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The B Atlantic – Stephenson Harwood secures Supreme Court victory

The Court ruling drug smuggling is neither a war risk nor malicious

The Supreme Court's decision in Navigators Insurance Company Ltd and others v Atlasnavios – Navegacao Lda ("B Atlantic", [2018] UKSC 26) was handed down on 22 May 2018.

The case will be of interest to all insurers and their insureds as:

1 It concerns the correct interpretation of the standard war risks clauses and in particular whether the owner is covered for detentions and confiscations of the vessel where the loss arises from a detention by reason of the vessel being caught drug smuggling; and

2 The legal principles on, amongst other things, the correct interpretation of insurance contracts are of broad application. This includes confirmation of the principle that where **a** or **the** proximate cause of a loss is excluded, insurers shall not be liable.

The Supreme Court has held that there is no cover under the standard war risks policy for vessels used to smuggle drugs. Accordingly, insureds whose trading routes include higher risk jurisdictions should speak to their brokers about purchasing the specific additional cover that is available for this risk.

Key facts

On 13 August 2007 the vessel completed loading a cargo of coal in Lake Maracaibo, Venezuela, for discharge in Italy. An underwater inspection by divers discovered three bags of cocaine weighing 132 kilograms strapped to the vessel's hull in the vicinity of the rudder, 10 metres below the waterline. This concealment constituted a criminal offence contrary to Venezuelan law.

When exactly the drugs were attached to the vessel is unknown. There had been an inspection on 12 August 2007 when the divers noticed that an underwater grille on the hull was loose and that various objects not belonging to the vessel (a grappling hook, a saw, a rope and other tools) were inside the space behind the grille. The Master was told to have the grille rewelded because of the risk of drug smuggling. He declined to do so because the vessel was due to sail that night. But the vessel did not sail then because there had been a miscalculation of the vessel's draft and consequently a short loading, so that 800 m.t. of additional cargo was loaded. A second inspection was carried out the next day when the drugs were found. The vessel was detained and the crew was arrested.

The Master and Second Officer were charged with complicity with drug smuggling. On 31 October 2007 a Venezuelan judge sent them for trial and ordered the continued preventive detention of the vessel pursuant to Venezuelan law. The vessel remained in detention until, in August 2010, following a jury trial, the two officers were convicted and sentenced to 9 years' imprisonment. The court ordered the final confiscation of the vessel, which the owner had abandoned to the court in September 2009.

The owner presented a claim for the loss of the vessel to its war risk insurers.

Issues in dispute

The insurers declined cover, in reliance on the standard war risk exclusion for detentions arising by reason of infringement of customs regulations, it being well established by previous cases that the customs regulations exclusion applies to cases of drug smuggling.

At the first instance trial, the owner argued that the exclusion did not apply as (i) the detention and confiscation of the vessel was due to political interference in the judicial process in Venezuela rather than due to the infringement of customs regulations; and (ii) on a correct construction of policy the exclusion did not apply as the loss arose from the malicious acts of third parties, which was an insured risk.

Flaux J rejected the owner's allegations of political interference, but held that the loss was covered by the

policy. He decided that "*upon the correct construction of the policy and reading the malicious acts cover and the exclusions together, "infringement of customs regulations" in the exclusion does not include an "infringement" which is itself no more than the manifestation of the relevant act of third parties acting maliciously and the exclusion is subject to that limitation"*. The insurers appealed against Flaux J's finding on construction to the Court of Appeal.

The Court of Appeal's decision

Clarke LJ (with whom Sir Timothy Lloyd and Lord Justice Laws agreed) reversed the decision of Flaux J. The owner therefore applied for permission to appeal to the Supreme Court, which was granted by Lord Mance, Clarke and Toulson.

In March 2018, the matter was heard by Lords Mance, Sumption, Hughes, Hodge and Briggs.

The Supreme Court's decision

On 22 May 2018, the Supreme Court handed down its judgment dismissing owners' appeal. The decision was arrived at by Lord Mance, but with whom the other 4 Lords were in agreement.

Lord Mance arrived at the same result as the Court of Appeal, albeit by different reasoning. He ruled in insurers' favour on two grounds – (1) the planting of the drugs was not a 'malicious act' within the meaning of insuring clause 1.5, and (2) the customs regulation exclusion at 4.1.5 applies. Taking each in turn:

1 The Supreme Court held that although the smuggling was a wrongful act done intentionally without just cause or excuse, it was not 'malicious' within the meaning of insuring clause 1.5. In order to prove a 'malicious act', one needs to prove that the act was done with spite or ill will (a direct intention to cause harm) towards the vessel, the owner or any other property or person which could harm the vessel or owner. Drug smuggling is no such act as smugglers do not intend for a vessel to be detained or for any other property or persons to be lost or damaged. To the contrary, they intend that the drugs avoid detection, that the vessel, property and persons remain unharmed and therefore that the intended recipients get what they have paid for. In coming to this decision:

a The Court placed emphasis on the positioning of the phrase *"any persons acting maliciously"* as falling in between its companions – terrorists and persons acting from a political motive. From this Lord Mance concluded that *"What the drafters appear to have had in mind are persons [i.e. terrorists and those with a political agenda] whose actions are aimed at causing loss of or damage to the vessel, or, it may well be, to other property or persons as a by-product of which the vessel is lost or damaged."*

b The Court applied the Court of Appeal cases of *The Mandarin Star* (1968) and *The Salem* (1982) on the basis that they would have been in the minds of the drafters when drafting and issuing a fresh set of Institute War and Strikes Clauses back in 1983:

i In *The Mandarin Star*, Lord Denning MR concluded that 'maliciously' means *"spite, or ill will or the like".*

ii In *The Salem*, Lord Denning MR acknowledged Mustill J's first instance comments, where the claim for *"persons acting maliciously"* failed on the ground that, giving the words the meaning attributed to them in *The Mandarin Star*:

> *"The conspirators were not inspired by personal malice against Pontoil [the innocent charterers]. There may consistently with the decision in The Mandarin Star, be a right to recover where the is insured property is damaged by an act of wanton violence, the malice being directed... at the goods rather than their owner. But it is unnecessary to decide this here, for the cargo was not lost because the conspirators desired to harm either the goods or their owner…"*

c The Court did not apply the broader test set down by the House of Lords in *Allen v Flood* (1898) where the Court stated that 'malice' in its legal sense was *"a wrongful act done intentionally without just cause or excuse"*. The view of Lord Mance was that the tests established in *The Mandarin Star* and *The Salem* constituted a *"sounder basis for a proper understanding of the intention of the drafters of the 1983 Institute Clauses",*

especially given that the *Allen v Flood* test was imported from *"an entirely different area of the law [i.e. the tortious context]."*

d The Court reviewed the decisions of *The Grecia Express* (2002) and *The North Star* (2005), where Colman J appeared to indicate that recklessness as to harm (merely foreseeing the possibility of loss or damage to property or persons without the element of spite, ill-will or intention to harm) was sufficient to establish malicious conduct, and decided those cases were inapplicable for the following reasons:

i The submission being made before Colman J was that *"maliciousness"* required the owner to show that the sinking of the vessel was directed at them, rather than the result of casual or random vandalism.

ii When considering the submission, Colman J was not intending to do more than apply the tests in *The Mandarin Star* and *The Salem*. In other words, he was seeking to figure out whether 'malice', as defined in these cases, required proof that the person concerned intended to injure the assured or even knew the identity of the assured such as to cover random vandalism. In Colman's view, it did not require such proof. The traditional Court of Appeal tests for 'malice' were therefore interpreted to include ill-will directed towards persons or property which could harm the insured property or its owner. If Colman J was operating within the existing parameters of these traditional tests, it cannot have been his intention for the tests to be altered to include recklessness, despite various comments which could be interpreted as indicating otherwise.

iii In any event, *The Grecia Express* and *The North Star* can be distinguished from the *B Atlantic* as both concerned loss or damage which was due to either a deliberate attempt to write the ship off or vandalise property. This is different from the facts of the B Atlantic, where the question that arises is of whether 'any persons acting maliciously' includes a criminal act which has quite a different intention to vandalism, but which might, however foreseeably, lead to seizure and detention of the vessel by public authorities. This question was not required to be addressed by Colman J and therefore his comments cannot be considered authoritative on the point.

iv Colman J's references to the concept of 'malice' in the criminal law context of the Malicious Damage Act 1861 (many of the sections of which were superseded by the Criminal Damage Act 1971 and from which he took the concept of recklessness) can be discounted given the *"negligible chance that either of the Acts were in the minds of the drafters of the Institute Clauses in 1983"* and that the old criminal law definition of 'malice' *"was developed in a context and for a purpose very different from those applying the Institute War and Strikes Clauses."*

2 The Supreme Court held that, however you look at it, exclusion 4.1.5 applies to insuring clause 1.5. In arriving at this conclusion the Court made the following findings:

a Generally speaking, 4.1.5 is capable of applying to 1.5, as (i) it would be surprising if by making a claim on the basis of a malicious act under 1.5 an insured could improve the position that would apply if it invoked 1.2 (seizure, arrest, detainment etc.) or 1.6 (confiscation etc.), and (ii) owners must, by relying on clause 3 to establish a constructive total loss, accept that the vessel has been lost as a result of seizure, arrest, restraint or detainment, which is exactly the subject matter of 4.1.5.

b There was no apparent basis for Flaux J to imply a limitation on 4.1.5 as none of the criteria for implication of an implied term can be satisfied (i.e. it is necessary for business efficacy or alternatively be so obvious as to go without saying - *Marks and Spencer Plc v BNP Paribas Securities (2015)*) and it is *"entirely understandable that clause 4.1.5 should cut back or define the limits of cover otherwise available under clause 1."*

c There is no basis, neither as a matter of construction or causation, for not applying 4.1.5 to the present loss. The owner's submission that the malicious act, rather than the infringement of customs regulations, fell to be regarded as the proximate cause of the loss, faces a number of problems:

i The is no distinction between the malicious act and the customs infringement meaning that, if the role of 4.1.5 is to cut back on loss caused by the insured perils, then 4.1.5 must cut carve out from 1.5 situations where the malicious act and the customs infringement are one and the same.

ii Even if a distinction exists, this does not mean a binary choice needs to be made between two competing proximate causes of the loss – *"What is required is an exercise of construction of the particular wording, giving effect at each stage to the natural meaning of the words in their context"*. This exercise falls into three stages – (a) was the loss caused by a malicious act under 1.5? Yes (if we operate on the premise that drug smuggling is 'malicious'), (b) was the means by which the loss arose the vessel's continuous detainment for six months under clause 3? Yes, (c) was such detainment by reason of a customs infringement within 4.1.5? Yes.

iii Although the general aim in insurance law is to find a single proximate cause, the correct analysis in some cases is that there are two concurrent causes. This applies in the present case where the drug smuggling was only one element in the causative chain leading to the loss; *"detection, detainment and its continuation for a period of at least six continuous months [being]… equally essential contributing causes of any loss"*. There are of course cases where one peril will dominate and exclude from relevance a later development which taken by itself might engage an exception. Scenarios such as those hypothesised by Flaux J (i.e. where a malicious third party plants drugs in order to blackmail the owners and when they refuse to pay informs the authorities about the drugs leading to the vessel's seizure, or the malicious third party simply plants the drugs and informs the authorities in order to get the vessel detained) can be seen as such examples. However, these are not the facts of this case.

iv The subsequent authority of *P Samuel & Co v Dumas (1924)* and Wayne Tank (1974) confirms Lord Blackburn's conclusion in *Cory v Burr (1883)* that *"where an insured loss arises from the combination of two causes, one insured, the other excluded, the exclusion prevents recovery".* In this case, the two potential causes were the malicious act and the seizure and detainment (which arose from the excluded peril of customs' infringements). The malicious act would not have caused the loss without the seizure and detainment – *"it was the combination of the two that was fatal".*

v Owners' construction would be significantly destructive to the ambit of clause 4.1.5 – (a) 4.1.5 does not need to cater for smuggling by owners themselves, and (b) crew barratry is excluded by clause 4.2 as it is covered by clause 6.2.5 of Institute Time Clauses Hulls. There may be scenarios in which 4.1.5 may still bite even if it fails to apply to third party smuggling – innocent importation/exportation of prohibited goods or breaches of customs regulations not involving smuggling – however, there is nothing to suggest anyone contemplated such a narrow confine to its operation. There may also be scenarios which are not caught by 4.1.5 – purely domestic smuggling within a country – but these too provide no reason for not giving 4.1.5 its ordinary meaning in the commonplace scenarios the drafters were addressing.

Comment

The Supreme Court's decision provides confirmation that the smuggling of drugs or contraband is not a war risk. If insureds would like cover for detentions due to third parties using their vessels to smuggle, they should discuss this with their insurance brokers and purchase the specialist cover that is available.

The Supreme Court decision also lays down principles that are of broad application:

A The test for what can be considered 'malicious' will vary depending on the context. In the context of war risks insurance policies 'malice' has to involve spite, ill-will or the like which is directed towards property or persons. It remains an open issue whether the Courts will apply a similar definition of "malice" in the non-marine insurance context and in commercial contracts more generally.

B Insurance law will always look to find a sole proximate cause, but in some cases there will be two concurrent proximate causes (i.e. two causes of equal causative potency).

C The principle established by *Cory v Burr* and confirmed in *Wayne Tank* that – where a or the proximate cause of an insured loss is excluded, insurers will not be liable – remains good law.

D When interpreting contracts incorporating standard clauses, the Courts should apply a 'textual' approach. This means that (a) they should look at *"the particular wording, giving effect at each stage to the natural meaning of the words in their context"*, and (b) when considering context the Courts will not only give weight to the intention of the parties at the time they entered into the policy, but when construing standard clauses, the minds of the drafters (which will be informed by the resources and authorities to which they would have had access) at the time the standard clauses were prepared.

E The Courts should not imply additional language into the express language of insurance policies, such as qualifications to exclusion clauses, unless the legal criteria for doing so (i.e. business efficacy or obviousness) have been satisfied.

Stephenson Harwood LLP's marine insurance group acted for the insurers; the team was led by Simon Moore, who was assisted by Paul Hofmeyr and Jide Adesokan. Clyde & Co, Ross & Co and W Legal acted for the owner.

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