

## Warranties in Marine Insurance Policies

A recent decision of the British Columbia Court of Appeal addresses the interesting issue of warranties in a marine insurance policy. The case is *Elkhorn Developments Ltd. v. Sovereign General Insurance Co.* Elkhorn's barge sank in Brooks Bay and was a total constructive loss. Five days earlier it had been towed to Brooks Bay from Finn Bay, approximately 100 miles away. Insurance coverage was denied on the ground that Elkhorn failed to comply with the warranty to obtain prior approval from the insurer to move the barge.

A warranty in a marine insurance policy is defined in section 32 of the *Marine Insurance Act* as follows:

- 32 (1) In this section and sections 33 to 39, "warranty" means a promissory warranty by which the insured
  - (a) undertakes that some particular thing will or will not be done or that some condition will be fulfilled; or
  - (b) affirms or negates the existence of particular facts.
- (2) A warranty may be an express warranty or an implied warranty.

Section 39 of the *Act* further states:

- (1) Subject to this section, a warranty must be exactly complied with, whether or not it is material to the risk.
- (2) Subject to any express provision in the marine policy or any waiver by the insurer, where a warranty is not exactly complied with, the breach of the warranty discharges the insurer from liability for any loss occurring on or after the date of the breach, but does not affect any liability incurred by the insurer before that date.

Historical examples of express warranties include sailing warranties, for example, "warranted to sail before July 24, 2001", in which case the question is whether the vessel had actually sailed on

the insured voyage by the date specified; or, number of crew, for example, “warranted to sail with 35 crewmembers”.

Under section 33 of the *Marine Insurance Act*, an express warranty may be in any form of words from which the intention to warrant may be inferred. An express warranty must be included in, or written on, the marine policy or be contained in a document incorporated by reference into the policy.

In addition to express warranties, there are implied warranties in marine insurance policies, including the following:

1. Section 37 of the *Marine Insurance Act* states that there is an implied warranty in every voyage policy that, at the commencement of the voyage, the ship will be seaworthy for the purpose of the particular marine adventure insured. A ship is deemed to be seaworthy if it is reasonably fit in all respects to encounter the ordinary perils of the seas of the marine adventure insured.
2. Section 38(2) states that there is an implied warranty in every voyage policy on insurable property, other than a ship, that, at the commencement of the voyage, the ship is seaworthy and reasonably fit to carry the insurable property to the destination contemplated by the policy.
3. Section 34 states that 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.

In the *Elkhorn* case, the barge was covered by a hull and machinery policy subject to the following two express warranties:

1. Warranted vessel laid-up permanently at Pearce Bay, B.C.;
2. Warranted any movements of this vessel to be subject to underwriter prior approval of such tow.

The barge had been the subject of a marine survey report commenting that barges of that age did not normally stand up well to constant moving and are better suited to sitting in one location.

After the barge sank the insurers advised the barge owner's broker that since they had not been advised of the move they considered the insured to have fundamentally breached the warranties and that the insurers were consequently discharged from liability.

The central issue was whether the two warranties regarding lay-up and notice of movement were promissory warranties or suspensive conditions. Despite the fact that the *Marine Insurance Act* states that a warranty "must be exactly complied with, whether or not it is material to the risk", the courts have sometimes described a clause appearing to be a warranty as a suspensive condition. The basis for making that distinction is based on an interpretation of the insurance contract to the effect that the parties to the insurance contract, in labeling a particular clause a warranty, did not intend that such a clause would have the effect of discharging the insurer from the coverage. In these situations, courts have found on the facts that the parties did not intend that the strict consequences of a breach of a promissory warranty apply to the clause. Rather the parties intended the clause to limit or describe the risk covered by the policy.

In the *Elkhorn* case, the Court of Appeal referred to the case of *Century Insurance Co. of Canada v. Case Existological*. In the *Case Existological* case, a vessel sank as a result of the negligent operation of an air pressure valve that allowed the vessel to take on too much water. The insurance policy contained the following express warranty:

WARRANTED that a watchman is stationed on board the BAMCELL II each night from 2200 hours to 0600 hours with instructions for shutting down all equipment in an emergency.

Although the insured had failed to hire a watchman after the insurance had come into effect, the sinking of the vessel occurred long before 2200 hours. The Judge in that case concluded that despite the clause having been described as a warranty, it was not a warranty but a limitation of the risk. He stated:

The opening of the deck valves in this case occurred in the early afternoon and the sinking occurred shortly thereafter, long before 2200 hours. So the clause bears no relationship whatever to the risk or the occurrence that caused the loss.

The Supreme Court of Canada agreed, stating the following:

It is significant that, although there was no watchman stationed on board BAMCELL II during the hours prescribed in that clause, this had absolutely no bearing whatever on the loss of the vessel which occurred in mid-afternoon. The clause would only have been effective if the loss had occurred between 2200 hours and 0600 hours and it was proved that there was no watchman stationed aboard during those hours. To this extent the condition in the clause constituted a limitation of the risk insured against but it was not a warranty.

In interpreting the contract of insurance, a court seeks to identify the intention of the parties in entering into the contract. The Court of Appeal in the *Elkhorn* case concluded that it was clear that the parties intended the coverage to include a promissory warranty that Elkhorn not move the barge without the prior approval of the insurer for the following reasons:

- Although not determinative, the policy described the obligation as a warranty;
- The parties were sophisticated, and receiving advice from professionals and were aware of the consequences associated with agreeing to a warranty;
- The owner of the barge had difficulty obtaining insurance because of the age and condition of the barge;
- The policy was negotiated to fit the unique circumstances of the barge;
- On three separate occasions, cover notes were sent to the barge owners stating the policy was subject to “No moves without prior approval”.

The two warranties on their face appearing to have been breached and the insurer having given no prior approval for the move, the Court was of the view that prior approval, before moving the barge, was a clear condition precedent to the insurers providing the insurance coverage.

The Court concluded that it was clear that the parties intended that the coverage included a promissory warranty that the owner not move the barge without the prior approval of the insurer and that the parties intended that the clause be strictly complied with. This was considered by the Court to be a reasonable term of the agreement as, given the condition of the barge, the insurers needed to protect against the possibility that moving the barge would make an already vulnerable vessel an even greater risk than they originally contracted to cover.

Finally, the Court stated that it is not a case that involves a clause that as in *Case Existological*, “bears no relationship whatever to the risk or occurrence that caused the loss”. The moving of the barge posed a risk of damage contemplated by the coverage that may or may not have resulted in the sinking of the barge. Therefore, according to section 39(1) and (2) of the *Marine Insurance Act*, the insurers were discharged from any liability for losses occurring on or after the date of the breach as the warranty was not exactly complied with.

Thus, the *Elkhorn* case emphasizes the need to review a marine insurance policy carefully to ensure compliance with any express warranties. If an insured does not comply with an express warranty, the insurer may be discharged from liability for a loss occurring on or after the date of the breach of the warranty.