v. Hellenic Mutual*, footnote 29 above.

⁵² Svea Appeal Court RfH 1988:40.

compensation. These two cases do not seem to support any decisive distinction in strictness between the English and the Swedish practical approach to combating insurance fraud.

Epilogue

What, then, happened to DeGeorge with his four sunken yachts and other unexplained insurance losses?

The attorney for *Cigna Insurance*, the insurer of his last yacht the *Principe*, did not attempt to disprove the airy story of a mutineering crew having holed the boat and left its owner with friends to perish. Instead he alleged breach of the “utmost good faith rule” by DeGeorge’s failure, when applying for insurance, to disclose his prior losses. It was this reasoning that the Ninth Circuit Court of Appeals accepted and that led it to refusing cover for the loss of the yacht.⁵³

After the judgement, DeGeorge filed for bankruptcy in the US to block Cigna from recovery and then moved to his seaside residence on his native island of Rhodes. Upon expiry of the limitation period for his various insurance crimes, he returned briefly to the US to attend to his bankruptcy, not knowing that an accomplice had turned informer and revealed other crimes. DeGeorge was arrested on arrival and is now finally languishing in a US jail, where he can, however, enjoy the triumph of having abstracted all his assets out of Cigna’s reach, the insurer having expended the full value of the sunken *Principe* in litigation costs.⁵⁴

⁵³ *Cigna Property & Casualty Insurance Co. and Others v. Polaris Pictures Corp. and Others* (9 CCA 1999) 159 F.3d 412.

⁵⁴ Los Angeles Times 1999 cited from *Latitude 38* on the Internet.

Fraud and sinking ships in marine insurance. by Hugo Tiberg, professor in Maritime Law and Marine Insurance Law. On a fine November afternoon in 1992, Italian coastguards found two inflatable rafts by a sinking 76-foot luxury cruiser. Valued policies Valued policies have long been used in marine insurance, and they are said to have sprung from a practical need in the time of sailing ships, when an undeveloped market and poor communications made it hard to find a market. Today it is claimed that. Valued policies reduce disputes, since, as we have seen, ships' values are hard to establish Marine insurance is based on Uberrimae Fidei or utmost good faith but it hasn't worked out that way. Author Ed Geary closely examines the schemes of marine insurance fraud and conspiracy that involves not only boat owners and policy holders, but insurance brokers, and marine underwriters. During his five year USCG training mission of the Venezuelan Coastguard Geary's disclosure of the Central Intelligence Agency's clandestine Operation Deep Six to destabilize the elected government of Venezuela and install Hugo Chavez as president put him in the cross-hairs of the Agency. Silenc