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FAULT FINDING AND MARINE LIABILITY

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FAULT FINDING AND MARINE LIABILITY

A shipowner's right to limit the amount of compensation payable for loss or damage caused by the shipowner's vessel is a longstanding, yet controversial keystone of international maritime law. The right to limit liability goes against the fundamental legal principle of *restitutio ad integram*, meaning that the damages awardable against a person who suffered a loss at the hands of a wrongdoer should bring that person as close to the injured person's original condition as possible.

Historical Context

The law limiting liability for maritime claims has been in continental Europe at least since the 19th century.[1] Its origins are political—the law intended to support the growth and development of the shipping industry. At the time, maritime adventures were fraught with risk. Navigational aids and communication equipment was rudimentary. If an incident at sea occurred involving a shipowner's vessel, the shipowner faced the risk of personal liability often beyond what may have been his original investment. A shipowner not acting as a master would be legally liable for what happened to the ship and cargo despite the fact that, once the vessel was at sea, the shipowner had had little to no control over the master and crew and no way to communicate with them. Financial ruin was a real possibility. These risks discouraged investment in the shipping industry.

The limitation of liability was legislated to protect against the risks inherent to a marine voyage. It provided vessel investors with protection from being liable above a certain amount, in the form of a cap on awardable damages. Another important benefit of this legal principle was that it made the risk of marine voyages more ascertainable to insurers, which promoted the growth of the shipping industry.

The rule did not apply automatically. In order to be able to rely on the rule, a shipowner had to prove that the loss occurred without his "actual fault or privity".[2] As time passed, problems emerged with this test. Judges in various jurisdictions would avoid the damages cap by liberally interpreting the "actual fault or privity" test.[3] Because strict or absolute liability did not exist in maritime law, and negligence law was so amorphous, judges would find negligence by the shipowner where it did not exist.[4] Another problem with the limitation of liability test was that its interpretation varied across jurisdictions, with little uniformity.[5] Though these issues certainly kept lawyers busy, the unpredictable nature of whether limited liability would apply caused understandable problems for the shipping and marine insurance industry.

Recent History

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[1] Duygu, Damar. *Wilful Misconduct: Hamburg Studies on Maritime Affairs*, vol 22 (Springer: 2011) at 10 [*Damar*].

[2] *International Convention Relating to the Limitation of Liability of Owners of Sea-Going Ships, 1957,* 10 October 1957, 1412 UNTS 73 (entered into force 19 June 1975), art. 1.

[3] Comité Maritime International. *The Travaux Preparatoires of the LLMC Convention, 1976 and of the Protocol of 1996*. Antwerp, Belgium: CMI, 2000 at 122 -123 [*Travaux Preparatoires*]; See e.g. *Lady Gwendolen (The),* [1965] 1 Lloyd's Rep 335 (duty by shipowner to impress upon master the necessity of using radar in fog); See e.g. *Rederij v England (The),* [1973] 1 Lloyd's LR 373 (owner failed to ensure master had by-laws on the vessel); See e.g. *Stein v Kathy K (The),* [1972] FC 585, aff'd [1976] 2 SCR 802 (fault found against shipowner on basis of shipowner's acquiescence in the tug and tow being left in inexperienced hands).

[4] *Ibid.*

[5] See generally *Travaux Preparatoires*, supra note 3, at 122.

The adoption of 1976 *Convention on Limitation for Liability for Maritime Claims*[6] remedied the difficulty of the limitation being too easily breakable. The international community abandoned the "actual fault or privity" test, in favour of a new, essentially watertight test that required a very high level of fault worthy conduct to break the limitation.

It was the *Convention's* purpose to set a high bar and to make the limitation of liability difficult to break.[7] In exchange for the new test, access to the limitation fund and the sum of money available to victims was substantially increased. With some modifications, Canada adopted Article 4 into its own laws.[8]

Article 4 of the *Convention* provides that a shipowner's entitlement to limit liability could only be removed "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".[9] Therefore, the claimant had to prove that the shipowner had subjective awareness of probable consequences.

For several reasons, the change to the new test was not without substantial controversy. First, Article 4 turned the limitation of liability, which many viewed should be a privilege, into a right. It required such a high level of fault that it was akin to the *mens rea* requirement in criminal law. Also, the burden of proof shifted from the shipowner and onto the victim. Second, by the 1970s, the rationale for any limitation on liability had become much less persuasive.[10] The shipping industry was now a mature and well-established industry. It did not require state support to attract investment. Due to advances in communication technology, it was no longer the case that a shipowner had no control over his or her vessel while it was out at sea. Third, the corporate veil became the standard for doing business, already shielding incorporated persons from personal liability.[11] Fourth, the near-guarantee of limitation of liability could incentivize a failure to take adequate precautions, also known as 'moral hazard'.[12] These issues lead one to question the validity of this law. Nonetheless, for better or for worse, Article 4 continues to have a broad-reaching effect in international maritime law.

Benefits for Marine Insurers

In drafting the *Convention,* marine insurance was a major concern.[13] Attention was directed at insurance premiums and insurance coverage for various risks.[14] The damages cap set

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[6] *Convention on Limitation for Liability for Maritime Claims,* 19 November 1976, 1496 UNTS 221 (entered into force 1 December 1986) [*Convention*].
[7] *Travaux Preparatoires*, supra at note 3, at 124.
[8] See *Canada Shipping Act*, RSC 1985, c S-9, Sch. VI (as enacted by SC 1998, c 6, s 26); See also *Marine Liability Act*, SC 2001, c 6 Part 3 and Sch 1 [*MLA*]: The persons who can limit their liability under the *MLA* are not limited to the shipowner, but also include a charterer, manager, operator, salvor, master, crew, insurer, owners of docks, canals, and ports, and others. Though it covers a broad range of claims, it does not cover claims for remuneration for salvage, contribution to general average, marine pollution damage, nuclear damage, and certain other claims.
[9] *Convention*, *supra* note 2, art 4.
[10] Serge Killingbeck, "Limitation of Liability for Maritime Claims and Its Place in the Past Present and Future — How Can it Survive?" (1999) 3 S Cross UL Rev 1 at 12.
[11] *Ibid*, at 26; See also Muhammad Masum Billah, *Economic Analysis of Limitation of Shipowners' Liability* [2005-1006] 19 USF Mar LJ 297 at 312 [*Billah*].
[12] *Billah*, supra note 11 at 304.
[13] *Damar, supra* note 1 at 169; See generally *Travaux Preparatoires*, supra at note 3.
[14] *Ibid.*

by the *Convention* sought to strike a better balance between the rights of innocent victims to compensation and the view that a shipowner should be able to free himself from liabilities that exceed amounts coverable by insurance.[15]

It is clear that the limitation of liability confers substantial benefits to marine insurers in a number of important ways. First, the liability scheme provides insurers with a predicable and ascertainable way to measure insurance risks. Marine liability insurance is available to cover losses to third parties up to the limits of the *Convention,* while keeping premiums affordable. Second, the limitation of liability unifies the law with respect to the amount of damages to be paid. For example, a container ship will have many different goods on board with many different origins. Were it not for the *Convention* and the limitation of liability, marine losses would be much more complicated to resolve. Third, the high standard set by Article 4 encourages settlement and discourages litigation.[16] It also simplifies claims handling procedures and facilitates quick resolutions. Overall, the *Convention* enables lower transaction costs with respect to marine insurance.

Relationship between Article 4 and Marine Insurance

The circumstances that led to the drafting of the *Convention* suggest that the provisions relating to the limitation of liability should be read harmoniously with the statutory marine insurance exclusion under which an insured could lose the benefit of his or her liability insurance policy. For example, with respect to Article 4, it was said that

> the words 'recklessly and with knowledge that such loss would probably occur' [came] very near to the English legal term 'wilful misconduct', which is normally the degree of blame required if the insurance cover shall be forfeited…. The proposed text, therefore, implies that there will be right of limitation where the insurance cover is intact. Making the limitation unbreakable to this extent should make possible a significant raise of the limits of liability.[17]

Before exploring this relationship further, a brief discussion of the statutory insurance exclusion is necessary. The "willful misconduct" exclusion was first codified by the English *Marine Insurance Act*, *1906*,[18] and later adopted in the modern-day Canadian statute by the same name.[19] The *Marine Insurance Act* provides that "an insurer is not liable for any loss attributable to the wilful misconduct of the insured".[20] Similarly to Article 4, wilful misconduct requires subjective intent and therefore sets a high fault threshold. To date, nearly all of the marine insurance cases finding "wilful misconduct" have been in the context of a deliberate scuttling of a vessel to obtain insurance proceeds.[21]

There are two central reasons for the existence of the insurance exclusion. First, the exclusion guards against the 'moral hazard' of allowing insured persons to rely on coverage under an insurance policy to avoid the consequences of their deliberate conduct. Second, it also promotes insurability of marine liability, which is based on indemnification for

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[15] *Travaux Preparatoires*, supra at note 3, p. 15.
[16] *Ibid* at 23
[17] *Travaux Preparoires, supra* note 4 at 127.
[18] *Marine Insurance Act, 1906* (UK), 6 Edw 7, c 41, s 55(2)(*a*).
[19] *Marine Insurance Act*, SC 1993, c 22, at s. 53(2) [*Marine Insurance Act*].
[20] *Ibid*.
[21] *Damar*, *supra* note 1 at 41.

unforeseeable risks or perils. Insurers can attempt to quantify the risk of unforeseen perils, but it would be impossible for the insurer to quantify the risk of an action that is entirely within the control of the insured.

This relationship between the two clauses leads to the important question of whether the right to insurance coverage is co-extensive to the limits of liability under Art. 4. A recent Supreme Court of Canada decision, however, answers this question in the negative.[22]

Peracomo Inc. v. TELUS Communications Co.

In *Peracomo,* a fisherman's anchor got tangled in a submarine cable. The fisherman was under the impression that the cable was not in use, and cut it off using an electric saw. Unfortunately, the cable turned out to be a live fibre-optic cable, the cutting of which caused nearly $1 million in damage. The Supreme Court of Canada considered two questions. The first question was whether the fisherman's act met the standard of fault in Art. 4, so that the limitation of liability did not apply. Second, the court considered whether the act fell within the "wilful misconduct" statutory insurance exclusion. Both the limitation of liability and the insurance issue turned on the fisherman's degree of fault. The majority decision of the court held that the limit on liability under the *Convention* did apply, but the loss was caused by the fisherman's wilful misconduct, and was therefore excluded from insurance coverage.

In coming to this decision, the court analyzed how the phrase "such loss" found in Art. 4 applied to the facts. The court found that the loss was the diminution in value of the cable measured by the cost of repairing it. Though the fisherman intended to cut the cable, he was under the impression that it was not a live cable. Therefore, he did not intend to cause "such loss" nor did he know that it was a probable consequence of his actions.

The court held that the fisherman's conduct was not merely negligent, but qualified as "wilful misconduct". The fisherman had a duty to consult proper marine charts and be aware of the existence of a live submarine cable. If he did not know what the cable was, he should have communicated with marine traffic control as to its nature and use.

In the dissent, Wagner J., contended that the fisherman's actions did not qualify as wilful misconduct. Wagner J. supported his argument in part by the view that the drafters of the *Convention* were seeking to tie the limit of liability to the legal rules governing insurance coverage in the event of wilful misconduct:[23]

> [A] person who can limit his or her liability for a loss resulting from certain acts should not lose the benefit of his or her insurance coverage for those same acts, as such an outcome could upset the principles of balance, consistency and fairness that underlie certain provisions with respect to insurance that reduce the coverage and protection of a liability insurance policy.[24]

The majority of the court, however, rejected this view. Although Art. 4 was related to the insurance exclusion clause, the majority viewed the two as having important differences in purpose. The provision of the former was to create a "virtually unbreakable upper limit on

[22] *Peracomo Inc v. TELUS Communications Co,* 2014 SCC 29 [*Peracomo*].
[23] *Ibid,* at para 100.
[24] *Ibid,* at para 102.

liability", whereas the purpose of the latter was to "define and limit the type of risk insured under that overarching limit created by the *Convention*".[25] The two provisions are related, in that they both facilitate insurability at affordable rates. To the majority, this did not however mean that the fault standard employed by each was coextensive.

The upshot of *Peracamo* is that, although the limitations under the *Convention* remains nearly unbreakable, the court will apply the marine insurance exclusion to exclude some conduct from coverage more readily. In these circumstances, a shipowner will be found without insurance coverage and access to the limitation fund, but still have the benefit of limitation of liability.

Conclusion

Although today's reasons for the continued existence of the limitation of liability for marine claims under the *Convention* are less persuasive than the reasons of the past, the *Convention* is an old tradition from which a departure is unlikely.

Insurance considerations represented a key issue at the time the *Convention* was drafted. Indeed, insurers reap many direct benefits from the limitation on liability set by the *Convention* and the virtually unbreakable standard set by Article 4 respecting conduct barring access to the limitation of liability. This leads to the question of whether the fault thresholds found in Article 4 and the "wilful misconduct" marine insurance exclusion, though differently worded, are coincident. In the recent decision of *Peracomo,* the Supreme Court of Canada rejected this proposition. Although both clauses represent a high fault standard, because the "wilful misconduct" insurance exclusion did not require the subjective intent of specific loss actually brought about, conduct is more likely to fall within the insurance exclusion under the *Marine Insurance Act* than under Article 4 of the *Convention*.

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[25] *Ibid*, at para 24.