DIRECT ACTION OF A THIRD PARTY AGAINST THE INSURER IN MARINE INSURANCE WITH A SPECIAL FOCUS ON THE DEVELOPMENTS IN CROATIAN LAW

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The direct action is an action of an injured third party against the insurer of the wrongdoer’s liability. As a general rule a contract of insurance of liability is a res inter alios acta, and the right of direct action can only be exceptionally granted by a statute. The direct action is virtually always granted when insurance is compulsory. Voluntary marine insurance of liability is provided through P&I Clubs based on mutuality and due to its specificity can hardly sustain a wide right of direct action. International maritime liability and compensation conventions largely introduce compulsory insurance and the right of direct action due to the growing social consciousness. The current reform of the Croatian Maritime Code deals with the issue of the direct action. The proposed solutions are critically approached.

Key words: Direct action, marine insurance, insurance of liability, compulsory insurance, P&I Clubs.

1. INTRODUCTION

This paper has been inspired by a number of relatively recent developments in the area of maritime law dealing with marine insurance of liability. First and foremost, the idea for the topic came from a debate currently taking place in Croatian maritime law circles in relation to the proposed amendments to the Maritime Code of the Republic of Croatia, 1994 (in further text referred to as the Code).¹

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¹ The Maritime Code of the Republic of Croatia (NN 17/94, 74/94, 43/96). Currently, there is a new draft proposal to amend the Code prepared by the Ministry of Maritime Affairs, Traffic and Communications, the last version dating from January, 2003 and awaiting parliamentary procedure.
One of the matters taken into account in the current revision of the Code is the possibility for a third party who suffers damage for which a shipowner\(^2\) is liable, to institute a direct action (\textit{actio directa}) against the insurer of the shipowner’s (in further text referred to as the \textit{insured}) liability. The \textit{actio directa} was an innovation introduced in the 1994 Code\(^3\) that attracted a lot of debate, and today is being challenged again. Furthermore, the issue of direct action against the insurers of liability in marine insurance has become a very topical one in the United Kingdom, especially after two controversial cases finally decided by a judgement of the House of Lords in \textit{The “Fanti” and “Padre Island”}.\(^4\)

This judgement put the effectiveness of the Third Parties [Rights against Insurers] Act 1930\(^5\) (in further text, the \textit{1930 Act}) in serious doubt particularly when the insurers are Protection & Indemnity Clubs (further referred to as \textit{P&I Clubs}) and generally when it is applied to marine insurance of liability. The judgement triggered many debates within the UK but also internationally, since much of the world’s marine insurance is transacted in London and governed expressly or impliedly by English law.\(^6\) In fact it is estimated that British P&I Clubs insure approximately 65 per cent of the world’s shipping fleet.\(^7\)

Within the UK this was one of the motives that led to a reform of the 1930 Act\(^8\) which has been awaiting implementation since September 2002. Finally, the issue of the direct action has gained a lot of importance through a global trend in the increase of compulsory insurances. Compulsory insurance goes hand in hand with the direct action, where as a matter of public interest and public policy a third party “victim” is given special protection and enabled to more easily and more certainly obtain compensation for the damage suffered. In the area of marine insurance law, this global

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\(^2\) Apart from the registered owner of the ship, this could also be another person, natural or juridical, who is in possession of the ship as the undertaker of the marine adventure (e.g. an operator, a demise charterer or in some cases a time charterer).

\(^3\) Prior to the Maritime Code 1994, the respective provisions were found in the Law of Marine and Inland Navigation, 1977 that was taken over from the Yugoslavian legislation upon succession as a transitional law.


\(^5\) Full title of the Act is: “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”.


trend is reflected in practically all the International Maritime Organisation’s (further referred to as IMO) liability and compensation conventions and in the joint IMO/ILO (International Labour Organisation) Working Group on Liability and Compensation regarding claims for Death, Personal Injury and Abandonment of Seafarers.  

Finally the various international instruments, be it those of hard law or soft law, project these ideas back to the domestic legal systems, i.e. the national legislation.

The aim of this paper is to present a critical approach to the current developments regarding this very specific issue of marine insurance law, and particularly to submit possible suggestions for the solution of the question of the direct action in Croatian marine insurance law. The argumentation shall be built firstly through examining the aim and justification of the direct action in the light of the nature of the insurer’s obligation in marine insurance of liability but also within the framework of the general insurance law. Thereafter, a comparative study shall be carried out to present the existing solutions in some different jurisdictions and in international maritime law. Finally, the current position in Croatian law shall be presented in detail, including the conflict of law implications.

2. GENERALLY ON DIRECT ACTION

The issue of the direct action arises in the context of the insurance of liability where a third party who has a liability claim against an insured may proceed with a legal action direct against the insurer. A general principle of law is that a contract is binding only between the parties. In the Civil law tradition this is illustrated by a Roman law maxim that the contract is *jus inter partes* (and therefore a *res inter alios acta* in respect of third parties), whereas the Common law doctrine reflecting this principle is that of privity of contract. Therefore, as a rule, an insurance contract creates rights and duties only for the insurer and the insured. A person who suffered either contractual or tortious damage from an insured (a person who insured his liability with an insurer) is not a party to the contract of insurance and therefore, according to the general principle, cannot have a right to claim compensation directly.

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9 See infra, chapter 3.3. Direct Action in Compulsory Marine Insurance - Present and Future (International Instruments).

10 The term “insurance of liability” rather than “liability insurance” is used to avoid confusion. Namely, some distinguished authors traditionally differ between “liability insurance” as opposed to “indemnity insurance”. For the purposes of this work the term “insurance of liability” encompasses any insurance against third party risks and is therefore wider than “liability insurance” in its traditional meaning. The insurance against third party risks may take the form either of a liability insurance contract or of an indemnity insurance contract.
from the insurer of liability. This principle is valid also in the cases where the insured is incapable of satisfying the claims, for example because he has become bankrupt or insolvent. However, contrary to this general principle, many jurisdictions statutorily confer the extraordinary right upon the third party to obtain compensation direct from the insurer of liability by means of a direct action. The justification for the statutory introduction of the right to the direct action is in the public policy that tends to protect the innocent third party “victim” by providing simplified proceedings and a quicker and more certain compensation.\textsuperscript{11} Without the possibility of finding recourse through a direct action, in cases of the insured’s insolvency, the third party would not receive all the insurance proceeds. These would be treated as an asset of the insured and would be distributed under the insolvency legislation between all the creditors of the insured, one of them being the respective third party. As a result, the third party would be likely to recover only a small portion of the proceeds, whereas the balance would increase the dividends of the other creditors.\textsuperscript{12}

The public interest is particularly emphasised in certain branches of insurance. In fact, one could speak of a general tendency of increase of statutorily-prescribed compulsory insurances of third party liability. For example, compulsory insurance of motor liability is almost universally recognised; many jurisdictions recognise different compulsory insurances of professional liability, etc. In comparative maritime law compulsory insurance and the direct action against the insurer of liability are largely recognised in the context of liability for oil pollution by ships. Generally compulsory insurance is a consequence of a public interest to ensure that the restitution to the original position of the injured third party is established as soon as possible after the damage has been suffered. Persons conducting certain activities that are likely to incur liability for third party damage are therefore obliged by law to insure their liability and in case the insured risk materialises, the injured third party will be compensated by the insurer. Another argument for compulsory insurance is that the risks, if materialised, may cause such a high level of damage to third parties that it would be likely to expect that the person liable would not be capable of providing compensation without an insurance policy and would become insolvent upon such single event. To confer an additional security upon the third party “victim” the law will regularly allow the direct action, since it is a tool for enforcing the right to direct compensation and therefore indivisible from compulsory insurance. Finally a legislator, by prescribing compulsory insurance, in effect secures business for the insurance compa-


\textsuperscript{12} Law Com No 272; 31 July 2001, p. 1.
nies. Therefore it seems justifiable to expect that these companies may be exposed to the direct action by third parties. It could be said that the increase of compulsory insurance represents a process of “decontractualisation”\(^{13}\) in certain branches of insurance of liability. One can no longer argue in favour of privity of contract on the basis that the parties enter the contract and agree upon their rights and duties on their own free will. In practice the insurers will offer standard policies that will eventually have to comply with particular statutory requirements, whereas the insureds will simply have to accede to them with no or little possibility to modify them, which leaves the insureds without any negotiating powers. In return, it is on the insurers to establish mechanisms to deal with third parties’ claims and possibly be exposed to direct legal actions if the insureds fail to fulfil their duties.

However, some legal systems allow the direct action in voluntary insurance of liability as well, subject to some specified conditions. For example, the *actio directa* is recognised under some circumstances in English, American, French, Swedish and Norwegian law. In Croatia, as aforesaid, it was introduced with the 1994 Maritime Code.\(^{14}\) The justification for the direct action in the context of voluntary insurance is debatable. Here, unlike in compulsory insurance, the contract is a result of free dispositions of both contracting parties. The third party has no rights from the contract between the insured and the insurer, unless the contracting parties have included stipulations that the contract is for the benefit of a third party. A contract for the benefit of a third party is one whereby one contracting party is obliged to undertake the performance of a certain obligation for the benefit of a third person. Such contract *inter alia* gives the third party (beneficiary) a right to a direct action against the party obliged to perform. The third party, however, must be nominated or at least identifiable.\(^{15}\) In the scenario of insurance of liability, the third party is abstractly determined (not nominated), but is concretely identifiable upon the materialisation of the risk insured. Stipulations of this kind are recognised in most of the European Civil law traditions. Common law jurisdictions relying on the doctrine of privity of contract do not recognize contracts for the benefit of third parties, but would allow contractual assignment of the insured’s claim to an injured third party, which would have a similar effect.\(^{16}\) In insurance law a typical example of such clauses or stipulations can be

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13 Although in a somewhat different context, this term was used by S.J. Hazelwood in “P&I Clubs: Law and Practice”, LLP, London, 1989, p. 233. This author uses the term to describe the effect of the 1930 Act in English law.

14 D. Pavić, op. cit. at fn 11, p. 371.


found in the reinsurance contracts (between insurers and reinsurers). The insured, as a third party, may only recover on the policy of reinsurance if such clause is included in the contract of reinsurance.\textsuperscript{17}

At this point it would be important to consider how the actio directa relates to the so called actio surrogatoria existing in some traditional civil law jurisdictions that base their civil law on the Napoleonic Civil Code, typically France, Italy and Malta. Namely, through the actio surrogatoria, or actio debitor debitoris mei rights and actions which appertain to the debtor vis-a-vis his debtor, but which are not exercised by that debtor may be made use of by his creditor. The Maltese Civil Code provides as follows:

\begin{quote}
“It shall be competent to any creditor in order to obtain what is due to him to exercise any right or action pertaining to his debtor, with the exception of such rights or actions as are exclusively personal.”\textsuperscript{18}
\end{quote}

At first sight it appears that the actio directa in insurance law could be just a special case of the actio surrogatoria in general civil law since the liability insurer is considered to be a debtor of the insured under the insurance contract as soon as an insured event has occurred, whilst the injured third party is a creditor of the insured. Therefore, the third party could sue the insurer by virtue of the actio surrogatoria. This conclusion is only partially correct. The third party would indeed be entitled to exercise the actio surrogatoria, but that would not be equivalent to the direct action. The actio surrogatoria is not a direct right of action; it is an indirect action against an indirect debtor on behalf of the direct debtor, even though without his consent. The creditor in this action does not exercise his own rights, but those of his debtor (nomine debitoris). The result of the proceedings is not given to the creditor (the plaintiff) but is taken by the debtor, so that the debtor’s property is enhanced. Therefore, this action is carried out in the collective interest of all the creditors because eventually they will all benefit from the proceedings. Since the actio surrogatoria is only an actio indirecta the creditor sues for the recovery of the entire amount which is due to the direct debtor, even though his claim against the direct debtor is less than the claim that the direct debtor has against the indirect debtor. Some courts have taken a view that before the creditor can exercise this action it must be proven that the debtor is insolvent because if the debtor has other assets one cannot force him to exercise his

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\textsuperscript{17} T.J. Shoenbaum, op. cit. at fn 7, p. 591.

\textsuperscript{18} Section 1143, Civil Code [CAP. 16], the Laws of Malta; Similar provision to be found in the French Code Civile and the Italian Codice Civile with the difference that the Italian provision extends this right to a potential creditor and not only actual creditor.
rights. As a consequence all the creditors will participate in the proceeds according to their priority, and it is conceivable that the plaintiff will not be able to recover anything if his claim ranks lower than the claims of other creditors. Furthermore Maltese case law shows that the action is not admissible if instituted against the indirect debtor only, since both the direct debtor and the indirect debtor should be the defendants and called to the suit. To conclude this point, the actio surrogatria, unlike the actio directa, gives only a very limited right to a creditor to protect his position and secure the satisfaction of his claim. He may exercise this action when his debtor’s inactivity in obtaining compensation for his own claims is prejudicing the position of the creditor.

On the other hand, the aim of the direct action is to enable an injured third party to claim compensation direct from the insurer, in an action independent from the other creditors of the insured. The actio directa, as an extraordinary right, must be conferred upon a third party specifically by a statute. The question is whether it is justified to introduce the direct action in respect of voluntary insurance of liability? What would be its practical effect and possible repercussions? And finally what is the position of the third party in relation to the insurer? To examine these questions, the nature of the insurance of liability and the insurer’s obligation need to be analyzed. When assessing the justification of the direct action in this context, a distinction between commercial contracts of insurance and non-commercial insurance contracts should also be taken into account.

2.1. Nature of the Contract of Insurance of Liability

Insurance of liability falls under indemnity insurance in a broader sense which also encompasses property insurance. In indemnity insurance the insurer’s obligation need to be analyzed. When assessing the justification of the direct action in this context, a distinction between commercial contracts of insurance and non-commercial insurance contracts should also be taken into account.

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19 There are no express provisions to this effect in the respective Civil Codes.

20 Lectures delivered by Mr Justice Dr. Tonio Mallia, Civil Law Department, Faculty of Law, University of Malta. See also Torrente A., Schlesinger P.: “Manuale di Diritto Privato”, 13th Ed., Giuffré Editore, Milano, 1990, pp. 485-487.

21 Commercial contract is one between parties who are both professionally conducting commercial activities and made in the course of their businesses or in relation to their businesses.

22 As opposed to indemnity insurance in a broader sense, contingency insurance is of a completely different nature and its purpose is to provide a benefit to the insured upon the occurrence of an insured event (usually being death or personal injury). The benefit is usually the payment of money or the provision of money’s worth and it bears no necessary relation to any loss suffered by the insured. - N. Campbell: “The Nature of an Insurer’s obligation”, [2000] LMCLQ 42, at p.42.
tion by its nature is a promise to indemnify the insured fully or partially for the loss suffered in the event of the occurrence of an insured peril.\(^\text{23}\) The type of loss that the insurer promises to indemnify is either damage or liability, and on the basis of that distinction some authors traditionally distinguish between indemnity insurance (in the stricter sense) and liability insurance.\(^\text{24}\) In indemnity insurance in the stricter sense the indemnity by the insurer will take the form of compensation for damage. Property insurance is therefore always indemnity insurance in the stricter sense since in property insurance, the “loss” is damage to or loss of the insured’s property\(^\text{25}\) caused by one of the risks covered by the insurance policy. The “loss” is physical. However in insurance of liability the “loss” is somewhat more difficult to identify. The “loss” is that which is specified within the contract. The parties are free to identify the “loss” in any way they choose and thereby decide when the right to indemnity will first arise.\(^\text{26}\) In traditional liability policies the nature of the insurer’s obligation to indemnify takes the form of a promise to sustain the loss being suffered instead of the insured.\(^\text{27}\) The insurer promises to prevent the insured from sustaining the financial loss he would have otherwise personally suffered as a consequence of his liability. A liability insurer provides the insured with the moneys necessary to satisfy the third party’s claim against the insured (fully or partially), or pays the moneys direct to the third party, depending on the contract. However the insurance of liability may be contracted as indemnity insurance in the stricter sense; so that the nature of the insurer’s obligation to indemnify is to compensate the insured for the loss he suffered by discharging his liability to the third party claimant. Insurance of liability that takes the form of indemnity insurance in the stricter sense is typical for P&I Clubs due to the “pay to be paid” rule traditionally found in the Rules of the Clubs. According to this rule the obligation of the Club does not arise before the member (the insured) has discharged his liability to the third party. Only after he has paid, will he have a claim against the Club. In other words, it means that there is no right to indemnity by way of payment until the insured has made payment.\(^\text{28}\)


\(^\text{24}\) See note 10.

\(^\text{25}\) It would also include property not owned by the insured, but possessed by him, for which he is responsible, e.g. a ship in the hands of a bareboat charterer.

\(^\text{26}\) M.C. Hemsworth, op. cit. at fn 23, p. 299.

\(^\text{27}\) Ibid, p. 296.

\(^\text{28}\) Ibid, p. 298.
Regardless of this fine distinction between the different insurance of liability contracts, it is clear that they are always made to save the insured harmless. The insured is the one benefiting from the insurance proceeds. Ultimately it will be a third injured party who will receive compensation, but the insurance proceeds belong to the insured, and not to the third party. It is essential to distinguish between two completely separate and distinguished legal relationships that exist upon the occurrence of an insured peril. One is between a tortfeasor or a person in breach of a contractual obligation (the debtor) and the person who suffers damage (the creditor). If the debtor from the first relationship happened to be insured against the liability he incurred, than the other legal relationship that is relevant is the one between the insured (now, the creditor) and his insurer (the debtor). In the second relationship the person who suffered damage is a third party therefore with no rights from that relationship. Even the fact that the insured and the insurer have arranged that in the event of the insured incurring liability the insurer will pay the moneys direct to the third injured party does not change what was said about the two separate relationships.

### 2.2. Practical Implications

This paper deals with commercial contracts of insurance, where the insured is a professional who enters into the contracts in relation to his commercial activity. When the insurance of liability is voluntary the insured will have entered such contract
because he is a prudent businessman. A prudent businessman is expected to take into account risk management as a necessary part of the exercise of his commercial activity and, in the course of dealing with the risks inherent in his activity, effect appropriate insurance. By insuring his liability he will act responsibly towards the world at large while maintaining the viable and uninterrupted operation of his business. The relationship between the insurer and the insured is based on their commercial confidence and the terms of their contract will very much depend on that mutual confidence. Any third party is incidental to this relationship. The insurer is just as free to refuse to enter into the contract, unlike in compulsory insurance. Therefore one could argue that the introduction of the direct action would represent a disincentive for insurers to accept a larger number of offers. It would also lead to the increase of premia. Only selected prudent businessmen would continue to insure all their third party risks, and consequently the price of their services would grow. The unconscientious businessmen who are anyway often reluctant to diligently insure their liability will be even less motivated to do so. These are after all those who are more likely to cause damage to third parties through the conduct of their commercial activities. The ultimate effect again seems to be negatively affecting the users of services. Those who have the capacity to pay high prices for the services they use will be in an advantageous position in many respects. They probably will never even be in need of additional protection such as the right to a direct action, since the mechanisms will be in place to settle the claims outside the courts. Those with poor financial powers will be destined to deal with less conscientious businessmen. When forced to resort to a direct action, it is not unlikely to expect that the claimants will be faced with no recourse because their debtor is not insured for the respective risk or the reputation of his insurers may be questionable.

2.3. Position of the Third Party Claimant when the Direct Action is Admitted

When the direct action is admitted, it is important to determine the position of the third party in relation to the insurer. That will affect the defences that the insurer may rely upon. In this respect the difference between voluntary and compulsory insurance needs to be taken into account. The issue will certainly depend on the domestic legislation, but generally two main opposite approaches can be taken, while there is a spectrum of possible solutions between these two opposites. The first approach is to treat the direct action as an independent right of the third party claimant. The legal

29 Obviously, the insured can be a natural person, but it is more likely to be a company in this context.
position of the third party is separate and independent. In this variant, a third party is not affected by the contractual relationship between the insurer and the insured. The insurer, if sued directly, will not be entitled to defences that he has against the insured on the basis of the contract of insurance. However, he might rely on defences that the insured has against the third party claimant. This solution is likely to be found in the context of compulsory insurance. On the other hand in voluntary insurance if the direct action is allowed it is probable that a third party claimant will be subrogated in the legal position of the insured. Therefore, in the second variant, the right to the direct action is a right statutorily transferred to the third party who steps into the shoes of the insured for the purposes of exercising the rights under the contract of insurance. The insurer should be able to raise all the defences he would have had against the insured under the terms of the insurance contract up to the time of loss, or those arising from the law. Some examples of these defences are material misrepresentation of the risk at the time of contracting, default in payment of premia or calls, arbitration clause, wilful misconduct of the insured, etc. On the other hand the insurer, assuming the obligation for which the insured is primarily liable, is subrogated into the position of the insured for the purposes of defending the insured’s position as a debtor of the third party. Therefore the insurer should also be able to raise all the legitimate defences that the insured would have had against the third party, including the time-bars, exemptions from liability, limitation of liability etc.

3. APPLICABILITY OF THE DIRECT ACTION IN THE CONTEXT OF MARINE INSURANCE OF LIABILITY

3.1. Nature of Marine Insurance of Liability

Marine insurance of liability is a contract of indemnity just like all marine insurance contracts. Although being a special sort of insurance of liability existing in the general insurance law, marine insurance of liability in many ways differs from it due to its particular background and evolution. Namely, marine insurance of liability owes its existence to the development of Protection and Indemnity Insurance. P&I Clubs

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32. "A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in a manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to the marine adventure.” - The definition is taken from section 1 of the British Marine Insurance Act 1906.
are mutual insurance societies, whereby the members (shipowners) insure one another on an indemnity basis for a variety of third party liabilities relating to the use and operation of ships.\textsuperscript{33} They first came into common use after the case of De Vaux v. Salvador\textsuperscript{34} which established that collision liability is not a “peril of the sea” and thus not covered under the basic Lloyd’s hull insurance policy. Soon after a standard “Running Down Clause” was devised by the Lloyd’s underwriters and added to the existing hull insurance policies to cover 3/4 of this risk in return for an additional premium.\textsuperscript{35} Consequently, P&I Clubs were founded to cover the remaining 1/4. They gradually broadened their coverage to include other third party risks and risks not covered by the hull policies, thus today they cover virtually all the risks not covered by hull insurance. For example they cover claims for damage or compensation in respect of personal injury or loss of life of crew members, stevedores, passengers and others, collision liabilities not covered by hull insurance, loss or damage to property other than cargo, pollution, liabilities under contracts, wreck liabilities, cargo liabilities, etc.\textsuperscript{36} As the practical and statutory liabilities of shipowners increased, the coverage provided by the P&I Clubs extended. In relation to the increase in compulsory insurance, P&I policies started to include “compulsory by law” provision under which the liability coverage varies depending on the local law.\textsuperscript{37} The nature of P&I insurance is particular, since shipowners are both insurers and insureds, but the general principle of indemnity functions just like in commercial hull (and cargo) insurance. Clubs’ Rules are general terms and conditions of the cover provided, what in commercial insurance is found in the policy. However, there is an additional element central to the concept of mutuality and that is that the same Rules regulate the relationship between members “in order to ensure that all members are treated on equal basis and fulfil their mutual obligations to one another [n]o responsible and conscientious member wishes to see his premiums subsidising irresponsible members.”\textsuperscript{38} One has to have in mind all this when discussing the applicability of the direct action in the context of marine insurance of liability, since the majority of this insurance is

\textsuperscript{33} A definition by the International Group of P&I Clubs.

\textsuperscript{34} 111. Eng.Rep. 845 (K.B. 1836).

\textsuperscript{35} The remaining 1/4 was thought to be covered by the shipowners to discourage the ships’ masters from being negligent.

\textsuperscript{36} T.J. Shoenbaum, op. cit. at fn 7, pp. 566, 567.

\textsuperscript{37} Ibid.

\textsuperscript{38} From the submission by the International Group of P&I Clubs to the 3rd session of the IMO/ILO ad hoc Expert Working Group on Liability and Compensation Regarding Claims for Death, Personal Injury and Abandonment of Seafarers; 3rd April 2002; Document IMO/ILO/WGLCCS 3/4/3.
provided by the P&I Clubs or other specialised mutual insurance organisations that function on the same basis and principles. Commercial insurance companies today sometimes also offer cover for shipowners’ liability, but again largely translating long-recognised P&I terms and conditions into their policies.

3.2. Direct Action and Voluntary Insurance

Taking into consideration all the previously stated arguments, there is no real or legal justification for an unconditional right to a direct action in voluntary marine insurance of liability. The only situation where a dilemma could possibly arise is where the shipowner (or the ship operator) who is liable for contractual or tortious damage to a third party becomes insolvent upon situations such as bankruptcy or liquidation. An injured third party in such situations may be left totally or partially with no compensation regardless of the fact that his wrongdoer had insured his third party risk.\[39\] In addition, insolvency in the shipping business is not a rare problem due to the industry’s typical features such as “single vessel” companies, general recession in the shipping industry, problems of the countries in transition many of which are still affected by the process of privatisation. Even if it were to be agreed in principle that in such situations it would be justified to grant the exceptional and extraordinary right to a direct action, it does not seem fair that all kinds of claims should be given equal importance. For example, a crew member’s claim for death or personal injury would certainly deserve better public interest protection than a claim by a person with an interest in damaged cargo to whom the shipowner is contractually liable on the basis of a contract of carriage. In fact, it is submitted that in the latter case many of the justifications born from the public interest theory do not hold. Namely, the person with an interest in cargo will most probably be a trader and, as a prudent trader, should obtain appropriate cargo insurance. Already that would ensure a quick, certain and easy way of compensation, as well as a fast restitution to the original position.\[40\] From there on, the cargo insurer would be subrogated into the legal position of his insured and in a situation to make a claim against the shipowner liable for the damage or his subrogated liability insurer. Can we still speak of public interest to grant additional and exceptional protection? It seems that only those third parties with certain selected types of claims would deserve additional protection. In that

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\[40\] These reasons were stated as the main justification for the direct action.
case, is it not futile to grant the right to a direct action based on a principle of public interest, but to leave it up to the free will of the respective parties to take out cover for certain types of claims?

It is submitted that the only consistent and legally justified solution is to introduce the direct action for those claims for which compulsory insurance is prescribed. However in reality many jurisdictions do allow the direct action in voluntary marine insurance of liability. As aforesaid those affected are mostly P&I Clubs. Another common insurance of liability in marine insurance is typically the above-mentioned “Running Down Clause”, today’s “Collision Liability Clause” in hull insurance policies covering 3/4 of collision liability.

3.2. a. Effect on the P&I Clubs

The particularities inherent to P&I Clubs may strongly affect the operation of the direct action against them, if such action is allowed by statute. As aforesaid, in the context of voluntary insurance, a directly sued insurer should be allowed to raise all the defences he has against the insured and all the defences that the insured would have against the third party claimant. Likewise, when a P&I Club is a defendant in a direct action by a third party, it may raise all the defences it has against its member—the insured. Among the Club’s defences against its member, would also be the so-called “cesser” clause and, even more so, the “pay to be paid” or “pay first” rule, both of which are traditionally found in the rules of virtually all P&I Clubs. Therefore, in introducing the direct action, the legislator would have to take into account and eventually pre-empt the effect of these potential defences. Otherwise the purpose of the direct action would be defeated whenever such defence is raised.

The effect of the standard “cesser” clause is that any member failing to pay calls forfeits not only future, but also all outstanding claims on any entered vessel, therefore providing cancellation of the P&I Clubs’ liability in respect of accrued claims (retrospectively). If raised upon a direct action, this defence would make it impossible for the third party claimant to obtain compensation from the Club even where, for example, the insured has failed to pay only one call.

Particularly interesting is the “pay to be paid” rule. P&I rules typically cover claims and expenses which their members “have become liable to pay and […] in fact have paid.” This would preclude recovery when the insured is insolvent and unable

41 J. Mance, op. cit. at fn 16, p. 45.

42 See supra, chapter 2.1. Nature of the Contract of Insurance of Liability.
to pay. The rule has a strong maritime background which is sometimes described as a “theory of maritime antiquity”. Historically such clauses were included so that the Club members could rely on the financial soundness of other members. It has been argued that:

“…in a mutual insurance association such as a P&I Club, it is essential that members should be able to assume the financial probity of other members, because all of them are insurers as well as insured. To that end it is customary to require each member to discharge his own liability before he can be indemnified against it by the Club. Each member is, after all, running his own business; it is up to him to make sure that a claim against him is well founded, and the best way of ensuring that is to require him first to pay the claim before seeking indemnity from the Club.”

In reality, however, Clubs put up security (give a guarantee) and handle and settle claims direct like other insurers. Still, this rule has an important “psychological” significance for the Clubs operating as a “signpost” to the true insurance relationship. It is a safeguard to avoid a risk of members forgetting that the Club is a separate entity and seeking to operate or manipulate the Clubs insurance for their own benefit. These aims are in practice mostly achieved through ensuring a high quality of Club membership and Club management. Nevertheless, there is still a strong justification for keeping the “pay first” rule operative since it is clear that “the purpose of this rule is to meet the special needs of a mutual insurance association scheme in a members’ association or club.” Judging from English case law, which is certainly the most sophisticated case law in this area, the “pay first” principle has only ever been accepted in the special area of marine mutual insurance, and then only in the context of claims for financial loss. In other words in those instances the courts justify the operation of the rule as a successful defence in the direct action. However as the English law stands now there is nothing to prevent insurers from relying on this clause in other cases, including claims for personal injuries. This was one of the reasons for the reform of the 1930 Act which is currently awaiting implementation.

43 J. Mance, op. cit. at fn 16, p. 44.
44 Ibid, p. 45.
46 J. Mance, op. cit. at fn 16, p. 45.
47 Ibid.
49 UK Law Commission’s Report, op. cit. at fn 8, p. 54; see also infra, chapter 4.1. The United Kingdom
To conclude, the commercial importance of the “pay first” principle has been recognized in the context of mutual marine insurance, but the better practice for the Clubs would be not to hide behind this clause when claims are for death or personal injury. As regards the introduction of the right to a direct action, it is submitted that it is legally and practically more justified to identify the types of claims that deserve utmost public protection and to prescribe compulsory insurance of liability in respect of them together with the right to a direct action. The introduction of the direct action in voluntary marine insurance disturbs the fundamental principles on which this branch of insurance traditionally functions. Moreover, in practice, there is usually an alternative way to protect the claim by, for instance, seeking the arrest of property at the earliest opportunity in order to obtain Club security which is not dependent on the insured’s solvency so that the “pay first” defence does not even arise. 50

3.2. b. Effect on the Hull Insurers with respect to the “Collision Liability Clause”

There is at least one clause in everyday marine insurance use within the commercial market which is a “pay first” clause and that is the standard “collision liability clause” in the Institute Time Clauses Hulls (95), clause 8 and the Institute Voyage Clauses Hulls (95), clause 6, under which the insurer undertakes to indemnify the insured for 3/4 of the insured’s liability:

“The underwriters agree to indemnify the insured for three-fourths of any sum or sums paid by the insured to any other person or persons by reason of the insured becoming legally liable by way of damages…”

The insurer is not liable for the full amount, but only 3/4 of the sum paid by the insured to the third party. The idea was originally to encourage the insured to exercise due care and attention. In practice today the remaining 1/4 is absorbed by P&I cover. It is apparent from the opening words of clause 8.1 that there is a prerequisite which has to be fulfilled before the insured may be indemnified for third party liability for collision - the insured has to provide proof of payment before he can be indemnified. He has to “pay to be paid”. This principle, well known under P&I cover, is of crucial importance to the insured, but also to the third party when there is a right to a direct action

50 J. Mance, op. cit. at fn 16, p. 47.
transferred to him by statute. The statutory right of the 3rd party is dependent on the rights of the insured.\textsuperscript{51}

“The effect of these provisions is that, in case where the insurer would have had a good defence to a claim made by the insured before the statutory transfer of his right to the third party, the insurer will have precisely the same good defence to a claim made by the third party after such a transfer.”\textsuperscript{52}

In the jurisdictions where the direct action is statutorily granted in the context of voluntary insurance, the prevailing opinion is that the “pay to be paid” rule would be “entirely inappropriate in the non club environment of a commercial insurance contract” such as the present example.\textsuperscript{53} The aforementioned reform of the 1930 Act is also on these lines. In other words, it would be up to the legislator to remedy the effect of the operation of such clauses within the framework of the direct action provisions.

3.3. Direct Action in Compulsory Marine Insurance - Present and Future (International Instruments)

The law on occasion insists on the insurance of liability of the shipowners. Internationally there are a number of Conventions that make insurance or other financial security arrangements mandatory for the shipowners and in fact one may speak of a general trend in this sense. When the concept was adopted for the first time in an IMO liability and compensation Convention (Convention on Civil Liability for Oil Pollution Damage, 1969), it was a very controversial issue. However, in the last decade the IMO has become very active in drafting liability conventions which include a similar formula of compulsory insurance and the direct action. It has been argued that these Conventions and Protocols “substantially displace standard insurance concepts and radically reshape the traditional legal relationship between marine insurers, shipowners and claimants.”\textsuperscript{54} The direct action provisions in the respective Conventions,

\textsuperscript{52} Lord Brandon: the “Fanti” and the “Padre Island” [1990] 2 Lloyd’s Rep. 191 (H.L.), at p. 197.
\textsuperscript{53} Hirst, J. op. cit. at fn 48.
as will be presented, nullify most coverage defences except wilful misconduct. Consequently marine insurers lose a lot of their ability to shape their coverage and the behaviour of the insured, since upon a direct action any conditions and exclusions from the cover cannot be enforced.\textsuperscript{55} At best, the insurers are left with a possibility of recourse against the insured in separate proceedings.

Despite the fact that this is fundamentally changing the nature of the insurer’s obligation in marine liability insurance, particularly that of the P\&I Clubs, there has been a growing political will in the international community to additionally protect the victims of marine incidents. Introducing compulsory insurance and the direct action is a way to bridge the problems of compensation that frequently arise in relation to the numerous single ship companies. These companies have a separate legal personality and very little property other than the ship herself. Therefore when faced with a number of substantial claims it is likely that the company will become insolvent and leave the claimants uncompensated. Compulsory insurance cover is therefore a measure of financial stability and an indirect protection of the claimant. It may also contribute to the enhanced safety of the ship, since the provider of financial security may require higher safety standards as a condition for the provision of financial security.\textsuperscript{56} The direct action against the insurer as devised in the respective international instruments avoids the problem of identification of the person liable and the availability of assets belonging to such person for execution of a judgement. The problem may be that this tendency will lead towards having virtually all kinds of maritime claims being covered by similar instruments. P\&I Clubs today are becoming guarantors for their members, rather than their insurers. The question is how far-reaching the repercussions are going to be.


This is the earliest maritime Convention that imposes compulsory insurance (or other financial security) on the ship operators.\textsuperscript{57} It applies to the insurance of liability for nuclear damage of the operators of nuclearpowered ships. It is also the first maritime Convention authorising direct actions against insurers. Still, it is left at the op-
tion of the applicable national law to recognize the right to a direct action. The relevant provision is found in Article XVIII of this Convention:

“An action for compensation for nuclear damage shall be brought against the operator, it may also be brought against the insurer or any person other than the licensing State who has provided financial security to the operator pursuant to paragraph 2 of Article III, if the right to bring an action against the insurer or such other person is provided under the applicable national law.”

“The applicable national law” is the national law of the court having jurisdiction under the rules of the Convention, which according to Art. X.1. is, at the option of the claimant, either the court of the licensing State or the court of the Contracting State in whose territory nuclear damage has been sustained.

This Convention, however, has never entered into force.

3.3. b. Convention on Civil Liability for Oil Pollution Damage (CLC), 1969/1992

The issue of compulsory insurance of the shipowners’ liability and the direct action against their insurers was a revolutionary idea at the time when the CLC was drafted. The concept was born during the preparatory work on the Convention within the IMCO Legal Committee. The aim was to provide those suffering the consequences of oil pollution damage with a mechanism of equitable compensation which would ensure effective protection and quick settlement of claims. The issue was so controversial that due to the division of opinion, the Legal Committee did not take a decision on the issue, but they submitted the draft article to the Conference. Similarly, the delegations at the Conference were divided over the issue, and finally the relevant article was adopted with 9 votes in favour and 8 against.

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59 With the exception of the operators of nuclear powered ships under the 1962 Convention.
60 Inter-Governmental Maritime Consultative Organization; changed the name to International Maritime Organization in 1982.
The arguments in favour of the compulsory insurance principle were that the execution proceedings were expensive and long-lasting. Bankruptcy and liquidations of shipping companies, which are frequent in the circumstances in which the shipping industry functions, render the compensation often impossible. The level of damages for oil pollution is likely to be too high to be compensated where there is no additional financial security. It also seemed a logical addition to the adopted principle of strict liability of the shipowner. The defenders of the opposite opinion argued that the shipowners normally insured their liability, and there was no need to impose it as a duty. It would be difficult to obtain insurance on the world insurance market unless liability limits were low. The costs of the insurance available for oil pollution damage would increase extremely. The State Parties would have difficulty monitoring and checking the adequacy of the insurance. It would be unjustified to put the claims for oil pollution damage in unequal position in relation to the other maritime claims. After long debates and various proposals, the following solution for financial security was adopted in Article VII paragraph 1 of the Convention:

“The owner of a ship registered in a Contracting State and carrying more than 2,000 tons of oil in bulk as cargo shall be required to maintain insurance or other financial security, such as the guarantee of a bank or a certificate delivered by an international compensation fund, in the sums fixed by applying the limits of liability prescribed in Article V, paragraph 1 to cover his liability for pollution damage under this Convention.”

The financial security, therefore, can be an insurance cover (most commonly a P&I cover) or other financial security. The list of types of financial security in the provision is not exhaustive, and it would be up to the flag State party to the Convention to determine the acceptable types of security. The financial security is mandatory up to the limit of the shipowner’s liability determined by the Convention and only for the ships carrying more than 2,000 tons of oil in bulk (oil used for petrol is not included).

Ibid.

Note that the Convention puts the liability for oil pollution damage on the registered owner, not on the operator, manager, charterer (including bareboat charterer), servants and agents, pilots, salvors (performing salvage with the consent of the owner or on the instruction of a public authority), and persons taking preventive measures, unless they are personally at fault (intentionally or recklessly). Therefore, all the claims must be channeled to the owner/ his insurer save in the latter scenario. (Art. III.4, CLC 1992). The shipowner or the subrogated insurer will eventually have a right to be indemnified by the respective person, but in separate proceedings. (Art. III.5.).

D. Čorić, op. cit. at fn 62.
The direct action as a right of a third party “victim” to submit the claim directly against the wrongdoer’s insurer is one of the most important instruments of protection. The debates at the Conference were mostly related to the question of whether the direct action should be allowed in all cases or only when the shipowner is insolvent. Most civil law countries supported the first view, while the strongest supporters of the latter view were common law countries. The following is the submission of the United Kingdom regarding this issue:

“The United Kingdom is opposed to direct recourse against the insurer or other person providing financial security, except in the case where the shipowner is insolvent. In such cases, the insurer should enjoy appropriate safeguards. Provision for direct recourse would put the insurer at a substantial disadvantage because the shipowner would have little interest in assisting the insurer in a defence action and it would, in some cases, lessen the incentive for shipowners to take due care.”

Despite the differences in opinions, the provision on the direct action was eventually adopted in the Article VII paragraph 8:

“All claim for compensation for pollution damage may be brought directly against the insurer or other person providing financial security for the owner’s liability for pollution damage. In such case the defendant may, irrespective of the actual fault or privity of the owner, avail himself of the limits of liability prescribed in Article V, paragraph 1. He may further avail himself of the defences (other than the bankruptcy or winding up of the owner) which the owner himself would have been entitled to invoke. Furthermore, the defendant may avail himself of the defence that the pollution damage resulted from the wilful misconduct of the owner himself, but the defendant shall not avail himself of any other defence which he might have been entitled to invoke in proceedings brought by the owner against him. The defendant shall in any event have the right to require the owner to be joined in the proceedings.”

On the basis of this article any claim for compensation may, in all cases, be brought against the shipowner’s insurer. When sued directly, the insurer may rely on the limitation of liability established in the Convention, even in those situations where the shipowner has lost the right to limit his liability due to his fault or privity. The insurer

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66 IMCO, op. cit. at fn 61, p. 477.
may raise all the defences that could legitimately have been invoked by the shipowner. The insurer may also invoke the defence that the damage resulted from the wilful misconduct of the shipowner, which frees him from his liability. However that would be hardly possible to prove.67 The insurer cannot rely on any other defences that he could normally use in an action brought against him by the shipowner (e.g. unseaworthiness, non-payment of the calls/premia, “pay to be paid”, etc.).68 This means that the third party claimant is not affected by the contractual relationship between the insurer and the insured and that the direct action is to that extent an independent right of the third party. For the concerns expressed in the UK submission, the insurer is always entitled to require the shipowner to be joined in the proceedings.

There has been an argument (based on the express language of Article VII, paragraph 8) that the direct action, unlike compulsory insurance, does not depend on the volume of cargo carried, and that it is allowed also where the insurance is not compulsory.69 However, it is submitted that the said paragraph 8, dealing with the direct action should not be read in isolation, but in the context of Article VII as a whole, and therefore applied only where the insurance is compulsory. In particular, paragraph 10. of the same Article states:

“A Contracting State shall not permit a ship under its flag to which this Article applies to trade…”

The ship to which Article VII applies is that referred to in paragraph 1. (in other words, a ship registered in a Contracting State and carrying more than 2,000 tons of oil in bulk as cargo).

Actions for compensation may only be brought in the courts of those member countries under whose jurisdiction the damage has occurred or preventive measures were taken to prevent or minimize pollution (Art. IX). The Convention ensures that all the valid judgements will be recognized and enforceable in all State parties.

Finally, the Convention provides that any sum provided by compulsory insurance shall be available exclusively for the satisfaction of claims under this Convention.70

67 Wilful misconduct would encompass the highest levels of fault, such as intent and gross negligence. The strongest argument for the introduction of this defence into the direct action provision was the principle of mutuality on which P&I Clubs are based. It is not justified to expect that the members of the Club would be obliged to cover liability of a member who caused damage by wilful misconduct. In addition, that would be against any principle of fair competition.

68 D. Čorić, op. cit. at fn 62, p. 43, 44.

69 Ibid, p. 44.

The Convention has been in force since 1975, and amended by the 1992 Protocol which replaces it, but contains the same provisions on compulsory insurance and the direct action. It has attracted worldwide acceptance and is incorporated in the national laws in a large number of countries. Some countries that have not ratified it enforced their own regimes of liability and compensation for oil pollution and damage, such as the US Oil Pollution Act 1990. OPA 1990 establishes a similar, but stricter, regime of liability and contains provisions on compulsory insurance and the direct action.

3.3. c. Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea (HNS), 1996

The HNS Convention borrows the principles of strict liability, compulsory insurance and the direct action from the CLC 1969. The provision on compulsory insurance of the registered owner’s liability is found in Art. 12.1, whereas a practically identical formula for the direct action is adopted in Art. 12.8. All the provisions apply to vessels actually carrying hazardous and noxious substances, regardless of the size or volume of the cargo. Liability is on the owner like in the CLC. The Convention will enter into force 18 months after 12 nations have adhered to it.

3.3. d. Convention on Civil Liability for Bunker Oil Pollution Damage (Bunkers Convention), 2001

Like CLC and HNS, the Bunkers Convention establishes strict liability of the owner, compulsory insurance71 and the direct action72. The insurance is compulsory for the registered owners of the ships over 1000 gross tonnage. The direct action formula is virtually identical to the former two liability conventions.

The Bunkers Convention does not establish specific limitation of liability, but refers to the applicable national law or international regime, such as the Convention on Limitation of Liability for Maritime Claims, 1976, as amended.73 That however brings legal uncertainty affecting not only the shipowner, but also the insurer who

71 Art. VII.1, Bunkers Convention, 2001.
72 Art. VII.10, ibid.
73 Art. VI, ibid.
may rely on the same limitation of liability. There are international regimes on global limitation of liability other than 1976 LLMC, and there are some States that do not implement any of the existing international regimes but have their own. As a rule and under the provisions of the Bunkers Convention, the applicable law would be the law of the State where the damage occurred.

The Bunkers Convention, unlike the CLC 1992 and HNS 1996, does not require all the claims to be channelled to the shipowner or his insurer.\(^7\)\(^4\) Moreover, the Bunkers Convention extends the definition of the shipowner to include the registered owner, bareboat charterer, manager and operator of the ship all of whom can be liable for the damage and their liability is joint and several.\(^7\)\(^5\) Therefore, compared to the CLC and HNS, a large part of the burden of liability for compensation is removed from the registered owner and consequently from his insurer, since the direct action is allowed only against the insurer of the registered owner when the insurance is compulsory. The Convention shall enter into force when it obtains 18 ratifications.

### 3.3. e. Protocol to the 1974 Athens Convention relating to the Carriage of Passengers and their Luggage by Sea, 2002

In November 2002 a new Protocol to the Athens Convention was adopted which introduced compulsory insurance for passengers’ death and personal injury claims with the possibility of a direct action. This Protocol will enter into force 12 months after 10 States have adhered to it and for them it will replace the old Athens Convention. The insurance (or other financial security) is compulsory for any carrier who actually performs the whole or a part of the (international) carriage of passengers (on a ship licensed to carry more than 12 passengers) to cover liability under the amended Convention in respect of the death of and personal injury to passengers. The limit of the compulsory insurance is minimum 250,000 SDR (340,000 USD) per passenger on each distinct occasion.\(^7\)\(^6\) Basically it is the shipowner, charterer or ship operator actually performing the carriage who must maintain the compulsory insurance, whether or not the contract of carriage was made by him (or on his behalf).\(^7\)\(^7\) The carrier’s liability for death and personal injury\(^7\)\(^8\) is different depending on whether it occurred

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\(^7\)\(^4\) Art III.4, CLC 1992 and Art. VIII.5, HNS 1996.

\(^7\)\(^5\) Art. I.3 and Art III.1 and 2, Bunkers Convention 2001.

\(^7\)\(^6\) Athens Convention as amended by the 2002 Protocol: Art. 4 bis, paragraph 1.

\(^7\)\(^7\) Ibid, Art. 1. (a), (b) and (c).

\(^7\)\(^8\) Ibid, Art. 3. 1 and 2.
in relation to a “shipping incident”79 or not. Consequently, the insurer’s liability towards the third party claimant in a direct action will be equal to that of the actual carrier. The minimum amount that must be insured per passenger on each distinct occasion is the same as the limit for strict liability of the carrier for death and personal injury caused by a shipping incident.

The direct action is allowed against the insurer or other person providing compulsory financial security. The latter can always invoke limitation of liability up to 250,000 SDR even when the actual carrier is not entitled to it. They may also invoke all the defences (other than bankruptcy or winding up) that the carrier would have been able to invoke such as the exemptions from the carrier’s liability or the time-bar. They may not invoke any defence they would have against the insured, except the defence that the damage was caused by the carrier’s (insured’s) wilful misconduct. In any case they can always require the carrier and the performing carrier to be joined in the proceedings.80 The direct action can be brought at the option of the claimant before one of the courts where the proceedings against the carrier (or the performing carrier) can be instituted.81

At the Diplomatic Conference in December 2002, the introduction of compulsory insurance and the direct action into this Protocol was no longer such a revolutionary issue. The majority of governments were principally in favour of it. The debates were mostly going on about the limits of liability and the defences that may be used in such action. Certain interest groups such as International Group of P&I Clubs82, International Council of Cruise Lines (ICCL)83, Comité Maritime International (CMI)84 and International Union of Marine Insurance (IUMI)85 expressed their deep concerns regarding the solution in the Protocol. Liability for death and personal injuries of the passengers by its nature is different than the formerly presented extra-contractual liabilities of the shipowner and brings in very different implications. Firstly, modern passenger ships carry thousands of passengers daily and they are often more similar to some kind of moving hotels rather than traditional vessels. The number of the claims for personal injuries arising from even a minor incident is therefore very high.

79 Ibid, Art. 3. 5 (a) and (c).
80 Ibid, Art. 4 bis, paragraph 10.
81 Ibid, Art. 17. 1 and 2.
84 LEG/CONF.13/17, 2 October 2002.
85 LEG/CONF.13/10, 22 August 2002.
The passenger carriers normally insure their liability for these claims mostly with P&I Clubs that offer unlimited cover, and there is an internationally well-established system based on the years of experience. With the introduction of compulsory insurance and the direct action under this Protocol, the cumulative effect of the new insurance requirements is immense. There were suggestions that the compulsory insurance and the direct action should be limited to the claims for death and personal injury arising from shipping incidents (collisions, defect in the ship, stranding, capsizing, etc.) for which there is strict liability, while the rest should be left to the freedom of contract. Moreover the limit of 250,000 SDR is much higher than in any other branch of transport. A question is posed whether there is capacity in the existing insurance market. There are concerns about the availability and sustainability of cover. This is very likely going to call for alternative solutions regarding the insurance formulas. Finally, the costs of the insurance and reinsurance policies will grow and so will the prices of the tickets. How will it affect the competitiveness in relation to the other means of transport? The Norwegian delegation, on the other hand, submitted a study and statistics showing that it is possible for the industry to arrange for the fulfilment of the new insurance rules and meet the new requirements.

3.3. f. Draft Convention on Wreck Removal

Currently, the IMO Legal Committee is working on a draft convention regarding liability and compensation for the removal of maritime wrecks. The diplomatic conference is expected to take place during 2004-2005.

This draft convention imposes strict liability on the owner of the wrecked ship for the costs of locating, marking and removing the wreck with the possibility of proving one of the 3 well known exemptions. He may limit his liability under any applicable national or international regime. Once again, the owner of a ship over a certain length is obliged to maintain insurance (or other financial security) to cover his liabil-

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87 For example, under the 1999 Montreal Convention the limit for compulsory insurance of liability for the death of and personal injury to passengers in civil aviation is 100,000 SDR. However, there were submissions showing that the higher limits were justified due to the inflation rates.
88 Insurance and Statistics (Norway) LEG/CONF.13/8, 30 August 2002.
89 Draft Convention on Wreck Removal, Art. 11.
90 See comments to the similar provision in Bunkers Convention, chapter 3.3. d. supra.
ity under this convention.\(^91\) The direct action formula with the limited defences is the one from the CLC, HNS and the Bunkers Convention.\(^92\) Like in the Bunkers Convention, the limits of liability that can always be invoked by the insurer (regardless of whether the shipowner has lost the right to rely on them) are uncertain and depend on the applicable law. The competent jurisdiction for any claim arising from this convention is that of the State where the damage occurred. It could be that the inclusion of wrecks in the list of hazards covered by compulsory insurance and the direct action is seen similar in nature to the oil or chemical spills in that it may involve the leaving of waste upon the shores of an “otherwise innocent nation”.\(^93\) However the draft does not limit this regime to such grave circumstances. Moreover, the rule that in a direct action the insurer may not invoke any defence (other than wilful misconduct) that he might have had against the insured has specific implications in this particular context. Namely, breach of class requirements or other shortcomings on the part of the insured (which are not outright wilful misconduct) may not be invoked as a defence by the insurer even though they actually caused the wreck. Consequently it appears that under these draft provisions the shipowner could neglect the upkeep of his ship with impunity and in the event of a wreck the marine insurers would still be responsible to pay up to the applicable limits of liability, not being entitled to raise these defences in a direct action.\(^94\)

3.3. g. Liability and Compensation regarding Claims for Death, Personal Injury and Abandonment of Seafarers

The fact that insurance of liability for maritime claims is attaining a strong social character under the political pressure of the international public policies is also reflected in the 2 IMO resolutions and guidelines on shipowners’ responsibility for crew claims. Namely, IMO Assembly at its 22\(^{nd}\) session (November 2001) adopted the Resolution and Guidelines A.930 (22) on Provision of Financial Security in Case of Abandonment of Seafarers and the Resolution and Guidelines A.931 (22) on Shipowners’ Responsibilities in Respect of Contractual Claims for Personal Injury or Death of Seafarers. Both these instruments contain provisions that the shipowners should maintain effective insurance for the respective liabilities. Consequently they were also adopted by the Governing Body of the ILO (International Labour Organisa-

\(^92\) Ibid, Art. 13.9.
\(^93\) R.P. Hayden, op. cit. at fn 54, p. 19.
\(^94\) Ibid, p. 18.
tion) at its 282nd session. They are not mandatory, but recommendatory in nature. Their implementation is being monitored by a joint IMO/ILO Ad Hoc Expert Working Group on Liability and Compensation regarding Claims for Death, Personal Injury and Abandonment of Seafarers. It is likely that these instruments are an interim solution to be followed by a new convention that will introduce compulsory insurance and the possibility of direct recourse from the insurer for the respective claims.

Finally, the growing tendency towards the social element of marine insurance where the role of liability insurance is to benefit the third party “victims” rather than the shipowners is specifically reflected in the IMO Resolution and Guidelines A.898(21) on Shipowners’ Responsibilities in Respect of Maritime Claims of 25 November 1999. This instrument was a result of ongoing discussions in the IMO Legal Committee where there had initially been an intention to create a convention to deal with the compulsory financial security for shipowners’ liabilities. The purpose is to invite the member States to urge shipowners to comply with the guidelines, i.e. to maintain effective mechanisms of financial security for all maritime claims contained in the 1976 Convention on Limitation of Liability for Maritime Claims including any amendment that is in force internationally.

4. DIRECT ACTION IN COMPARATIVE MARINE INSURANCE LAW

4.1. The United Kingdom

In the UK, prior to the 1930 Act, the injured person was not entitled to look into the insurance proceeds of its wrongdoer that became insolvent and therefore unable to satisfy the judgement debt. The 1930 Act introduced a general system of subrogation, marking a change in the philosophy concerning liability insurance in the UK. This Act came about at the time of the proliferation of motor liability where it was considered unjust that innocent persons were frequently left without compensation due to the insolvency of the persons liable. The 1930 Act applies to all contracts of insurance under which a person is insured against liabilities to third parties. The

97 See supra, pp. 36, 49, 51.
99 S. 1(1), 1930 Act.
statutory subrogation arises in the event of the insured’s insolvency (bankruptcy or liquidation). The effect of the subrogation is that the contractual rights of the insured against his insurers are transferred to and vested in the third party who suffers the liability insured. 100 Therefore the insurers become liable to the third party and their liability is the same as it would have been towards the insured. Any condition in the policy purporting to avoid the policy, directly or indirectly, or to alter the rights of the parties under the policy, in the event of the insured’s insolvency is void.101 To succeed, the third party must establish:

- the existence of a contract of insurance between the insured who has incurred liability and the insurer,
- that the liability incurred is covered by the relevant contract of insurance,
- that the insured has been made bankrupt or closed in liquidation or put in a similar position, as contemplated in the Act,
- that the rights of the insured against the insurer can effectively be transferred,
- that the third party can successfully counter any defences which the insurer might put up against him under the terms and conditions of the insurance contract (or the rules of the P&I Club)102

A number of difficulties arise in the application of the 1930 Act due to the interpretation of the English courts. For example, to establish that there is particular liability of the insured the third party must have obtained evidence of a judgement of the court, or of an award in arbitration or of an agreement (settlement). This can be extremely cumbersome especially in combination with the insolvency requirement. If a company is already wound-up, before a judgement or an award can be obtained the company must be restored to the register, a procedure that is subject to specific time-bars. Where the insured is not yet wound-up and a judgement against him has been obtained, to be able to proceed against the insurer the third party must first obtain a winding-up order of a court in the UK (in respect of the insured) to satisfy the statutory requirement of insolvency. This can be troublesome when the insured is a foreign company. Even if all these requirements are satisfied it is frequently impossible to counter all the insurer’s defences, many of which are predominantly of a formal nature.103 This has given rise to a reform of the 1930 Act104 since it was felt unjust that

100 S. 1(1), ibid.
101 S. 1(3), ibid.
104 UK Law Commission’s Report, op. cit. at fn 8.
purely formal requirements are frequently a hurdle to a successful direct action of third parties which was not the original intention of Parliament.\footnote{105}

When the 1930 Act is applied to marine liability insurance, particularly to insurance cover offered by P&I Clubs, the largest hurdle for a successful direct action are the defences of the Club on the basis of the Club’s rules being basically the terms of contract between the Club and the member. The leading judgement is a decision of the House of Lords in the case \textit{The “Fanti” and “Padre Island”} of 1990.\footnote{106} This judgement finally established that the direct action against a P&I Club cannot succeed due to the application of the “pay to be paid” rule.\footnote{107} In the event of insolvency the insured will not have discharged his liability (by effecting payment to the injured party), meaning that the condition precedent for the insurer’s obligation to pay is not satisfied, therefore there is no right to an indemnity. The right to an indemnity under such P&I cover is an inchoate (contingent) right. The insured will have a claim only after he has discharged the liability. Since the rights transferred to the third party are no better than those of the insured, the third party will not have a claim against the insurer. The judgement established that the “anti-avoidance” section 1(3) of the 1930 Act does not render these clauses void.\footnote{108} Consequently, in any insurance contract containing a similar clause the defence would be successful. It is argued that it is unlikely for commercial insurance companies to include such clauses in their standard policies since that would render them commercially unattractive so there is no fear of their abuse. Moreover it is undesirable to use this defence when the claim is for death or personal injury, and the practice in the UK shows that indeed the Clubs do not use it in such cases. However, at strict law, there is nothing to prevent the clause to be used to decline any claim. Therefore it was felt that there was a need for a legislative remedy. The reform of the 1930 Act proposes, \textit{inter alia}, that the functioning of the “pay first” clauses be nullified in all cases except where the insurer is a P&I Club, and even then if the claim is for death or personal injury. The drafters did not want to intervene in the field of marine insurance of liability not to create conflict with any international rules, having in mind that the outcome of the described developments on the international level is yet to follow.\footnote{109}

\footnote{105}A. V. Padovan, Direct Action of a Third Party Against the Insurer in Marine Insurance with a Special Focus on the Developments in Croatian Law, \textit{PPP god.} 42 (2003) 157, 35-83


\footnote{107}The “Fanti” and “Padre Island”, op. cit. at fn 4.

\footnote{108}See supra, chapter 3.2. Direct Action in Voluntary Insurance.

\footnote{109}The section makes void any contract of insurance in so far as “it purports, whether directly or indirectly, to avoid the contract or to alter the rights of the parties thereunder” on a statutory transfer. The argument that “pay first” clauses have such effect was used in the judgments of the lower instances, which were overruled by the decision of the House of Lords.

\footnote{109}UK Law Commission’s Report, op. cit. at fn 8, pp. 51-54.
In the special context of liability for oil pollution, the Merchant Shipping Act 1995 makes insurance compulsory upon the owners of tankers registered in the UK or entering or leaving ports or terminals in the UK or its territorial waters, and enables an injured party to sue the insurer directly even where the insured is fully solvent.\(^{110}\) The Act incorporates the provisions of the CLC 1969/1992.\(^{111}\) Furthermore, in 1997, the UK incorporated the provisions of the HNS 1996 Convention\(^{112}\) in the 1995 Merchant Shipping Act,\(^{113}\) but since that Convention has not yet entered into force, the relative provisions are also not yet enforceable. The operation of the 1930 Act in these cases is excluded.

4.2. The United States

Most American jurisdictions that have the direct action outlaw clauses such as "pay to be paid". Many of them just require a claimant to proceed against the insurer after first obtaining a final judgement against the insured. Legislation mostly negates "pay first" (known as the "no-action" clause) clauses as being against the public policy.\(^{114}\) Some states even forbid the issue of an insurance policy without an express provision that "the claimant shall have a right of action against the insurer in the event of the insured’s insolvency."\(^{115}\) The famous Louisiana Statute that is directed towards liability, as opposed to indemnity insurance proclaims the difference in the philosophy between these two types of insurance, liability insurance being executed for the benefit of all injured persons to whom the insured is liable. The case law shows that the Louisiana Statute applies to the P&I policies which may be directly attacked by third parties, since the Statute applies to all contracts of marine liability insurance; and the “no-action” clauses are expressly void under the Statute. The issue is that the P&I policies are not distinguished as indemnity insurance, but equated with all other liability insurance.

\(^{110}\) UK Merchant Shipping Act 1995 (c. 21), sections 163-165.

\(^{111}\) See supra, chapter 3.3.b.

\(^{112}\) See supra, chapter 3.3.c.

\(^{113}\) UK Merchant Shipping and Maritime Security Act 1997 (c. 28), sections 14-16 and schedule 3 (Provisions to be inserted as Schedule 5A to the Merchant Shipping Act 1995).

\(^{114}\) Saunders v. Austin W. Fishing Corp. [1967] A.M.C. 984: the court held that such a clause was unenforceable as being against the public policy and in this case a seaman suing under the Jones Act was able to recover directly from the insurers.

However a New York Court has criticized this approach as ignoring the difference between liability and indemnity policies. Moreover the Direct Action Statute of New York explicitly excludes P&I insurance from its Direct Action section.

Typically compulsory insurance and the direct action are envisaged for oil pollution liability in the Oil Pollution Act 1990.

4.3. France

Article L173-23 of the French Insurance Code provides as follows:

“The insured shall be entitled to reimbursement under liability insurance only if the wronged third party has been compensated and to the extent thereof, unless the insurance compensation is allocated to form the limitation fund…”

The French courts have interpreted this provision as conferring the right of a direct action against the marine liability insurer. In practice most debates turn on the issue of what law should be applied to determine whether a direct action is admissible or not. The position seems to be that whenever a loss has arisen in France, irrespective of whether the underlying third party’s claim is in tort or in contract, the French law is to determine whether a right of direct action exists against a P&I Club, even when the law governing the respective contract of insurance does not provide for such right. In France there seems to be no clear view on the question to what extent should the terms of the insurance contract be binding on the third party. The practice is inconsistent and mostly does not uphold the P&I Clubs’ rules as their defence to restrict the right to a direct action. The prevailing tendency appears to be that of the underlying public policy to protect the “innocent victim” rather than the basic principles of contract law.

As regards the direct action in the context of compulsory insurance, France is a party to the CLC 1969/1992.

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116 New York Insurance Law.
119 “Hakki Morgul”, Rouen Commercial Court, 1988; cited from O. Purcell, ibid.
120 O. Purcell, op. cit. at fn 118.
4.4. Malta

In Maltese marine insurance law there is no general provision that would allow the direct action. Such right is only recognized in the context of liability for oil pollution damage. Malta is a party to the CLC 1969/1992; therefore insurance for oil pollution damage is compulsory as prescribed in the Convention and accordingly there is a direct action formula.\textsuperscript{121} In addition, there is another compulsory insurance under the Maltese marine insurance law. Namely, the shipowner must maintain an insurance policy to cover:

a) liability for expenses (funeral, medical care, maintenance, etc.) related to the death, injury or illness of a crew member;
b) liability to pay compensation or damages in accordance with Maltese Law in relation to the injury, illness or death of a crew member;
c) liability for repatriation and abandonment of the crew members;
d) liability for wages payable to the injured or sick crew member or on death to his estate;
e) liability for loss or damage to the personal effects of the crew.\textsuperscript{122}

The aim of the provision is to protect seamen employed on Maltese ships, particularly those who are foreign and therefore not covered by the provisions of the Maltese social security legislation. However the right to a direct action in this particular context is not conferred.

4.5. Slovenia

In Slovenia marine insurance law is regulated by the Maritime Code. The provisions of the general law of obligations relating to insurance contracts expressly exclude the contracts of marine insurance from their application. The relevant provision in the Maritime Code regulating the insurance of liability is article 739. The same article allows a third party suffering damage caused by the insured in connection with the operation of the ship to claim compensation directly from the insurer of liability, but only up to the amount of the insurer’s obligation and only when that insurance of liability is compulsory. If the liability is insured up to a specified amount, the compensation can be given only up to the amount insured.\textsuperscript{123}

\textsuperscript{121} Oil Pollution (Compensation and Liability) Act, [CAP. 351], The Laws of Malta.

\textsuperscript{122} Merchant Shipping Act [CAP. 234.], The Laws of Malta, Article 168A.; see also subsidiary legislation: Merchant Shipping (Protection of Seamen) Regulations (LN 255 of 2002) under the Merchant Shipping Act.

\textsuperscript{123} The Maritime Code of the Republic of Slovenia (Ur. l. RS 26/2001), Art. 739.
In the Maritime Code there is only one prescription for compulsory insurance of liability and that is the one for oil pollution damage in accordance with the CLC 1969/1992.\(^{124}\) However the direct action formula for this particular liability is specifically provided in a separate article which replicates the respective provision of the Convention.\(^{125}\) The question is then what compulsory marine insurance does the general provision on the direct action from article 739. apply to. There is another compulsory insurance of liability in the last amendment to the Law on Compulsory Insurance in Traffic which could be regarded as a special case of marine insurance. Namely, the latter Law introduces compulsory insurance of liability of the owners of small waterborne craft for damage caused to third persons. This insurance is compulsory for the owners of registered motor-powered boats with an engine power higher than 3.7 kW.\(^{126}\) However, the right to a direct action and the liability of the insurer in this context is regulated in the same Law on Compulsory Insurance in Traffic.\(^{127}\) The question of the intention of article 739. of the Maritime Code therefore remains open. It may be assumed that it is there as a reflection of a general principle that a direct action may only be admitted against the insurer of liability if the insurance is compulsory. The provision would apply to any potential compulsory marine insurance that may be introduced in the future.

5. DIRECT ACTION IN CROATIAN MARINE INSURANCE LAW

In Croatia general insurance law is regulated under the Law of Obligations and the Law of Insurance. However marine insurance contracts are expressly excluded from the application of the Law of Obligations and are governed by the Maritime Code which is a \textit{lex specialis}. The relevant provisions of the Law of Insurance apply as well.

\(^{124}\) Ibid, Art. 128.

\(^{125}\) Ibid, Art 835.


\(^{127}\) Ibid, Art 33d. in conjunction with Art. 20.
5.1. The Present Position (de lege lata)

5.1. a. Compulsory Insurance

Croatian law distinguishes between compulsory and voluntary insurance of liability. Generally compulsory insurance is regulated in the Law of Insurance. The legislator in this way protects the individuals, their physical integrity, life and property, by ensuring some kind of guarantee that they will be compensated for the damage suffered. The fundamental characteristic of compulsory insurance is that it protects the interest of the injured parties, rather than the interests of the insured. For this reason the terms of coverage, the minimum insured amounts and the prices of the premia are not subject to contractual agreement. There is a right to a direct action and a third party claimant is therefore in a position which is independent from the relationship between the insurer and the insured. The insurer as a defendant in a direct action may not rely on any of the defences he would have had against the insured on the basis of the insurance contract (e.g. deductibles, non-payment of premia, etc.) or on the basis of a statute. Nor may defences such as the wrongful intent or gross negligence of the insured be invoked, although normally damage caused by such misconduct is excluded from insurance under the law.

The Law of Insurance, inter alia, prescribes compulsory insurance of liability of the owners or users of motor-powered boats (registered sport and pleasure craft with an engine power higher than 15 kW) for damage caused to third persons (for personal injury, death and damage to health). However there was an omission in legislative

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128 The Law of Insurance (NN 46/1997), Chapter VI on Compulsory Insurance.
129 Ibid, Art. 76, 85, 103, 104.
132 Other compulsory liability insurances under this Law are motor liability insurance, aviation insurance and insurance of passengers in public transport. There are a number of other compulsory insurances under different special laws.
133 The Law of Insurance, op. cit. at fn 128, Art 75.4. and Art. 104.
134 Zaninović, Z., op. cit at fn 130, pp. 18-19.
drafting so that the direct action was not expressly prescribed for that case of compulsory insurance, even though by way of analogy it is clear that it was envisaged.

In the Maritime Code there are two special cases of compulsory insurance of the shipowner’s liability. First is the liability for oil pollution damage on the basis of the CLC 1969/1992. The direct action formula with the limited insurer’s defences from the Convention is contained in a specific provision thereof. It should be remembered that here the wilful misconduct defence is allowed. Second is compulsory insurance of liability of the operators of nuclear-powered ships. The direct action is expressly allowed, but there is no detailed provision determining the position of the claimant in relation to the insurer and the defences available to the insurer. It is correct to assume that the claimant’s position should be treated according to the above-described general principles of compulsory insurance. These provisions are obviously inspired by the 1962 Convention.

5.1. b. Voluntary Insurance

The Maritime Code regulates marine insurance contracts of liability which are based on the free will of the parties. A shipowner (including any operator or manager of a ship) may insure his liability (both contractual and extra-contractual) for damage caused to third persons in relation to the operation of the ship. The Code introduces an unconditional right to a direct action against the insurer of liability which therefore does not depend on the impossibility of obtaining compensation from the liable insured person (e.g. due to bankruptcy or liquidation):

“Art. 756.
2. Third party, […], may claim an indemnity directly from the insurer for the damage or loss sustained in an event for which the insured is liable, but only up to the amount of the insurer’s liability.

4. Where the contract of insurance provides an amount for which the liability is insured, the indemnity shall be paid only up to the amount insured.”

137 Ibid, Art. 858.
139 See supra, chapter 3.3. a.
140 The Maritime Code, Art. 697.1.(3) and Art. 756. - 758.
The insurer may rely on the same limitation of liability as the insured:

4. The insurer of liability for claims subject to limitation according to the provisions of this Law, shall be entitled to avail himself of the benefit of this part of the Law to the same amount as the insured person.”

Unlike in compulsory insurance (where there is hardly any contractual freedom and the position of the injured party against the insurer is independent of the contractual relationship of insurance); here the relationship between the third party claimant and the insurer continues to be governed by the contract of insurance. Therefore the insurer may rely on any defence on the basis of the contract or on the basis of the statutory provisions. His liability towards a third party is within the limits of his liability towards the insured. Furthermore the insurer may raise any defence that the insured would have had against the third party. Basically two groups of defences may be identified, first being those arising from the contractual relationship between the insurer and the insured and second being the respective relationship (contractual or tortious) between the insured and the third party. Unfortunately the courts in Croatia sometimes confuse the nature of voluntary insurance with that of compulsory insurance. This results in the incorrect interpretation of the relevant provisions of the Maritime Code and the incorrect application of substantive law on the respective relationships between the insurer, the insured and the third party claimant. The legislator should keep this in mind and deal with it in a clearer manner in order to reduce the possibility of incorrect interpretation.

The same unconditional right to a direct action against the liability insurer exists in the general insurance law under the Law of Obligations. In marine insurance the right to a direct action was introduced with the 1994 Maritime Code. It had never existed under the previous Croatian maritime law and at that point it brought about heavy debates in the maritime law circles. The supporters of the direct action based

142 See supra, chapter 2.3. Position of the Third Party Claimant when the Direct Action is Admitted.
143 Zaninović, Z., op. cit at fn 130, para. 2.2, pp. 29-38.
144 The Law of Obligations, Art. 941.1.
their argument on the necessity of the additional protection of the claimants due to the ever more frequent bankruptcies and liquidations of shipping companies. This was particularly true for the Croatian companies in the transitional period and the process of privatisation. The new reform\textsuperscript{146} of the Code once again brought about discussions on the same topic.

5.2. The Proposed Amendments under the Current Reform of the Maritime Code (de lege ferenda)

The proposed amendments to the direct action provision are as follows: the direct action is to be allowed

\begin{itemize}
  \item[a)] in compulsory insurance of liability;\footnote{147} and
  \item[b)] in voluntary insurance of liability when the claim is for death and personal injury of a crew member according to the relevant provisions of the Maritime Code.\footnote{148}
\end{itemize}

Again the claim can be made only up to the limit of the insurer’s liability.\footnote{149} Furthermore, a new paragraph is proposed clarifying that when the direct claim against the liability insurer is for death and personal injury of a crew member, the insurer may invoke all the defences which he is entitled to bring against the insured on the basis of law or on the basis of the insurance contract. On the direct action in compulsory insurance, the rules of general insurance law apply.\footnote{150}

The proposed amendments deserve criticism on several points. Firstly, as a matter of general principle, legal consistency and the practical implications discussed in the previous chapters, it only makes sense to allow the direct action in compulsory insurance. The liability for crew claims for death and personal injury is insured voluntarily under Croatian law. If these types of claims are considered to deserve utmost

\footnote{146} See note 1. \footnote{147} This apparently is to be introduced to cover the owners of motor-powered pleasure craft. - Čorić, D, op. cit at fn 145. \footnote{148} Liability for loss caused by death and personal injury of crew members is regulated in Art. 161. of the Code. \footnote{149} If a P&I insures only the costs of medical treatment, repatriation, funeral expenses (which is usually the case), that is all that will be recoverable in a direct action, even though Croatian law provides for more generous compensation including non-material damage and loss of earnings. All that is in excess of the P&I cover will have to be claimed in an action against the shipowner, and not in the direct action. \footnote{150} See supra, chapter 5.1. a. Compulsory Insurance. \footnote{151} See supra, chapter 2. Generally on Direct Action; chapter 3. Applicability of the Direct Action in the Context of Marine Insurance of Liability.
social protection the legislator should, following the same argument, prescribe compulsorily insurance for the respective liabilities. However compulsory insurance may only be imposed upon and enforced in respect of the operators (or owners) of Croatian ships. Since there are not many Croatian ships and Croatian seamen are mostly employed on foreign vessels, compulsory insurance would not have a wider effect. The only way to enforce compulsory insurance on foreign ships is through port State control. All ships calling at Croatian ports would be obliged to carry a certificate attesting to the provision of adequate financial security for the respective claims. In that case at least the insurers would be aware of their exposure upon the exercise of a direct action against them. But such course of action would itself most probably adversely affect the competitiveness of Croatian ports.

Secondly, even if one insists on allowing the direct action in voluntary marine liability insurance, this can only be justified in the cases where compensation cannot be obtained from the insured (for instance, due to insolvency).\(^1\) The current proposal entirely ignores this consideration. With a provision like this, in practice virtually all claims would be first directed against the insurer since that is far more convenient, expedient and much less expensive.

Thirdly, if the insurer may invoke all the defences under the contract of insurance (as proposed), one of these will almost certainly be “pay to be paid” which means that the action will fail. Therefore, if one wishes to be consistent on this point, the “pay to be paid” defence would have to be nullified by an express provision. Furthermore, in the amendments there is no mention of the insurer being entitled to the defences that the insured would have had against the third party claimant on the basis of the original cause of action. This omission could be misleading, especially since there is an express provision allowing the defences on the basis of the insurance relationship. This could lead one to think that no other defences may be invoked. Not even the article on the subrogation of the insurer\(^2\) resolves this issue since it requires, as a condition for subrogation, that the insurer has paid the indemnity. Therefore, for the purpose of clarity, the amendment should have expressly envisaged the availability of the insured’s defences to the insurer.

Finally, together with the conflict of law provisions (as they will be presented hereunder), the effect is such that it allows the Croatian courts to assume jurisdiction and apply Croatian law very widely whenever the claimant is a Croatian seafarer. This would mean that the P&I Clubs of virtually all shipowners employing Croatian crew would become exposed to the direct action in Croatian courts and under Croatian

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1. See supra, chapter 3.2, Direct Action and Voluntary Insurance.
2. The Maritime Code, Art. 736, para. 1.: “By payment of the indemnity all rights of the insured against third parties in respect of the loss for which the indemnity has been paid shall be transferred to the insurer, but only up to the amount paid.”
substantive law. This could lead to an internal policy within the P&I Clubs to encourage their members not to employ Croatian crew. Shifting the burden unilaterally on the foreign shipowners and their insurers through over-protective laws is a shortsighted solution which will ultimately result in the uncompetitiveness of the domestic industry.

To conclude, it is submitted that the direct action should be allowed only when the insurance is compulsory. It is suggested that the direct action formula be prescribed separately for each case of compulsory insurance under the Maritime Code.\textsuperscript{154} The direct action in the case of compulsory insurance of the owners of motor-powered sport and pleasure craft should be regulated in the Law of Insurance and not in the Maritime Code.\textsuperscript{155}

5.3. Conflict of Laws Issues

5.3. a. Jurisdiction of the Croatian Courts

The general rule is that the courts will have jurisdiction where the defendant (in our case being the insurer of liability) is domiciled in Croatia, which for legal persons would mean that they have their principal place of business in Croatia. In addition to that, in all cases where the damage (whether contractual or tortious) giving rise to a claim occurs in the territory of Croatia, or the damage is identified or the consequences of the tortious act are felt in Croatian territory, the Croatian courts will have jurisdiction over the insurer of third party liability on the basis of the provisions on the direct liability of the insurers.\textsuperscript{156} Specifically, if the claim is for death and personal injury, the Croatian courts will have jurisdiction whenever the claimant is domiciled or habitually resides in Croatia.

5.3. b. Applicable Law

Once the Croatian courts have established their jurisdiction according to the rules described above, they will decide on the admissibility of the direct action on the basis of Croatian law, since the direct action is a procedural remedy given to the third party.

\textsuperscript{154} Oil pollution, nuclear damage.

\textsuperscript{155} See supra, chapter 5.1 a. Compulsory Insurance.

De lege lata, as was presented, the direct action under the Maritime Code is admissible in all cases, unconditionally. Where the insurance is compulsory under Croatian law, and therefore compensation is a primary objective and the contractual freedoms are taken away from the parties including obviously the choice of applicable law, the defences available to the insurer upon the direct action will be determined by the relevant provisions of Croatian law. To a certain extent the insurer is statutorily made a guarantor of the insured and is liable to a third party together with the insured. However where the insurance is voluntary the parties to the insurance contract have the freedom, inter alia, to choose the applicable law. In default of an express choice of law, the applicable law is the law of the principal place of business of the insurer. Having this in mind and all that was said in connection with voluntary insurance, the applicable law for the defences arising from the contract of insurance would be the law of the contract, since the insurer’s liability may only be established on the basis of the insurance contract. On the other hand, logically, the defences that the insurer may invoke on the basis of the relationship between the primarily liable insured and the injured third party should be determined by whichever law is applicable to that relationship, be it contractual or extra-contractual. De lege ferenda, the only voluntary marine insurance where the direct action is admissible is for death and personal injury of crew members. The proposed amendments to the Maritime Code include also new provisions on the law applicable to the legal relationship arising from the contracts of employment of crew members:

Art. 993. (Proposal to amend)
1. For the private law relationships arising from the contract of employment of crew members, the applicable law is the law that the parties choose.
2. In default of an express choice of law, the applicable law is the law of the ship’s nationality, unless the circumstances of the case refer to another law which legally and factually has a closer link with the respective relationship and the parties.
3. The application of paragraphs 1. and 2. of this article does not exclude the application of the compulsory provisions of the law of the closest link regarding death and personal injury of a crew member if they are more favourable for the crew member.

Therefore it is likely that the compulsory provisions of the Maritime Code regarding death and personal injury of a crew member which are very favourable for the claimant, will apply when the claimant is a Croatian seafarer. If a seaman proceeds in

a direct action the insurer will be able to rely on the defences he has against the insured. These defences will be judged by reference to the law of the contract. The defences that the insured would have had against the crew member would be based on Croatian law.

6. CONCLUSION

The direct action is an action of an injured third party against the insurer of the wrongdoer’s liability. As a general rule a contract of insurance of liability is a res inter alios acta creating rights and obligations only between the contracting parties and no other person may benefit from it.

However some laws expressly grant a right of direct action to third parties who have suffered damage as a result of an act or omission or breach of contract of the insured, and this as additional protection that allows a quicker, simpler and more certain compensation. Usually this right is tied to compulsory insurance as a procedural tool. As a matter of public policy some subjects are obliged by law to maintain insurance for the liabilities they may incur towards third parties in connection with their activities. When so, the law itself prescribes most of the terms and conditions of such insurance and largely limits the parties’ contractual freedom. The insurer can be sued directly by the injured person and will be liable under similar or even stricter conditions as the insured. The insurer will not be entitled to raise any of the defences he would have had against the insured. The social element is transforming insurance into a contract for the benefit of third party victims and the insurers are attaining a role of guarantors. In international maritime law this concept is largely adopted in the system of liability and compensation for oil pollution damage through the wide application of the 1969/1992 CLC Convention. The trend is followed in the new international instruments regulating liability and compensation for maritime claims.

On the other hand voluntary insurance of liability is still strongly governed by the general principles of the law of contract. The insured enters into a contract to protect his own interest and not the interests of his potential creditors. If the insured incurs liability and has to pay for the compensation he will be reimbursed by his insurer. This is the main feature of indemnity insurance. The direct action therefore in this context comes as a very unnatural concept and, if at all, should be allowed only in exceptional cases. English law, for example, allows it only when the insured is insolvent. It can still make some sense in the traditional liability policies where the insurer promises to save the insured harmless by preventing him from loss and compensating the injured third person instead of him. However it becomes almost inconceivable in the indemnity policies which are mostly based on the “pay to be paid” principle,
where the liability of the insurer is triggered only after the insured has actually discharged his liability. The latter is the typical form of marine insurance of liability and is tied to the P&I system of mutual insurance. For these reasons the direct action is a controversial issue in voluntary marine insurance since it is hardly applicable unless the nature of these contracts and the general principles governing them are fundamentally changed. Even though some jurisdictions allow the direct action in voluntary marine insurance by expressly prescribing it in their laws, it is submitted that there is not enough legal or practical justification for it. It creates legal uncertainty and frustrates the legitimate expectations of the contracting parties, particularly when combined with the conflict of law rules. From a practical point of view it makes insurance cover more expensive and consequently raises the prices of services making them less available to the financially weaker subjects. It also puts in question the availability of the cover, since too big an exposure creates a disincentive for the insurers.

The reform of the Croatian Maritime Code that is currently being proposed should correct the patently unreasonable solution regarding the direct action which allows the application of such action unconditionally. The direct action should be allowed only in compulsory insurance and not in voluntary marine insurance. The seamen being identified as a critical group of claimants should be identified and eventually protected by compulsory insurance or through alternative means such as national social insurance. Legislative over-protectiveness at the expense of the employers will only render them uncompetitive on the international marine labour market.
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Sažetak:

**DIREKTNA TUŽBA TREĆE OŠTEĆENE OSOBE PROTIV OSIGURATELJA U POMORSKOM OSIGURANJU S POSEBNIM OSVRTOM NA RAZVOJ U HRVATSKOM PRAVU**

Direktna tužba je tužba treće oštećene osobe protiv osiguratela štetnikove odgovornosti. Opće je pravilo da je ugovor o osiguranju odgovornosti res inter alios acta, te se pravo na direktnu tužbu može samo iznimno priznati zakonom. Direktna tužba se gotovo uvijek priznaje u obveznom osiguranju. Dobrovoljno pomorsko osiguranje odgovornosti funkcionira kroz P&I Klubove koji se temelje na uzajamnosti pa zbog svojih posebnosti teško podnosi široko priznato pravo direktna tužbe. Međunarodne pomorske konvencije o odgovornosti i naknadi tute uvelike uvode obvezno siguranje i pravo na direktnu tužbu zahvaljujući rastućoj socijalnoj osjećenosti. Tekuća reforma hrvatskog Pomorskog Zakonika također se bavi problematikom direktnu tužbe. Predložena rješenja su kritički prikazana.

Ključne riječi: Direktna tužba, pomorsko osiguranje, osiguranje odgovornosti, obvezno osiguranje, P&I Klubovi.