Does the right to limit liability inevitably mean that there is insurance cover for the liability that has been limited?

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Examination of the inter-connection between the right to limit liability and insurance cover for such liability in light of a recent Canadian Supreme Court judgment.

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The Canadian Supreme Court has recently delivered a judgement in the case of *Peracomo v Real Vallee and others v Telus Communications etc.* relating to the inter-connection between the right to limit liability and insurance cover for such liability which can best be described as 'a curate's egg', that is to say, it is good in parts – but not in all parts!

The facts of the case were as follows:

The REALICE is a fishing vessel which was operated in the St Lawrence River by Real Vallee who, as sole shareholder, was effectively the owner of the vessel through his company Peracomo Inc. The vessel's fishing gear became entangled with a fibre-optic submarine cable and Mr Vallee raised the cable to the surface and proceeded to cut it. He appreciated that there was a possible risk that the cable was still in use but formed the view that it was not currently in use based on a quick reading of the handwritten word ' *abandonee*' that he had seen on a map on a museum wall the year before. However, the cable was live and the owners brought a claim against Mr Vallee and his company for almost USD 1 million by way of repair costs. Mr Vallee's company was found to be liable for the loss and Mr Vallee himself was also found to be personally liable. However, the vessel's limit under the 1976 Limitation Convention was USD 500,000 and Mr Vallee and his company sought to limit their liability to such a sum and to claim an indemnity for such limited liability from their liability insurers the Royal & Sun Alliance Insurance Co. of Canada.

The Canadian Supreme Court found that Mr Vallee acted recklessly when cutting the cable since whilst appreciating that there was a risk that the cable could still be live, he did not consult any of the relevant marine charts which he was obliged to do pursuant to the Canadian Charts and Nautical Publications Regulations 1995 and did not " *communicate with marine traffic control to make inquiries as to the nature and use of the cable*" . However, the court also found that since Mr Vallee had believed that the cable had been abandoned, " *he did not actually know that his actions would probably result in damaging someone's property who would then have to repair it*." Consequently, by a majority of four to one, the Supreme Court found that Peracomo Inc. and Mr Vallee were entitled to limit their liability but were not entitled to an indemnity for that limited liability from their liability insurers. The dissenting judge (Wagner J) agreed that Peracomo Inc. and Mr Vallee were entitled to limit their liability but held that they were entitled to an indemnity from their insurers.

In essence, the majority of the judges drew a distinction between the sort of wrongdoing that is required to break limit and the sort of wrongdoing that is required to debar insurance cover. The court concluded that limitation is broken under the 1976 Convention only if the wrongdoer when committing the relevant wrongful act or omission, whether intentional or reckless, also foresees the type of loss that will probably result. However, the court concluded that in order to debar insurance cover all that is required is wrongdoing, whether intentional or reckless, which foresees that damage or injury could result but not necessarily with foresight of the loss that actually resulted. Consequently, situations could arise, as in this case, where the wrongdoer is entitled to limit his liability because he did not foresee the actual type of loss that resulted from his conduct but is nevertheless, because his conduct does constitute intentional or reckless wrongdoing, not entitled to be indemnified by his liability insurers for that limit.

The decision is welcome in relation to the right to limit in that the Canadian Supreme Court unanimously overturned the earlier decisions of the lower courts holding that there was no right to limit and its reasoning for doing so is consistent with the approach that has been adopted in other jurisdictions, thereby enforcing the understanding that a shipowner has an " *almost indisputable right to limit"* 1 and that *"it is likely that only truly exceptional cases will give rise to any real prospect of defeating an owner's right to limit"*. 2

However, the comments of the majority decision in relation to insurance cover is surprising since it has generally been assumed in the shipping and insurance industry that should a defendant have the right to limit liability, the defendant will be entitled to be indemnified for such liability under P&I and other similar forms of liability insurance. That understanding is important since maritime claims can be very high value claims which often exceed the value of the shipowner's assets. Therefore, the availability of liability insurance is something that benefits both the shipowner and the claimant in that they both have the comfort of knowing that claims are underwritten up to the limit by a creditworthy third party that has the ability to provide the necessary compensation promptly. Indeed, this linkage between the right to limit and the availability of liability insurance is now the cornerstone of the very effective compensation scheme that the industry and governments have developed over many years through the IMO to regulate maritime claims of many different kinds. Therefore, if a defendant that is entitled to limit liability for a maritime claim is, nevertheless, not entitled to be indemnified under his liability insurance, that would seem to undermine the delicate balance that underpins the integrity of the scheme as a whole. Somewhat ironically, the decision would seem to have the consequence that even though the *guilty defendant's* conduct is not deemed sufficiently serious to offend against public policy in relation to his right to limit liability, it is deemed sufficiently offensive to deprive the *innocent claimant* of the protection that is afforded to it by liability insurance (in some cases compulsory liability insurance).

Therefore, why did the majority of the judges come to this surprising conclusion? They believed that a distinction should be drawn between the right to limit and the existence of insurance cover for the following reasons:

1. The two provisions have different purposes; and
2. The terminology of the 1976 Limitation Convention and the Marine Insurance Act is very different and emphasises the different purposes.

1. The Different Purposes The majority of the judges came to the conclusion that whilst there is a linkage between the provisions of the 1976 Limitation Convention and the availability of insurance, the two instruments are not co-extensive in the sense that the right to insurance cover must automatically be assumed if there is a right to limit liability. The court concluded that insurance was relevant only in establishing the total amount of limited liability under the 1976 Limitation Convention and that therefore, there was no policy reason why it should be assumed that once a defendant had proved that his conduct was not such as to break limit, it must necessarily follow that it was not such as to debar the right to be indemnified by insurance.

However, it is also true to say that there was an expectation on the part of those that drafted the 1976 Limitation Convention and the insurers who were also heavily involved in the negotiation of the Convention that the right to limit liability and the availability of insurance to underwrite liability when limited was to be co-extensive in the vast majority of cases. It is also relevant to remember that the subsequent development of the system whereby potentially very high liability limits are guaranteed by the provision of certificates from liability insurers 3 is designed to ensure that adequate funds will be available for claimants and that there will be prompt and effective payment of claims. 4 Local and national authorities rely very heavily on the comfort that such a system provides and such reliance is based on the expectation that if limitation is available to the wrongdoer, that limit will normally be covered by the insurer. Nevertheless, it must also be remembered that such certificates recognise the right of the insurer to refuse compensation if the relevant loss or damage resulted from the misconduct of the assured itself (see below).

2. The Different Terminology Article 4 of the 1976 Limitation Convention states that:

"A person liable shall not be entitled to limit his liability if it is proved that the loss resulted from his personal act or omission, committed with the intent to cause such loss, or recklessly and with knowledge that such loss would probably result". 5

However, Section 55 of the UK Marine Insurance Act 1906 6 states that:

"(1) Subject to the provisions of this Act, and unless the policy otherwise provides, the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against.

(2) In particular, -

(a) the insurer is not liable for any loss attributable to the wilful misconduct of the assured but unless the policy otherwise provides, he is liable for any loss proximately caused by a peril insured against, even though the loss would not have happened but for the misconduct or negligence of the master or crew;"

Whilst it is true that the underlined words could be read to suggest that the misconduct that is required to debar the right to limit liability should relate more specifically to the particular resulting loss than the more general provisions of the MIA, that distinction is likely to be relevant in very few cases. The fact findings that caused the Canadian Supreme Court to consider such a distinction were at best unusual and could, furthermore, be open to criticism as is clear from the comments of the dissenting judge, Wagner J. Furthermore, Gard is not aware of any case in which a P&I club that is a member of the International Group has sought to rely on Section 55 of the MIA 1906 in a case where the owner's right to limit liability has been upheld in relation to a claim that otherwise qualifies for cover. It is believed that the circumstances would have to be extraordinary for this to happen.

Furthermore, whatever be the correct interpretation of the relevant terminology of the MIA 1906 it should nevertheless be emphasised that in order to debar the right to be covered by insurance, the relevant wrongdoing must be that of the assured itself rather than that of an employee or servant of the assured. 7 Therefore, if the loss or damage is caused by the intentional or reckless acts of a crew-member, that would not normally be sufficient to prevent *the assured* from claiming under the policy since, insofar as the assured itself was concerned, the loss or liability had nevertheless been caused by the fortuitous operation of an insured peril.

However, the situation is often somewhat more complicated since, in most cases, the assured is a corporation which conducts its business through human agencies. Therefore, a potential dichotomy can arise if the loss or liability has been caused by the wilful misconduct of one of its servants or agents: is such misconduct to be considered to be that that of a servant or agent of the assured or is it the conduct of the assured itself? The traditional solution 8 is to ascertain whether the relevant person can be considered to be the 'directing mind' or alter ego of the assured. 9 If so, then the conduct is deemed to be that of the assured itself. In the majority of cases, that enquiry is not difficult since the relevant misconduct relates to one aspect of the corporation's business (often management aspects). However, in some rare cases, the relevant person is acting in two capacities and it is necessary to ascertain in which capacity the misconduct was committed. The classic example is where (as in the REALICE case) the wrongdoer is both the master and the de facto owner of a (usually small) ship.

Perhaps surprisingly, this issue does not seem to have been considered by the Canadian Supreme Court. The court found that Mr Vallee had been personally reckless and consequently, it is not surprising that he personally could not recover an indemnity under the policy. However, the court also held that Peracomo Inc. was not protected by the policy since Mr Vallee, as the sole share-holder in, and de facto owner of, Peracomo Inc., was also the 'directing mind' or *alter ego* of Peracomo Inc. and that his recklessness also debarred Peracomo Inc. from recovering under the policy. However, the facts would suggest that when acting recklessly in cutting the cable, Mr Vallee was acting more in his capacity as a master/navigator than as the 'directing mind' or alter ego of the company. In such circumstances, the predominant view in most countries appears to be that his conduct should be considered to be personal conduct rather than that of Peracomo Inc. 10 and that, consequently, Peracomo Inc. should have been entitled to be indemnified under the policy.

However, although there does not appear to be any express comment to this effect in the judgement, the Canadian Supreme Court may, when coming to the conclusion that Peracomo Inc. was also not entitled to be indemnified under the policy, have been influenced by the fact that Peracomo Inc. and Mr Vallee were very closely connected and joint assured under the policy. In these circumstances, there is authority which suggests that where two persons who have effectively the same interest in the same property or adventure are jointly insured by one policy, the misconduct of one assured can debar the right of both assured to be indemnified. This issue was considered by the English House of Lords in the well-known insurance case of *Samuel v Dumas* and Viscount Cave held that:

"My Lords, there is force in this argument, but I am not prepared to say that in the present case it should prevail. 11 *It may well be that, when two persons are jointly insured and their interests are inseparably connected so that a loss or gain necessarily affects them both, the misconduct of one is sufficient to contaminate the whole insurance (Phillips' Law of Insurance, Vol. I., s. 235)".* 12

The fact that Mr Vallee was also the sole shareholder in Peracomo Inc. would suggest that " *their interests"* could indeedbe considered to be *"inseparably connected so that a loss or gain necessarily affects them both",* in which case, what appears at first impression to be a surprising conclusion of the Canadian court in relation to insurance cover may be justifiable given the somewhat unusual facts of the Peracomo case.

To Sum Up The decision of the Canadian Supreme Court is welcome insofar as it unanimously re-emphasises the difficulty that a claimant has in breaking limit under the 1976 Limitation Convention. However, the decision of the majority of the court (Wagner J dissenting) is surprising to the extent that it suggests that, notwithstanding the fact that a defendant is entitled to limit his liability, the defendant may not be entitled to be indemnified by insurance. Such a conclusion runs contrary to the understanding and expectation of the shipping and insurance industry and some of the conclusions reached by the majority are open to question but may be explainable by the somewhat unusual facts. It would not be surprising if a different view were to be taken by other courts in other jurisdictions.

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1 Per Sheen J in *The BOWBELLE* (1990) 3 AER 476.2 Per Gross J in *The SAINT JACQUES II* (2003) 1 Lloyd's Rep 203.3 Such requirements exist pursuant to pollution conventions such as the CLC, Bunkers and HNS Conventions and pursuant to passenger liability conventions such as the Athens Conventions. Such requirements also exist under the national laws of countries such as the USA.4 For a detailed explanation of the rationale behind the need for compulsory insurance see *Compulsory Maritime Insurance* by Prof Erik Rosaeg in the Scandinavian Institute of Maritime Law Yearbook 2000 (http://folk.uio.no/erikro/WWW/corrgr/insurance/simply.pdf).5 Other conventions have similar wording but the issue is complicated by the fact that the terminology that is used to debar the right to limit is not uniform. Some conventions require conduct that foresees the specific loss or damage (The Hamburg Rule (Art. 8), The Rotterdam Rules (Art. 61) Rules, CMR (Art. 29), CIM-COTIF (Art. 44), The Budapest Convention (Art. 21), The Athens Convention (Art. 13), CLC' 92 (Art. 6 (2) and the HNS Convention (Art. 9 (2)) whereas other conventions merely require conduct that refers generically to non-specific loss or damage (The Hague-Visby Rules (Art. IV Rule 5 (e)), the amended Warsaw Convention (Art. 25 of the Hague Protocol) and Art. 22 (5) of the Montreal Convention).6 The wording of Section 53 (2) of the Canadian Marine Insurance Act 1993 that was applicable in the case of the REALICE differed slightly but not materially: " *Without limiting the generality of subsection (1), an insurer is not liable for any loss attributable to the wilful misconduct of the insured nor, unless the marine policy otherwise provides, for... ."* 7 See section 55 (2) (a) of the MIA 1906. This is a long-standing rule of the common law (see *Thompson v Hopper* (1858) E.B.& E. 1047 and *Trinder v Thames and Mersey Ins. Co* (1898) 2 QB 114).8 This is predominantly the rule that has been used in the context of the limitation of liability but it is likely that a similar approach would also be adopted in relation to insurance cover (see for example, paragraph 18.25 of *Marine Insurance Law and Practice* by Prof Francis Rose, Informa 2nd edition 2012 and pages 112-13 of *O'May on Marine Insurance* , Sweet & Maxwell 1993).9 Historically, such a person was likely to be a senior officer of the corporation (See *Lennard's Carrying Co v Asiatic Petroleum Co.* (1915) AC 705 and *The LADY GWENDOLEN* (1965) Probate 294). However, with the advent of the requirement of the Designated Person (DP) pursuant to the ISM and ISPS Codes, it may be that such person may also be considered to be the *alter ego* in relation to the matters for which the DP has the ultimate responsibility no matter what that person's ranking may be in the corporate personnel structure. Furthermore, under US law, the relevant conduct need only be that of a 'managing officer' i.e. someone who actually manages or directs the relevant aspect of the company's affairs (*Coryell v. Phipps* 317 US 406 – Supreme Court 1943).10 See *The ANNIE HAY* (1968) Probate 341. A similar view is taken under Norwegian law – see the Norwegian Supreme Court decision in the *M/K HADSELØ v. M/K POLLY* (Rt-1957-624) and the views expressed by Professors Falkanger and Bull in their leading textbook *Introduction to Maritime Law.* 11 The reason why Viscount Cave made this comment was because the two co-assured in that case were mortgagor and mortgagee and the court concluded that the two assured did not have the same interest in the insured property.12 (1924) 18 Lloyd's Rep. 211 at 214. See also *Marine Insurance Legislation* by Robert Merkin, Lloyds's List Group,2000, at page 76 and *O'May on Marine Insurance* , Sweet & Maxwell 1993 at page 114