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I
INTRODUCTION

The Korean marine insurance market has been heavily influenced by English marine insurance law. Most Korean shipowners become members of one of the UK based P&I Clubs and enter into Protection & Indemnity (P&I) insurance contracts with the Club containing an English governing law clause. When Korean shipowners enter into hull insurance contracts with a Korean hull insurer, the Institute Time Clauses (Hull) form with an English governing law clause is engaged. For this reason, most of the Korean Supreme Court's cases regarding marine insurance are related to the cases governed by the English law. The Korean Supreme Court shows a tendency to respect the UK courts' interpretations on the 1906 Marine Insurance Act (MIA). The application of the law of warranty is a good example. The Korean Supreme court has rendered several decisions holding warranties valid under the English law. Attempts by the insured to nullify the warranty clause have failed since January 11, 1977 when the Court decided that the English governing law clause was valid in Korean Supreme Court case *1977.1.11. Docket No. 71da2116.*[1]

Several countries, such as Korea and the UK, have a statutory provision to allow third party victims to claim insurance proceeds against the liability insurer of the tortfeasor. On the other hand, almost all P&I insurance Club Rules (contracts) contain the pay first (pay-to-be-paid) rule. Under this rule, the insurer successfully argues that its liability to the insured does not

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[1]The Korean Supreme Court repeatedly held that the English governing law clause was valid; Korean Supreme Court case *1991.5.14. Docket No. 90daka25314; 1996.3.8. Docket No. 95da28779; 2005.11.25. Docket No. 2002da59528.*

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arise until the victim has been paid by the insured, and thus it is not liable to the third party victim under the English law. The Korean situation did not differ from that in the UK until 2000.

However, since 2000, when the Korea P&I club was established and started its operation with Korean governing law clause, the situation has changed. The Korea P&I club as the insurer and Korean and foreign insureds started to enter into an insurance contract containing a Korean governing law clause rather than the English governing law clause. The Korean Club Rules contain the same words of the warranty and the pay-to-be-paid rules as the International Group of P&I club Rules. Currently, the validity of the warranty and the pay-to-be-paid rules is being reexamined from the perspective of Korean law. Several academics and experts have expressed the opinion that the warranty and pay-to-be-paid rules under Korean law should be interpreted differently from the English law. These trends led to the revision of both clauses in the P&I insurance rules of the Korean Shipping Association in July 2012.

The author would like to introduce the new development in Korea on the warranty and pay-to-be-paid rules in marine insurance.

II
WARRANTY

A. Warranty Under the English Law

1906 MIA has provisions on warranty.[2,3] A Warranty in marine insurance is different from that in general contract law. As soon as the insured breaches a warranty, the insurer is discharged from liability in marine insurance, whereas, a breach of warranty in the general contract law does not bring about an automatic discharge of the non-breaching party from liability under the contract but allows the claimant (obligee) to claim damages.[4] In marine insurance, whether the breach is material or trivial is not relevant.[5] A link causal between the breach of the warranty and the insurance accident is not

[2]Articles 33 to 41 of the 1906 MIA are related to the warranty.

[3]Art. 33(3) of the1906 MIA: A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not. If it be not so complied with, then, subject to any express provision in the policy, the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date.

[4]Baris Soyer, Warranties in Marine Insurance 1 (2006).

[5]Ibid., at 135.

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required.[6] Accordingly, even if the breach of the warranty is not related to the accident, the insurer is discharged from liability. The effect of a breach of warranty is triggered automatically without any further action by the insurer such as expression of its intention to terminate the contract. The contract is automatically terminated as soon as the insured breaches the warranty.[7]

For the ship owner to maintain a specified number of crew on board is a good example of the warranty. If it is included as a warranty in the marine insurance policy and the shipowner, as the insured, does not supply the specified number of crew, the insurer is discharged from liability from the moment the breach occurs, even though the accident is not caused by the missing crew member.

The harshness of the warranty has been heavily criticized by several commentators in different jurisdictions and a variety of ideas for improvement have been introduced.[8] However, the1906 MIA is still intact and the UK Supreme Court maintains its position that the warranty is valid.

In the meantime, the US does not have a separate and independent codified federal marine insurance law. *In Wilburn Boat Co. v. Fireman's Fund Insurance Co.*, the US Supreme Court held, in a complex opinion, that if the general maritime law did not provide a settled rule of law, and the issue did not require the creation of a maritime law rule, the matter should be resolved by reference to state law.[9] *In Albany Insurance Co. v. Anh Thi Kieu*, the Fifth Circuit Court of Appeals decided that the insurer was not discharged from the liability because there was no causation between the breach of the warranty and the marine accident.[10] The majority view holds that the breach merely suspends coverage which can be reinstated if the breach is corrected by the insured prior to the accident.[11] The marine insurance policy remains in effect and the insurer does not have power to terminate the contract.[12]

China has a provision on warranty in its the Maritime Code. Art. 235 of the China Maritime Code says that "the insured shall notify the insurer in writing immediately where the insured has not complied with the warranties

[6] Ibid; Howard Bennett, The Law of Marine Insurance 549 (2006).

[7] Good Luck [1991] 2 Lloyd's Report 191; Baris Soyer, supra note 4 at 149.

[8] Baris Soyer, supra note 4 at 212 and 221; John Hare, The CMI review of marine insurance report to the 38th conference of the CMI Vancouver, 2004, CMI Yearbook 254 (2004); Longmore, Good faith and breach of warranty [2004] LMCLQ, 164.

[9] 348 U.S. 310 (1955); 1955 AMC 467.

[10] 1991 AMC 2211(5th Cir.), cert. denied, 502 U.S. 901(1991) (finding that long settled maritime law on the warranty in question was no longer long settled).

[11] Thomas J. Schoenbaum, Key Divergences between English and American Law of Marine Insurance: a Comparative Study 148 (1999).

[12] Ibid., at 149.

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under the contract. The insurer may, upon receipt of the notice, terminate the contract or demand an amendment to the terms and conditions of the insurance coverage or an increase in the premium."

Japan does not have any provision on warranty in its Commercial Code.

B. Warranty under Korean Law

Korean marine insurance law is included in the Korean Commercial Code (hereinafter KCC).[13] All provisions in the marine insurance section in the KCC are non-mandatory[14] and thus parties in the insurance contract are free in making an agreement which varies from the provisions in the KCC.

It is usual practice in Korea that a Korean shipowner enters into the hull insurance contract with a Korean marine insurer,[15] but places P&I insurance with a member of International Group of P&I Clubs, under which the governing law is usually English law except Assuranceforeningen Gard P&I and the Japan P&I Club.

The Korean Supreme Court maintains its firm position that the English governing law clause is valid. However, minority commentators argue that when the case involves a solely Korean domestic interest, the governing law should be the Korean law rather than the English law. Their argument is based on a public policy reason; when the insurer and the insured are both Korean because the marine insurance contract is a kind of adhesion contract and thus the insured, who is in a disfavored position, should be protected by the application of the Korean law.[16]

When the insurance contract has a Korean governing law clause rather than the English governing law clause, the interpretation of the warranty is subject to Korean law.[17] The KCC does not have a warranty provision and thus the validity of the warranty clause depends on the Korean court's judgment. From the perspective of Korean law, warranty is very peculiar. The

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[13]The Korean Commercial Code is divided into 6 Books. Insurance law is covered in Book IV. Marine insurance law is also included in the Book IV unlike Japan and China. Marine insurance law is a part of maritime law in the Japanese Commercial Code and Chinese Maritime Code.

[14]The KCC has a compulsory provision in relation to insurance. Article 663 says that any insurance agreement will be null and void if it is made by the insurer for the purpose of derogating from its obligation and liability stipulated in the insurance chapter detrimental to the insured except reinsurance and marine insurance.

[15]The non-life insurance company is allowed to sell non-life insurance policy. 11 non-marine insurance companies operate in Korea.

[16]Se Min Park, a critical analysis on the effectiveness and the extent of application of 'English Law and Practice Clause' in marine insurance, 33(1) Journal of Korea Maritime Law Association 212 (2011).

[17]Party autonomy prevails under the Korean Private International Law (KPIL). Parties are allowed to select the governing law explicitly or implicitly for the contract in accordance with Art. 25(1) of the KPIL.

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Korean law requires the presence of causation between a party's act and damages in order that the aggrieved party is allowed to get compensation from the breaching party in case of breach of the contract[18] or from a tort-feasor in case of a tort.[19] If the insured does not keep the warranty, the insurer is exempted from liability under the English law, even though the act of the insured who breaches the warranty does not contribute to insurance damages. This different legal effect of the warranty in the 1906 MIA from Korean law has invited many marine insurance law disputes in Korea.[20]

In Korean Supreme Court case *1996.10.11. Docket No. 94da60332*,[21] the Court explained that it would follow the interpretation of the English court when the governing law was UK law and decided that the warranty was valid under English law. Since then, the Court has maintained its position. Nevertheless, many commentators expressed their views that the warranty should be interpreted to be void by the Korean Supreme Court partly because the effect of the breach of the warranty under Art. 39(1) of the 1906 MIA was too harsh for the insured,[22] and partly because in that case a Korean insurer and Korean insured were parties to the marine insurance contract, and the insured did not know the meaning of the warranty which does not exist under the Korean law.[23]

These challenges against the validity of the warranty have been strengthened since the Korea P&I club was established in 2000.[24] The insurance policy of the Korea P&I Club has the Korean governing law clause and, furthermore, the Korean Shipping Association (KSA)'s hull insurance and P&I insurance policy also inserts a Korean governing law clause with the warranty clause.[25]

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[18]Art. 393 of the Korean Civil Code; Kwak Yun Jik, Contract I 116 (2007).

[19]Art. 750 of the Korean Civil Code.

[20]Korean Supreme Court case *1996.10.11. Docket No. 94da60332; 1998.5.15. Docket No. 96da27773; 2001.7.27. Docket No. 99da55533.*

[21]The following wording was inserted in the Hull insurance policy (ITC Hull): "Warranted seaworthiness certificate issued by Lloyd's agent surveyor or KR surveyor."

[22]Sur Ki Suk, The effect of the breach of the warranty and waiver, 244 Human Rights and Justice 109 (1996).

[23]Se Min Park, supra note 15 at 212.

[24]Korea Protection and Indemnity Club (www.kpiclub.or.kr) is an non-profit making organization which is composed of ocean going vessels owners. Even though it is not a member of International Group of P&I Clubs, it increased the tonnage of entered vessels from 156 vessels with annual premium of USD 1.24 Million in 2000 to 810 vessels with annual premium of USD 26 Million in 2011.

[25]The Korean Shipping Association (www.haewoon.or.kr) established in 1961 is a cooperative entity which is composed of the coastal vessel's owners. The Association operates hull insurance, and P&I insurance for the members. Even though the legal nature of the insurance is a kind of mutual insurance, the premium is not mutually collected but fixed. The KSA has expanded its entered vessels from domestic coastal vessels to include ocean-going vessels, and from Korean shipowners only to include foreign shipowners.

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There is no precedent for the Korean courts to decide the validity of warranty under Korean law. The KCC does not provide any provision on the warranty and thus it depends on the interpretation of the clause by the Korean court.

The dispute regarding the warranty in Korea has two prongs; (i) whether the warranty clause in a marine insurance policy between a Korean insurer and a Korean insured with an English governing law clause is still valid when the Korean courts hear the case; (ii) whether the warranty clause with the Korean governing law clause is valid or not when the Korean courts exercise jurisdiction.

C. New Development

1. Imposing the duty to explain on the insurer

A new approach from the Korean courts can be found in the recent Korean Supreme Court case *2010.9.9. Docket No. 2009da105383.*[26] The hull insurance contract between a Korean shipowner and a Korean marine insurance company had the English governing law clause. The contract included a warranty clause which said that the insured should pass a condition survey by July 2, 2006. When the insurance contract was entered, the insurer did not explain the effect of the breach of the warranty to the insured. In the meantime, the insured did not pass the condition survey on the fixed time but belatedly passed it on May 2, 2007 which was past the due date under the contract. Unfortunately, a collision occurred on May 6, 2007. Subsequently, the insured claimed repair expenses which resulted from the collision from the insurer. The insurer rejected the claim on the ground that it was exempted from paying insurance proceeds because the insured breached the warranty. The insurer brought suit seeking the court's declaration of the absence of its liability. The insured argued that the insurer was not entitled to avail himself of the effect of the warranty because the insurer had not explained its effect, which was against the Korean Law regulating General Terms (hereinafter LGT) Art. 3(4). The LGT 3(4) says, inter alia, that when a merchant fails to explain the material fact in an agreement within the General Terms to the customer,[27] the merchant is not allowed to invoke the effect of the relevant agreement in the General Terms.

[26]For the case comment, please refer to In Hyeon Kim, Korean Maritime Law Update: 2010, 42 Journal of Maritime Law and Commerce 421 (2011).

[27]The material fact in this case was that the insurer will be discharged from liability if the insured did not keep the warranty. The Korean Supreme Court regarded the warranty clause in the hull insurance policy as falling under the General Terms.

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As usual, the Korean Supreme Court decided that the English governing law clause was valid and that the warranty clause should be interpreted in accordance with it. The Court expounded as follows; it cannot be denied that the effect of the warranty is abnormal from the view point of regulation of General Terms in Korea and that the insurer has a duty to explain to the insured the meaning of the warranty and its effect when the warranty is not kept; if the insurer does not explain the meaning and the effect of the warranty, the insured cannot understand the warranty and thus may unexpectedly suffer from loss; in this case, the warranty agreement is not allowed to be incorporated into the marine insurance contract.

The Court concluded that the insurer was not allowed to terminate the insurance contract, even though the insured breached the warranty, because the insurer did not explain the material fact when the insurance contract was entered into.

The Court did not explain why it applied the Korean law for the particular issue of the duty to explain whereas it admitted the English law as the governing law for the insurance contract. Under the English law, the duty to explain on the content in the General Terms seems not imposed upon the insurer,[28] which is different from Korean law.[29] If the Court applies the English law for the issue, the Court may decide that the insurer does not have duty to explain the warranty and its effect, as a result of which the insurer might be discharged from liability due to the insured's breach of the warranty.

It can be interpreted that the Korean Supreme Court attempted to protect the insured by applying Korean law rather than English law. By doing this the harshness of the effect was alleviated when the warranty clause was breached.[30] Even though the Court did not explain the legal basis to justify the partial application of Korean law to the case, the public policy provision in the Korean International Private Law can be served as the basis. It seems

[28]Jong Hyeon Choi, Insuer's Duty of Explanation of Insurance Clauses in a Marine Insurance Contract, 28-2 Journal of Korea Maritime Law Association 87 (2006). The MIA does not have any provision to impose the duty to explain on the insurer. There is dispute whether the duty to explain of the insurer can be derived from the duty of utmost good faith in Art. 17.

[29]Apart from Article 3 of the LGT, the KCC also imposes the duty to explain the material fact upon the insurer (Article 638 ter). Art. 638ter (1) says that the insurer should explain the insured of the material fact in the General Terms when it enters into the insurance contact. The Korean Supreme Court holds that the insured can select both articles alternatively (Korean Supreme Court case *1996.4.12. Docket No. 96da4893; 1998.11.27. Docket No. 98da32564; 1999.3.9. Docket No. 43342*).

[30]Prior to the captioned case, the Korean Supreme Court (*2001.7.27. Docket No. 99da55533*) imposed the duty to explain on the insurer in a case which involved in a warranty, even though the insurance contract has the English governing law clause.

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to the author that the Korean Supreme Court invented a detour device to alleviate the harshness of the effect of the warranty under the English law.[31]

2. The newly revised warranty provision

The KSA has a warranty provision in its rules as follows;
Rules 13.2 Warranty

> (1) A warranty means a promissory warranty, that is to say, a warranty by which the Member undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts. A warranty may be expressed or implied. A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not.
>
> (2) If a warranty be not so complied with, then, subject to any express provision in the Certificate of Entry, the Association is discharged from liability <caused by the breach of the warranty>(newly inserted) as from the time of the breach of warranty, but without prejudice to any liability incurred by the Association before that time. Nevertheless a warranty is broken, where breach has been remedied, and the warranty complied with before loss, the Member can avail himself of the defence.

In July 2012, the KSA revised standard conditions in the P&I insurance rules. The Association sought for the mitigation of the effect of warranty in 1906 MIA and matched the effect of the warranty with the general Korean law theory and thus a phrase of "caused by the breach of the warranty" was inserted in Rule 13.2(2). The newly revised article requires causation between the breach of the warranty and marine insurance accident. Without causation between the breach of warranty and the insurance accident, the effect stipulated in the warranty is not activated.

The revised KSA's warranty provision has two differences from that in the 1906 MIA. First, the insurer is liable for damages by the subsequent accident "after the breached warranty was restored or complied with." Under Art. 39(3) of the 1906 MIA the insurance contract is automatically terminated at the moment when the insured breaches the warranty.[32] Second, the insurer is exempted from liability only if the breached warranty has a causal connection with the accident. Therefore, the insurer is still liable for the subsequent damages not caused by the breach of the warranty. The newly revised warranty provision of the KSA is beneficial for the insured as

[31]Several experts negatively commented on the judgment because it made well-settled warranty rule unstable and unpredictable; Jong Hyeon Choi, supra note 28 at 92; Young Hwa Suhr, Warranty Clauses in Marine Insurance and the Insurer's Duty to Explain, 33-1 Journal of Korea maritime Law 26 (2011).

[32]It has been exited before it was revised in July 2012.

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opposed to that of 1906 MIA in which the insurer is not liable for the subsequent damages even though the breached warranty did not contribute to the insurance accident.

It seems that the revision will affect the interpretation of the warranty under the Korean jurisdiction.[33] It may stimulate the Korean government to insert a provision on warranty in the marine insurance law section in the KCC.[34]

III
DIRECT ACTION AND PAY-TO-BE-PAID RULE

A. Under the law of England and of other jurisdictions

The third party victim is not a party in the insurance contract. The third party victim is allowed to make claim against the tortfeasor as the insured under the tort law theory. With indemnity insurance, the insured as the tortfeasor first pays damages to the victim and then the insurer indemnifies the loss of the insured.[35] If the insured goes bankrupt, the victim cannot be paid by the tortfeasor as the insured and, in addition, the third party victim does not have any privity with the insurer and thus it is not allowed to claim insurance proceeds from the insurer in accordance with the privity of contract theory, under which the third party is not allowed to avail himself of the right of the party in the contract.[36] Therefore, the victim is not protected by the insurance arrangement through which the insured as the tortfeasor intended to pay the victim.

The UK enacted the Third Party (Right against the Insurers) Act 1930 and granted the third party a right of the direct action against the insurer as the

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[33] The Korea P&I club's warranty clause is identical to that of the International Group of P&I Club. KPI Rule 2-1 Warranty

(1) If a warranty be not so complied with, then, subject to any express provision in the Certificate of Entry, the Association is discharged from liability as from the time of the breach of warranty, but without prejudice to any liability incurred by the Association before that time.

(2) Where a warranty is broken, the Member cannot avail himself of the defence that the breach has been remedied, and the warranty complied, before loss.

Because it is governed by Korean law rather than English law, and the KCC does not have any provision on warranty, the newly revised warranty provision will affect the validity of the Korean P&I Club's warranty clause negatively when the Korean courts decide the validity of the warranty.

[34] Department of Justice in Korea has operated the revision committee for the maritime law since 2011. Marine insurance law is one of the subjects to be addressed by the committee.

[35] Under the KCC, only reference to liability insurance can be found. It is very rare for authors of the insurance law books author to distinguish the indemnity insurance from liability insurance in Korea.

[36] Howard Bennett, supra note 6 at 598.

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obligor in a very limited case such as bankruptcy in an insurance arrangement.[37] Direct action is a very useful tool to give statutory rights to the victims against the insurer on behalf of the insured.

However, the P& I insurance policy has a so-called "pay-to-be-paid" rule.[38] The rule means that the insured is not allowed to claim the insurance proceeds against the insurer unless it first pays the liability. Even though the third party has a right to raise the direct action by the operation of a statute, the pay-to-be-paid rule affects the third party's rights in a direct action. According to the rule, only when the insured has paid damages to the third party victim and, thus, it suffered damages, does the obligation of the insurer to pay the insurance proceeds to the insured arise. In other words, the payment by the insured to the third party victim is a condition precedent which triggers the insurer's obligation to pay insurance proceeds.[39] Therefore, if the insured goes bankrupt and it does not pay the damages to the victim, the insurer's obligation to pay insurance proceeds has not yet been brought about and thus the victim's right of direct action does not arise. As a result, the third party cannot claim the insurance proceeds directly from the insurer.

Under the UK law, the clause was decided as being valid in *The Fanti and the Padre Island* case[40] rendered by the UK House of Lords, under which the insurer can successfully defeat the claims of the third party by the pay-to-be-paid rule defense. The pay-to-be-paid rule prevents the victim from invoking the right.

In the meantime, the US law on direct action is not a maritime or federal law matter, but a state law matter. Most states do not have any statutory provision to allow the victim to pursue a direct action; but New York and Louisiana do have state law provisions allowing victims to exercise the right

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[37]Ibid at 613. The Act originally aimed to protect third party creditors of the insured in a case that the insured goes bankrupt, the insurance proceeds are subject to the insured's liquidator or trustee in bankruptcy for distribution by the insolvency law.

[38](1) American Steamship Mutual P&I Association Art. 28(1)

It is a condition precedent of a Member's right to recover from the funds of the Association in respect of any liabilities, cost or expenses that he shall first have discharged and paid the same out of funds belong to him unconditionally and not by any loan or otherwise.

(2) UK P&I Club Rule 5(A) (Payment First by the Owner)

Unless the Directors in their discretion otherwise decide, it is a condition precedent of an Owner's right to recover from the funds of the Association in respect of any liabilities, cost or expenses that he shall first have discharged or paid the same.

[39]Steven J. Hazelwood, P&I Club-Law and Practice 329 (1994).

[40][1990] 2 Lloyd's Report, 191

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of direct action.[41] In most jurisdictions, the third party victim has no right of direct action against the P&I Club as the liability insurer.

Direct action is not allowed in Japan. However, the third party victim is allowed to exercise the right of preferred lien upon the insured's claim for the insurance proceeds against the liability insurer pursuant to Art. 22 of the new Japanese Insurance Act, which came into force as of 2008.

B. Under the Korean Law

In 1991, Korea inserted a general provision, allowing a victim to invoke a direct action against the liability insurer, into Article 724(2) of the KCC.[42] The third party is not required to fulfill any prerequisite in Art. 724(2) before being allowed to invoke the right. The direct action has very broad scope of application. Unlike UK law, the third party victim can invoke the direct action against the insurer even though the insured does not go bankrupt. The direct action functions as a legal tool to protect victims in tort under the KCC.[43]

Three differences between the Korean direct action and the Third Party (Right against the Insurers) Act 1930 in the UK are noticeable. First, under the Korean law, the victims can make claims directly against the insurer without resorting to the insured as the tortfeasor in advance by the operation of Art. 724(2). The victim has a direct action against the tortfeasor. The insurer is deemed to assume liability jointly and severally with the tortfeasor. Second, the extent of the claims which bring about the right has no limitation and thus claimants can exercise the right, regardless of the nature of the claims. Third, the time bar period is three years according to Korean Supreme Court which regards the legal nature of the direct action as a derivative from tort liability rather than insurance contract liability.[44]

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[41]R. Foster, Marine Insurance: Direct Action Statues and Related Issues, 11 U.S.F. Maritime Law Journal 268 (1998-1999). The Louisiana direct action statute is applicable to P&I insurance (Grubbs v Gulf International Marine, Inc. 625 So. 2nd at 495; 1994 AMC 244) whereas New York's statute is not applicable to P&I insurance (NY Insurance Law, Section 167(4)).

[42]The direct action in the motor car insurance protection law was introduced earlier than the general direct action in the KCC.

[43]Under Korean contract law, privity of contract theory is not so strictly applied as in UK law. The Korean Civil Code has a general provision allowing the third party to avail himself of the benefit of the contract between the obligor and obligee (Art. 539). It is very similar to the third party beneficiary theory in the US.

[44]According to the Korean Supreme Court, the legal nature of the direct action is based on tort and thus the time bar provision for tort rather than that for the insurance contract is applicable (Korean Supreme Court case *1998.7.10. Docket No. 97da17544*; *2010.10.28. Docket No. 2010da53754*). The time bar period for tort is three years from the date when the victim knew of the damages and the tortfeasor or ten years from the date when the tort was committed in accordance with Art. 766 of the Korean Civil Code (Korean Supreme Court case *2005.10.7. Docket No. 3003da6774*). The time bar period for the insured to claim the insurance proceeds is two years (Art. 662 of the KCC).

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Currently, most Korean shipowners enter into a P&I insurance contract with one of the International Group of P&I clubs. These contracts contain the pay-to-be-paid rule with an English governing law clause. If the marine insurance dispute goes before a Korean court, the court may decide that the pay-to-be-paid rule is valid under the UK law and, if that is the case, the Korean victim is not allowed to successfully invoke the right of direct action.

However, since 2000, when the Korea P&I club started its business in Korea with the Korean governing law clause and, in addition, the pay-to-be-paid rule, a view differing from the traditional one on the validity of the pay-to-be-paid rule emerged in Korea.

The majority view is that the rule is null and void because it makes the direct action stipulated in Art. 724(2) useless and thus it is against public policy.[45] According to this view, the third party victim is allowed to claim the insurance proceeds against the insurer regardless of the rule. The minority view is that the rule is still valid because it reflects the special nature of the mutuality of P&I insurance, partly because P&I insurance is not liability insurance but indemnity insurance[46] and partly because Art. 724(2) does not have any provision to prohibit the victim from invoking its right against the insured and against the third party.[47]

The disputes on the pay-to-be-paid rule under Korean jurisdiction are (i) whether the rule under English law is still valid when the victim is a Korean (ii) whether the rule inserted in insurance contracts with Korean governing law is still valid.

C. New Development

1. Case Law

In Seoul District Court *2002.7.5. Docket No. 2001gahap36981*, a Korean hull insurance company entered into a hull insurance contract with a Korean shipowner. In a collision accident, the skipper of the opposite vessel died.

[45]Jong Hyeon. Choi, Hull Insurance and Direct Action, 4 Journal of Insurance Law Association 120 (2002); Se Min Park, supra note 15 at 219. These views regard the right of direct action as having a mandatory nature and thus the victim, as the class of persons to be protected by Art. 724(2), should not be put in a detrimental position.

[46]In P&I insurance, members have the status as the insurer and the insured as well. The supplementary call is collected after each fiscal year ends and thus the P&I club cannot collect the supplementary call after a member goes bankrupt. Therefore, in a case in which a member is a tortfeasor, and the club is forced to pay damages instead of the tortfeasor as the insured, the payment may impose undue financial burden on the other member and will hurt the mutual insurance principle because the Club can no longer collect the supplementary call from the bankrupt member.

[47]In Hyeon Kim, Transport Law in South Korea (Kluwer) 150 (2011).

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The bereaved family of the skipper filed a direct action against the insurer of the colliding vessel. A lower court held that the insurer was not allowed to invoke the pay-to-be-paid rule defense against the third party victim in a collision case. The Court reasoned that the rules regulate the contractual relationship only between the insured and the insurer, and thus it could not affect the third party victim's right under Art. 724(2). However, since the case involved not P&I insurance (non-profit making entity) but general liability insurance offered by a private insurance company, the ruling is not so decisive.

In a recent Pusan High Court case *2009.6.17. Docket No. 2008na3906*, a crewman claimed compensation against the P&I club which was headquarter in the UK.[48] The Court held that the case should be decided in accordance with the English law which was designated as the governing law in the contract. The Court applied the third party (Right against Insurers) Act 1930 to the case and looked for whether the crewman met the requirement to trigger the direct action under the Act. According to the Act, the third party victim must prove that the shipowner, as the insured, went bankrupt or the shipowner paid (Art. 1(1)). However, the crewman did not seek a claim against the insured, and thus the Court decided that the crewman lost the case.

It seems to the author that the legal nature of the direct action is based on the tort rather than the liability insurance principles according to the Korean Supreme Court, as a result, the governing law for a direct action between a Korean plaintiff and the foreign defendant may be Korean law because the place where the result of the tort is experienced or the place where the tort was committed becomes the governing law in accordance with the Korean Private International Law Art. 32.[49] If that is the case, the Court should have applied Art. 724(2) of the KCC in deciding whether or not the plaintiff had a right of direct action. Because a direct action under the KCC does not require any prerequisite, the crewman in such a case might win the case.

2. KSA Rules

In July 2012, the KSA revised the rule in the P&I insurance policy. According to the newly revised rules, the pay-to-be-paid rule still exists under the contract. However, the insurer is not allowed to invoke the defense

[48] Korean jurisdiction was justified by the fact that the UK based P&I club had a correspondent office, even though the defendant did not have domicile in Korea. For details, refer to In Hyeon Kim, Korean Maritime Law Update: 41 JMLC 379 (2010).

[49] The law of the place where the tort was committed governs the tort (Art. 32(1)).

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in a case in which the defense is not permitted under Korean domestic or international maritime law.

Rule 37(4)

It shall not be allowed for the third party directly to present a claim for insurance money against the Association, "*unless otherwise provided, however, the foregoing shall not apply to cases where the pay-to-be-paid rule is not admitted by the terms of International Conventions or Korean Law" (newly inserted).*[50]

Oil pollution under the Civil Liability Convention and the Bunker Convention, wreck removal under the Wreck Removal Convention are examples of international conventions, and crew compensation matters under the Korean Seamen's Act are examples of domestic law which falls within the scope of the application of Rule 37(4).[51] These conventions have explicit provision to prohibit the liability insurer from invoking the pay-to-be-paid defense (Art. VII (8) of the CLC, Art. 12 (10) of the Wreck Removal Convention, and Art. 7(10) of the Bunker Convention). However, currently only the CLC and Bunker Conventions have come into force.

Under the newly revised Rules, when a crewmember claims against the KSA, the pay-to-be-paid defense is no longer available to the KSA under the contract and thus the KSA should pay the damages to the third party. On the other hand, when a cargo claimant claims against the KSA as the insurer, the defense is still available under the contract and thus it is not required to pay damages. However, the possibility can not be excluded that it may be ruled null and void under Art. 724(2) by the Korean courts.[52] The author thinks that the revised provision in the KSA's P&I insurance is a well balanced com-

[50]In the meantime, Korea P&I Rules 44(3) states: The insurance money by the Association shall be paid after a Member has completed his payment in respect of any liabilities, costs and expenses incurred by him and finalized in the relevant case, unless otherwise approved by the Association.

[51]Korea is a contracting state of the CLC and Bunker Conventions. The Korean Oil Pollution Compensation Act is the domestic law which implements the CLC and Bunker Conventions. It contains a provision providing that the insurer is not allowed to avail himself of the pay-to-be-paid rule against the third party victim of oil pollution (Art. 16(2) and Art. 49). Art. 106 of Crew Act imposes a compulsory obligation for crew compensation upon the shipowners, and thus, the pay-to-be-paid defense is not allowed.

[52]However, it is the author's opinion that it should be held to be valid. Except for the above three examples, the third party victim, such as a cargo owner, usually maintains its own insurance arrangement. Its insurance company (A) may pay insurance proceeds to the insured and be subrogated to the right of claim which the insured (cargo owner) has against the tortfeasor such as the carrier. The tortfeasor will be the insured in the separate liability insurance. Insurance company (A) may try to collect damages against the liability insurer (B) of the carrier by way of a direct action. In other words, the third party as the plaintiff who exercises the direct action in this scenario is the insurance company rather than the private person. In this case, the need to protect the third party victim is not so high as in the case of a private person such as a crewmember in a compensation matter. We have a policy reason to allow the P&I Club as a liability insurer (B) to invoke the defense of the pay-to-be-paid rule in the cargo claim case.

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promise for protecting the victims, on one hand, and the P&I club, which is not a for profit business entity, on the other hand.

IV
CONCLUSION

The warranty and pay-to-be-paid rules have been used as a lawful tool as for the insurer not to hold liability. In recent years their validity or justification has been challenged in several jurisdictions, including Korea.

Most marine insurance contracts contain the English governing law clause. MIA 1906 has several provisions on the warranty. However, it is under criticism because the effect of the breach is too harsh on the insured. The tendency of the Korean courts, which have upheld the validity of the warranty under the English governing law clause pursuant to MIA 1906, has started to change since 2000. Two new developments are noticeable in Korea. First, On September 9, 2010 the Korean Supreme Court applied Korean rather than English law to the matter of regulation of General terms in the insurance contract. The Court denied the integration of the warranty clause into the contract in accordance with the Korean Law for Regulating General Terms because the insurer did not explain the warranty and its effect even though the insured breached the warranty. As a result the insurer was required to pay the insurance proceeds to the insured. Second, the causation between the breaching party's action and damages is required under the Korean law. In order to avoid the dispute of the validity of the warranty, the Korean Shipping Association inserted a phrase "caused by the breach of the warranty" in its rules (General Terms) for P&I insurance contracts.

Direct action is required for the protection of the third party victim. In liability insurance, the third party cannot avail himself of the benefit of the contract in accordance with the privity of contract theory. Korea is one of the countries which have a statutory provision to allow the third party to invoke the right. The pay-to-be-paid rule stands in the way of the direct action by the third party. The third party victim is not allowed to receive insurance proceeds from the insurer if the pay-to-be-paid rule is valid even though it has the power to invoke the direct action. Because the obligation of the insurer to pay the insurance proceeds to the insured has not arisen (unless the insured pays damages incurred to the victim) in a case that the insured goes bankrupt, the third party victim is not entitled to exercise the subrogated right of the insured against the insurer. The rule is valid in the UK jurisdiction.

The KCC has a provision to allow the third party victim to invoke the claims again the liability insurer, which is regarded as a mandatory provi-

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sion. It is the majority view in Korea that the pay-to-be-paid rule does not affect the rights of the third party victim but the minority view is against the majority view. Reflecting both views, the KSA inserted a new provision, providing that the KSA will no longer assert the pay-to-be-paid rule defence against the victims in oil pollution accident and crew personal injury matters, however, it is still available for other cases, such as cargo claims.

The KSA's newly revised General Terms in the marine insurance contract may affect the interpretation by the Korean court on the warranty and pay-to-be-paid rules. The author hopes that the new revision of the KSA rules will strike balance for protection between the insurer, the insured and the third party victims.

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