CASE NOTES

Marine insurance — practice of "laying to"

*HARBOUR INN SEAFOODS LTD v SWITZERLAND GENERAL INSURANCE CO LTD**

Jeannette Waite**

I. INTRODUCTION

On 8 March 1989 the fishing vessel *Magnet* ran aground off the Wairarapa coast. The vessel was wrecked. The wreck was sold for $25,000. The owner of the vessel, Harbour Inn Seafoods Limited ("Harbour Inn"), looked to insurers, Switzerland General Insurance Company Limited ("Switzerland"), for indemnity. Switzerland declined to pay. Harbour Inn issued proceedings in the Auckland High Court Commercial List against Switzerland. The claim was heard in September 1990 by Fisher J. The decision is of relevance to insured parties, insurers and brokers. It highlights the need:

(1) for all of the parties to a contract of insurance to be certain of its terms when the contract is entered into; and
(2) to comply with the duty of utmost good faith between insurer and insured both when:
    (a) completing a proposal for insurance (whether personally or through a broker); and
    (b) submitting a claim for indemnity.

II. FACTS

Magnet carried a master and one crew member. On the morning of 7 March 1989 *Magnet* set sail from Wellington. Its purpose was to fish off the south Wairarapa coast. The day was spent fishing. On the evening of 7 March 1989 *Magnet* was approximately 6 miles south of Te Kau Kau Point, off the Wairarapa coast. The forecast was for a southerly wind, but that was not expected until the morning. Both master and crew turned in for the night at 9.30 pm. As was their custom in fishing off that coast, they shut down the engine, turned on the lights and retired to sleep below without anyone on watch.

During the night a wind came up from the southerly quarter. By a combination of wind, tide and current, the vessel drifted towards land. The crew were woken by a loud crash at 3 am. *Magnet* had struck the

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rocks off Te Kau Kau Point. The crew realised that the situation was hopeless. They escaped from the vessel in a life raft. The vessel was left foundering and being pushed further onto the rocks.

On the morning of 8 March 1989 both Mr d'Esposito, the managing director of Harbour Inn, and a marine surveyor appointed by Switzerland arrived at the coast. Mr d'Esposito, *Magnet*'s crew, various fishermen, a local farmer and the surveyor made attempts to salvage *Magnet*. They were hindered in their efforts by wind and tide and difficulty with equipment. *Magnet* continued to beat against the rocks and thus became a total loss. Whilst still at the coast, Mr d'Esposito and *Magnet*'s crew were interviewed by insurance surveyors representing Switzerland. At a later date, the same people were interviewed by an insurance assessor and investigator who, again, were acting on behalf of Switzerland.

Harbour Inn lodged an insurance claim for $362,000. On 21 March 1989 Switzerland declined the claim, giving a number of reasons for its decision. Harbour Inn issued proceedings claiming the $362,000 which it alleged represented the original entitlement under the insurance policy plus consequential losses associated with the need to purchase a replacement vessel.

III. REASONS FOR DECLINING THE CLAIM

The grounds upon which Switzerland declined the claim were all related to the fact that the vessel was laying to at the time of the accident. The grounds for declining the claim were:

(1) breach of express warranty of legality;
(2) breach of implied warranty of legality;
(3) breach of clause 4 of the policy (want of due diligence by insured, owners, or managers);
(4) false statements;
(5) non-disclosure.

Harbour Inn claimed that Switzerland was not entitled to rely on any of those grounds to decline indemnity and that it should be indemnified in full. Furthermore, it claimed consequential losses based on Switzerland's refusal to indemnify.

IV. ISSUES TO BE DETERMINED

The following issues were agreed by counsel for the parties:

(1) The loss was caused by a combination of the following:
    (a) the master's decision to lay to without a watch; and
    (b) wind and tide conditions which allowed the boat to drift on to the rocks;
(2) If the boat had not been laying to the loss would have been covered by the policy of insurance. It was accepted that there was a valid contract of insurance between Harbour Inn and

Switzerland providing an indemnity cover of up to $400,000; and

(3) Mr d'Esposito's knowledge or lack of knowledge of the practice could be imputed to the insured, Harbour Inn.

Fisher J identified 2 areas of dispute between the parties. They were:

(1) the terms of the insurance contract in force at the date of the accident;
(2) the significance of the crew's decision to lay to without any watch at night, both as a general practice and on this night in particular. Switzerland alleged that there was no liability to indemnify because:
    (a) Harbour Inn failed to disclose that practice;
    (b) the practice constituted a breach of the policy; and
    (c) Harbour Inn, through Mr d'Esposito, made false statements on that topic after the accident.

Switzerland also claimed that laying to on that night, combined with lack of due diligence on the part of Harbour Inn, took the accident outside the perils for which Harbour Inn was insured.

V. TERMS OF THE INSURANCE CONTRACT

The parties had difficulty in establishing the terms of their contract of insurance. Harbour Inn's original insurance policy was placed with Switzerland's Australian office through a New Zealand broker and an Australian sub-broker. At that time Switzerland did not have an office in New Zealand. The Australian sub-broker negotiated the insurance contract with Switzerland Australia. The contract was subject to 1971 Institute Fishing Vessel Clauses, with certain amendments. The insurance policy was renewed for the 1987/88 year and 1988/89 year.

Fisher J carefully recited the steps taken by the parties when negotiating the original contract of insurance in 1986 and upon subsequent renewals. Switzerland contended that the terms and conditions of insurance altered when the policy was renewed. In particular, Switzerland said that the renewed insurance was subject to its own standard policy which contained certain warranties and referred to the 1987 Institute Clauses rather than the 1971 Institute Clauses.

Fisher J considered the correspondence which passed between Switzerland and the brokers. Various crucial terms were set out in the correspondence. However, it was difficult to determine which terms applied because it was not easily established from the documents and evidence exactly when a binding contract was concluded.

Switzerland satisfied Fisher J that the terms and conditions of the contract, as renewed for the 1988/89 year, were those set out in its standard policy which included:

(1) a warranty of legality upon which Switzerland relied to decline indemnity; and
(2) the 1987 Institute Clauses.

In addition, there were the terms implied by the Marine Insurance Act 1908.

VI. THE PRACTICE OF "LAYING TO"

Before considering the effect of laying to, it was necessary to determine what this expression meant. It was agreed by the witnesses for both parties that it meant at least drifting in a vessel with the engines shut down. However, the majority of witnesses took the expression to indicate also that while this was being done no watch would be kept. Fisher J used the expression "laying to" to mean drifting at night with the engines shut down with no-one on watch.

Fisher J made 2 general comments about laying to. They were that:

(1) the practice is contrary to "ideal standards of seamanship". Switzerland relied on several Ministry of Transport *Notices to Mariners* issued during the 1980s which actively discourage the practice. The Judge noted that these notices do not have the status of law, but they do "represent an authoritative guide as to desirable standards of seamanship";[1] and
(2) the degree of risk depends upon the circumstances in which laying to is done. There are 2 separate risks. One is collision with other vessels and the other is running aground. The risk must be relative to the circumstances in which laying to is done. For example, if drifting many miles from land or reefs, the risk would be minimal.

Fisher J also considered the extent to which the practice of laying to is well-known by New Zealand fishermen. The overwhelming evidence was that not only was it a common practice in New Zealand waters but knowledge of the practice was widespread throughout the fishing industry.

Of course, Harbour Inn wanted to show notoriety of the practice in order to establish that all marine insurance underwriters would know about laying to. This was in response to Switzerland's non-disclosure defence. But this was a double-edged sword for Harbour Inn, because the notoriety of the practice was essential for Switzerland to establish its false statements defence.

Fisher J concluded that the practice was not only commonplace but was well-known within the industry. It followed, very importantly, that Mr d'Esposito was aware of the practice and that it was engaged in on *Magnet*. When interviewed by Switzerland's representatives directly

[1] See p15 of the unreported judgment.

after the accident and again within a week or so of the accident Mr d'Esposito admitted that he was aware that *Magnet* laid to. He said that there was no other viable option. Later he claimed not to have learned of the practice until after the accident. In particular he said that he did not know that *Magnet* engaged in the practice of laying to. Mr d'Esposito's (and therefore Harbour Inn's) knowledge of the practice prior to the accident was crucial to the defences of breach of implied warranty, false statements and non-disclosure.

A. Breach of Legal Warranties

Switzerland contended that laying to in this case constituted a breach of 2 warranties:

(1) the express warranty of legality in Switzerland's standard policy;
(2) the warranty of legality implied by section 42 of the Marine Insurance Act 1908.

1. Express warranty

Warranty 2 of Switzerland's standard policy stated:

> That the vessel will be skippered, manned, crewed, operated and licensed in accordance with the regulations and by-laws and all other applicable laws of the appropriate governmental authorities of the state of registration at all times during the currency of the policy.

This warranty did not require any knowledge or control on the part of the insured. No causative connection between a breach of warranty and a loss had to exist before cover might be declined. In essence, warranty 2 required the Magnet crew to comply with the law. In order to decline indemnity Switzerland simply had to establish that the law had not been complied with.

Switzerland submitted that the practice of laying to constituted a breach of the Collision Regulations 1988.[2] Sections 287(2)(c) and (d) of the Shipping and Seamen Act 1952 make it compulsory that the vessel comply with these regulations. Rule 5 of the Regulations provides that:

> Every vessel shall at all times maintain a proper look-out by sight and hearing as well as by all available means appropriate in the prevailing circumstances and conditions so as to make a full appraisal of the situation and of the risk of collision.

There was no suggestion that *Magnet* had complied with Rule 5 of the Collision Regulations. The Judge held that *Magnet* was "under way" in terms of Rule 3 of the Regulations, and that there was no lookout kept. Accordingly, he found that there was a breach of the regulations and therefore a breach of warranty 2 of the policy. The claim for insurance failed on that ground alone.

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[2] See the Shipping (Distress Signals and Prevention of Collisions) Regulations 1988, SR No 19. The relevant rules are contained in the Schedule to the Regulations.

2. Implied warranty

Section 42 of the Marine Insurance Act provided an independent ground for declining indemnity. Section 42 was clearly applicable because there was a contract of marine insurance in terms of section 3 of the Act and the vessel was involved in a marine adventure in terms of section 4. Section 42 states: "There is an implied warranty that the adventure insured is a lawful one, and that, so far as the insured can control the matter, the adventure shall be carried out in a lawful manner."

Switzerland contended that the venture was:

(1) carried out in an unlawful manner, namely by laying to without watch; and
(2) within the control of Harbour Inn through Mr d'Esposito.

By being in breach of the Collision Regulations the adventure was clearly carried out in an unlawful manner in terms of section 42. Fisher J had already found that the practice of laying to was within the knowledge of Mr d'Esposito. Furthermore, he found that Mr d'Esposito was able to prevent the practice of laying to and that it was therefore a matter which was within the control of the insured. Fisher J concluded that the warranty implied by section 42 had also been breached and that this was an independent ground upon which Switzerland was entitled to decline indemnity.

B. False Statements in Support of Claim

A further independent defence and ground for declining indemnity was the allegation that Harbour Inn, through its managing director Mr d'Esposito, made false statements in support of the claim for indemnity. Initially, Mr d'Esposito admitted to Switzerland's representatives that he knew that *Magnet* laid to. He said that it was a common practice; that everyone does it. Later, Mr d'Esposito said to Switzerland's assessors and solicitors and to the Court that he did not know about the practice of laying to until after the grounding. He made this assertion in:

(1) oral statements to Switzerland's solicitors;
(2) a letter from Harbour Inn's solicitors to Switzerland's solicitors;
(3) a statutory declaration;
(4) evidence given in Court.

Having found that Mr d'Esposito had the relevant knowledge throughout, due to laying to being a widespread practice and one which was well-known throughout the fishing industry, Fisher J was "forced to the conclusion that on each of these occasions there was a deliberate falsehood on his part."[3]

[3] See p40 of the unreported judgment.

It is the duty of every insured to observe the utmost good faith in his or her dealings with insurers. The claim must be honestly made and if it is fraudulent the insured will forfeit all benefit under the policy whether there is a condition to that effect or not. Fisher J found a clear breach of good faith. This independently invalidated Harbour Inn's claim.

Harbour Inn's claim therefore failed on the following grounds:

(1) breach of express warranty;
(2) breach of implied warranty;
(3) false statements.

Switzerland's other defences of lack of due diligence and non-disclosure were unsuccessful.

C. Negligence or Lack of Due Diligence

Switzerland submitted that, by laying to, Harbour Inn was negligent or lacked due diligence and that this took the accident outside the insured perils. In other words, Switzerland relied on the due diligence exception in the Institute Clauses (Clause 6.2).

The Judge held that by laying to in the particular circumstances the master was negligent. Laying to would not always be negligent. It depended on the conditions. Fisher J held that there was want of due diligence by Harbour Inn in terms of Clause 6.2. However, on a proper interpretation of the Clauses, recovery under Clause 6.1.1 (general insurance against perils of the sea) was not precluded.

D. Non-Disclosure

Fisher J found that the allegation of non-disclosure was not made out by Switzerland. He stated that the practice of laying to was not a material circumstance, because neither the insured nor the insurer would have grounds for predicting that a qualified and experienced master would lay to in circumstances which involved an unacceptable degree of risk. The judge emphasised that the practice of laying to "is not necessarily and in all circumstances such that it would alarm the reasonable and prudent insurer."[4] It was, rather, a question of the particular circumstances in which it was done.

Fisher J also held that the practice was so notorious in the fishing industry and those associated with it that the prudent insurer ought to have known about it.

Finally, section 18(3)(d) of the Marine Insurance Act makes disclosure of this nature redundant in circumstances where the insured party undertakes an express or implied warranty to act in a way which will avoid the creation of the risk in any event.

Judgment was entered for Switzerland on all claims brought by Harbour Inn.

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[4] See p43 of the unreported judgment.