

IUMI 2017 TOKYO



Misappropriation



ND – panel introduction

- Moderator: Nick Derrick, Chairman Cargo Committee,
- Sean M. Dalton, Vice Chairman Cargo Committee, Head of Marine Underwriting NA, Munich Re America, USA-New York,
- John Minton, CEO, Minton, Treharne & Davies Group MTD, UK-London,
- Mike Roderick, Partner, Clyde & Co. LLP, UK-London

Background -JM

- Although the subject of misappropriation and inventory loss claims is receiving current attention from the market, it is not new.
- In 1953 an incident arose that became known as ‘The Great Salad Oil Swindle’. A gentleman called [Tino De Angelis](#) was operating a business supposedly storing soya bean oil. It was used as collateral for loans by himself and various owners of the stock.
- American Express (AE) were the major lenders. They loaned him \$150 million (now \$3 billion) from their new Field Warehousing operation.
- Inspectors for AE confirmed the presence of the stock, although in fact there was almost nothing. De Angelis had fabricated warehouse receipts for stocks that he did not have.

Background – JM

- The inspectors had been fooled by a variety of ‘techniques’ still in use today.
- Around 50 other companies including Proctor & Gamble, Bunge, Bank of America etc. suffered substantial physical and financial losses.
- The financial markets collapsed. It is said that the NY Stock Exchange would have collapsed but it closed the same day because President Kennedy was assassinated.
- One famous person benefited greatly. [Warren Buffet](#) decided that the collapse in value of American Express was overdone. He founded his fortune by investing heavily at that time.

Background

List of some known cases.

Commodity	Country	Quantum	Period	Cause
Soya Oil	USA	\$3 Billion	3 Years	Theft by Storage Contractor
Crude Oil	Canada	\$70,000,000	2 Years	Theft by refinery
Crude Oil	Puerto Rico	\$40,000,000	3 years	False accounting
Crude Oil	Caribbean	\$20,000,000	2 years	Theft by refinery
Fuel Oil	Persian Gulf	\$350,000,000	3 years	Theft by storage contractor
Fuel Oil	Europe	\$12,000,000	2 years	False stock accounting
Crude Oil	Romania	\$40,000,000	2 years	Theft by refinery
Crude Oil	Romania	\$20,000,000	2 years	Theft by refinery
Oil Products	Albania	\$70,000,000	2 years	Theft by distributor
Gold Concentrate	Tanzania	\$9,000,000	1 year	Theft in transit
Lead Concentrate	Peru	\$6,000,000	1 year	Theft from Warehouse
Silver Concentrate	Mexico	\$3,000,000	6 months	Theft in transit
Copper Concentrate	Peru	\$200,000	1 month	Assay Tampering
Coal	Germany	\$4,000,000	18 months	Theft by receiver
Coal	India	\$1,100,000	1 year	Theft by receiver
Copper Cathode	Greece	\$20,000,000	1 year	Theft by receiver
Aluminium/Alumina	China	\$3 Billion	3 years	?
Crude Oil	Morocco	\$400,000,000	6 months?	?
Bitumen	China	\$81,000,000	?	?

Background

List of some known cases.

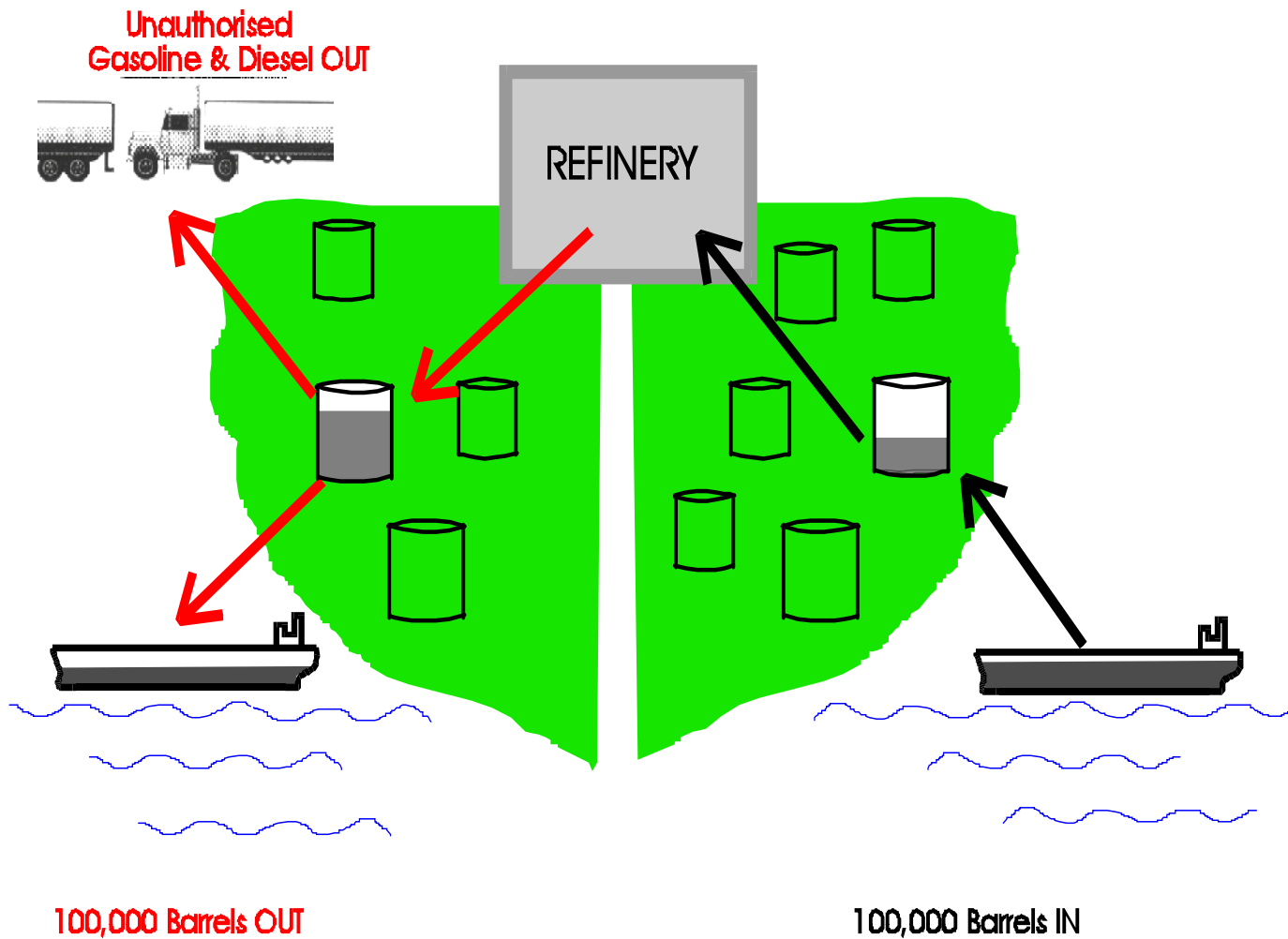
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Total: \$7.15 billion, including the salad oil swindle at today's value.

Background - JM

- Removing such large volumes of a commodity can rarely if ever be done quickly. Almost always (or always) a significant period of time is required.
- The fraudster needs to make sure that no one detects his crime whilst he is doing it.
- There are many tricks that he can use.
- All involve some version of the following.

Background



JC2017/002 – 01.03.2017 – ND



Misappropriation Exclusion

In no case shall this insurance cover loss or damage arising from misappropriation. Misappropriation shall in this insurance **be deemed to mean the unauthorised conversion use release or disposal of the subject-matter insured at or from a warehouse or other place of storage whether on or offshore by or with the knowledge of the bailee or of any other person or entity including their officers and employees to whom the subject-matter insured has been entrusted.**

JC2017/003 – 01.03.2017 – ND



Misappropriation Inclusion

Subject always to the other limitations and exceptions of this insurance, this insurance covers loss or damage arising from misappropriation **provided always that the loss or damage occurs not more than 45 days prior to the date of its notification to underwriters.**

Misappropriation shall in this insurance be deemed to mean the unauthorised conversion use release or disposal of the subject-matter insured at or from a warehouse or other place of storage whether on or offshore by or with the knowledge of the bailee or of any other person or entity including their officers and employees to whom the subject-matter insured has been entrusted.

Cover for misappropriation shall in any event be subject to an annual aggregate limit as stated in the Schedule to this insurance.

Legal considerations -MR

- In a marine insurance context theft is to be given a business-like meaning rather than follow the criminal law definition under the Theft Act 1968
- Theft, whether clandestine or violent, is an All risks peril within ICC(A) cover
- There is no accepted definition of misappropriation

Legal considerations - MR

- A typical scenario : the removal of cargo, without the insured's agreement, from a warehouse or other place of storage over a period of months with the knowledge and/or involvement of the warehouse/CMA operator staff
- The insured will argue that this is a theft or series of individual thefts and covered as an All risks loss
- So how does the misappropriation exclusion operate?
 - Misappropriation has been given a specific definition
 - The burden is on insurers to establish that an exclusion operates

Legal considerations -MR

- It is well settled that where there are two effective causes of loss, one a peril insured, the other an excluded peril, the exclusion prevails
- I.e. the exclusion “trumps” the insured peril with the result that the insured is unable to recover
- Cf. *Wayne Tank v Employers Liability* [1974]

The Possible Effect of the Clause - JM

- I have been asked to consider and advise on what effect the imposition of such a clause might have had in relation to the claims on my earlier list. This is difficult to predict without detailed analysis of each claim individually.
- However I have two simple thoughts:
 - It seems to me from experience that these frauds run on average for at least 12 months and often at a steady rate of loss. 45 days is roughly 12.5% of a year so on this basis the reduction of loss on such a claim might be 80 to 90%.
 - Second, the frauds only run at all because of inadequate inventory monitoring by the owners of the goods. If the new insurance clause forces better monitoring, then the reduction in claims may be even greater.

Cargo Underwriters' Challenges with Misappropriation



- Inconsistent approach, exclusions deleted in whole or part. Policies silent.
- Need for improved policy wording (requisite exclusions and proper definitions).
- Jurisdiction and dispute resolution.
- Insured interest.
- Underwriting of crime exposure and controls.
- Occurrence definition or Claims Made approach.

Misappropriation

Property Market

- In US may vary by state.
- Clearer definitions and contractual language.
- Sublimit.
- Aggregate Limits.

Crime / Surety Market

- Extend Crime Policy to 3rd Party Contractors.
- 3rd Party Fidelity Bond (require by contract).
- Limits modest in comparison to cargo policy (\$ 1 million to \$ 10 million)
- Extensive underwriting, controls, and risk appropriate premium required.

Possible Solutions

- Clearly written contracts (exclusions, definitions, occurrence, jurisdiction, dispute resolution, etc.).
- Sublimit losses due to misappropriation, unexplained / mysterious disappearance, shortage upon taking inventory.
- Contractually require 3rd party storage facility to have Fidelity Bond in place with adequate limit.
- If writing excess inventory, address misappropriation exposure and know how your policy will respond.

Conclusion

- John has shown us the pitfalls of giving misappropriation cover on a cargo policy and how use of the new JCC Clauses can exclude or mitigate these losses.
- Mike has given us the legal considerations.
- Sean has talked on the Underwriting approach of misappropriation.
- **NOW QUESTIONS FROM THE FLOOR.**

Nick Derrick, Travelers Syndicate
Sean Dalton, Munich Re America
John Minton, Minton Treharne & Davies
Mike Roderick, Clyde & Co LLP

Thank You

*The
End*

**Have Fun This
Evening!**



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