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AN ADJUSTER'S NOTE ON THE SUPREME COURT DECISION IN THE "B ATLANTIC"

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Background

On 13 August 2007, after loading a cargo of coal at Lake Maracaibo, Venezuela, a routine underwater inspection revealed three bags of cocaine strapped to the hull of the bulk carrier "B Atlantic". The crew was arrested immediately and the vessel was confiscated by the Venezuelan authorities under the strict Venezuelan anti-drug laws, despite the owners having no part in the drug smuggling. Eventually, the master and second officer were sentenced to nine years in prison for complicity in drug trafficking and the vessel was detained by the Venezuelan courts. On 18 June 2008, Owners served a Notice of Abandonment to their war risk insurers to recover their loss as a constructive total loss together with sue and labour expenses incurred[1].

The Owners had in place war risk cover with the following perils insured against, in particular:

"Loss of or damage to the vessel caused by"

Clause 1.2: "capture seizure arrest restraint or detainment, and the consequences thereof or any attempt thereat"

Clause 1.5: "any terrorist or any person acting maliciously or from a political motive"

Clause 1.6: "confiscation or expropriation"

Exclusions applied to any "loss damage liability or expense arising from", in particular:

Clause 4.1.5: "arrest restraint detainment confiscation or expropriation under quarantine regulations or by reason of infringement of any customs or trading regulations"

1 Under typical English conditions, expenses incurred in attempting to avoid a loss by a peril insured against are typically recoverable under the sue and labour clause, over and above the sum insured paid out for the total loss.

Clause 3: The cover provided for the vessel to be deemed a constructive total loss after having been "The subject of capture seizure arrest restraint detainment confiscation or expropriation" and the assured having "lost the free use and disposal of the vessel for a continuous period of 12 months". This was satisfied in this case and was not at issue.

The insurers argued that they were exempt from liability by way of the exclusion in Clause 4.1.5. It was the owners' opinion that the exemption did not apply and that their loss was proximately caused by persons acting maliciously, a peril insured under Clause 1.5.

Preliminary issues before Hamblen J

Preliminary issues in respect of the exclusion in clause 4.1.5 were heard by Hamblen J and decided as follows:

In order for underwriters to rely on the exclusion, it was not necessary to show the insured's or their servants' or agents' privity or complicity in any infringement of customs regulations. Further, the exclusion clause was applicable not only to losses covered under clauses 1.2 and 1.6, but also to the other perils insured against under clause 1 of the conditions.

High Court

The dispute subsequently went to trial and, at first instance before Flaux J, insurers were found liable under the policy terms. The case proceeded on the understanding that it was common ground between assured and insurers that Clause 1.5 should apply and the court concluded that the loss had indeed resulted from malicious acts of drug smugglers, covered thereunder. The exclusion in Clause 4.1.5. was found inapplicable on the basis that it should be implied that the clause could not preclude a claim where the infringement of customs regulation itself resulted from the otherwise covered malicious act. Sue and labour charges were recoverable in addition, including charges incurred after the date of the notice of abandonment. Flaux J ruled that, in circumstances where the notice of abandonment was rejected by insurers but they treated the case as if a writ / claim form had been issued, it was in both insurers' and assureds' interests to continue incurring expenses to mitigate the loss, as the vessel remained in "grip" of the peril. The right to recover sue and labour expenses only ceased when proceedings were actually issued. Insurers contended that charges claimed in respect of manning and technical management during the detention were excluded by Clause 16 and 17 of the Institute Time Clauses – Hulls 1/10/83[2], incorporated into the policy. However, the judge found that the clauses applied to partial losses or particular average only and had no bearing on claims under the sue and labour clause, which is supplementary to the cover. The following costs were thus held to be allowable in addition to the claim for a constructive total loss:

a. Legal expenses incurred to seek the release of the vessel and defence of the crew

b. Costs of manning the vessel and providing for its technical management during the detention less the minimal expense of keeping a skeleton crew on board

c. Costs in relation to a team of investigators

Court of Appeal

The insurers appealed and the court reversed the first instance judgement, finding no basis for any implied term circumventing the exclusion in Clause 4.1.5. Rather, the cover was designed to exclude claims arising from any detainment by reason of an infringement of customs regulations, albeit resulting from the malicious acts of a third party. The exclusion under Clause 4.1.5 therefore applied / prevailed. There was no claim under the policy.

[2] *Clause 16 (Wages and Maintenance): "No claim shall be allowed, other than in general average, for wages and maintenance of the Master, Officers and Crew, or any member thereof, except when incurred solely for the necessary removal of the Vessel from one part to another for the repair of damage covered by the Underwriters, or for trial trips for such repairs, and then only for such wages and maintenance as are incurred whilst the Vessel is under way."*

Clause 17 (Agency Commission): "In no case shall any sum be allowed under this insurance either by way of remuneration of the Assured for time and trouble taken to obtain and supply information or documents or in respect of the commission or charges of any manager, agent, managing or agency company or the like, appointed by or on behalf of the Assured to perform such services."

Supreme Court

The owners appealed. The Supreme Court initially clarified that, contrary to what was taken as common ground, the total loss of the vessel (due to drug smuggling), did not amount to “any person acting maliciously” as per Clause 1.5. The concept of “acting maliciously” required some “spite” or “ill-will” or similar in relation to the property insured or to some other property, or possibly even a person. Drug smugglers had no such intent, their aim being to remain undiscovered. Rather, the vessel was lost as a result of “seizure, arrest, restraint or detainment” in accordance with clause 1.2 and the loss was excluded by 4.1.5.

The court went on to comment on the outcome were clause 1.5 to be applied, holding that a limitation to the exclusion in 4.1.5, on the basis of Flaux J’s High Court judgement, could not be implied. The correct approach was to look at the proximate cause of the loss. In the circumstances, the loss would be regarded as proximately caused by

a. malicious acts covered under clause 1.5 and

b. detainment by infringement of customs regulation excluded by clause 4.1.5.

In accordance with well-established case law[3], where a loss was proximately caused by two perils, one of which is expressly excluded (i.e. infringement of customs regulation), there would be no claim under the policy.

The appeal by the owners was dismissed and the claim for a constructive total loss failed.

Conclusions

The Supreme Court judgement clarifies that the detention of a vessel as a result of drug trafficking does not, in itself, constitute a malicious act and furthermore is a peril specifically excluded by Clause 4.1.5 of the Institute War and Strikes Clauses. The court also reaffirmed the principles of proximate cause as opposed to the idea of an implied limitation to an exclusion clause.

The allowance in the first instance judgment of sue and labour expenses incurred after giving notice of abandonment involves an important clarification. Sue and labour expenses would appear to continue being recoverable up to the point when proceedings are actually issued and irrespective of a writ agreement. Moreover, Clauses 16 and 17 of the Institute Time Clauses - Hulls would appear to be inapplicable to the supplementary sue and labour clause. However, this point has not been considered further in the Court of Appeal and Supreme Court judgements.

[3] *See Cory v Burr (1883), The Miss Jay Jay [1987]*