Marine Insurance: Third Party Claims Against a Policy

By David K. Jones
A Vancouver lawyer
with Bernard & Partners

The case of *Conohan v. The Cooperators*, a recent decision of the Federal Court of Appeal, raises some interesting issues with respect to third party claims against a policy of marine insurance.

The case arose out of a collision off Prince Edward Island between the "Cape Light II" and the "Lady Brittany". The "Lady Brittany" was heading to fish tuna off the north coast of Prince Edward Island when it collided with the "Cape Light II", which was at anchor and showing its anchor light. The "Cape Light II" was a constructive total loss.

The "Lady Brittany" and her owner (Gaudet) were insured under a policy of marine insurance issued by The Cooperators.

The owner (Conohan) of the "Cape Light II" and its insurers, Eastern Marine Underwriters, claimed that they were entitled to be indemnified under Gaudet's policy for the losses they sustained as a result of the collision. Conohan claimed for lost revenue. Eastern Marine claimed for $66,155.90 they had paid to Conohan for the destruction of the "Cape Light II".

The Cooperators refused to pay Conohan's claim, and refused to defend Gaudet against Conohan's claim on the ground that Gaudet had breached the policy by being impaired and because of other alleged illegal conduct in the operation of his vessel.

In Conohan's action against Gaudet, Gaudet admitted liability, confessed to judgment, and assigned all of his rights of claim and action against the Cooperators to Conohan and Eastern Marine, who commenced the court action against the Cooperators.

Therefore, the issues considered by the Court were not whether Gaudet could claim against his own policy, but whether or not third parties to that policy, Conohan and Eastern Marine, could claim against Gaudet's policy.

Three of the issues considered by the Court in the Federal Court Trial Division were as follows:

1. Did Gaudet operate the "Lady Brittany" in a lawful manner within the context of section 34 of the *Marine Insurance Act*? If the vessel had not been operated in a lawful manner, the breach of the implied warranty could result in the insurers being discharged from any liability under the policy.

2. Was the loss suffered by Conohan attributable to the "wilful misconduct" of Gaudet within the context of subsection 53(2) of the Act? Under that subsection of the Act, an insurer is not liable for any loss attributable to the wilful misconduct of the insured.

3. Does clause 16 of the policy, which provided liability cover to Gaudet for claims made against him by persons whom he has caused damage, apply to allow Conohan to claim against Gaudet's insurer, the Cooperators, for its damages?

The first issue was whether Gaudet operated the "Lady Brittany" in a lawful manner within the context of section 34 of the *Marine Insurance Act*.

Section 34 of the Act reads as follows:

> 34. There is an implied warranty in every marine policy that the marine adventure insured is lawful and, in so far as the insured has control, will be carried out in a lawful manner.

The Act also contains the following definitions in section 2 which are relevant to section 34:

> **"marine adventure"** means any situation where insurable property is exposed to maritime perils, and includes any situation where
>
> (a) the earning or acquisition of any freight, commission, profit or other pecuniary benefit, or the security for any advance, loan or disbursement, is endangered by the exposure of insurable property to maritime perils, and
>
> (b) any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils;
>
> **"marine policy"** means the instrument evidencing a contract;

> **"maritime perils"** means the perils consequent on or incidental to navigation, including perils of the sea, fire, war perils, acts of pirates or thieves, captures, seizures, restraints, detainments of princes and peoples, jettisons, barratry and all other perils of a like kind and, in respect of a marine policy, any peril designated by the policy;

If the implied warranty in section 34 of the Act applied in this case, Gaudet's insurer, the Cooperators, would be discharged from liability if the marine adventure was unlawful or carried out in an unlawful manner. Conohan argued that section 34 of the Act does not apply to a claim by the insured, in this case Gaudet, against his own insurer, to be reimbursed for the money he was requested to pay to Conohan since this part of his coverage is liability insurance which is in place to protect Gaudet should a third party have a claim against him.

The Court referred to the definitions of "marine adventure" and "maritime perils" noted above. The Court noted that the definition of "maritime perils" lists the types of perils that are included in that definition. All of the perils are events that are not in the control of Gaudet. In the present case, the Court found that the collision with Conohan's vessel was caused by the negligence of Gaudet who, among other things, failed to keep a proper lookout. This is not a maritime peril as it does not fit within any of the perils listed in the policy. As well, the Court was of the opinion that it is not a marine adventure as the liability to the third party, Conohan, was not incurred "by reason of maritime perils".

Paragraph 6(1)(a) of the Act states:

> 6. (1) A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent agreed in the contract, against
>
> (a) losses that are incidental to a marine adventure or an adventure analogous to a marine adventure, including losses arising from a land or air peril incidental to such an adventure if they are provided for in the contract or by usage of the trade …

Since the Court found that there was no marine adventure with respect to Conohan's claim against Gaudet, it followed that this portion of the policy is not a contract of marine insurance within the meaning of paragraph 6(1)(a) of the Act or a marine policy as the term is used in section 34 of the Act. Therefore, the implied warranty in section 34 did not apply in this case and Gaudet's insurer could not be discharged from liability for Conohan's claim.

The second issue considered by the Court was whether the loss suffered by Conohan was attributable to the "wilful misconduct" of Gaudet within the context of subsection 53(2) of the Act.

Section 53 of the Act reads as follows:

> 53. (1) Subject to this Act and unless a marine policy otherwise provides, an insurer is liable only for a loss that is proximately caused by a peril insured against, including a loss that would not have occurred but for the misconduct of negligence of the master or crew.
>
> (2) Without limiting the generality of subsection (1), <u>an insurer is not liable for any loss attributable to the wilful misconduct of the insured</u> nor, unless the marine policy otherwise provides, for …
> [Emphasis added.]

The Court referred to a number of cases in which the term "wilful misconduct" has been considered by a court, including, for example, that the words "wilful misconduct" mean an act other than by accidental or negligent means, or an act done consciously and intentionally which the doer knows or as a matter of law is presumed to have known was wrongful in the circumstances.

The conduct which the Cooperators alleged offended this section was the breach of the collision rules and the alleged impairment of Gaudet. The Court found that there was no indication in the evidence that Gaudet wilfully tried to breach the collision rules. All that was known is that the "Lady Brittany" was being operated without an adequate lookout. There was no indication of any wilful misconduct on the part of Gaudet. Therefore, there was no basis for finding that Conohan's loss was caused by the wilful misconduct of Gaudet. Consequently the insurer was not entitled to deny liability on the basis of subsection 53(2).

The third issue was whether clause 16 of the policy, which provided liability cover to Gaudet for claims made against him by persons whom he has caused damage, applied to allow Conohan to claim against Gaudet's insurer, the Cooperators, for his damages.

Clause 16 of the policy is the 4/4ths collision liability clause, worded in part as follows:

> It is further agreed that if the vessel hereby insured shall come into collision with any other vessel and the insured shall in consequence therefore <u>become liable to</u>

> pay and shall pay by way of damages to any other person or persons any sum or sums in respect of such collision for:
>
> a. loss of or damage to any other vessel or property on any other vessel;
>
> b. delay to or loss of use of any such other vessel or property thereon; or
>
> c. general average of, salvage of, or salvage under contract of, any other vessel or property thereon. …
> [Emphasis added.]

The Cooperators argued that it would only be liable to pay Gaudet if Gaudet had "become liable to pay and shall pay by way of damages to any other person any sum". Since Gaudet had not paid any sum to Conohan, the Cooperators argued that it did not have to pay any sum to Conohan and Eastern Marine, who, by the assignment, stood in the shoes of Gaudet. Therefore, Conohan and Eastern Marine only had the claims that Gaudet had against the Cooperators. The Court decided that the words used in clause 16, the "pay to be paid clause", clearly required that Gaudet first pay the claim of Conohan before Gaudet made a claim to his insurer for the amount. For this reason, the Cooperators were not required to pay the claims of Conohan and Eastern Marine.

Conohan and Eastern Marine appealed the decision of the Trial Division to the Federal Court of Appeal. One of the grounds of appeal argued by the appellants was that the trial judge erred in determining that non-adherence to the "pay to be paid" clause constituted a defence to the third party liability claim of Conohan and Eastern Marine under the policy of insurance covering Gaudet and the "Lady Brittany".

In analysing this issue, the Court of Appeal commented on the nature of a contract of marine insurance, and reviewed the history of the collision clause, as follows:

> "In approaching the issue under discussion, it is well to recall, as indeed section 6(1) of the Marine Insurance Act emphasises, that a contract of marine insurance 'is a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent agreed in the contract …'".
>
> "The collision clause evolved in England during the nineteenth century after the courts had determined that marine insurance policies of the day did not, in collision cases, respond to the liability of the insured in negligence to a third party. A portion of this vacuum was filled by the insurance market which agreed in their contracts of insurance to cover three-fourths of the amounts of such

> liability leaving the excess amount to be covered by shipowners mutual insurance associations (P&I Clubs) …. In the present case, as we have seen, Clause 16 covered the full four-fourths of potential liability to a third party arising from a collision. …
>
> The collision clause in this policy should thus be seen in its historical setting. At common law, no action could be maintained on a contract of indemnity until the person seeking indemnification had suffered an actual loss ….”

The Court of Appeal reviewed a number of English cases, some involving P&I Clubs in a mutual marine insurance context, and others involving an “ordinary marine policy available in the open market”. Counsel for Conohan and Eastern Marine argued that the cases involving P&I Clubs did not contain a principle of broad application that should govern liability in a non-mutual marine insurance policy; however, the Court was not persuaded that there was a difference between the mutual and non-mutual markets that should dictate a different result. The Court stated that what is of foremost importance is the express language of the policy. Here, the language of clause 16 covered collision liability where the insured “shall … become liable to pay and shall pay by way of damages”.

The Court noted that there was little to be found in the decided cases regarding whether a “pay to be paid” clause constitutes a barrier to recovery under a collision clause outside of the mutual marine insurance context.

The Court concluded its analysis of clause 16 by phrasing the issue as follows:

> “Did the ‘pay to be paid’ requirement of Clause 16 impose an obligation on Gaudet to pay the damages incurred to the appellant Conohan by reason of the collision before he could collect under the policy?”

In the Court’s view, the ordinary meaning of the words of the clause plainly required that payment first be made by Gaudet to the third party Conohan as a condition precedent to recovery.

Therefore, the Court of Appeal upheld the decision of the Trial Division and the appeal was dismissed. Consequently, Conohan and Eastern Marine, as third parties to Gaudet’s marine insurance policy, could not recover directly against Gaudet’s insurers.