MORTGAGEES' INTEREST INSURANCE AND MORTGAGEES' POLITICAL RISKS & MORTGAGE RIGHTS INSURANCE

Hrvoje Kačić, redoviti
profesor Pomorskog fakulteta
u Dubrovniku

UDK 347.798.2:368.23
Izvorni znanstveni rad
Primljeno (received):
travanj 1991.

1. INTRODUCTION

My address is devoted to two different subjects and as seen from the title, these are the Mortgagees' Interest Insurance (hereinafter called MII) on the one side and the Mortgagees' Political Risks and Mortgage Right Insurance (hereinafter called PRAMRI) on the other side. Although they represent two completely different types of risk insured, and are always embodied in two separate contracts of insurance and defined by the conditions agreed between respective parties, their similarities are evident.

In respect of the form of insurance contract, a common link is manifested in the fact that a Mortgagee is always in the position of the assured party who has secured the repayment of his loan granted to a debtor by a mortgage on a vessel or on an aircraft. For the sake of clarity, the term mortgage hereinafter corresponds to the term of contractual right of pledge as introduced in the Yugoslav Act on Maritime and Inland Navigation[1] or to the concept of hypothec in all other countries of continental Europe with the exception of Greece which recognizes both concepts, i.e. the Mortgage and the Hypothec. I assume that the differences between the mortgage and the contractual right of pledge and the hypothec respectively are known to the audience.

MII and PRAMRI are types of maritime or aviation insurances that have developed in the recent period as a very restrictive and poor surrogate for credit insurance.

[1] Official Gazette of SFRY No 22/77, April 22/77; amended Off. Gazette of SFRY No 30/85, June 21/85.

The credit insurance for loans given on the commercial market is gradually disappearing in the refinancing of vessels and aircraft as a result of the extremely high insurance premiums. Namely, in certain instances the rates of credit insurances were exceeding the profits achievable by the bankers. Therefore due to a fierce competition on the market and in order to improve profitability and competitiveness of financing circles (creditors) were not happy to transfer the greater share of the profit in the form of insurance premiums to the underwriters. Instead, the bankers turned to more selective criteria in granting loans, accompanying their facility offers with more sophisticated forms and types of securities. In many instances such securities remain concurrently in existence throughout the full loan repayment period.

Within such a framework, beside a very wide spectrum of principal or collateral securities, two completely new models emerged on the insurance markets, i.e. MII and PRAMRI, between the two world wars. Albeit both models of insurances, from the theoretical point of view, could be classified within the concept of credit insurance (»del credere«), it is important to note that neither MII nor PRAMRI can be considered as part of genuine commercial credit insurance contracts.

In my further presentation I will limit myself only to vessels and to a situation prevailing nowadays on the insurance markets in respect of MII and PRAMRI. Therefore I will not deal with the opportunities existing in certain countries regarding MII and PRAMRI supported by the Governmental or parastatal agencies and I will not refer any more to aircraft, although, to a large extent, whatever is elaborated in respect of vessels, can be implemented mutatis mutandis to aircraft as well.

2. ELEMENTS COMMON TO MII AND PRAMRI

Features common to both MII and PRAMRI can be summarized as follows:

a) The assured is the Mortgagee; generally, that means that the assured cannot be either the shipowner or the operator or the charterer or the manager of a vessel. Under the conditions of all insurance contracts, Mortgagees are qualified as »innocent Mortgagees« and only in certain instances (i.e. when the flag country of the ship is different from the citizenship of the registered owners) in the position of the assured may exceptionally appear an »innocent Owner« or an »innocent Lessor«;

b) For both models of insurance contracts under consideration, it is a condition precedent that the mortgage over the vessel is properly and definitively registered in conformity with requirements of the law of the flag country;

c) Insurances automatically terminate whenever war risks insurances cease to be in force in conformity with a termination clause of the contract governing the front line war risks insurance contract;

d) Insurances do not cover losses resulting from:

— any fluctuation in exchange rates between different currencies;

— deductibles and any other interest which remain self-insured;

— bankruptcy or insolvency of the debtor or mortgagor.

e) In the event that any claim or settlement is effected under the respective insurance policies, the assured is committed to subrogate to the underwriters all rights that the assured might have against any other party for the recovery under or in respect of mortgage and all other front line insurance policies existing in respect of the vessel in favour of the shipowner, operator manager and/or charterer.

It is interesting to note that when MII and PRAMRI enter into force no notification of assignment is required. However, under the respective subrogation clauses the underwriters will definitely not pay any amount to the assured unless, depending on the circumstances of the case, all appropriate assignments and notices including an acknowledgement are provided to the satisfaction of the underwriters.

f) It is quite common in entering into contracts for MII and PRAMRI to restrict the sum insured first to an amount not exceeding the total outstanding indebtedness and secondly to the market value of the vessel.

Whenever the market value of a ship is inserted in practice, a clear tendency is manifested that the market value of the vessel in sound condition is such as fixed at the time when the loan is granted. That means that the market value of a vessel at the time when the loss actually took place is not relevant any more. This issue has been under dispute in the well known Captain Pangos D.P. case;[2]

g) As time elapses the sum insured is gradually decreasing in proportion to the amount of loan instalments repaid. Accordingly, tractu tempore the premium rates due should be applicable only to the principal outstanding and should remain subject to adjustments either quarterly or semi-annually depending on the maturity dates of each instalment of the loan. The assured should identify such a calculation of premium at the time of placing the insurance and not leave it so that the premium rates are payable at the level of the outstanding loan at the time of yearly renewals of the respective insurance contracts;

h) All rights of the assured are lost and forfeited under insurance policies if the loss or damage is a result of the fault or privity of the assured;

i) MII and PRAMRI are always collateral insurance securities and can never exist independently as the front line insurances.

[2] »The Captain Panagos D.P.« Continental Illinois National Bank v. Bathurst, 1985, Vol 1. Lloyd's Law Reports 625.

3. BASIC DIFFERENCES BETWEEN MII AND PRAMRI

In spite of the fact that common features of MII and PRAMRI are quite numerous, there are many substantial differences between these two models of insurance contracts arising from the diversity of risks covered, and the purpose and scope of the two different and separate insurance contracts. This will be dealt with in detail herebelow under separate headings. Here we will limit ourselves just to mention the following:

Under MII the risks covered are determined in respect of the standard of behaviour of the shipowner/debtor or in other words in relation to the nature and degree of the shipowner's/debtor's faults causing him to lose his right to recover payment under the front line insurance policies. In short, it is a type of insurance contract aiming to protect the lender/mortgagee against misbehaviour or malign conduct of the shipowner.

On the contrary, in respect of PRAMRI the risks insured are related to and defined in respect of the standard of behaviour of the government or the state under which flag the vessel sails in all three functions of the state authority, i.e. legislative, executive (administrative) and judicial. In other words it is a type of insurance for the protection of a lender/mortgagee against misconduct or malign actions of a state or state agency.

Furthermore, an assignment or subrogation of the rights under MII and PRAMRI is not applicable and there is no space for an interrelated recovery between them, since the scope of risks covered does not have any mutual link or overlapping interests.

It is also worth noting that MII is not subject to a »confidentiality clause«, although by its substance it relates to the misconduct of the Mortgagor, while PRAMRI contains a socalled »confidentiality clause« although the Mortgagor remains »innocent« and risks covered are related to the misconduct of the State or Government.

Finally, a condition precedent for effectiveness of PRAMRI is that MII is already in full force. That means MII may be in existence independently of PRAMRI, which is in practice very often the case. On the contrary PRAMRI cannot be in force unless beforehand MII is properly in place.

4. MORTGAGEES' INTEREST INSURANCE

The basis of MII was devised in London practice to protect an innocent Mortgagee (yet not an innocent Owner or a Lessor) only after it had been decided by the House of Lords in Samuel v. Dumas (1924)[3] that the underwriters under a front line insurance policy were not bound to compensate the innocent Mortgagee whose name appeared in the insurance policy as a joint co-assured, because the effect of a fault committed with the privity of the owners (also being noted under the same policy as a coassured) gave to the Hull and Machinery Underwriters a right to decline any payment for

loss and damage sustained by the vessel insured. According to the circumstances of the case, the loss was caused directly by the privity of the shipowners. Since that decision was published, but particularly after the Second World War, quite a number of different sets of clauses had been drafted on the insurance market (in London as well as in the United States and Sweden) for covering MII. The wording of the respective various sets of clauses differred significantly depending on the draftsmen so that a satisfactory degree of standardization was not reached. It is not surprising that the Institute of London Underwriters had not offered to the market a standard form of the Institute Mortgagees Interest Clauses Hulls until May 1986.[4] Apparently, the Institute of London Underwriters did not feel it appropriate to embark upon the task of drafting standard clauses before some important issues as to the concept of MII had been tested before the Courts. This took place only in the eighties in two very illustrative cases discussed before the Courts in London, i.e. The Alexion Hope (1987)[5] and The Captain Panagos D.P. (1985) cases.

Although many passages of the above mentioned Court decisions are read with admiration, the significance of both cases is now largly historical because the relevant text in the respective MII contracts that had given rise to the Court disputes, was replaced and amended by a substitute wording which cannot provoke again a dispute at least as far as the specific issues already challenged are concerned. This is a clear example of how the market in Great Britain reacts, carefully taking care that commercial documents are relieved of ambiguities in order to avoid litigation as much as it is practically possible.

Consequently we now have the Institute Mortgagees Interest Clauses Hulls (30/5/86) in a standard form, and in my review I will refer further to the set of standard clauses as prepared by the Institute of London Underwriters.

The objective of MII is to protect an innocent Mortgagee in a situation when the Underwriters under front line insurance policies decline to pay loss or damage sustained by the mortgaged vessel because such loss or damage has been suffered by »any act or omission of one or more of the owners, operators, charterers or managers of the vessel or their servants or agents including breach or alleged breach of warranty or condition whether expressed or implied or non-disclosure or alleged non-disclosure of any fact or circumstances of any kind whatsoever.« (cl. 6.1.1.)

The indemnity to the assured is also extended in cases subsequent to non-payment under front line policies including P & I entries resulting from »any alleged deliberate, negligent or accidental act or omission or any know-

[3] House of Lords, 1924, LL3 211.
[4] Institute Mortgagees Interest Clauses 30/5/86, as published by Witherby & Co. Ltd., London, cl. 337.
[5] »The Alexion Hope«, Schiffshypotekenbank Zu Lubeck AG v. Compton, 1987 Vol. 1. Lloyd's Law Report 60.

ledge or privity of any one or more of the owners, operators, charterers or managers of the vessel or their servants or agents, including the deliberate or negligent casting away or damaging of the vessel or the vessel being unseaworthy«. (cl. 6.1.2.)

Under front line insurance contracts we do consider Hull and Machinery Policy, the Increased Value Policy, War Risks Policy, the Excess Liability Clauses and Protection and Indemnity Risks Policy, which by the Institute of London Underwriters are specified to the Institute Time Clauses or American Institute Clauses or any other insurance contract equivalent to the above mentioned set of clauses.

Preconditions for entering into force of MII are the following:

a) that a contractual debt in favour of the identified creditor (the assured under MII) is validly existing and the payment of which is secured by the duly executed Mortgage properly registered as the preferred mortgage with the relevant maritime authorities of the flag country. The Institute Mortgagees Interest Clauses are in standard form referring only to the First Preferred Mortgage which is equivalent to the first rank mortgage in other European countries. Nevertheless, our view is that by specific agreements between the parties, MII can also be applied to the second and subsequent mortgages provided the respective mortgages are supported by the appropriate front line insurances;

b) that in respect of the mortgaged vessel the insurance policies have been taken out and shall be maintained through the currency of MII;

c) that all rights under front line insurance policies have been duly assigned in favour of the Mortgagee and all notices and acknowledgements of assignments are executed as required under the governing law.

Cover under MII is of course cancelled if loss or damage is caused by the privity of the assured (Mortgagee) himself.

The essential particulars to be reported to the underwriters are the name of the ship, the name of the assured, the name of the shipowner, the names of the underwriters under front line insurances including the name of the P & I associations and the main particulars concerning the mortgage itself.

The time of payment of any amount remains a controversial issue as per conditions of the Institute MII Clauses Hulls (30/5/86). In addition to the situation that non-payment by the underwriters under the front line insurances is deemed to arise only when a final Court judgment is delivered in favour of the front line underwriters, clause 8.1.2. provides the following: »or at such earlier time as the Assured can demonstrate to the satisfaction of the Underwriters hereon that there is no reasonable prospect of the Owners and/or Assured succeeding in the claim against the Underwriters of the Owners' Policies and/or Club Entries. In the event of disagreement between the Assured and the Underwriters hereon this issue shall be referred to a sole arbitrator to be agreed upon between the Underwriters hereon and the Assured.«

The first section introduces an element which remains too discretional to the underwriters, because the elements »to the satisfaction of the underwriters hereon that there is no reasonable prospect...« contain a vague and weak obligation. If such an underwriter is not satisfied with the results of a »demonstration of evidence«, the relevant issues under dispute shall be referred to a sole arbitrator to be agreed between the parties concerned. Here again if the underwriters are not sufficiently cooperative in giving consent in the selection of a person to act as a sole arbitrator, the matter might be blocked and again made subject to the final Court judgment in a dispute between the front line underwriters and the Mortgagor and/or Mortgagee acting in the capacity of Assignee under Owners' Policies. Therefore we feel that it would be more efficient to add an appropriate wording in clause 8.1.2. with the tenor introducing a notion that if the parties fail to agree on a person to act as a sole arbitrator, the sole arbitrator will be appointed exempli gratia by the Chairman of the London Arbitration Association.

If the MII contract is amended to contain a specific period of time within which the underwriters under the MII policy are bound to pay the insurance proceeds, if the front line underwriters do not compensate the owners or mortgagees, in our view the MII contract is converted into the front line insurance and it might be qualified as elapsing out of the MII scope.

Otherwise terms and conditions as set out in the Institute Mortgagees Interest, in our opinion, represent a balanced reconciliation of interests between the Assured and the Underwriters spelt out in a consistent, fair and clear manner.

It is important to note that Institute Mortgagees Interest Clauses Hulls have explicitly provided that the relevant insurance contract is governed by the English Law and practice and so the Marine Insurance Act (1906) is incorporated together with all other relevant sources of the English Law.

5. MORTGAGEES' POLITICAL RISKS AND MORTGAGE RIGHTS INSURANCE

First of all it has to be mentioned that there is no standard set of clauses on the Mortgagees' Political Risks and Mortgage Rights Insurance commonly accepted in practice on a wide scale. However, there are certain forms of clauses drafted by the reputable insurance brokers' firms, which from time to time are amended or modified to suit the wishes of the parties involved, i.e. the Mortgagee (Assured) and the Underwriters. It is also worth noting that to the conditions of PRAMRI an additional document is sometimes attached under the name of »Memorandum of Understanding«[6] conta-

[6] C. Kjelgaard, The Merits of Merret, Airfinance Journal, London, May 1988, No 90.

ining clarification and interpretation of certain conditions mostly in relation to the country to which PRAMRI is taken over.

In spite of the research undertaken, to the best of our knowledge, there is no case to date in the marine insurance practice that any underwriter has paid any money under a PRAMRI policy. This is not because the underwriters are not ready to honour their obligations, but such a situation results from the fact that in shipping practice no case has developed where the risks identified in the PRAMRI insurance cover have been manifested. Shipping experience is different from that of aviation in which sector, as we have been informed, some payments were made. Furthermore, no case has been tested so far before any jurisdiction on the issue contained in the PRAMRI cover. This explains the very rare and limited literature, and save for very brief references on the subject in daily newpapers and magazines we were not able to trace any additional point of reference.

Our deliberations and comments are based on a certain set of clauses that from time to time circulate on the insurance market either in London or in the United States or in other West European insurance centers.

PRAMRI as a model of insurance has developed primarily in the aviation insurance in the seventies after the collapse of the oil prices, which brought financial difficulties to a number of oil exporting countries. As a result, the loans given to such countries or to the companies domiciled in such countries went into protracted default situations. Some of these countries, due to ideological and confessional doctrines, did not have any law or the normal functioning of the legal system was suspended. In some of these countries it is not possible to obtain judgments in the local Courts granting interest on the amounts due on the principal of the loans granted.

However, in the early eighties demands for PRAMRI were gradually commencing to appear from time to time, still exceptionally, also in respect of the loans offered directly or indirectly in the financing of the ships to be registered in some developing countries. That is when our interest was attracted to that matter.

The first astonishment came because we were told that the PRAMRI conditions contained a so called »confidentiality clause« which banned the Assured/Creditor from disclosing the terms of that insurance policy to any party other than the Assured, Auditors and Inspectors... without prior approval of the Underwriters. Thus the Mortgagor or Debtor has no chance to become familiar with the conditions agreed by PRAMRI although the risks covered are not related to the misconduct of the Mortgagor. In most situations both parties to the Agreement under the PRAMRI insurance are foreigners who, with due respect, do not have sufficient knowledge of the legal system as in force and functioning in the relevant country. Our intention is not to challenge that the parties to such an Agreement do not have access to accurate information on the political situation in a relevant country, but as we will see shortly PRAMRI deals primarily with the risks connected with the legal system of a specific country.

On the issue of »confidentiality« we have difficulty in giving a proper interpretation of what the consequences would be if the Assured/Mortgagee disclosed to the Mortgagor some or all conditions of the PRAMRI policy. Such a disclosure would under normal circumstances also be quite usual because the Mortgagee expects the Mortgagor to pay indirectly or to refund him for the costs of the insurance premium under the PRAMRI policy. Whether or not such a breach of contract would entitle the Underwriters to decline payment of the insurance proceeds, I would prefer to invite our learned colleagues from London to express their views on this point.

At this stage we would limit ourselves to the possible motives and aims for the »confidentiality« character of the PRAMRI policy. An extensive application of »confidentiality« or »secrets« always creates a certain degree of suspicion and definitely is detrimental to the maintenance of confidence and reliability between the parties, which in our view are of a paramount importance for fair conduct of commercial affairs and in particular at the time when two partners enter into a *credit* arrangement.

With your permission we will use an extreme example which has a taste of clear »confidentiality«. Still nowadays, as a heritage of an old defective regime in Moscow, the city with over 10 million inhabitants, probably with about 1 million telephone units, has no phone directory, because the particulars recorded in a phone directory are considered to be of a classified nature.

We would imagine that there must be a better explanation for the introduction of a »confidentiality clause« in the set of clauses of PRAMRI, because with the lack of a more suitable argument one can remain under impression that the objective for the implementation of a veil of confidentiality is to keep the Mortgagor ignorant — he cannot even give his comments or suggestions for modifications of the conditions that this type of insurance model imposes on the whole transaction. Irrespective of whether the Mortgagee or the Mortgagor ultimately pays, it always remains an expenditure thrown away for nothing. As a result of such circumstances, all outgoings in the form of additional premiums for the PRAMRI policies will continue to flow only in one direction. We would be delighted to find out that our assumptions are wrong, but until it is manifested otherwise it remains irrespective what are the total costs spent on that account, an expenditure representing a form of how those who are rich are getting richer and those who are poor are getting poorer.

It should be noted that sec. 2 of art. 14 of the Marine Insurance Act (1906) dealing with the concept of insurable interest provides that the Mortgagee has insurable interest in respect of any sum due or to become due under the Mortgage. The Yugoslav Law (point 2. sec. 1 of art. 689 of the Maritime and Inland Navigation Act (1977)) also lists »insurance of Mortgagee's rights« as being part of marine insurance, and consequently, in a similar manner as the British MIA, the Yugoslav Law recognizes that the Mortgagee has insurable interest in respect of the amount secured by the respective Mortgage.

The quotation below serves only as a point of reference for a form or pattern of how the risks covered are defined in Mortgagees Political Risks and Mortgage Rights Insurance in the Flag Country of a Vessel insurance contract.

Quote: »Coverage

1. Loss of and/or damage to the Vessel covered by this Policy (The »Vessel«) directly caused by the Confiscation, Nationalization, Seizure, Appropriation, Expropriation, Requisition for title or use or wilful destruction by or under the order of the Government (whether Civil, Military or Defacto) and/or public or local authority of the Country in which the Vessel is registered (namely in flag country).

2. Loss arising from the Assured being impeded or prevented from:

(a) enforcing its rights under a First Preferred Mortgage on the Vessel (»the Mortgage«) which has been duly registered with relevant Maritime Authorities of the Flag Country, or

(b) repatriating any proceeds realized by virtue of the Mortgage on the Vessel in the currency of the Mortgage, or

(c) asserting, as registered First Preferred Mortgagee, its priority in and to any judicially determined distribution of the proceeds of sale of the Vessel;

(d) purchasing the Vessel under Court Sale, either directly themselves or through their own appointed nominee.

either Caused by any Court or arbitration order or judgment, Governmental or other official decree or legislation or regulation of, or applicable in, the Flag Country, including but without limitation any failure of any Court, arbitration or Government or other official authority in the Flag Country to recognize or uphold the title, rights and priorities of the Assured under the Mortgage or to allow or to expedite repatriation of mortgage proceeds thereunder for any reason whatsoever.

or Caused by any Court or similar tribunal in a recognized jurisdiction (other than the Flag Country) applying any Court order, arbitration order or judgment, Governmental or other official decree or retrospective legislation or regulation of, or applicable in, the Flag Country.

3. The relevant authorities of the Flag Country formally declining to De-Register the Vessel and/or failing to issue a Deletion Certificate upon an application by or on behalf of the Assured or, following any change of ownership under a Court Bill of Sale under any recognized jurisdiction (other than the Flag Country), upon a joint application by the new Owners of the Vessel and the Assured.« Unquote.

Arriving at a summary description of the insurance as defined in the PRAMRI just quoted above, we feel that everybody would agree that all the listed events as risks covered are within a very restrictive area of the so called »political risks«.

It is recognized that all relevant political risks are linked to the Mortgage over the ship and its registration, but it should also be underlined that the more important and vast area of Mortgage rights has remained under PRAMRI uncovered by insurance and is completely outside insurance protection. Furthermore, everybody would agree that the definition of risks covered under any insurance contract should remain within the freedom of the contractual parties to make their choice. While recognizing that any contract is defined, in the first place, by its contents and not by its title, we are inclined to conclude that the title Mortgagees' Political Risks and Mortgage Rights Insurance in the Flag Country of a Vessel is wrong and at the same time it may even have a misleading effect.

In order to avoid ambiguities and misleading impressions in particular as regards any Assured, we would suggest, without hesitation, deleting the words »and Mortgage Rights«. It would be more appropriate and just to circulate the respective insurance model under the title »Mortgagees' Political Risks Insurance in the Flag Country of a Vessel«. Such a title would be in line with the actual nature of the risks covered and even more in line with the MII pattern and the character of the insurance would be reflected in its title, without exaggeration, in a more appropriate way.

The additional classification linked to the title with the term »in the Flag Country of a Vessel« reflects the actual state of things in an accurate manner and is not subject to criticism although it remains open to discussion whether it is necessary that this be pointed out in the title itself or whether it is sufficient to transfer it within the contents of the insurance contract.

We will refrain from analyzing the details in defining the events for which the PRAMRI policy offers its insurance cover, because space and time allocated do not permit us to do so. Res ipsa loquitur.

Regarding the exclusion conditions of the insurance cover under PRAMRI which, as in many insurance contracts commonly appear in determining the scope and field of the insurance cover, we are afraid that at this stage we cannot avoid to draw attention to one clause, which among others deals with the exclusion of coverage under PRAMRI; it runs as follows:

Quote: »Notwithstanding anything to the contrary contained herein, this Policy does not cover loss or damage directly or indirectly occasioned by happening through or in consequence of war, invasion, acts of foreign enemies, hostilities (whether war be declared or not) civil war, rebellion, revolution, insurrection, military or usurped power.« Unquote.

We are not suggesting that this clause has remained a condition in all PRAMRI contracts placed so far, but we feel it deserves a few comments even if it has appeared as an integral part of the PRAMRI contract only from time to time.

Namely, our submission is that a situation with political risks as defined in the wording set out above, can arise only if the political, legal and social system is overthrown or suspended by use of or interference by means

which are against the Constitution. Such events may appear only when some sort of hostilities, civil war, rebellion, military or *usurped* power are at scene, or such measures were successful in taking control and power in a State. In practical terms that means that by the wording of this clause the insurance cover of the risks defined may be overridden by the events which have caused manifestation of the very risks which it was the objective of the Assured to protect himself against.

Consequently, if the above quoted exemption clause is left as a part of the insurance contract, our question is whether anything is left under the insurance cover in conformity with PRAMRI? And our next question is what is actually offered for sale under the PRAMRI model when it si recommended to be implemented over transactions in connection with vessels to be registered in countries which have a fair and developed legal system?

Without too much imagination we are inclined to believe that the situation just outlined above would most likely bring any judge who might be in a position to consider a case in respect of the PRAMRI contract, to react as Mr. Justice Staughton did recently in the London Court when referring to a MII policy. He said:

»The Master of a merchant ship once said in evidence that he never recorded a wind of force 12 on the Beaufort scale in his log book, as that might tempt the Almighty to do worse. Similarly, if I were to say that the contract in this case compresses the greatest possible ambiguity in the smallest compass, who knows what the City would produce next?«[7]

We wonder what would be the reaction of a London judge reading an example of PRAMRI within the parameters outlined above.

There are areas in the present world that are still without a proper legal system, like the Near East where the Sheriat Law is still the main or only source of law or the People's Republic of China where as a result of the cultural revolution the legal system has remained at a rudimentary level. There are also many countries whose systems do not know or recognize either a mortgage or any similar registered charge over the vessel. In such situations again the PRAMRI model as circulating at present does not represent a suitable system for implementation, because the preconditions required for its entering into force cannot be fulfilled, due to the fact that the Mortgage itself is not a known category.

While we still do not exclude that the PRAMRI model might be recommendable in certain areas (like present-day Columbia) where the situation requires special caution, I am at difficulty to accept that Yugoslawia with all its tradition, results and achievements has ruined its reputation to such an extent that it is selected for the loans granted in financing acquisition of ships to be subject to an implementation of the PRAMRI model. Those who take the opposite view probably would do best to decide to keep away from such business because of the total lack of required confidence.

[7] »The Alexion Hope« op. cit. supra.

There is no dispute that Yugoslavia is geographically a European country. However it is only fair to admit that it still has a long way to go until it becomes mature enough for access to the European Community. In spite of tremendous achievements that have been made, particularly the introduction of a very developed legal system within the framework of state functions, in some instances the facts and achievements are ignored. As it often happens in life, the lack of knowledge and experience is very often sufficient reason for uncertainty, doubts and reservations. That is, in our submission, provenance of demands for the implementation of PRAMRI insurance over loans to be granted in respect of the ships contemplated to be registered in the Yugoslav Registry.

However the root of the problem is in rating Yugoslav stability, now deteriorating in certain areas, linked with the performance of the Yugoslav economy generally, inflation rate, promotion of human rights, liberalization of political life, tensions among certain Republics etc. All these factors are very important in creating public opinion on the international scale and therefore, under such impressions, people financing the acquisition of ships to be registered in Yugoslavia tend to achieve additional comfort which is in our submission of a psychological nature. However, the economical and political stability of any country is a completely different matter from the so called »political risks« offered to be covered by the PRAMRI insurances.

When we referred earlier to achievements in Yugoslavia in creating an efficient legal system and in performing parliamentary functions, it was impossible to mention it all in one article. However in respect of the field in question, let us draw your attention to the following:

— Yugoslavia has a complete Maritime Code which regulates practically all issues required for modern shipping activity with a substantial part devoted to substantive and procedural issues on the law of mortgages;

— it is known that Yugoslavia has incorporated all essential principles and solutions of the International Convention on Maritime Liens and Mortgages (1926):

— there is a very developed judiciary system with specialised sections for marine litigations;

— there is in force an operating and very efficient insurance system with independent underwriting organizations which have not failed to honour their obligations;

— during the last twenty years more than three hundred and fifty vessels were mortgaged, financed by foreigners in respect of whose loans the only or main security was the Mortgage over the acquired ships;

— loans granted for the acquisition of tonnage belonging to Yugoslav shipping companies have remained outside the volume of the country's debt which was made subject to re-scheduling. There were only few exceptions where the loans for the purchase of ships abroad have been made subject to re-scheduling only due to the fact that the foreign banks or yards were requiring guarantees of the Yugoslav banks instead of the Mortgage as security for repayment of the loan;

— transfer of the sale proceeds abroad achieved through an enforcement of the Mortgage over the ship in convertible currencies is guaranteed by an explicit provision of the Maritime and Inland Navigation Act (art. 214); etc. etc.

Furthermore, it should be recognized that in the late forties post-war Yugoslavia passed through a process of nationalization when in a climate created by a mixture of revolutionary and ideological enthusiasm and various atrocities, by two Acts on Nationalization, in 1946 and 1948, practically everything that was important in industrial activity was nationalized.

So all Yugoslav vessels in excess of fifty DWT were already nationalized in 1946, passing under the full control of the State and coming at the same time into the State or public ownership. However, even in those days, and this should be put on record, Yugoslavia compensated the shipowners and shareholders in the shipowning companies at fair market values of each ship under a Treaty made between the Yugoslav and British Governments and the respective shipowning companies and shareholders, that was signed in London on July 31, 1947. Those who during the war and immediately after the war left the Country collected proper compensation and were able to continue to operate shipowning business with the capital they got on the basis of compensation for the nationalized ships.

It is also important to note that Yugoslavia with its Constitutional Amendments in 1988 opened opportunities to all entrepreneurs, both foreigners and local individuals, for free investment into practically all sectors of the Yugoslav economy. In performance of such a policy two foundation stones for the free market oriented economy were laid, i.e. the Foreign Investment Law and the Company Law, and after several decades, joint stock companies and other forms of partnership, including shareholding within the joint venture undertakings or other, are again resurrected reality.

In a very concise article under the heading »Insurance against state actions — not terrorism«[8] A. Brown defines the objective of the Political Risks Insurance cover, quote: »companies investing or constructing overseas against falling foul of government actions which deprive them of their assets«, unquote.

We think Mr. Brown is right in his qualification of the Political Risks Insurance, but at the same time such a justifiable qualification may be helpful in developing a better understanding of our position in respect of Mortgages registered in the Yugoslav Registry, in order to secure repayment of the loans granted, the Mortgagees' Political Risks and Mortgage Right Insurance does not need to be applied and is meaningless.

6. CONCLUSIVE OBSERVATION

Whereas MII has steered into the way and has won its affirmation while stabilizing a field for its application in commercial practice worldwide, we

[8] A. Brown, Insurance against state actions — not terrorism, Lloyd's List, London, May 27 1986.

feel obliged to make a few comments on the experience of the MII model in Yugoslavia.

As an exception, but still implemented from time to time, the MII model of insurance policy has been invoked in order to make it a part of the collateral security in connection with the financing of acquisitions of tonnage from abroad. From the legal point of view there are no hindrances or obstacles to go along with such demands. The other issue is whether the money spent on purchasing that form of insurance is well spent? It is recognized that premium rates for MII are very modest indeed and of course are in proportion with the risks covered, which are very remote indeed.

However, from the commercial aspect it is very useful to get familiar with the kind of relationship prevailing between an Underwriter under the front line insurance and a particular shipowner assured, and at same time the mortgagor. It should not be disregarded whether a particular ship is covered on a separate insurance slip as a single interest with the Underwriter who does not know much of the standing and standard of this particular shipowner, or MII is fitted to a ship which makes part of the fleet of Vessels that were kept insured with the same front line underwriters for years or even decades. This element should be also influential in establishing adequate rating in respect of the insurance premium due under the MII policy.

It is also important to note that the insured value of the vessels navigating worldwide or outside the Yugoslav coastal waters is expressed in convertible currencies, mostly in US Dollars, and the conditions of insurance are the same as stipulated by the London Institute Time Clauses.

In Yugoslavia there are about 16 shipowning companies and only a few (four in total) insurance companies underwriting marine hull portfolio. Insurance agreements between the underwriters and the respective shipowner are longterm, and fluctuations from the above pattern are minimal. Therefore the standard of the management and care the specific shipowner takes of his vessels is not a secret for the Insurer. Those Underwriters who are the most exposed in covering marine hull business have their own superintendents who from time to time visit some of the vessels even where no incident or damage has been reported. Under these circumstances the Yugoslav Underwriters are in line with the general tendencies followed by leading marine underwriters in the world and there are many channels to implement a proper standard of maintenance if it appears that the standard of maintenance of any particular shipowner deserves improvement or criticism. Such a type of Underwriters do not look for any serious case to take benefit of on the proviso of privity, which is in the Yugoslav Law spelt out with a phrase that insurance does not cover losses from defects of seaworthiness of the ship if the assured knows of them or could have learned of them by exercising due diligence of a prudent ship operator and could have prevented consequences thereof.[9]

[9] Art. 733 of the Maritime and Inland Navigation Act (1977), op. cit. supra.

Summarizing our deliberations on the Mortgagees' Political Risks and Mortgage Right Insurance we feel that our views have already been expressed sufficiently clearly. However, in order that we should not be associated with the speakers within »agitprop« machineries, it has to be recognized with bitter sadness that from time to time some alarming information is coming from Yugoslavia, causing concern, reservations and confusion, and such a climate is not favorable to encourage bankers and other financing institutions to grant financing.[10] Reverting with your permission to sport language, let us say that one cannot blame the opposing participants in the game for lack of understanding because the boys of his own team are committing faults and errors.

Nevertheless we are confident that the domestic situation cannot develop to such an extent that any creditor might derive any benefit of the PRAMRI model for the reason elaborated above.

We are also ready to associate ourselves with the qualifications given by J. Freeman who addresses Political Risks Insurance as a protection against »legalized theft«[11] because any action which may fall within perils covered by PRAMRI is misconduct with deliberate discrimination against foreign interests. Governments that give the impression that at any time they may behave in a discriminatory way, force us at least to stop trading with them on credit terms. It would be, in our submission, more productive in the long run to tell them directly the reasons why they do not deserve support on credit terms, rather than, with a smile on the face, endeavour to buy PRAMRI confidentially in an attempt to transfer perils resulting from a legalised theft to somebody else.

To conclude our deliberation on the PRAMRI model and conditions of Mortgagees' Political Risks and Mortgage Rights Insurance as available in the City, let us recall again the words of Mr. Justice Staughton, »who knows what the City would produce next?«[12], which should be read in conjunction with an earlier section quoted above, because it fits with even more justification the PRAMRI model than the old MII model.

[10] »Politika«, Beograd, 23 Sept. 1988; »The Financial Times«, London, (Article under heading »The Yugoslav Time Bomb«) 1 August 1988; »Nedjeljna Dalmacija«, Split No 966, 5 Nov. 1989, p. 6: »Danas«, Zagreb, 10 Oct. 1989; »International Herald Tribune«, Paris, 31 Oct. 1989; etc.

[11] J. Freeman, Fifty Years Protection Against »Legalised Theft«, Lloyd's List, London, 27 May 1986.

[12] »The Alexion Hope«, op. cit. supra.

H. Kačić: Mortgagees' Interest Insurance and Mortgagees' Political Risks & Mortgage Rights Insurance, UPP, v. 33, (3—4), 215—231 (1991)

Sažetak

OSIGURANJE INTERESA UGOVORNOG ZALOŽNOG VJEROVNIKA I OSIGURANJE POLITIČKIH RIZIKA

&

OSIGURANJE PRAVA ZALOŽNOG VJEROVNIKA

Osiguranje interesa založnih vjerovnika i njihovih političkih rizika, te osiguranje založnih prava je tema koja u suvremenoj poslovnoj praksi i teoretskoj obradi pobuđuje sve veći interes.

U raspravi se obrađuju sličnost i razlike između ovih ugovora pomorskog osiguranja. Za sklapanje ovih ugovora prethodno mora biti: a) valjano zaključen ugovor o osiguranju broda; b) uredno utemeljena hipoteka ili mortgage ili ugovorno založno pravo na brodu; c) osiguranik može biti samo vjerovnik u odnosu na tražbine uredno pokrivene založnim pravom na brodu.

Studija temeljito obrađuje rizike koji se definiraju u standardnim uvjetima ovih tipova osiguranja, vodeći računa o gledištima izraženim u dosadašnjoj svjetskoj judikaturi.

Temeljitom analizom odgovarajućih uvjeta standardnih ugovora o osiguranju i solidnom pravno-ekonomskom argumentacijom u raspravi se upućuje na zaključak da postoji opravdan prostor rizika za plasman ugovora o osiguranju interesa založnih vjerovnika.

U pogledu osiguranja političkih rizika ugovornih založnih vjerovnika i osiguranja založnog prava sugerira se zaključak da nema opravdanog osnova za pokriće političkih rizika i založnih prava putem osiguranja u odnosu na brodove upisane u upisnike brodova koji se vode kod lučkih kapetanija u Jugoslaviji.