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THE 'PAY TO BE PAID' RULE SHIPOWNER'S BANKRUPTCY AND DIRECT ACTIONS AGAINST P&I CLUBS

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A. Introduction

The insurance cover rendered by Protection & Indemnity Clubs (“P&I Clubs”) is as essential for shipowners’ business in the 21st century as it was for shipowners when the first of those insurance associations, the *Shipowners’ Mutual Protection Society*, was established by Peter Tindall in 1855.¹ Thereby, he reacted upon the necessity to protect the shipowners of those days against the possibility of unlimited liability. Such a risk was probably due to a considerable potential increase of liability caused by the technological developments of the 19th century, in particular the newly developed possibilities of steam ships. Before this association was established, shipowners were not able to obtain insurance cover for the whole value of their vessel, because hull insurers accomplish no more than a ‘limited public liability protection’ covering only three-quarters of a claim; a shipowner therefore had to cover the last quarter by himself.² The last quarter was in turn covered by virtue of his membership in one of the newly established associations.³

After some significant incidents, it was however held that the shipowners of those times were not covered through their membership in one of the aforementioned associations in a case where a loss was not caused by the ‘perils of the sea’. In 1870, *The Westernhope* was on her way to Cape Town, when she deviated from her route and berthed in Port Elizabeth.⁴ Thereby, the shipper suffered loss due to the delay. The Court held that the shipowner was fully liable for the damages incurred by the shipper caused by the breach of the contract of carriage, but the shipowner was not insured by his membership of the

¹ However, only ‘Protection’ risks were covered by the membership of this Association, eg liability for loss, personal injury, collision, dock damage and wreck removal. In contrast, ‘Indemnity’ risks, ie liability for loss or damage to cargo and fines, were not covered; see *Ronneberg*, ‘An introduction to the Protection & Indemnity Clubs and the Marine Insurance they provide’, *University of San Francisco Maritime Law Journal*, 1990/1991, 3 U S F Mar L J 1, at 3 f.

² See *Schoenbaum*, *Admiralty and Maritime Law*, 1st Edition, St Paul, 1987, at 566.

³ See *Hazelwood*, *P&I Clubs, Law and Practice*, 3rd Edition, London, Hong Kong, 2000, at 6, for a more detailed description of the historical development of the P&I Clubs; further, see a comprehensive illustration of the development and the current situation of the mutual insurance offered by P&I Clubs given by *Hare*, *Shipping Law & Admiralty Jurisdiction in South Africa*, Cape Town, 1999, at 757 ff; see also *Augustine*, ‘Other States should “get with the program” and follow Louisiana’s lead: An examination of Louisiana’s Direct Action Statute and its application in the Marine Insurance industry’, *Tulane Maritime Law Journal*, Winter 2002, 27 Tul Mar L J 109, at 112; further, see *Rosas*, ‘Argentina: A new development in direct actions against Indemnity Insurers’, *Tulane Maritime Law Journal*, Winter 1997, 22 Tul Mar L J 191.

⁴ See *Hare*, *ibid*, at 757 f.

North of England Protecting Club which defended the claim on grounds that its cover did not provide indemnity for this loss. Further, there was the loss of *The Emily* and her cargo caused by negligent navigation which was then not one of the covered perils. On the basis of this argument, her Protection Association refused its coverage as well.⁵

Thereafter, the majority of shipowners joined the *North of England Protection Association* to obtain cover including an indemnification against these and other risks.⁶ Mr Tindall's society followed in 1866 by introducing cover for shipowners' liabilities for loss, shortage or damage suffered by owners of cargo loaded on board the member's vessel.⁷

Nowadays, ninety percent of all merchant ships trading around the world are entered by their owners in P&I Clubs to reach the wide insurance cover against several risks not covered under an ordinary policy.⁸ Basically, a shipowner is covered by his P&I policy against liability to third parties caused by his vessel or his crew.⁹ Further, a P&I Club generally provides its members with coverage against injury or death of crew-members or passengers, collision damage and damage to the environment.¹⁰

After a ship is entered into a P&I Club, the shipowner becomes a 'member' of that Club and he thus enjoys the rights and owes the duties under a mutual organized and non-profit-making insurance association. Such a mutual insurance is described by section 85 of the English Marine Insurance Act of 1906 in general as 'two or more persons mutually

⁵ See *Hare*, *ibid*, at 758.

⁶ See *Hazelwood*, *ibid*, at 7.

⁷ See *Hazelwood*, *ibid*, at 7.

⁸ The twenty most important P&I Clubs formed the 'International Group of P&I Clubs' to pursue common issues together, eg collective re-insurance and representation of their members; see *Hare*, *ibid*, at 758 f; and see *Ronneberg*, *ibid*, at 1; see further *Gyselen*, 'P&I Insurance: the European Commission's decision concerning the agreement of the International Group of P&I Clubs', *Marine Insurance at the turn of the Millennium*, Volume 1, Antwerp, 1999, at 181; regularly, shipowners obtain Hull & Machinery insurance from commercial insurers.

⁹ See *Hare*, *ibid*, at 759, for the details of the cover generally provided by P&I Clubs; see also *Augustine*, *ibid*, at 109; in contrast, a Hull & Machinery insurance regularly defines the covered risks expressly, for instance by referring to the International Hull Clauses of 2003.

¹⁰ See *Gyselen*, *ibid*, at 182; see also *Schoenbaum*, *ibid*, at 567; beside this classical P&I coverage, there is another kind of mutual insurance procured for claims and liabilities with regard to freight, demurrage and defence, abbreviated and known as FD&D.

agree to insure each other against marine losses'.¹¹ It is a peculiarity of the insurance cover offered by P&I Clubs that a member is both insurer and insured because his claim against the Club is paid out of all members' contributions named 'calls' (including his own). By these calls, the members provide liquidity to enable the club to cover claims of all other members.¹²

Generally, a P&I Club is provided with a comprehensive discretion with regard to all relevant aspects of the relationship between Club and member, for instance to decide about shipowner's accession to the club and the settlement of claims. Such a discretionary power will be regularly exercised by a Club's management or its board of directors.¹³ Normally, those directors will be elected at a general meeting for a period of at least one year and they are drawn from members of the club, ie as representatives of the shipowners they influence the daily business of the association.¹⁴

The relationship between a shipowner and his P&I Club is mainly governed by certain Club Rules, normally laid down in a Rule Book. Besides those Rule Books, there are other means of regulating the contractual relationship of a Club and its members, eg Certificate of Entry,¹⁵ Articles or Statutes and a Memorandum of the Association.¹⁶ Notwithstanding the particularities of those rules, an agreement between shipowner and P&I Club is in any case a contract whereby the P&I Club is bound to reimburse the shipowner for a financial loss if the contractual prescribed stipulations are fulfilled. Similar to an insurance contract covering risks typically based on land, the shipowner has to pay

¹¹ Sir Chalmers's draft was the basis for the first codification of marine insurance law, and it was the role model for at least the corresponding legislation in Australia, Canada and New Zealand. Further, it was used for the regulation of marine insurance as a part of the California Insurance Code; see *Staring/Waddell*, 'Marine Insurance', *Tulane Law Review*, June 1999, 73 *Tul L Rev* 1619, at 1622.

¹² See Lord Brandon of Oakbrook with a general introduction in *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti) and Socony Mobil Oil Company Inc v West of England Shipowners Mutual Insurance Association Ltd (The Padre Island)*, [1990] 2 *Lloyd's Rep* 191.

¹³ See *Hazelwood*, *ibid*, at 25.

¹⁴ See *Hazelwood*, *ibid*, at 17.

¹⁵ The 'contract' between P&I Club and shipowner is proved and created by this certificate, regularly with reference to Club's rules; see *Ronneberg*, *ibid*, at 6.

¹⁶ See *Hazelwood*, *ibid*, at 55, with a general overview about the construction and particularities of those rules.

the call as agreed (it is named 'premium' in regard to ordinary insurance contracts) as consideration to receive insurance cover for each particular loss or damage.¹⁷

First of all, the Club's Rule Book regulates whether or not the respective P&I Club is obliged to cover a particular loss suffered by its member, or if the Club is entitled to refuse the relevant claim.¹⁸ This initial and quite substantial question shall be a main aspect of this paper. It is not possible to consider the Club's duties to reimburse its members for a particular loss in all possible cases. This paper will rather treat the P&I Club's entitlement to reject a claim on the basis of a certain clause normally part of most, if not all, Clubs' Rule-Books: the 'Pay to be Paid' rule.

In the case where such a rule is incorporated in the Rule Book, it is thereby agreed between the Club and its members, in quite general words, that a member is not entitled to seek reimbursement by the Club until he has settled the claim with the injured party himself and, particularly, by his own means. It can easily be seen that such a rule causes difficulties if the shipowner becomes bankrupt and is therefore not able to settle the claim with the third party by his own means as required by the applicable Rule Book.

Hence, it is the aim of this paper to examine the consequences of such a rule with regard to the relationship between the shipowner, his P&I Club and the injured party. In fact, a third party who suffered any kind of loss caused by a shipowner's behaviour would seek compensation, either from the shipowner himself or from his P&I Club. As we will see below, there are however considerable differences in approach among various legal systems concerning the third party's demand. Thus, it is a further objective of this paper to clarify under which legal system and in which country respectively the courts or the legislator shall provide an injured third party with a right to claim directly against the P&I Club, particularly in the case of shipowner's bankruptcy. Further, it has to be shown that a Club is generally allowed to invoke certain defences, either on the basis of the insurance policy concluded between the shipowner and the Club or with regard to the relationship between the shipowner and the injured party.

¹⁷ See *Augustine*, *ibid*, at 110 f; and see *Gyselen*, *ibid*, at 182, who refers to the system of 'advanced calls' and 'supplementary calls': Each shipowner has to pay his contribution at the beginning of the period of insurance on the 20th of February of every year, and each shipowner has to make another contribution after the actual amount of the member's obligations has been ascertained with regard to the then concluded year.

¹⁸ See *Ronneberg*, *ibid*, at 6, who provides a comprehensive list of generally covered claims.

B. The 'Pay to be Paid' rule

As stated above, a 'Pay to be Paid' rule is part of most, if not all, Rule Books of P&I Clubs.¹⁹ This clause reveals the indemnity character of the insurance rendered by these Clubs.²⁰ Such a clause prescribes member's obligation to pay first in the case where he is liable for a certain claim.²¹ Only after the shipowner has done as agreed, he is entitled to ask his P&I Club for reimbursement because in this case the shipowner has suffered a particular loss due to the fact that 'the money leaves his property'.²² The difficulties however occur in a case where due to his bankruptcy the member is not able to discharge third party's claim. Then, the shipowner is apparently not able to settle the claim by his own means.

I. General

The P&I Clubs provide their members, who are shipowners or charterers, with a special kind of insurance: The P&I Clubs only render cover for indemnity.²³ This has to be distinguished from all kinds of cover provided by other insurers. Unlike indemnity cover, each liability insurer offers cover against any claim caused by insured's liability arising in the contractual determined circumstances, whereas all indemnity insurers provide cover where the insured has already paid the claim in favour of the claimant, thus suffering an

¹⁹ See *Fossion*, 'An eternal triangle at sea: Loss of insurance cover under a direct action in marine liability insurance', available at <http://www.law.kuleuven.ac.be/jura/39n2/fossion.htm>, at 14; see also *Hawkins*, "'Pay to be Paid" Wording in Marine Insurance Policies', available at <http://www.bernardpartners.com/images2005/pdfs/PaytobePaid.pdf>, at 1 f; see *ITIC*, 'Misdirected Arrows', *The Baltic Magazine*, available at http://www.itic-insure.com/bulletins_and_pr_detail.php?id=30; and see *Johnson* with a particular emphasis on 'Asbestos Disease Claims Against Ship Owners', available at <http://www.johnpickering.co.uk/news/merchantnavy.html>.

²⁰ See *Rosas*, *ibid*, at 191; see *Tetley*, *International Maritime and Admiralty Law*, Blais, Montreal, 2003, at 619.

²¹ See *Rosas*, *ibid*, at 191; see *Dougherty*, 'The Impact of a Member's Insolvency or Bankruptcy on a Protection & Indemnity Club', *Tulane Law Review*, June 1985, 59 *Tul L Rev* 1466, at 1479; see *Hawkins*, *ibid*, at 1.

²² See *Fossion*, *ibid*, at 14.

²³ See *Holstein-Childress*, 'The Enforceability of Arbitral Clauses contained in Marine Insurance Contracts against nonsignatory direct action Claimants', *Tulane Maritime Law Journal*, Winter 2002, 27 *Tul Mar L J* 205, at 208; also, see *Dougherty*, *ibid*, at 1478.

actual financial loss.²⁴ In general words: The assured is only entitled to seek compensation for the amount he has in fact lost due to the occurrence of an incident against which an insurer is bound to protect him.²⁵ In contrast, the advanced payment is not necessary under a liability policy where the insurer is obligated to pay without any financial efforts of the assured. The payment has to be undertaken directly in favour of the injured party.²⁶

We can see from section 1 of the English Marine Insurance Act, 1906 that

'A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in manner and to extent thereby agreed, against marine losses, ...'.

It follows therefrom that the contract of a P&I insurance is 'not a contract of indemnity ideally, but of an indemnity according to the conventional terms of the bargain'.²⁷ Thus, the P&I Club and its members are generally free to agree a 'Pay to be Paid' rule by incorporating it into the Club's Rule Book. Normally, the peculiarity of the indemnity insurance is prescribed in P&I Club's rules which each shipowner has to accept when he enters his vessel into the Club.²⁸

II. Examples

For instance, Rule 10 of the *West of England P&I Club* prescribes a member's duty to settle the claim in question by his own funds before the Club's obligation to reimburse occurs, as follows:²⁹

'Payment First by the Member, ... The insurance afforded to a member is indemnity only and not liability. Unless the Committee in its discretion otherwise determines it shall be a condition precedent of a Member's right to recover from

²⁴ See *Ronneberg*, *ibid*, at 14.

²⁵ See *Chorley and Giles*, *Shipping Law*, 8th Edition, London, 1987, at 519, with reference to the doctrine of subrogation as a result of the doctrine of indemnity.

²⁶ See *Rosas*, *ibid*, at 192.

²⁷ See *Hawkins*, *ibid*, at 2.

²⁸ See *Hazelwood*, *ibid*, at 351.

²⁹ Available at <http://www.westpandi.com/WestPandi/Rules/2007/Class+1/Part+2/RULE+10.htm>.

*the funds of the Association in respect of any loss, damage, liabilities, costs or expenses that he shall **first have discharged or paid** the same otherwise than from money advanced expressly or impliedly for that purpose whether by way of loan or otherwise.'*

The following 'Payment first by Member' clause is laid down in Rule 87 of the Norwegian P&I Club Gard:³⁰

*'1 Unless the Association shall in its absolute discretion otherwise determine, it is a condition precedent to a Member's right to recover from the Association in respect of any liability, loss, cost or expense that he shall **first have discharged or paid** the same.*

2 The Association shall not be obliged to compensate a Member for a payment made to a third party unless the Member's liability to make that payment has been determined by: a) a final judgment or order of a competent court; or b) a final arbitration award (if settlement of the dispute by arbitration was agreed upon before the dispute arose, or was, with the consent of the Association, agreed upon subsequently); or c) a final settlement of the dispute approved by the Association.'

Furthermore, Skuld agrees with its members by virtue of Rule 28.5 that

*'Unless the Association shall in its absolute discretion otherwise determine, it shall be a condition precedent of the member's right to claim against the Association that the liabilities, losses, expenses or costs (which are the subject of the claim) **have actually been paid or discharged by the member, joint member or co-assured** and that, in the event of a liability, the liability has been discharged pursuant to:*

a) a court order or judgment, other than a default judgment, b) an award, other than a default award, of an arbitration tribunal appointed with the consent of the Association or in accordance with an arbitration agreement entered into before the

³⁰ Available at http://www.gard.no/pages/GardNO/Publications/StatutesAndRules?MainMenuID=10&SubMenuID=78&p_d_v=&p_d_c=.

event giving rise to the claim arose, or c) a settlement approved by the Association.’³¹

As a last example, Rule 20 of the *North of England* Protecting and Indemnity Association reads as follows:

‘Unless the Directors in their discretion otherwise decide, it is a condition precedent of a Member’s right to recover from the funds of the Association in respect of any liabilities, costs or expenses that he shall have discharged or paid the same.’

P&I Club’s duty to reimburse the member therefore only occurs if an actual payment has been made by the member. Hence, these rules are a kind of determination of risks covered by shipowner’s membership and are therefore essential for the relationship between the P&I Club and its member. As it is shown by the above-mentioned rule of the *West of England* P&I Club, it depends on the particular Rule Book whether or not the member is allowed to borrow money to discharge this deductible.³² Nevertheless, reference will be made below to particular cases where it has been decided that a member could be entitled to settle a claim using means he has borrowed previously.

Generally, a shipowner is not entitled to request indemnity by his P&I Club until he has fulfilled all his duties as set out in the contractual relationship. In particular, as is expressly prescribed by the cited clauses of *Skuld* and *Gard*, the shipowner’s liability must be established, for example by a judgment or an arbitral award, and in addition he must have paid the claim.³³ If such a contractual obligation is not observed, the Club is not obliged to pay, even though the member has already paid the claim. By determining its member’s liability by an arbitral award or a final judgment, a Club’s duty to reimburse its member is however regularly created.³⁴

Moreover, an agreed ‘Pay to be Paid’ rule is a means of quantifying a Club’s obligation of payment. For instance, in the case where an assured shipowner has been found liable for a particular amount by a judgment or award, shipowner’s liability has been ascertained to just this sum. If the third party has initially claimed more than adjudged, and the

³¹ Available at <http://www.skuld.com/templates/Page.aspx?id=1265>.

³² See *Hazelwood*, *ibid*, at 354

³³ See *Ronneberg*, *ibid*, at 5.

³⁴ See *Hazelwood*, *ibid*, at 352.

shipowner has paid the whole demand, there is nonetheless no claim against the Club in the case where the actual payment of the member exceeds the amount determined by the judge or arbitrator. Even though a shipowner may not have paid the whole amount laid down in the judgment or award, the P&I Club is not obliged to indemnify the shipowner.³⁵ If the shipowner makes part-payment, the club is only obliged to reimburse the shipowner for that part-payment.

III. Discretionary payments

As we can see from the rules cited above, there is in at least some Clubs a possibility of a discretionary exception to the general requirement that a member has to pay in advance. However, such an exception requires P&I Club's intention to exercise its discretion laid down in the Rule Book to assist its member in a certain situation. There could be a moral duty to assist a shipowner in pecuniary distress after years of a close relationship and having successfully worked together. Normally, the rules entitle the P&I Club to exercise its discretion to allow the settlement of a claim to avoid court proceedings.³⁶ The discretion should be, however, used equitably by the directors or managers of the Club, considering other members' interests on the one hand and the interests of the wrongdoing shipowner on the other.³⁷

Furthermore, the P&I Club can effect another exception to the general rule of member's advanced payment by issuing a Letter of Undertaking. These letters are intended to guard a shipper against loss of or damage to the cargo he has loaded on board the member's vessel. Based on this letter of undertaking, the particular cargo-owner is entitled to demand a payment by the Club, but only in the case where member's liability has been established in a way described above.³⁸

It has to be borne in mind that these deviations from the 'Pay to be Paid' rule are only applicable to a particular claim in respect of P&I Club's discretion, and the member is in no way legally entitled to insist on the Club to exercise its discretion. There is surely not a legal duty to reimburse the shipowner for the claim in question.³⁹

³⁵ See *Hazelwood*, *ibid*, at 356.

³⁶ See *Hazelwood*, *ibid*, at 352.

³⁷ See *Dougherty*, *ibid*, at 1484.

³⁸ See *Hazelwood*, *ibid*, at 352.

³⁹ See *Hazelwood*, *ibid*, at 352 f.

IV. Common law and equity

It is a rule of common law that the assured under an indemnity policy has to pay the claim first and he is only afterwards entitled to request the insurer for reimbursement. Notwithstanding this general rule, it has been claimed that the principle of equity sets forth insurer's obligation to waive the assured's duty of prior payment if this obligation would cause his bankruptcy. It was held in *Johnston and Others v The Salvage Association and McKiver* that 'in equity a contract to indemnify can be specifically enforced before there has been any such breach of the contract as would sustain an action at law. In equity the plaintiff need not to pay and perhaps ruin himself before seeking relief'.⁴⁰

Unlike this approach, the insured is generally obliged to indemnify the injured party before he asks his insurer for payment due to the express wording of most Clubs' Rule Books. As we will see below in more detail, it results from the Club's express provision that a member cannot refer to principles of equity to substantiate his claim against the Club.⁴¹

V. Direct Actions against P&I Clubs

The obvious and initial problem of an injured party in respect of the relationship to the wrongdoer's P&I Club is that the third party is not a party to the particular insurance contract. There is thus no legal connection between insurer and third party on the basis of the policy, and the third party is not otherwise entitled to raise a claim against the Club on the basis of the insurance contract. In general, the insurer is obliged under the contract only to assist his contractual counterpart, the Club's member, in the case of any loss or damage; but not a third party. Rather, only the shipowner is entitled to obtain the benefit under the Club's rules, but not a third party.⁴²

At first sight, there is no relationship between the insurer and the injured party, neither on a contractual basis nor on the basis of delict or tort. Therefore, the injured party is basically not provided with a right to act directly against the insurer for the loss or damage he has suffered by the assured's tort.⁴³

⁴⁰ [1887] L R 19 Q B D 458.

⁴¹ See *Hazelwood*, *ibid*, at 355.

⁴² See *Ronneberg*, *ibid*, at 31.

⁴³ See *Ronneberg*, *ibid*, at 31.

It is worse for the injured party in the case of insured's bankruptcy because a dispute might arise with both the assured and the insurer. But the assured is bankrupt and hence not able to pay for the tort he has committed, and the insurer will raise every defence available, particularly the fact that the shipowner has not settled the claim by his own means and the Club's obligation to pay has not occurred under the policy.

As we will see below, several legislators have tried to soothe injured party's difficulties in this situation while providing a third party with a statutory right to act directly against the insurer.⁴⁴ Those statutes differ with regard to the issue whether or not the insured's liability has to be proved by a pursuant judgment.⁴⁵ The more significant issue in respect of this paper is whether the third party is entitled to act against the insurer in the case of the assured's bankruptcy, or even without this requirement.

Besides national legislation, there are other conventions and statutes generally providing a direct action against the insurer, eg the US Oil Pollution Act of 1990 and the International Convention on Civil Liability for Oil Pollution Damage of 1969. Under both statutory regimes, the insurer is nonetheless entitled to invoke all available defences against its contractual counterpart. Moreover, the insurer is entitled to raise those defences the insured would have in the relation to the third party.⁴⁶

For instance under the English Third Parties (Rights Against Insurers) Act of 1930 ("The 1930 Act"), a third party could be entitled to claim directly against an insurer in the case where the assured goes bankrupt.⁴⁷ In former times, the only possibility for a third party was to apply for participation in the regular 'insolvency proceedings as a mere ordinary creditor'.⁴⁸

⁴⁴ The concept of direct action has its origin in the civil law. The legislator saw the necessity to protect a third party who had suffered a particular loss that was originally regulated in the relationship between the wrongdoer and another party; see *Foosion*, *ibid*, at 4.

⁴⁵ See *Tetley*, *ibid*, at 617 f, who states that these 'suits are not true direct actions'. A *true* Direct Action Statute rather provides a right of direct action independent from a judgment.

⁴⁶ See *Tetley*, *ibid*, at 618; see *Ronneberg*, *ibid*, at 35.

⁴⁷ See *Wood*, 'Maximising recovery/minimising exposure: recent developments in Marine Insurance', *International Insurance Law Review* 1994, *Int I L R* 1994, 2(3), 89, at 95.

⁴⁸ See *Hazelwood*, *ibid*, at 309.

As we will see below, the specialty of indemnity insurance leads to crucial problems with regard to the application of the 1930 Act, although this Act aims to protect a party who has suffered loss or injury at the hands of an insured who has since gone bankrupt.⁴⁹

⁴⁹ See *Hazelwood*, *ibid*, at 316.

C. Law of England

There is a significant body of English law relating to disputes arising under P&I Insurance, probably because London is the historical and current centre of marine insurance and is the place of business of many P&I Clubs.⁵⁰

The common law of England however does not provide a third party with a general right to act directly against an insurer. In the case of the assured's bankruptcy, the insurance policy is thus a part of the general asset, and the injured party ranks as an ordinary creditor.⁵¹ Despite this general understanding of the English bankruptcy law, the 1930 Act seeks to provide an injured party with a direct right against insurers in particular circumstances.

1. Third Parties (Rights against Insurers) Act, 1930

The 1930 Act was the first step in protecting a third party who suffered loss or damage caused by an insured tortfeasor. It was long titled as an 'Act to confer on third parties rights against insurers of third party risks in the event of the insured becoming insolvent, and in certain other events',⁵² and the Act thereby provided an injured party with a limited right of a direct action against an insurer.⁵³

Nevertheless, this Act was merely intended to create a better legal basis for third parties trying to claim against an insurer who has entered into a liability contract with an insured who subsequently became bankrupt. This objective was based on the general understanding that one of the main aspects of an insurance contract is to benefit an injured party rather than to protect the insured. Before the 1930 Act came into force, the relationship between insurer and assured was aimed at protecting the latter because he has paid for insurance cover.⁵⁴ The rights of the injured party to act against an insurer under the 1930 Act are in any case limited to all rights agreed under the relevant

⁵⁰ See *Dougherty*, *ibid*, at 1466; *Staring/Waddell*, 'Marine Insurance', *Tulane Law Review*, June 1999, 73 *Tul L Rev* 1619, at 1621.

⁵¹ See *Dougherty*, *ibid*, at 1481 f.

⁵² See Lord Brandon of Oakbrook's reference in *The Fanti and The Padre Island*, [1990] 2 *Lloyd's Rep* 191, at 195.

⁵³ See *Holstein-Childress*, *ibid*, at 220.

⁵⁴ See *Hazelwood*, *ibid*, at 309, who described this Act as 'victims' charter'.

insurance contract.⁵⁵ Therefore, the third party has usually to pursue arbitration before it can turn to court, because this procedure is laid down in most Rule Books. Furthermore, the injured party must have obtained a judgment against the assured before it acts against the P&I Club under the 1930 Act.⁵⁶

By section 1 of the 1930 Act, the 'rights of third parties against insurers on bankruptcy &c. of the insured' are defined as arising where a contract has been concluded under which 'a person is insured against liabilities to third parties'. In the case of insured's insolvency or bankruptcy and 'in the case of the insured being a company, in the event of a winding-up order' made with regard to the respective company, the third party becomes entitled to relief by virtue of the subrogation determined by the 1930 Act.⁵⁷ Such winding-up orders are the most common circumstance where a maritime claimant files a suit under the 1930 Act, because a winding-up order is the most probable consequence of a judgment creditor's court petition.⁵⁸

Under the 1930 Act, this particular subrogation transfers all rights of the bankrupt insured to the injured third party to whom the insured is liable from his action or omission of whatsoever kind. Insured's liability, however, must be covered by the contractual agreement between the insured and the insurer.⁵⁹ Consequently, a case of liability has to be obvious. Otherwise, there is no obligation of the insurer to reimburse the insured which can be transferred to a third party.

While considering insurer's obligation to render indemnity under a particular policy, section 1(3) of the 1930 Act has to be borne in mind. This section provides that any direct or indirect condition purporting to avoid the insurance policy, as well as any alteration of the rights under the contract, for the case of insured's bankruptcy is ineffective. This section aims to ensure that the injured party is able to gather the full benefit of assured's rights against the insurer under the contract. This rule cannot be altered or diminished by

⁵⁵ See *Foster*, 'Marine Insurance: Direct Action Statutes and related issues', University of San Francisco Maritime Law Journal, 1998-1999, 11 U S F Mar L J 261, at 262.

⁵⁶ See *Dougherty*, *ibid*, at 1483 f.

⁵⁷ Cf Section 1(1)(b) of the 1930 Act.

⁵⁸ See *Dougherty*, *ibid*, at 1484 f.

⁵⁹ As prescribed by section 1(4) of the 1930 Act; Subrogation is normally known in insurance law when the insurer has reimbursed the injured party and consequently, the rights of the injured party against the wrongdoer are transferred to the insurer who is then entitled to pursue the claim by its own.

a stipulation or provision of the policy which is incorporated into the contract to cancel, prejudice or minimize those rights provided by the act.

Further, section 3 of the 1930 Act expressly prohibits the parties to an insurance contract from concluding an agreement to exclude a third party from its entitlement under the 1930 Act to proceed against the insurer after the assured became bankrupt.

Moreover, section 2 of the 1930 Act determines an insured's obligation to provide a third party with all information necessary to enforce a right which has been transferred to the third party under 1930 Act's provisions. This means that each liable person or company or their person in charge (eg trustee, liquidator, administrator, receiver or manager) has to provide each claimant with 'such information as may reasonable be required by him for the purpose of ascertaining whether or not any rights have been transferred to and vested in him by [the 1930] Act and for the purpose of enforcing such right'.

II. The impact of the 1930 Act to P&I Clubs

Of course, the question arises whether or not a third party, who would like to claim against a shipowner due to a particular loss or damage, can turn directly to the P&I Club and ask the Club for reimbursement in the case where the Club's member is bankrupt. It apparently follows from section 1(1) of the 1930 Act that a third party can only try to proceed against the P&I Club 'where under any contract of insurance a person (...) is insured against liabilities to third parties which may incur'.

First, section 1(1) of the 1930 Act came under discussion because the Act is thereunder only applicable to 'any contract of insurance'. Subsequently, the question arose whether or not the relationship between a P&I Club and its member can be determined as a 'contract of insurance' in the meaning of the 1930 Act.⁶⁰ Judge Slade stated in *The Allobrogia* dealing with this issue that

'Difficulty sometimes arises in deciding whether a particular agreement is a contract of insurance. A mutual indemnity society which derived its funds from the contributions of its members was held to be an insurer in Wooding v. Monmouthshire and South Wales Mutual Indemnity Society Ltd., [1939] 4 All E.R. 570, so that an agreement to indemnify one of its members could be held to be a

⁶⁰ See *Hazelwood*, *ibid*, at 311.

*contract of insurance. But a person may belong to a society (such as a P. & I. Club) whose rules do not entitle him to an indemnity but only to contributions from other members towards his loss. Since the essence of a contract of insurance is that the insured should be entitled to an indemnity, it seems that in such a case there cannot be a contract of insurance. ... It appears to me that the contract between an owner and the association is thus a "contract of insurance" within the ordinary meaning of words and none the less so because the association itself is to be funded by contributions from its members, including the owner.'*⁶¹

Therefore, it is appropriate to define the relationship between P&I Clubs and their members as a 'contract of insurance' under the meaning of s 1(1) of the 1930 Act.

The second question of importance for suits against P&I Clubs that arose in respect of the 1930 Act was whether a third party could claim directly against a Club based in a foreign country. However, based on the scope of the influence of the English Court of Admiralty, it was considered to be not difficult to pursue a decision about a member's liability against the Club and enforce court's judgment all over the world.⁶² In any case, the claimant has to gain a judgment which declares the member's liability. Afterwards, the claimant can initiate the proceeding for a member's winding-up in the case where the member is not able to meet claimant's demand by his means, and can seek reimbursement from the Club.⁶³

A third, and quite essential issue, has been discussed with regard to third parties' direct action against insurers. As has been pointed out, indemnity insurers and in particular the P&I Clubs regularly require within their rules that a member is only entitled to request his indemnification if his liability has been determined by the decision of a court or an arbitration tribunal. It was held by Lord Denning in *Post Office v Norwich Union Fire Insurance Society Ltd* as follows:⁶⁴

⁶¹ *Allobrogia Steamship Corporation (The Allobrogia)*, [1979] 1 Lloyd's Rep 190, at 194; in this case, the plaintiff suffered loss of cargo, but he obtained a pursuant judgment. Afterwards, the plaintiff requested an order to wind up the wrongdoer.

⁶² See *Hazelwood*, *ibid*, at 311 f.

⁶³ See *Hazelwood*, *ibid*, at 312, who refers to section 666 of the Companies Act, 1985 and states clearly that 'a winding-up order against a foreign company in an English court' is possible if there are 'assets available'.

⁶⁴ [1967] 1 Lloyd's Rep 216.

'It seems to me that the insured only acquires a right to sue for the money when his liability to the injured person has been established so as to give rise to a right of indemnity. His liability to the injured person must be ascertained and determined to exist, either by judgment of the Court or by an award in an arbitration or by agreement. Until that is done, the right to an indemnity does not arise'.

And he argued furthermore,

'... it is clear to me that the injured person cannot sue the insurance company except in such circumstances as the insured himself could have sued the insurance company. The insured could only have sued for an indemnity when his liability to the third person was established and the amount of the loss ascertained'.

Thus, a third party can only claim against an insurer under the 1930 Act in the case where he or she established the insured's liability, as we have already seen above.

III. Defence against third party's claim

The English legislator obviously sought to protect a third party in the case of the wrongdoer's bankruptcy when enacting the 1930 Act. But what about the insurer's rights against the claim of the injured party? Basically, the insurer is provided with every kind of defence which is available in favour of the insured,⁶⁵ because the claiming third party follows a bankrupt insured exactly in its position under the 1930 Act.

This relationship is determined, first of all, by the Club's rules. As it has been decided, the third party is only entitled to stand 'in the shoes of the member'.⁶⁶ Therefore, it has to be kept in mind that a third party's position is based on the former contractual relationship between a P&I Club and its member. This relationship, however, could be modified by the impact of a particular statute drafted to do so.⁶⁷ In England, it is the 1930 Act which provides the 'general proposition that the insurer may rely upon all defences which would

⁶⁵ See *Hazelwood*, *ibid*, at 313, with reference to section 1(4) of the 1930 Act.

⁶⁶ See *Hazelwood*, *ibid*, at 313 f, who describes the third party claimant as a 'successor'.

⁶⁷ Again, see *Hazelwood*, *ibid*, at 313 f.

have been available against the insured'. Thereby, third party's obligation to consider the rules of the concerned Club is prescribed, particularly while filing a suit against the Club.

Hence, member's agreed obligation to discharge the claim in full before he is entitled to request the Club's payment meets the third party as well. Notwithstanding the wording of section 1(3) of the 1930 Act, the Act cannot be regarded as the unlimited basis of a third party's right to claim directly against a P&I Club.⁶⁸ The P&I Club can rather refuse a claim, for instance due to the lack of the rendering of calls by the member, if this is laid down in the rules as such a reason. Further, the P&I Club is entitled to decline its obligation to indemnify whomsoever in the case where the member has not fulfilled his considerable pre-contractual duty of disclosure; the Club has the same right in relation to the third party.⁶⁹ Likewise, this principle is reasonable for each kind of limitation of Club's liability under its rules.

Consequently, the 'Pay to be Paid' rule is able to constitute a considerable kind of defence besides the other defences available in favour of the Club.

IV. The Fanti and The Padre Island

In *The Fanti* and *The Padre Island*, the English Jurisdiction was for the first time faced with an action of a third party against the respective P&I Clubs in the case of member's bankruptcy. Both cases were decisive for the development of English law with regard to the 'Pay to be Paid' clause included in the Rule Book of both P&I Clubs involved,⁷⁰ and included in most of the other Clubs' Rule Books, in particular because the House of Lords had not previously considered a comparable case.⁷¹

⁶⁸ See *Hazelwood*, *ibid*, at 315.

⁶⁹ *McCormick and Another v National Motor & Accident Insurance Union Ltd*, (1934) 49 Ll L Rep 361, at 366.

⁷⁰ See *Wood*, *ibid*, at 95.

⁷¹ See Lord Brandon of Oakbrook's estimation, [1990] 2 Lloyd's Rep 191, at 194: '*..., these two appeals which have been heard together, raise the same important question of law in the field of marine insurance. It is a question which has been long debated but never until now come before the Courts for decision*'.

1. *The Fanti*

In March 1983, the motor vessel *Fanti*, then owned by the *Central Shipping Line* of Ghana, was on her voyage from Rostock in Germany, laden with cement packed in bags for discharge in Nigeria. This cargo was owned by the *Firma C-Trade SA*. Eight days after the voyage commenced, *The Fanti* sent a distress signal after she had suffered considerable leakage and an inrush of water. One of her tanks was flooded and the water entered into two of her lower holds. To handle the situation, a salvage tug arrived and escorted her to Portuguese waters.

Afterwards, the vessel and the cargo on board were abandoned to the salvors instead of rendering the usual salvage remuneration. As a result the cargo owners suffered loss, and subsequently they started an action against the owners of the ship, which was at that time a member of the *Newcastle Protection and Indemnity Association*. The owners gave no notice of their intention to defend against this action and therefore the claimant obtained a judgment by default. Shipper's damages were determined in the amount of US\$ 748.953,00. Despite this court decision, the shipowners did not pay the shipper for the loss. The claimant therefore requested an order to wind-up the shipowners, and the Companies Court of the Chancery Division acted in accordance with this request.

To enforce their rights, the claimant subsequently initiated an arbitration tribunal against the shipowner's P&I Club, claiming indemnity on the basis of the 1930 Act. The most important issue was whether the claimant had in fact a claim against the P&I Club which was transferable under the 1930 Act.

This arbitration tribunal concluded with an award in favour of the P&I Club, but the shipper appealed to the Queen's Bench Division (Commercial Court) for a decision by Staughton LJ.⁷² The learned judge was encouraged 'to determine a point which has perplexed maritime lawyers for at least 30 years, ... Can the claimants recover direct from the association in respect of their loss, despite the fact that the association's rules require a claim to be paid by the members before the members have any remedy against the association?'

⁷² *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti)*, [1987] 2 Lloyd's Rep 299.

Doubtless, the starting point for him was Rule 4 of the 1983 version of the Club's Rule Book which reads

'4. Subject to the provisions of these Rules, the Member shall be protected and indemnified against all or any of the following claims and expenses which he shall become liable to pay and shall in fact have paid in respect of a ship entered in this class of the Association ...'

Judge Staughton stated with reference to *Post Office v Norwich Union Fire Insurance Society*⁷³ that the insured party under a contract of liability insurance was not entitled to act directly against the insurer until the insured's liability to the injured party had been assessed or was subject of an agreement. This is however not an argument against the claim of the shipper because the claim was determined on their request. Nevertheless, the claim of the third party was not paid at that time.

Therefore, the crucial question arose as which kind of rights could be transferred by the 1930 Act. Again, Judge Staughton referred to *Post Office* where Lord Denning stated with regard to section 1(1) of the 1930 Act that 'the injured person steps into the shoes of the wrongdoer'. He further concluded that a transfer of 'all the contractual rights of the insured to the third party' took place and therefore a cause of action was available.

Judge Staughton subsequently continued that, due to the winding-up of the shipowners, all contractual rights 'were transferred to the claimants' in the case where such rights were related to the claim in question. These rights would include the claimant gaining the shipowner's remedies against the Club but only if the shipowner paid for a certain claim. Consequently, the claimant might be obligated to pay himself for his own claim. Hence, Judge Staughton stated that

'Such a term makes no sense. I do not consider that, in the ordinary or legal meaning of payment, a person can pay himself. At any rate it would be a futile exercise to do so'.⁷⁴

Moreover, he concluded that after a winding up order has been issued, surely, member's rights were transferred to the claimant, but 'it would have been impossible or at least futile

⁷³ [1967] 1 Lloyd's Rep 216.

⁷⁴ [1987] 2 Lloyd's Rep 299, at 306

for the claimants to pay themselves' and 'such a term would fail under section 1 (3) of the 1930 Act'.⁷⁵ Eventually, Staughton LJ allowed the claimant's appeal.

2. The Padre Island

In *Socony Mobil Oil v West of England Ship Owners Mutual Insurance Association*,⁷⁶ there was also an action of the cargo-owners against the shipowner's P&I Club after the member became bankrupt.

In 1965 the company *Steam Tanker Padre Island Inc* entered its vessel *Padre Island* for P&I cover in the *West of England Ship Owners Mutual Insurance Association*, in particular for the coverage of cargo claims. It was prescribed by Club's rule 2 that the Club had to

'... protect and indemnify members in respect of losses of claims which they as owners of the entered vessel shall have become liable to pay and shall have in fact paid'.

The claimant had several cargo claims against the member, incurred on a voyage in the same year. Consequently, the claimant pursued litigation in Florida and eventually he obtained a decision about his claim of the District Court in 1975 and a final decision in 1979. He was awarded US\$ 238.315,88, but the shipowner did not pay a cent.

Thereafter, the shipowners received an order to wind up because the aforementioned judgment was not satisfied, and subsequently the claimant went to court to proceed against the P&I Club. He based his claim of direct indemnity on the statement 'that the right to recover the sum has been transferred to them under the 1930 Act'.⁷⁷ Due to the fact that an arbitration clause was part of the Club's rules, this action was dismissed, but arbitration proceedings were conducted afterwards. This tribunal concluded however with an award in favour of the Club, with the result that the owners of the cargo appealed to the Commercial Court of Queen's Bench Division as well.

⁷⁵ See *Wood*, *ibid*, at 95.

⁷⁶ [1987] 2 Lloyd's Rep 529.

⁷⁷ [1987] 2 Lloyd's Rep 529, at 531.

In this suit, Judge Saville held that the claimant had no right to be indemnified by the Club because the shipowner had not discharged their liability. Therefore, he concluded besides that no right could be transferred to the third party under the 1930 Act. Moreover, he argued that the member had only a 'contingent right' to payment by the Club dependent upon his payment in advance.⁷⁸ He stated that such a right was not modified by the winding-up order with respect to section 1(3) of the 1930 Act, and thus he dismissed this appeal.

3. Court of Appeal

On the request of the P&I Club in *The Fanti* and on the request of the cargo-owners in *The Padre Island*, both cases were heard together before the Court of Appeal.⁷⁹

The Court of Appeal followed Judge Saville's opinion and held that there was no suitable transfer of a right to claim directly against the P&I Club under the 1930 Act, because such a right of the member had not been established before the winding-up order was issued. Rather, only 'contingent rights' were transferred and would only grow into effective rights of immediate indemnity upon payment rendered by the shipowner as required by the Clubs' Rule Books.⁸⁰

Further, it was held that a 'bundle of rights and duties' was transferred to the claimant, and the claimant thereby received the obligation of payment first laid down in the Rule Books of the Clubs involved. However, Lord Bingham stated that

'the condition of prior payment was impossible to perform once the statutory transfer had taken place and so must be denied effective'.⁸¹

The Court of Appeal continued that the 1930 Act was not appropriate to avoid the stipulations of the respective insurance contracts by virtue of the winding-up of the

⁷⁸ See *Wood*, *ibid*, at 95.

⁷⁹ *Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti) and SoconyMobil Oil Co Inc v West of England Shipowners Mutual Insurance Association Ltd (The Padre Island)*, [1989] 1 Lloyd's Rep 239.

⁸⁰ [1989] 1 Lloyd's Rep 239, at 241; see also *Wood*, *ibid*, at 95.

⁸¹ [1989] 1 Lloyd's Rep 239, at 250.

shipowner. Nor was a 'Pay to be Paid' rule itself able to modify member's actual right. It was rather the member's ability to enjoy their rights and not the rights themselves.⁸²

Therefore, the appeal of the Club was dismissed whereas the appeal of the cargo-owners was allowed.

4. House of Lords

Subsequently, a further appeal of both P&I Clubs involved brought *The Fanti* and *The Padre Island* to the House of Lords. In their Lordships' judgment, Lord Brandon of Oakbrook initially pointed out three decisive issues:

'First, immediately before the members were ordered to be wound up, what rights, if any, did the members have against the clubs under their contracts of insurance in respect of the liabilities which the members had previously incurred to the third parties? Secondly, did the "pay to be paid" provisions, being terms of the contract of insurance made between the members and the clubs, purport, whether directly or indirectly, to avoid those contracts, or to alter the rights of the parties under them, upon the members being ordered to be wound up, so as to render those provisions to that extent of no effect under s. 1(3) of the 1930 Act? Thirdly, having regard to the answers to the first and the second questions, what rights against the clubs, if any, were transferred from the members to the third parties upon the members being ordered to be wound up?'

The Court of Appeal approached the first issue on the basis of equitable principles. Thereby, it was held that a member was entitled to be paid by his Club in the moment when 'the existence and the amount of the liabilities had been established'.⁸³ The difference between the law and equity was that at law an insured was obliged to discharge the injured party and thereafter he could request his indemnity by the contractual counterpart. Under the rules of equity, it could be a condition of the contract of indemnity that the insurer is obliged to pay the amount in question directly to the injured party.

⁸² [1990] 2 Lloyd's Rep 191, at 196.

⁸³ [1990] 2 Lloyd's Rep 191, at 197.

However, the difficulty with this appeal was that the rules of equity were not appropriate to overrule the expressly chosen rule of the contract that the member had to pay first. Therefore, Lord Brandon of Oakbrook concluded the first issue by stating that the member had only the contingent right to be reimbursed by the Club in the case where he has already paid for third party's claim based on member's liability.⁸⁴

Second, their Lordships were reluctant to accept any alteration of the 'Pay to be Paid' clause by virtue of section 1(3) of the 1930 Act due to the order to the member to wind up.

A Club's rules governing its relationship with its members are not a condition only applicable in the case where a particular event takes place, eg such as an order to wind up a shipowner. The fact of being unable to discharge the liability due to member's insolvency is nevertheless not enough to alter the member's contractual rights and obligations. In such a case, the member is merely unable to serve his contractual duties and gain his rights.

Their Lordships agreed with Judge Saville and the Court of Appeal's decision. Thus, they concluded that the 'Pay to be Paid' rule as contractually agreed between the Club and its member

'did not purport, either directly or indirectly, to avoid those contracts, or to alter the rights of the parties under them, upon the members being ordered to be wound up, so as to render those provisions to that extent of no effect under s. 1(3) of the 1930 Act'.⁸⁵

With regard to the third issue, it was held that an injured party was not entitled to be in a better position than the member was when his rights passed over to the third party by a statutory transfer. Thus, the House of Lords also followed Judge Saville in *The Padre Island* with reference to the wording of section 1 of the 1930 Act. It was concluded that the P&I Club had the 'same good defence to a claim made by the third party after such transfer'.⁸⁶

⁸⁴ [1990] 2 Lloyd's Rep 191, at 197.

⁸⁵ [1990] 2 Lloyd's Rep 191, at 197.

⁸⁶ [1990] 2 Lloyd's Rep 191, at 198.

Of course, both Clubs involved were entitled to reject the members' claims on the basis of the members' obligation to satisfy the third party's claim established by appropriate court decisions. Therefore, the Clubs were able in law to defend claims on the same arguments as they are allowed to do in relation to the member.

Lord Goff of Chieveley added under the 'futility point' that the injured party was not able to pay itself for the claim he had against the wrongdoer and, consequently, the duty to pay first laid down in Club's rules was either not possible to be performed or 'it is futile to require a person to pay himself'.⁸⁷ Their Lordships held that no-one can pay in his own favour, and hence there remains the member's obligation first to settle the claim by his own means and that this very obligation is transferred to the third party. This obligation is, however, unable to be performed and will never be fulfilled.

It was argued, in addition, that a principle of equity cannot determine the relationship between insurer and assured if their contract expressly prescribes that the assured has to pay in advance and can only recover from his insurer afterwards.⁸⁸ As we have seen, it is more likely that disputes arise in the case where the insured is bankrupt. Surely, the Club's 'Pay to be Paid' rule seeks to reject a claim if the member has not paid for a loss or damage, whereas the provisions of the 1930 Act aim to protect the injured third party where the wrongdoer is bankrupt. Without the member's payment of a liability first, there is no right of recover against the relevant P&I Club. That is a peculiarity of indemnity insurance cover.⁸⁹

As mentioned above, Judge Staughton found his judgment in favour of the owners of the cargo. Thus they had a direct right against the P&I Club under the 1930 Act. In contrast, Judge Saville rejected the third party's claim, upholding the Club's opinion. It was argued by the Clubs involved that the respective 'Pay to be Paid' rule could not be applicable in the case where a third party sought payment. Their Lordships agreed with this opinion and all arguments for cargo interest's position were refused by the House of Lords.

The House of Lords held that in the case where the third party steps into the assured's shoes under the 1930 Act, the third party has to be considered in the same way as would a member of the P&I Club. The third party therefore has to ensure that all conditions have

⁸⁷ [1990] 2 Lloyd's Rep 191, at 199; see *Wood*, *ibid*, at 96.

⁸⁸ [1990] 2 Lloyd's Rep 191.

⁸⁹ See *Hazelwood*, *ibid*, at 316.

been fulfilled to create Club's obligation to settle the claim. Their Lordships found that it was impossible for a third party to indemnify itself and request Club's payment afterwards.⁹⁰

Further, the House of Lords held that the rules of the respective P&I Clubs could not be nullified by the 1930 Act. Only in the case where the particular Rule Book provides no 'Pay to be Paid' rule, it might be possible for the third party to act directly against the P&I Club. Where the rules expressly prescribe member's duty to pay first and recover his actual financial loss afterwards from the Club, there is no opportunity for the third party to avoid this precondition of club's duty of payment.

The right of payment against the Club after having paid in advance was defined as a 'contingent right' against the club and it was this 'contingent right' which was transferred to the third party under the 1930 Act.⁹¹ It was quite obvious to their Lordships that the third party could not be provided with a *better* right than the member had previously.⁹² In particular, the P&I Club had the same rights of defence against the third party as he would have had against the member. Their Lordships argued that an expressly chosen part of a contractual relationship could not be invalid if this provision is merely not enforceable. Their Lordships held that a 'Pay to be Paid' rule did not set out to avoid an insurance contract by including such a clause, or to modify a party's rights under the contract in the case of member's winding up 'to that extent of no effect under s. 1(3) of the 1930 Act'.

Moreover, it was held that when the insured member of the Club received the order to wind up, he was only in the position to have 'contingent rights against the club in respect of the liabilities to third parties incurred by them'. These rights were 'contingent' due to the obligation 'precedent to the members being indemnified by the clubs in respect of those liabilities that they should first have been discharged by the members themselves'.

Further, it was pointed out unambiguously that the intention of the 1930 Act was not 'to put the third party in any better position as against the insurer than that of the insured

⁹⁰ See *Hazelwood*, *ibid*, at 317.

⁹¹ See *Hazelwood*, *ibid*, at 318.

⁹² See *Hawkins*, *ibid*, at 3.

himself.⁹³ As we have seen, the insured owner had no right to be reimbursed by his P&I Club if he had not previously discharged the liability subject to third party's claim. And there is consequently no right of the third party to be in a better position or have 'larger rights than those which the member has previously possessed'. A P&I Club is generally entitled to defend the certain claim on the basis of the lack of member's payment. Hence, this defence is also appropriate in relation to the third party.⁹⁴ Only the member's settlement of the claim in question would have reasonably constituted the Club's obligation to pay for the loss the third party had suffered, but not a payment in advance undertaken by the injured party itself. Such a payment had to be recognized as a breach of the contract, because member's prior payment has been agreed.

Eventually, their Lordships allowed appeals of both P&I Clubs. Since then, an injured party who suffered loss or damage due to shipowner's tort is, under English law, not entitled to act directly against shipowner's P&I Club in the case where the wrongdoing shipowner goes bankrupt. Bankruptcy therefore defeats a claimant's right in English law to recover losses direct from a wrongdoing shipowner's or charterer's P&I Club.

⁹³ Rather 'the purpose of the Act was to remedy the injustice under which insurance proceeds were distributed to other creditors', see *Wood*, *ibid*, at 96.

⁹⁴ [1990] 2 Lloyd's Rep 191, at 193.

D. Law of the United States of America

At the outset, it has to be pointed out that legislators of the United States of America ("USA") have never codified marine insurance law as the English legislators did by enacting the 1906 Act.⁹⁵ Therefore, the question is, which law applies where a dispute arises in the USA with regards to a P&I policy.

In *Wilburn Boat Company v Fireman's Fund Insurance Company*,⁹⁶ the Supreme Court of the USA held that the federal states were responsible for the regulation of marine insurance because no superior rule applied to govern a claim against a marine insurer. Thus, state law was applicable but not the rules of the federal law of the USA. The Supreme Court nevertheless recommended that the courts of the federal states consider the English jurisprudence regarding the law of marine insurance in the case where no federal rule provided certainty.⁹⁷

In several states of the USA, a development contrary to English law can be recognized. In these States, the legislators decided to bring statutes into force, in which the incorporation of a 'Pay to be Paid' clause in insurance policies was prohibited because of public policy.⁹⁸ Although the maritime law generally seeks uniformity in this essential international field of law, and although the insurance of maritime property and maritime risks seems to be a kind of maritime contract, an action under a marine insurance policy is not governed by the general maritime law, ie the customary doctrines of the

⁹⁵ See *Ancona*, 'The price of uniformity: Aasma and third-party rights of direct action; In the maritime context: Aasma v American Steamship Owners Mutual Protection & Indemnity Association', *Tulane Maritime Law Journal*, Summer 1997, 21 Tul Mar LJ 593, at 594; see further *Holstein-Childress*, *ibid*, at 208; and see *Dougherty*, *ibid*, at 1478; as well as *Staring/Waddell*, *ibid*, at 1620 ff, with a brief illustration of the history of the development of marine insurance under the law of the USA.

⁹⁶ 348 U S 310, 75 S Ct 368; the court had to deal with the breach of a warranty agreed between insurer and assured. The lower court held with regard to general maritime law that the marine policy was null and void in the case of the breach of warranty. However, the United States Supreme Court reversed this judgment. It was rather held that under the law of the USA, the law applicable towards marine insurance was no longer part of the admiralty jurisdiction, although those contracts were in fact maritime contracts; see also *Staring/Waddell*, *ibid*, at 1625 ff.

⁹⁷ See *Ancona*, *ibid*, at 594 and 601; see *Staring/Waddell*, *ibid*, at 1622.

⁹⁸ See *Ancona*, *ibid*, at 597.

admiralty,⁹⁹ but by the law of the respective state.¹⁰⁰ Under the law of the respective state, an injured party may be entitled to seek indemnity directly from the respective P&I Club regarding a loss or damage caused by Club's member on the basis of the statutes mentioned above. The basic and common aim of these statutes is to 'prevent an insurer from denying an injured person the ability to collect the proceeds of an insurance policy which might have been bought for the injured person's benefit'.¹⁰¹ Thus, it is clearly shown that the legislature treats an insurance contract as a contract mainly concluded to protect the victim against the assured's tort. On the basis of this understanding, it is not the objective of an insurance contract to procure for the assured a better position with regard to the injured party.

I. General

Under the common law of the USA, the right to be indemnified under an indemnity policy regularly arises only in the relationship between insurer and assured being parties of the insurance contract.¹⁰² Originally, no third party gained a direct right under this insurance contract in the United States.¹⁰³ There is no right of a third party of a 'direct action' against the insurer under the common law,¹⁰⁴ either on a contractual basis or on the basis of the law of tort. Therefore, an injured party has to be provided with such a right by the responsible legislator if it is the intention to protect this party.¹⁰⁵

In the case where a federal state enacts a statute 'in the interest of protecting the welfare of its citizens',¹⁰⁶ an injured party is, basically, provided with a separate right to file a suit directly against the insurer alone, or he can act against both the insurer and the assured

⁹⁹ See *Staring/Waddell*, *ibid*, at 1623.

¹⁰⁰ See *Augustine*, *ibid*, at 113.

¹⁰¹ See *Hooper*, 'Limitation of Liability and the Direct Action Statute: a troubled marriage', *Louisiana Law Review*, March 1995, 55 *La L Rev* 843, with reference to an insurance for automobile accidents.

¹⁰² See *Dougherty*, *ibid*, at 1478.

¹⁰³ See *Augustine*, *ibid*, at 110 f, who expressly refers to contracts of marine insurance as agreements only between insurer and assured. He also provides a general overview of general aspects of an insurance contract with regard to marine insurance, eg payment of the premium and assured's obligation to disclose all circumstances which might considerably affect the risk insured; see *Ancona*, *ibid*, at 596.

¹⁰⁴ See *Dougherty*, *ibid*, at 1478.

¹⁰⁵ See *Foster*, *ibid*, at 262.

¹⁰⁶ See *Dougherty*, *ibid*, at 1481.

jointly;¹⁰⁷ it depends on the peculiarities of the statute applicable to the claim in question. Due to the objective of protecting the injured party, several states enacted a particular kind of statute called 'Direct Action Statute'. In general words, these statutes provide some rule to prohibit a classical 'Pay to be Paid' clause, by allowing third parties the direct action against the insurer although an assured (eg a shipowner) has not been able to settle the claim by his own means due to his bankruptcy. Under such a statute, it could be sufficient to obtain a pursuant court decision to act directly against wrongdoer's insurer. Therefore, in certain states of the USA, the indemnity insurance shifts towards a kind of liability insurance.¹⁰⁸

The objective of such statutes is to give an innocent and injured person the right to file a recovery action against wrongdoer's insurer, to 'reap the benefits of a contract, the purpose of which is to compensate for covered loss'.¹⁰⁹ As was held by the Supreme Court of Massachusetts in *Saunders v Austin W Fishing Corporation*,¹¹⁰ the 'Pay to be Paid' clause of the participating insurer was not enforceable because of the contradiction to *public policy*. There are, however, differences among the statutes enacted by the governments of those federal states which wanted to improve a third party's position. As we will see below, it depends on the requirements of the particular statute whether or not the third party can enforce a direct action against the insurer.¹¹¹

Despite these developments, the distinction described between liability insurance and indemnity insurance was confirmed by the United States Court of Appeal in *Weeks v Beryl Shipping Inc* in following words:¹¹²

¹⁰⁷ See *Foster*, *ibid*, at 262 f, who draws a distinction between *pure* direct action statutes and *judgment* statutes. Such a pure statute enables a third party to sue the insurer independent of the question of insured's insolvency, whereas the judgment statutes only provide the right to sue the insurer in the case where the insured does not satisfy a prior judgment due to his bankruptcy; see *Dougherty*, *ibid*, at 1479; see also *Hooper*, *ibid*, at 844, who refers to the difficulties between shipowner's right to limit liability on the one hand and third parties right to sue directly against shipowner's P&I Club on the other.

¹⁰⁸ See *Hazelwood*, *ibid*, at 319 and 356; he criticizes such a development as the conversion of 'indemnity policies into policies of liability insurance'.

¹⁰⁹ See *Foster*, *ibid*, at 263.

¹¹⁰ 352 Mass 169, 224 N E 2d 215, 1967 A M C 984.

¹¹¹ See *Foster*, *ibid*, at 262.

¹¹² 845 F 2d 304, 1988 A M C 2187, at 306

'Under a liability policy, the insurer is liable for "damages for bodily injury or property damage for which any covered person becomes legally liable, up to the applicable policy limits". In other words, the insurer must pay the damages if the insured is found liable. Under an indemnity policy, on the other hand, the insurer is liable only for "loss actually paid" the injured party by the insured. Thus, actual payment by the insured is a condition precedent to any obligation on the part of the insurer. "The presence of a 'no action' clause providing that no action will lie against an insurer unless brought for losses actually sustained and paid in money is generally indicative of an indemnity rather than a liability policy." '.

Subsequently, attention is drawn to these statutes, particularly to their relevance in the field of marine insurance. It depends on the applicable statute if a third party will be entitled to act successfully against shipowner's P&I Club because those statutes vary from state to state. The question of the law governing the certain claim of the injured party therefore arises and will be considered later.¹¹³

The distinction between liability insurance and indemnity policies is essential where the applicability of a statute is in question. As we have seen above, liability insurance covers any kind of liability notwithstanding a certain (pecuniary) loss whereas an indemnity policy provides the right to ask the insurer for payment in the case where the insured suffered an actual loss due to the discharge of his liability. There is thus no actual loss where the shipowner is bankrupt and not able to discharge a claim,¹¹⁴ because he has – quite simply – not paid for the claim.

Unlike to the indemnity cover offered by P&I Clubs, the parties to a liability insurance contract agree about insurer's joint liability if the insured is held responsible for a certain claim. Therefore, the injured party is entitled to ask the insurer directly for payment. Thus, direct action statutes transform an indemnity policy into a liability contract and it is therefore third parties' weapon to act directly against a P&I Club if the shipowner goes bankrupt.¹¹⁵ That is the main issue of those statutes, because a P&I Club is regularly not bound to any party other than its member.

¹¹³ See *Foster*, *ibid*, at 265.

¹¹⁴ See *Foster*, *ibid*, at 266.

¹¹⁵ See *Foster*, *ibid*, at 267.

First, attention shall be drawn to the legal systems of the states of Louisiana, New York, Wisconsin, California, Puerto Rico, and Alabama. These states enacted Direct Action Statutes to provide an injured party with a more or less generous right to act directly against insurers in general and P&I Clubs in particular.¹¹⁶ Second, reference will be made to other federal states without such a statute and their approach to the issue of direct actions against insurers.

II. Louisiana

In Louisiana, an injured party is entitled to claim directly against the insurer under the Louisiana Direct Action Statute of 1918. Louisiana was the first American legislator which felt encouraged to enact a statute, even before the English 1930 Act, because of the regular use of no-action clauses in insurance contracts. The legislator was concerned that the injured party was not able to obtain compensation for the loss or damage suffered because of the insured's failure due to bankruptcy.¹¹⁷

1. Direct Action Statute

The Louisiana Direct Action Statute goes so far as to provide a third party with a right to act directly against the insurer independently from assured's insolvency. Thereby, a wide-ranging right in favour of the injured third party has been installed as legislator's reaction to insurer's practice of inserting a clause in the policy to generally prohibit an action against the insurer. The legislator aimed to protect the public, and therefore the validity of such a stipulation inserted in insurer's policies has been disregarded.¹¹⁸

The significant section 655 of the Louisiana Direct Action Statute, laid down in the Insurance Code, reads as follows:

¹¹⁶ See *Holstein-Childress*, *ibid*, at 208.

¹¹⁷ See *Foster*, *ibid*, at 270; further, see *Shariff*, 'Grubbs v. Gulf International Marine Co.: The Louisiana Supreme Court declares the Direct Action Statute applicable to Marine P&I Insurance', 68 Tul L Rev 1653, at 1654.

¹¹⁸ See *Foster*, *ibid*, at 270; see *Holstein-Childress*, *ibid*, at 20, with a particular view towards the difficulties arising in regard to a direct action against an insurer and an arbitration clause incorporated into the underlying insurance contract.

'Liability policy; insolvency or bankruptcy of insured and inability to effect service of citation or other process; direct action against insurer

A. No policy or contract of liability insurance shall be issued or delivered in this state, unless it contains provisions to the effect that the insolvency or bankruptcy of the insured shall not release the insurer from the payment of damages for injuries sustained or loss occasioned during the existence of the policy, and any judgment which may be rendered against the insured for which the insurer is liable which shall have become executory, shall be deemed prima facie evidence of the insolvency of the insured, and an action may thereafter be maintained within the terms and limits of the policy by the injured person, or his or her survivors, mentioned in Civil Code Art. 2315.1, or heirs against the insurer.

B. (1) The injured person or his or her survivors or heirs mentioned in Subsection A, at their option, shall have a right of direct action against the insurer within the terms and limits of the policy; and, such action may be brought against the insurer alone, or against both the insured and insurer jointly and in solido, in the parish in which the accident or injury occurred or in the parish in which an action could be brought against either the insured or the insurer under the general rules of venue prescribed by Code of Civil Procedure Art. 42 only. However, such action may be brought against the insurer alone only when:

(a) The insured has been adjudged a bankrupt by a court of competent jurisdiction or when proceedings to adjudge an insured a bankrupt have been commenced before a court of competent jurisdiction;

(b) The insured is insolvent; ...'

It is prescribed by subsection A. that an insurer cannot issue a policy if this policy does not contain any condition providing that the insurer is not free from its obligation to render coverage for a particular damage or loss suffered while the respective policy was valid. Thereby, the legislator prohibited a contractual term in a policy to avoid insurer's liability generally where the assured is bankrupt.

In the case where a judgment against the assured determines his liability, and his insolvency is proved, the injured party is expressly entitled to maintain an action directly against the insurer. Subsection B. sets forth an injured party's right 'of direct action against the insurer within the terms and limits of the policy'. The injured party is thereby entitled to file a suit against the insurer solely or jointly against both parties of the respective insurance contract, insurer and insured as well. As cited above, the third party

is entitled by subsection B. (1) to bring an action against the insurer alone only in the case where the 'insured has been adjudged a bankrupt by a court of competent jurisdiction or when proceedings to adjudge an insured a bankrupt have been commenced before a court of competent jurisdiction' and when the 'insured is insolvent'.

Generally, a third party is therefore entitled to sue the P&I Club directly on the basis of Louisiana's Statute if the incident causing the claim happened in the state of Louisiana, or if the underlying insurance policy was issued in the state Louisiana or the policy was delivered into Louisiana.¹¹⁹

Since an amendment to the Statute in 1948, an exclusion of contracts of 'ocean marine insurance' has been prescribed by section 611. It is hardly surprising that the affected marine insurers, faced in the future with injured parties' suits, argued that a direct action against a marine insurer is hence not allowed under Louisiana's Statute.¹²⁰ As we will see below, this argument has been overruled. It was rather held that a third party could also act directly against a P&I Club because the insurance contracts governed by the Club's rules were treated as any other insurance contract and the mentioned exception was not applicable to P&I cover.¹²¹

The legislator of Louisiana, however, set aside the general interest in uniformity, particularly desired in regard to marine insurance, to enforce the protection of injured parties.¹²² The different approach in comparison with the English solution is thereby obvious.

2. *Grubbs v Gulf*

After a third party's certainty under the statute of Louisiana had lasted some seventy years, the District Court for the Eastern District of Louisiana held in *Grubbs v Gulf International Marine* that a third party had no right to claim directly against a P&I Club

¹¹⁹ See *Foster*, *ibid*, at 273 f, who points out that the Louisiana Direct Action Statute is therefore 'one of the most generous direct action statutes in the United States'.

¹²⁰ See *Foster*, *ibid*, at 270; before, the Direct Action Statute of Louisiana was without any comparable limit; see *Shariff*, *ibid*, at 1655 ff, with a detailed description of the jurisdiction and discussion concerning this modification.

¹²¹ See *Hazelwood*, *ibid*, at 319.

¹²² See *Augustine*, *ibid*, at 109.

because the 'marine protection and indemnity insurance was within the ocean marine exclusion' of the Statute referred to above. This decision was approved by the Federal Court of Appeal.¹²³

This case had the following background: The plaintiff was one of the defendant's employees working as an engineer on a tug owned and operated by the defendant. The *American Steamship Owner's Mutual Protection Indemnity Association* was bound to cover this tug under a P&I policy after the defendant entered the tug into the association and became a member. Mr Grubbs suffered personal injury during work, and thereafter sought reimbursement with regard to his injuries while filing a court action jointly against his employer and the P&I Club. Initially, the district court rejected the applicability of the Louisiana Direct Action Statute because the policy was not issued or delivered in the state of Louisiana.¹²⁴ Furthermore, the Court of Appeals of the Fifth Circuit, court in charge of Mr Grubbs's appeal, held that the insurance contract in question was one of 'ocean marine insurance' and therefore the plaintiff was not entitled to rely on the more expansive rights of the Louisiana Direct Action Statute. However, the court was aware of two different appeals where the competent courts held, in contrast, that the Statute is indeed applicable to contracts of P&I insurance.¹²⁵

Consequently, the case was submitted to the Supreme Court of Louisiana, where the lower court's opinion was overruled, and it was held that Mr Grubbs was in fact entitled to act directly against his employer's P&I Club for reimbursement under the Direct Action Statute.¹²⁶ The Supreme Court adjudicated, contrary to the lower courts, that the Direct Action Statute rather allowed the third party's direct action against the wrongdoer's P&I Club,¹²⁷ because the Statute 'applies to any insurance against the liability of the insured for the personal injury of corporeal property damage to a tort victim, regardless of whether the policy is framed in liability or indemnity terms' as a whole.¹²⁸

¹²³ 985 F 2d 762.

¹²⁴ *Grubbs v Gulf International Marine Inc*, 625 So 2d 495 (La 1993), at 496.

¹²⁵ It was held in *Hae Woo Youn v Maritime Overseas Corporation*, 605 So 2d 187 (La Ct App 5th Cir 1992), at 208 f, that section 611 is not able to overrule the specific intention of the Direct Action Statute. Further, see *Treadway v Certain Underwriters at Lloyds*, No 92-C-1500 (La Ct App 4th Cir 1992).

¹²⁶ See *Shariff*, *ibid*, at 1653.

¹²⁷ 625 So 2d 495, 1994 A M C 244.

¹²⁸ See *Foster*, *ibid*, at 271; and see *Shariff*, *ibid*, at 1659.

The court referred to the history of the Louisiana Direct Action Statute and legislator's intention, and decided on the basis of those considerations against a strict understanding of the Statute's wording. In particular, none of the amendments of the Statute ever referred directly towards P&I Insurance.¹²⁹ The Supreme Court continued that the exclusion laid down in section 611 of the Insurance Code was not in any way applicable to direct actions against P&I Clubs due to the fact that such an understanding was not in accordance with the legislator's intention.¹³⁰ It was therefore held that the Statute was applicable to policies of P&I Insurance because the Statute aimed to cover each kind of liability insurance.

A policy of P&I Insurance is described by the Insurance Code as a particular kind of liability insurance developed to provide coverage for loss or damage occurring during the operation of a vessel. With reference to this understanding the Supreme Court rejected the significant distinction between indemnity and liability insurance, as we have seen with regard to the English law. It follows therefrom that the legislator created a very generous remedy in favour of the injured party to seek coverage from insurers including P&I Clubs.¹³¹

As pointed out above, this generosity went so far that not even a shipowner's insolvency or an underlying judgment was required to file an action against the Club under Louisiana's law. The injured party could sue the insurer solely on the base of tort notwithstanding the fact that 'a suit has [not] been instituted or a judgment obtained against the insured when the insured is bankrupt, insolvent, or cannot be served with process' before.¹³² A third party is only allowed to sue both the insurer and the assured jointly in the case where the insured is still solvent.

Furthermore, it is provided by subsection B. (2) of section 655 that a direct action

'shall exist whether or not the policy of insurance sued upon was written or delivered in the state of Louisiana and whether or not such policy contains a

¹²⁹ See *Shariff*, *ibid*, at 1661.

¹³⁰ See *Foster*, *ibid*, at 271, who states that P&I insurance was not expressly excluded from the scope of the Statute.

¹³¹ See *Foster*, *ibid*, at 272.

¹³² See *Foster*, *ibid*, at 273.

provision forbidding such a direct action, provided the accident or injury occurred within the state of Louisiana'.

However, third party's rights laid down in the Statute are not generally 'construed to affect the provisions of the policy of contract if such provisions are not in violation of the laws' of Louisiana.¹³³

3. Insurer's defence

An insurer is in general allowed to use all kind of defence against the third party's claim on the basis of the Direct Action Statute which he would be allowed to raise in the case of assured's action itself.¹³⁴ As a result of third party's decision not to base its claim on the assured's right to be indemnified, some defences are not appropriate in a dispute between insurer and a third party, because the Louisiana Direct Action Statute generates an own contractual relationship between an insurer and a third party. A third party has to be considered therefore as the actual beneficiary of the insurance contract.¹³⁵

In conclusion, the Louisiana Direct Action Statute entitles a third party who has suffered loss or damage caused by an assured shipowner to a wide right to file a suit against the wrongdoer's P&I Club in the case where such a loss or damage took place in Louisiana. This action is not dependant on shipowner's settlement of the claim in question by his own means as normally required by P&I Club's Rule Book. Even though the shipowner is not bankrupt, the injured party can sue the insurer jointly with the wrongdoer. The Direct Action Statute of Louisiana provides an injured party with the right to act against the insurer in tort alone even though the third party has not obtained a judgment against the insured.¹³⁶

¹³³ See subsection B. (2).

¹³⁴ See *Dougherty*, *ibid*, at 1478 and 1481; see *Tetley*, *ibid*, at 618; see *Holstein-Childress*, *ibid*, at 209.

¹³⁵ See *Foster*, *ibid*, at 276, with reference to *Shockley v Sallows*, 615 F 2d 233 (5th Cir 1980), at 238; and with further possibilities for the insurer to defend third party's claim.

¹³⁶ See *Foster*, *ibid*, at 273.

III. New York

The legislator of the state of New York also enacted a Direct Action Statute to improve the injured party's position. This Statute requires a judgment against the insured to have been already returned without satisfaction before the third party is allowed to turn to the P&I Club. In any case, the third party is, under a so-called *Judgment Direct Action Statute*, only entitled to seek insurer's payment for the amount ascertained within a certain judgment. Moreover, the Statute requires that the respective loss or damage is covered by the policy,¹³⁷ as is normal with regard to a claim against an insurer.

1. Direct Action Statute

Unlike the Statute of Louisiana, the New York Statute concentrates on third party's protection only in the case where the wrongdoer is bankrupt. The Statute is thus 'much more restrictive, conservative, and straightforward' than the Statute of Louisiana.¹³⁸ The New York Statute sets forth insurer's obligation to reimburse the affected party in the case where the insured is bankrupt, but only if the assured's liability is already determined by an actual court decision.¹³⁹ In *Perlman v Independence Indemnity Company of Philadelphia*, the court was faced with the situation that an 'execution against the assured is returned unsatisfied because of the insolvency or bankruptcy of the assured'. Therefore, 'an action may be maintained by the injured person against the insurance company'.¹⁴⁰

Section 3420 of the Insurance Code of New York provides regulations for the 'liability insurance, standard provisions and the right of injured person' and reads as follows:

'(a) No policy or contract insuring against liability for injury to person, except as provided in subsection (g) hereof, or against liability for injury to, or destruction of, property shall be issued or delivered in this state, unless it contains in substance the following provisions or provisions which are equally or more favorable to the insured and to judgment creditors so far as such provisions relate to judgment

¹³⁷ See *Foster*, *ibid*, at 281.

¹³⁸ See *Foster*, *ibid*, at 281.

¹³⁹ *Bean v Allstate Insurance Company*, 403 A 2d 793, 796 (Md 1979).

¹⁴⁰ 134 Misc 499, 235 N Y S 194.

creditors:

(1) A provision that the insolvency or bankruptcy of the person insured, or the insolvency of his estate, shall not release the insurer from the payment of damages for injury sustained or loss occasioned during the life of and within the coverage of such policy or contract. ...'

An insurer is therefore not free from his duty to pay indemnity because of insured's bankruptcy. An insurer cannot repudiate its liability on the basis of a 'no-action clause' included in the agreed contract if the insured has not actually paid a claim with regard to a particular judgment. Under the law of New York, an insurer is in fact not allowed to refuse a claim in such a case, even though the assured did not comply with his agreed duties under the policy.¹⁴¹

However, the legislator was not willing to generate a separate right of allowing injured party to claim reimbursement from the insurer, as was the legislator's intention in Louisiana.¹⁴² As cited above, the New York Statute requires that the underlying policy contains a particular condition to set forth the right to sue directly against the insurer if certain stipulations are fulfilled. Even though such a clause is not incorporated into the policy, such a wording 'will be inferred, and will invalidate any policy provisions to the contrary'.¹⁴³ It is thus not necessary to incorporate a pursuant stipulation into P&I Club's rules; a third party is nonetheless able to sue an insurer directly under the Direct Action Statute of New York.

Further, the policy must have been issued and delivered in the state of New York, if a third party wants to act directly against the insurer under the Statute. In this case, a third party can also file a suit against the insurer even if the tort has happened outside the state of New York. *Vice versa*, a third party is not allowed to sue an insurer under the Statute if the policy was issued outside the state of New York, though the underlying incident occurred in this area.¹⁴⁴

¹⁴¹ See *Foster*, *ibid*, at 281 f.

¹⁴² See *Augustine*, *ibid*, at 128; see *Foster*, *ibid*, at 282.

¹⁴³ See *Foster*, *ibid*, at 282.

¹⁴⁴ See *Foster*, *ibid*, at 282.

Despite the fact that under a Direct Action Statute the particularities of indemnity contracts are generally modified towards those policies of liability insurance, the third party is however obliged to enforce his claim by court proceedings against the wrongdoer before the right to act against the insurer arises under the law of New York. The actual liability of the insured has therefore to be proved. The fact that a 'Pay to be Paid' clause has not been fulfilled is nevertheless not sufficient to free the insurer from its obligation to pay for a particular loss under the policy in question.¹⁴⁵

2. Insurer's defence

Similar to the Louisiana Statute, the insurer is entitled under the law of New York to raise every defence available in relation to the insured. In *Brown v Employer's Reinsurance Corporation*,¹⁴⁶ the insured breached a material duty of the insurance contract and therefore on this basis the defendant was entitled to reject third party's claim. It could however be difficult for the third party to adduce the evidence that the insured had not committed a material breach of his duties as set forth in the contract, particularly if the third party is not provided with detailed information about the contractual relationship between insurer and assured.

And again, the creditor in a judgment is only able to recover his loss up to the amount set forth in the relevant policy. The other limit is the amount which had been adjudicated by the competent court.¹⁴⁷ Those rules offer an injured party the benefits of an insurance contract, but the insurer is nevertheless not faced with unexpected costs.¹⁴⁸

3. Application to Marine Insurance

While dealing with the possibility of filing a suit against a P&I Club, however, section 3420 (b) (2) of the New York Insurance Code has to be borne in mind. This provides particular exclusion of indemnity policies and direct actions against P&I Clubs are therefore covered. It reads as follows:

¹⁴⁵ See *Foster*, *ibid*, at 283.

¹⁴⁶ 206 Conn 668, 539 A 2d 138.

¹⁴⁷ *Dumas Brothers Manufacturing Company Inc v Southern Guaranty Insurance Company*, 431 So 2d 534.

¹⁴⁸ See *Foster*, *ibid*, at 285.

"Subject to the limitations and conditions of paragraph two of subsection (a) hereof, an action may be maintained by the following persons against the insurer upon any policy or contract of liability insurance which is governed by such paragraph, to recover the amount of a judgment against the insured or his personal representative:

... any person who, or the personal representative of any person who, has obtained a judgment against the insured or his personal representative to enforce a right of contribution or indemnity, or any person subrogated to the judgment creditor's rights under such judgment; ...'

Unlike Louisiana's law, a direct suit of a judgment creditor under the Direct Action Statute with regard to a P&I policy is excluded because the above-mentioned provision is valid for types of insurance specified within section 1113 (a) (21) of the New York Insurance Law:

"Marine protection and indemnity insurance," means insurance against, or against legal liability of the insured for, loss, damage or expense arising out of, or incident to, the ownership, operation, chartering, maintenance, use, repair or construction of any vessel, craft or instrumentality in use in ocean or inland waterways, including liability of the insured for personal injury, illness or death or for loss of or damage to the property of another person'.

Thus, the New York legislator enacted a more restrictive Direct Action Statute than Louisiana's legislator did. This rule is surely based upon the intention to promote the marine insurance industry of New York by assisting with a possibility to decline claims of a third party. Such a motivation shows clearly the discrepancies between those different Direct Action Statutes. As long as the federal states are responsible, there might be such discrepancies in the future.

4. *Liman* agreements

Despite this exclusion, there is legislation of significance for an action against P&I Clubs which should be kept in mind. In *Liman v American Steamship Owners Mutual Protection and Indemnity Association*,¹⁴⁹ an operator of merchant vessels went bankrupt. He was assured through various indemnity policies issued by the defendant, and the assured paid the premiums as agreed. The defendant was bound to indemnify his member 'against loss, damages and expenses sustained by it as the owner, charterer or operator of certain vessels, including losses sustained as the result of personal injury claims'.¹⁵⁰ After the assured became bankrupt, he was faced with several claims from seafarers and longshoremen who suffered loss by personal injuries. Under the policy, the assured was obliged to afford a deductible of US\$ 1.000,00 before he was entitled to claim reimbursement against the defendant. The payment of such a deductible in the face of the bankruptcy of the shipowner would, however, be a violation of the United States Bankruptcy Code because an illegal preference would be committed thereby.¹⁵¹

To avoid this illegality, the bankruptcy trustee concluded an agreement with certain claimants in the *Liman* case where the claimants were entitled to recover a payment of more than US\$ 1.000,00. The injured party agreed to be paid in full by the estate, and in countermove, the claimant was bound to pay the sum of US\$ 1.000,00 in favour of the estate. On the basis of such payment, the claimant became a general creditor to the estate.¹⁵²

This procedure did not establish an illegal preference under the Bankruptcy Code, because the insurer's obligation to render indemnity occurred after he had received the deductible of US\$ 1.000,00.¹⁵³ Judge Mansfield approved these agreements by his statement that a deductible was not part of an insurance contract to procure indemnity only for a solvent assured. A deductible rather aims 'to avoid responsibility for small claims which are usually both numerous and costly'.¹⁵⁴ Therefore, the origin of the

¹⁴⁹ *Liman v American SS Owners Mutual Protection & Indemnity Association Inc*, 299 F Supp 106 D C N Y 1969.

¹⁵⁰ 299 F Supp 106 D C N Y 1969, at 107.

¹⁵¹ See *Foster*, *ibid*, at 292.

¹⁵² See *Dougherty*, *ibid*, at 1471.

¹⁵³ See *Foster*, *ibid*, at 292.

¹⁵⁴ 299 F Supp 106 D C N Y 1969, at 110.

deductible cannot be relevant for the insurer. These agreements were initiated to bind the insurer to indemnify certain claims based on loss or damage. It was held that such an agreement was not made in bad faith, in particular because the assured obtained no kind of unjust benefit. Hence, the defendant was obliged 'to indemnify plaintiff for payments made in accordance with the Trustee's proposed plan'.¹⁵⁵

Further, it was held that shipowner's obligation to pay a claim first was fulfilled because a third party has discharged a claim to compensate for a member's liability. The New York District Court concluded that it was not a breach of a particular 'Pay to be Paid' rule if member's bankruptcy trustee paid first, independent of the question whether or not this payment took place as a loan or as a gift. Several P&I Clubs contradicted by arguing that a member had to afford a payment by his own funds.¹⁵⁶

5. Conoco v Republic Insurance Company

In *Conoco Inc v Republic Insurance Company*,¹⁵⁷ the Texas Court of Appeals heard a charterer's claim against the owner of a chartered barge. In contrast to the *Liman* case, however, the wrongdoer was completely without any asset, and the bankrupt insured rather did not expect any means or payments in his favour. It was therefore held that a promissory note issued by the bankrupt wrongdoer was not able to constitute an actual payment in accordance with the P&I Club's 'Pay to be Paid' rule.¹⁵⁸

Judge Williams concluded that the *Liman* case 'does not stand for the proposition that "payment" can be made by the use of a promissory note worthless from the day it is executed'.¹⁵⁹ He continued that

¹⁵⁵ 299 F Supp 106 D C N Y 1969, at 110.

¹⁵⁶ *Hazelwood*, *ibid*, at 353 f, provides an abstract rule under which several Clubs have tried to prohibit the possibility to settle the claim first by using third party's money: '*In the case of a liability, actual payment (which shall be made out of monies belonging to the member absolutely and not by way of loan or otherwise) by the member of the full amount of such liability shall, unless the committee otherwise decide, be a condition precedent to the right of a member to recover and the obligation of the club to satisfy and make good.*'

¹⁵⁷ 819 F 2d 120, C A 5 (Tex), 1987.

¹⁵⁸ See *Ancona*, *ibid*, at 597.

¹⁵⁹ 819 F 2d 120, at 122.

'(the) insured's execution of demand note in favor of charterer did not constitute payment so as to activate indemnity provision of policy and make insurer liable to charterer, and [...] time charterer lacked standing as third-party beneficiary to proceed directly against insurer to enforce indemnity provision of policy'.¹⁶⁰

6. Ahmed v American SS Mutual

However, the significance of the *Liman* case has since been limited. In *Ahmed v American SS Mutual Protection & Indemnity Association*,¹⁶¹ it was held that 'indemnification policies came within exclusion of New York direct action statute'. In this case, twenty-six seafarers sued their employer's insurer under several indemnity policies. Before this suit, they obtained several judgments against the employer due to personal injuries they had suffered. The court found a judgment about US\$ 577,015.54 in favour of the injured seafarers, but the employer did not satisfy these judgments because he became insolvent.

First was necessary to decide about the law governing this case. The court concluded too that there was no federal rule of the maritime law to prohibit or allow a third party's direct action against the P&I Club of a bankrupt shipowner.¹⁶² Therefore, only the law of the state of New York and hence its Direct Action Statute was applicable.¹⁶³ Eventually, Judge Sweigert made reference to the above-mentioned exemption of marine insurance contracts and held that the marine protection and indemnity policies in question were clearly exempted from the application of the Statute.¹⁶⁴ The employees were thus not successful with their direct suit against the P&I Club.

It can be concluded that under the law of New York a bankrupt shipowner is only entitled to afford the deductible of a particular claim by borrowed means. He nonetheless violates a 'Pay to be paid' clause where he borrows the whole amount to settle the claim and asks his P&I Club thereafter for reimbursement.¹⁶⁵ Further, a third party is only entitled to sue an insurer directly where the policy in question is not one of marine insurance.

¹⁶⁰ 819 F 2d 120, at 120.

¹⁶¹ 640 F 2d 993, C A Cal, 1981.

¹⁶² As we have seen above with regard to *Wilburn Boat*.

¹⁶³ See *Ancona*, *ibid*, at 599.

¹⁶⁴ 640 F 2d 993, at 996.

¹⁶⁵ See *Foster*, *ibid*, at 298.

Therefore, the *Liman* case did not provide a *real* direct action against P&I Clubs because those agreements are only suitable to bring the assured in a position where he is allowed to seek for reimbursement from his Club.¹⁶⁶ It is not in any way a direct suit of the injured party against a P&I Club.

7. *Miller v American Steamship*

In *Miller v American Steamship Owners Mutual Protection and Indemnity Company*, a seaman suffered personal injuries on board of *The American Forwarder*. At that time, his loss was actually covered by a certain policy agreed between shipowner and the defendant. The seaman claimed successfully against the shipowner for damages to an amount of US\$ 19.136,00, but nothing was paid in his favour due to the owners' insolvency. Thereafter, the insurer argued that a person who is not part of the insurance contract cannot claim under the policy. The insurer further stated that a direct action against the insurer was not available under the governing law of New York.

The crucial stipulation under the insurance policy prescribed that

'The Association agrees to indemnify the Assured against loss, damage of expence which the assured shall become liable to pay and shall pay by reason of the fact that the Assured is the owner'.¹⁶⁷

The District Court held also that the seaman was not allowed to bring a direct action against an insurer. As we have seen through the judgment in *Ahmed v American*, the New York Direct Action Statute does not permit a direct action against an insurer under a marine insurance policy, whether or not the policy in question provides liability or indemnity insurance. Under the law of New York, the court saw actually no statutory right to provide the seaman with a direct action against the Club in the case where the insured was bankrupt.¹⁶⁸

¹⁶⁶ See *Dougherty*, *ibid*, at 1471.

¹⁶⁷ *Miller v American Steamship Owners Mutual Protection and Indemnity Company*, 509 F Supp 1047, 1981 A M C 903, at 1048.

¹⁶⁸ 509 F Supp 1047, 1981 A M C 903.

IV. Wisconsin

The Direct Action Statute of the state of Wisconsin follows a more moderate approach towards the issues concerning a third party's claim against the insurer of a bankrupt assured.¹⁶⁹ In particular, an injured party is only allowed to file an action directly against an insurer in the case where either the policy is issued in the State Wisconsin, or the incident happened in Wisconsin.¹⁷⁰

Section 632.24 of the Wisconsin Statute deals with a direct action against insurers and prescribes that

'Any bond or policy of insurance covering liability to others for negligence makes the insurer liable, up to the amounts stated in the bond or policy, to the persons entitled to recover against the insured for the death of any person or for injury to persons or property, irrespective of whether the liability is presently established or is contingent and to become fixed or certain by final judgment against the insured.'

Like the Louisiana Statute, the Statute of Wisconsin entitles a third party to sue the insurer not only in the case of insured's insolvency. Under the Wisconsin Statute, the third party is rather allowed to sue the insurer without joining the insured.¹⁷¹ Because there is no exclusion of marine insurance, a direct action against the shipowner's P&I Club is possible under the law of Wisconsin.

¹⁶⁹ See *Augustine*, *ibid*, at 127.

¹⁷⁰ *Bielke v Iowa National Mutual Insurance Company*, 451 F Supp 376, (E D Wisc 1978) at 377.

¹⁷¹ See *Foster*, *ibid*, at 279.

V. California

To sue the tortfeasor's P&I Club directly under the Direct Action Statute of California, 1919, a third party has to be a beneficiary of the insurance contract, or the third party must have received a final judgment against the assured to ascertain the actual claim.¹⁷² It appears that, under the law of California, there is no need for the third party to maintain the assured's shortage of own means to the judgment creditor's claim before he turns against the insurer.¹⁷³

VI. Puerto Rico

Puerto Rico brought a Direct Action Statute into force which is similar to the Statute of Louisiana.¹⁷⁴ Particularly, the Direct Action Statute of Puerto Rico is based on the principle that an injured party is entitled to act jointly against the wrongdoer and his insurer. The Statute provides the third party with 'a separate and distinct claim against an insurer under the policy'. It is therefore possible for a third party to enforce a claim against

¹⁷² Section 11580 of the California Insurance Code prescribes the 'required policy provisions' as follows: *'A policy insuring against losses set forth in subdivision (a) shall not be issued or delivered to any person in this state unless it contains the provisions set forth in subdivision (b). Such policy, whether or not actually containing such provisions, shall be construed as if such provisions were embodied therein.*

(a) Unless it contains such provisions, the following policies of insurance shall not be thus issued or delivered:

(1) Against loss or damage resulting from liability for injury suffered by another person other than (i) a policy of workers' compensation insurance, or (ii) a policy issued by a nonadmitted Mexican insurer solely for use in the Republic of Mexico.

(2) Against loss of or damage to property caused by draught animals or any vehicle, and for which the insured is liable, other than a policy which provides insurance in the Republic of Mexico, issued or delivered in this state by a nonadmitted Mexican insurer.

(b) Such policy shall not be thus issued or delivered to any person in this state unless it contains all the following provisions:

(1) A provision that the insolvency or bankruptcy of the insured will not release the insurer from the payment of damages for injury sustained or loss occasioned during the life of such policy.

(2) A provision that whenever judgment is secured against the insured or the executor or administrator of a deceased insured in an action based upon bodily injury, death, or property damage, then an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment.'

¹⁷³ See *Foster*, *ibid*, at 279 f.

¹⁷⁴ See *Augustine*, *ibid*, at 126.

the insurer solely or jointly with the insured, but only in respect of the coverage prescribed by the policy under which insurer's obligation to pay for a particular claim might occur.¹⁷⁵ Thereby, the law of Puerto Rico allows third party's claim on the basis of contract and tort as well.¹⁷⁶ Again, the insurer is entitled to defend the claim by the use of all means stemming from the contract. It should be pointed out that it was held in *Morales-Melendez v SS Mutual Underwriting Association*,¹⁷⁷ that the Direct Action Statute of Puerto Rico is a part of 'every policy enforceable in its Commonwealth'.

VII. Alabama

In *Morewitz v West of England Ship Owners Mutual Protection and Indemnity Association*, the leading case for direct actions against insurers under the law of Alabama, the court found that the Statute of Alabama allowed a third party to act directly against an insurer, 'rather than English bankruptcy law which does not allow such actions'.¹⁷⁸

In this case, the administrator of seven seamen's estates filed a suit against a shipowner's P&I Club due to the wrongful death of those crew members. *The Imbros* disappeared during her voyage from Mobile in Alabama to Quebec, Canada, when a severe leakage in the salt water cooling system for her main engine was recognized. Eventually, *The Imbros* disappeared in the region of the Bermuda Triangle in December 1975 without a trace of her eighteen crew members and the cargo loaded onboard after she had sent an SOS broadcast by the crew.¹⁷⁹ Before suit against her P&I insurer was filed, a judgment was obtained in favour of the plaintiff about US\$ 460.000,00, but the defendants, *The Imbros*' owner and her managing director, did not satisfy this judgment.

It was held that the Alabama Direct Action Statute provides a direct action under every kind of insurance contract, but the question arose whether the 'Pay to be Paid' clause

¹⁷⁵ See *Foster*, *ibid*, at 278 f, who also provides a translation of section 2003(1) of the Statute as follows: 'Any individual sustaining damages and losses shall have, at his option, a direct action against the insurer under the terms and limitations of the policy, which action he may exercise against the insurer only or against the insurer and the insured jointly'.

¹⁷⁶ See *Augustine*, *ibid*, at 126.

¹⁷⁷ 763 F Supp 1174, 1179, 1991 A M C 2475, (D P R 1991), at 2480 ff.

¹⁷⁸ 62 F d 1356, 1996 A M C 707.

¹⁷⁹ 62 F d 1356, 1996 A M C 707, at 1359.

inserted in the P&I Club's Rule Book was enforceable. If English law applied, the answer would be Yes, and hence the plaintiff would have no right to be reimbursed by a payment from the Club. However, under the Direct Action Statute of Alabama, the right of recovery does 'not depend upon the satisfaction by the insured of a final judgment against him for loss'.¹⁸⁰

The court finally concluded that the law of Alabama was applicable whereas federal maritime law or English law was not proper. An arbitration clause being part of the contract was only applicable to the relationship between the shipowner and the P&I club. Therefore, it did not apply to the crew-members. Even if the arbitration clause should be applicable between the third party and the P&I Club, the court stated that the club had waived the benefit of this clause at the moment when it defended the initial action in Virginia; the Club did not demand an arbitral tribunal but accepted the court proceeding.¹⁸¹

VIII. States refusing direct actions

Beside those legislative efforts in favour of an injured party referred to above, there are other states in the USA generally refusing direct actions of third parties against insurers.

The state of Florida, for instance, is one which has not enacted a specific statute to provide an injured party with a right to act directly against an insurer. It has been however accepted by Florida's common law that a third party is entitled to sue the insurer on the basis of the pursuant policy in the case where this party obtained a judgment against the insured.¹⁸² It was held in *Steelmet Inc v Caribe Towing Corporation* that the suing shipper had a direct right against the maritime insurers for an actual loss he had suffered when a barge sank due to her unseaworthy condition because he was treated 'as a third-party beneficiary of liability and protection and indemnity policies'.¹⁸³ But one year later, this understanding was overruled by the Florida Supreme Court's judgment in *Metropolitan*

¹⁸⁰ See *Black*, 'Recent Developments in Admiralty Law in the United States Supreme Court, the Fifth Circuit, and the Eleventh Circuit', *Houston Journal of International Law*, Winter 1997, 19 *Hous J Int'l L* 327, at 361 ff.

¹⁸¹ See *Black*, *ibid*, at 361 ff.

¹⁸² See *Foster*, *ibid*, at 286 f.

¹⁸³ 747 F 2d 689, 53 USLW 2299, 1985 A M C 956.

Life Insurance Company v McCarson.¹⁸⁴ Judge Ehrlich followed the English law and argued that a third party was only allowed to act directly against the insurer under a liability policy,¹⁸⁵ though the policy in question provided indemnity insurance.

New Mexico is another example of those states refusing a direct action of a third party against an insurer. Section 41-4-17 of the New Mexico Tort Claims Act provides the 'Exclusiveness of remedy' as

'no action brought pursuant to the provisions of the Tort Claims Act shall name as a party any insurance company insuring any risk for which immunity has been waived by that act'.

It was therefore held in *England v New Mexico State Highway Commission* that a third party was only allowed to sue an insurer jointly if the wording of a relevant statute did not 'negate the idea of joinder of an insurance company'.¹⁸⁶

The Appellate Court of Illinois, in *Richardson v Economy Fire & Casualty Company*, held that 'direct action suits against insurers for negligence of the insured are not permitted in Illinois'.¹⁸⁷ And under the law of Alaska¹⁸⁸ and Arizona,¹⁸⁹ direct action has been rejected as well. Under the law of New Jersey, a third party is not entitled to start an action against an insurer on the basis of equity, as the court expressly stated.¹⁹⁰

¹⁸⁴ 467 So 2d 277, 10 Fla L Weekly 154.

¹⁸⁵ 467 So 2d 277, at 279.

¹⁸⁶ 91 N M 406, 575 P 2d 96.

¹⁸⁷ 126 Ill App 3d 520, 467 N E 2d 317, 81 Ill Dec 617.

¹⁸⁸ *Evron v Gilo*, 777 P 2d 182

¹⁸⁹ *Natiomwide Mutual v Arizona Health Care Cost Containment System*, 166 Ariz 514, 803 P 2d 925.

¹⁹⁰ *Van Reen v Aetna Life Insurance Company*, 209 F 691, D C N J 1913.

E. Law of Scandinavia

When analysing the Scandinavian legal systems with regard to an injured party's direct action against the P&I Club of a bankrupt shipowner, it must be borne in mind that the legal systems of the Scandinavian countries are closely connected, particularly concerning the law of marine insurance. In 1927, the Insurance Contract Act ("ICA") of Sweden came into force, and it was followed by the ICAs of Norway and Denmark in 1930.¹⁹¹ The legislators' intention to bring these acts into force was obviously the same as it was in England when the 1930 Act was enacted, and the Direct Action Statutes to be found in several federal states of the USA follow this line as well: the protection of an injured party by procurement of the right to claim directly against an insurer, in particular in the case of the assured's bankruptcy. It is a general feature of these legal regimes that an insurance contract is mainly understood to be a kind of protection of the injured party,¹⁹² but not to assist the assured.

Until the new Acts came into force, section 95 (3) of the ICA of Norway and Sweden read as follows:

'Where an insured, who has been declared bankrupt or placed in insolvent liquidation, possesses a claim against the insurer for an indemnity which he may not collect without the assent of the injured party, the latter shall be entitled, in the event payment of such sum is not received by him for the estate in bankruptcy or estate in liquidation, to have the claim of the insured awarded to him'.

Under this section, third party's right of direct action against an insurer was laid down,¹⁹³ and there was no alteration of this general rule when the new legislation where enacted.

¹⁹¹ See *Fossion*, *ibid*, at 5.

¹⁹² See *Tiberg*, 'Direct Action/Claim', available at <http://www.juridicum.su.se/jurweb/utbildning/exchange/marineins/direct%20action.pdf>, at 1.

¹⁹³ See *Fossion*, *ibid*, at 5 f.

I. Law of Norway

As pointed out above, the ICA 1930 has been superseded by the ICA of 1989. But as will be seen below, there was no alteration of the Norwegian general policy to provide a third party with a wide ranging protection in the case where the wrongdoer is bankrupt and therefore not able to settle the questionable claim.

1. Norwegian Insurance Contract Act, 1989

Under section 7-6 to 7-8 of the ICA 1989, an injured party is allowed to sue a shipowner's P&I Club directly. As we have seen while dealing with the approach of other legal systems, the Club can raise the defences against third party's claim which would have been available in favour of the assured in relation to the injured party, and the Club is further entitled to raise the defences available in his relation to the assured. There are, however, some limitations to a voluntary liability insurance which is what a P&I policy is.¹⁹⁴ Generally, the third party is only entitled to sue directly against a P&I Club under Norwegian law where the shipowner is bankrupt. In this case, section 7-6 and 7-7 of the ICA are mandatory, and thus the Club cannot raise any conditions of the insurance agreement laid down in the Rule Book in relation to the third party. The Club is rather obliged to reimburse the third party.

Before 1989, a judgment of the Norwegian Supreme Court of 1956 ruled generally that the insurance rendered by P&I Clubs is one of liability but not of indemnity. In any event, the ICA does not provide a third party with a general direct action against a P&I Club as the legislator of Louisiana did, because a marine insurer is entitled to exclude the right of direct action by the contract's stipulations notwithstanding the policy of protecting an injured party.¹⁹⁵ Therefore, a P&I Club is basically entitled to incorporate a 'Pay to be Paid' rule into the respective contract to avoid a direct action,¹⁹⁶ as is provided by sections 7-6 to 7-8.

However, a P&I Club is not entitled under Norwegian law to exclude third party's right to act directly against a Club in any case. As we have seen, the 1989 Act rather rules that

¹⁹⁴ See *Falkanger/Bull/Brautaset*, *Scandinavian Maritime Law*, Oslo, 2004, at 537.

¹⁹⁵ See *Fossion*, *ibid*, at 5.

¹⁹⁶ See *West of England*, 'Norway: direct action against P&I clubs allowed', available at www.westpandi.com/NR/rdonlyres/625A9D63-34AF-4105-813C-7DC395EA0D/0/newsletter_2002_08.pdf.

the right of a direct action against the P&I Club is compulsory in the case of member's insolvency.¹⁹⁷ By the ICA 1989, the injured party obtains a well protected position in the case of the assured's insolvency.¹⁹⁸

The 1989 Act is however not applicable to every matter regarding to the cover granted by P&I Clubs. The 1989 Act is rather only applicable in the case where the rules of Norwegian civil procedural law provide for the application of the 1989 Act. This regularly occurs if the underlying claim is able to be described as a domestic one because 'all matters in relation to the claim are purely Norwegian'. Otherwise, for instance if the direct action in question is against a foreign P&I Club, the Norwegian rules on the conflict of laws set forth which country's jurisdiction is applicable. Under the Lugano Convention, the court in charge might be able to decide about this essential question with regard to the place where the underlying incident occurred.¹⁹⁹

2. *The Skogholm*

Under Norwegian law, *The Skogholm* is still the leading case in respect of a third party's direct action against shipowner's P&I Club.²⁰⁰ The Norwegian Supreme Court emphasized that third party's direct action is mandatory under the (former) ICA laid down in section 95, although the direct action was not expressly mentioned.²⁰¹

In 1949, *The Skogholm* was laden with frozen herring from Bergen, Norway, to Hull in England. During this voyage, she sank due to her poor stability already observed when she commenced the transit. The cargo insurer reimbursed the shipper and claimed against the shipowner afterwards, stating that *The Skogholm* was in an unseaworthy condition when she left the port of loading. However, the owner was bankrupt and hence not able to settle the claim, though he was responsible for her unseaworthy condition and therefore liable for the loss of the consignment of herring.

¹⁹⁷ See *West of England*, *ibid.*

¹⁹⁸ See *Fossion*, *ibid.*, at 6.

¹⁹⁹ See *West of England*, *ibid.*

²⁰⁰ ND 1954, at 445; see *Falkanger/Bull/Brautaset*, *ibid.*, at 537.

²⁰¹ See *Fossion*, *ibid.*, at 6.

The Supreme Court declared the 'Pay to be Paid' rule invalid because a P&I Club is in any case not allowed to avoid third party's statutory rights.²⁰² Although the shipowner was not able to settle the cargo insurer's claim by his own means, and he thereby violated *Skuld's* rule 87, the Supreme Court interpreted the insurance rendered by a P&I Club as insurance intended firstly to protect the injured party. Because the provisions of the ICA are mandatory, the court set the 'Pay to be Paid' rule of *Skuld* aside. The competent judges approached the question of the duty to bear the loss while asking which party involved has the closest connection to the tortfeasor who has actually caused the loss. It was held that the insurer and its insured had to be considered as one unit on the one hand, and the third party with his cargo-insurer as one unit on the other hand. The court continued that a Club's rule shall not negate the right of a third party which suffered loss and seeks reimbursement. The ICA rather seeks to protect the third party and the statutory protection overrules the contractual agreement in the case of the shipowner's inability to indemnify the claimant by his own means.

II. Law of Sweden

The Swedish ICA 1927 provided in section 95 that a bankruptcy trustee had to cede the assured's rights against his insurer to the injured party in the case of the assured's bankruptcy. Thereby, the third party receives a direct action against the insurer.²⁰³

1. Swedish Insurance Contract Act, 1927

Until the ICA 2006 came into force, the ICA 1927 was the significant legislature for nearly 80 years. It means therefore, that the former ICA should be considered while looking at the Swedish concept of direct actions against P&I Clubs. Section 95 of the ICA 1927 prescribed among others things that

'the assured is not entitled to receive payment under the insurance to a greater extent than he has compensated the victim or has received the latter's approval'.

²⁰² See *Fossion*, *ibid*, at 14.

²⁰³ See *Tiberg*, 'Direct Action/Claim', available at

<http://www.juridicum.su.se/jurweb/utbildning/exchange/marineins/direct%20action.pdf>, at 2 f.

Further, it was set forth that

'if payment has been made without the victim receiving compensation or approving the payment, and if the victim cannot later obtain the damages due to him from the assured, he (the victim) is entitled to claim the deficit from the insurer, within the margin paid to the assured'.

The crucial obligation of the trustee to cede the assured's right to the third party reads as follows:

*'If an assured goes bankrupt while having a claim against the insurer which he is not entitled to lift, without the victim's agreement, the latter may, unless covered by the bankruptcy estate, require the estate to assign the right to him'.*²⁰⁴

However, the following requirements are necessary to act directly against an insurer under Swedish law: 'manifest insolvency of the insured tortfeasor; possession of a claim of indemnity; payment is not received and the claim is to be assigned to the third party'.²⁰⁵

2. Jurisdiction

In *The Degeroe*,²⁰⁶ a shipowner was found liable by an Australian court for damage to a cargo of fibre materials incurred during a voyage from Aarhus to Sydney in 1978. However, a time charterer who actually caused the damage to the cargo by negligent stowage was found liable to the shipowner by an arbitral tribunal pursued in London. As expectable, this charterer went bankrupt and thus his rights were ceded to the shipowner under the ICA. Thereafter, the shipowner claimed damages from the charterer's P&I Club *Skuld*. Club's rules set forth that a member was not allowed to assign cover under the contract to a third party. Notwithstanding this clause, the arbitral award was appropriate and therefore, the shipowner obtained charterer's claim against *Skuld* under the wrongdoer's membership. It was held that this claim still exists, although the assured did not make a particular payment.²⁰⁷ The Court of Appeal in Stockholm concluded 'that

²⁰⁴ See *Tiberg*, *ibid*, at 3, for the citation and translation of the ICA 1927.

²⁰⁵ See *Fossion*, *ibid*, at 6.

²⁰⁶ ND 1996, at 1.

²⁰⁷ *Tiberg*, *ibid*, at 14 f.

section 95 is a mandatory rule that cannot be derogated by the contractual parties'.²⁰⁸ Thereby, the Swedish court followed the same line as the Norwegian Supreme Court did and gave an injured party the right of direct action.

In *The Eastholm*,²⁰⁹ a bankrupt shipowner's trustee ceded a claim under a P&I contract in favour of the injured party with regard to section 95 of the 1927 Act. Again, the Club denied the validity of this assignment on the basis of its Rule Book. It was held again that the 1927 Act was mandatory for the Club, particularly because the Club's rules only prohibited the cession of rights before an incident occurs. The competent court considered section 95 of the 1927 Act as providing regulations for the relationship between an injured party and the wrongdoer's insurer. It was further held that this relation could not be affected by an agreement made between the parties of the insurance contract, ie insurer and assured.²¹⁰

The Maloe was also loaded with herring, but for a voyage from Finland to Skagen in Denmark, and after developing a list and being towed into the port of Aeland, she sank.²¹¹ Afterwards, local authorities ordered the shipowners to remove the wreck. The instructed salvage company thereafter brought a successful suit against the owners, but the shipowners were not able to satisfy this judgment. Therefore, the salvors asked *Skuld* directly to settle the claim in question. It was held that *Skuld* was free in this case due to court's opinion that the 'Pay to be Paid' rule was valid. To void the 'Pay to be Paid' clause and allow the third party to act against the insurer because of their claim for the removal, the shipowner had to be bankrupt. In fact, the bankruptcy of the shipowner's was not declared, and thus there was no need for a direct action against the Club.²¹² Accordingly, the salvor's claim was rejected.

3. Swedish Insurance Contract Act, 2006

As referred to above, a new Insurance Act came into force in Sweden in 2006. This Act includes section 7 to enable the injured party to 'raise his compensation claim directly against the insurer' in the case where

²⁰⁸ See *Fossion*, *ibid*, at 14.

²⁰⁹ ND 1988, at 52.

²¹⁰ See *Tiberg*, *ibid*, at 8 ff.

²¹¹ ND 1996, 28

²¹² See *Tiberg*, *ibid*, at 16 f.

- 1. the insurer is legally obliged under any Act or other legal provision to have a liability insurance covering the damage,*
- 2. bankruptcy or official accord has been declared for the assured,*
- 3. the assured is a legal person that is now dissolved.'*

The first provision describes the intention in general to protect third parties, and its application to all kinds of insurance is prescribed by that. Provision 2 broadened the old assignment rule, thus making it more effective. Despite the technical difference from the former section 95, 'the practical effect was very much the same, though widened to some new cases'.²¹³ Under the 2006 Act, the insurer is nonetheless entitled to raise any defence in relation to the third party as available against the assured.²¹⁴

III. Law of Denmark

Under Danish law, the third party has to establish the assured's liability before he is allowed to act directly against the insurer. The injured party can establish assured's liability through a successful court proceeding or an agreement with the tortfeasor.²¹⁵

²¹³ See *Tiberg*, *ibid*, at 5 ff.

²¹⁴ See *Tiberg*, *ibid*, at 8.

²¹⁵ See *Fossion*, *ibid*, at 6.

F. Other legal systems

Attention has been drawn to three of the essential legal systems with regard to the field of Shipping (ie England, USA and Scandinavia). Some other legal systems shall now be considered to get a more comprehensive overview about different approaches to the issues caused by tortfeasor's bankruptcy and the right of direct action.

I. Law of Canada

In *Conohan v The Cooperators*,²¹⁶ the owner of the fishing vessel *Cape Light II* brought a claim against the insurer of the fishing vessel *Lady Brittany*. Both vessels involved in this dispute collided when the former was anchored off the coast of Prince Edward Island. The master of the *Lady Brittany* did not ensure a proper lookout, thus causing the collision. As a result the owner of the *Lady Brittany* assigned all rights against his insurer to the plaintiff who thereafter commenced proceedings against them.²¹⁷

The insurers refused the claim and stressed, beside other arguments, that the respective section of the policy required the insured's payment for the liability before the insurer had to pay reimbursement for the claim. It was held that the insurer was not liable unless the wrongdoer had first settled the claim. Thus, the insurer had no duty to pay.²¹⁸

Afterwards, the owner of the *Cape Light II* appealed against this decision and argued that the rules of English law were not appropriate to decide liability under a particular clause in a non-mutual marine insurance policy. Despite this argument, it was held by the Federal Court of Appeal that this was not reasonable to make a distinction. The court therefore adjudged that the unambiguous wording in the policy, requiring the payment in advance in favour of the injured party, set a condition precedent to reimbursement under the insurance contract. Due to the expressly chosen wording of the policy, the court held further that the principles of equity are not reasonable to decide in a different way.²¹⁹

²¹⁶ 2002 FCA 60 (Feb 11, 2002).

²¹⁷ See *Southcott/Walsh*, 'Canadian Maritime Law Update: 2002', *Journal of Maritime Law and Commerce*, July 2003, 34 J Mar L & Com 391, at 407 f; see also *Hawkins*, *ibid*, at 1.

²¹⁸ See *Southcott/Walsh*, *ibid*, at 408.

²¹⁹ See *Southcott/Walsh*, *ibid*, at 408; and see *Hawkins*, *ibid*, at 4.

II. Law of Spain

Under traditional Spanish law, an injured party was entitled to seek for reimbursement from the wrongdoer's insurer by the right of *Subrogatoria*. Thereby, the third party was provided with an *indirect* action against the insurer in the case where the assured's liability was established, and the wrongdoer was insolvent and thus unable to settle a claim. The third party had, however, no interest in terms of law. Hence, the insurance money was treated as a part of the assured's general assets. It was a considerable disadvantage for the third party not to be privileged in comparison to other creditors.

It was held therefore, that civil liability insurance was an agreement in favour of the third party. Because the insurers were personally obligated to reimburse the third party, insurer and assured were jointly and severally liable. Despite this understanding, the insurer was entitled to raise any further defence available under the contract.²²⁰

1. Spanish Insurance Contract Act, 1980

In 1980, the Spanish Insurance Contract Act came into force. Article 76 of this Act provides that an injured party is entitled to act directly against an insurer. It reads as follows:

'The injured party or their heirs can take direct action against the insurer to demand the fulfillment of the obligation to indemnify',

and further,

'In order to enforce direct action, the assured is obliged to state to the injured person or his heirs the existence of the insurance contract and its content'.

By this rule, the Spanish legislator also sought to protect the affected party in a case where the assured's liability was established. In contrast to the above-mentioned statutes, the injured party obtains a better position under article 76 than the assured had

²²⁰ See *Noguero*, 'Third parties' rights against insurers under Spanish law', *Journal of Business Law* 2004, J B L 2004, Nov, 711, at 712 f.

under the policy. It is prescribed by article 76 that 'the direct action is immune from any defence which would have been available to the insurer against the assured'.²²¹

As we can see from this legislation, the third party is in a better position than the assured himself. Nonetheless, the third party is only privileged in that way because the insurer is prohibited from refusing a claim on the basis of personal defences available against the assured, eg failure to declare the risk, non-payment of premiums, not notified a claim in time. The insurer is however entitled to plead all objective defences in a dispute with a third party, for example, agreed exclusion of the particular loss or invalidity of the contract at the time of the incident.²²²

By virtue of this general acceptance of a third party's direct action against an insurer, it is recognized under Spanish law that the parties to the insurance contract are not allowed to exclude this right by agreement. It was held that an injured party has to be considered by the insurer and the assured while concluding the contract as well as the needs by the society in general. On the basis of this understanding, the right of direct action of a third party is valid in all contracts of liability insurance, even though article 76 is not applicable.²²³ Therefore, an injured party is indeed entitled to file a direct suit against the wrongdoer's insurer in the case where Spanish law is applicable.

2. *The Seabank*

The Seabank was laden with frozen tuna fish when she deviated from the originally agreed route from the Seychelles to La Coruna. Despite the stipulation of the route, the vessel entered Port Aden in Yemen where some Iraqis seized the vessel including the cargo, while Iraq occupied Kuwait. A second vessel had to be chartered to ship the cargo to the actual destination. The additional costs thereby occurred were settled by the insurers of the cargo interest. Subsequently, these insurers commenced court proceedings against the owners of *The Seabank* to recover their loss while chartering the substitute vessel; they sued the P&I Club and the shipowners jointly.²²⁴

²²¹ See *Noguero*, *ibid*, at 714.

²²² See *Noguero*, *ibid*, at 714.

²²³ See *Noguero*, *ibid*, at 716.

²²⁴ See *West of England*, 'Spain: Supreme Court decision on direct action against P&I Clubs', available at http://www.westpandi.com/NR/rdonlyres/9DBF3C0F-17D9-489E-BA8E-4A947EAAADF5/0/newsletter_2004_06.pdf.

Under article 76 of the ICA 1980, the claimant was successful against the P&I Club in the first and second instance. Thereafter, the defendant P&I Club appealed to the Spanish Supreme Court.

Although it was stated that the English understanding of a 'Pay to be Paid' rule is contrary to 'Spanish conflict of laws and public order principles',²²⁵ the Supreme Court rejected the claim against the P&I Club for the following reasons: First, the claimant had to consider an arbitration and jurisdiction clause laid down in the P&I Club's Rule Book. Second, it was held that the 'Pay to be Paid' clause agreed had to be considered as well. Third, the Supreme Court continued that a direct action under article 76 of the Spanish ICA was not applicable to any dispute arising under a policy of marine insurance because cover under a marine policy was one of the of 'large risks'.²²⁶ Those risks allow the parties of an insurance contract to prohibit a direct action by an injured party against wrongdoer's insurer.²²⁷

It was claimed that on the contrary a 'Pay to be Paid' rule was void, because it was prescribed by article 78 of the Spanish State Ports Act, 1992 that a Spanish shipowner is generally obliged to be insured against civil liability. Furthermore, the claimant stated that article 107.1(b) of the Spanish ICA provided that Spanish law was applicable to a contract in the case where this 'insurance contract is the result of compliance with a Spanish obligatory law' as article 78 of the State Ports Act is. Therefore, it was argued that English law should not be applicable.²²⁸

Despite those arguments, the Spanish court, then faced with a suit against the shipowner's P&I Club, judged that these Clubs as mutual insurance associations were all governed by English law. This opinion was based on the argument that there was no comparable legal entity under Spanish law. The Supreme Court thus held that the rules of the P&I Clubs were to be treated in the same way as the English law does. Thus, the 'Pay to be Paid' clause in question was valid. Further, the argument regarding article 107.1(b) of the Spanish ICA was rejected by the competent court because the 'Pay to be

²²⁵ See *Larrucea*, 'Pay first rules', available at http://www.maritimeadvocate.com/i25_spai.php.

²²⁶ See *Noguero*, *ibid*, at 714.

²²⁷ See *West of England*, *ibid*.

²²⁸ See *Larrucea*, *ibid*.

Paid' clause complied with the Spanish conditions of the conflict of laws as well as with the principles of public order.

The court stressed that, on the one hand, marine insurance law was ruled by the Spanish Commercial Code and not by the Spanish Insurance Act,²²⁹ and also that a contract shall be governed by the law of that country the parties have chosen insofar as the chosen law has a connection with the contract. It was held that the insurance cover rendered by a P&I Club has its origin in England. For this reason the choice of law was found valid in respect of Spanish law.²³⁰ On the other hand, the Court adjudicated that a 'Pay to be Paid' rule did not contravene public order principles. From the Supreme Court's point of view, it was in fact not a violation of the Spanish public order if another democratic country regulated certain legal issues in a different way from the Spanish legislator.²³¹

3. Current developments in Spain

Notwithstanding this jurisdiction, there is currently a process at work to enact a General Maritime Navigation Act to provide the Spanish legal system with comprehensive and appropriate shipping regulations. From the initial draft of this pursuant act, legislators' intention to protect an injured party in the future was apparent without express mention of P&I insurance. However, within a second draft of this act, this understanding of third party's rights regarding to the wrongdoer's P&I Club was overruled, and thus the English opinion was upheld. At present, the Spanish Parliament is faced with the final draft of this act, and eventually, the competent draftsmen were convinced to provide a third party with a direct action against P&I Clubs. It has been stated that 'the special legal regime of P&I insurance is unjustified, as such insurance is a particular type of liability insurance'. Thus, the P&I Clubs shall not be allowed to waive their obligations to cover a particular loss by a contractual agreement. It is the present intention to procure reasonable compensation for loss or damage caused by maritime casualties under Spanish law.²³²

²²⁹ See *de Sas*, 'Will the new act allow direct actions against P&I Clubs?', available at <http://www.uria.com/eng/publications/art.asp?id=165>.

²³⁰ See also *Noguero*, *ibid*, at 720, with reference the opinion of the Appeal Court of Madrid, which was not reluctant to apply English law to entitle the P&I Club to refuse the claim in question.

²³¹ See *Larrucea*, *ibid*; see *Noguero*, *ibid*, at 720, who refers to the contradiction of several Spanish jurists.

²³² See *de Sas*, *ibid*.

The eventual decision of the Spanish legislator remains to be seen. There is in fact a huge probability that the injured party will be better protected than under the present Spanish law. Nevertheless, it is another question how Spanish courts will apply this prospective act to disputes of third parties against P&I Clubs if the legislator fails to provide an explicit wording for marine insurance in general and P&I cover in particular.

III. Law of Argentina

Unlike current Spanish law, under the law of Argentina a third party is allowed to act directly against a P&I Club in the case of member's bankruptcy. It was held in *Compania de Seguros La Franco Argentina* that an injured party affected by shipowner's tort was entitled to a direct action against the insurer.²³³

Notwithstanding the fact that the legislator of Argentina has not yet enacted a statute comparable with those as mentioned above, the Federal Appellate Court held that a judgment against the bankrupt shipowner could be executed against his P&I Club although the Rule Book contained a 'Pay to be paid' clause. The court argued that, otherwise, such a clause gave effect to P&I Club's unjust enrichment, to the disadvantage of the injured party. The court examined the compliance of those clauses with the Argentine liability insurance law, and beside the essential distinction between liability and indemnity policies, the court recognized assured's protection 'from liability by indemnifying him under the terms of the insurance contract' as the common aim of both kinds of policies.²³⁴

On the basis of this objective, the court concluded that a P&I Club is not relieved of its obligation by the fact that the insolvent shipowner is not able to settle the claim within his own means. Thereby, the court completely altered the understanding of Argentina's law with regard to marine indemnity policies. This alteration was doubtless based on public policy reasons, particularly on the understanding that an insurer is regularly in the better position to bear the actual loss in question, rather than the injured party which anyhow suffered a particular loss due to the assured's fault.²³⁵

²³³ CNA Civ Y Com Fed, causa 12.383/94 (1994) (Plenario).

²³⁴ See *Rosas*, *ibid*, at 193.

²³⁵ See *Rosas*, *ibid*, at 195.

IV. Law of Germany

Under German law, an injured party has no basic right to act directly against a P&I Club in the case where the assured is bankrupt.

1. The *Galcrest*

In *The Galcrest*, the Hamburg Regional Court had to consider the effectiveness of a 'Pay to be Paid' clause under German law.²³⁶ The plaintiff, a Chilean shipping firm which chartered *The Galcrest*, was obliged to load cargo on board the vessel for a voyage from Livorno to a Turkish port of discharge. The engine of the vessel broke down because it was not well maintained. Subsequently, salvors arrived to tow the vessel to the port of Piraeus. The shipper had to contribute to the salvors' remuneration, but successfully claimed the paid amount from the charterer. The shipowner's liability for the engine's breakdown was ascertained by an arbitral tribunal. Consequently, the charterer attached the shipowner's claim against its P&I Club and sought indemnification from the owner's Club.²³⁷

First, it was an issue whether or not German law was applicable to the claim in question. In this case, the parties had agreed that German law should govern the insurance contract. Therefore, the question arose if the 'Pay to be Paid' clause was valid under German law. This question had to be answered in respect of section 307 of the German Civil Code. This prescribes that a standard condition like the 'Pay to be Paid' clause is invalid in the case where the contractual counterpart is inadequately penalised by the use of the term in question against the principle of good faith, which is accepted in German law in general and not only with regard to insurance law. The German legislator treats a term in the way described if it is contrary to the legal rule from which the term departs,²³⁸ or in the case where the term used limits the rights and obligations under the concluded contract to the extent that the objective of the contract is jeopardised.²³⁹

The court rejected a violation under the first alternative and stated that a 'Pay to be Paid' clause was compatible with the main features of the Civil Code. It was held that a clause

²³⁶ Transportrecht, 2002, at 470.

²³⁷ Transportrecht, 2002, at 470.

²³⁸ Cf section 307 (1) Nr 1 of the German Civil Code.

²³⁹ Cf section 307 (2) Nr 2 of the German Civil Code.

which obliges the assured to pay first did not contradict the principle of good faith because the insurer's obligation to reimburse the assured was only altered but not limited. The 'Pay to be Paid' clause only affects the maturity of the Club's duty to indemnify the assured, but not the obligation itself. The court continued that the assured was allowed to seek a bank's credit to bring up the payment in advance, if he was not able to settle the claim by his own means.²⁴⁰

Further, the court argued that the assured was encouraged by such a 'Pay to be Paid' clause to avoid a claim and use all possible efforts to reject it. It was moreover stated that those clauses were common in the Rule Books of the English P&I Clubs and therefore not able to constitute insurer's abuse.²⁴¹ In so doing, the court followed an approach similar to the Spanish Court.

In the court's view, the 'Pay to be Paid' rule did not violate the second alternative of section 307 (1) of the German Civil Code because the objective of the insurance contract was not affected. Mainly, the insurer was obliged to reimburse the insured for a particular loss, but this main obligation was not altered by the clause in question.²⁴²

Eventually, it was held that the 'Pay to be Paid' clause of the defendant P&I Club was valid, and therefore the court refused the claim.

2. German Insurance Contract Code, 1908

Under section 157 of the German Insurance Contract Code, the injured party is entitled to seek reimbursement in the case of personal liability insurance, even though the insured is insolvent because the claim was not a part of insured's estate. Therefore, the third party is not obliged to consider the ranking under the German insolvency law. However, the German Insurance Contract Code is not applicable to marine insurance because those contracts are currently excluded by section 186 of the Code. The German law of marine

²⁴⁰ Transportrecht, 2002, at 471; see *Hesse*, "Pay to be paid" – Vorauszahlungsklauseln in der P&I Versicherung', *HANSA International Maritime Journal*, 2007, Nr 4, at 1.

²⁴¹ Transportrecht, 2002, at 472.

²⁴² See *Hesse*, *ibid*, at 2.

insurance is rather governed by the German Commercial Code and several other conditions, particularly by the General German Marine Insurance Terms of 1919.²⁴³

After nearly one hundred years of validity, the German legislator decided to enact a completely revised code governing the law of insurance contracts. This code will come into force on the 1st of January 2008, and there is a general rule of a direct action against insurers in the case of the insured's insolvency if the insurance contract is a compulsory one, for instance if an attorney is liable but insolvent.²⁴⁴ Although a commission of experts recommended the inclusion of the law of marine insurance into a new code, the legislator eventually decided to stay with the present situation. Therefore, the marine insurance will continue to be excluded from the application of the code. The government thereby considered the insurer's and shipowner's concern and, believing that the practice of marine insurance worked properly over the last decades, that is therefore no need to alter the time-tested law.²⁴⁵

²⁴³ See *Kostka*, 'Marine Transport Insurance in Germany: The German Cargo Conditions in comparison to the Institute Cargo Clauses and recent German court decisions', *Marine Insurance at the turn of the Millennium*, Volume 1, Antwerp, 1999, at 361 f.

²⁴⁴ See *Bundesministerium der Justiz*, 'Bundestag beschließt neues Versicherungsvertragsrecht', available at http://www.bmj.bund.de/enid/Presse/Pressemitteilungen_58.html?druck=1&pmc_id=4554.

²⁴⁵ See *Ehlers*, 'Auswirkungen der Reform des Versicherungsvertragsgesetzes (VVG) auf das Transportversicherungsrecht', *Transportrecht*, 2007, at 5 ff.

G. Applicable law in an international context

In a matter where a P&I Club is seated in England, its assured is for example a shipping company from South Africa, and both are sued jointly by an injured shipper from Germany, it is quite obvious that the question arises which law is applicable to this dispute.

As we have seen above, there is an apparent lack of uniformity in the field of marine insurance law, although maritime lawyers normally seek for as much uniformity as possible. Despite the efforts of the *Comité Maritime International* ("CMI") to develop an International Convention of Marine Insurance,²⁴⁶ every country involved in matters of marine insurance regulates those matters by its own legislation and jurisdiction. Therefore, the conflict of laws arises, in particular in the case where one of the above-mentioned Direct Action Statutes allows an injured party to file a direct suit against the P&I Club. The field of marine insurance is however widely influenced by the English Marine Insurance Act of 1906, and thus not an area where the conflict of laws occurs as often as in other fields of the law.²⁴⁷

If the P&I Club is seated in England, the Club's rules will in almost every case define that the insurance contract concluded between the shipowner and the Club is governed by English law;²⁴⁸ sometimes those contracts are concluded in accordance with Scandinavian law.²⁴⁹

As it has pointed out, the US Supreme Court is not reluctant to state that a marine insurance policy is subject to English law if a pursuant clause is incorporated into the Club's Rule Book. In contrast to that understanding, there are opinions that those choices of law are against public policy reasons and therefore void. At least, those rules might only be a kind of procedural law and thus not applicable by courts outside England.²⁵⁰

²⁴⁶ See *Tetley*, 'Marine Insurance and the Conflict of Laws', *Marine Insurance at the turn of the Millennium*, Volume 1, Antwerp, 1999, 303.

²⁴⁷ See *Tetley*, *ibid*, at 324.

²⁴⁸ See *Dougherty*, *ibid*, at 1475.

²⁴⁹ See *Ronneberg*, *ibid*, at 18.

²⁵⁰ See *Ronneberg*, *ibid*, at 19.

In the case where such an express choice of the law governing the insurance contract is missing from the P&I Club's Rule Book, the competent court has to ask which country's law has the closest connection with the insurance contract in question. Basically, a contract of marine insurance has 'to be construed and governed by the insurance law of the individual states'.²⁵¹

Accordingly, the court has to consider the place of contracting, the place of the preliminary negotiations, the place where the policy has been issued and delivered, and where the seats of the contract's parties are. Lastly, the court should consider where the most events with relevance to the particular claim happened.²⁵²

As we have also seen, the law of England and the law of the USA are closely connected. The Supreme Court of the USA provided to keep the English law in mind in the case where an US court has to decide about a claim with regards to a P&I policy. It seems to be a rule, though every rule has exemptions, that a policy issued by an English P&I Club is governed by English law. *Vice versa*, a policy issued within the United States of America is governed by US law.²⁵³ The answer to this question determines whether or not the injured party can act directly against the P&I Club of the bankrupt shipowner.

²⁵¹ See *Ronneberg*, *ibid*, at 19 f, who provides following five aspects to be considered in general: '1) where the insurance agreements were negotiated, issued and signed; 2) the *situs* of principal place of business of the insurance company; 3) where the plaintiffs reside; 4) where the contract was to be performed; and 5) where the casualty occurred'.

²⁵² See *Dougherty*, *ibid*, at 1477.

²⁵³ See *Dougherty*, *ibid*, at 1478.

H. Conclusion

This paper has attempted to draw the reader's attention to the different approaches of various legal systems upon how to handle the issues arising out of an injured party's claim against the shipowner's P&I Club in the case of the defendant assured's bankruptcy. On the one hand, the intention of protecting the injured party on the basis of public policy has been pointed out. On the other hand, it has appeared that the English solution is mainly based on the stipulations of the contract concluded between Club and member.

While dealing with an injured party's separate right against the insurer in the case of the assured's bankruptcy, it has to be borne in mind that the law should avoid punishing the third party twice: First, with regard to the loss or damage it has actually suffered due to the assured's tort; and second, in regard to the fact that the wrongdoer became bankrupt and is thus not able to reimburse the third party: The wrongdoer's insurer refuses the claim with reference to its rules agreed between the parties to the insurance contract. The latter aspect penalises the injured party particularly because the basis for the insurer's right to reject the claim is laid down in its own Rule Book and is in fact agreed between the Club and its members.

As has been shown, domestic legal systems' solutions to resolve this problematic situation are quite different. This is particularly precarious in the field of marine insurance where the need of uniformity is more than obvious. As can be seen from the difficulties in the USA,²⁵⁴ it might be even more complicated to enforce solution internationally in the community of seafaring nations. Nonetheless, the need for uniformity must be recognized and a kind of solution has to be a future aim.

One should also not forget that the P&I Clubs are the insurers which offer a wide range of cover not only in favour of the member. Also the injured party might be aware of the cover rendered by the Clubs. As a matter of fact, the Clubs are the only insurers who render cover for natural catastrophes caused by oil pollution and undertake thereby a huge

²⁵⁴ The USA undertook some endeavors to harmonise at least the marine insurance law of the USA. However, the suggestion of an US Marine Insurance Act drafted by the Maritime Law Association of the USA failed in 1995 due to the Congress' inability to achieve a compromise with regard to such an act; see *Foster*, *ibid*, at 296.

responsibility.²⁵⁵ That is a reason why to impose the obligation for each and every loss or damage caused by its members upon the Clubs it might not be the universal remedy. The only way to resolve the issue in a reasonable way is to seek a compromise in the interest of both the P&I Clubs and the injured party.

The Clubs are non-profit insurers and are therefore obliged to handle their members' funds responsibly and carefully; the member's obligation to pay first is a means of doing just that. The Club is, however, entitled to exercise its discretion laid down in the Rule Book to handle a particular situation and waive the member's obligation to pay first if this appears to be appropriate. But this right to exercise its discretion is not a reliable means of harmonising the differences between the various legal systems.

It might be obvious that both the member of a Club as well as a third party seek an internationally accepted principle of how the Clubs handle the injured party's claim in the case of the member's bankruptcy. As has been pointed out, it depends currently on several, more or less, accidentally occurring circumstances whether the third party might be entitled to file a suit directly against the Club, eg the place of the underlying incident, the applicable law, or the place where the policy has been issued or agreed. Particularly in the field of the law of marine insurance, it is hardly satisfactory for the parties being involved to be subject to such random criteria.

In spite of the lack of success of the US efforts, it is advisable to initiate some undertakings to assimilate the different approaches by an international Convention or far reaching treaty. The CMI is doubtless the right institution to consider both contrary positions referred to above. Therefore, the draft of a generally accepted regime unifying the different approaches could be the right way to harmonise the question of how to handle the 'Pay to be Paid' rule. An attempt should be made to propose a general solution applicable to all legal systems concerned with marine insurance. There is a considerable contrast between the English approach adhering to the contractual stipulations on the one the hand, and the approach of Louisiana or Scandinavia based on public policy to protect the injured party on the other hand. There might be severe difficulties in convincing legislators and courts of those countries following the English line to enact another statutory measure besides the 1930 Act to provide the third party with a right to claim directly against a Club. Particularly, the interest of the shipowners and

²⁵⁵ See *Ronneberg*, *ibid*, at 1.

Clubs is very strong in English-influenced legal systems. Therefore, there need to be good reasons to convince those countries of the need to find a compromise.

The leading parties involved in the field of marine insurance (eg P&I Clubs, shipowners, charterers, cargo interests) and also insolvency administrators ought to be involved in this process and sit together in a forum led by the CMI to find a solution of voluntary binding. Such an agreement could be a starting point of harmonisation by participating Clubs.

For example, one should consider the Clubs' obligation to reimburse the third party even though the member has not settled the claim by his own means in the case where the amount involved does not exceed a particular limit. The International Group formed by the most influential P&I Clubs should try to work together with the CMI to the advantage of both the injured party and the Clubs' members.

The criticism of the English legal system regarding a third party's right to evade the requirements of the 'Pay to be Paid' rule is obvious and understandable: The insurance rendered by P&I Clubs is one of indemnity and would be shifted to one of liability although P&I insurance is deliberately different from those of liability policies. Nevertheless, the intention of the legislators and courts acting in favour of the injured party is also more than clear: The party who has already suffered a particular loss or damage should not be punished by an agreement between the insurer and the assured.

Also, the difficulties of allowing the bankrupt member to take a loan to settle the claim by his *own* means are apparent: This will generally be a commitment against the law of bankruptcy and, therefore, the other debtors of the bankrupt shipowner will challenge such a procedure. Nonetheless, it could be a further consideration to allow the member to borrow money to settle a claim if he is otherwise not able to avert his bankruptcy.

The P&I Clubs thereby should at least undertake to consider a long and successful relationship to a particular member who might be in financial distress, of course in any case with regard to the other members' right to demand the Club's careful handling of the associations' assets.

It is not in question that there is no contractual nexus between the Club and the injured party, and there might also be no right to sue the Club in delict or tort. The Clubs could however agree under a possible convention, treaty or model law to be obliged at least to

consider how the Club can assist a third party because there should be a responsibility of the insurer for the assured's tort. In this way, the third party could obtain some benefit from the Club's strong position on the basis of a voluntary undertaking.

However, it might be difficult to pursue persons in charge to provide a third party with the right of direct action against the Club on the basis of an International Convention, as is the case with the Convention on Civil Liability for Oil Pollution Damage, 1969 because the aim of this convention is the responsibility for damages to the environment and this aim ranks much higher than, for example, the right of a cargo owner who seeks indemnity for damage to the cargo.

As we have seen with the 1930 Act, the English legislator sought to protect the third party in the case of the member's bankruptcy. But why should there be no possibility of persuading the P&I Clubs to accept the need to offer an injured party a kind of protection in the case of a defendant member's bankruptcy? Even if legislative protection is unenforceable, the legal position of an injured party would be much strengthened by an agreement concluded by the lobbies of the maritime world binding themselves voluntarily to the softening of the often hard outcome of the 'Pay to be Paid' rule.

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