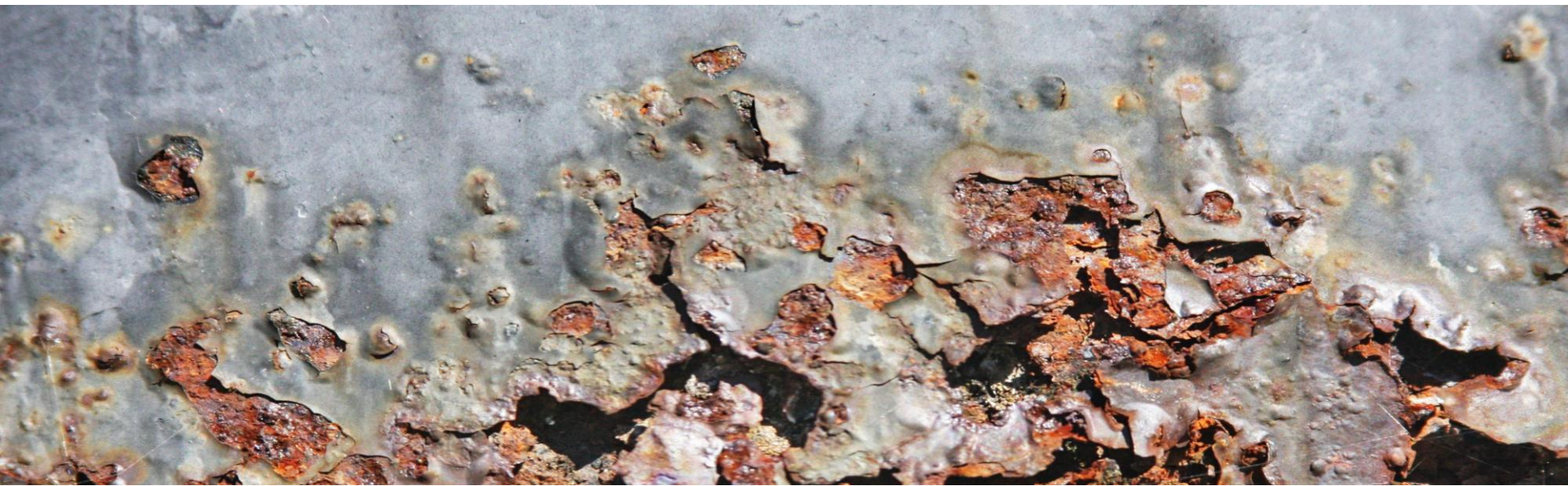


The Lillehammer Energy Claims Conference - 2013

Corrosion and Exclusion Clauses – an English law perspective

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7 March 2013



Scope of presentation

- General English law principles relating to insured perils, exclusions and causation
- Specific issues and cases relating to corrosion
- Sample exclusion clauses



“The rust problem turned out to be more extensive than we expected”

All risks cover - general principles

- Insurance is intended to provide cover against the risk of “*fortuitous events*”.
- The purpose of insurance is therefore to provide an indemnity against accidents which may happen, not against events which must happen.
- Section 55(2)(c) Marine Insurance Act 1906:
“Unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear, ordinary leakage and breakage, inherent vice or nature of the subject-matter insured ...”

Exclusion clauses - general principles

- Purpose - to exclude risks which, apart from the exclusion clause, would rest upon the underwriter.
- Interpretation - exclusion clauses are generally construed “*contra proferentem*”. That is, where the clause is ambiguous and capable of two meanings, the clause which gives the insured more cover will usually be preferred.
- Burden of proof - on the insurer to demonstrate that the exclusion applies.

Exclusion clauses - application by the courts

- Two-stage test:
 - What is the proximate cause of the loss?
 - Is that cause caught by the exclusion?
- The doctrine of proximate cause:
 - The courts will look to ascertain the effective or dominate cause of the loss.
 - This is a question of fact.
 - This is not necessarily the “*immediate*” cause, being the one latest in time prior to the loss - *Leyland Shipping Co. Limited v Norwich Union Fire Insurance Society Limited* [1918] A.C.350.
 - The question of proximate cause is to be answered applying the “*common sense of a business or seafaring man*” - *T M Noten B.V. v Harding* [1990] 2 Lloyd’s Rep 283, 286-287.

Exclusion clauses - application by the courts

- What if there are two proximate causes?
 - If one cause is covered and one cause is excluded, then the exclusion prevails - *Wayne Tank & Pump Co. Limited v Employer's Liability Assurance Corporation Limited* [1974] 1 Q.B. 57.
 - Where one cause is covered and one is not covered (but is not excluded), the insured is entitled to recover "*The Miss Jay Jay*" [1987] 1 Lloyd's Rep 32 [1985] 1 Lloyd's Rep 264.

Inherent vice/wear and tear - recent decisions

- Relevance:
 - Lack of English authorities on corrosion exclusions.
 - Inherent vice and wear and tear are often referred to in the same exclusion clause as corrosion.
 - The approach of the courts to such cases is a guide to how corrosion exclusions may be construed.
 - Many of the decisions have been overturned on appeal showing the difficulties that can arise in construing these types of exclusion and applying them to the facts of a given case.

Inherent vice/wear and tear - recent decisions

- Inherent vice - *The Cendor Mopu* [2011] UKSC 5:
 - The assured purchased a jack up rig for conversion into a MOPU for use off the coast of Malaysia.
 - The rig was towed on a barge with its legs in place and elevated above the deck.
 - The risk of fatigue cracking during the voyage was known in advance. This occurred due to the repeated bending of the legs caused by the motion of the barge.
 - One leg broke and fell into the sea due to a “final straw wave” which fractured the weakened steel. The other two legs subsequently suffered the same fate.
 - The weather conditions during the voyage were within the range that would have been anticipated.

Inherent vice/wear and tear - recent decisions

- The rig was insured against all risks (under Institute Cargo Clauses (A)), which contain an exclusion for inherent vice.
- Insurers denied liability asserting that the loss was either inherent vice or the inevitable consequence of the rig's inability to undertake the voyage.
- At first instance, insurers lost on inevitability but succeeded on inherent vice.
- There was no appeal by the insurers against the inevitability ruling, but the insured appealed successfully to the Court of Appeal on the question of inherent vice.
- The Supreme Court upheld the Court of Appeal decision.
- Accordingly, there will only be a loss by inherent vice if the sole cause of the loss is something internal to the subject matter insured.

Inherent vice/wear and tear - recent decisions

- Ordinary wear and tear - *JSM Management Pty Limited v QBE Insurance (Australia) Limited* [2011] VSC 339
 - The insured landlord owned a trucking depot which was leased to a tenant under a 5 year lease. This included an area of hard-standing which had a load-bearing rating of 40 tonnes for forklifts.
 - Despite being advised of the weight restrictions, the tenant used much heavier forklifts and after around 8 months of use cracks appeared in the hard-standing area.
 - A claim was made and the insurers invoked the wear and tear exception.
 - Insurers succeeded at first instance but lost before the Supreme Court of Victoria.
 - The Supreme Court defined ordinary wear and tear as “*damage due to or sustained during ordinary usage*”. To fall within the exclusion, damage had to be proximately caused by ordinary rather than extraordinary events. The damage to the hard-standing would not have occurred but for extraordinary use, and the loss was therefore covered by the insurance.

Inherent vice/wear and tear - recent decisions

- Ordinary wear and tear - *Midland Mainline Ltd v Commercial Union Assurance Co Ltd* [2004] Lloyd's Rep. I.R.239
 - Following the Hatfield rail disaster in October 2000 caused by a broken rail, the track operator imposed a series of emergency speed restrictions (ESRs) on other parts of the rail network where there was known to be gauge corner cracking.
 - The cracking was the result of rolling contact fatigue.
 - The ESRs played havoc with the timetables of the train operators who claimed against their BI insurers on the basis that the ESRs were the proximate cause of the loss.
 - The insurers relied upon a wear and tear exclusion.
 - At first instance, the insured succeeded on grounds that the ESRs were the proximate cause and wear and tear was simply part of the background.
 - The Court of Appeal upheld insurers' appeal, on grounds that wear and tear was the sole or at least a concurrent cause of the loss.

Corrosion - the legal authorities

- *Burts and Harvey Ltd v Vulcan Boiler & General Insurance Co Ltd* [1966] 1 Lloyd's Rep 161
 - Insurance covered sudden and accidental damage by any fortuitous cause but excluded loss or damage resulting from wear and tear/corrosion.
 - A crack occurred in a tube in a heat exchanger which allowed cooling water to mix with gaseous maleic anhydride to form corrosive maleic acid which caused damage to the heat exchanger through rapid corrosion.
 - The insurers alleged that the loss therefore fell within the corrosion exclusion.
 - It was held that the cracking of the tube was the proximate cause of the corrosion damage, which was the consequence of the insured loss not the cause.
 - The exclusion was only intended to exclude corrosion occurring during ordinary production and use.

Corrosion - the legal authorities

- *Navalight Shipping Limited v Sovag* (Court of Appeal – The Hague - 15 March 2011)
 - The claim concerned severe pitting corrosion to a vessel's ballast tanks. Class required the plating to be replaced. Hull insurers (on one of the potentially relevant years) declined the claim.
 - The hull insurance was subject to English law but Dutch jurisdiction.
 - Insurers successfully denied liability on grounds that the insured could not prove any recoverable damage during their policy period.
 - The insured contended that the damage was caused by SRB present in the ballast water and that this constituted a loss by perils of the seas.
 - The insurers submitted that the proximate cause of the loss was failings on the part of the insured to protect the vessel against SRB attack.

Corrosion - the legal authorities

- The Court of Appeal held in favour of insurers.
- The Court did not consider the origin, cause or rate of corrosion to be relevant to the issue of coverage.
- It was the insured's failure to put in hand measures to prevent SRB damage which was the proximate cause of the loss.

Corrosion exclusions - what the clauses say

- “*There shall be no liability under this insurance in respect of ... wear and tear, ... corrosion*” (Sample operational wording)
- “*Excluding loss or damage resulting from wear and tear, corrosion*” (Burts & Harvey)
- “*The coverage afforded by this policy shall not apply to...costs of repairing, correcting or rectifying wear and tear, rust and oxidisation and fluctuations in temperature.*” (WELCAR)

Corrosion exclusions – what the clauses say

- *Exclusion 1 – excludes loss or damage resulting from corrosion*
 - *Burts and Harvey* example.
 - Excludes corrosion in “ordinary course”.
 - Does not exclude “consequential corrosion”.
- *Exclusion 2 – no liability in respect of corrosion*
 - Excludes corrosion in “ordinary course”.
 - Does it exclude consequential damage?
- *Exclusion 3 – cover shall not apply to the cost of repairing corrosion*
 - No express reference to cause – just quantum.
 - Excludes costs of repairing corrosion in “ordinary course”.
 - Does it go further than this? No express limits in the clause itself- just excludes the cost of repairing corrosion.
 - Would the clause exclude the cost of repairing corrosion which is consequential damage arising from an otherwise insured event?

Corrosion - some final remarks

- There is very little authority on the interpretation of exclusion clauses relating to corrosion.
- The Supreme Court decision in *Cendor Mopu* may point to a change in approach to losses due to concurrent causes.
- The number of successful appeals on related cases dealing with wear and tear and inherent vice show the difficulty in applying such clauses to the particular facts in individual cases.
- “Ordinary corrosion” highly unlikely to be covered.
- “Consequential corrosion” may be, but this will all depend on the wording of the exclusion clause.

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