St. Mary's Law Journal

Volume 47 | Number 4 Article 1

1-1-2016

A Law and Economics Analysis of the Duty of Utmost Good Faith (Uberrimae Fidei) in Marine Insurance Law for Protection and Indemnity Clubs.

Elizabeth Germano

Follow this and additional works at: https://commons.stmarytx.edu/thestmaryslawjournal

Part of the Environmental Law Commons, Health Law and Policy Commons, Immigration Law Commons, Jurisprudence Commons, Law and Society Commons, Legal Ethics and Professional Responsibility Commons, Military, War, and Peace Commons, Oil, Gas, and Mineral Law Commons, and the State and Local Government Law Commons

Recommended Citation

Elizabeth Germano, *A Law and Economics Analysis of the Duty of Utmost Good Faith (Uberrimae Fidei) in Marine Insurance Law for Protection and Indemnity Clubs.*, 47 ST. MARY'S L.J. (2016).
Available at: https://commons.stmarytx.edu/thestmaryslawjournal/vol47/iss4/1

This Article is brought to you for free and open access by the St. Mary's Law Journals at Digital Commons at St. Mary's University. It has been accepted for inclusion in St. Mary's Law Journal by an authorized editor of Digital Commons at St. Mary's University. For more information, please contact egoode@stmarytx.edu, sfowler@stmarytx.edu.

ARTICLE

A LAW AND ECONOMICS ANALYSIS OF THE DUTY OF UTMOST GOOD FAITH (*UBERRIMAE FIDEI*) IN MARINE INSURANCE LAW FOR PROTECTION AND INDEMNITY CLUBS

ELIZABETH GERMANO*

I. Introduction 728
   A. Marine Insurance Policies Are Subject to Federal Admiralty Jurisdiction 728
   B. The *Wilburn Boat* Choice-of-Law Analysis Highlights the Importance of Judicially Established Federal Admiralty Rules 732
II. Legal Analysis of *Uberrimae Fidei* as a Judicially Established Federal Admiralty Rule 740
   A. The Origin and Evolution of *Uberrimae Fidei* 740
   B. Central Attributes of *Uberrimae Fidei* 750
      1. Materiality 751
      2. Disclosure 757

* The author wishes to express her appreciation to University of Connecticut School of Law Professors Peter Siegelman, Robert Birmingham, and Michael Eisele for their constant intellectual challenge, without which this Article would still be an unfinished thought. The author also wishes to thank her parents, Gerald and Joanne Germano, for their endless faith and bottomless love, without which such an undertaking would be inconceivable.

Published by Digital Commons at St. Mary's University, 2015

3. Reliance . . . 760
C. Positions of the United States Circuit Courts on *Uberrimae Fidei* . . . 762
1. Second Circuit . . . 764
2. Eleventh Circuit . . . 764
3. Fifth Circuit . . . 765
4. Seventh Circuit . . . 766
5. Fourth Circuit . . . 767
6. Ninth Circuit . . . 768
7. Third Circuit . . . 769
8. Eighth Circuit . . . 770
9. First Circuit . . . 771
D. Summary of Legal Analysis . . . 774
III. Economic Analysis of *Uberrimae Fidei* as a Judicially Established Federal Admiralty Rule for Protection and Indemnity Clubs . . . 775
A. Judicial Discussion of the Reasons for *Uberrimae Fidei* . . . 775
B. Legal Commentators' Approach to the Economic Efficiency of *Uberrimae Fidei* . . . 777
C. Economists' Approach to the Efficiency of *Uberrimae Fidei* . 779
1. Economists' Approach to Insurance . . . 779
2. Economists' Models of the Insurance Market with *Uberrimae Fidei* . . . 787
D. Application to Protection and Indemnity Clubs . . . 800
1. Special Characteristics of Protection and Indemnity Clubs . . . 800
2. Issues of Information Asymmetry . . . 814
E. Summary of the Economic Efficiencies of *Uberrimae Fidei* . . 818
IV. Conclusion . . . 820

I. INTRODUCTION

A. *Marine Insurance Policies Are Subject to Federal Admiralty Jurisdiction*

Writing for the Supreme Court in *The Lottawanna*[1] in 1875, Justice Joseph P. Bradley envisioned federal and state regulation of maritime

1. The Lottawanna, 88 U.S. (21 Wall) 558 (1875).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

affairs as "a system of law coextensive with, and operating uniformly in, the whole country."[2] He considered state involvement in maritime law to defeat the consistency and uniformity the Constitution sought to achieve for interstate and international commerce.[3] Over one hundred years later, Supreme Court Justice Antonin Scalia described the current relationship between state and federal regulation in the admiralty arena: "It would be idle to pretend that the line separating permissible from impermissible state regulation is readily discernible in our admiralty jurisprudence, or indeed is even entirely consistent within our admiralty jurisprudence."[4] The chief reason for this state of affairs is admiralty jurisprudence has evolved from court rulings rather than black letter law.[5]

Because contracts are conceptual, "[t]he boundaries of admiralty jurisdiction over contracts" have been challenging to define.[6] To be cognizable in admiralty, "a contract must be wholly maritime."[7] One United States district court has recently defined a maritime contract as "one that . . . relates to a ship and its use as such, or to commerce or to navigation on navigable waters, or to transportation by sea or to maritime employment."[8] The court continued to clarify "[t]he only general rule is that to be a maritime contract, the subject matter [i.e., the insurable interest] of the contract must be directly and intimately related to the operation of a vessel and navigation; it is not enough that the contract related in some preliminary (shoreside) manner to maritime affairs."[9] The characterization of a contract as "maritime" is significant because if "the dispute is not inherently local, federal law controls" the interpretation of a maritime contract.[10]

---

2. *Id.* at 575.

3. *Id.*

4. *See* Am. Dredging Co. v. Miller, 510 U.S. 443, 452 (1994) (deciding the application of state or federal forum non conveniens law in a Jones Act suit); *see also* Bank of San Pedro v. Forbes Westar, Inc., 53 F.3d 273, 275 (9th Cir. 1995) (quoting Justice Scalia's opinion to support the determination of state or federal law in a marine insurance dispute).

5. Wilburn Boat Co. v. Fireman's Fund Ins. Co., 348 U.S. 310, 323–24 (1955) (Frankfurter, J., concurring) ("It is appropriate to recall that the preponderant body of maritime law comes from this Court and not from Congress. . . . Under the distribution of power between national authority and local law, admiralty has developed for more than a hundred years by rulings of the Court, but not by absolutes either of abstention or extension.").

6. Kossick v. United Fruit Co., 365 U.S. 731, 735 (1961).

7. Commercial Union Ins. Co. v. Detyens Shipyard, Inc., 147 F. Supp. 2d 413, 419 (D.S.C. 2001) (quoting Wilkins v. Commercial Inv. Tr. Corp., 153, F.3d 1273, 1276 (11th Cir. 1998)).

8. *Id.* at 419 (quoting 1 BENEDICT ON ADMIRALTY § 182, at 12-4 (8th ed. 1996)).

9. *Id.* (quoting 1 THOMAS J. SCHOENBAUM, ADMIRALTY & MARITIME LAW § 3–10, at 111 (2d ed. 1994)).

10. Norfolk S. Ry. Co. v. Kirby, 543 U.S. 14, 22–23 (2004) (citing *Kossick*, 365 U.S. at 735); *see*

Published by Digital Commons at St. Mary's University, 2015

Federal common law is not the only source of law governing marine insurance contracts.[11] These contracts straddle the divide between state law and federal law.[12] Maritime jurisdiction over marine insurance contracts was an issue of first impression in *DeLovio v. Boit*.[13] The 1815 *DeLovio* court, a United States circuit court sitting in Massachusetts, considered a libel action resulting from a marine insurance policy on the basis that the policy was a maritime contract.[14] The court ultimately held marine insurance policies fell within federal admiralty jurisdiction[15] after a rigorous examination of the scope of a maritime contract in English custom and usage.[16] Based on their expansive reading of the Admiralty Clause of the United States Constitution, the circuit court departed from the rigid English common law interpretation of admiralty jurisdiction as being limited to those "things done upon the sea."[17] However, rather than describe a maritime contract with respect to a list of attributes, the circuit answered the query "what is a maritime contract?" with a list of examples.[18]

Fifty-five years later, the Supreme Court affirmed maritime jurisdiction

---

also Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 649 (9th Cir. 2008) ("Marine insurance has always occupied a unique place in the legal universe, straddling federal and state regulatory jurisdiction."); Kalmbach, Inc. v. Ins. Co. of Pa., 529 F.2d 552, 554 (9th Cir. 1976) ("Whether federal or local law applies to a maritime insurance contract can present a troublesome question.").

11. Progressive N. Ins. Co. v. Bachmann, 314 F. Supp. 2d 820, 826 (W.D. Wis. 2004) ("Although it is undisputed that marine contracts, including marine insurance contracts, fall under federal admiralty jurisdiction in Article 3, Section 2 of the United States Constitution, federal common law is not the exclusive source of law governing such contracts." (citations omitted)).

12. AIG Centennial Ins. Co. v. O'Neill, 782 F.3d 1296, 1302 (11th Cir. 2015) ("Marine insurance is a curious legal creature, bearing the markings of both the state common law of contracts and the federal common law of admiralty.").

13. DeLovio v. Boit, 7 F. Cas. 418 (C.C.D. Mass. 1815), *superseded by statute*, Extension of Admiralty Jurisdiction Act, 62 Stat. 496 (1948).

14. *Id.* at 418.

15. *Id.* at 444.

16. *Id.* at 432–44.

17. *Id.* at 442 ("The clause however of the [C]onstitution not only confers admiralty jurisdiction, but the word 'maritime' is superadded, seemingly ex industria, to remove every latent doubt. 'Cases of maritime jurisdiction' must include all maritime contracts, torts and injuries, which are in the understanding of the common law, as well as of the admiralty, 'causae civiles et maritimae.'").

18. *Id.* at 444 ("The next inquiry is, what are properly to be deemed 'maritime contracts.' Happily in this particular there is little room for controversy. All civilians and jurists agree, that in this appellation are included, among other things, charter parties, affreightments, marine hypothecations, contracts for maritime service in the building, repairing, supplying, and navigating ships; contracts between part owners of ships; contracts and quasi contracts respecting averages, contributions and jettisons; and, what is more material to our present purpose, policies of insurance.").

over marine insurance contracts in *New England Mutual Marine Insurance Co. v. Dunham.*[19] The central issue in *Dunham* was whether a federal court "sitting in admiralty, ha[s] jurisdiction to entertain" the libel in a case between a marine insurance company and an insured.[20] First, the Court determined the extent of maritime jurisdiction had been well-established.[21] The Court then proceeded to the trickier question of how to define a maritime contract. It rejected the English "locality" test and determined "the true criterion [was] the nature and subject-matter of the contract, as whether it was a maritime contract, having reference to maritime service or maritime transactions."[22] Having established its baselines, the Court then proceeded to examine whether a contract of marine insurance was a maritime contract.[23] The Court first discussed marine insurance in terms of the marine risks insured.[24] Next, the Court examined the systems of law that gave rise to and govern marine insurance.[25] The Court determined insurance contracts were "unknown to the common law" because they originated in maritime law.[26] The Court found this was true

---

19. New Eng. Mut. Marine Ins. Co. v. Dunham, 78 U.S. (11 Wall.) 1 (1870); *see also* Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 649 (9th Cir. 2008) ("It was not until 1870 that the Supreme Court even recognized marine insurance contracts as within the federal courts' maritime jurisdiction."); Irwin v. Eagle Star Ins. Co., 455 F.2d 827, 828–29 (5th Cir. 1972) ("A hundred years ago, the Supreme Court, in a thoroughly exhaustive opinion authored by Mr. Justice Bradley, held that a contract of marine insurance is a maritime contract, within the admiralty and maritime jurisdiction, though not within the exclusive jurisdiction of the United States Courts . . . ." (citing *Dunham*, 78 U.S. at 1)).

20. *Dunham*, 78 U.S. at 22.

21. *Id.* at 25 ("First, as to the *locus* or territory of maritime jurisdiction; that is, the place or territory *where* the law maritime prevails, where torts must be committed, and where business must be transacted, in order to be maritime in their character; a long train of decisions has settled that it extends not only to the main sea, but to all the navigable waters of the United States, or bordering on the same, whether landlocked or open, salt or fresh, tide or no tide.").

22. *Id.* at 26.

23. *Id.* at 27.

24. *Id.* at 30 ("But if we carefully analyze the contract of insurance we shall find that, in effect, it is a contract, or guaranty, on the part of the insurer, that the ship or goods shall pass safely over the sea, and through its storms and its many casualties, to the port of its destination; and if they do not pass safely, but meet with disaster from any of the misadventures insured against, the insurer will pay the loss sustained.").

25. *Id.* at 31.

26. *Id.* at 31–32 ("[I]t is well[-]known that the contract of insurance sprang from the law maritime[] and derives all its material rules and incidents therefrom. It was unknown to the common law; and the common law remedies, when applied to it, were so inadequate and clumsy that disputes arising out of the contract were generally left to arbitration, until the year A. D. 1601, when the statute of 43 Elizabeth was passed creating a special court, or commission, for hearing and determining causes arising on policies of insurance . . . . [T]he contract of marine insurance is an exotic in the common law. And we know the fact, historically, that its first appearance in any code or system of laws was in the law maritime as promulgated by the various maritime states and cities of

not only in the English-speaking world but also globally.[27] Therefore, the Court determined a contract of marine insurance fell within federal admiralty jurisdiction.[28]

In the 1961 decision *Kossick v. United Fruit Co.*,[29] the United States Supreme Court affirmed a contract to insure a ship is maritime and, therefore, upheld federal courts' admiralty jurisdiction.[30] As recently as 2006, United States federal circuit courts have confirmed federal admiralty jurisdiction encompasses marine insurance contracts.[31]

B. *The* Wilburn Boat *Choice-of-Law Analysis Highlights the Importance of Judicially Established Federal Admiralty Rules*

Substantive admiralty rights must be enforced in accordance with federal admiralty law regardless of the court hearing the admiralty

Europe.").

27. *Id.* at 34.

28. *Id.* at 35 ("The learned and exhaustive opinion of Justice Story, in the case of *De Lovio* v. *Boit*, affirming the admiralty jurisdiction over policies of marine insurance, has never been answered, and will always stand as a monument of his great erudition. . . . [W]e are of opinion that the conclusion of Justice Story was correct." (footnote omitted)).

29. Kossick v. United Fruit Co., 365 U.S. 731 (1961).

30. *Id.* at 735 (citing *Dunham*, 78 U.S. at 20); *see also* Irwin v. Eagle Star Ins. Co., 455 F.2d 827, 829–30 (5th Cir. 1972) (discussing the ramifications of *Kossick* on choice-of-law analysis for marine insurance contracts).

31. *See* Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 37 (1st Cir. 2006) ("This case arises under our admiralty jurisdiction since it involves a marine insurance policy."); *see also* N.Y. Marine & Gen. Ins. Co. v. Tradeline LLC, 266 F.3d 112, 121 (2d Cir. 2001) ("Federal admiralty jurisdiction extends to cases involving marine insurance contracts."); Cent. Int'l Co. v. Kemper Nat'l Ins. Cos., 202 F.3d 372, 373 (1st Cir. 2000) ("Suits on maritime insurance policies are classic examples of matters within federal maritime jurisdiction."); Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50, 54 (1st Cir. 1995) ("The propriety of maritime jurisdiction over a suit involving a marine insurance policy is unquestionable."); St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 237 (D. Mass. 2007) ("This case comes before this court under the umbrella of admiralty jurisdiction, since it involves a marine insurance policy."); Commercial Union Ins. Co. v. Detyens Shipyard, Inc. 147 F. Supp. 2d 413, 418–19 (D.S.C. 2001) ("It is well-settled that federal admiralty jurisdiction over maritime contracts extends to suits involving marine insurance policies." (quoting Atl. Mut. Ins. Co. v. Balfour Maclaine Int'l Ltd., 968 F.2d 196, 199 (2d Cir. 1992))); ABB Power T & D Co. v. Gothaer Versicherungsbank VVAG, 939 F. Supp. 1568, 1575 (S.D. Fla. 1996) ("[C]ourts consistently held that 'a contract of marine insurance is a maritime contract, within the admiralty and maritime jurisdiction . . . of the United States Courts.'" (quoting *Irwin*, 455 F.2d at 828–29)); Barber v. Chatham, 939 F. Supp. 782, 786 (D. Haw. 1996) ("Marine insurance policies are maritime contracts within federal admiralty jurisdiction."); St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 984 (N.D. Ill. 1993) ("It is undisputed that marine contracts, including marine insurance contracts, fall under federal admiralty jurisdiction in Article 3, Section 2 of the United States Constitution."); Hartford Ins. Co. v. Garvey, 1989 A.M.C. 652, 656 (N.D. Cal. 1988) ("Admiralty jurisdiction over a suit involving a marine insurance policy is unquestionable."); Reliance Ins. v. McGrath, 671 F. Supp. 669, 676 (N.D. Cal. 1987) ("Admiralty jurisdiction over a suit involving a marine insurance policy is unquestionable.").

dispute.[32] Although the boundary between procedure and substance is nebulous, the characterization of a given rule often is determined by whether the state law "unduly interferes with the federal interest in maintaining the free flow of maritime commerce."[33] The emphasis is not only on whether the state provision conflicts with the substantive federal statutory or common law but also on whether federal maritime rules occupy the field so as to prevent application of state law.[34]

According to the United States Supreme Court, "The purpose of a conflict-of-laws doctrine is to assure that a case will be treated in the same way under the appropriate law regardless of the fortuitous circumstances which often determine the forum."[35] Therefore, a United States federal court exercising admiralty jurisdiction will follow federal conflict of law principles.[36] Until 1955, there was no choice-of-law analysis conducted in marine insurance law cases.[37] United States federal circuit courts interpreted marine insurance cases based on federal admiralty precedent.[38] If there was no clear federal admiralty precedent, then the courts looked to

---

32. Wilburn Boat Co. v. Fireman's Fund Ins., 348 U.S. 310, 327 (1955) (Reed, J., dissenting) ("One rule of law stands unquestioned. That is that all courts, state and federal, which have jurisdiction to enforce maritime or admiralty substantive rights must do so according to federal admiralty law."); Doucette v. Vincent, 194 F.2d 834, 841–42 (1st Cir. 1952) ("[W]e take it now to be fully established that when a common law action is brought, whether in a state or in a federal court, to enforce a cause of action cognizable also in admiralty, the substantive law to be applied is the same as would be applied by an admiralty court—that is, the general maritime law, as developed and declared, in the last analysis, by the Supreme Court of the United States, or as modified from time to time by Act of Congress.").

33. Am. Dredging Co. v. Miller, 510 U.S. 443, 458 (1994) (Souter, J., concurring in part).

34. *Id.* at 461.

35. Lauritzen v. Larsen, 345 U.S. 571, 591 (1953).

36. *See* State Trading Corp. of India, Ltd. v. Assuranceforeningen Skuld, 921 F.2d 409, 414 (2d Cir. 1990) ("A federal court sitting in admiralty must apply federal choice[-]of[-]law rules."); *see also* Advani Enters, Inc. v. Underwriters at Lloyds, 140 F.3d 157, 162 (2d Cir. 1998) ("This policy is a maritime contract. Therefore, general federal maritime law, including federal choice-of-law rules apply."); Aqua-Marine Constructors, Inc. v. Banks, 110 F.3d 663, 670 (9th Cir. 1997) ("This is so because a federal court sitting in diversity applies the choice-of-law rules of the forum state . . . whereas a federal court sitting in admiralty must apply federal maritime choice-of-law rules." (citation omitted)); Thebes Shipping, Inc. v. Assicurazioni Ausonia SPA, 599 F. Supp. 405, 424 (S.D.N.Y. 1984) ("If this Court must make a choice[-]of[-]law, the rules to be applied in making the choice should be federal choice[-]of[-]law rules . . . .").

37. *See* Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 649 (9th Cir. 2008) ("In the years between *Dunham* and the Court's watershed decision in 1955 in *Wilburn Boat*, both states and the federal government, through statutes and judicial decisions, regulated marine insurance, with state laws yielding to federal laws whenever they were deemed to 'enter an area of maritime jurisdiction withdrawn from the States[.]'" (alteration in original) (quoting Md. Cas. Co. v. Cushing, 347 U.S. 409, 413 (1954))).

38. *See, e.g.*, *id.* at 649 ("Before *Wilburn Boat*, we would have simply looked to our admiralty precedent. . . .").

English law.[39] According to the United States Supreme Court, because the admiralty laws came from England, it was advantageous to maintain "harmony" with English marine insurance laws.[40]

In *Wilburn Boat v. Fireman's Fund Insurance Co.*,[41] the United States "Supreme Court signaled a major shift in the approach to" the interpretation of marine insurance cases by enunciating a two-step choice-of-law analysis for marine insurance law cases.[42] The two-step choice-of-law analysis asked two questions: "(1) Is there a judicially established federal admiralty rule . . . ? (2) If not, should we fashion one?"[43] Because of this decision, choice-of-law issues have become "pervasive and characteristic of marine insurance . . . and they can often determine the result."[44] Approximately thirty years later, one United States district court summarized the interplay of federal admiralty jurisdiction and the *Wilburn Boat* choice-of-law analysis: "Although the propriety of admiralty jurisdiction over a suit involving a marine insurance policy is unquestionable . . . the [federal] court must employ the channel markers of *Wilburn Boat* to deduce whether federal admiralty law or state insurance law will control the litigation."[45]

The bifurcation of admiralty jurisdiction and choice-of-law analysis for contract interpretation as a result of the *Wilburn Boat* decision has been "troublesome" and has created a "grey area" with respect to marine insurance contracts.[46] Since *Wilburn Boat*, a myriad of explanations of the

---

39. *Id.* As late as 1974, the Second Circuit looked to English law for its precedential effect. *See* Nw. Mut. Life Ins. Co. v. Linard, 498 F.2d 556, 561 (2d Cir. 1974) (giving weight to English case law regarding marine insurance contracts).

40. Queen Ins. Co. of Am. v. Globe & Rutgers Fire Ins. Co., 263 U.S. 487, 493 (1924) ("There are special reasons for keeping in harmony with the marine insurance laws of England, the great field of this business . . . ."); *see also* Wilburn Boat Co. v. Fireman's Fund Ins. Co., 348 U.S. 310, 325 (1955) (Reed, J., dissenting) ("Our admiralty laws, like our common law, came from England. As a matter of American judicial policy, we tend to keep our marine insurance laws in harmony with those of England."); St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 987–88 (N.D. Ill. 1993) ("The custom of marine shippers and American courts to harmonize their interpretation of marine insurance policies with the laws of Great Britain illustrates that maritime disputes with an international flavor require a single national voice for resolution.").

41. Wilburn Boat Co. v. Fireman's Fund Ins., 348 U.S. 310 (1955).

42. *Inlet Fisheries*, 518 F.3d at 649.

43. *Wilburn Boat*, 348 U.S. at 314.

44. Graydon S. Starring, *Admiralty and Maritime Law: Selected Topics*, 26 TORT & INS. L.J. 538, 559 (1991).

45. Albany Ins. Co. v. Wisniewski, 579 F. Supp. 1004, 1013 (D.R.I. 1984) (citations omitted).

46. *See* Yu v. Albany Ins. Co., 281 F.3d 803, 808 n.5 (9th Cir. 2002) ("[T]he choice[-]of[-]law determination in wake of [*Wilburn Boat*] can be 'troublesome.'" (quoting Bohemia, Inc. v. Home Ins., 725 F.2d 506, 509 (9th Cir. 1984))); St. Paul Fire & Marine Ins. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 237 (D. Mass. 2007) ("Though the rules of admiralty law supersede local authority, federal

choice-of-law principles for marine insurance law disputes have proliferated in the United States federal circuit and district courts.[47] The First Circuit has described the state of affairs as "an abyss of confusion."[48] One legal commentator analyzed the variability in the language used in United States district court applications of the *Wilburn Boat* test and provided nine samples of widely varying interpretations.[49]

A minority of courts have paraphrased the *Wilburn Boat* choice-of-law analysis to emphasize marine insurance contracts are governed first by federal law and are governed by state law only in the circumstance when there is no "established" federal law.[50] The Ninth Circuit has also allowed for federal law to control when there was a "need for uniformity in admiralty practice."[51]

---

courts of all levels, including the Supreme Court, have acknowledged a gray area with respect to maritime risk policies."); Crowley Marine Servs., Inc. v. Hunt, 1995 A.M.C. 2562, 2568 (W.D. Wash. 1995) ("The Ninth Circuit has frequently observed that the issue of whether federal or local law applies to a maritime insurance contract can present a troublesome question."); *see also Wisniewski*, 579 F. Supp. at 1013 ("Whether federal or state law should apply [to the interpretation of a marine insurance policy], however, is a much more enigmatic question. The uncertainty prescinds wholly from the United States Supreme Court's decision in *Wilburn Boat Co.* . . . .").

47. *See, e.g.*, Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 885 (5th Cir. 1991) ("Oblivious to the tangled mess it has left the practitioner to decipher, this Court has extended numerous—and often seemingly inconsistent—explanations of the appropriate choice[-]of[-]law in marine insurance disputes.").

48. Cent. Int'l Co. v. Kemper Nat'l Ins. Cos., 202 F.3d 372, 373 (1st Cir. 2000) ("Beneath this surface agreement on general principles lies an abyss of confusion. One might think that construing a maritime insurance policy, in relation to damage occurring on the high seas, would be a paradigm case for a uniform body of federal law . . . but the tensions in Supreme Court precedents are legendary . . . with regard to the reach of state law in federal maritime law generally . . . ." (citations omitted)).

49. Christopher W. Nicoll, *Uberrimae Fidei: The Doctrine That's on Everyone's Lips*, 21 U.S.F. MAR. L.J. 1, 15–17 (2008). In an analysis of 105 United States marine insurance cases, the author found approximately thirty different formulations of the *Wilburn Boat* test.

50. *See* AIG Centennial Ins. v. O'Neill, 782 F.3d 1296, 1302 (11th Cir. 2015) ("In the absence of a 'judicially established federal admiralty rule,' we rely on state law when addressing questions of marine insurance." (citing Wilburn Boat Co. v. Fireman's Fund Ins., 348 U.S. 310, 320–21 (1955))); Cargill, Inc. v. Commercial Union Ins., 889 F.2d 174, 178 (8th Cir. 1989) ("Federal admiralty law governs the interpretation of these marine insurance policies, unless no established federal admiralty law exists, in which case state law applies."); Great Lakes Reinsurance (UK) PLC v. Kranig, No. 2011-122, 2013 WL 2631861, at *6 (D.V.I. June 12, 2013) ("Marine insurance [policies] are governed by federal admiralty law when there is an established federal rule, and by state law when there is not." (quoting Ingersoll Milling Mach. Co. v. M/V Bodena, 829 F.2d 293, 305 (2d Cir. 1987))).

51. *See, e.g.*, Kiernan v. Zurich Cos., 150 F.3d 1120, 1121 (9th Cir. 1998) ("Disputes arising under marine insurance contracts are governed by federal admiralty law when an established federal rule addresses the issues raised. . . . In the absence of an established federal rule, a federal court may, in certain circumstances, fashion one. . . . State law governs disputes arising under marine insurance contracts only 'in the absence of a federal statute, a judicially fashioned admiralty rule, or a need for uniformity in admiralty practice . . . .'" (quoting Suma Fruit Int'l. v. Albany Ins. Co., 122 F.3d 34, 35

A majority of courts have paraphrased the *Wilburn Boat* choice-of-law analysis to emphasize the states' power in the interpretation of marine insurance policies.[52] For example, the First Circuit has recently described the states' regulatory powers with respect to marine insurance as "largely unfettered."[53] One United States district court describes *Wilburn Boat* as having decided state law "ordinarily governs" the interpretation of marine insurance contracts.[54] The same district court described the preference for state law in *Wilburn Boat* as being "clearly established."[55] Another district court described there being a "broad presumption" that state law will control marine insurance contracts.[56] Thirty years after *Wilburn Boat*, the Fifth Circuit stated it was "now axiomatic" that state law controlled the interpretation of marine insurance law contracts "in absence of a specific

(9th Cir. 1997))).

52. *See* Northfield Ins. v. Barlow, 983 F. Supp. 1376, 1379 (N.D. Fla. 1997) ("The Supreme Court in *Wilburn Boat* noted the importance of state law in governing maritime disputes; however, it carved out an exception to the state law application where federal admiralty law was 'firmly entrenched.'"); Albany Ins. Co. v. Wisniewski, 579 F. Supp. 1004, 1013–14 (D.R.I. 1984) ("In the absence of a settled federal marine insurance rule, the *Wilburn Boat* inquiry generally has been interpreted, in deference to state hegemony over insurance, to discourage the fashioning of new federal law and to favor the application of state law."). Before the twenty-first century, United States circuit court decisions supported a uniform rule of *uberrimae fidei*. One legal commentator offered the following harsh opinion:

> *Wilburn Boat* has created a situation in which admiralty courts have largely abrogated their unique power to fashion maritime rules, at least in the area of marine insurance. From the perspective of the district courts, the safest approach to the adjudication of marine insurance contract disputes is to focus on, and adhere to, state law. Generally, admiralty decisions do not display a tendency to view maritime law as a unique and coherent body of rules. By *de facto* delegation of the rule-making power, formerly vested in the federal courts, to the various state forums, *Wilburn Boat* has put leadership with regard to the evolution of consistent admiralty rules into the hands of state judges and legislators. These entities, unlike their federal counterparts, may have little interest and a lack of experience in maritime law. This makes the development of consistent admiralty rules theoretically and practically improbable.

Thomas R. Beer, Comment, *Established Federal Admiralty Rules in Marine Insurance Contracts and the* Wilburn Boat *Case*, 1 U.S.F. MAR. L.J. 149, 168 (1989).

53. Catlin at Lloyd's v. San Juan Towing & Marine Serv., Inc., 778 F.3d 69, 76 (1st Cir. 2015).

54. ABB Power T & D Co. v. Gothaer Versicherungsbank VVAG, 939 F. Supp. 1568, 1575 (S.D. Fla. 1996) ("Based on these important state interests the Court greatly limited the role federal admiralty law would play in the interpretation of marine insurance contracts. Specifically, the Court determined that state law, not federal, ordinarily governs the interpretation of such contracts and that admiralty law would thereafter be confined only to those limited areas in which earlier doctrines were firmly entrenched.").

55. *Id.* ("Although a preference for state law was clearly established by the decision in *Wilburn*, federal admiralty law was not completely written out of the equation.").

56. St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 984 (N.D. Ill. 1993).

and controlling federal rule."[57] Such courts paraphrase the *Wilburn Boat* analysis in the following terms: "state law governs unless there is a well settled federal admiralty rule applicable to the particular issues of the case."[58] Although, as will be later discussed in this Article, there is some controversy between the federal courts as to exactly what type of admiralty rule will displace state law.[59]

The formulation of the *Wilburn Boat* test in the Ninth Circuit has been unique among the United States federal circuits since its decision in *Bohemia, Inc. v. Home Insurance Co.*[60] in 1984. This formulation reads *Wilburn Boat* together with the later Supreme Court decision *Kossick v. United Fruit Co.*[61] to allow federal law to control the interpretation of a marine insurance contract where there is "a federal statute, a judicially fashioned admiralty rule, or a need for uniformity in admiralty practice."[62] This standard has been applied by both the Ninth Circuit and by district courts within the Ninth Circuit.[63] One district court within the Ninth

57. INA of Tex. v. Richard, 800 F.2d 1379, 1380 (5th Cir. 1986).

58. Thebes Shipping, Inc. v. Assicurazioni Ausonia SPA, 599 F. Supp. 405, 425 (S.D.N.Y. 1984) (quoting Navegacion Goya S.A. v. Mut. Boiler & Mach. Ins. Co., 411 F. Supp. 929, 934 (S.D.N.Y. 1975)); *see also* N.Y. Marine & Gen. Ins. Co. v. Cont'l Cement Co., 761 F.3d 830, 836 (8th Cir. 2014) ("A dispute arising under a marine insurance contract is 'governed by state law, unless an established federal admiralty rule addresses the issue raised.'" (quoting Assicurazioni Generali SPA v. Black & Veatch Corp., 362 F.3d 1108, 1111 (8th Cir. 2004))); Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 886 (5th Cir. 1991) ("State law, therefore, governs the interpretation of marine insurance policies unless an available federal maritime rule controls the disputed issue."); Kilpatrick Marine Piling v. Fireman's Fund Ins. Co., 795 F.2d 940, 948 (11th Cir. 1986) ("In *Wilburn Boat*, the Supreme Court applied state law when it found no federal admiralty law on the subject.").

59. *Compare N.Y. Marine*, 761 F.3d at 839 ("Striking a balance between the two in *Wilburn Boat*, the Court determined that courts should apply state law to maritime insurance disputes unless there is a judicially established federal admiralty rule governing the issue."), *with* McAdam v. State Nat'l Ins., 28 F. Supp. 3d 1110, 1116 (S.D. Cal. 2014) ("A marine insurance contract is interpreted in accordance with the law of the state in which it was formed unless there is a controlling federal rule on point, or unless there is a reason to create a federal rule. . . . Following this rule, except where there is an 'entrenched federal precedent,' state substantive insurance law governs marine insurance disputes.").

60. Bohemia, Inc. v. Home Ins. Co., 725 F.2d 506 (9th Cir. 1984).

61. Kossick v. United Fruit Co., 365 U.S. 731 (1961).

62. *Bohemia*, 725 F.2d at 510.

63. *See* Yu v. Albany Ins. Co., 281 F.3d 803, 806 (9th Cir. 2002) ("Disputes arising under marine insurance contracts are governed by state law . . . unless an established federal rule addresses the issues raised, or there is a need for uniformity in admiralty practice."); Kiernan v. Zurich Cos., 150 F.3d 1120, 1121 (9th Cir. 1998) ("State law governs disputes arising under marine insurance contracts only 'in the absence of a federal statute, a judicially fashioned admiralty rule, or a need for uniformity in admiralty practice . . . .'" (quoting Suma Fruit Int'l. v. Albany Ins. Co., 122 F.3d 34, 35 (9th Cir. 1997))); Crowley Marine Servs., Inc. v. Hunt, 1995 A.M.C. 2562, 2568 (W.D. Wash. 1995) ("However, the [Ninth] circuit court has generally held that state law is applicable in the absence of a federal statute, a judicially fashioned admiralty rule, or a need for uniformity in admiralty practice."

Circuit has also considered the relationship between the federal admiralty rule and the state rule in its choice-of-law analysis under *Wilburn Boat*.[64]

The First Circuit requires the federal admiralty rule be "materially different from state law" for it to control.[65] Materiality is also a factor in the Fifth Circuit formulation:

> This Circuit has identified three factors that a court should consider in determining if a federal maritime rule controls the disputed issue: (1) whether the federal maritime rule constitutes "entrenched federal precedent," . . . (2) whether the state has a substantial and legitimate interest in the application of its law, . . . (3) whether the state's rule is materially different from the federal maritime rule.[66]

These widely varying federal court interpretations of the *Wilburn Boat* choice-of-law analysis illustrate "the issue of admiralty versus state law in the interpretation of marine insurance contracts[] is a highly amorphous and confusing aspect of federal jurisprudence."[67] Writing in his concurrence to *Wilburn Boat*, Justice Frankfurter declared, "It cannot be

(citing *Bohemia*, 725 F.2d at 510)); Port Lynch, Inc. v. New Eng. Int'l Assurety of Am., Inc., 754 F. Supp. 816, 820 (W.D. Wash. 1991) ("The Court finds that the standard in the Ninth Circuit for applying federal admiralty law or state law is set forth in *Bohemia* as follows: state law controls in the absence of a federal statute, a judicially fashioned admiralty rule, or a need for uniformity in admiralty practice." (citing *Bohemia*, 725 F.2d at 510)); Hartford Ins. Co. v. Garvey, 1989 A.M.C. 652, 656 (N.D. Cal. 1988) ("State law will control the interpretation of a marine insurance policy in the absence of a federal statute, a judicially fashioned admiralty rule, or a need for uniformity in admiralty practice." (citing *Bohemia*, 725 F.2d at 510)).

64. *Garvey*, 1989 A.M.C. at 656 ("The courts draw from both federal marine insurance principles and applicable state law when the controlling precedents demonstrate that the federal admiralty precepts and those of the state having the most significant relationship to the policy, here California, are harmonious on the disposition of the issues.").

65. *See* Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 37 (1st Cir. 2006) ("Generally, in cases involving a marine insurance contract, we will apply state law unless an established 'maritime rule controls the disputed issue, *and* that rule is materially different from state law.'" (emphasis in original)); Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50, 54 (1st Cir. 1995) ("State law may supplement maritime law when maritime law is silent or a local matter is at issue, but state law may not be applied where it is materially different from maritime law, or where it would defeat the reasonably settled expectations of maritime actors."); Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 974 F. Supp. 2d 64, 74 (D.P.R. 2013) ("The First Circuit Court of Appeals has held that in a case involving a marine insurance contract, state law will apply unless an established maritime rule controls the disputed issue, *and* that rule is materially different from state law." (citing *Pesante*, 459 F.3d at 37)); St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 237 (D. Mass. 2007) ("But *Wilburn Boat* does not reach so far as to render the application of maritime law obsolete in the context of insurance disputes. In cases involving marine insurance contracts, this court will apply state law, unless an established maritime rule controls the issue and the rule materially differs from state law." (citing *Pesante*, 459 F.3d at 37)).

66. Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 886 (5th Cir. 1991) (citations omitted).

67. ABB Power T & D Co. v. Gothaer Versicherungsbank VVAG, 939 F. Supp. 1568, 1577 (S.D. Fla. 1996).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

that by this decision the Court means suddenly to jettison the whole past of the admiralty provision of Article III and to renounce requirements for nationwide maritime uniformity, except insofar as Congress has specifically enacted them, in the field of marine insurance."[68] Marine insurance law is certainly an area that cries out for uniformity.[69] Because marine insurance is essential to interstate and international maritime commerce, uniform laws are needed at the federal level so they can be synchronized with those of other maritime powers.[70]

One of the doctrines limited by the application of the *Wilburn Boat* choice-of-law analysis is the duty of utmost good faith—*uberrimae fidei*—in maritime insurance.[71] The concept of *uberrimae fidei* under federal admiralty law is broader in application than state consumer insurance laws.[72] The central thesis of this Article is *uberrimae fidei* should be recognized as a United States federal admiralty rule for marine protection and indemnity insurance offered by mutual insurance clubs because such a duty promotes economic efficiency in the insurance marketplace.

Part II of this Article tackles the first part of the *Wilburn Boat* choice-of-law analysis—is there a judicially established federal admiralty rule?—by examining *uberrimae fidei* from a legal perspective. First, United States case law is reviewed to illustrate the origins of *uberrimae fidei* and its evolution through United States jurisprudence. Three central aspects of *uberrimae fidei*—materiality, reliance, and disclosure—are discussed at greater length because these are the most litigated aspects of the duty. Finally, recent United States federal circuit court cases are surveyed to determine which federal circuits recognize *uberrimae fidei* as a judicially established federal admiralty rule as of October 2015.

Part III of this Article addresses the second part of the *Wilburn Boat* choice-of-law analysis—whether a judicially established federal admiralty should rule be fashioned—by examining *uberrimae fidei* from an economic perspective. The federal bench and legal commentators seldom expound

---

68. Wilburn Boat Co. v. Fireman's Fund Ins. Co., 348 U.S. 310, 323 (1955) (Frankfurter, J., concurring).

69. *Id.* at 333 (Reed, J., dissenting).

70. *See id.* at 323 (Frankfurter, J., concurring) ("The business of marine insurance often may be so related to the success of many manifestations of commercial maritime endeavor as to demand application of a uniform rule of law designed to eliminate the vagaries of state law and to keep harmony with the marine insurance laws of other great maritime powers.").

71. Markel Am. Ins. Co. v. Veras, 995 F. Supp. 2d 65, 72 (D.P.R. 2014).

72. *See, e.g.*, Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1383 (N.D. Fla. 1997) (comparing the concept of materiality under *uberrimae fidei* to the concept of materiality as applied to a Florida state statute where a life insurance policy was at issue).

Published by Digital Commons at St. Mary's University, 2015

on the economic rationale for *uberrimae fidei*; however, this information, where available, isdiscussed. A review of four scholarly papers, which focus on an economic analysis of *uberrimae fidei*—with respect to insurance generally—reveals *uberrimae fidei*'s primary benefit is reducing the negative impacts of information asymmetries, such as adverse selection and moral hazard.[73] Marine insurance offered by protection and indemnity clubs is analyzed within that framework. First, the unique characteristics of protection and indemnity clubs will be outlined. Then, how information asymmetries can negatively impact the functioning of that market and how *uberrimae fidei* can reduce those negative impacts for marine insurance offered by protection and indemnity clubs are discussed.

Part IV concludes by asserting specifically with respect to protection and indemnity clubs, economic theory supports the efficiency of *uberrimae fidei* as a means to dispel information asymmetry and broaden the availability of insurance to low-risk individuals.

II. LEGAL ANALYSIS OF *UBERRIMAE FIDEI* AS A JUDICIALLY ESTABLISHED FEDERAL ADMIRALTY RULE

A. *The Origin and Evolution of* Uberrimae Fidei

The doctrine of *uberrimae fidei* has its origins in the earliest days of marine insurance, when the insurance underwriters' only source of information came from the shipowners and merchants whose cargo sailed on the ships.[74] "*Uberrimae fidei*" loosely translates from Latin as "of the utmost good faith."[75] According to the doctrine *uberrimae fidei*, there is a mutual duty between the parties to a marine insurance contract to perform their duties according to the highest standard of good faith.[76] The

73. *See infra* Part III.C.

74. Fed. Ins. Co. v. PGG Realty, LLC, 538 F. Supp. 2d 680, 687 (S.D.N.Y. 2008) (quoting Stecker v. Am. Home Fire Assurance Co., 84 N.E.2d 797, 799, *reh'g denied*, 86 N.E.2d 182 (N.Y. (1949)).

75. Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 37 (1st Cir. 2006) (quoting Grande v. St. Paul Fire & Marine Ins. Co., 436 F.3d 277, 282 (1st Cir. 2006)); *see also* Commercial Union Ins. Co. v. Detyens Shipyard, Inc. 147 F. Supp. 2d 413, 423 (D.S.C. 2001) ("Literally translated the phrase '*uberrimae fidei*' means of the utmost good faith." (quoting N. Am. Specialty Ins. Co. v. Savage, 977 F. Supp. 725, 732 (D. Md. 1997))).

76. *See* St. Paul Fire & Marine Ins. Co. v. Abhe & Svoboda, Inc., 798 F.3d 715, 719 (8th Cir. 2015) ("Under the doctrine of *uberrimae fidei*, 'the parties to a marine insurance policy must accord each other the highest degree of good faith.'" (quoting Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 13 (2d Cir. 1986))); Crowley Marine Servs., Inc. v. Hunt, 1995 A.M.C. 2562, 2568 (W.D. Wash. 1995) ("The doctrine of *uberrimae fidei* holds both parties to a contract of insurance to the duty of utmost good faith.").

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

obligation of utmost good faith arose from the nature of the insurance relationship and the character of the insurance contract.[77] The Ninth Circuit summarized the origin of the doctrine as follows:

> Historically, all insurance policies were contracts *uberrimae fidei,* meaning that both parties were held to the highest standard of good faith in the transaction. The doctrine of *uberrimae fidei* was grounded both in morality and efficiency; insureds were considered morally obligated to disclose all information material to the risk the insurer was asked to shoulder, but such a principle was also an economic necessity where insurers had no reasonable means of obtaining this information efficiently, without the ubiquity of telephones, email, digital photography, and air travel.[78]

Uberrimae fidei was formally addressed by Lord Mansfield as early as 1766 in the English case of *Carter v. Boehm*,[79] which dealt with a policy insuring against the loss of Fort Marlborough. Lord Mansfield wrote his opinion based on the notion that insurance is a speculative contract.[80] The duty of good faith prevents either party to the insurance contract from concealing private knowledge to induce the other party into the agreement.[81] The insured is under an obligation to disclose "special facts, upon which the contingent chance is to be computed" because such facts are frequently only known to the insured.[82] In the sailing world of the 1700s, the underwriter had to implicitly trust the representations of the insured.[83] Therefore, the remedy for withholding such "special facts" by the insured was voiding the insurance policy.[84] This harsh result was achieved even if the insured acted without scienter to deceive the underwriter.[85] However,

77. *See* Stipcich v. Metro. Life Ins. Co., 277 U.S. 311, 318 (1928) ("The obligation was not one stipulated for by the parties, but is one imposed by law as a result of the relationship assumed by them and because of the peculiar character of the insurance contract. The necessity for complying with it is not dispensed with by the failure of the insurer to stipulate in the policy for such disclosure.").

78. Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 646 (9th Cir. 2008).

79. Carter v. Boehm (1766) 97 Eng. Rep. 1162 (Eng.).

80. *Id.* at 1164.

81. *See id.* ("Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.").

82. *Id.*

83. *See id.* ("[T]he under-writer trusts to [the insured's] representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risque, as if it did not exist.").

84. *See id.* ("The keeping back such circumstance is a fraud, and therefore the policy is void.").

85. *See id.* ("Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived, and the policy is void; because the risque run is really

avoidance of the policy was limited to circumstances when the concealed information was material to the risk insured.[86] In his conclusion, Lord Mansfield reasoned the parties should be obligated to disclose "special facts" to promote good faith and prevent fraud.[87] He found similar reasons for his rule against concealment of "special facts."[88]

In 1828, the issue of *uberrimae fidei* reached the United States Supreme Court in *M'Lanahan v. Universal Insurance Co.*,[89] which was concerned with four instances of concealment of "material circumstances" in issuing insurance on the brig Creole.[90] Justice Joseph Story, writing for the Supreme Court, started from the presumption "[t]he contract of insurance has been said to be a contract *uberrimae fidei*, and the principles which govern it are those of an enlightened moral policy."[91] The opinion then proceeded to illuminate the specifics of that basic presumption: the insured must assume the underwriter is going forward on the belief the insured has disclosed all the facts "material to the risk."[92] Procuring insurance while in possession of "secret information" is a fraud that voids the insurance contract.[93] Scienter is not a requirement to void an insurance policy; much like Lord Mansfield, Justice Story held an unintentional omission of a material fact by the insured permits the insurer to void the policy.[94] The key is whether the insured exercised "due and

different from the risque understood and intended to be run, at the time of the agreement.").

86. *See id.* at 1164–65 ("There are many matters, as to which the insured may be innocently silent—he need not mention what the under-writer knows . . . . The under-writer needs not be told what lessens the risque agreed and understood to be run by the express terms of the policy."); *see also* Thomas J. Schoenbaum, *The Duty of Utmost Good Faith in Marine Insurance Law: A Comparative Analysis of American and English Law*, 29 J. MAR. L. & COMM. 1, 2 (1998) ("In *Carter*, however, Lord Mansfield applied the doctrine in a very practical way. The duty of disclosure was limited to material (Lord Mansfield used the term 'special') facts within the exclusive knowledge of the assured.").

87. *See Carter*, 97 Eng. Rep. at 1165 ("The reason of the rule which obliges parties to disclose, is to prevent fraud, and to encourage good faith.").

88. *See id.* at 1169 ("The reason of the rule against concealment is, to prevent fraud and encourage good faith.").

89. M'Lanahan v. Universal Ins. Co., 26 U.S. (1 Pet.) 170 (1828).

90. *Id.* at 178.

91. *Id.* at 185. For recent examples of the enduring nature of this statement, see Fireman's Fund Insurance Co. v. Great American Insurance Co., 10 F. Supp. 3d 460, 476 (S.D.N.Y. 2014); and Thebes Shipping, Inc. v. Assicurazioni Ausonia SPA, 599 F. Supp. 405 (S.D.N.Y. 1984).

92. *See M'Lanahan*, 26 U.S. at 185 ("The underwriter must be presumed to act upon the belief, that the party procuring insurance, is not, at the time, in possession of any facts, material to the risk which he does not disclose; and that no known loss had occurred, which by reasonable diligence might have been communicated to him.").

93. *Id.*

94. *See id.* ("And even if there be no intentional fraud, still the underwriter has a right to a disclosure of all material facts, which it was in the power of the party to communicate by ordinary means; and the omission is fatal to the insurance.").

reasonable diligence" in informing the underwriter of the material facts.[95] What constitutes "due and reasonable diligence" is determined under the circumstances of the individual case.[96] This position constituted both a softening of some stricter state court positions of "extreme diligence" and a clarification of other state court decisions that left the standard open for discussion.[97]

The United States Supreme Court again touched upon *uberrimae fidei* approximately sixty years later in *Sun Mutual Insurance Co. v. Ocean Insurance Co.*,[98] which addressed the reinsurance of a marine risk. After establishing the duty of disclosure in a reinsurance policy did not differ from that of an original insurance policy, the Supreme Court stated *uberrimae fidei* was the basic obligation of both types of policies.[99] The Court reiterated scienter is not an element of *uberrimae fidei*: "The duty of communication, indeed, is independent of the intention, and is violated by the fact of concealment even where there is no design to deceive."[100] More significantly, the Court clarified its standard for "material" information, which was left undefined in *M'Lanahan*. According to the Court, the concealment of any information "that, if disclosed, would probably have influenced the terms of insurance" is material enough to avoid the insurance contract.[101]

As late as the 1920s, the United States Supreme Court held all insurance policies—maritime and otherwise—had an implied duty of *uberrimae fidei*.[102] However, the basic definition of *uberrimae fidei*, with respect to marine insurance, has been fairly consistent throughout the United States federal courts since *Sun Mutual*.[103]

One twenty-first century case stated "[m]odern maritime cases" describe

95. *See id.* ("The true principle deducible from the authorities on this subject is, that where a party orders insurance, and afterwards receives intelligence material to the risk, or has knowledge of a loss; he ought to communicate it to the agent, as soon as, with due and reasonable diligence, it can be communicated, for the purpose of countermanding the order, or laying the circumstances before the underwriter. If he omits so to do, and by due and reasonable diligence the information might have been communicated, so as to have countermanded the insurance, the policy is void.").

96. *Id.* at 185–86.

97. *Id.*

98. Sun Mut. Ins. Co. v. Ocean Ins. Co., 107 U.S. 485 (1883).

99. *Id.* at 510.

100. *Id.*

101. *Id.* at 510–11; *see also* State Nat'l Ins. Co. v. Anzhela Explorer, LLC, 812 F. Supp. 2d 1326, 1351 (S.D. Fla. 2011) (quoting *Sun Mutual*, 107 U.S. at 510–11).

102. Stipcich v. Metro. Life Ins. Co., 277 U.S. 311, 316 (1928) ("Insurance policies are traditionally contracts *uberrimae fidei* and a failure by the insured to disclose conditions affecting the risk, of which he is aware, makes the contract voidable at the insurer's option.").

103. Schoenbaum, *supra* note 86, at 9 ("[M]ost United States federal courts have consistently applied the doctrine of utmost good faith in marine insurance cases.").

uberrimae fidei in terms that originate in *Btesh v. Royal Insurance Co. of Liverpool*,[104] a short 1931 Second Circuit decision by Judge Learned Hand.[105] *Btesh* involved an "open" policy of insurance covering marine shipments.[106] A cargo of silk material, which had been labeled as cotton, was stolen en route, and the cargo owner sued to reclaim the full value of the silk rather than the declared value of the cotton.[107] Judge Learned Hand expounded on four key points regarding *uberrimae fidei*. First, under marine policies, the insured "must disclose to the underwriter all circumstances known to him which materially affect the risk."[108] This is a succinct summary of the precedents set in *M'Lanahan* and *Sun Mutual*. Second, materiality is defined as "something which would have controlled the underwriter's decision" and is subject to a "reasonable person" standard.[109] Third, intent to deceive on the part of the insured is not required to void the policy,[110] which is aligned with precedent. Finally, the ultimate purpose of *uberrimae fidei* is that the insurers "are not exposed to unassumed risks directly touching the property insured."[111]

The Second Circuit briefly revisited *uberrimae fidei* the following year in an automobile financing insurance case.[112] At the time, the circuit court viewed the rule as applicable to all types of insurance.[113] The key innovation in this case was the scope of when material changes in risk needed to be communicated to the insurer because "known changes in conditions material to the risk which occur between the opening of negotiations for insurance and the issuance of the policy must be divulged."[114]

Two state courts examined *uberrimae fidei* before the Second Circuit

104. Btesh v. Royal Ins. Co. of Liverpool, 49 F.2d 720 (2d Cir. 1931).

105. Progressive N. Ins. Co. v. Bachmann, 314 F. Supp. 2d 820, 827 (W.D. Wis. 2004) (citing *Btesh*, 49 F.2d at 721).

106. *Btesh*, 49 F.2d at 720.

107. *Id.*

108. *Id.* at 721.

109. *Id.*

110. *Id.*

111. *Id.* at 722.

112. Hare & Chase, Inc. v. Nat'l Sur. Co., 60 F.2d 909, 911 (2d Cir. 1932) ("The question presented is whether an insured who intentionally fails to disclose material facts because of his belief that the insurance is not to cover the undisclosed risk and who pays no premium for such risk until after loss thereunder has been incurred may establish a claim in respect to such a risk. In our opinion it was properly answered in the negative.").

113. *See id.* ("This rule, originating in marine insurance, was extended in England and in a few early American cases to other types of insurance.").

114. *Id.*

revisited the issue.[115] In 1979, the Southern District of New York stated, "It is undeniable that parties to a contract of marine insurance must be held to a standard of the highest fidelity in their dealings."[116] Distilling case precedent, the court defined *uberrimae fidei* as a doctrine that "obligates the assured to volunteer information which might have a bearing on the scope of the risk assumed, and the failure to do so will allow the insurer to avoid the policy."[117] In 1984, the District of Rhode Island proposed its own similarly lackluster definition: "The marine insurance contract is *uberrima fides*: it is conceived in the uttermost good faith and incubated in a legal environment which transcends the sharper practices of the world of commerce. Either party's failure to observe that standard of conduct renders the contract voidable at the instance of the other party."[118]

In 1985, the Second Circuit decided *Puritan Insurance Co. v. Eagle Steamship Co. S.A.*,[119] in which an insurer sought to void a hull and machinery policy *ab initio* due to misrepresentation of pre-policy losses. The circuit court started its analysis by stating *uberrimae fidei* was well-established and required "the party seeking insurance . . . to disclose all circumstances known to him which materially affect the risk."[120] "All circumstances" includes any material information acquired after having applied for insurance.[121] The opinion focused on three central attributes of *uberrimae fidei*: information must be disclosed, the information must be material, and must be relied upon.[122] Materiality was defined by quoting *Btesh* as "something which would have controlled the underwriter's decision."[123] Furthermore, only substantial compliance with the rule is

115. Contractors Realty Co. v. Ins. Co. of N. Am., 469 F. Supp. 1287, 1294 (S.D.N.Y. 1979); Albany Ins. Co. v. Wisniewski, 579 F. Supp. 1004, 1014 (D.R.I. 1984).

116. *Contractors Realty Co.*, 469 F. Supp. at 1294.

117. *Id.* (first citing Gulfstream Cargo, Ltd. v. Reliance Ins. Co., 409 F.2d 974 (5th Cir. 1969); then citing Fireman's Fund Ins. Co. v. Wilburn Boat Co., 300 F.2d 631, 646–47 (5th Cir. 1962), *abrogated by* Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 888 (5th Cir. 1991); then citing King v. Aetna Ins. Co., 54 F.2d 253, 254 (2d Cir. 1931); then citing *Btesh*, 49 F2d at 721; then citing Navegacion Goya S.A. v. Mut. Boiler & Mach. Ins. Co., 411 F. Supp. 929, 935 (S.D.N.Y. 1975); then citing Anne Quinn Corp. v. Am. Mfg. Mut. Ins. Co., 369 F. Supp. 1312, 1315 (S.D.N.Y 1973), *aff'd mem.*, 505 F.2d 727 (2d Cir. 1974); then citing Neubros Corp. v. Nw. Nat'l Ins. Co., 359 F. Supp. 310, 317 (E.D.N.Y. 1972); then citing Rosenthal v. Poland, 337 F. Supp. 1161, 1168 (S.D.N.Y. 1972); and then citing Stecker v. Am. Home Fire Assurance Co., 84 N.E.2d 797, 798 (N.Y. 1949)).

118. *Wisniewski*, 579 F. Supp. at 1014.

119. Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866 (2d Cir. 1985).

120. *Id.* at 870 (citing *Btesh*, 49 F.2d at 721).

121. *Id.*

122. *Id.* at 871 ("The principle of *uberrimae fidei* does not require the voiding of the contract unless the undisclosed facts were material and relied upon.").

123. *Id.* (quoting *Btesh*, 49 F.2d at 721).

required; if the insured discloses sufficient information to alert the underwriter of a need to investigate further, then the insured has satisfied his duty.[124] Finally, the alleged misrepresentation must both be relied upon by the insurer and actually mislead the insurer.[125] The following year, the Second Circuit summarized its position on *uberrimae fidei*: "The doctrine of *uberrimae fidei* requires a party seeking marine insurance to disclose all circumstances known to it which materially affect the risk.... If a party fails to disclose material information applicable to the risk involved, the policy is void."[126]

Two cases in the Northern District of California also proposed comprehensive definitions of *uberrimae fidei*. In discussing an all-risks policy on a yacht in 1987, the district court described *uberrimae fidei* as applicable to all marine insurance policies in the following terms:

> The marine insurance contract is conceived in uttermost good faith (*uberrimae fidei*), and the assured must disclose every material circumstance which in the ordinary course of business ought to be known to him. Thus the assured is obligated to volunteer information which might have a bearing on the scope of the risk assumed, and the failure to do so will allow the insurer to void the policy.[127]

The decision the following year used a very similar formulation.[128]

Twenty-first century jurisprudence affirms precedent rather than makes new law in the arena of *uberrimae fidei*. For example, the 2000 Eleventh Circuit decision in *HIH Marine Services v. Fraser*[129] relied on the 1984 Eleventh Circuit *Steelmet*[130] decision and the 1962 Fifth Circuit *Wilburn Boat*[131] decision for its definition of *uberrimae fidei*: "*Uberrimae fidei* requires that an insured fully and voluntarily disclose to the insurer all facts material

124. *Id.* (quoting 2 M. MUSTILL & J. GILMAN, ARNOULD'S LAW OF MARINE INSURANCE AND AVERAGE § 646, at 493 (16th ed. 1981)).

125. *Id.* at 870 (quoting Rose & Lucy, Inc. v. Resolute Ins. Co., 249 F. Supp. 991, 992 (D. Mass. 1965)).

126. Ingersoll Milling Mach. Co. v. M/V Bodena, 829 F.2d 293, 308 (2d Cir. 1987) (citations omitted).

127. Reliance Ins. Co. v. McGrath, 671 F. Supp. 669, 678 (N.D. Cal. 1987) (citations omitted).

128. *See* Hartford Ins. Co. v. Garvey, 1989 A.M.C. 652, 659 (N.D. Cal. 1988) ("The marine insurance contract is conceived in uttermost good faith, *uberrimae fidei*, and the insured must disclose every material circumstance which in the ordinary course of business ought to be known (or is fairly presumed to be known) to him. The doctrine of *uberrimae fidei* is applicable to all forms of marine insurance.").

129. HIH Marine Servs. v. Fraser, 211 F.3d 1359 (11th Cir. 2000).

130. Steelmet, Inc. v. Caribe Towing Corp., 747 F.2d 689 (11th Cir. 1984).

131. Fireman's Fund Ins. Co. v. Wilburn Boat Co., 300 F.2d 631 (5th Cir. 1962).

to a calculation of the insurance risk."[132] The case also heavily relied on *Northfield Insurance Co. v. Barlow*,[133] borrowing its definition of materiality and its core logic that the insured bears the burden of disclosure.[134]

The 2001 Second Circuit decision in *New York Marine & General Insurance Co. v. Tradeline LLC*[135] confirmed *uberrimae fidei* holdings from the 1980s. With respect to a general definition, the court quoted directly from *Puritan*.[136] Additionally, the circuit court stated "[*u*]*berrimae fidae*, the duty of utmost good faith, requires an assured to disclose any information that materially affects the risk being insured, because the assured is more likely to be aware of such information."[137] Finally, the circuit court defined an undisclosed fact as "material if it would have affected the insurer's decision to insure at all or at a particular premium."[138]

When the Second Circuit revisited *uberrimae fidei* in an unpublished decision in 2013, it quoted the definition directly from its 1986 decision, *Knight v. U.S. Fire Insurance Co.*[139] The circuit court then reiterated the disclosure requirement as formulated in *Tradeline*.[140] To conclude its brief discussion of *uberrimae fidei*, the circuit court quoted *Knight* as the authority for voiding a policy *ab initio* if the insured fails to disclose the required material information.[141] The Southern District of New York's decision

---

132. *HIH Marine Servs.*, 211 F.3d at 1362.

133. Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376 (N.D. Fla. 1997).

134. *See HIH Marine Servs.*, 211 F.3d at 1362–63 ("A misrepresentation is material if 'it might have a bearing on the risk to be assumed by the insurer.' . . . The central principle of *uberrimae fidei*, however, is that the *insured* bears the burden of full and voluntary disclosure of facts material to the decision to insure. This duty to disclose is based on the rationale that requiring the marine insurer to investigate each and every claim made by those applying for coverage 'would be both time consuming and expensive.' . . . Instead, the law has placed the burden of good faith disclosure with the person in the best position to know all the facts: the insured." (quoting *Barlow*, 983 F. Supp. at 1380, 1383)).

135. N.Y. Marine & Gen. Ins. Co. v. Tradeline LLC, 266 F.3d 112 (2d Cir. 2001).

136. *Id.* at 123 ("[P]arties to a marine insurance contract are held to the highest degree of good faith. Under this obligation, called *uberrimae fidae*, the party seeking insurance is required to disclose all circumstances known to him which materially affect the risk." (quoting Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 870 (2d Cir. 1985))).

137. *Id.* (citing Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 13 (2d Cir. 1986)).

138. *Id.* (citing Mut. Benefit Life Ins. Co. v. JMR Elecs. Corp., 848 F.2d 30, 32–33 (2d Cir. 1988)).

139. Knight v. U.S. Fire Ins. Co., 804 F.2d 9 (2d Cir. 1986); *see also* St. Paul Fire & Marine Ins. Co. v. Matrix Posh, LLC, 507 F. Appx. 94, 95 (2d Cir. 2013) ("The doctrine of *uberrimae fidei* demands 'that the parties to a marine insurance policy must accord each other the highest degree of good faith.'" (quoting *Knight*, 804 F.2d at 13)).

140. *See Matrix Posh*, 507 F. Appx. at 95 ("This duty of utmost good faith 'requires an assured to disclose any information that materially affects the risk being insured, because the assured is more likely to be aware of such information.'" (quoting *Tradeline*, 266 F.3d at 123)).

141. *Id.* (quoting *Knight*, 804 F.2d at 13).

the following year relied exclusively on this unpublished decision for its definition of *uberrimae fidei*.[142]

The 2006 decision in the First Circuit also reiterates earlier formulations of *uberrimae fidei*: "[u]nder this doctrine, the insured is required 'to disclose to the insurer all known circumstances that materially affect the insurer's risk, the default of which . . . renders the insurance contract voidable by the insurer."[143] The earlier First Circuit decision, *Windsor Mount Joy Mutual Insurance Co. v. Giragosian*,[144] relied on the Second Circuit *Knight* decision. In *Windsor Mount Joy*, the circuit court defined *uberrimae fidei* as "requir[ing] the parties to a marine insurance policy to accord one another the highest degree of good faith."[145] According to the circuit court, there is a "strict duty" imposed upon "the insured to disclose all known circumstances that materially affect the insurer's risk" or else the policy is void *ab initio*.[146] The 2006 First Circuit decision picked up that same thread, emphasizing the strictness of the rule of "full disclosure of all material facts."[147] This formulation was cited a year later by the District of Massachusetts.[148]

These First and Second Circuit formulations of *uberrimae fidei* were synthesized in a 2013 decision by the District of Puerto Rico.[149] The district court premised its definition of *uberrimae fidei* on the fact the doctrine is based on the belief that the insured "is in the best position to

142. *See* Fireman's Fund Ins. Co. v. Great Am. Ins. Co., 10 F. Supp. 3d 460, 476–77 (S.D.N.Y. 2014) ("Under the doctrine of utmost good faith, 'parties to a marine insurance policy must accord each other the highest degree of good faith,' and the insured is obligated to 'disclose any information that materially affects the risk being insured, because [it] is more likely to be aware of such information.'" (quoting *Matrix Posh*, 507 F. Appx. at 95)).

143. Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 37 (1st Cir. 2006) (quoting Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50, 54–55 (1st Cir. 1995)).

144. Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50 (1st Cir. 1995).

145. *Id.* at 54 (citing *Knight*, 804 F.2d at 13).

146. *Id.* at 54–55 (citing *Knight*, 804 F.2d at 13).

147. Grande v. St. Paul Fire & Marine Ins. Co., 436 F.3d 277, 283 (1st Cir. 2006) ("Nevertheless, under the strict maritime rule of *uberrimae fidei*, an insured must make 'full disclosure of all material facts of which the insured has, or ought to have, knowledge . . . even though no inquiry be made. This doctrine apparently rests on the special circumstances of maritime insurance in which the insurer may have less than ordinary opportunities to inspect and verify." (citations omitted)).

148. *See* St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 237 (D. Mass. 2007) ("The maritime doctrine of *uberrimae fidei* imposes on the prospective insured a duty to render information in the 'utmost good faith.' Under this doctrine, the individual seeking insurance coverage is required to provide the carrier with 'all known circumstances that materially affect the insurer's risk, the default of which . . . renders the insurance contract voidable by the insurer.'" (citing *Pesante*, 459 F.3d at 37–38)).

149. *See* Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 974 F. Supp. 2d 64, 78 (D.P.R. 2013) (mentioning most circuit courts agree the *uberrimae fidei* doctrine controls in maritime insurance cases).

know of any circumstances material to the risk [and] must reveal those facts to the underwriter."[150] Therefore, the insured must fully disclose all material facts to the underwriter, even if the underwriter does not inquire about them.[151] Because *uberrimae fidei* involves both nondisclosure and misrepresentation, there is a dual duty to disclose and to not misrepresent.[152] The District of Virgin Islands decision, also in 2013, described *uberrimae fidei* as a "longstanding federal maritime doctrine"[153] and relied on a 2000 vintage Eleventh Circuit decision for the core of its definition.[154] The definition proposed emphasized full and voluntary disclosure by the insured of all material facts, regardless of whether the insurer made an inquiry.[155] A fact was material if it bore on the risk to be insured.[156] The District of Puerto Rico decision the following year essentially encapsulated the same elements in its definition of *uberrimae fidei* by quoting from the 2006 *Pesante* case.[157]

In 2008, the Ninth Circuit stated, "The doctrine of *uberrimae fidei* imposes a duty of utmost good faith . . . and 'requires that an insured fully and voluntarily disclose to the insurer all facts material to a calculation of the insurance risk.'"[158] A few months later, the Third Circuit held, "The doctrine of *uberrimae fidei* imposes a duty of the utmost good faith and requires that parties to an insurance contract disclose all facts material to the risk. If an insured defaults on this duty, the contract may be avoided by the insurer."[159] The Third Circuit formulation was a medley of *Inlet Fisheries*, *HIH Marine Services*, and *Knight*.[160]

---

150. *Id.* (quoting *Knight*, 804 F.2d at 13).

151. *Id.* (quoting *Grande*, 436 F.3d at 283).

152. *Id.*

153. Great Lakes Reinsurance (UK) PLC v. Kranig, No. 2011-122, 2013 WL 2631861, at *7 (D.V.I. June 12, 2013).

154. *Id.* ("Meaning 'utmost good faith,' the doctrine requires applicants for marine insurance to 'fully and voluntarily disclose to the insurer all facts material to a calculation of the insurance risk," even when this information is not explicitly sought or asked for by the insurer."' (quoting HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1362 (11th Cir. 2000))).

155. *Id.*

156. *Id.*

157. Markel Am. Ins. Co. v. Veras, 995 F. Supp. 2d 65, 72 (D.P.R. 2014) ("The doctrine requires the insured 'to disclose to the insurer all known circumstances that materially affect the insurer's risk, the default of which renders the insurance contract voidable by the insurer."' (quoting Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 37 (1st Cir. 2006))).

158. Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 648 (9th Cir. 2008); *see also* Pringle v. Water Quality Ins. Syndicate, 646 F. Supp. 2d 1161, 1169 (C.D. Cal. 2009) (quoting *Inlet Fisheries*, 518 F.3d at 648).

159. AGF Marine Aviation & Transp. v. Cassin, 544 F.3d 255, 262 (3d Cir. 2008).

160. *Inlet Fisheries*, 518 F.3d 645; HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359 (11th Cir. 2000); Knight v. U.S. Fire Ins. Co., 804 F.2d 9 (2d Cir. 1986).

Decisions within the past two years also do not make new law. A 2014 Southern District of California decision both harkened back to *M'Lanahan* and reiterated *Inlet Fisheries.*[161] An Eighth Circuit decision in 2014 looked back to *Stipcich v. Metropolitan Life Insurance Co.*[162] for the essence of *uberrimae fidei.*[163] In 2015, the Eighth Circuit relied on *Knight.*[164] A 2015 Eleventh Circuit case looked to *M'Lanahan*[165] and *Sun Mutual*[166] for the spirit of *uberrimae fidei.* Finally, although a 2015 First Circuit decision relegates the definition of *uberrimae fidei* to a footnote,[167] the definition itself is borrowed from the 1995 *Windsor Mount Joy* case.[168]

B. *Central Attributes of* Uberrimae Fidei

In his comparative analysis of the English and American interpretations of the duty of utmost good faith in marine insurance law, Thomas J. Schoenbaum notes nine "particular elements of the duty of utmost good faith."[169] However, the three most litigated aspects of *uberrimae fidei* are the materiality of the misrepresentation or omission, whether the

161. *See* McAdam v. State Nat'l Ins. Co., 28 F. Supp. 3d 1110, 1123 (S.D. Cal. 2014) ("Marine hull insurance policies are contracts *uberrimae fidei*—i.e., they are grounded in the utmost good faith. Under the doctrine, an underwriter is presumed to act on the belief that the insurance applicant disclosed all facts material to the risk." (citations omitted)).

162. Stipcich v. Metro. Life Ins. Co., 277 U.S. 311 (1928).

163. *See* N.Y. Marine & Gen. Ins. Co. v. Cont'l Cement Co., 761 F.3d 830, 837 (8th Cir. 2014) ("Under the federal common law doctrine of utmost good faith or *uberrimae fidei*, 'a failure by the insured to disclose conditions affecting the risk, of which he is aware, makes the contract voidable at the insurer's option.'" (quoting *Stipcich*, 277 U.S. at 316)).

164. *See* St. Paul Fire & Marine Ins. Co. v. Abhe & Svoboda, Inc., 798 F.3d 715, 719 (8th Cir. 2015) ("Under the doctrine of *uberrimae fidei*, 'the parties to a marine insurance policy must accord each other the highest degree of good faith.' This duty of good faith requires the insured to 'disclose to the insurer all known circumstances that materially affect the risk being insured.'" (quoting *Knight*, 804 F.2d at 13)).

165. AIG Centennial Ins. Co. v. O'Neill, 782 F.3d 1296, 1303 (11th Cir. 2015) ("*Uberrimae fidei* reflects 'an enlightened moral policy' based upon the presumption that 'the party procuring insurance, is not . . . in possession of any facts, material to the risk which he does not disclose.'" (quoting M'Lanahan v. Universal Ins. Co., 26 U.S. (1 Pet.) 170, 176 (1828))).

166. *Id.* ("Indeed, '[i]t is the duty of the [insured] to place the underwriter in the same situation as himself.'" (quoting Sun Mut. Ins. Co. v. Ocean Ins. Co., 107 U.S. 485, 510–11 (1883))).

167. *See* Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 778 F.3d 69, 71 n.2 (1st Cir. 2015) ("*Uberrimae fidei* means roughly 'utmost good faith.'").

168. *Id.* ("Under this doctrine, the insured in a maritime insurance contract is required 'to disclose to the insurer all known circumstances that materially affect the insurer's risk, the default of which . . . renders the insurance contract voidable by the insurer.'" (quoting Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50, 54–55 (1st Cir. 1995))).

169. *See* Schoenbaum, *supra* note 86, at 14–38 (listing the nine elements for the duty of good faith as follows: misrepresentation and non-disclosure, mutuality, scienter and intent, materiality, inducement (reliance and causation), burden of proof and presumption of inducement, role of agents, waiver, and legal effect of the breach).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

information was adequately disclosed, and whether the information was relied upon.[170]

1. Materiality

The materiality of a fact is an often-litigated issue in a marine insurance coverage dispute. If the fact concealed or misrepresented is material, the insurer may be able to void the marine insurance policy *ab initio*.[171] An alternate view proposed by one district court has not gained traction:

> [W]hen the insurer produces evidence of intentional misrepresentation of facts or concealment of material facts by the insured which is equal to or more convincing than the evidence produced by the insured to show that the policy was in effect and that the loss was fortuitous, then coverage will be denied.[172]

A recent view within the Ninth Circuit balances materiality of the information with scienter. "An insurer may rescind an insurance contract

---

170. Based on a personal survey of approximately ninety marine insurance cases dealing with *uberrimae fidei*, these three elements are also central to Schoenbaum's summary of *uberrimae fidei*: "A material misrepresentation or omission, whether or not in response to a specific inquiry, renders the coverage voidable. The truth of material representations is judged under a 'substantial compliance' standard." *Id.* at 9–10.

171. *See* Markel Am. Ins. Co. v. Nordarse, 297 F. Appx. 852, 853 (11th Cir. 2008) ("A material misrepresentation on the marine insurance application is grounds for voiding the policy."); HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1363 (11th Cir. 2000) ("A material misrepresentation on the marine insurance application is grounds for voiding the policy"); Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 13 (2d Cir. 1986) ("The assured's failure to meet this standard [of good faith] entitles the underwriter to void the policy *ab initio*."); Hartford Ins. Co. v. Garvey, 1989 A.M.C. 652, 657–58 (N.D. Cal. 1988) (suggesting a "misrepresentation of facts and concealment of material facts as [a justification for] rescission"); McAdam v. State Nat'l Ins. Co., 28 F. Supp. 3d 1110, 1123 (S.D. Cal. 2014) ("If the insured misrepresents or conceals known material facts, the insurer may rescind the policy *ab initio*, even if the misrepresentation was unintentional."); State Nat'l Ins. Co. v. Anzhela Explorer, LLC, 812 F. Supp. 2d 1326, 1351–52 (S.D. Fla. 2011) ("Consequently a material misrepresentation or non-disclosure on an application for marine insurance is grounds for voiding the policy."); Reliance Nat'l Ins. Co. (Eur.) Ltd. v. Hanover, 246 F. Supp. 2d 126, 136 (D. Mass. 2003) ("The assured's failure to meet this standard [of good faith] entitles the underwriter to void the policy *ab initio*." (citing *Knight*, 804 F.2d at 13)); Commercial Union Ins. Co. v. Detyens Shipyard, Inc., 147 F. Supp. 2d 413, 423 (D.S.C. 2001) ("If such a [good faith] disclosure is not made by the insured, the insurance contract will be deemed void."); Fireman's Fund Ins. Co. v. Great Am. Ins. Co., 10 F. Supp. 3d 460, 477 (S.D.N.Y. 2014) ("If the insured breaches its duty of utmost good faith, the insurer is entitled to void the policy *ab initio* . . . ."); Crowley Marine Servs., Inc. v. Hunt, 1995 A.M.C. 2562, 2569 (W.D. Wash. 1995) ("Under the doctrine, a marine insurance policy is void *ab initio* when the insured fails to disclose material increases in the risks insured."); Port Lynch, Inc. v. New Eng. Int'l Assurety of Am., Inc., 754 F. Supp. 816, 820–21 (W.D. Wash. 1991) ("Accordingly, under established maritime law, a marine insurance policy is void *ab initio* where the insured fails to disclose material increases in the marine risk or makes misrepresentations material to the marine risk.").

172. *Garvey*, 1989 A.M.C. at 657–58.

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

if it can show either intentional misrepresentation of a fact, regardless of materiality, or nondisclosure of a fact material to the risk, regardless of the risk."[173]

A word needs to be said here about scienter. Most courts hold an "absence of an intent to deceive or conceal will not save the contract from rescission."[174] According to one district court, "The duty of communication [of material facts], indeed, is independent of the intention, and is violated by the fact of concealment even where there is no design to conceal."[175] According to another district court, "Fraud by intentional concealment is not necessary if a policy of marine insurance is issued upon false and material misrepresentations."[176] A third district court stated that in making the determination of whether the disclosures were in good faith, "it does not matter whether the insured's failure to disclose was due to negligence, mistake, accident, or voluntary ignorance."[177] Therefore, it is irrelevant whether the party intended to conceal material information.[178]

173. Pringle v. Water Quality Ins. Syndicate, 646 F. Supp. 2d 1161, 1169 (C.D. Cal. 2009) (quoting Certain Underwriters at Lloyds, London v. Inlet Fisheries Inc., 518 F.3d 645, 655 (9th Cir. 2008)); Cigna Prop. & Cas. Ins. Co. v. Polaris Pictures Corp., 159 F.3d 412, 420 (9th Cir. 1998) (quoting Wash. Int'l Ins. Co. v. Mellone, 773 F. Supp. 189, 191 (C.D. Cal. 1990)).

174. *See, e.g.*, Reliance Ins. Co. v. McGrath, 671 F. Supp. 669, 677 (N.D. Cal. 1987) (discussing scienter and contract recission).

175. Thebes Shipping, Inc. v. Assicurazioni Ausonia SPA, 599 F. Supp. 405, 426 (S.D.N.Y. 1984) (quoting Sun Mutual Ins. Co. v. Ocean Ins. Co., 107 U.S. 485, 510 (1883)).

176. *McGrath*, 671 F. Supp. at 677.

177. Commercial Union Ins. Co. v. Detyens Shipyard, Inc. 147 F. Supp. 2d 413, 423 (D.S.C. 2001); *see also* Great Lakes Reinsurance (UK) PLC v. Morales, 760 F. Supp. 2d 1315, 1323 (S.D. Fla. 2010) ("Under *uberrimae fidei*, 'a material misrepresentation on an application for marine insurance is grounds for voiding the policy,' even if the misrepresentation is a result of 'mistake, accident, or forgetfulness.'" (quoting Certain Underwriters at Lloyd's, London v. Giroire, 27 F. Supp. 2d 1306, 1313 (S.D.Fla. 1998))); Fireman's Fund Ins. Co. v. Great Am. Ins. Co., 10 F. Supp. 3d 460, 477 (S.D.N.Y. 2014) ("If the insured breaches its duty of utmost good faith, the insurer is entitled to void the policy *ab initio*, 'regardless of whether the misrepresentation or omission was intentional or was the result of accident or mistake.'" (quoting Fed. Ins. Co. v. PGG Realty, LLC, 538 F. Supp. 2d 680, 688 (S.D.N.Y. 2008))); Progressive N. Ins. Co. v. Bachmann, 314 F. Supp. 2d 820, 827 (W.D. Wis. 2004) ("A failure by the insured to comply with this duty, 'although it may arise from mistake, accident, or forgetfulness, is attended with the rigorous consequences that the policy never attaches and is void.'" (quoting Gulfstream Cargo, Ltd. v. Reliance Ins. Co., 409 F.2d 974, 981 (5th Cir. 1969))).

178. AGF Marine Aviation & Transp. v. Cassin, 544 F.3d 255, 262 (3d Cir. 2008) ("A party's intent to conceal, or lack thereof, is irrelevant to the *uberrimae fidei* analysis."); Am. Home Assurance Co. v. Masters' Ship Mgmt. S.A., 423 F. Supp. 2d 193, 223 (S.D.N.Y. 2006) ("The duty of communication [of material facts], indeed, is independent of the intention, and is violated by the fact of concealment even where there is no design to deceive." (quoting *Sun Mutual*, 107 U.S. at 510)); *Thebes Shipping*, 599 F. Supp. at 426 ("It is not necessary that plaintiffs prove that [the insurance applicant] had an intent to conceal . . . . This intent, in respect of marine insurance, is irrelevant."); *see also* Great Lakes Reinsurance (UK) PLC v. Kranig, No. 2011-122, 2013 WL 2631861, at *6 (D.V.I.

https://commons.stmarytx.edu/thestmaryslawjournal/vol47/iss4/1

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

The obligation to disclose material information is "independent of intent" and is breached even if there is no intent to deceive.[179] According to one district court, "[I]t is of no moment whether the insured breaches its duty to disclose by virtue of calculated deceit or by innocent mistake; the insured's failure to disclose voids the contract and its coverage."[180] The fact a material misrepresentation or omission had been made is what is important to the *uberrimae fidei* analysis.[181]

In 1887, the Supreme Court of the United States addressed the question of materiality of answers to insurance policy application interrogatories in the life insurance context.[182] The Supreme Court held, "The misrepresentation or concealment by the assured of any material fact entitles the insurers to avoid the policy."[183] Although materiality was not defined in the case, the Supreme Court characterized the grounds on which the insurer could avoid the policy.[184] If the insured made what looked like a complete answer to a direct question and that answer contained "any substantial misstatement or omission," that policy could be avoided.[185] However, if the answer space is blank or incomplete, then it is on the insurer to follow up for more details before issuing the policy.[186]

"Materiality is a broad concept" under federal admiralty law.[187] Perhaps the most comprehensive and most often cited discussion of materiality in marine insurance law is the 1986 Second Circuit *Knight* decision, in which a cargo policy was void *ab initio* because of a misrepresentation of the cargo value and a failure to disclose a previously

June 12, 2013) ("'A party's intent to conceal, or lack thereof, is irrelevant to the *uberrimae fidei* analysis'—the insured's failure to disclose voids the contract and its coverage." (quoting *AGF Marine*, 544 F.3d at 262)).

179. *See* St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 237 (D. Mass. 2007) (stating the "duty to disclose material facts applies even where no inquiry has been made. And the obligation to disclose is independent of intent and is violated even where no intent to deceive is present").

180. N.H. Ins. Co. v. Diller, 678 F. Supp. 2d 288, 297 (D.N.J. 2009).

181. *See AGF Marine*, 544 F.3d at 262 ("The only thing that matters is the existence of a material misrepresentation.").

182. *See generally* Phx. Mut. Life Ins. Co. v. Raddin, 120 U.S. 183 (1887) (discussing the materiality of answers to interrogatories concerning a life insurance policy application).

183. *Id.* at 189.

184. *See id.* at 189–90 (stating when a policy may be avoided).

185. *Id.*

186. *Id.* at 190.

187. *See* Great Lakes Reinsurance (UK) PLC v. Yellow Fin 36 LLC, 736 F. Supp. 2d 1302, 1307 (M.D. Fla. 2010) ("Under federal maritime law, materiality is a broad concept."); *see also* Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1380 (N.D. Fla. 1997) ("The standard for what information qualifies as material is very broad . . . .").

cancelled insurance policy.[188] As previously discussed, the definition of *uberrimae fidei* in *Knight* was derived from *Puritan*: "[T]he parties to a marine insurance policy must accord each other the highest degree of good faith. This stringent doctrine requires the assured to disclose to the insurer all known circumstances that materially affect the risk being insured."[189] This definition of materiality was derived from the 1931 *Btesh* case: "To be material, the fact must be 'something which would have controlled the underwriter's decision' to accept the risk."[190] Therefore, "the materiality of the nondisclosure does not depend on what an investigation would have revealed."[191]

The *Btesh* definition of materiality, as quoted in *Knight*, has been often quoted by district courts.[192] Other circuit and district courts have adopted very similar formulations.[193] For example, also in 1986, the Eleventh Circuit defined materiality as that "which could possibly influence the mind of a prudent and intelligent insurer in determining whether he would accept the risk, and . . . that concealment of such facts

188. Knight v. U.S. Fire Ins. Co., 804 F.2d 9 (2d Cir. 1986).

189. *Id.* at 13 (citing Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 870 (2d Cir. 1985)).

190. *Id.* (quoting Btesh v. Royal Ins. Co., 49 F.2d 720, 721 (2d Cir. 1931)).

191. *Id.*

192. For districts courts that cite *Knight*, see Hartford Ins. Co. v. Garvey, 1989 A.M.C. 652, 659 (N.D. Cal. 1988); Reliance Nat'l Ins. Co. (Europe) Ltd. v. Hanover, 246 F. Supp. 2d 126, 136 (D. Mass. 2003); Fed. Ins. Co. v. PGG Realty, LLC, 538 F. Supp. 2d 680, 687 (S.D.N.Y. 2008); Port Lynch, Inc. v. New Eng. Int'l Assurety of Am., Inc., 754 F. Supp. 816, 822 (W.D. Wash. 1991); and Progressive North Ins. Co. v. Bachmann, 314 F. Supp. 2d 820 (W.D. Wis. 2004).

193. HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1363 (11th Cir. 2000) ("A misrepresentation 'is material if it might have a bearing on the risk to be assumed by the insurer."' (citation omitted)); State Nat'l Ins. Co. v. Anzhela Explorer, LLC, 812 F. Supp. 2d 1326, 1353 (S.D. Fla. 2011) ("[A] misrepresentation or non-disclosure is material if it might have a bearing on the risk to be assumed by the insurer." (citing *HIH Marine Servs.*, 211 F.3d at 1363)); Great Lakes Reinsurance PLC v. Arbos, No. 08-20439-CIV, 2009 WL 8642003, at *4 (S.D. Fla. Jan. 6, 2009) ("A misrepresentation is material if it might have a bearing on the risk to be assumed by the insurer." (citing *HIH Marine Servs.*, 211 F.3d at 1363)); Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1380 (N.D. Fla. 1997) ("[I]n the case of marine insurance a fact is material if it might have a bearing on the risk to be assumed by the insurer."); *PGG Realty*, 538 F. Supp. 2d at 687 ("To be material, a fact must be something . . . which 'would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk."' (citation omitted)); Am. Home Assurance Co. v. Masters' Ship Mgmt. S.A., 423 F. Supp. 2d 193, 221 (S.D.N.Y. 2006) ("A fact is material if it is something 'likely to influence [the underwriter's] judgment in accepting the risk."' (quoting Sun Mut. Ins. Co. v. Ocean Ins. Co., 107 U.S. 485, 509 (1883))); Albany Ins. Co. v. Wisniewski, 579 F. Supp. 1004, 1015 (D.R.I. 1984) ("[T]he misrepresentation must be material, that is, 'it must be something which would have controlled the underwriter's decision . . . . [A] circumstance which 'would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk."' (citations omitted)); Crowley Marine Servs., Inc. v. Hunt, 1995 A.M.C. 2562, 2569 (W.D. Wash. 1995) ("A fact is material if it would influence the judgment of a reasonable insurer in fixing the premium or in determining if it will take the risk." (citations omitted)).

voids the policy, whether the concealment be due to fraud, negligence, accident, or mistake."[194] Similarly, in one 2006 case, the First Circuit defined a material misrepresentation as "one that affects the insurer's decision to accept the risk and insure the applicant"[195] and a material fact as "that which can possibly influence the mind of a prudent and intelligent insurer in determining whether it will accept the risk."[196] In another case in 2006, the First Circuit stated:

> Absent a different regime imposed by statute, an insurance contract is ordinarily voidable if a false statement in the application was "material"—materiality meaning something that affects the risk and might lead either to a higher premium or a refusal of insurance. There are various formulations: one treatise says that in the marine insurance context a material fact is "that which can possibly influence the mind of a prudent and intelligent insurer in determining whether it will accept the risk."[197]

In 2008, the Third Circuit took a critical look at the Second Circuit's definition of materiality in *Knight* and found it to be too narrow.[198] Examining the question of materiality "from the perspective of a reasonable person in the insured's position,"[199] the circuit court determined a fact does not necessarily need to "control an underwriter's decision in order to be material."[200] Although the Third Circuit never arrived at a definition of materiality, it was persuaded by the analysis of the Ninth Circuit in *New Hampshire Insurance Co. v. C'Est Moi, Inc.*,[201] wherein the court determined the purchase price of a vessel was a material fact in an application for marine insurance.[202]

The materiality standards proffered in recent cases have sounded very similar to the *Btesh* standard offered in *Knight*. In 2010, the Middle District

194. Kilpatrick Marine Piling v. Fireman's Fund Ins. Co., 795 F.2d 940, 942–43, 943 n.2 (11th Cir. 1986) (concurring with the lower court's statement of law); *see also Barlow*, 983 F. Supp. at 1383 (N.D. Fla. 1997) (rejecting defendant's reliance on case law that narrowly interprets materiality in context of state insurance law, and instead favoring a widely accepted definition in context of federal admiralty law).

195. Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 38 (1st Cir. 2006).

196. *Id.*; *see also* St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 240 (D. Mass. 2007) ("Though the notion of materiality is subjective by nature, it has been defined in these circumstances as 'that which can possibly influence the mind of a prudent and intelligent insurer in determining whether it will accept the risk.'" (quoting *Pesante*, 459 F.3d at 38)).

197. Grande v. St. Paul Fire & Marine Ins. Co., 436 F.3d 277, 282–83 (1st Cir. 2006) (quoting 4A APPLEMAN & APPLEMAN, INSURANCE LAW AND PRACTICE § 2651 (rev. ed. Supp. 2005)).

198. AGF Marine Aviation & Transp. v. Cassin, 544 F.3d 255, 265 (3d Cir. 2008).

199. *Id.* at 264.

200. *Id.* at 265.

201. N.H. Ins. Co. v. C'Est Moi, Inc., 519 F.3d 937 (9th Cir. 2008).

202. *AGF Marine*, 544 F.3d at 265.

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

of Florida defined materiality as "that which could possibly influence the mind of a prudent and intelligent insurer in determining whether he would accept the risk."[203] That same year the Southern District of Florida defined a material misrepresentation as one that "might have a bearing on the risk to be assumed by the insurer."[204] In 2013, the District of the Virgin Islands defined a material fact "for purposes of the *uberrimae fidei* doctrine if it would have either prevented an insurer from issuing a policy or prompted an insurer to issue the policy at a higher premium had it been disclosed before the policy was executed."[205] The Southern District of California adopted a strikingly similar definition.[206]

The Southern District of New York's discussion of materiality in 2014 both summarized and affirmed existing Second Circuit precedent. According to the district court, "A non-disclosed fact is material if it would have affected the insurer's decision to insure at all or at a particular premium."[207] The district court adopted an objective standard for materiality that focused on "whether a reasonable person in the assured's position would know that the particular fact is material."[208] However, the district court also envisioned a subjective element to materiality, making the materiality inquiry bipartite: "(i) would a reasonable insured believe that the disclosure would be material to the insurer's decision; and (ii) was the non-disclosure in fact material to the insurer's decision?"[209]

The Eleventh Circuit in 2015 affirmed prior circuit precedent, relying heavily on *M'Lanahan*. The circuit court first emphasized that materiality is a broadly defined concept, which must be evaluated from "the perspective of a reasonable insurer."[210] The test for materiality was whether the fact could "possibly influence the mind of a prudent and intelligent insurer in determining whether he would accept the risk."[211] According to the

203. Great Lakes Reinsurance (UK) PLC v. Yellow Fin 36 LLC, 736 F. Supp. 2d 1302, 1307 (M.D. Fla. 2010) (quoting Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1379 (N.D.Fla. 1997)).

204. Great Lakes Reinsurance (UK) PLC v. Morales, 760 F. Supp. 2d 1315, 1325 (S.D. Fla. 2010) (quoting HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1363 (11th Cir. 2000)).

205. Great Lakes Reinsurance (UK) PLC v. Kranig, No. 2011-122, 2013 WL 2631861, at *7 (D.V.I. June 12, 2013) (citations omitted).

206. McAdam v. State Nat'l Ins. Co., Inc., 28 F. Supp. 3d 1110, 1123 (S.D. Cal. 2014) ("Material facts are those that tend to bear upon an insurer's decision to accept the risk, the premium, or the terms under which the risk is insured." (citations omitted)).

207. Fireman's Fund Ins. Co. v. Great Am. Ins. Co., 10 F. Supp. 3d 460, 477 (S.D.N.Y. 2014) (quoting N.Y. Marine & Gen. Ins. Co. v. Tradeline LLC, 266 F.3d 112, 123 (2d Cir. 2001)).

208. *Id.* (quoting Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 13 (2d Cir. 1986)).

209. *Id.* (quoting Fed. Ins. Co. v. PGG Realty, LLC, 538 F. Supp. 2d 680, 688 (S.D.N.Y. 2008)).

210. AIG Centennial Ins. Co. v. O'Neill, 782 F.3d 1296, 1303–04 (11th Cir. 2015).

211. *Id.* (quoting Kilpatrick Marine Piling v. Fireman's Fund Ins. Co., 795 F.2d 940, 942–43 (11th Cir. 1986)).

Eleventh Circuit, because the insured is in the best position to know all the material facts, if he conceals or misrepresents a material fact, he commits "manifest fraud" and "avoids the policy."[212] Accident, mistake, negligence, and voluntary ignorance do not excuse the result.[213]

2. Disclosure

"The doctrine of *uberrima fidei* requires the parties to a marine [insurance] contract exercise the highest degree of good faith and fully disclose all facts material to the risk."[214] As the District Court of Massachusetts stated in 2007, "If the information is material, it must be disclosed."[215] However, the insured is not required to make "a minute disclosure of every material circumstance."[216] The general rule is the insured has to supply sufficient information to call the underwriter's attention to the matter in such a way so he can ask for additional information.[217] However, once information is determined to be material, the insured must disclose it regardless of a specific request by the insurer.[218]

---

212. *See id.* at 1303 (citations omitted) (requiring the insured to disclose fully all material facts to the insurance provider so the insurance provider can make an informed decision).

213. *Id.*; *see also* Kilpatrick Marine Piling v. Fireman's Fund Ins. Co., 795 F.2d 940, 943 (11th Cir. 1986) (stating a policy is void even if the non-disclosure is due to negligence, mistake, accident, or fraud).

214. Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1380 (N.D. Fla. 1997); *see also* Fed. Ins. Co. v. PGG Realty, LLC, 538 F. Supp. 2d 680, 687 (S.D.N.Y. 2008) ("Under the doctrine of utmost good faith, the party applying for marine insurance must 'disclose all circumstances known to him which materially affect the risk.'" (quoting Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 870 (2d Cir. 1985))).

215. St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 240 (D. Mass. 2007).

216. Am. Home Assurance Co. v. Masters' Ship Mgmt. S.A., 423 F. Supp. 2d 193, 221–22 (S.D.N.Y. 2006).

217. *Id.*

218. HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1362 (11th Cir. 2000) ("The duty to disclose extends to those material facts not directly inquired into by the insurer." (citations omitted)); Pringle v. Water Quality Ins. Syndicate, 646 F. Supp. 2d 1161, 1169 (C.D. Cal. 2009) ("Further, an insured is 'obligated to disclose all material information, regardless of a request by' the insurer." (quoting Certain Underwriters at Lloyds, London v. Inlet Fisheries Inc., 518 F.3d 645, 648 (9th Cir. 2008))); *see also* St. Paul Fire & Marine Ins. Co. v. Abhe & Svoboda, Inc., 798 F.3d 715, 719 (8th Cir. 2015) ("Because the insured is in the best position to know of any facts that may be material to the risk, the insured is obligated to disclose those facts to the insurer, regardless of whether the insurer makes a specific inquiry."); Cigna Prop. & Cas. Ins. Co. v. Polaris Pictures Corp., 159 F.3d 412, 420 (9th Cir. 1998) ("Whether or not asked, an applicant for a marine insurance policy is bound to reveal every fact within his knowledge that is material to the risk." (citations omitted)); *Barlow*, 983 F. Supp. at 1380 ("The doctrine of *uberrima fidei* places a strict burden on the insured to disclose all material facts."); State Nat'l Ins. Co. v. Anzhela Explorer, LLC, 812 F. Supp. 2d 1326, 1351 (S.D. Fla. 2011) ("The duty of good faith by necessity extends to those facts not directly inquired into by the insurer."

It is the insured who bears the burden of disclosure.[219] The prospective insured must "voluntarily and accurately disclose to the insurance company all facts which might have bearing on the insurer's decision to accept or reject the risk."[220] From as early as 1949, it has been held in the marine insurance context that "an applicant for marine insurance must state all material facts which are known to him and unknown to the insurer."[221] Not only must the prospective insured disclose every material fact actually known to him but he also "is deemed to know every circumstance which in the ordinary course of business ought to be known to him."[222] This is "because the insured is in the best position to know of any facts that may be material to the risk."[223] When

---

(citations omitted)); Great Lakes Reinsurance PLC v. Arbos, No. 08-20439-CIV, 2009 WL 8642003, at *4 (S.D. Fla. Jan. 6, 2009) ("The duty to disclose extends to those material facts not directly inquired into by the insurer."); *Halifax Trawlers*, 495 F. Supp. 2d at 237 ("This duty to disclose material facts applies even where no inquiry has been made."); Albany Ins. Co. v. Wisniewski, 579 F. Supp. 1004, 1014 (D.R.I. 1984) ("The insured is bound, even absent inquiry, to reveal every fact within his knowledge which is material to the risk"); Progressive N. Ins. Co. v. Bachmann, 314 F. Supp. 2d 820, 827 (W.D. Wis. 2004) ("The insured is bound to communicate all material information voluntarily regardless whether the insurer made any inquiry concerning it."); Stecker v. Am. Home Fire Assurance Co., 84 N.E. 2d 797, 798–99 (N.Y. 1949) ("In marine insurance, the insured is bound, although no inquiry be made, to disclose every fact material to the risk, within his knowledge." (quoting Gates v. Madison Cty. Mut. Ins. Co., 5 N.Y. 469, 474 (1851))).

219. *HIH Marine Servs.*, 211 F.3d at 1363 ("The central principle of *uberrimae fidei*, however, is that the *insured* bears the burden of full and voluntary disclosure of facts material to the decision to insure."); *see also PGG Realty*, 538 F. Supp. 2d at 687–88 ("It is important to bear in mind that the insurer is not placed on a duty of inquiry; rather, 'the insured is bound to communicate every material fact within his knowledge not known or presumed to be known to the underwriter, whether inquired for or not.'" (quoting Gulfstream Cargo, Ltd. v. Reliance Ins. Co., 409 F.2d 974, 980–81 (5th Cir. 1969))).

220. Great Lakes Reinsurance (UK) PLC v. Morales, 760 F. Supp. 2d 1315, 1323 (S.D. Fla. 2010) (quoting Certain Underwriters at Lloyd's, London v. Giroire, 27 F. Supp. 2d 1306, 1311 (S.D.Fla. 1998)); *see also* N.H. Ins. Co. v. C'Est Moi, Inc., 519 F.3d 937, 938 (9th Cir. 2008) (stating *uberrimae fidei* "'imposes a duty of utmost good faith'" such that an applicant for a marine insurance policy must reveal that which is within his knowledge and is material to the risk (quoting *Inlet Fisheries*, 518 F.3d at 648)); AIG Centennial Ins. Co. v. O'Neill, 782 F.3d 1296, 1303 (11th Cir. 2015) ("And from duty springs obligation: an insured must 'fully and voluntarily disclose to the insurer all facts material to a calculation of the insurance risk.'" (quoting *HIH Marine Servs.*, 211 F.3d at 1362)); *Anzhela Explorer*, 812 F. Supp. 2d at 1351 ("The doctrine requires that an insured fully and voluntarily disclose to insurer facts material to a calculation of the insurance risk."); *Wisniewski*, 579 F. Supp. at 1016 ("[T]he law of marine insurance imposes a duty upon the insured to disclose voluntarily to the insurer, even though no inquiry is made, every material fact and circumstance within his knowledge and unknown (or fairly presumed to be unknown) to the insurer; and failure to do so—intentionally or otherwise—allows the insurer to have the contract declared void *ab initio*.").

221. *Stecker*, 84 N.E. 2d at 799.

222. Reliance Ins. Co. v. McGrath, 671 F. Supp. 669, 677 (N.D. Cal. 1987).

223. *Abbe & Svoboda*, 798 F.3d at 719; *see also HIH Marine Servs.*, 211 F.3d at 1363 ("[T]he law has placed the burden of good faith disclosure with the person in the best position to know all the

the insured fails in his duty of disclosure, the marine insurance policy is voidable at the option of the insurer.[224]

The reasons for the strict marine insurance law doctrine regarding disclosures originated in the age of sail.[225] For example, a Maryland ship insurance case decided in 1840 laid the groundwork for the modern *uberrimae fidei* disclosure requirements. The state judge determined if a party obtains "a material fact" while his agent is negotiating for insurance, he must promptly communicate such fact to the insurer.[226] Both promptness and diligence were required lest the insured "bear the consequences of his neglect."[227] Such a strict rule was made necessary because it was impossible to define the line between "prompt attention" and "unreasonable delay," and it was difficult to ascertain the motives behind the insured's actions.[228]

In *Knight*, the Second Circuit stated "the assured is required to communicate the information to the insurer before the policy is issued, so that the insurer can decide for itself at that time whether to accept the risk."[229] The insured bears the obligation of communication because it is less burdensome to him and "it comports with the open disclosure required by the doctrine of *uberrimae fidei*."[230] The duty to disclose is also "based on the rationale that requiring the marine insurer to investigate each and every claim made by those applying for coverage 'would be both time consuming and expensive.'"[231]

The obligation of disclosure includes both misrepresentation and concealment of material facts.[232] According to the Eleventh Circuit,

---

facts: the insured.").

224. Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 974 F. Supp. 2d 64, 78 (D.P.R. 2013) ("When the insured fails to disclose to the insurer all circumstances known to it and unknown to the insurer, which materially affect the risk, the policy is voidable at the option of the innocent party."); *see also McGrath*, 671 F. Supp. at 678 ("A marine insurance policy is void *ab initio* where the assured fails to disclose material increases in the risk insured.").

225. *Stecker*, 84 N.E. 2d at 799 ("The reasons which brought into being the strict marine insurance law doctrine as to disclosures, go far back into the early days of marine insurance, when sailing ships in faraway seas were insured in London by underwriters who could get no information except from the shipowners.").

226. Neptune Ins. Co. v. Robinson, 11 Gill & J. 256, 260 (Md. 1840) ("Thus, if a party with knowledge, that his agent is in treaty for insurance, obtains information of a material fact, he is bound promptly to use the means of communicating it.").

227. *Id.*

228. *Id.*

229. Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 14 (2d Cir. 1986).

230. *Id.*

231. HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1363 (11th Cir. 2000) (quoting Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1383 (N.D. Fla. 1997)).

232. Albany Ins. Co. v. Wisniewski, 579 F. Supp. 1004, 1014–15 (D.R.I. 1984) ("Distortion of

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

> In the context of marine insurance, "concealment" is the failure to disclose any material fact or circumstance in relation to the subject matter of the contract which may increase the liability to loss, or affect the risk assumed, and which is, in fact or law, within or ought to be within, the knowledge of one party, and of which the other party has no actual or presumptive knowledge.[233]

In general, an objective standard for disclosure applies "whether a reasonable person in the insured's position would know that a particular fact is material."[234] However, the rule going back to an 1830 Massachusetts case states, if the underwriter already knows the material facts, the policy is not voided.[235] Nevertheless, the insurer generally bears the burden of proving the insured failed to disclose material information.[236]

3. Reliance

In 1965, the District of Massachusetts held a marine insurance policy "cannot be voided for misrepresentation where the alleged misrepresentation was not relied upon and did not in any way mislead the insurer."[237] This statement was incorporated into one of the core holdings of the well-known Second Circuit *Puritan* case.[238] As recently as 2014, the Southern District of New York acknowledged this Second

---

the factual underpinnings upon which the contract of marine insurance rests, fairly attributable to the insured, cedes to the insurer a right to rescind, irrespective of whether the warp is brought about by knowing concealment of relevant facts or by outright misrepresentation.").

233. Great Lakes Reinsurance (UK) PLC v. Yellow Fin 36 LLC, 736 F. Supp. 2d 1302, 1307–08 (M.D. Fla. 2010) (quoting Steelmet, Inc. v. Caribe Towing Corp., 747 F.2d 689, 695 (11th Cir. 1984)).

234. Hartford Ins. Co. v. Garvey, 1989 A.M.C. 652, 659 (N.D. Cal. 1988); *see* Am. Home Assurance Co. v. Masters' Ship Mgmt S.A., 423 F. Supp. 2d 193, 221 (S.D.N.Y. 2006) (quoting *Knight*, 804 F.2d at 13); *see also* Great Lakes Reinsurance (UK) PLC v. Kranig, No. 2011-122, 2013 WL 2631861, at *8 (D.V.I. June 12, 2013) ("An objective standard for disclosure applies—that is, whether a reasonable insured would believe that a particular fact is material to the insurer's decision regarding whether to accept the risk and on what terms.").

235. Green v. Merchants' Ins. Co., 27 Mass. 402, 413 (1830) ("It is a well[-]known rule of law, that the concealment, or rather silence of the assured in regard to facts already known to the underwriter, if no inquiry is made on the subject, although the facts are material to the risk, will not vacate the policy.").

236. *Kranig*, 2013 WL 2631861, at *8 ("The burden of proof of a material nondisclosure or misrepresentation lies with the insurer.").

237. Rose & Lucy, Inc. v. Resolute Ins. Co., 249 F. Supp. 991, 992 (D. Mass. 1965).

238. Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 871 (2d Cir. 1985) (reiterating "a marine insurance policy 'cannot be voided for misrepresentation where the alleged misrepresentation was not relied upon and did not in any way mislead the insurer'" (quoting *Rose & Lucy*, 249 F. Supp. at 992)).

https://commons.stmarytx.edu/thestmaryslawjournal/vol47/iss4/1

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

Circuit holding.[239]

The element of reliance in *uberrimae fidei* figured into a 1987 opinion from the Northern District of California. There, the district court wrote, "A material concealment in reliance upon which a policy is issued is grounds for avoidance of the policy whether the concealment is made with knowledge of its falsity or instead is made through a good faith mistake."[240] In 2011, the Southern District of Florida echoed this approach when it sought to make avoidance of a marine insurance policy under *uberrimae fidei* a two-step process: (1) The insurer must demonstrate materiality; and (2) the insurer must demonstrate reliance.[241]

A 2015 Eighth Circuit case, *St. Paul Fire & Marine Insurance Co. v. Abbe & Svoboda, Inc.*,[242] focused almost exclusively on the issue of reliance via the doctrine of *uberrimae fidei* in marine insurance law. The circuit court first distinguished materiality from reliance: "While materiality examines whether a fact would have influenced the judgment of a *reasonable and prudent* underwriter, reliance examines whether there was a causal connection between the misrepresentation or concealment of that material fact and the actual underwriter's decision to issue the policy."[243] Finding "surprisingly little authority" on the issue of "whether a showing of reliance is required to void a[] [marine] insurance policy under the doctrine of *uberrimae fidei*," the Eighth Circuit noted the Second Circuit's *Puritan* decision was "[t]he principle case to address the question directly."[244] In *Puritan*, the Second Circuit held, "The principle of *uberrimae fidei* does not require the voiding of the contract unless the undisclosed facts were material and relied upon."[245]

The Eighth Circuit interpreted this holding as requiring an insurer to "show reliance on an insured's nondisclosure, regardless of whether the insurer had knowledge" of the omission when "it decided to issue the

239. Fireman's Fund Ins. Co. v. Great Am. Ins. Co., 10 F. Supp. 3d 460, 477 (S.D.N.Y. 2014) ("Even if a non-disclosed fact is material, however, the policy 'cannot be voided for misrepresentation where the alleged misrepresentation was not relied upon and did not in any way mislead the insurer.'" (quoting *Puritan*, 779 F.2d at 871)).

240. Reliance Ins. Co. v. McGrath, 671 F. Supp. 669, 677 (N.D. Cal. 1987).

241. State Nat'l Ins. Co. v. Anzhela Explorer, LLC, 812 F. Supp. 2d 1326, 1352 (S.D. Fla. 2011) ("To void a policy, the insurer must show, first, that a misrepresentation or non-disclosure was indeed made by the insured prior to coverage attaching and, second, that this deficient disclosure was material to or relied upon by the insurer.").

242. St. Paul Fire & Marine Ins. Co. v. Abhe & Svoboda, Inc., 798 F.3d 715 (8th Cir. 2015).

243. *Id.* at 722 (citation omitted).

244. *Id.* at 719–20.

245. Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 871 (2d Cir. 1985).

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

policy."[246] Because the Eighth Circuit found the Second Circuit's reasoning to be analogous to general contract law, it was persuaded by the Second Circuit's holding and adopted the requirement of causation "in the context of marine insurance contracts."[247] The Eighth Circuit then surveyed the status of the reliance requirement in the other federal circuit courts.[248] The Ninth and the Eleventh Circuits apply "a subjective test for materiality that asks whether the insurer in fact would have found the omitted information to be material."[249] Therefore, "[t]o satisfy the materiality element of the *uberrimae fidei* defense in these jurisdictions, insurers must show that," had they known about the undisclosed fact, they either "would not have issued the policy[] or would have issued it at a different premium."[250] Other decisions in the Fifth and Ninth Circuits "applying the *uberrimae fidei* defense rely on evidence of actual reliance or inducement on the part of the insurer, even where they have not articulated reliance as a requirement distinct from materiality."[251]

C. *Positions of the United States Circuit Courts on* Uberrimae Fidei

Although apparently abstract, the determination of whether a particular doctrine is a judicially established federal admiralty rule can be dispositive in admiralty cases because the *Wilburn Boat* choice-of-law analysis hinges on that determination.[252] According to the clear dictate of *Wilburn Boat,* the question is whether there is a "judicially established federal admiralty rule governing" the marine insurance issue.[253] Unfortunately, the Court provided little guidance on how to determine what "a judicially established federal admiralty rule" looks like.[254] One United States district court

246. *Abbe & Svoboda*, 798 F.3d at 720.

247. *See id.* ("We find the Second Circuit's reasoning persuasive. In general contract law, a misrepresentation by omission has no legal effect 'unless it induces action by the recipient, that is, unless [the recipient] manifests his assent to the contract in reliance on it.' . . . In other words, a party is required to show a causal connection between the other party's omission and the issuing of the contract. . . . We discern no reason why the requirement of causation should be removed in the context of marine insurance contracts." (alteration in original) (citations omitted)).

248. *Id.* at 721.

249. *Id.*

250. *Id.*

251. *Id.*

252. *See* Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 778 F.3d 69, 80 (1st Cir. 2015) ("The question of whether a doctrine is an established rule of maritime law, though seemingly abstruse, is of vital importance in admiralty cases as it can prove to be dispositive in controversies such as the dispute at hand.").

253. Wilburn Boat Co. v. Fireman's Fund Ins. Co., 348 U.S. 310, 314 (1955).

254. Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 650 (9th Cir. 2008) ("*Wilburn Boat* itself provides limited direction on how we are to determine whether a rule is

posited the fact a state law was newer than or conflicted with the federal admiralty law was not enough for the state law to trump the federal admiralty law.[255] However, across the United States circuits, the requirements and terminology used are different. For example, the Fifth Circuit requires the federal admiralty rule to be "entrenched federal precedent"[256] to gain precedence over state law, which is not surprising given the three-part test favoring the application of state law in that circuit. The Ninth Circuit requires a federal admiralty rule be "sufficiently longstanding and accepted within admiralty law that it can be said to be 'established.'"[257] The Eighth Circuit mimics the Ninth Circuit approach of "an established rule of federal maritime law."[258] The Second Circuit avoided the *Wilburn Boat* analysis entirely in *Puritan* by finding *uberrimae fidei* was a well-established rule.[259] The First Circuit mixes the Second and Ninth Circuit requirements and "only appl[ies] federal maritime rules that are established and settled."[260] Finally, the Eleventh Circuit puts its own gloss on the Second Circuit requirement and requires federal admiralty rules to be both "well settled" and a "clear rule of maritime law."[261]

Prior to *Wilburn Boat* in 1955, "it was generally accepted that *uberrimae fidei* applied to" marine insurance contracts.[262] However, the choice-of-law analysis propounded by the decision limited the possible scenarios

---

'judicially established.'" (quoting *Wilburn Boat*, 348 U.S. at 314)).

255. *See* ABB Power T & D Co. v. Gothaer Versicherungsbank VVAG, 939 F. Supp. 1568, 1580 (S.D. Fla. 1996) ("According to the clear dictate of *Wilburn*, federal maritime law, *where entrenched*, preempts state law[] and controls the interpretation of a marine insurance contract. The fact that a state law exists, in direct conflict with a federal maritime rule is a factor to be taken into account when determining what law to apply, but that is a far cry from stating the proposition that, since the state law is *newer*[,] it must reign supreme.").

256. Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 888 (5th Cir. 1991).

257. *Inlet Fisheries*, 518 F.3d at 650.

258. N.Y. Marine & Gen. Ins. Co. v. Cont'l Cement Co., 761 F.3d 830, 840 (8th Cir. 2014) (quoting *Inlet Fisheries*, 518 F.3d at 654).

259. *See* Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 870 (2d Cir. 1985) (agreeing with the maxim "parties to a marine insurance contract are held to the highest degree of good faith").

260. Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 778 F.3d 69, 80 (1st Cir. 2015).

261. Steelmet, Inc. v. Caribe Towing Corp., 747 F.2d 689, 695 (11th Cir. 1984) ("The general rule of marine insurance, requiring full disclosure, is well settled in this circuit, and as a clear rule of maritime law it is the controlling federal rule even in the face of contrary state authority."); *see also* Kilpatrick Marine Piling v. Fireman's Fund Ins. Co., 795 F.2d 940, 942 (11th Cir. 1986) (citing *Steelmet*, 747 F.2d at 695) (underscoring the Eleventh Circuit's requirement for full disclosure for marine insurance).

262. St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 985 (N.D. Ill. 1993) ("Prior to 1955, it was generally accepted that *uberrimae fidei* applied to all of the conduct which assureds and insurers accorded each other regarding marine insurance.").

when the doctrine applied.[263] Over the past sixty years, United States circuit courts have decided one by one whether *uberrimae fidei* is a judicially established federal admiralty rule that supersedes state law.

1. Second Circuit

Within the Second Circuit, the Southern District of New York was an early proponent of *uberrimae fidei* as universally applicable to marine insurance contracts.[264] In 2006, after citing extensive definitions from *M'Lanahan* and *Sun Mutual*, the Southern District of New York affirmed "[t]he duty of utmost good faith is an established federal admiralty rule."[265]

2. Eleventh Circuit

Writing in 2015, the Eleventh Circuit refers to "[t]he age-old federal marine-insurance doctrine of *uberrimae fidei* . . . [that] provides 'the controlling federal rule even in the face of contrary state authority.'"[266] However, this circuit recognized *uberrimae fidei* as a judicially established federal admiralty rule almost since its inception.[267] In 1997, one district court within the Eleventh Circuit noted *uberrimae fidei* had been accepted since the *Steelmet* decision in 1984.[268] This assertion is supported by an unpublished Southern District of Florida opinion from 2009[269] and a published Southern District of Florida opinion from 2011.[270] The latter

263. *See id.* at 985–86 ("Some confusion sprung up that year when *Wilburn Boat Co. v. Fireman's Fund Ins. Co.* constricted the range of scenarios to which *uberrimae fidei* applied.").

264. Contractors Realty Co. v. Ins. Co. of N. Am., 469 F. Supp. 1287, 1294 (S.D.N.Y. 1979) ("It is undeniable that parties to a contract of marine insurance must be held to a standard of the highest fidelity in their dealings."); *see also* Thebes Shipping, Inc. v. Assicurazioni Ausonia SPA., 599 F. Supp. 405, 426 (S.D.N.Y. 1984) ("There can be no dispute about the principles of law applicable to marine insurance contracts."). For a discussion of *Thebes Shipping* as exemplifying the "established" nature of *uberrimae fidei*, see generally Beer, *supra* note 52, at 149.

265. Am. Home Assurance Co. v. Masters' Ship Mgmt. S.A., 423 F. Supp. 2d 193, 221 (S.D.N.Y. 2006) (citing Puritan Ins. Co. v. Eagle S.S. Co. S.A., 779 F.2d 866, 870 (2d Cir. 1985)).

266. AIG Centennial Ins. Co. v. O'Neill, 782 F.3d 1296, 1302–03 (11th Cir. 2015) (quoting *Steelmet*, 747 F.2d at 695).

267. *See id.* at 1303 (acknowledging *uberrimae fidei* is the controlling law within the Eleventh Circuit's jurisdiction).

268. *See* Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1379 (N.D. Fla. 1997) ("*Uberrima fidei*, requiring parties to a maritime contract to deal in utmost good faith and full disclosure, has been accepted in the Eleventh Circuit as firmly entrenched precedent, controlling even in the face of contrary state authority.").

269. Great Lakes Reinsurance PLC v. Arbos, No. 08-20439-CIV, 2009 WL 8642003, at *4 (S.D. Fla. Jan. 6, 2009).

270. State Nat'l Ins. Co. v. Anzhela Explorer, LLC, 812 F. Supp. 2d 1326, 1351 (S.D. Fla. 2011).

opinion grounded its findings in the *Gulfstream Cargo, Ltd. v. Reliance Insurance Co.*[271] decision before the circuit split: "As our predecessor circuit explained, '[n]othing is better established in the law of marine insurance than that a mistake or commission material to a marine risk, whether it be wil[l]ful or accidental, or result from mistake, negligence or voluntary ignorance, avoids the policy.'"[272] In 2000, the Eleventh Circuit declared *uberrimae fidei* was "well-settled" and the "controlling law" of the circuit.[273] An unpublished circuit opinion in 2008 cited *HIH Marine Services* as establishing the doctrine of *uberrimae fidei* as controlling law of the Eleventh Circuit.[274]

3. Fifth Circuit

In 1991, the Fifth Circuit authored *Albany Insurance Co. v. Anh Thi Kieu*,[275] which discussed the doctrine of *uberrimae fidei* at length. The circuit court noted "repeated references" to *uberrimae fidei* appear in early United States Supreme Court insurance cases;[276] however, the "sole remaining substantial vestige of the doctrine" today is in marine insurance law.[277] The circuit court found only three cases examining the availability of *uberrimae fidei* within the Fifth Circuit, and none of them applied the doctrine to void a marine insurance contract.[278] The Fifth Circuit recognized the doctrine of *uberrimae fidei* but never applied it because the court determined the doctrine was not an "entrenched federal precedent."[279]

Other United States federal circuits have criticized the *Anh Thi Kieu* decision. The Ninth Circuit characterized the Fifth Circuit's analysis as "not persuasive" and an abrupt change of course.[280] The court explained,

---

271. Gulfstream Cargo, Ltd. v. Reliance Ins. Co., 409 F.2d 974 (5th Cir. 1969).

272. *Anzhela Explorer*, 812 F. Supp. 2d at 1351 (first alteration in original) (quoting *Gulfstream Cargo*, 409 F.2d at 980).

273. *See* HIH Marine Servs. Inc. v. Fraser, 211 F.3d 1359, 1362 (11th Cir. 2000) (citing cases from 1984 to 1996).

274. Markel Am. Ins. Co. v. Nordarse, 297 F. App'x 852, 853 (11th Cir. 2008) (citing *HIH Marine Servs.*, 211 F.3d at 1362).

275. Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882 (5th Cir. 1991).

276. *Id.* at 888 (first citing Stipcich v. Metro. Life Ins. Co., 277 U.S. 311, 316 (1928); and then citing Phx. Mut. Life Ins. Co. v. Raddin, 120 U.S. 183, 189 (1887)).

277. *See id.* (citing marine insurance treatises from 1934, 1950 and 1952).

278. *Id.* at 889 ("None of the opinions of this Court which have cited the *uberrimae fidei* doctrine *authoritatively* conclude, however, that the doctrine applies to the exclusion of state law. For that matter, no opinion of this Court has ever explicitly authorized the application of the *uberrimae fidei* doctrine to invalidate a marine insurance policy.").

279. *Id.*

280. Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 652, 653

"It does violence to the meaning of the term 'entrenched' to reason that because few cases have disputed the application of *uberrimae fidei,* it has somehow become unmoored or 'unentrenched.'"[281] At the conclusion of its analysis, the Ninth Circuit found it "[n]ot surprising[]" that "no other circuit has followed *Anh Thi Kieu* . . . [because] in the face of 200 years of precedent, it takes more than a single circuit case and spotty citation in recent years to uproot an entrenched doctrine."[282] In 2008, the Third Circuit accepted *uberrimae fidei* as a judicially established federal admiral rule, but not before highlighting that the Fifth Circuit's rejection of the doctrine was heavily criticized by courts and scholars[283] and that it was the only federal circuit to "disavow" the precedential effect of *uberrimae fidei.*[284] Likewise, in a February 2015 opinion acknowledging *uberrimae fidei* as a judicially established federal admiralty rule, the First Circuit characterized the Fifth Circuit opinion as "heavily criticized"[285] and recognized the Fifth Circuit stood alone in its rejection of the doctrine.[286]

4. Seventh Circuit

The Northern District of Illinois wrote in 1993 regarding the Seventh Circuit position on *uberrimae fidei.*[287] At the time, the Seventh Circuit had addressed neither the problem of the *Wilburn Boat* choice-of-law analysis nor the question of *uberrimae fidei* as a judicially established federal admiralty law.[288] In deciding whether *uberrimae fidei* was an established federal precedent, the district court considered three factors: judicial precedent, the history of the insurance industry, and "the need for uniformity and coherence of a vital international industry."[289] Although the district court limited its decision to certain matters, it determined that *uberrimae fidei* was an established federal admiralty law that superseded state

---

(9th Cir. 2008).

281. *Id.* at 653.

282. *Id.*

283. *See* AGF Marine Aviation & Transp. v. Cassin, 544 F.3d 255, 263 (3d Cir. 2008) ("The Fifth Circuit's position has been criticized quite heavily, most recently by the Ninth Circuit in *Inlet Fisheries.* It also contradicts the general sentiment in scholarly literature." (citations omitted)).

284. *Id.*

285. Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 778 F.3d 69, 80 n.13 (1st Cir. 2015) (citing *Inlet Fisheries,* 518 F.3d at 650–54).

286. *Id.*; *see also Cassin,* 554 F.3d at 263 ("The Fifth Circuit is alone in holding that *uberrimae fidei* is 'not entrenched federal precedent.'" (quoting Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 889 (5th Cir. 1991))).

287. St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 986 (N.D. Ill. 1993).

288. *Id.*

289. *Id.* at 988.

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

law.[290] The limitation of the decision was to "ongoing contractual obligations between parties engaged in international and commercial matters."[291] In a footnote, the district court reserved its opinion on whether *uberrimae fidei* would apply to marine insurance contracts that were of "a less commercial or international scope."[292]

In 2004, the Western District of Wisconsin refused to apply *uberrimae fidei* in a declaratory action by an insurer to cover damage to a thirty-four-foot powerboat that was operated on internal navigable waters of the United States.[293] However, rather than subvert the doctrine of *uberrimae fidei*, the district court distinguished the case from *St. Paul Insurance Co. of Illinois v. Great Lakes Turnings*[294] based on specific facts that did not warrant the application of federal admiralty law.[295]

5. Fourth Circuit

The District of South Carolina wrote in 2001 regarding the Fourth Circuit position on *uberrimae fidei*.[296] The district court began its discussion by acknowledging most courts faced with the issue have applied utmost good faith to marine insurance contracts.[297] The court also acknowledged the recent *Anh Thi Kieu* decision that disavowed the entrenchment of *uberrimae fidei* as federal precedent.[298] However, the

290. *See id.* ("Indeed, to decide that *uberrimae fidei* is not established federal precedent in this dispute would require this court to ignore four hundred years of judicial decisions, the entire history of insurance, and the need for uniformity and coherence of a vital international industry. Accordingly, the federal admiralty doctrine of *uberrimae fidei* applies to marine insurance disputes over ongoing contractual obligations between parties engaged in international and commercial matters."); *see also* Progressive N. Ins. Co. v. Bachmann, 314 F. Supp. 2d 820, 829 (W.D. Wis. 2004) ("In a thoroughly researched and well-reasoned opinion, the [Northern District of Illinois] court concluded that *uberrimae fidei* is established federal precedent that should supersede state law 'in marine insurance disputes over ongoing contractual obligations between parties engaged in international and commercial matters.'" (quoting *Great Lakes Turnings*, 829 F. Supp. at 988)).

291. *Great Lakes Turnings*, 829 F. Supp. at 988.

292. *Id.* at 988 n.6.

293. *Bachmann*, 314 F. Supp. 2d at 823–25, 829.

294. St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982 (N.D. Ill. 1993).

295. *See Bachmann*, 314 F. Supp. 2d at 829 ("Unlike *Great Lakes Turnings* and like *Wilburn Boat*, this case does not involve facts of any commercial or international scope but a policy of insurance for a recreational boat that was damaged while in operation on an inland lake and that was available for plaintiff to inspect before it issued its policy. The Supreme Court has indicated that such localized maritime matters are better subject to state regulation than to federal admiralty law, which is concerned primarily with national and international commercial shipping.").

296. Commercial Union Ins. Co. v. Detyens Shipyard, Inc., 147 F. Supp. 2d 413, 423–24 (D.S.C. 2001).

297. *Id.* at 423 (first citing Steelmet, Inc. v. Caribe Towing Corp., 747 F.2d 689, 695 (11th Cir. 1984); and then citing Knight v. U.S. Fire Ins., 804 F.2d 9, 13 (2d Cir. 1986)).

298. *Id.*

court determined "[e]ven if this court were to adopt the analysis discussed in *Anh Thi Kieu*, the doctrine of *uberrimae fidei* would still govern the insurance policies"[299] because South Carolina law did not compel a "contrary conclusion" and Fourth Circuit jurisprudence did not require abandoning *uberrimae fidei*.[300] Therefore, the district court held the doctrine of *uberrimae fidei* was "a firmly entrenched federal maritime doctrine."[301]

6. Ninth Circuit

Within the Ninth Circuit, the Western District of Washington was an early proponent of *uberrimae fidei* as "a well established principle of general marine law."[302] In a footnote to a 1998 marine insurance dispute, the Ninth Circuit recognized *uberrimae fidei* existed under federal admiralty law.[303] Ten years later, the circuit court authored the landmark decision that unambiguously recognized *uberrimae fidei* as a judicially established federal admiralty law.[304] In *Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc.*,[305] the Ninth Circuit addressed whether the doctrine of *uberrimae fidei* applied to "vessel pollution insurance policies covering statutory environmental liabilities."[306] The first task before the circuit court was to determine what a "judicially established" federal admiralty rule looked like. In the Ninth Circuit, the requirement was the rule be "sufficiently longstanding and accepted within admiralty law," while in the Fifth Circuit the requirement was the rule be an "entrenched federal precedent."[307] However, the Ninth Circuit determined "[u]nder either gloss," *uberrimae fidei* was such a doctrine.[308] The Ninth Circuit considered

299. *Id.* at 424.

300. *Id.* ("There is no South Carolina state law mandating a contrary conclusion and no Fourth Circuit case law mandating that district courts abandon the doctrine.").

301. *Id.*

302. Port Lynch, Inc. v. New Eng. Int'l Assurety of Am., Inc., 754 F. Supp. 816, 820 (W.D. Wash. 1991).

303. *See* Cigna Prop. & Cas. Ins. Co. v. Polaris Pictures Corp., 159 F.3d 412, 420 n.3 (9th Cir. 1998) ("This principle, known as *uberrimae fidei* exists under both California insurance law and federal admiralty law." (citation omitted)).

304. Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 647 (9th Cir. 2008); *see also* Nicoll, *supra* note 49, at 5 ("*Inlet Fisheries* is the Ninth Circuit's firm statement that uberrimae fidei is judicially established and displaces contrary state law in matters concerning marine insurance.").

305. Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645 (9th Cir. 2008).

306. *Id.* at 647.

307. *Id.* at 650.

308. *Id.*

the history of the doctrine, beginning with Lord Mansfield in 1766 and incorporated into United States jurisprudence by the Supreme Court in 1828.[309] Because of its almost 200-year history in American law, the Ninth Circuit determined there were few marine insurance doctrines "more uniformly accepted in admiralty law" than *uberrimae fidei* "at the time *Wilburn Boat* was decided."[310] Because the circuit court believed "*Wilburn Boat* did nothing to change the standing of this doctrine," it launched into a critique of the Fifth Circuit *Anh Thi Kieu* decision.[311] According to the Ninth Circuit, the *Anh Thi Kieu* decision was the only reason why *uberrimae fidei* was being doubted as a firmly entrenched doctrine of admiralty law.[312] Because the Ninth Circuit found the *Anh Thi Kieu* analysis was "not persuasive," it elected to follow the framework of *Wilburn Boat*.[313] Under that rubric, the court held "the longstanding federal maritime doctrine of *uberrimae fidei,* rather than state law, applies to marine insurance contracts."[314]

Later in 2008, the Ninth Circuit reaffirmed its position that "[*u*]*berrimae fidei* is a 'longstanding federal maritime doctrine' that 'applies to marine insurance contracts.'"[315] The following year, the Central District of California cited *Inlet Fisheries* as the basis for describing "*uberrimae fidei* [a]s an 'established federal maritime law rule' that applies to [marine] insurance."[316]

7. Third Circuit

In 1985, the Third Circuit authored a footnote to a marine insurance case agreeing "that in the maritime context a boat owner must meet its duty of *uberrimae fidae.*"[317] In 2008, after a brief discussion of the *Anh Thi Kieu* decision, the Third Circuit stated, "We reaffirm our prior precedent,

309. *Id.* at 650, 652.

310. *Id.* at 650.

311. *Id.*

312. *See id.* at 652 ("Ironically, were it not for the *Anh Thi Kieu* decision itself, there would be little cause at all to doubt that *uberrimae fidei* is indeed firmly entrenched maritime law.").

313. *Id.* at 653–54.

314. *Id.* at 654.

315. N.H. Ins. Co. v. C'Est Moi, Inc., 519 F.3d 937, 938 (9th Cir. 2008) (quoting *Inlet Fisheries,* 518 F.3d at 650); *see also* Nicoll, *supra* note 49, at 5–6 ("*C'Est Moi* re-emphasizes the Ninth Circuit's stand on the entrenchment of *uberrimae fidei,* while also notifying parties that, at least in this circuit, contractual avoidance of the requirement of utmost good faith in marine insurance will require clear and unmistakable language.").

316. Pringle v. Water Quality Ins. Syndicate, 646 F. Supp. 2d 1161, 1169 (C.D. Cal. 2009) (quoting *Inlet Fisheries,* 518 F.3d at 649–55).

317. E. Coast Tender Serv., Inc. v. Winzinger, Inc., 759 F.2d 280, 284 n.3 (3d Cir. 1985).

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

and conclude that the doctrine of *uberrimae fidei* is well entrenched and therefore controls this dispute."[318]

8. Eighth Circuit

In 2013, the Eastern District of Missouri considered whether *uberrimae fidei* was a judicially established federal admiralty rule and found "the duty of *uberrimae fidelis* remains entrenched federal precedent."[319] Although the district court acknowledged the Fifth Circuit found the duty was "no longer [an] entrenched federal precedent," it also determined that "most other circuits" recognized the duty.[320] Most importantly, the district found that the Eighth Circuit implicitly recognized *uberrimae fidei.*[321]

The Eighth Circuit explicitly recognized *uberrimae fidei* as a judicially established federal admiralty rule in 2014.[322] The circuit court's logic was very straightforward. First, the court determined the doctrine had been long recognized by the Supreme Court[323] and then noted other federal circuit courts also recognized the doctrine.[324] Therefore, the Eighth Circuit concluded that "[b]ased on its lengthy history . . . 'no rule of marine insurance is better established tha[n] the utmost good faith rule.'"[325] The circuit court then proceeded to consider the *Anh Thi Kieu* decision and ultimately declined to follow that approach because a number of circuit courts had subsequently addressed the issue and concluded *uberrimae fidei* remains a judicially established federal admiralty rule.[326] The Eighth Circuit gave specific weight to the Ninth Circuit's critique of *Anh Thi Kieu* in *Inlet Fisheries* and found the Second, Third and Eleventh Circuits reached similar conclusions to the Ninth Circuit in a marine context. [327] The Eight Circuit administered proper application of

318. AGF Marine Aviation & Transp. v. Cassin, 544 F.3d 255, 263 (3d Cir. 2008). For an extensive discussion of this case, see generally Stephen C. Richman, Note, Uberrimae Fidei-*Once Entrenched, Always Entrenched: The Third Circuit Joins the Majority in* AGF Marine Aviation & Transport v. Cassin, *but Is That Enough?*, 33 TUL. MAR. L.J. 553 (2009).

319. Starr Indem. & Liab. Co. v. Cont'l Cement Co., No. 4:11CV809 JAR, 2013 WL 1442456, at *14 (E.D. Mo. 2013).

320. *Id.*

321. *Id.* (citing Shipley v. Ark. Blue Cross & Blue Shield, 333 F.3d 898, 903 (8th Cir. 2003)).

322. N.Y. Marine & Gen. Ins. Co. v. Cont'l Cement Co., 761 F.3d 830, 839 (8th Cir. 2014) ("We conclude that the doctrine of utmost good faith is such a judicially established federal admiralty rule.").

323. *Id.* (citing United States Supreme Court cases from 1828, 1887, and 1928).

324. *Id.* at 839–40 (citing Second Circuit, Third Circuit, and Eleventh Circuit decisions).

325. *Id.* at 840 (quoting Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 653–54 (9th Cir. 2008)).

326. *Id.* at 839–40.

327. *Id.* at 840.

uberrimae fidei to marine insurance policies by 2015.[328]

9. First Circuit

In 1995, the First Circuit heard a marine insurance case that raised the issue of *uberrimae fidei* but did not decide whether the doctrine was a judicially established federal admiralty law.[329] In a footnote, the court cited *Anh Thi Kieu* and raised the specter it might follow suit.[330] Eleven years later, *uberrimae fidei* again came before the First Circuit. The court stated, "While we have never actually decided the issue, it is true that we have questioned whether *uberrimae fidei* is an established rule of maritime law."[331] However, at the time, the court did not decide the issue because it found the policy voidable under Rhode Island state law due to a misrepresentation.[332]

In 2007, the District of Massachusetts read the *Anh Thi Kieu* decision both as questioning "the universal application of *uberrimae fidei*" and as validating "the continued relevance of the doctrine."[333] In the Massachusetts district court's opinion, the Fifth Circuit's stance on *uberrimae fidei* was a minority view within the circuit courts.[334] For example, the Second Circuit acknowledged the doctrine's entrenchment,[335] and the Eleventh Circuit cited *uberrimae fidei* as a "clear rule of maritime law."[336] On this basis, the district court recognized *uberrimae fidei* as an established federal admiralty rule.[337]

328. *See, e.g.* St. Paul Fire & Marine Ins. Co. v. Abhe & Svoboda, Inc., 798 F.3d 715, 719 (8th Cir. 2015) ("This dispute concerns a marine insurance contract and therefore is governed by the principle of *uberrimae fidei*, or utmost good faith." (citing *N.Y. Marine*, 761 F.3d at 839)).

329. Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50, 55 (1st Cir. 1995) ("Whatever the exact extent of the applicability of the strict *uberrimae fidei* standard, we cannot believe that in these times it requires a pleasure boat owner to notify the insurer every time the craft takes on a small amount of water, or has engine trouble, at pain of losing coverage.").

330. *Id.* at 54 n.3 ("[H]owever, it is debatable whether the doctrine can still be deemed an 'entrenched' rule of law." (quoting Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 889–90 (5th Cir. 1991))).

331. Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 38 (1st Cir. 2006).

332. *Id.*

333. St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232, 238–39 (D. Mass. 2007) ("While it is true that some federal decisions, including that of the Fifth Circuit in *Albany Ins. Co. v. Anh Thi Kieu*, question the universal application of *uberrimae fidei*, it is equally important to note that the Fifth Circuit qualified its decision, acknowledging the continued relevance of the doctrine.").

334. *Id.* at 239.

335. *Id.* (citing Knight v. U.S. Fire Ins. Co., 804 F.2d 9, 13 (2d Cir. 1986)).

336. *Id.* (quoting Steelmet Inc. v. Caribe Towing Corp., 747 F.2d 689, 695 (11th Cir. 1984)).

337. *Id.* ("Considering the predominant acceptance of this doctrine by federal courts across the country, this court concludes that the doctrine of *uberrimae fidei* is an established maritime rule.").

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

On the third iteration of *Catlin at Lloyd's v. San Juan Towing & Marine Services, Inc.*,[338] the District of Puerto Rico acknowledged the First Circuit was presented with the issue of *uberrimae fidei* twice but did not take "an authoritative stance" on the issue of whether the doctrine was a judicially established federal admiralty rule.[339] The district court held *uberrimae fidei* was "a well-entrenched federal precedent."[340] The decision relied on the analysis done by the District of Massachusetts in *St. Paul Fire & Marine Insurance Co. v. Halifax Trawlers, Inc.*,[341] which illustrated the weight of authority was in favor of concluding *uberrimae fidei* was well-entrenched.[342] According to the District of Puerto Rico, "The majority of circuits are in agreement that *uberrimae fidei* controls in maritime insurance disputes."[343] Although the district court recognized the position of the Fifth Circuit,[344] Puerto Rico ultimately agreed with the Ninth Circuit's evaluation of that position.[345]

In 2014, like a broken record, the District of Puerto Rico again criticized the First Circuit for failing to rule on whether the doctrine of *uberrimae fidei* was a judicially established federal admiralty rule.[346] The district court

338. Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 974 F. Supp. 2d 64 (D.P.R. 2013).

339. *Id.* at 74–75 (first citing Commercial Union Ins. Co. v. Pesante, 459 F.3d 34, 38 (1st Cir. 2006); and then citing Windsor Mount Joy Mut. Ins. Co. v. Giragosian, 57 F.3d 50, 54 n.3 (1st Cir. 1995)).

340. *Id.* at 76 ("Having weighed the Fifth Circuit Court of Appeals' opinion against opposing authority from other circuits and legal scholars, the Court holds that the *uberrimae fidei* doctrine constitutes a well-entrenched federal precedent, even in the face of the First Circuit Court of Appeals apparent hesitation to hold it does not.").

341. St. Paul Fire & Marine Ins. Co. v. Halifax Trawlers, Inc., 495 F. Supp. 2d 232 (D. Mass. 2007).

342. *San Juan Towing*, 974 F. Supp. 2d at 75 ("Even despite the lack of a clear stance on the issue by the First Circuit Court of Appeals, however, 'the number and ratio of courts endorsing the doctrine weigh in favor of [the] conclusion [that *uberrimae fidei* is an established rule of maritime law].'" (alterations in original) (quoting *Halifax Trawlers*, 495 F. Supp. 2d at 238)).

343. *Id.*

344. *Id.* ("The only circuit to disavow the doctrine of *uberrimae fidei* as 'not entrenched federal precedent' is the Fifth Circuit Court of Appeals." (quoting Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 889 (5th Cir. 1991))).

345. *Id.* ("The Court thus subscribes to the Ninth Circuit Court of Appeals' conclusion that '[i]ronically, were it not for the *Anh Thi Kieu* decision itself, there would be little cause at all to doubt that *uberrimae fidei* is indeed firmly entrenched maritime law.'" (alteration in original) (quoting Certain Underwriters at Lloyds, London v. Inlet Fisheries, Inc., 518 F.3d 645, 652 (9th Cir. 2008))).

346. *See* Markel Am. Ins. Co. v. Veras, 995 F. Supp. 2d 65, 73 (D.P.R. 2014) ("[T]he First Circuit has had numerous opportunities to rule on whether the doctrine of *uberrimae fidei* is a well-established rule of maritime law, it has nonetheless declined to do so." (first citing Lloyd's of London v. Pagan-Sanchez, 539 F.3d 19 (1st Cir. 2008); and then citing Commercial Union Ins. Co. v. Pesante, 459 F.3d 34 (1st Cir. 2006); and then quoting Grande v. St. Paul Fire & Marine Ins. Co., 436 F.3d 277 (1st Cir. 2006))).

noted none of the First Circuit cases expressly rejected *uberrimae fidei* as being established in federal admiralty law.[347] Although there was a split in the circuit courts on the issue,[348] the magistrate judge was unable to find cases within the district holding *uberrimae fidei* was not a well-established admiralty doctrine.[349] Based on precedent reaching back to 1828, the district court agreed with the magistrate judge and held the doctrine of *uberrimae fidei* was a judicially established federal admiralty rule.[350]

On the fifth iteration of the *San Juan Towing* case in 2015, the First Circuit acknowledged, while it was presented with the issue of *uberrimae fidei* twice previously, the circuit had yet to take "an authoritative stance" on whether the doctrine was a judicially established federal admiralty law.[351] The circuit court affirmed that it was doing so.[352] In summarizing its decision, the First Circuit cited three reasons: the policy rationale, the long history, and the consistent application of the doctrine.[353] Characterizing its ruling as "hardly . . . surprising," the circuit court discussed the precedential effect of *M'Lanahan* and *Stipcich*.[354] It then noted that even after *Wilburn Boat*, the circuit courts "routinely applied" *uberrimae fidei* to marine insurance contracts as an established federal admiralty rule.[355] Additionally, the circuit court found it "instructive" that three circuit courts formally recognized *uberrimae fidei* as an established federal admiralty rule *after* the First Circuit expressed doubts about the doctrine's entrenchment.[356] Finally, the First Circuit noted the Second and Eleventh Circuits reaffirmed the relevance of *uberrimae fidei* within their jurisdictions.[357]

---

347. *Id.* ("[N]one of the aforementioned cases *reject* the notion that *uberrimae fidei* is entrenched in federal admiralty law.").

348. *See id.* ("The U.S. Courts of Appeals are split on the issue, with the Second, Third, Ninth, and Eleventh Circuits holding that *uberrimae fidei* is a well-established maritime rule, and the Fifth Circuit disavowing said doctrine as 'not entrenched federal precedent.'").

349. *See id.* ("In fact, most of the courts in this district have concluded that *uberrimae fidei* is a well-established rule of maritime law . . . .").

350. *Id.* at 73–74.

351. Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 778 F.3d 69, 80 (1st Cir. 2015).

352. *Id.* at 80–81 ("Although this court had not yet held definitively that *uberrimae fidei* is an established rule of maritime law, we do so now, thus joining the near-unanimous consensus of our sister circuits, ruling without further equivocation that the doctrine of uberrimae fidei is an established rule of maritime law in this Circuit." (footnote omitted)).

353. *Id.* at 82.

354. *Id.* at 81.

355. *Id.*

356. *Id.*

357. *Id.* at 81–82.

D. *Summary of Legal Analysis*

Understanding *uberrimae fidei* is vitally important because violation of the duty results in the voiding of the marine insurance policy *ab initio* and the return of premiums paid. The doctrine of *uberrimae fidei* is rooted in the earliest days of marine insurance when insurance underwriters relied on shipowners and merchants for information about the risks that they were insuring.[358] The typical formulation of *uberrimae fidei* is "[t]he assured under a marine policy must disclose to the underwriter all circumstances known to him which materially affect the risk."[359] Therefore, the central attributes of *uberrimae fidei* are materiality, disclosure, and reliance. As far back as 1931, materiality in marine insurance has been defined as "something which would have controlled the underwriter's decision" to insure the risk.[360] A modern formulation of materiality from the Eleventh Circuit is "that which could possibly influence the mind of a prudent and intelligent insurer in determining whether he would accept the risk, and . . . that concealment of such facts voids the policy, whether the concealment be due to fraud, negligence, accident, or mistake."[361] The later formulation reinforces that scienter is not necessary to violate *uberrimae fidei*. Once information is determined to be material, the insured must disclose it regardless of a specific request by the insurer.[362] Reliance on the material information is an evolving field; however, some circuit courts consider it to be akin to a subjective element of material.[363] As of October 2015, the Fifth Circuit was the only United Stated Circuit Court of Appeal to expressly deny *uberrimae fidei* is a judicially established federal admiralty rule.[364]

358. Fed. Ins. Co. v. PGG Realty, LLC, 538 F. Supp. 2d 680, 687 (S.D.N.Y. 2008) (citing Stecker v. Am. Home Fire Assurance Co., 84 N.E.2d 797 (N.Y. 1949), *aff'd*, 340 F. App'x 5 (2d Cir. 2009)).

359. Btesh v. Royal Ins. Co., 49 F.2d 720, 721 (2d Cir. 1931).

360. *Id.*

361. Kilpatrick Marine Piling v. Fireman's Fund Ins. Co., 795 F.2d 940, 942–43 (11th Cir. 1986) (concurring with the lower court's statement of law).

362. *See* HIH Marine Servs., Inc. v. Fraser, 211 F.3d 1359, 1362 (11th Cir. 2000) ("The duty to disclose extends to those material facts not directly inquired into by the insurer."); Pringle v. Water Quality Ins. Syndicate, 646 F. Supp. 2d 1161, 1169 (C.D. Cal. 2009) ("Further, an insured is 'obligated to disclose all material information, regardless of a request by' the insurer." (quoting Certain Underwriters at Lloyds, London v. Inlet Fisheries Inc., 518 F.3d 645, 648 (9th Cir. 2008))).

363. *See* St. Paul Fire & Marine Ins. Co. v. Abhe & Svoboda, Inc., 798 F.3d 715, 721 (8th Cir. 2015) ("[S]ome courts have applied a subjective test for materiality that asks whether the insurer in fact would have found the omitted information to be material.").

364. *See* Catlin at Lloyd's v. San Juan Towing & Marine Servs., Inc., 778 F.3d 69, 81 (1st Cir. 2015) (pointing to the Fifth Circuit's decision in *Anh Thi Kieu* as the sole circuit court decision refusing to recognize *uberrimae fidei* as an established and entrenched doctrine in maritime law).

III. ECONOMIC ANALYSIS OF *UBERRIMAE FIDEI* AS A JUDICIALLY ESTABLISHED FEDERAL ADMIRALTY RULE FOR PROTECTION AND INDEMNITY CLUBS

A. *Judicial Discussion of the Reasons for* Uberrimae Fidei

According to Lord Mansfield in 1766, there were two basic reasons to enforce the duty of *uberrimae fidei* in insurance: "to prevent fraud and to encourage good faith."[365] In the late nineteenth century and early twentieth century, the United States Supreme Court considered *uberrimae fidei* to be an aspect of all insurance law.[366] However, as insurance regulation shifted to the states, standards became more favorable to the insured.[367] *Uberrimae fidei* was displaced in most insurance contexts, except for marine insurance.[368] The First Circuit explained why *uberrimae fidei* still exists in marine insurance in its 2015 *Catlin* decision:

> Marine insurance is vital to the adequate flow of commerce. The nature of the risks that are covered by maritime insurance is such that, given the urgent necessity for the placement of this type of insurance coverage that is often present in the business of maritime commerce, as well as the extreme distances that often separate the insurance seeker and the insurer, it is imperative that the insurer be provided with truthful and valid information about the risk the insurer is asked to undertake by the party most able to provide such data: the insured.[369]

This reasoning echoes the rationale of the 1932 *Hare & Chase* court.[370] According to Judge Swan, insurance is a speculative contract and the underwriter proceeds upon the belief the insured does not withhold any known fact affecting the risk, since such facts often lie within the special knowledge of the insured alone.[371] The principle of *uberrimae fidei* had

---

365. Carter v. Boehm (1766) 97 Eng. Rep. 1162, 1165; 3 Burr, 1905, 1911 (KB).

366. *See* Stipcich v. Metro. Life Ins. Co., 277 U.S. 311, 316 (1928) (explaining the vital presence of *uberrimae fidei* in every insurance contract); *accord* Phoenix Mut. Life Ins. Co. v. Raddin, 120 U.S. 183 (1887) (upholding a requirement of good faith by both parties to an insurance contract).

367. *See* Progressive N. Ins. Co. v. Bachmann, 314 F. Supp. 2d 820, 827 (W.D. Wis. 2004) (remarking the state began to implement standards more favorable to the insured when they took over insurance regulatory duties).

368. Certain Underwriters at Lloyds, London v. Inlet Fisheries Inc., 518 F.3d 645, 646 (9th Cir. 2008); *see also* Albany Ins. Co. v. Anh Thi Kieu, 927 F.2d 882, 888 (5th Cir. 1991) ("Today, the sole remaining substantial vestige of the [*uberrimae fidei*] doctrine is in maritime insurance law.").

369. *Catlin*, 778 F.3d at 80.

370. *See* Hare & Chase, Inc. v. Nat'l Sur. Co., 60 F.2d 909, 911–13 (2d Cir. 1932) (reasoning that since only the insured has access to all material facts, the insurer must rely on the insured's full disclosure to properly assess risk).

371. *Id.* at 911.

been relaxed in other areas of insurance in the United States, such as fire and life insurance, because the insurers make inspections or ask questions to produce the information that the insurers need.[372] Because this is not the case in marine insurance, "the rule of *uberrimae fidei* should still be enforced."[373]

Likewise, the Northern District of Florida envisioned the purpose of *uberrimae fidei* as protecting the underwriter, who lacked the means to verify the accuracy or sufficiency of the information supplied by the prospective insured.[374] Material misrepresentations in marine insurance are often impractical to investigate at policy inception.[375] The district court reasoned that "placing the burden of good faith on the insured" saves the time and cost of an investigation, which is normally passed on to the consumer through higher insurance rates.[376] Therefore, "the good faith requirement saves money for both the insured and insurer at very little cost—simply the truthfulness of the insurance applicant."[377]

Other courts have been less verbose about their reasons for enforcing the rule of *uberrimae fidei*. According to the Ninth Circuit, the purpose of the doctrine is to both protect the insurer and "the integrity of the risk pool."[378] The Northern District of Illinois enumerated a list of purposes: "protecting insurance company assets and the assets of policy holders; deterring the submission of misleading information; promoting personal integrity by imposing harsh penalties on dishonesty; preventing the imposition of frauds and perjuries on the court; and injecting certainty, predictability and uniformity into the law."[379]

In summary, the courts that have expressed an opinion about the reason for the existence of *uberrimae fidei* in marine insurance law have primarily cited that it protects underwriters from taking unnecessary risks and that it

372. *Id.*

373. *Id.*

374. *See* Northfield Ins. Co. v. Barlow, 983 F. Supp. 1376, 1380 (N.D. Fla. 1997) ("It has been said that the insured is bound to communicate every material fact within his knowledge not known or presumed to be known to the underwriter, whether inquired for or not; and that a failure in either particular, although it may arise from mistake, accident, or forgetfulness, is attended with the rigorous consequences that the policy never attaches and is void, for the reason that the risk assumed is not the one intended to be assumed by the parties." (quoting Gulfstream Cargo, Ltd. v. Reliance Ins. Co., 409 F.2d 974, 980–81 (5th Cir. 1969))).

375. *Id.* at 1383.

376. *See id.* (noting the good faith requirement has a positive impact for both insured and insurer, at a low cost to the insured).

377. *Id.*

378. N.H. Ins. Co. v. C'Est Moi, Inc., 519 F.3d 937, 939 (9th Cir. 2008).

379. St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 987 (N.D. Ill. 1993).

saves the time and cost of preliminary investigations.

B. *Legal Commentators' Approach to the Economic Efficiency of* Uberrimae Fidei

Thomas Schoenbaum, a noted admiralty law scholar, briefly discussed the economic efficiency of *uberrimae fidei* in an article comparing the American and English laws on the duty of utmost good faith. According to Schoenbaum, "[T]he doctrine of utmost good faith still has utility in marine insurance because it fosters a high standard of care, economic efficiency, and lower premiums for assureds."[380] Economic efficiency is the basis for the doctrine because it minimizes costs to the insurer and insured.[381] Lower and more precise premiums are available to the insured because the doctrine places the burden to disclose on the insured, who is the party with exclusive knowledge of the circumstances affecting the risk, which allows the risks to be evaluated more precisely and cheaply.[382] Because marine insurance is an industry where risk calculation and negotiation are done on an individual basis, "the doctrine of *uberrimae fidei* is of continuing importance."[383]

John Kavanagh, a Fifth Circuit clerk in the 1990s, also briefly discussed the economic efficiency of *uberrimae fidei* in his article on the topic. He concludes adherence to *uberrimae fidei* would "foster economic efficiency and honest dealings in marine insurance transactions."[384] He looks at the economic efficiency of the doctrine from the perspective of "'transactional cost[s]' associated with contractual dealings."[385] According to Kavanagh, high transactional costs will increase the overall costs for the parties to the contract.[386] One such transactional cost is the "cost of collecting information concerning the insured risk."[387] It is "both logical and economically efficient" to burden the insured with the responsibility of full disclosure because that is the party with all the material facts.[388] Monitoring and enforcement also act to increase transaction costs.[389] Because *uberrimae fidei* incentivizes the insured "to engage in full, good faith

380. Schoenbaum, *supra* note 86, at 39.
381. *Id.* at 3.
382. *Id.*
383. *Id.* at 3–4.
384. John P. Kavanagh, Jr., *"Ask Me No Questions and I'll Tell You No Lies": The Doctrine of* Uberrimae Fidei *in Marine Insurance Transactions*, 17 TUL. MAR. L.J. 37, 50 (1992).
385. *Id.* at 48.
386. *Id.*
387. *Id.*
388. *Id.*
389. *Id.*

disclosure with their underwriters," it "minimizes monitoring expenses for these underwriters."[390] Without the doctrine, the higher costs of monitoring and enforcement would be passed on indiscriminately to all insured, regardless of whether they were honest or dishonest.[391]

Mitchell Popham and Chau Vo synthesized the comments of Kavanagh and Schoenbaum about the economic efficiency of *uberrimae fidei* in their article about the doctrine in the Ninth Circuit.[392] They agree that the doctrine promotes economic efficiency[393] and that "it is designed to minimize costs to both the insurers and the insured."[394] They echo Kavanagh's analysis that information collection and risk investigation comprise a portion of the premium associated with transactional costs incurred by the underwriter and that "any significant increase in the transactional cost of a contract increases the overall costs for the parties involved in the contract."[395] The insured "can more efficiently carry the burden of full disclosure" because the insured is in full possession of "the material facts concerning the risks."[396] Therefore, "a rule placing the burden of disclosure on the insured leads to lower costs for insurers and a corresponding reduction in premiums [for the insured]."[397]

In summary, the legal commentators who have written about the economic efficiency of *uberrimae fidei*[398] have principally considered its role in the reduction of costs, whether they are specifically investigation costs or more generally transactional costs in contracting. This is a slight departure from the judicial interpretation of economic efficiency, which also considered the broader perspective of the prevention of fraud, the

390. *Id.*

391. *Id.* at 48–49.

392. Mitchell J. Popham & Chau Vo, *Misrepresentation and Concealment in Marine Insurance Contracts: An Analysis of Federal and State Law Within the Ninth Circuit*, 11 U.S.F. MAR. L.J. 99, 104–05 (1999).

393. *See id.* at 104 (citing Kavanagh, *supra* note 384, at 48).

394. *See id.* (citing Schoenbaum, *supra* note 86, at 3).

395. *Id.* at 104–05 (citing Kavanagh, *supra* note 384, at 48).

396. *Id.* at 105 (citing Schoenbaum, *supra* note 86, at 3).

397. *Id.*

398. Two other legal papers have mentioned the economic impact of *uberrimae fidei* in one passing sentence each. *See* Jeffery B. Struckhoff, *The Irony of* Uberrimae Fidei*: Bad Faith Practices in Marine Insurance*, 29 TUL. MAR. L.J. 287, 308 (2005) ("Among legal scholars and commentators (and insurers), there appears to be near-universal agreement that uniformity between English and American law regarding the duty of utmost good faith is not only desirable, it is economically indispensable."); Paula Hamilton Lee, Comment, *Untying the Gordian Knot and Opening Pandora's Box: The Need for a Uniform Federal Maritime Rule of* Uberrimae Fidei *with Respect to Marine Insurance*, 19 TUL. MAR. L.J. 411, 427 (1995) ("Many insurers agree that *uberrimae fidei* is the bedrock upon which insurance is founded; if it is removed, the market could collapse.").

protection of assets, and the protection of the integrity of the risk pool, among other economically related reasons.

C. *Economists' Approach to the Efficiency of* Uberrimae Fidei

Four academic papers have been written about the impact of *uberrimae fidei* on the economic model of the insurance market with asymmetric information developed by Michael Rothschild and Joseph Stiglitz in 1976.[399] Before delving into the details of the four papers specifically addressing *uberrimae fidei*, it is important to understand how economists generally see the insurance market and how the Rothschild–Stiglitz model impacts that vision.

1. Economists' Approach to Insurance

Economics focuses on "the allocation of resources in the presence of scarcity."[400] Today's insurance market reflects a need to manage and allocate risks because insurance is nothing more than "a legal mechanism by which the insured pays a premium to purchase from an insurer some financial protection against a future potential loss."[401] Therefore, to economists, insurance is important "because it allows individuals and entities to engage in" risky activities that they might limit or refrain from all together in the absence of insurance.[402]

However, sometimes "there is no economic advantage to insurance."[403] Sometimes the insured can more effectively reduce or protect against the

399. Avinash Dixit, *Adverse Selection and Insurance with* Uberrima Fides, *in* INCENTIVES, ORGANIZATION AND PUBLIC ECONOMICS: PAPERS IN HONOR OF SIR JAMES MIRRLEES 41 (Peter J. Hammond & Gareth D. Myles eds., Oxford Univ. Press 2000); Avinash Dixit & Pierre Picard, *On the Role of Good Faith in Insurance Contracting* 1 (Princeton Univ., Econ. Theory Working Paper No. 02S2, 2002), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=303841; Pierre Picard, *Costly Risk Verification Without Commitment in Competitive Insurance Markets*, 66 GAMES & ECON. BEHAV. 893 (2009); Jason David Strauss, Uberrimae Fidei *and Adverse Selection: The Equitable Legal Judgment of Insurance Contracts* 1 (MPRA Paper No. 10874, 2008), http://mpra.ub.uni-muenchen.de/10874; Michael Rothschild & Joseph Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 Q.J. ECON. 629, 630–38 (1976).

400. George L. Priest, *Economic Problems of Accidents and Compensation*, 15 U. HAW. L. REV. 544, 549 (1993).

401. Ronen Avraham, *The Economics of Insurance Law—A Primer*, 19 CONN. INS. L.J. 29, 32, 111 (2012).

402. George L. Priest, *A Principled Approach to Insurance Law: The Economics of Insurance and the Current Restatement Project* 5 (Yale Law, Econ. & Pub. Pol'y Research Paper No. 527, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2631123; *see also* Avraham, *supra* note 401, at 32 ("The goal of [the insurance] transaction is to provide the insured protection from financial risks to her assets, health, and life, or from third party claims, while incentivizing her to guard against those risks.").

403. Priest, *supra* note 402, at 6.

risk than the insurer, and sometimes the insured does not want to pay the premium required to support the risk.[404] According to George Priest, "From an economic standpoint, an insurance contract represents a joint allocation as between the policyholder and insurer as to how best to minimize the risks that the policyholder faces in the context of the risks that the insurer can effectively reduce."[405] Therefore, when designing rules governing insurance contracts, those rules should "maximize the availability of insurance coverage to the society."[406] It follows that, when an insured "is in a position to reduce loss (by prevention) at a lower cost than what the insurer would charge for coverage of the loss," it would be advantageous for both parties for the insured to take that action because it will reduce insurance premiums and expand the overall availability of insurance.[407] However, insurance products also have many hidden characteristics such that there is ample opportunity for insurers to behave strategically at the expense of the individuals insured.[408]

According to Priest, an insurance regime effectively reduces its risk level through three principle features: "the aggregation of risks, the separation of risks into separate risk pools[,] and the control of moral hazard."[409] According to Ronen Avraham, the design of an insurance regime should focus on alleviating informational impediments, including moral hazard and other impediments to efficiency.[410] Priest's approach serves as the better foundation for the four economic papers discussing the efficiency of *uberrimae fidei*.[411] Issues of information asymmetry, specifically adverse selection, will be addressed separately later in this Article.

Aggregation of risks assumes insurance operates when losses are stochastic or probabilistic, because it would be uneconomic for an insured to pay an insurer to estimate the risk, maintain reserves, and perform other

404. *Id.* at 3.

405. *Id.*

406. *Id.* at 5.

407. *Id.* at 7.

408. Avraham, *supra* note 401, at 33 ("The problem is that the product sold, insurance coverage, is not usually well defined in the minds of insureds. What exactly is covered under the policy? What type of 'protection' will be delivered? What constitutes an 'occurrence' which triggers coverage? Not only are all of these left undefined in the minds of insureds, but they are all widely litigated questions.").

409. Priest, *supra* note 402, at 9.

410. Avraham, *supra* note 401, at 29. The main informational impediments are adverse selection, reverse adverse selection, moral hazard, and reverse moral hazard. Other impediments to efficiency include administrative costs, negative externalities, correlated risks, non-competitive pricing and irrational behavior. *Id.* at 34.

411. Priest, *supra* note 402, at 9.

functions for a loss that is certain to occur during a given period.[412] It would be more economic for the insured to accumulate savings to restore its previous position.[413] For insurance to reduce the risk level, losses must be described by a probability distribution, either with respect to whether the losses will occur or with respect to when the losses will occur.[414] By aggregating uncorrelated losses, insurance can reduce the risk of loss due to the operation of the law of large numbers.[415] This happens in two ways: first, the accuracy and prediction of the risk generated by each individual holding an independent and identically-valued risk will improve as the number of those individuals increases.[416] Second, the ability to predict the risk level and to reduce the effective risk level will also improve as the number of statistically independent risks is increased.[417] Therefore, aggregation of risks is critical to risk reduction efforts in the insurance market.

Separation of risks into separate risk pools "refers to insurer efforts to distinguish relatively high-risk from low-risk policyholders and then to assign them to narrowly defined risk pools."[418] Risk pool definition is also called insurance underwriting.[419] Like the aggregation function of insurance, the segregation function of insurance seeks to "increase predictive accuracy in order to reduce the risk level and the total effective

412. *Id.* at 9–10.

413. *Id.* at 9; *see also* Avraham, *supra* note 401, at 37–38 ("The idea was that the sample mean for a probabilistic set nears the expected mean for an occurrence or process in the population as the sample size increases . . . . This is known as the law of large numbers. The obvious extrapolation to be made is that pooling of risks reduces the risk per insured, as long as these risks are not perfectly correlated.").

414. Priest, *supra* note 402, at 10 ("The mean of the distribution represents the most likely probability of occurrence of the loss; the distribution or error term surrounding the mean represents the greater or lesser likelihood that the loss or set of losses will occur. The expected cost of the loss is determined by summing the amount of the loss weighted by these probabilities."); *see also* Avraham, *supra* note 401, at 38 ("Insurance policies utilize the law of large numbers to reduce uncertainty for risk-averse individuals. The first step in that process is risk transfer, by which the risk of a certain event is shifted from one party to another. The law of large numbers, discussed above, allows an insurer to predict with reasonable certainty the aggregate losses it will pay in a given year . . . ." (footnote omitted)).

415. Priest, *supra* note 402, at 11 (noting the "law of large numbers" is "the empirical phenomenon according to which the probability density function of a loss tends to become concentrated around the mean as the sample number increases" (footnote omitted)). That basically means the more numbers there are in a sample, the more likely the number pulled will be around the mean value.

416. *Id.*

417. *Id.* at 12.

418. *Id.* at 13.

419. *Id.*

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

costs of losses."[420] There are two separate dimensions to risk segregation: a reduction in the "statistical variance below that of a more broadly aggregated pool" and an influence on the level of risky activity by setting the insurance premium to more precisely align with the risk that the activity adds to the risk pool.[421] Segregation can reduce statistical risk variance below that of a more broadly aggregated pool if the high-risk insured are segregated from the low-risk insured.[422] This reduction in statistical variance reduces the overall pool risk level, improves predictive accuracy by virtue of the law of large numbers, and, as a result, reduces aggregate insurance premiums.[423] By setting an insurance premium that most accurately reflects the insured's risk, risk segregation can reduce the underlying level of losses.[424] This helps the insured internalize the cost of their risky behavior because the insured can decide how much of the risky behavior to engage in based on the cost of the insurance.[425] The low-risk insured will be charged lower premiums than the high-risk insured.[426] Although at least one economist asserts that more accurate risk segregation maximizes insurance coverage,[427] and risk segregation can also create problems of both efficiency and distributive justice, as insurance companies can reallocate resources between the segregated risk classes.[428]

The control of moral hazard also maximizes the gains from insurance.[429] Moral hazard describes the condition when the underlying level of activity and the underlying loss rate will increase because the expected loss costs to the insured have fallen, owing to the presence of insurance.[430] "A necessary . . . condition to the characterization of moral hazard is that the suboptimal behavior of the insured is *the result of* the

420. *Id.* at 19 (footnote omitted).

421. *Id.* at 13.

422. *Id.*

423. *Id.* at 14.

424. *Id.* at 16.

425. Priest, *supra* note 402, at 16.

426. *Id.*

427. *Id.* at 17–18 ("[I]t is well-established that the more precisely insurers can accurately segregate risks by insurance discrimination, the more broadly insurance can be offered in the society." (footnote omitted)).

428. Avraham, *supra* note 401, at 47–48 ("Insurers—private or public—have the ability to redistribute resources between the classes they have separated by overcharging, intentionally or otherwise, the less risky and undercharging the more risky. In health insurance, for example, the healthy subsidize the chronically sick." (footnote omitted)).

429. Priest, *supra* note 402, at 19.

430. *Id.*

insurance coverage."[431] Therefore, "the insured's behavior must be examined in relation to" his conduct in a world where he had no insurance coverage.[432] *Ex ante* moral hazards are the reduced precautions to prevent the loss taken by an insured because of the existence of insurance that increase the frequency of loss.[433] *Ex post* moral hazards are the increased claims against the insurance beyond what the insured would have consumed in absence of insurance that "increases the costs of losses that have actually occurred."[434] Another type of *ex post* moral hazard, which may be considered fraud depending on its magnitude, is the exaggeration of a loss by the insured to increase his reimbursement.[435] Because the insurance company cannot separate those who behave according to moral hazard from those who do not, the insurance company charges all insured the same premium, leading to cross subsidization of the "immoral" insured.[436] Because moral hazard increases the loss costs, it results in an increased risk level for the insured pool.[437]

"[C]ontrolling both *ex ante* and *ex post* moral hazard [reduces risk]."[438] "Moral hazard is often a problem . . . in the third-party liability insurance context."[439] Theoretically, addressing the *ex ante* moral hazard issue requires "disincentivizing the deviations from the optimal level of care," which can either be a "carrot" or a "stick" approach.[440] Because at the heart of moral hazard is a principal–agent problem, one way to alleviate moral hazard is to have the parties "contract on care," which would require certain precautions be taken by the insured in exchange for lower premiums.[441] Also, the more closely aligned the insured's incentives are with those of the insurance company, the less frequent moral hazard will be.[442] However, the insurance company will still incur the cost of

---

431. Avraham, *supra* note 401, at 67.

432. *Id.*

433. Priest, *supra* note 402, at 19; *see also* Avraham, *supra* note 401, at 66 ("[W]hen insureds take less than optimal care in protecting themselves against the insured risk . . . is considered *ex-ante* moral hazard.").

434. Priest, *supra* note 402, at 19; *see also* Avraham, *supra* note 401, at 66 ("[W]hen insureds make less of an effort to minimize their loss should the risk occur . . . [it] is considered *ex-post* moral hazard.").

435. Avraham, *supra* note 401, at 66.

436. *Id.*

437. Priest, *supra* note 402, at 19; *see also* Avraham, *supra* note 401, at 66 ("Moral hazard consists of the risk of three distinct kinds of behavior by insureds, all of which are hidden from the insurer.").

438. Priest, *supra* note 402, at 20.

439. Avraham, *supra* note 401, at 67.

440. *Id.* at 70.

441. *Id.*

442. *See id.* (describing how utilizing the "stick" and "carrot" approach can solve moral hazard

deciding the appropriate loss prevention measures and monitoring the insured's compliance with the agreement.[443]

Careful design of the insurance policy can also control moral hazard.[444] Defining insurance coverage to constrain or exclude certain losses and designing insurance benefits to introduce deductibles and coinsurance that shift part of the loss back to the insured are both two key ways to control for moral hazard.[445] Deductibles are most appropriate in the case of small losses; co-insurance in the case of moderate losses; and policy limits in the case of large losses.[446] The cost savings resulting from these measures necessarily make insurance available to insureds who may not otherwise be able to pay the full actuarial cost of their insurance.[447] Experience ratings, especially in third-party insurance, are another way that an insurer can protect against moral hazard.[448] An experience rating classifies the insured according to their experiences with the loss to be insured, and then associates higher premiums with higher experience ratings.[449] Policy exclusions are a final way to mitigate *ex ante* moral hazard, as it "pressure[s] the insured party to avoid the proscribed behavior."[450]

Ex post moral hazard can also be addressed in several different ways. First and foremost, insurance companies refuse to insure non-pecuniary losses because the scope of such losses may be impossible to prove.[451] Second, insurance companies audit claims that are suspected to involve *ex post* moral hazard due to specific characteristics.[452] Finally, the insurance companies design their policies as indemnity policies rather than stated

---

because the incentives of both the insured and insurer become more aligned).

443. *Id.*

444. *Id.* at 71.

445. Priest, *supra* note 402, at 20–21; *see also* Avraham, *supra* note 401, at 71 ("Deductibles and co-insurance clauses in the policy force insureds to bear some specified amount or percentage of harm (respectively), thereby forcing the insured to internalize some of the cost of an occurrence and incentivizing careful behavior. Policy limits, or caps on the total amount payable under the policy, similarly provide a strong incentive to avoid risky behavior and to minimize total harm.").

446. Avraham, *supra* note 401, at 72.

447. Priest, *supra* note 402, at 22.

448. Avraham, *supra* note 401, at 73.

449. *See id.* ("In other words, insurers threaten higher premiums for those insureds with the highest losses, incentivizing the insureds to invest in minimizing their losses (as well as reducing cross subsidization of high-risk insureds by low-risk insureds). Some insurers offer policies that are experience rated retrospectively, meaning that the premium is set after the loss experience is known. Insureds with lower losses receive refunds for part of their premiums, while a surcharge is levied on those with higher losses.").

450. *Id.* at 74.

451. *Id.* at 75.

452. *Id.*

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

value policies to minimize the incentive of the insured to exaggerate a claim.[453]

According to economist Ronen Avraham, reverse moral hazard is also a risk that should be controlled because insurance companies behave strategically once the insured are under contract.[454] Problems of reverse moral hazard arise because the insurance company is the insured's agent but can act to "maximize its own interests rather than the insured's interests."[455] Theoretically, there are multiple ways to combat reverse moral hazard, such as requiring a full and detailed disclosure of the coverage decisions made by insurance companies so that such disclosure could be used to punish opportunistic behavior by insurance companies.[456] Additionally, individual insureds could have a legal claim for damages that result from insurance companies' bad faith denials or have access to an alternate dispute resolution mechanism to challenge insurance companies' decisions.[457] Designing a liability insurance policy to require the insurance company "to defend a suit unless the insured consents" to a settlement in writing will also reduce reverse moral hazard.[458]

Against this general background of insurance economics, Priest provides the briefest analysis of *uberrimae fidei*.[459] In his view, insurance contracts do not differ from other contracts in that they generally allocate the duties and responsibilities between the insured and the insurers.[460] This allocation is based upon "the relative comparative advantages of each party in contributing towards the objective of the contract."[461] According

453. *Id.*

454. *See id.* at 87 ("Just like there is reverse adverse selection, there is arguably also reverse moral hazard. It is not insured parties alone that behave strategically once the insurance contract is in place—insurers are similarly the perpetrators of opportunistic behavior, finding it easy and advantageous to mistreat their insureds once they are locked in a contract. This is especially true because barriers to litigation can prevent insureds from challenging insurer abuse." (footnote omitted)).

455. *Id.* at 90.

456. *Id.* at 88.

457. *Id.* See, for example, the Connecticut Unfair Insurance Practices Act (CUPA), CONN. GEN. STAT. ANN. §§ 38a-815 to 819 (West, Westlaw through 2015). For the laundry list of "unfair methods of competition and unfair and deceptive acts or practices in the business of insurance," see CONN. GEN. STAT. ANN. § 38a-816. The Connecticut Unfair Trade Practices Act permits a private individual to bring an action in court if he suffers "any ascertainable loss of money or property, real or personal" as a result of any "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce. *Id.* §§ 42-110a, -110b, -110g.

458. Avraham, *supra* note 401, at 90.

459. Priest, *supra* note 402, at 1.

460. *Id.* at 23.

461. *Id.*

Published by Digital Commons at St. Mary's University, 2015

to Priest, the "current law" is that "a misrepresentation of a material fact by an applicant for insurance voids the insurance contract."[462] There are good economic reasons for supporting this rule. "Parties to contracts need to know the risks they are facing to create a contract that maximizes mutual value to them."[463] It is essential to know the material facts in order to place the insured into the appropriate risk pool.[464] Misrepresentation defeats the insurer's efforts to segregate risks and increase insurance, availability.[465] Finally, this rule is "cost effective in terms of maximizing the possibilities of insurance" because "the potential policyholder is in the best position to know" the relevant material facts.[466]

The marine insurance contract is a specific type of insurance contract in which an insurer "assumes some of the maritime risks on a vessel or cargo, or both, in exchange for a premium."[467] Covered risks may include risks in port or at sea, for a particular voyage, or for a specific period of time.[468] By the beginning of the eighteenth century, when marine insurance had developed into a familiar practice, insurers faced three main categories of "uncertainty and complex information asymmetries that created agency problems for both the insurer and the insured" shipowner.[469] First, the shipowners and merchants often had better information than the insurers about the various aspects of the risk to be insured, such as the route, the seaworthiness of the ship, the quality of the crew and its armament, and the risk of seizure at sea or in port.[470] Second, there was a high potential "for moral hazard on the part of the insured."[471] Opportunities ranged from extreme risk taking to blatant fraud, and the insurers were seriously concerned about the possibility of fraudulent overinsurance and deliberate shipwreck.[472] Finally, shipowners and merchants preferred to insure with insurers who they perceived to be

---

462. *Id.* at 28.

463. *Id.*

464. *Id.*

465. *Id.* at 29.

466. *Id.* at 28.

467. Christopher Kingston, *Marine Insurance in Britain and America, 1720–1844: A Comparative Institutional Analysis*, 67 J. ECON. HIST. 379, 380 (2007).

468. *Id.*

469. *Id.* at 380–81.

470. *Id.* at 381.

471. *Id.*

472. *See id.* ("[T]here were many opportunities for moral hazard on the part of the insured. These ranged from excessive risk-taking, such as sending unseaworthy ships to sea or attempting to carry goods into a blockaded port; to outright frauds, such as deliberately sinking an insured ship, misrepresenting the value of the goods, insuring the same goods multiple times, or seeking to insure a ship already known to have been lost.").

non-litigious and financially secure.[473] Insurers had the opportunity to protest claims or delay payment because of the unpredictable nature of sailing ship voyages and the slow, costly process of assembling proof to support a claim in court.[474] Because the English marine insurance market was predominantly composed of private individuals, shipowners and merchants were seriously concerned about the financial stability of the insurers.[475]

Information itself was critical to combat these three categories of information asymmetries and agency problems.[476] Despite the fact information traveled slowly in the eighteenth century, marine insurance was able to support the expansion of trade throughout the next two centuries.[477] Although there are alternate explanations for this phenomenon,[478] the judicial endorsement of the mercantile practice of *uberrimae fidei* by Lord Mansfield in 1766 was a significant step toward alleviating the problems resulting from the rampant information asymmetries because the doctrine voided the marine insurance policies of any insured who misrepresented or concealed facts or of any vessel that deviated from the planned voyage without reasonable cause.[479] This extreme "punishment" for dishonesty encouraged information sharing between shipowners, merchants and insurers.

2. Economists' Models of the Insurance Market with *Uberrimae Fidei*

Economists are "quite willing to accept that people will take full private advantage of opportunities to conceal information (or take unobservable actions)."[480] Michael Rothschild and Joseph Stiglitz developed the "economist's standard model of insurance with asymmetric information"[481] in their article written in 1976.[482] Because that article is

---

473. *Id.* at 382.

474. *Id.*

475. *Id.*

476. *See id.* ("In the context of these information asymmetries and agency problems, information was critical.").

477. *See* Kingston, *supra* note 467, at 382–83 (recognizing that despite the problems created by information asymmetries during the eighteenth century, "marine insurance provided crucial support for the expansion of trade throughout the eighteenth and nineteenth centuries").

478. For example, Professor Kingston posits that development of insurance institutions to mitigate information asymmetries and agency problems are responsible for the expansion of maritime trade in this era. *Id.*

479. *See id.* at 389 (discussing the steps taken by Lord Mansfield to void an insurance policy if any concealment or misrepresentation of facts was found in addition to a change in a planned trip without reasonable cause).

480. Dixit, *supra* note 399, at 42.

481. *Id.* at 41.

"widely considered as one of the most important contributions to the insurance economics literature,"[483] it is necessary to understand the basics of their model to understand the impact of the incorporation of *uberrimae fidei* by later economists. The models with *uberrimae fidei* illustrate the economic efficiency of that doctrine to the general insurance market, which can be extended to the mutual marine insurance market of protection and indemnity clubs.

In general, Rothschild and Stiglitz analyzed the insurance market as an example of a competitive market in which the characteristics of the commodities exchanged are not fully known to at least one of the parties, and they concluded imperfect information is a factor that needs to be considered in economic modeling.[484] When there is imperfect information competitive equilibria may not exist, and the equilibria that may exist can have strange properties.[485] They had three specific findings relevant to the insurance market. First, in the insurance market, sales offers consist of a price and a quantity, rather than just a quantity.[486] Second, everyone in the market would be better off if individuals were willing or able to reveal their private information.[487] Third, the mere existence of high-risk individuals in the market causes an externality: the low-risk individuals are worse off.[488] However, the opposite is not true: high-risk individuals are not better off when low-risk individuals are absent.[489] In the summary to their article, Rothschild and Stiglitz phrased their three principle findings somewhat differently. First, competition in markets with imperfect information is more complex than in standard models because perfect competitors may limit the quantities their customers can buy (i.e. price-quantity competition) in order to improve their information about their customers.[490] Secondly, equilibrium may not exist.[491] "Finally, competitive equilibria are not Pareto optimal."[492]

---

482. Rothschild & Stiglitz, *supra* note 399, at 629.

483. Pierre Picard, *Participating Insurance Contracts and the Rothschild–Stiglitz Equilibrium Puzzle*, 39 GENEVA RISK & INS. REV. 153, 153 (2014).

484. *See* Rothschild & Stiglitz, *supra* note 399, at 629 (analyzing flawed information as a factor to consider in insurance markets).

485. *Id.*

486. *See id.* ("In the insurance market . . . sales offers . . . do not specify a price at which customers can buy all the insurance they want, but instead consist of both a price and a quantity . . . .").

487. *Id.*

488. *Id.*

489. *Id.*

490. *Id.*

491. *Id.*

The basic model is an individual has one income if he is lucky enough to avoid an accident and a lesser income if an accident occurs. The individual can insure himself against the accident by paying an insurance company a premium, in return for which he will receive a payment if an accident occurs. This results in four possible states: "accident," "no accident" without insurance, and "accident," "no accident" with insurance.[493] In a competitive insurance market with free entry among competitors, insurance contracts are traded by the individuals who buy insurance and the companies who sell insurance.[494] "An individual purchases an insurance contract so as to alter his pattern of income across states of nature."[495] All individuals are risk averse and are identical in all respects except for their probability of having an accident.[496] "Risk aversion" has a precise meaning for economists: "in simplest terms, it implies an unwillingness to take actuarially fair bets."[497] In fact, "[t[he return from an insurance contract is a random variable."[498] Insurance companies are risk neutral and are only concerned with expected profits.[499] "Insurance companies have financial resources such that they are willing and able to sell any number of contracts that they think will make an expected profit."[500] Taken as a whole, "these assumptions guarantee that any contract" that is expected to be profitable will be supplied when demanded.[501]

The Rothschild–Stiglitz model assumes "individuals know their accident probabilities, while [the insurance] companies do not," setting up a classic situation of asymmetric information.[502] However, an insurance company may infer accident probabilities from its customers' market behavior because, for example, those individuals with higher accident probabilities will demand more insurance than those with lower accident

492. *Id.*

493. Rothschild & Stiglitz, *supra* note 399, at 630. For this concept represented mathematically, see *id.*

494. *Id.*

495. *Id.* For a mathematical representation of the value of an insurance contract to an individual, see *id.*

496. *Id.* at 631.

497. David Hemenway, *Propitious Selection*, 105 Q.J. ECON. 1063, 1067–68 (1990).

498. Rothschild & Stiglitz, *supra* note 399, at 631.

499. *Id.* For a mathematical representation of how firms are likely to behave as if they maximize the profitability equation, see *id.*

500. *Id*

501. *Id.*

502. *Id.* at 632.

probabilities.[503] When the market consists of low-risk individuals and high-risk individuals as two distinct customer groups, there cannot be a pooling equilibrium in which both groups buy the same contract.[504] If there is equilibrium, it must be a separating equilibrium in which the different types purchase different contracts.[505] "[E]ach contract in the equilibrium set makes zero profits."[506] However, a competitive insurance market may not have equilibrium.[507] Equilibrium will not exist if the low-risk individual has low costs of pooling or high costs of separating.[508] "One of the interesting properties of the equilibrium is the presence of the high-risk individuals" yields a negative externality on the low-risk individuals.[509] However, the high-risk individuals are no better off than they are in isolation.[510] Therefore, if only the high-risk individuals would admit their riskiness, all individuals in the marketplace would be made better off without anyone being made worse off.[511]

As already discussed at length, the core of the doctrine of *uberrimae fidei* is full disclosure of all material facts relevant to the risk to be insured by the individual to be insured. In 2000, Princeton economics professor Avinash Dixit placed the concept of *uberrimae fidei* into the Rothschild–Stiglitz model and recognized *uberrimae fidei* achieves a Pareto improvement by allowing insurers to better separate low-risk individuals from high-risk individuals.[512] According to Dixit, "[T]his social attempt to enforce morally superior behavior by placing the onus of disclosure on the insured leads to an outcome that is in the rational personal interest of all."[513]

When the Rothschild–Stiglitz model was modified to discover how the contracts and equilibrium changed with the imposition of *uberrimae fidei*, it was shown the inclusion of the doctrine deters high-risk individuals from claiming to be low-risk individuals.[514] Dixit endeavored to keep his

503. *See id.* (recognizing an insurance firm's ability to "use its customers' market behavior to make inferences about their accident probabilities" because generally, those with higher accident probabilities tend to demand more insurance).

504. *Id.* at 634.

505. *Id.* at 635.

506. *Id.*

507. Rothschild & Stiglitz, *supra* note 399, at 637.

508. *See id.* (stating "because there are relatively few of the high-risk individuals who have to be subsidized, or because the subsidy per individual is low" an equilibrium will not exist).

509. *Id.* at 638.

510. *Id.*

511. *Id.*

512. Dixit, *supra* note 399, at 41, 42; Picard, *supra* note 399, at 893–94.

513. Dixit, *supra* note 399, at 41, 42.

514. *See id.* at 41 (explaining how high-risk individuals can be deterred from claiming to be low-risk).

model as similar as possible to the standard Rothschild–Stiglitz model. While he maintained the probability of loss was private information, he assumed the size of the loss was common knowledge.[515] However, the "insurance company offering a contract can" make it available to a certain risk type, provided the individual must certify that he is that risk type in his application for the insurance contract.[516] At any time, the company can investigate the truth of the individual's certification; if the certification is found to be false, "the company can void the contract" but must return the premium paid to the individual.[517] An investigation will reveal the truth accurately and unambiguously; therefore, a rational company will only investigate, if at all, after a claim is made.[518]

In summary, the standard of *uberrimae fidei* makes an extra set of economic tools available to an insurance company, including the prospect of an investigation, penalties for lying, and rewards for truthfulness.[519] Combined in the economic model, these tools make it more difficult for high-risk individuals to claim to be low-risk individuals.[520] That, in turn, reduces the information asymmetries that block mutually beneficial trades of risk.[521]

The changes to the model basically operate as follows: when an insurance company introduces a contract specified for low-risk individuals, the individual must certify himself as a low risk and pay the low-risk level premium.[522] If an accident occurs, the insurance company will investigate the truth of the insured's risk certification.[523] If the individual is actually a low-risk individual, the insurance company will pay him such that his final wealth is restored to his pre-accident state; however, if the individual is actually a high-risk individual, the company will only refund his insurance premium.[524] In this situation, the high-risk individual would be better off not buying the insurance intended for the low-risk individual and would have been best off buying the insurance intended for high-risk individuals

515. *Id.* at 42.

516. Id. at 43.

517. *Id.*

518. *Id.*

519. *Id.* at 49.

520. *Id.*

521. *See generally* George A. Akerlof, *The Market for 'Lemons': Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970) (summarizing the classic discussion of how information asymmetry blocks mutually beneficial trades of risk).

522. Dixit, *supra* note 399, at 44.

523. *Id.*

524. *Id.*

in a separating equilibrium.[525] Therefore, implementation of *uberrimae fidei* in the Rothschild–Stiglitz model substantially improves the insurance company's ability to separate risk types.[526] Because separation can be more easily achieved, the low-risk individuals can get better coverage in a Rothschild–Stiglitz equilibrium with *uberrimae fidei* than one without.[527] The high-risk individuals "continue to get the same fair, full insurance as in the Rothschild–Stiglitz equilibrium."[528]

However, Dixit noted moral hazard may arise in three ways in his modified model. First, the insurance company experiences moral hazard in that it may not completely randomize its investigations, as is generally realized with probabilistic auditing.[529] Therefore, its randomization technique must be publicly verifiable.[530] Second, the insurance customer may pretend to suffer a loss when no actual loss has occurred.[531] This would require an audit, which is different than the investigation into private information about risk type.[532] Finally, the insurance customer may be better off with a loss and therefore create a genuine accident.[533]

The assumption in Dixit's model that investigations always accurately and unambiguously reveal the truth is troublesome. Combating fraudulent insurance claims is a major concern of most insurance companies.[534] Because it is costly to monitor suspicious claims, strong action against fraud is often difficult for insurance companies to follow through with.[535] Still, to deter fraud, insurance companies need to convince their policyholders that a stringent monitoring policy will be enforced, despite the fact it is difficult for an insurer to obtain a reputation for being tough on fraud.[536] Insurance companies engage in an "audit game" with

525. *Id.*

526. *Id.* at 45.

527. *Id.* at 44.

528. *Id.* at 49.

529. *Id.*

530. *Id.*

531. *Id.* at 50.

532. Dixit, *supra* note 399, at 50.

533. *Id.*

534. Pierre Picard, *Auditing Claims in the Insurance Market with Fraud: The Credibility Issue*, 63 J. PUB. ECON. 27, 28 (1996).

535. *Id.*

536. *Id.* at 29 ("First, optimal claim handling usually involves random auditing, which makes it difficult for policyholders to monitor devaluations of the company from its pre-announced strategy. Second, the probability of suffering a loss may be too low for a policyholder to experiment with the credibility of the insurer's auditing strategy. Third, policyholders may have only aggregate information on the average probability among insurers for a claim to be audited. Such global information could be volunteered by insurance regulators, but then we are faced with the problem of

policyholders as follows: "the insurer has incomplete information" regarding the policyholder's risk type, the policyholder may or may not experience a loss, and opportunistic policyholders may decide to file fraudulent claims.[537] The insurance company determines whether to audit the claims that have been filed.[538] If it is discovered a policyholder submitted a fraudulent claim, he can be prosecuted and fined.[539] The equilibrium of the audit game between an insurance company and a policyholder "depends on whether the insurance company can commit . . . to its auditing strategy."[540] Commitment gives an advantage to the insurance company; however, in "absence of commitment, the auditing strategy of the insurance company should be a best response to" the opportunistic policyholder's fraud strategy.[541] Most helpful for insurance companies would be a common agency to resolve the commitment problem.[542] As will be discussed later, although the major marine protection and indemnity clubs belong to the International Group of P&I Clubs, that organization plays no role in settling claims outside the pooling agreement.[543]

One important critique of the assumptions used in Dixit's extension of the Rothschild–Stiglitz model is the *uberrimae fidei* doctrine itself may be fundamentally flawed in assessing the relative strength of the parties with respect to the information they hold.[544] Because the individual does not know what information he holds that is relevant to the insurance company, he may actually be in a weaker position relative to the insurance company.[545] The strength of the insurance company's position lies in the fact that it is aware of what information it needs to determine individual risk type.[546] Even under a limited formulation of *uberrimae fidei* that

the credibility of this public announcement, since any insurer has an incentive to deviate.").

537. *Id.*

538. *Id.*

539. *Id.*

540. *Id.*

541. *Id.*

542. *Id.* at 30; *see also id.* at 41–45 (providing an extensive economic explanation and proof of this proposition).

543. *See The Role of the Group*, INT'L GROUP P&I CLUBS, http://www.igpandi.org/article/the-role-of-the-group (last visited May 18, 2016) ("One of the main roles of the Group is coordinating the operation and regulation of the clubs' claim-sharing agreement (the Pooling Agreement).").

544. *See* R. A. Hasson, *The Doctrine of* Uberrima Fides *in Insurance Law—A Critical Evaluation*, 32 MOD. L. REV. 615, 633 (1969) ("[T]he doctrine is in error in assessing the strength of the parties with regard to knowledge. The doctrine assumes that the insured is in a stronger position than the insurer because he (the insured) has more knowledge than the insurer.").

545. *Id.*

546. *Id.* at 633–34.

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

requires an individual to only disclose facts within his knowledge, the individual still may be at a disadvantage vis-à-vis the insurance company because he is either unaware or uncertain of the materiality of a given fact.[547]

However, in marine insurance law, the foregoing critique is not necessarily valid. As discussed earlier in this Article, the materiality of information in an application for marine insurance has been heavily litigated and the contours of what constitutes "something which would have controlled the underwriter's decision"[548] have been fairly well fleshed out.

Dixit's Rothschild–Stiglitz model with *uberrimae fidei* assumed any misrepresentation of risk type was intentional because the individuals were "perfectly privately informed about their risk types."[549] This model was extended by Dixit and Picard to a setting in which the individuals only perceive a signal of their risk level, rather than know their risk level for certain, and distinguished between unknowing and intentional misrepresentations.[550] The economists intended to reflect the reality that individuals may not be aware of their actual risk type and believe themselves in good faith to be low risk.[551] To illustrate this difference, the economic model incorporated not only the cost of the investigation of the insured's actual risk type but also the cost of investigating whether the insured was aware of his risk type (signal receipt).[552] The model also assumed if a post-accident investigation revealed a low-risk individual knew himself to be a high-risk individual, the law allowed the insurance company to both rescind the contract and levy a fine on the insured.[553] Therefore, the optimal contract design will be subject to both these legal provisions as well as the usual economic profit and incentive constraints.[554]

This economic model is essentially the same as Dixit's version of the Rothschild–Stiglitz model with *uberrimae fidei*, except each individual also receives a signal about his risk type.[555] Low-risk individuals always get a

547. *Id.* at 634.
548. Btesh v. Royal Ins. Co., Ltd., of Liverpool, 49 F.2d 720, 721 (2d Cir. 1931).
549. Dixit & Picard, *supra* note 399, at 1, 2.
550. *Id.* at 3.
551. *Id.* at 2.
552. *Id.* at 3.
553. *Id.*
554. *Id.*
555. *Id.* at 4.

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

true signal, but high-risk individuals sometimes get a false signal.[556] That is, sometimes high-risk individuals believe in good faith they are low-risk individuals and will act in the market as if they are low-risk individuals. The model then operates as a multistage game to reach equilibrium. First, a potential insurance company decides whether to offer insurance; if so, it decides what type of contract and the price–quantity specifications of the contract.[557] Second, the insurance consumer decides whether to accept an insurance contract; if so, he decides which one based on the expected utility of the risk signal he has received.[558] In the following stages, each individual's outcome is realized. Those individuals who have suffered losses file claims, and "the insurance companies follow through with their" investigation strategies, reveal the true risk type of the individuals, and pay the appropriate indemnities.[559] Like Dixit's model with *uberrimae fidei*, when there is equilibrium, it is Pareto superior to the equilibrium in the basic Rothschild-Stiglitz model.[560]

In this economic model, the insurance companies elicit information about customer risk type and information signal through post-accident investigations.[561] The insurance company may either verify risk type as the first step in a sequential claims handling procedure or directly investigate the individual's signal type.[562] If the insurance company engages in a sequential claims handling procedure and the type verification reveals high risk, then the insurer may decide to investigate the individual further by performing a signal investigation to establish whether the misrepresentation was intentional.[563] If a direct signal investigation is done, a later investigation of risk type should not be done.[564] This is because "if [a direct] signal investigation reveals bad faith," then the individual risk type is made known to the insurance company and the type verification is unnecessary.[565] However, "if [a direct] signal investigation reveals good faith," then the risk type is still unknown to both the company and the individual and, therefore, compels the same payout

556. *Id.*
557. *Id.* at 7.
558. *Id.* at 6.
559. Dixit & Picard, *supra* note 399, at 6.
560. *Id.* at 8.
561. *Id.* at 7.
562. *Id.* at 3.
563. *Id.*
564. *Id.* at 11.
565. *Id.*

regardless of risk type.[566] The model shows the optimal signal investigation is always random because the investigation "is [being] used as an incentive . . . to deter" the recipients of bad signals from being dishonest.[567] However, insurance companies will use only the less expensive of the two procedures for signal verification.[568]

Insurance companies in this model reward good faith disclosures and punish bad faith disclosures; the gap between each is important to elicit the truth.[569] To incentivize honesty, enforcement of the highest possible penalty for dishonest high-risk types is required, which is "canceling [the] insurance contract and returning the premium."[570] On the other hand, an excessive payout is the reward for honest low-risk types.[571] This paradigm allows for more robust contract forms because there is zero indemnity when bad faith is established, partial coverage when neither good faith nor bad faith is established (no investigation conducted), and over-coverage when good faith is established.[572]

The law of contracts places the burden of proving bad faith on the insurer, and the Dixit–Picard economic model suggests this is usually the most efficient solution.[573] When the cost to the insurer of proving bad faith is not greater than the cost to the individual insured of proving good faith, the burden of proof should rest with the insurer.[574] This is consistent with the law of marine insurance.[575]

A third variation on the Rothschild–Stiglitz model with *uberrimae fidei* was developed by Picard to account for the conditions in which insurers are unable to pre-commit to their risk investigation strategies.[576] The two

566. *Id.*

567. *Id.*

568. *Id.* at 3.

569. Dixit & Picard, *supra* note 399, at 2 (indicating "[a] larger insurance indemnity should be paid to a (truthful) low[-]risk individual" while "[n]o insurance indemnity should be paid to a policyholder caught lying").

570. *See id.* at 2, 9 (providing mathematical proof for the principle that "it is optimal to enforce the highest possible penalty" when a policy holder has acted in bad faith).

571. *See id.* at 3, 9 ("Overinsurance is a reward for truthtelling.").

572. *See id.* at 4 ("[I]f investigation shows that the policyholder was in good faith . . . , then the handling of the claim usually leads to the payment of a positive indemnity . . . .").

573. *Id.*

574. *Id.* at 12–13.

575. *See* Great Lakes Reinsurance (UK) PLC v. Kranig, No. 2011-122, 2013 WL 2631861, at *5 (V.I. June 12, 2013) ("The burden of proof of a material nondisclosure or misrepresentation lies with the insurer.").

576. *See* Picard, *supra* note 399, at 893 (discussing the potential for individuals not being aware of their risk type at the time of application); *see also* Strauss, *supra* note 399, at 2 (proposing the notion that individuals must know their risk type).

previous Rothschild–Stiglitz models with *uberrimae fidei* assumed all individuals revealed their risk types truthfully at equilibrium and, therefore, derived a random investigation strategy was the best for insurers.[577] As a result, when investigation is expensive, insurance companies may decide not to verify individual risk type "or perceived signals with the preannounced frequency, which implies the insur[ance companies' investigation] strategies" are "weakened by credibility problems."[578]

The economic model is similar to the Rothschild–Stiglitz model: both low-risk and high-risk individuals "seek . . . insurance on a competitive market," and a high-risk individual "may announce that he is . . . low-risk in order to benefit from cheaper insurance."[579] Insurers conduct a "costly [investigation] of the risk type of alleged low[-]risk individuals who file a claim."[580] *Uberrimae fidei* allows the insurance company to cancel any insurance contract and return any premium paid by any dishonest low-risk individual.[581] Nature plays a role, as she chooses each individual risk type and whether the individual has an accident.[582] The insurance companies, the individuals, and nature play a seemingly unpredictable game where, at equilibrium, the insurance company's investigation "probability is the best response to the [individual's] contract choice strategy."[583]

The principal finding of this economic model is that *uberrimae fidei* "is still Pareto-improving in [a] noncommittal setting."[584] In general, because *uberrimae fidei* "allows insurers to rescind contracts" once an "intentional misrepresentation of risk is established," the doctrine allows for "more efficient risk sharing in insurance markets [with] asymmetric information."[585] However, when there is a credibility constraint on the

577. *See* Picard, *supra* note 399, at 894 ("[I]n their model, all policyholders reveal their information truthfully at equilibrium . . . they are all in good faith."); *see also* Dixit, *supra* note 399, at 41 ("Common law attempts to [make] insurance contracts subject to an understanding that the insured should make a full disclosure in utmost good faith."); Dixit & Picard, *supra* note 399, at 1 (explaining the bifurcation of low-risk and high-risk applicants and the insurance companies' desire to only be responsible for the least possible amount of liability in cases pertaining to the latter grouping).

578. *See* Picard, *supra* note 399, at 894 (discussing the assertion that verification of accident probability is beneficial through random investigation, if it is not too costly).

579. *See id.* (working under the assumption where individuals know their own risk type at the time of application, a high-risk applicant can benefit by receiving a lower premium through bad faith).

580. *Id.*

581. *Id.* at 895.

582. *Id.* at 894.

583. *Id.*

584. *Id.*

585. *Id.* at 909.

insurance companies' investigation strategies, the effects of *uberrimae fidei* can "be weakened or even cancelled" out completely.[586] The equilibrium in this model can "be separating or semi-separating."[587] A semi-separating equilibrium is characterized by "some degree of bad faith from [the] high-risk individuals," who randomize between low-risk and high-risk contracts, and by overinsurance of the low-risk individuals.[588] However, low-risk individuals will still have partial coverage in a separating equilibrium.[589] The validity of the prevailing regime is determined by "the fraction of high-risk individuals in the population and the cost of risk type [investigation]."[590] "[E]quilibrium will always exist if the [investigation] cost is low enough" because the possibility of rescinding the contract for bad faith extends the set of parameters for which a competitive equilibrium exists.[591]

In his variation of the Rothschild–Stiglitz model with *uberrimae fidei*, Jason Strauss purports to contribute a new theory of underwriting.[592] He develops four propositions from the basic framework of the Rothschild–Stiglitz model with *uberrimae fidei*. First, "if the individual consumer knows his risk type and understands the concept of *uberrimae fidei*, he will truthfully reveal" the information about his risk type and probability of loss to the insurance company.[593] As a result, "there will be no asymmetric information in the [insurance] market."[594] Telling the insurance company the truth is the only option that is consistent with utility maximization because reporting a lower-than-actual probability of loss will leave the individual with a level of utility equivalent to not having any insurance and reporting a higher-than-actual probability of loss will cause the individual to obtain insurance at a higher-than-actuarially-fair price.[595] With "no asymmetric information in the market," Dixit's Pareto-optimal outcome is repeated.[596] If the courts strictly enforce insurance contracts, then insurance companies do not have to do any underwriting

586. *Id.*

587. *Id.* at 910.

588. Picard, *supra* note 399, at 910.

589. *Id.*

590. *Id.*

591. *Id.* at 910.

592. *See* Strauss, *supra* note 399, at 1 (asserting that consumers must know their risk type and their potential liability for bad faith).

593. *Id.* at 3.

594. *Id.*

595. *Id.*

596. *Id.*; *see* Dixit, *supra* note 399, at 41 (comparing a new model for risk against the Rothschild–Stiglitz model).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

because they know the information provided to them by the individuals seeking insurance is truthful.[597] An insurance company's investment into underwriting is the same if one or both of the original assumptions about individual rationality does not hold.[598] Actually, it is even preferable for insurance companies not to underwrite—even when underwriting is costless—when individuals do not know their risk type or do not understand *uberrimae fidei.*[599]

The second proposition provides insurance companies will not underwrite, even if underwriting is costless, "if courts . . . strictly enforce insurance contracts, and [if individuals] do not know their risk type" or do not understand *uberrimae fidei.*[600] "[T]he insurer will earn [an] economic profit on every [individual] who underestimates his risk [type] and does not have a loss."[601] However, if the individual underestimates his risk type and does have a loss, the insurer will discover the true risk type, rescind the contract, and refund the premiums paid.[602] Related to this is the third proposition, which holds "for any normally behaved social welfare function," this situation will decrease social welfare.[603]

Profit-maximizing insurance companies will be incentivized to underwrite when there is "[a]n *ex ante* expectation that courts" will equitably, rather than strictly, enforce insurance contracts when the customer has withheld material information, such as probability of loss.[604] The intuition behind this is as follows:

> If the probability of accurately discovering a consumer's risk type increases with the amount of money spent on underwriting, then the level of underwriting will be a positively related function of the ex-ante probability that a court of law will rule equitably in favor of the consumer if the consumer under-estimates his probability of loss. If a court is nearly always equitable towards the consumer if the consumer's stated risk type is lower than his actual risk type and there is a loss, then insurers will spend a sufficiently high level of money to reveal consumer's risk types. If the court is only equitable towards consumers some of the time, then insurers will spend a less, yet still positive, amount of money on underwriting, such that

597. Strauss, *supra* note 399, at 4.

598. *See id.* at 3–4 (arguing consumers' knowledge of good faith doesn't influence an insurer's decision to underwrite when courts are strict).

599. *See id.* at 4 ("In this way, insurers will be able to earn economic profit on the consumers who have invalid insurance for which their coverage is actually void and whom have no loss.").

600. *Id.*

601. *Id.*

602. *Id.*

603. *Id.*

604. *Id.* at 5.

Published by Digital Commons at St. Mary's University, 2015

they maximize their expected profits.[605]

Therefore, when individuals are unaware of their risk type or do not understand *uberrimae fidei*, an equitable rather than strict legal standard can increase social welfare by maximizing insurance coverage, albeit "at the expense of decreasing social welfare through the additional expense of underwriting."[606] In this situation, the insurance companies' *ex ante* expectation that courts will rule in favor of the individuals who have misrepresented their risk type can incentivize the insurance companies to underwrite to maximize profits.[607]

In summary, the four extensions of the Rothschild–Stiglitz model illustrate the primary benefit of incorporating *uberrimae fidei* into the basic economic model of asymmetric information in the insurance market is the expansion of insurance coverage for the low-risk individuals; although, a credibility constraint on insurance companies' investigation strategies can weaken or cancel out the improving effects of *uberrimae fidei*. Based on insurance companies' ability to enforce segregation of the risk pools, low-risk individuals expand from partial coverage at equilibrium in the original Rothschild–Stiglitz model to full coverage in the separating equilibria of the extended models incorporating *uberrimae fidei*. This is true whether the individuals are aware of their actual risk type. In a situation where individuals are unaware of their risk type, optimal signal investigation is always random. Finally, the underwriting investment required by insurance companies will depend on how strictly or equitably courts enforce the doctrine of *uberrimae fidei*.

D. *Application to Protection and Indemnity Clubs*

1. Special Characteristics of Protection and Indemnity Clubs

Because marine insurance underwriters have traditionally sought to address the needs of marine interests, "the history and development of protection and indemnity insurance in the United States has [paralleled] the history and development of . . . laws affecting vessels' liability."[608] As increasing shipowners' third party liabilities began to present serious problems to the shipowners in the mid-nineteenth century, protection and indemnity clubs grew out of the declining hull clubs in English port

605. *Id.*
606. *Id.*
607. Strauss, *supra* note 399, at 5.
608. John P. Kipp, *The History and Development of P&I Insurance: The American Scene*, 43 TUL. L. REV. 475, 475 (1969).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

cities.[609] In 1855, the Shipowners' Mutual Protection Society was founded to cover "extra risks not covered by ordinary marine policies on ships with a collision or running down clause therein."[610] The shipowners established the associations based on the principle of mutuality, "the joint, shared or reciprocal protection against losses."[611] The thought was by pooling the risks of inevitable maritime losses among themselves, each individual shipowner could reduce his personal risk of a catastrophe.[612] Since the structure for the organization of the new clubs already existed in the declining hull clubs, there was a smooth transition between mutually insuring hulls to mutually insuring against these new risks.[613]

Initially, the associations insured only against "protection" risks: liability for death, personal injury, collision, structural damage and wreck removal.[614] Shipowners' liability for death and personal injury to passengers and crew was the main reason for the formation of the newer protection associations.[615] Originally, liability to passengers was of greater importance than liability to crew because of the potential for vicarious liability due to the negligent acts of the crew.[616] Liability to crew was also limited, to a certain extent, by legal precedent. For example, in 1903, the U.S. Supreme Court held in *The Osceola*,[617] in the event of injuries arising from unseaworthiness, a seaman had a right to an indemnity, as well as

---

609. *See* William R. A. Birch Reynardson, *The History and Development of P&I Insurance: The British Scene*, 43 TUL. L. REV. 457, 464 (1969) ("It was the gradual recognition of these liabilities and the refusal of the underwriters to cover them that brought the Protection and Indemnity Clubs into being."); Norman J. Ronneberg, Jr., *An Introduction to the Protection & Indemnity Clubs and the Marine Insurance They Provide*, 3 U.S.F. MAR. L.J. 1, 3 (1990) ("Responding to the needs of the market, the first English Protection Associations were founded in the mid-19th Century to cover maritime risks which were otherwise uninsurable.").

610. Reynardson, *supra* note 609, at 467; Javier A. Franco, *P&I Clubs and Their Treatment Under Columbian Law (Los Clubes de Protección e Indemnización (P&I Clubs) y Su Operación a la Luz del Derecho Colombiano)*, REVIST@E-*MERCATORIA*, July–Dec., http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1490991; *History*, BRITANNIA, http://www.britanniapandi.com/about/history (last visited May 18, 2016).

611. Ronneberg, *supra* note 609, at 4.

612. *Id.*

613. Reynardson, *supra* note 609, at 464.

614. *Id.* at 464–65; *see* Ronneberg, *supra* note 609, at 3 (citing Reynardson, *supra* note 610, at 464–69); *see also History*, *supra* note 610 ("On 20 February 1886 Britannia became a Protection & Indemnity (P&I) Club with the introduction of indemnity risk cover i.e. cargo claims and cargo's proportion of general average, in addition to other 'protection' risks.").

615. Reynardson, *supra* note 609, at 465.

616. *See id.* at 465–66 (citing Boson v. Sandford, 91 Eng. Rep. 382 (KB 1689)).

617. The Osceola, 189 U.S. 158 (1903).

Published by Digital Commons at St. Mary's University, 2015

maintenance, cure and wages.[618] However, "the seaman [was] not allowed to recover an indemnity for the negligence of the master, or any member of the crew, but is entitled to maintenance and cure, whether the injuries were received by negligence or accident."[619] At this time, there was also no wrongful death action available in admiralty.[620] However, the shipowners' insurance policy available at the time, through Lloyd's, made no provision for any such third party liabilities because the underwriters were unwilling to cover them.[621] Therefore, the protection risks were of greatest concern to the shipowners.

Indemnity risks, including liability for loss or damage to cargo and for fines, were added later because cargo claims were not a serious burden for shipowners until the second half of the nineteenth century.[622] Therefore, the first protection and indemnity association was founded in 1874.[623] As insurance underwriters became more assertive of their subrogation rights, the need for indemnity cover became more important.[624] In response, the members of protection associations formed indemnity classes.[625] As a result, by the end of the nineteenth century, mutual protection and indemnity clubs covering limited classes of risk were entrenched both in London and in other U.K. port cities.[626] In April 1899, six mutual protection and indemnity clubs had established a pooling agreement, which shared among them any covered claim in excess of $10,000.[627] The first $10,000 was retained by the protection and indemnity club that suffered the loss.[628] Individual shares of the remaining loss were calculated according to each club's share of the total tonnage entered into the group, up to a maximum of 3,000 tons per ship.[629]

A robust demand for protection and indemnity insurance did not originate in the United States until the dawn of World War I because the

618. *Id.* at 175; *see also* Kipp, *supra* note 608, at 478 (citing 1903 legislation providing seamen with the right to indemnity for injuries caused by unseaworthiness but not for the negligence of other crew members).

619. *The Osceola*, 189 U.S. at 175.

620. Kipp, *supra* note 608, at 478.

621. Reynardson, *supra* note 609, at 466.

622. *Id.* at 464–65; Ronneberg, *supra* note 609, at 3–4.

623. Reynardson, *supra* note 609, at 468.

624. *Id.*

625. *Id.*

626. *Id.*

627. *History*, *supra* note 610.

628. *Id.*

629. *Id.*

need for such insurance was being satisfied by the English clubs.[630] The first protection and indemnity club was established in the United States in 1917 because the British government's control over the English protection and indemnity clubs seriously compromised their ability to insure the fleets of neutral countries.[631] The new American club was a mutual association patterned after the English clubs and soon had all the members of the United States Shipping Board enrolled as members.[632] Four thousand ocean going vessels were enrolled by the end of World War I.[633]

Both the holding of *The Osceola* and the lack of a right of recovery for wrongful death in admiralty were reversed by United States congressional action in 1920.[634] The passage of the Jones Act provided American crew members a right of recovery for injury or death caused by negligence, and the Death on the High Seas Act provided a general right of recovery for wrongful death on the high seas.[635] Congress continued to expand shipowners' potential liabilities with the 1927 passage of the Longshoremen's and Harbor Workers' Compensation Act, which provided potential compensation benefits to an additional class of workers.[636]

Once Congress finished expanding shipowners' liabilities, the U.S. Supreme Court picked up the baton. The Court decided eight cases between 1944 and 1967 alone that resulted in the expansion of shipowners' liability.[637] In 1944, *Mahnich v. Southern Steamship Co.*[638]

630. Kipp, *supra* note 608, at 477. *See History of the Club*, AM. CLUB, http://www.american-club.com/page/history (last visited May 18, 2016) ("At that time [in 1916], the majority of internationally-trading US flag vessels were insured by British P&I clubs.").

631. Kipp, *supra* note 608, at 477; *see also* Ronneberg, *supra* note 609, at 4 ("The 'American Club,' the only P&I association in the Western Hemisphere, was created during World War I for foreign policy reasons. American shipowners feared that the established English Clubs were too closely tied to the British government, and thus threatened the United States' pre-1917 status as a neutral. In addition, as the size of the American merchant fleet increased, there were 'patriotic' reasons for having a home-grown protection and indemnity insurer." (citing Kipp, *supra* note 604, at 477)); *History of the Club*, *supra* note 630 ("The American Club was originally formed as a consequence of legislation passed in the United Kingdom at the height of World War I.").

632. Kipp, *supra* note 608, at 477; *see also History of the Club*, *supra* note 630 ("The early Rules and general terms of entry in the American Club were framed much in line with those of the London Club in which a significant volume of [U.S.] tonnage had traditionally been entered during the early part of the twentieth century.").

633. Kipp, *supra* note 608, at 477; *see also History of the Club*, *supra* note 630 ("However, by the end of the war, there were more than 4,000 ocean-going ships entered, the United States Shipping Board having committed its vessels to the Club in the interim.").

634. Kipp, *supra* note 608, at 478.

635. *Id.*

636. *Id.* at 478–79.

637. *See id.* at 480 (detailing U.S. Supreme Court decisions during 1944 and 1967, which

reinforced the holding of *The Osceola* by refusing to apply the fellow servant rule to limit the liability of the vessel and her owner for unseaworthiness.[639] Any negligence on the part of a fellow crewmember in preparing an appliance appurtenant to the ship did not relieve the vessel owner of his duty to furnish a seaworthy appliance.[640]

Two years later, the Court took up the question of whether a shipowner's obligation of seaworthiness extended to stevedores who were injured while working aboard the ship in *Seas Shipping Co. v. Sieracki*.[641] The provisions of the Longshoremen's and Harbor Workers' Act notwithstanding, the Supreme Court expanded shipowners' third party liabilities by holding "[t]he brunt of loss cast upon the worker and his dependents is the same, and is as inevitable, whether his pay comes directly from the ship owner or only indirectly through another with whom he arranges to have it done."[642] The holding in *Sieracki* was expanded even further to encompass shipowners' liability for injuries resulting from the unseaworthiness of equipment that "belongs to the stevedore's independent employer, is part of that employer's loading equipment, and is brought on board by such employer."[643] During this period, the U.S. Supreme Court also expanded the definition of unseaworthiness to include incompetence by crew members[644] and amplified the duty to provide a seaworthy ship to include both the cargo containers and to the work of longshoremen.[645]

Relying in part on *Sieracki*, the U.S. Supreme Court also decided a stevedore employed by a charterer could rely on the charterer's liability as shipowner for the vessel's unseaworthiness to support his libel in rem against the vessel itself, despite the provisions of the Longshoremen's and

resulted in an "expansion of shipowners' liability").

638. Mahnich v. S. S.S. Co., 321 U.S. 96 (1944).

639. *See id.* at 102–03 (refusing to apply the fellow servant rule because the staging, which caused petitioner's injury, was "unseaworthy in the sense that it was inadequate for the purpose for which it was ordinarily used, because of the defective rope with which it was rigged").

640. *Id.* at 103.

641. Seas Shipping Co. v. Sieracki, 328 U.S. 85, 87 (1946), *superseded by statute as stated in* Yamaha Motor Corp., U.S.A. v. Calhoun, 516 U.S. 199 (1996).

642. *Id.* at 95.

643. Alaska S.S. Co. v. Petterson, 347 U.S. 396, 397 (1954) (Burton, J., dissenting).

644. *See* Boudoin v. Lykes Bros. S.S. Co., 348 U.S. 336, 339–40 (1955) ("We see no reason to draw a line between the ship and the gear on the one hand and the ship's personnel on the other. A seaman with a proclivity for assaulting people may, indeed, be a more deadly risk than a rope with a weak strand or a hull with a latent defect.").

645. *See* Gutierrez v. Waterman S.S. Corp., 373 U.S. 206, 215 (1963) ("[We] hold that the duty to provide a seaworthy ship and gear, including cargo containers, applies to longshoremen unloading the ship whether they are standing aboard ship or on the pier.").

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

Harbor Workers' Compensation Act.[646] The Supreme Court affirmed this result four years later under a similar set of facts.[647] Finally, the U.S. Supreme Court decided the U.S. government may recover the costs of removing vessels negligently sunk in navigable waters under the Rivers and Harbors Act of 1899.[648]

The 1972 Amendments to the Longshoremen's and Harbor Workers' Compensation Act reversed the Supreme Court's expansion of shipowner liability to non-seamen;[649] however, significant third-party liabilities still remained. The increasing legal liabilities of shipowners and the improved coverage of risks by the protection and indemnity clubs have led to the growth of mutual protection and indemnity clubs in the twentieth and twenty-first centuries.[650]

Beginning in the 1920s, U.S. courts began to rough out some of the contours of how they considered protection and indemnity insurance to be different from other forms of insurance. In *Hanover Fire Insurance Co. v. Merchants' Transportation Co.*,[651] the Ninth Circuit stated:

> The object of this form of insurance is to afford protection to ship[]owners, in addition to that afforded by the ordinary marine policy, and the contract should be construed with that object in view. When so construed, we are clearly of opinion that it covered damages paid for loss of life arising from the negligence of the ship or ship-owner; for, in the absence of negligence on the part of either, there would be no loss or liability to be indemnified against. And, if the policy covered loss arising from negligence, the courts will not attempt to distinguish between the different kinds or degrees of

646. *See* Reed v. S.S. Yaka, 373 U.S. 410, 415–16 (1963) ("We conclude that petitioner was not barred by the Longshoremen's Act from relying on [the charterer's] liability as a shipowner for the Yaka's unseaworthiness in order to support his libel *in rem* against the vessel.").

647. *See* Jackson v. Lykes Bros. S.S. Co., 386 U.S. 731, 735 (1967) ("In this case as in *Yaka*, the fact that the longshoreman was hired directly by the owner instead of by the independent stevedore company makes no difference as to the liability of the ship or its owner.").

648. *See* Wyandotte Transp. Co. v. U.S., 389 U.S. 191, 210 (1967) (Harlan, J., concurring) ("I concur in the Court's holding that under § 15 of the Rivers and Harbors Act of 1899, 33 U.S.C. § 409, the United States may recover the costs of removing a vessel negligently sunk in navigable waters from those responsible for the sinking.").

649. *See* Edward M. Bull III, *Seaman Status Revisited: A Practical Guide to Status Determination*, 6 U.S.F. MAR. L.J. 547, 559 (1994) ("In 1972, after more than a decade of spiraling expansion of the availability of seamen's remedies, Congress hit the brakes by amending the LHWCA. It withdrew from all but seamen the unseaworthiness remedy, taking away from the longshore and harbor workers what had been given by the courts." (footnotes omitted)).

650. *See* Reynardson, *supra* note 609, at 468 (documenting association growth in Britain from 236 ships in 1876 to more than 4000 ships in 1968); *see generally* Kevin X. Li & Jia Yan, *Valuation of Information-Sharing in Marine Mutual Insurance*, 2 J. RISK & DECISION ANALYSIS 65 (2010) (citing an average growth rate of 9.11% for fourteen major marine mutual marine insurers as of 2010).

651. Hanover Fire Ins. Co. v. Merchants' Transp. Co., 15 F.2d 946, 948 (9th Cir. 1926).

negligence, unless, as agreed by counsel, the negligence was so gross as to amount to a willful, deliberate, and intentional wrong.[652]

U.S. courts have repeatedly recognized the limited nature of protection and indemnity policies.[653] The American Institute of Marine Underwriters SP-23 standard forms used by some protection and indemnity clubs to write these policies specifically enumerate either ten or fourteen "specific types of loss or damage as perils or risks insured against; these enumerated perils by no means would cover the entire range of a ship owner's liability."[654] Modern protection and indemnity insurance covers the gamut of maritime risks, ranging from Jones Act cases to pollution catastrophes.[655] Types of loss or damage include: loss of life, injury and illness; hospital, medical or other expenses; "crew member burial expense not to exceed $1,000 per person"; repatriation expenses; "damage to any fixed or movable object or property" regardless of cause, except damage to another vessel or property aboard it caused by collision with the vessel; removal of wreck; customs, immigration or other fines or penalties; "extraordinary expense arising from an outbreak of contagious disease"; deviation for the purpose of landing injured seaman; and costs and charges "reasonably incurred" for investigation and defense of claims.[656]

Both settled case law and the forms "leave no room for doubt or ambiguity as to who is the insured, in what capacity he is insured, and for

---

652. *Id.*

653. *See* St. Paul Fire & Marine Ins. Co. v. Vest Transp. Co., 666 F.2d 932, 941 (5th Cir. 1982) ("It must be stressed initially that protection and indemnity policies do not purport to cover all types of an insured's liability but extend only to the liabilities specifically enumerated in the insuring agreement."); Williams v. Treasure Chest Casino, LCC, 1998 A.M.C. 1300, 1303 (E.D. La. 1998) ("The Court recognizes that a protection and indemnity policy is of a limited nature.").

654. *St. Paul Fire & Marine Ins. Co.*, 666 F.2d at 941. *See* AM. INST. OF MARINE UNDERWRITERS, PROTECTION AND INDEMNITY FORM SP-23 (1956), http://www.aimu.org/forms/SP-23%20%28Revised%201-56%29.pdf [hereinafter P&I FORM SP-23] (providing an older protection and indemnity form with fourteen covered perils); *see also* AM. INST. OF MARINE UNDERWRITERS, PROTECTION AND INDEMNITY FORM 23 (1983), http://www.aimu.org/forms/23.pdf [P&I FORM 23] (providing a newer protection and indemnity form with ten covered perils). See *Rules*, AM. CLUB, http://www.american-club.com/page/rules (last visited May 18, 2016) for how mutual insurers of the International P&I Group define the covered risks and losses under Rule 2 "Risks and Losses Covered."

655. Ronneberg, *supra* note 609, at 35; *see also About the Group*, INT'L GROUP P&I CLUBS, http://www.igpandi.org/about (last visited May 18, 2016) ("Clubs cover a wide range of liabilities including personal injury to crew, passengers and others on board, cargo loss and damage, oil pollution, wreck removal and dock damage.").

656. P&I FORM 23, *supra* note 654; *see* P&I FORM SP-23, *supra* note 654 (stating the fourteen covered perils under the old version of the form).

which losses he will be indemnified."[657] An important feature of the protection and indemnity policy it only covers liability incurred by a vessel's owner, and if the liability is unrelated to the operation of the vessel, then it will not be covered under the protection and indemnity policy.[658] However, the protection and indemnity policy will cover any liability for claims brought against the vessel owner if "a seaman is injured in the course and scope of employment and the injury bears a 'causal operational relation' to the ship."[659]

U.S. courts have viewed protection and indemnity clubs as "peculiar to the maritime setting."[660] U.S. courts have not viewed protection and indemnity clubs to be "traditional insurance" companies because of the following distinguishing characteristics: mutuality of insurance, membership in the club, indemnity rather than liability coverage, and lack of a duty to defend.[661] Therefore, conflicts between seamen and protection and indemnity clubs are held to be uniquely maritime in nature and require application of federal maritime law.[662]

The "essence" of mutuality is "[t]he ship owners are not only co-insureds, but co-managers of the Club's funds."[663] Each protection and indemnity association is a non-profit association formed by shipowners banding together because "the unusual risks of the world-wide shipping

---

657. *St. Paul Fire & Marine Ins. Co.* 666 F.2d at 941.

658. *Williams*, 1998 A.M.C. at 1304 ("Fifth Circuit precedent clearly shows that even though a party may be an insured under a P&I policy, if its liability arises out of an employment relationship with the plaintiff and conduct unrelated to the operation of the insured vessel, there is no coverage under the policy.").

659. *Id.* at 1305.

660. Aasma v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n, Inc., 95 F.3d 400, 404 (6th Cir. 1996).

661. Psarianos v. Standard Marine, Ltd., 728 F. Supp. 438, 451 (E.D. Tex. 1989) (distinguishing between traditional insurance companies and P&I clubs). The *Psarianos* court explained:

> First, a protection and indemnity association is not a traditional insurance company; it is a group of ship owners who have agreed to insure one another's vessels for the mutual benefit of all. [The defendant] is a member of the Club, not simply an insured; and the coverage provided is indemnity, rather than liability. There is no duty to defend, although coverage does include reimbursement for defense costs.

Id.; *see also* Ronneberg, *supra* note 609, at 4 (defining a P&I club as a mutuality and an indemnity).

662. *See* TCW Special Credits v. F/V Chloe Z, 1998 A.M.C. 750, 761 (D. Guam 1997) (stating "conflicts between seamen and P&I Associations are uniquely maritime in nature, and therefore, demand a uniform admiralty rule" (citing *Aasma*, 95 F.3d at 404)); *see also* Heikkila v. Sphere Drake Ins. Underwriting Mgmt., Ltd., No. Civ. 96-00047, 1997 WL 995625, at *7 (D. Guam Aug. 29, 1997) (stressing standard insurance policies, when compared to P&I policies, require a specific admiralty rule).

663. Ronneberg, *supra* note 609, at 29.

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

industry render private insurance largely unavailable."[664] For a shipowner to obtain coverage from a protection and indemnity club, he must become and remain a member of the club.[665] Therefore, the shipowners are both the insured and the insurers.[666] Shipowners can collectively change or amend the protection and indemnity association rules.[667]

The members elect the board of directors, which manages the club's business, from among themselves.[668] A smaller group of directors administers the daily club's business and makes such decisions as setting the calls and amending the insuring agreement.[669] Each club also has "a staff of underwriters, lawyers," and other specialists "who are responsible for underwriting, handling claims and administering funds in accordance with the policies" established by its board of directors.[670] However, the directors must vote to approve a large settlement; therefore, one director cannot represent the club at a settlement conference in a United States court in advance of a board of directors' decision.[671]

Instead of fixed annual premiums, membership in a protection and indemnity club requires payment of an "advance call," which is estimated to cover the association's claims and operating expenses for the year.[672] The advance call, which is usually invested to create additional income for the fund, is based on each shipowner's claims history, his fleet size, the

---

664. *Aasma*, 95 F.3d at 404; *see also About the Group*, *supra* note 655 (explaining each "group club is an independent, non-profit making mutual insurance association, providing cover for its shipowner and charterer members against third party liabilities relating to the use and operation of ships").

665. *See* Ronneberg, *supra* note 609, at 5 (announcing the shipowners must become and remain members of the P&I club to obtain coverage).

666. *Id.* at 21; *see* Franco, *supra* note 610 (implying the dual capacity of the insurance policy in the club allows for the insured to also be the insurers).

667. Ronneberg, *supra* note 609, at 21–22 (explaining why the *contra proferentum* rule of construction should not apply to protection and indemnity insurance issued by clubs).

668. *Id.* at 24; *see About the Group*, *supra* note 655 (noting each club "is controlled by its members through a board of directors or committee elected from the membership").

669. *See* Ronneberg, *supra* note 609, at 24–25 (illustrating the daily activities and expectations of the executive committee).

670. *See id.* at 25 (echoing the presence of a manager or group of managers has an important role "as a trustee on behalf of the whole [shipowning] membership").

671. *Id.* at 29 (prohibiting one director from representing the club in a U.S. Court without first receiving a decision from the board).

672. *See* Aasma v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n, Inc., 95 F.3d 400, 404 (6th Cir. 1996) (delineating the differences from premiums of insurance carriers from the "advance calls" of the associations); *see also* Ronneberg, *supra* note 609, at 29 ("Shipowners (or 'members') do not pay 'premiums' for vessel P&I coverage. Instead, they pay 'advance calls' which are used to create a fund from which personal injury and other claims are paid, and from which the Club's day-to-day expenses are met."); Franco, *supra* note 610 (paraphrasing the description of "advanced call" as a premium paid by the members to cover expenses).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

anticipated needs of the association, as well as the overall character of the insurance market.[673] If there is a shortfall because the claims paid exceed the funds available that year, the members must pay a "supplemental call."[674] Supplemental calls also ensure policy years are closed with neither profit nor loss.[675]

Indemnity coverage provided by protection and indemnity clubs differs from standard liability insurance because the associations "are not ordinarily obligated to indemnify their members for covered losses unless and until the member has actually paid out a claim, judgment or settlement."[676] For example, the SP-23 form's indemnification agreement has a clear "pay to be paid" provision.[677] Therefore, the insured shipowner has no right of recovery against the protection and indemnity club "unless and until" it has fulfilled its obligation to the claimant.[678] For the insurer to be liable under an indemnity policy, unlike a standard liability policy, the insured "must have suffered an actual [monetary] loss before the insurer is liable."[679]

The modern maritime protection and indemnity market consists of a

673. *See* Ronneberg, *supra* note 609, at 29–30 (summarizing the amounts and uses of advanced calls). Other factors that may be used in calculating calls are the tonnage of the ships, the age and characteristics of the ships, the nature of the shipping traffic, the nationality of the ship, and the extension of the coverage. Franco, *supra* note 610.

674. *See Aasma*, 95 F.3d at 404 ("[W]hen claims exceed funds available, members must pay 'supplementary calls' to make up the shortfall."); *see also* Ronneberg, *supra* note 609, at 30 (expanding on the instances when "supplementary calls" are required); Franco, *supra* note 610 (indicating the additional amount, called "Supplementary Call," is determined by the director of the club and is a fixed relation to cover the largest amount to be paid).

675. *See* Ronneberg, *supra* note 609, at 30 (restating the year will close with no profit or loss).

676. *Id.* at 5.

677. *See* P&I FORM SP-23, *supra* note 654 ("The Assurer hereby undertakes to make good to the Assured or the Assured's executors, administrators and/or successors, all such loss and/or damage and/or expense as the Assured shall as owners of the vessel named herein have become liable to pay and shall pay on account of the liabilities, risks, events and/or happenings herein set forth . . . ."); *see also* P&I FORM 23, *supra* note 654 ("Subject to all exclusions and other terms of this Policy the Underwriters agree to indemnify the Assured for any sums which the Assured, as owner of the Vessel, shall have become liable to pay, and shall have paid, in respect of any casualty or occurrence during the currency of the Policy but only in consequence of any of the matters set forth hereunder. . . ."). The American Club has a rule that states, "It is a condition precedent of a Member's right to recover from the funds of the Association in respect of any liabilities, costs or expenses that he shall first have discharged and paid the same out of funds belonging to him unconditionally and not by way of loan or otherwise." *Rules*, *supra* note 654.

678. *See* Ronneberg, *supra* note 609, at 14 (refuting the chief indemnity policy); *see also* Franco, *supra* note 610 (limiting the coverage to civil liability for the owner or carrier that may arise from any kind of damage caused to third parties).

679. Ronneberg, *supra* note 609, at 14.

service component and several insurance tiers.[680] As of October 2015, there were thirteen principal underwriting member clubs of the International Group of Protection and Indemnity Clubs that provide protection and indemnity insurance for approximately ninety percent of the world's ocean-going ship tonnage.[681] The member clubs operate under the International Group Agreement, which "specifies how member clubs may quote rates," clarifies what information the clubs should gather from each other before providing premium rate quotes, regulates how clubs can accept applications from shipowners desiring to move from one club to another, and specifies the factors to be accounted for in setting "release calls" for vessels switching from one club to another.[682] The International Group Agreement ensures mutual cooperation between the member clubs in the operation of the Pooling Agreement, which is "an annually renewed agreement between the clubs to mutually reinsure each other by sharing claims between themselves."[683] As of February 2015, each member club had an individual retention of $9 million per vessel for owned entities; above that, the International Group's pool provides approximately $3 billion commercial reinsurance coverage.[684]

According to organizational economic theory, two broad conditions

680. Knut K. Aase, *Equilibrium in Marine Mutual Insurance Markets with Convex Operating Costs*, 74 J. RISK & INS. 239, 266 (2007).

681. The thirteen clubs are as follows: American Steamship Owners Mutual Protection and Indemnity Association, Inc.; Assuranceforeningen Skuld; Gard P&I (Bermuda) Ltd.; The Britannia Steam Ship Insurance Association Ltd.; The Japan Ship Owners' Mutual Protection & Indemnity Association; The London Steam-Ship Owners' Mutual Insurance Association Ltd.; The North of England Protecting & Indemnity Association Ltd.; The Shipowners' Mutual Protection & Indemnity Association (Luxembourg); The Standard Club Ltd.; The Steamship Mutual Underwriting Association (Bermuda) Ltd.; The Swedish Club; United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Ltd.; and The West of England Ship Owners Mutual Insurance Association (Luxembourg). *Group Clubs*, INT'L GROUP P&I CLUBS, http://www.igpandi.org/article/list-principal-clubs (last visited May 18, 2016).

682. *See* INT'L GRP. P&I CLUBS, INTERNATIONAL GROUP AGREEMENT (2013), http://static.coracleapps.com/igpi_website/media/article_attachments/IGA2013.pdf [hereinafter INTERNATIONAL GROUP AGREEMENT] (outlining the terms of the International Group Agreement).

683. *Id.*

684. *See Pooling Agreement*, INT'L GROUP P&I CLUBS, http://www.igpandi.org/group-agreements (last visited May 18, 2016) (providing the agreement, "which defines the risks that can be pooled and how losses are to be shared" among associated clubs); *Pool Reinsurance Programme 2016-17*, INT'L GROUP P&I CLUBS, http://www.igpandi.org/reinsurance (last visited May 18, 2016) (describing the reinsurance program and the Collective Overspill layer, "which combine to provide up to just over US $3 billion of commercial reinsurance" coverage). For a chart of the general excess of loss reinsurance contract structure for the 2016–2017 policy year, see *Reinsurance Diagram*, INT'L GROUP P&I CLUBS, http://static.igpandi.org/igpi_website/media/adminfiles/pandi-RIa.pdf (last visited May 18, 2016).

need to be satisfied for firms to be organized as consumer cooperatives. First, there needs to be a "relatively severe market failure in the firm's product market."[685] In the face of a market failure, mutual companies do better than stock companies because they only insure the better risks in the industry and "typically have a regular program of inspecting the firms they insured, both to assess the risk and to recommend loss prevention measures."[686] When the firm has a natural monopoly or otherwise faces very limited competition, consumer cooperatives most typically occur.[687] A consumer cooperative has an advantage in a natural monopoly because it substitutes an ownership relationship for a market mechanism, there is no conflict of interest between the firm's owners and consumers, and there is some assurance the firm will not charge monopoly prices.[688]

For the historical reasons previously discussed, mutual insurers have almost a natural monopoly in the marine protection and indemnity market. In August 2010, the European Commission opened formal proceedings to investigate whether the insurance and reinsurance agreements between the members of the International Group violated European Union antitrust rules by lessening competition between protection and indemnity clubs and by restricting access of commercial insurers and other mutual insurers to the relevant market.[689] Two years later, the Commission concluded its proceedings without sufficient findings conclusive enough to confirm their initial concerns.[690]

The second condition for firms to be organized as consumer cooperatives is the consumers need to be "able to assume effective control without incurring excessive costs."[691] In general, consumer cooperatives arise when the consumers repeatedly purchase a relatively large value of goods or services from the same firm over a significant period of time.[692] If this were not the case, "the transaction costs of registering, keeping track of, and communicating with members will be disproportionate to the value of goods consumed."[693] Also important to the success of the

685. Henry Hansmann, *The Organization of Insurance Companies: Mutual Versus Stock*, 1 J. L. ECON & ORG. 125, 126 (1985) (footnote omitted).

686. *Id.* at 145.

687. *Id.* at 126.

688. *Id.*

689. *Antitrust: Commission Opens Formal Probe into Marine Insurance Agreements*, EUROPEAN COMMISSION (Aug. 26, 2010), http://europa.eu/rapid/press-release_IP-10-1072_en.htm?locale=en.

690. *Antitrust: Commission Closes Investigation in P&I Clubs Case*, EUROPEAN COMMISSION (Aug. 1, 2012), http://europa.eu/rapid/press-release_IP-12-873_en.htm.

691. Hansmann, *supra* note 685, at 126.

692. *Id.* at 127.

693. *Id.*

cooperative form are relatively small requirements for organization-specific capital.[694] Finally, all consumers in the cooperative must purchase goods or services that are similar in type and quantity.[695] If this were not the case, the consumers' objectives would not be aligned and either one group of members could exploit another or strategic behavior could considerably increase the firm's decision-making costs.[696]

This second condition also holds true for marine mutual insurance. Shipowners typically purchase vessel or fleet coverage for one year at a time.[697] Homogeneity in services is guaranteed through the use of either the SP-23 form or rule book to define the standard protection and indemnity cover offered by the mutual marine insurer.[698]

"The mutual form mitigates conflicts of interest between the insurer and the insured."[699] According to one organizational theorist,

> Like the patrons of a typical nonprofit, the policyholders in a mutual company derive protection not from the exercise of control over the firm, but rather from the fact that the management of the mutual, unlike the management of a stock company, does not have a strong pecuniary incentive to exploit its policyholders.[700]

Because the members of protection and indemnity clubs elect their board of directors from among themselves,[701] there is little question of interest alignment.

Asymmetric information is also one of the root causes for the rise of mutual companies, which evidently form in part because traditional stock insurance companies cannot easily distinguish between the different risks the prospective insureds present.[702] "[T]he customers themselves are often likely to have better information than the insurance companies" about the risks they pose.[703]

The firms that joined to form the mutuals, on the other hand, were

694. *Id.*

695. *Id.* at 128.

696. *Id.*

697. Under Rule 1, the American Club defines "policy year" as "[a] year from noon GMT on any February 20 to noon GMT on the next following February 20." *Rules*, *supra* note 654.

698. *See supra* note 654.

699. Hansmann, *supra* note 685, at 148.

700. *Id.* at 143.

701. Ronneberg, *supra* note 609, at 24; *see also About the Group*, *supra* note 655 ("Each club is controlled by its members through a board of directors, or committee, elected from the membership.").

702. Hansmann, *supra* note 685, at 145.

703. *Id.*

> commonly owned and operated by individual entrepreneurs, who necessarily were already quite familiar with the available technology in the industry and the risks that it presented. This situation then provided an incentive for those firms within an industry that knew themselves to be unusually good risks to join together to form a mutual insurance company to insure themselves: the firms could recognize each other as good risks but would have difficulty convincing an insurance company from outside the industry that they deserve especially low premiums. Or, put differently, the cost of information about the riskiness of individual insureds was lower to firms within the industry than to those outside of it.[704]

Revisiting the history of the formation and expansion of the early protection associations, this statement most certainly rings true about modern protection and indemnity clubs.

Pierre Picard wrote an article in 2014 extending the Rothschild–Stiglitz model to account for the difference between participating and non-participating insurance contracts.[705] In his analysis, there were two types of insurance contracts: (1) participating contracts with dividends and supplementary calls, depending on the profitability of the risk underwriting; and (2) non-participating contracts with fixed premiums and an indemnity to be paid in the event of a loss.[706] The insurance market is composed of insurers who are allowed to offer one type of contract and individuals who are risk averse.[707] The key finding from this model was, when there was cross-subsidization between risk types by the insurer, "participating policies act as an implicit threat against deviant insurers who would like to attract low-risk individuals only."[708] This means no insurer who offers non-participating contracts will be able to exclusively target the low-risk segment of the market, to the exclusion of the high-risk segment, because the low-risk individuals will always be able to opt for an attractive participating contract.

Picard's theory explains why there still exists a market for fixed premium marine protection and indemnity insurance, despite the overwhelming dominance of the mutuals in the protection and indemnity insurance market.[709]

704. *Id.* at 146.

705. Picard, *supra* note 483, at 153.

706. *Id.* at 153–54.

707. *Id.* at 154.

708. *Id.*

709. Under Rule 1.1.7, the American Club allows members to be insured on a fixed premium basis. *Rules*, *supra* note 654.

2. Issues of Information Asymmetry

Adverse selection in insurance markets is the process by which individuals use private knowledge of their risk type in their decision to acquire insurance coverage.[710] There are four general assumptions to the model of adverse selection: first, the purchase of insurance is voluntary; second, risks are heterogeneous; third, heterogeneous risks are pooled and charged the same premium; and finally, the individuals purchasing insurance have private information about their own risks.[711] The heterogeneous risk pool of insureds is "personally better able to determine their own risk than the [insurance companies], which only know the average risk for a pool of observationally similar, but in fact heterogeneous, insureds."[712] Therefore, "high-risk parties . . . obtain insurance at a lower premium than what they would actually be otherwise willing to pay," and low-risk individuals face a higher premium than what they would otherwise be willing to pay because they are cross-subsidizing the high-risk parties.[713]

When insurance is voluntary, individuals who perceive themselves to be low risk may decide not to participate in the insurance program, which decreases the premium payments flowing into the program and increases the benefit payments flowing out of the program.[714] As the cost of insurance increases, the number of low-risk individuals who opt into the program decreases.[715] Similarly, those individuals who buy more insurance tend to pose higher costs for their insurers.[716] However, if the insurance companies had access to the individual's private information, they would use this to charge high-risk individuals higher premiums.[717] This positive relationship between an individual's risk type and insurance

710. Peter Siegelman, *Adverse Selection in Insurance Markets: An Exaggerated Threat*, 113 YALE L.J. 1223, 1223 (2004); *see also* Avraham, *supra* note 401, at 44 ("[A]dverse selection describes the phenomenon of high-risk parties who, knowing their 'type', seek more insurance coverage than low-risk parties.").

711. Hemenway, *supra* note 497, at 1063.

712. Avraham, *supra* note 401, at 44.

713. *Id.*

714. Currie v. Group Ins. Comm'n, 290 F.3d 1, 4 (1st Cir. 2002).

715. *Id. see* Avraham, *supra* note 401, at 44 ("Low-risk parties might object to *cross subsidizing* the high-risk parties-with insurers using the excess premiums of the low-risk parties to defray the costs of offering cheaper insurance to high-risk parties-and might therefore drop their coverage and leave the insurance pool. Consequently, the average risk faced by the insurer increases, the premium must increase, and this cycle of adverse selection repeats itself and theoretically might lead to the risk pool unraveling completely-a classic death spiral.").

716. Siegelman, *supra* note 710, at 1247; *see also* Hemenway, *supra* note 497, at 1063 (inferring a causal correlation between individuals with higher risks and those who purchase more insurance).

717. Siegelman, *supra* note 710, at 1247.

consumption lies at the heart of adverse selection.[718] As a result, all adverse selection models involve a constraint on the insurance companies who are unable to obtain the beneficial private information from the individuals they desire.[719] For example, when an individual knows he is a high-risk type, there is an informational asymmetry with the insurance company who may, out of ignorance, categorize the individual in the wrong risk pool.[720] If this misrepresentation is on an insurance application, the "informational asymmetry may substantially affect the insurer's underwriting."[721]

As discussed earlier, theoretically if equilibrium exists, the low-risk individuals will have partial coverage.[722] As long as the information asymmetry between the insurance company and the individual exists, it will be impossible to do better than this "second-best optimal" equilibrium.[723]

The four basic general assumptions of the adverse selection model are suspect when considering protection and indemnity insurance offered by clubs.[724] First, such insurance may not be voluntary.[725] As of January 1, 2012, European Union Directive 2009/20/EC requires each member states' ships of 300 gross tons or larger flying the member state's flag to carry "insurance with or without deductibles, and comprise, for example, indemnity insurance of the type currently provided by members of the International Group of P&I Clubs, and other effective forms of insurance (including proved self-insurance) and financial security offering similar conditions of cover."[726] Additionally, each member state shall require ships of other nationalities to have insurance when they enter a port under

718. *Id.*

719. *Id.* at 1261.

720. Priest, *supra* note 402, at 17.

721. *Id.*

722. Siegelman, *supra* note 710, at 1239–40; *see generally* Rothschild & Stiglitz, *supra* note 399, at 637 ("An equilibrium will not exist if the costs. . . of separating are high. The costs of separating arise from the individual's inability to obtain complete insurance. Thus, the costs of separating are related to the individuals' attitudes toward risk.").

723. Siegelman, *supra* note 710, at 1240; *see generally* Rothschild & Stiglitz, *supra* note 399, at 638 (recognizing without the risk information, low-risk individuals are worse of at equilibrium while high-risk individuals are no better off, thus no one benefits).

724. *See* Hemenway, *supra* note 497, at 1063 (listing the four assumptions of the adverse selection model).

725. *See id.* ("The model of adverse selection seems to contain four general assumptions: (1) insurance purchase is voluntary. . . .").

726. Directive 2009/20/EC, of the European Parliament and of the Council on the Insurance of Shipowners for Maritime Claims, arts. 2(1), 3(b), 4(1), 2009 O.J. L. 131/128, at 128–29 [hereinafter Directive 2009/20/EC].

St. Mary's Law Journal, Vol. 47 [2015], No. 4, Art. 1

a member state's jurisdiction.[727] The compulsory aspect of protection and indemnity insurance means low-risk shipowners can opt in only if they are willing to self-insure or otherwise post financial security. Therefore, a higher number of low-risk shipowners will be retained in the insurance pool.

Although the risks in the pool of ships enrolled in protection and indemnity clubs are heterogeneous, the risks are not charged the same premium.[728] As previously discussed, each shipowner's advance call is based on his claims history, his fleet size, the anticipated needs of the club, as well as the overall character of the insurance market.[729] Such risk-based pricing better aligns the call with insurance consumption and will further encourage low-risk shipowners to remain in the risk pool.

The marine insurance doctrine of *uberrimae fidei*[730] is the most basic solution to adverse selection because it requires full disclosure of all material facts in the application by the insured.[731] In general, with more accurate information about the characteristics of the insured, the insurance companies can better assess and price the overall insurance pool.[732] An insurance company may then mitigate the problem of adverse selection to some extent by dividing individuals according to their level of risk and assigning similar risks the same premium.[733] *Uberrimae fidei* is incorporated into the rule books of protection and indemnity clubs, as "[i]t shall be a condition precedent of such insurance that all the said particulars and information were true so far as the applicant [m]ember knew or could with reasonable diligence have ascertained."[734]

According to one economist, the added benefit of risk classification is that it may result in increasing the average costs of rival insurance companies, as high-risk individuals leave one insurance company for another that has a higher degree of cross subsidization.[735] For the

727. *Id.*

728. *See* Ronneberg, *supra* note 609, at 29 (explaining the members pay "advance calls" rather than "premiums" and personal injury claims are paid out of the resulting fund from these advance calls).

729. *Id.* at 29–30.

730. *See* Struckhoff, *supra* note 398, at 292 (describing the doctrine as a duty of the insured to disclose any and all material circumstances which speak to the individual's risk level to the insurer).

731. *See* Avraham, *supra* note 401, at 45 ("There are several possible solutions [to the adverse selection problem] on the theoretical level. The first and most basic is requiring disclosure by the insureds.").

732. *Id.*

733. Avraham, *supra* note 401, at 45.

734. *See Rules*, *supra* note 654 (including *uberrimae fidei* under Rule 1.4.2).

735. Avraham, *supra* note 401, at 45.

protection and indemnity clubs that are members of the International Group of P&I Clubs, such a transfer may not be beneficial because it is heavily regulated.[736] However, "because classification is never perfect, the certain insured (the less risky) essentially cross subsidize the others (the more risky) when they pay a higher premium than the risk they actually present."[737] This creates problems of both efficiency and distributive justice, as insurance companies can reallocate resources between the segregated risk classes.[738] In a protection and indemnity club, which is a mutual insurer, the concern over distributive justice is less prevalent because the insured are the insurers, and it takes a vote of the Board of Directors to approve a large settlement.[739]

Propitious selection "may sometimes serve to ameliorate the danger of adverse selection in the real world"[740] and act as the "force promoting favorable selection in . . . insurance."[741] The model has six general assumptions: first, the purchase of insurance is voluntary; second, risks are heterogeneous; third, such risks are pooled and charged the same premium; fourth, individuals can act knowingly to influence their risk level; fifth, individuals have different appetites for risk; and, finally, individuals are consistent in their appetite for physical and financial risk.[742] The primary outcome of the model "is that individuals who are highly "risk avoiding" are more likely both to act to reduce hazards and to purchase insurance."[743] "Risk avoidance" is not to be confused with the narrower, more economically precise term, "risk aversion."[744] The "ex ante moral

736. *See* INTERNATIONAL GROUP AGREEMENT, *supra* note 682 (announcing regulations exist for the International Group of P&I clubs). The International Group Agreement specifies how member clubs may quote rates, clarifies what information the clubs "should obtain from each other before quoting premium rates," regulates how clubs can accept applications from shipowners desiring to move from one club to another, and specifies the factors to be accounted for in setting "release calls" for vessels moving from one club to another. *Id.*

737. Avraham, *supra* note 401, at 47.

738. *Id.* at 47–48 ("Insurers—private or public—have the ability to redistribute resources between the classes they have separated by overcharging, intentionally or otherwise, the less risky and undercharging the more risky. In health insurance, for example, the healthy subsidize the chronically sick." (footnote omitted)).

739. *See* Ronneberg, *supra* note 609, at 29 (asserting protection and indemnity clubs require a vote by the directors or board members to approve big settlements; therefore, complete authority to bind the club is not vested in one person).

740. Hemenway, *supra* note 497, at 1063.

741. *Id.* at 1068.

742. *Id.* at 1063–64.

743. *Id.* at 1064 ("[P]eople who buy insurance tend to be more safety conscious and thus are more inclined to take physical precautions.").

744. *Id.* at 1067–68 ("'Risk aversion' has a precise meaning for economists; in simplest terms, it implies an unwillingness to take actuarially fair bets. This note uses the broader and more

hazard problem"[745] and the "adverse selection problem"[746] both assume "[f]or any particular individual insurance coverage and safety precautions are typically substitutes."[747] However, because the propitious selection model "compares people with different levels of risk avoidance[, t]hose with higher levels are more likely to both buy insurance and to exercise care."[748] "The theory of propitious selection suggests that risk-averse individuals will tend to be more generalized risk avoiders[.]"[749]

The history of protection and indemnity clubs illustrates the theory of propitious selection may be a better fit to explain their continued existence and growth. The clubs' organization on principles of mutuality demonstrates the shipowners' interest in risk avoidance.[750] For example, in the modern protection and indemnity club rule books, there are minimum standards for ship safety that need to be upheld to maintain membership in the club.[751] Therefore, the ships that are the highest risks (because they do not satisfy those minimum standards) are not eligible for membership in the clubs.

E. *Summary of the Economic Efficiencies of* Uberrimae Fidei

At its broadest, the judicial discussion of the economic efficiency of *uberrimae fidei* covered "protecting insurance company assets and the assets of policy holders; deterring the submission of misleading information; promoting personal integrity by imposing harsh penalties on dishonesty; preventing the imposition of frauds and perjuries on the court; and injecting certainty, predictability and uniformity into the law";[752] however, the majority of judicial discussion limited itself to focusing on time and cost savings realized from not having to undertake preliminary investigations or underwrite unnecessary risks. Legal commentators

amorphous terminology of 'risk avoidance.'").

745. *See id.* at 1064 (explaining the theory when a person buys insurance, the person takes less safety precautions).

746. *See id.* (introducing an alternate theory where a person who takes precautions may not be able to afford high premiums for insurance and will be less likely to buy insurance).

747. *Id.* at 1064.

748. *Id.*

749. *Id.* at 1068.

750. *See* Ronneberg, *supra* note 609, at 4 (implying maritime losses are inevitable, but the losses can be minimized by participation in a P&I association, which is based upon the principle of mutuality).

751. *See Rules*, *supra* note 654 (outlining the classification and statutory requirements for membership in the American P&I Club under Rule 1.4.14).

752. St. Paul Ins. Co. of Ill. v. Great Lakes Turnings, Ltd., 829 F. Supp. 982, 987 (N.D. Ill. 1993).

Germano: A Law and Economics Analysis of the Duty of Utmost Good Faith (Ub

likewise have principally considered the role of *uberrimae fidei* in reducing the costs of insurance contracting. Economists' extensive modeling of insurance markets with asymmetric information show the incorporation of *uberrimae fidei* broadens the availability of insurance for low-risk individuals because the greater availability of information allows better segregation of risk pools.[753]

Protection and indemnity clubs are unique forms of marine insurance that insure only third party protection and indemnity risks, such as Jones Act cases, collision, fines or penalties, and wreck removal.[754] They are non-profit associations of shipowners who band together to provide each other with insurance because such insurance is otherwise unavailable.[755] United States courts have not considered such clubs to be traditional insurance companies because they are mutuals, they require membership in the club, they offer indemnity rather than liability coverage, and they do not have a duty to defend.[756] As of October 2015, the thirteen principle underwriting member clubs of the International Group of Protection and Indemnity Clubs provided protection and indemnity insurance for approximately ninety percent of the world's ocean-going ship tonnage.[757] The history and nature of the protection and indemnity clubs align with organizational theorist's conditions for the rise of mutual insurance firms in certain markets.

The good faith disclosure required by the doctrine of *uberrimae fidei*, as well as the nature of the protection and indemnity market, defeat two of the four basic assumptions of the adverse selection model. First, protection and indemnity insurance is not voluntary in the European Union for ships over 300 gross tons, and the voluntary nature of insurance is a major assumption of the model.[758] Second, protection and indemnity

753. *See* Hemenway, *supra* note 497, at 1063–64 (suggesting incorporation of risk avoidance propensities can help separate risks pools, thus benefitting lower risk individuals).

754. *See* Ronneberg, *supra* note 609, at 3–4 (listing the risks insured against, including personal injury, collision, removal of wrecks, and fines).

755. *See id.* at 1–2 ("The Clubs, which are actually groups of vessel owners banded together to provide mutual insurance coverage, seem to exist in a backwater of their own making—gentlemanly, noncompetitive, and unchanging.").

756. Psarianos v. Standard Marine, Ltd., 728 F. Supp. 438, 451 (E.D. Tex. 1989) ("[A] protection and indemnity association is not a traditional insurance company. . . . Eagle is a member of the Club, not simply an insured; and the coverage provided is indemnity, rather than liability. There is no duty to defend . . . .").

757. *See* Ronneberg, *supra* note 609, at 1 (recognizing P&I Clubs insure ninety percent of the merchant vessels in the world, generating a combined premium income of over one billion dollars for the largest sixteen clubs).

758. *See* Directive 2009/20/EC, *supra* note 726, art 2(1) ("This Directive shall apply to ships of 300 gross tonnage or more.").

Published by Digital Commons at St. Mary's University, 2015

clubs do not charge heterogeneous risks homogenous premiums.[759] Advance calls, as they are known, are based on claims history, fleet size, and other risk related characteristics.[760] Third, with *uberrimae fidei* enforced by United States courts in admiralty, the insured will have to truthfully complete his application for insurance and otherwise disclose all facts material to the risk. The requirement for a truthful application is also a condition precedent to insurance coverage in the protection and indemnity club.[761] Finally, the theory of propitious selection may explain the health of protection and indemnity clubs, as there are minimum requirements for ship safety that need to be satisfied for membership. Risk avoidance may coincide with willingness to purchase insurance coverage.[762]

IV. CONCLUSION

Because the choice-of-law may be outcome determinative in admiralty cases, it is important to understand the *Wilburn Boat* analysis, which asks "(1) Is there a judicially established federal admiralty rule . . . ? (2) If not, should we fashion one?"[763] Except for the Fifth Circuit, all the federal circuits have examined the question of whether *uberrimae fidei* is a judicially established federal admiralty rule have determined that it is. Should the Fifth Circuit decide to revisit its decision, there is ample judicial reasoning, legal commentary, and economic theory that supports the economic efficiency of *uberrimae fidei.*

Specifically with respect to protection and indemnity clubs, economic theory supports the efficiency of *uberrimae fidei* as a means to dispel information asymmetry and broaden the availability of insurance to low-risk individuals.

759. *See* Hemenway, *supra* note 497, at 1063 (reflecting on an adverse selection model where heterogeneous risks are charged same price as other categories).

760. Ronneberg, *supra* note 609, at 29.

761. *See Rules*, *supra* note 654 ("It shall be a condition precedent of such insurance that all the said particulars and information were true so far as the applicant Member knew or could with reasonable diligence have ascertained.").

762. *See* Hemenway, *supra* note 497, at 1063–64 (noting the assumptions of the propitious selection model imply those who are high-risk avoiders are more cautions and thus are more likely to purchase insurance).

763. Wilburn Boat Co. v. Fireman's Fund Ins. Co., 348 U.S. 310, 314 (1955).