NOVA SCOTIA COURT OF APPEAL

Citation: Liberty International Canada v. Secunda Marine Services Ltd., 2006 NSCA 82

Date: 20060630
Docket: CA 251895
Registry: Halifax

Between:

Liberty Mutual Insurance Company, c.o.b. under the name Liberty International Canada, Royal & Sun Alliance Insurance Company of Canada and Reliance Insurance Company

Appellants

v.

Secunda Marine Services Limited

Respondent

Judge(s):	Roscoe, Saunders, Fichaud, JJ.A.
Appeal Heard:	April 3, 2006, in Halifax, Nova Scotia
Held:	Appeal is dismissed with costs awarded to the respondent on appeal per reasons for judgment of Saunders, J.A.; Roscoe and Fichaud, JJ.A. concurring.
Counsel:	Rui M. Fernandes and Demetrios Yiokaris, for the appellants Wyllie Spicer, Q.C. and Jane O'Neill, for the respondent

Reasons for judgment:

[1] While towing a barge from P.E.I. to Newfoundland a vessel lost its propeller and tail shaft as it entered Stephenville harbour. The cost of salvage and repairs was close to $700,000.00.

[2] The ship's insurers refused to indemnify the vessel's owners for the loss, claiming that a want of due diligence caused the tail shaft to break.

[3] This appeal addresses two primary issues. First, who has the burden of proving that such a loss did, or did not result from want of due diligence? Second, did this loss occur as a result of want of due diligence?

[4] For the reasons that follow, I would dismiss the appeal. In my respectful opinion the trial judge was correct in placing the burden of establishing a want of due diligence upon the appellant insurers. Further, his conclusion that this loss did not result from any lack of diligence on the part of the vessel's owners should not be disturbed.

[5] I will begin my analysis with a brief overview of the material facts surrounding this litigation.

Background to the Case

[6] The appellants are a group of insurers. They appeal from the decision and order of Nova Scotia Supreme Court Justice Douglas L. MacLellan who, after a three-day trial, held that the appellants were required to indemnify the respondent, Secunda Marine Services Limited (Secunda) under a policy of marine insurance for losses incurred as a result of damage to the tug, CHEBUCTO SEA (the vessel).

[7] Secunda owns and charters ships, and carries on ancillary sea-faring operations around the world. It owns the vessel and is the named insured under the policy.

[8] The vessel is a tug that was built in Canada in 1957. Secunda purchased the vessel from the government of Canada in November 1994. Before buying the tug,

Secunda's Superintendent, Mr. Jens Trygstad, a marine engineer with fifty years of experience, inspected the vessel and recommended that Secunda buy it.

[9] The vessel's tail shaft was approximately fifteen feet long. It had a continuous liner made of brass that was shrunk fit over the steel shaft to protect it from corrosion. The area of the shaft to which the propeller was attached was covered by an outer rope guard to protect against ropes and other debris getting tangled in the shaft. The continuous liner stopped approximately four inches from the flange, leaving that four-inch section of the tail shaft uncovered. This is a common design. There was evidence that it would be unusual for this four-inch portion of the shaft to be coated.

[10] After Secunda purchased the vessel, it registered the tug for commercial service in Canada. To do so, Secunda had to comply with all Transport Canada inspections and regulations.

[11] In accordance with such regulations, the vessel was dry docked and a periodic special inspection was performed in March 1995 at which time the tail shaft was removed and inspected. Mr. Peter Johnson, a marine surveyor at Transport Canada, examined the tail shaft. A dye penetrant test, which is a non-destructive examination used to detect cracks, was carried out on the tail shaft after the shaft was cleaned with a solvent and emery cloth. No cracks were discovered. The shaft was approved with directions that it did not have to be pulled for inspection again until March, 2000.

[12] The vessel was due for a periodic general inspection twice every five years. A general inspection entails dry docking but does not require that the tail shaft be pulled for full inspection.

[13] On June 8, 1996, the vessel was placed on bareboat charter for use on the St. Lawrence River. During the summer, Secunda learned that the vessel had grounded. Secunda ordered the vessel be dry docked so that its condition could be ascertained.

[14] As a result, in August 1996, the vessel was dry docked at a shipyard in Quebec. The Salvage Association, representing the appellant insurers, a representative from Secunda, a representative from the charterer, and a

representative from Transport Canada, participated in the vessel's inspection. The Salvage Association found that four blades on the propeller were damaged. These were repaired. Mr. Trygstad, who was responsible for the vessel, inspected the tail shaft by looking through the rope guard with a strong light. He did not see any damage. The Salvage Association did not recommend that the tail shaft be pulled for inspection, nor did any of the other representatives in attendance make such a request.

[15] In October 1996, Secunda arranged for an off-hire survey of the vessel in the form of an underwater inspection. Divers noted some nicks and scratches on the propeller blades. However, the evidence indicated that these are common occurrences. Nothing about the tug's condition caused Secunda any concern.

[16] On March 31, 1998, Transport Canada ruled that the inspection conducted during the dry docking in August 1996 satisfied the regulatory requirements of a periodic general inspection. As a result, the next periodic general inspection was scheduled for September 1999.

[17] On May 11, 1998, the vessel was placed on bareboat charter under a twenty-four month contract in PEI.

[18] Effective May 27, 1999, the appellants agreed to insure the vessel under an Institute Time Policy (Hulls). I will refer to certain provisions of the policy later in these reasons. At this point, it is enough to note that the policy purported to cover "breakage of shafts" provided that such did not arise as a result of any lack of due diligence on the part of the insured.

[19] On May 28, 1999 while under charter to John E. Canning Ltd. - one day after the insurance policy came into effect - having towed a barge from PEI to Newfoundland and while entering Stephenville Harbour with the barge in tow, the vessel lost pitch control to the propeller. The anchor was immediately dropped. The next day divers were sent below to find out what had gone wrong. They discovered that the tail shaft had broken off at the flange, resulting in a loss of the propeller.

[20] At the request of the Salvage Association representing the appellant insurers, the tail shaft was cut away and subjected to metallurgical examination. It

was established that the tail shaft failed as a result of corrosion fatigue cracking which caused a brittle fracture. Marine adjustors pegged the loss at $699,135.80. Quantum of damages was conceded by the appellants but they refused to indemnify Secunda under the policy. Relying upon the opinion of their own marine expert, Mr. Avijit Roy, the appellants argued at trial that certain actions and omissions on the part of the respondent constituted a want of due diligence and that this want of due diligence caused the shaft to break. This, in the appellants' submission, avoided any responsibility to indemnify the ship's owners for their loss.

[21] MacLellan, J. rejected the insurers' submissions. He found that Secunda exercised due diligence, complied with all statutory requirements, and used reasonable care in maintaining its vessel. He allowed Secunda's action for breach of contract against the appellant insurers in the full amount of $699,135.80, with liability for such damages to be apportioned among the various insurers in accordance with their obligations under contract. Justice MacLellan also awarded Secunda its costs of $25,349.07, together with reasonable disbursements, and pre-judgment interest of $120,673.65.

[22] It is from that order that the appellants now appeal. They ask that the judgment at trial be reversed in its entirety; that Secunda's action against the appellants be dismissed; that Secunda return all monies paid to it by the appellants in satisfaction of the judgment; and that the appellants be awarded their costs both at trial and on appeal.

[23] I will now set out the principal arguments advanced by the appellants and the issues that must be considered in our review.

Issues

[24] The constellation of grounds, issues and arguments raised by the appellants may be boiled down to three principal questions. They are:

(i) What is the proper standard of review in the case on appeal?

(ii) When interpreting this policy of marine insurance, who has the burden of proving that the loss or damage was, or was not the result of a want of due diligence?

(iii) Did the trial judge err in finding that Secunda exercised due diligence in the maintenance of its vessel, such that the appellants were liable under the terms of the policy to indemnify the owners for the full amount of their loss?

Analysis

(i) What is the proper standard of review in the case on appeal?

[25] As this Court observed in **McPhee v. Gwynne-Timothy**, 2005 NSCA 80 at ¶ 31 - 33:

> [31] A trial judge's findings of fact are not to be disturbed unless it can be shown that they are the result of some palpable and overriding error. The standard of review applicable to inferences drawn from fact is no less and no different than the standard applied to the trial judge's findings of fact. Again, such inferences are immutable unless shown to be the result of palpable and overriding error. If there is no such error in establishing the facts upon which the trial judge relies in drawing the inference, then it is only when palpable and overriding error can be shown in the inference drawing process itself that an appellate court is entitled to intervene. Thus, we are to apply the same standard of review in assessing Justice Richard's findings of fact, and the inferences he drew from those facts. **H. L. v. Canada (Attorney General),** [2005] S.C.J. No. 24; **Housen v. Nikolaisen**, [2002] 2 S.C.R. 235; **Campbell MacIsaac v. Deveaux & Lombard**, 2004 NSCA 87.
>
> [32] An error is said to be palpable if it is clear or obvious. An error is overriding if, in the context of the whole case, it is so serious as to be determinative when assessing the balance of probabilities with respect to that particular factual issue. Thus, invoking the "palpable and overriding error" standard recognizes that a high degree of deference is paid on appeal to findings of fact at trial. See, for example, **Housen**, supra, at ¶ 1-5 and **Delgamuukw v. British Columbia**, [1997] 3 S.C.R. 1010 at ¶ 78 and 80. Not every misapprehension of the evidence or every error of fact by the trial judge will justify appellate intervention. The error must not only be plainly seen, but "overriding and determinative."

> [33] On questions of law the trial judge must be right. The standard of review is one of correctness. There may be questions of mixed fact and law. Matters of mixed fact and law are said to fall along a "spectrum of particularity." Such matters typically involve applying a legal standard to a set of facts. Mixed questions of fact and law should be reviewed according to the palpable and overriding error standard unless the alleged error can be traced to an error of law which may be isolated from the mixed question of law and fact. Where that result obtains, the extricated legal principle will attract a correctness standard. Where, on the other hand, the legal principle in issue is not readily extricable, then the issue of mixed law and fact is reviewable on the standard of palpable and overriding error. See **Housen**, supra, generally at ¶ 19-28; **Campbell MacIsaac**, supra, at ¶ 40; **Davison v. Nova Scotia Government Employees Union**, 2005 NSCA 51.

[26] These same principles will be applied in my consideration of the questions that arise in this case. As noted earlier, the trial judge was faced with two principal inquiries: first, where lies the burden; and second, was a want of due diligence established on the evidence and shown to have resulted in the damages claimed? Different standards of review apply to each of these questions as I will now explain.

[27] While Justice MacLellan did not explicitly address the "burden of proof" in his decision, this "omission" is easily explained, and is not critical to my overall assessment of his judgment. The transcript of the exchanges between counsel and the trial judge during their opening and final submissions make it clear that <u>both</u> parties were content to have the case decided on its merits without having to decide which side bore the onus of proof. In other words, each side was so confident that the evidence supported its respective position and so displaced the burden - wherever it lay - that the claim ought to be decided on the merits without first disposing of the nice legal question concerning onus of proof. Shortly after the case was called we see this:

> THE COURT
>
> > Now, gentlemen, have we established the rules in regard to the burden about due diligence and whatever, or where are we at on that?

MR. SPICER

We haven't established the rules.

THE COURT

Mr. Fernandes has not addressed it in his pre-trial. I didn't think it was an issue for him. It appears to be an issue for you, Mr. Spicer.

. . .

MR. FERNANDES

... And so my position is My Friend has to present his case. There's a sub issue in this in that what does My Friend have to meet is that onus of due diligence on the insured or the insurer. That issue, I think, can be dealt with in argument. My Friend's going to present his evidence. What I said to you last Friday was he's going to present his witnesses, I'm going to present my witnesses. I don't think it's a real issue, at the end of the day, because —

THE COURT

Mr. Spicer. I guess – and I'll just put on the record I guess I discussed with both of you on the pre-trial that since it, in effect, was being raised as a defence that it seemed to me that the Plaintiff could deal with it in your evidence in chief as opposed to coming back on rebuttal and doing it.

MR. SPICER

Yes. And having thought about that, I think that that's satisfactory, subject to Your Lordship at the end of the day deciding who had the onus and who – whether they proved it or not.

[28] During the course of their final submissions we see this exchange:

MR. SPICER - SUBMISSIONS

Thank you, My Lord. I'll deal at some point in this argument with the obligation or the onus of due diligence. I'm going to submit to you, though, however, <u>that the case is so strong that there really is no need for</u>

> you to decide that it should – in other words, that the efforts and practices of the ship owner are such that deciding the onus question, although interesting, is perhaps not necessary. . . .
>
> ... is really a reiteration of what I have been submitting to Your Lordship that this provision has generally been treated by the cases and the authorities as an exception and, therefore, the onus rests on the insurer. .... And nothing really has changed, and the onus is on the insurer. So if you are needful of making a decision with respect to the onus, I would submit to you that the onus rests upon the insurer. ...

MR. FERNANDES - REPLY

> Just a couple of things, My Lord. I was always taught that if the facts are not on your side, argue the law. If the law's not on your side, argue the facts. I can, in this case, argue both because they're both on my side. Mr. Spicer thinks he has a strong case. I think I have a strong case. I agree, you don't even need to go on to the onus issue, if that is a quagmire, because I believe the underwriters have established due diligence has not been exercised. Sorry. I believe the underwriters have demonstrated the owners have not exercised due diligence. ... (underlining mine)

[29] From all of this, and a careful reading of the trial judge's decision, it appears to me that he accepted counsels' parallel submissions that it would not be necessary for him to decide the question of which party faced the onus of proof. In any event he was satisfied on the evidence that a want of due diligence on the part of the respondent did not result in the subject loss.

(ii) When interpreting this policy of marine insurance, who has the burden of proving that the loss or damage was, or was not the result of a want of due diligence?

[30] In view of the fact that this question has now been raised as a specific ground of appeal, I will dispose of it in these reasons for judgment. Included as their first ground of appeal the appellants say:

> 1. the Judge erred in law in failing to consider and in not finding that the want of due diligence provision in the liner negligence clause is upon the Plaintiff, John E. Canning and any other Assured(s) Owner(s) or Manager(s);

There is no dispute between the parties that the issue of which side has the burden of proving want of due diligence is a question of law, and one that this court is empowered to decide. It requires a review of the provisions of the insuring contract, rules of construction, and the leading jurisprudence where such provisions have been addressed. While obviously the standard that applies to such an analysis is one of correctness, I am not - for the reasons already provided - engaged in any judicial review of Justice MacLellan's response to the question, as he determined that he was not obliged to answer it.

[31] The Policy is an Institute Time Clauses Hulls 1/11/95 Policy. This is a standard policy. The one at issue in the present case has been modified. The clause particularly impugned in the present case is the Liner Negligence Clause. The standard policy contains what is known as an Inchmaree Clause. However, for an additional premium paid to the appellants in this case, the Inchmaree Clause was deleted and the Liner Negligence Clause was inserted to provide broader coverage. It is useful to view both clauses together:

I) Inchmaree Clause

6.2 This insurance also covers loss of or damage to the subject-matter insured caused by

6.2.1 accidents in loading discharging or shifting cargo or fuel

6.2.2 bursting of boilers breakage of shafts or any latent defect in the machinery or hull

6.2.3 negligence of Master Officers Crew or Pilots

6.2.4 negligence of repairers or charterers provided such repairers or charterers are not an Assured hereunder

6.2.5 barratry of Master Officers or Crew

provided such loss or damage has not resulted from want of due diligence by the Assured, Owners or Managers.

6.3 Master Officers Crew or Pilots not to be considered Owners within the meaning of this Clause 6 should they hold shares in the Vessel.

As noted, the subject policy contained the following replacement clause, known as the Liner Negligence Clause:

> In consideration of additional premium of included (*sic*), it is understood and agreed that the ADDITIONAL PERILS (INCHMAREE) Clause of the attached policy is deleted and in place thereof the following inserted:
>
> Subject to the conditions of this Policy, this insurance also covers:
>
> a. Breakdown of motor generators or other electrical machinery and electrical connections thereto; bursting of boilers; breakage of shafts; or any latent defect in the machinery or hull;
>
> b. Loss of damage to the subject matter insured directly caused by:
>
> 1. Accidents on shipboard or elsewhere, other than breakdown of or accidents to nuclear installations or reactors on board the Insured Vessel;
>
> 2. Negligence, error or judgment or incompetence of any person;
>
> excluding under both "a" and "b" above only the cost of repairing, replacing or renewing any part condemned solely as a result of a latent defect, wear and tear, gradual deterioration or fault or error in design or construction;
>
> provided such loss or damage (either as described in said "a" or "b" or both) has not resulted from want of due diligence by the Assured (s), the Owner(s) or Manager(s) of the vessel, or any of them. Masters, mates, engineers, pilots or crew not to be considered as part owners within the meaning of this clause should they hold shares in the Vessel.
>
> (underlining mine)

[32] When considering the terms of the policy, the appellants say that this particular clause is not an exclusion to the policy, but rather all part of the grant of coverage. Accordingly - to bring themselves within the policy's protection - the

appellants say that Secunda has the onus of establishing that each of its operators, including its charterer, John E. Canning Ltd. (Canning), exercised due diligence. In the alternative, the appellants say that if they bear the burden of establishing a want of due diligence on the part of Secunda, that the evidence in this case "was so overwhelming" as to satisfy any trier of fact of a lack of due diligence on the part of the respondent as well as its charter operator, Canning.

[33] The Inchmaree clause became part of standard hull and machinery policies as a result of a decision of the House of Lords in 1887 involving a vessel called the *Inchmaree*: **Thames and Mersey Marine Insurance Co. v. Hamilton, Fraser & Co.**, [1886-1890] All E.R. 241 (H.L.). In **Thames**, the House of Lords excluded coverage for damage to a vessel that had been caused by the malfunction of a valve which failed to close because it was not considered a peril of the sea.

[34] **Strathy and Moore, *The Law and Practice of Marine Insurance in Canada*** (2003), explain the history and purpose of the Inchmaree clause at pp. 117-119:

> Section 53(2)(d) of the *C.M.I.A.* excludes liability for "any loss or damage to machinery not proximately caused by maritime perils", unless the policy otherwise provides. Hull and machinery policies invariably contain a clause known as the "*Inchmaree* clause", that does "otherwise provide".
>
> ...
>
> The intent of the clause is that underwriters agree to insure the ship and its machinery against the consequences of certain types of "accidental" damage, including damage caused by operational negligence of shipboard employees, provided that it is not attributable to the failure of the owner to act responsibly in the upkeep of the ships or the training of the crew.

[35] The Liner Negligence clause is an extension of the Inchmaree clause and provides additional coverage. Francis Tétreault in ***The Hull Policy: The "Inchmaree" Clause*** (1967) 56 Tul. L. Rev. 325 describes the Liner Negligence clause at p. 334:

> The most far-reaching single "amendment" to the Inchmaree Clause is the so-called Liner Negligence Clause, which, for an additional premium, deletes the

> Inchmaree Clause from the policy and substitutes more generally inclusive language for the cumbersome enumeration which the clause has developed.

[36] ***Templeton on Marine Insurance*** at pp. 159-60 compares the Liner Negligence clause to the Inchmaree clause and concludes that it covers all accidental damage:

> Occasionally, in respect of well maintained liners, but not usually in respect of tramp vessels, underwriters may be prepared to grant a wider form of cover by attaching to the policy, in addition to the basic Institute Time Clauses - Hulls, a further set of clauses, the Institute Additional Perils Clauses - Hulls which read as follows:
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> ...
>
> It will be noticed that the matters covered [by the clause] are enumerated in distinct categories.
>
> The first category (Clause I .I .I.) covers the cost of repairing or replacing any boiler which bursts or shaft which breaks, with no words being used such as 'directly caused by', 'caused through', or 'through' as were contained in the Inchmaree Clause on which the decision was made in the *Jalavijaya* case. The Institute Additional Perils Clause thus covers the bursting of boilers and/or the breakage of shafts *simplicitor*, subject only to the proviso that there has been no want of due diligence by the owners or managers. It is, therefore, clearly the intention to assume liability for the cost of renewal of the boiler or shaft itself, in the event of the bursting of a boiler or breakage of a shaft, even when arising without the operation of one of the other named perils. Moreover, if a boiler bursts or a shaft breaks in consequence of a latent defect in the boiler or shaft then the cost of renewal or repairs is recoverable, including the cost of renewing the defective part itself.
>
> (underlining mine)

[37] From these authorities I conclude that the Liner Negligence clause covers the breakage of shafts, whatever the cause; and also covers all damage to the vessel caused by accidents. The effect is that this provision is essentially an "all risks clause". The exclusion to coverage under the Liner Negligence clause is only for want of due diligence by the insured and/or the manager of the vessel.

[38] It is well established that once an insured makes out a *prima facie* case of coverage under an insurance policy, the burden then shifts to the insurers to prove coverage may be denied because the loss was caused by an exclusion. See, for example, **Continental Insurance Co. v. Dalton Cartage Co.**, [1982] 1 S.C.R. 164. In order to rely upon the exclusion and escape having to indemnify the ship's owners under the policy, I am satisfied that the appellants must bear the burden of proving a want of due diligence on the part of the owner, master or manager of the vessel. In this case the shaft broke. It is *prima facie* covered under the Liner Negligence clause. The burden then fell to the appellants to prove that the fracture at the tail shaft and the loss of the propeller was caused by Secunda's want of due diligence.

[39] Such an interpretation of these contractual provisions finds strong support in the current case law.

[40] Of all the jurisprudence and academic commentary drawn to our attention by counsel, the clear weight of authority confirms the view that because "want of due diligence" is an affirmative defence brought forward by insurers who would be liable to pay but for the exclusion for losses caused by a lack of such diligence, the burden is on the insurer to bring itself within the exclusion.**Strathy and Moore, *The Law and Practice of Marine Insurance in Canada* , *supra***, state at p. 121:

> Unlike in the case of carriage of goods by water, however, the shipowner [under an Inchmaree clause] has no burden of proving the exercise of due diligence. The legal burden or *onus* will be on the underwriters to establish lack of due diligence.
>
> (underlining mine)

[41] The authors cite as authority **Hatfield v. Canada**, [1984] F.C.J. No. 123 (T.D.) (aff'd [1984] F.C.J. No. 802 (C.A.)). In that case, a vessel had been swamped by water and abandoned by the crew. The insurers denied coverage and argued that if the hatches had had sufficient openings, water that came aboard could have entered the bilges and the vessel would not have been damaged. Collier, J. specifically addressed the burden of proof and stated at p. 4:

> The onus, in this case, is on the defendant, to prove, on the part of the insured owner, want of due diligence.

> But I am not satisfied, the defendant has, on a balance of probabilities, shown that the plaintiff's practice was a bad one. Nor am I satisfied it amounted to want of due diligence.
>
> An open hatch may, or may not, have averted this casualty. As I have earlier said, defence testimony to that effect is speculation. It is not, to my mind, proof to a balance of probabilities, more likely than not.

[42] Other commentators have also taken the position that the burden of proving a lack of due diligence rests with the insurer. Leslie J. Buglass, ***Marine Insurance and General Average in the United States: An Average Adjuster's Viewpoint***, 3rd ed. (Centreville, Md: Cornell Maritime Press, 1991) at pp. 149 and 151 explains:

> The Inchmaree clause concludes with a general proviso reading as follows:
>
> > Provided such loss or damage has not resulted from want of due diligence by the Assured, the Owners or Managers of the Vessel, or any of them. Masters, Offices, Crew or Pilots are not to be considered Owners within the meaning of this clause should they hold shares in the Vessel.
>
> In this context the exercise of due diligence by the owners or managers refers to the provision of a seaworthy vessel, it not being the intention on the part of the underwriters to respond for the renewal of defective parts. However, the term "due diligence" is not to be construed as being the equivalent of the duty to exercise due diligence imposed on a carrier under a contract of affreightment governed by the Carriage of Goods by Sea Act. While the courts have usually interpreted very strictly this requirement in affreightment cases, the shipowner is in a better position when the meaning of due diligence is being considered in the context of the Inchmaree clause. <u>For one thing in considering this aspect of the clause, the burden of proof of lack of due diligence is on the underwriter if he wishes to defeat coverage on that score</u>. He must also prove that the assured's lack of due diligence occurred at the managerial level.
>
> ...
>
> The due diligence requirement is included in the Inchmaree clause to protect insurers in those cases where the vessel has been flagrantly mismanaged to such an extent as to render the vessel grossly unseaworthy and thereby result in a claim for loss or damage under the Inchmaree clause. <u>Generally speaking, courts are</u>

> reluctant to deprive an assured of coverage under a policy of insurance unless the facts indicating such a course are irrefutable. Consequently, underwriters seldom rely on this aspect of the clause as a defence to a claim.
>
> (underlining mine)

[43] The jurisprudence from the United States is replete with examples that the burden of proving a lack of due diligence lies with the underwriter. In **St. Paul Fire & Marine Ins. Co. v. SSA Gulf Terminals, Inc.**, 2002 US Dist. LEXIS 19138, a structure used for the processing of rice and grain sank in the Mississippi River in calm, clear weather, without having been struck by any other vessel. The insurance policy contained a Liner Negligence clause. The insured brought a motion for summary judgment under the Inchmaree clause. The court concluded that the insurer had the burden of proving that the loss was excluded for want of due diligence. At p. 7 and 8, the court stated:

> In the present case, however, the all risks language is made part of the Inchmaree clause, and it contains broader language than a typical Inchmaree clause. The clause at issue in this case may favorably be compared to what is known in the marine insurance industry as a Liner Negligence Clause. This type of clause, the Fifth circuit has recognized, provides broader coverage than the typical Inchmaree clause ... The Fifth Circuit, quoting an admiralty commentator with approval has noted that "the Liner Negligence Clause is really a species of an all risks policy, under which the underwriter must 'prove that the cause of the loss was one which was excluded by the words of the policy.'" ... In the present case, the coverage provided is even broader than the typical Liner Negligence Language, in that it provides coverage not just for mere negligence but also losses caused by any nature except want of due diligence. Therefore, it follows that the underwriter in the present case should have the burden of proving the exclusion. St. Paul, therefore, has the burden to show that the sinking of the DELTA CONVEYOR was caused by a want of due diligence by SSA.
>
> ...
>
> In summary, SSA's motion for summary judgment is GRANTED and the Court holds that as a matter of law this policy is an "all risks" policy. The Court further holds that as a matter of law SSA has the burden of showing that a loss occurred during the term of the policy, while St. Paul has the burden of showing an actual exclusion to that coverage.
>
> (underlining mine)

See as well **United States Fire Ins. Co. v. Riverside Ventures, Inc.**, 1990 U.S. Dist. LEXIS 641; **Proprietors Ins. Co. v. Siegal**, 1982 Fla. App. Lexis 19487; **Walker v. Travelers Indm. Co.**, 1974 L.S. App. LEXIS 3880; and **Vertichio v. Ennia Gen. Ins. Co.**, 1983 V.I. LEXIS 48; and, **Employers Ins. v. Occidental Petroleum Corp**., 1992 U.S. App. LEXIS 32242.

[44] In my respectful view, the authorities relied upon by the appellants do not assist them here. Fifty years ago in the case of **Atlantic Freighting Co. Ltd. v. Provincial Insurance Co. Ltd.** (1956), 5 D.L.R. (2d) 164, Parker, J. of this province's Supreme Court considered an Inchmaree clause and opined that the burden lay with the plaintiff/shipowner to show that damage to the hull did not result from want of due diligence by the vessel's owners or manager. I am satisfied that this single case is now an anomaly, and in the annals of modern marine insurance, can no longer be cited as good law.

[45] The appellants also rely upon Arnould, ***The Law of Marine Insurance and Average*** (16th ed.), vol. II at ¶ 832:

> ... It is submitted that the burden of proving due diligence is on the assured, when the point is put in issue.

However, I note that in a **Supplement** to that text published in 1995, the authors appear to have abandoned their earlier position and now accept that the burden is upon the insurer to prove lack of due diligence. The authors state at Vol. III, p. 64, footnote 31:

> It is also submitted at para. 832, 16th edition, that the burden of proof in relation to the proviso rests on the assured. This proposition is attacked in O'May *Marine Insurance* (1993) p. 137. Whatever the strict position may be, it appears to be a generally accepted practice that Underwriters must prove lack of due diligence if they wish to base a defence on it under C1. 6.2.

[46] I think it also significant that the case first relied upon by Arnould, *supra* as authority for the assertion that the burden lay with the vessel's owner to prove that no want of due diligence caused the loss, was the decision of a single trial judge in **Coast Ferries Ltd. v. Century Ins. Co. of Canada (The Brentwood)**, 1973 Lloyd's Rep. 232. In that case there was passing reference by the trial judge that the owner had discharged "the onus". However, neither the British Columbia

Court of Appeal nor the Supreme Court of Canada made any reference to, or otherwise dealt with the question of who bore the legal burden with respect to due diligence. Further, the reference in the trial decision [1971] B.C.J. No. 150 does not support any general principle that the burden is upon the insured to prove due diligence. Rather, the comments by the trial judge arose in the context of an insured arguing that the vessel was unseaworthy and that the unseaworthiness arose due to the negligence of the vessel's own crew. It was in those circumstances that the trial judge held there was a burden on the insured to demonstrate its ignorance of the crew's negligence. Clearly, those comments have no application to the facts here.

[47] Finally, the appellants rely upon **Bjorkman v. British Aviation Ins.**, [1956] S.C.R. 363 for the proposition that the words "provided such" in the Liner Negligence clause serve to characterize the "want of due diligence" provision as being a "coverage provision", as opposed to an exclusion. With respect, this case is of no help to the appellants.

[48] In **Bjorkman**, *supra*, the impugned provision was a coverage clause because it was an exception to an exclusion clause. There, an action was commenced under an aviation personal accident insurance policy, on behalf of the beneficiary who was killed while flying at night. Under the policy, the insured warranted that all air navigation and airworthiness orders and requirements had been complied with, in every respect. The Department of Transportation had issued a certificate authorizing the plane to fly at night, but only for instructional purposes. This was not an instructional flight. In attempting to bring the beneficiary within the policy's coverage, the claimant had to show that he was an exception to the exclusion. As a matter of law, the burden lay with the beneficiary to show that he ought to be excepted from the (insurer's) exclusion. Those principles have nothing to do with this case.

[49] In summary, on this issue, the authorities relied upon by the appellants are not applicable, or are no longer good law. The weight of prevailing authority makes it clear that an insurer who relies upon the exclusion clause as an affirmative defence to avoid having to indemnify the insured, bears the burden of proving that the claimant's losses were the result of want of due diligence. Here, the onus lay with the appellants to show on a balance of probabilities that Secunda's damages were caused by its own lack of due diligence.

[50] At the hearing counsel for the appellants argued that the issue of what constitutes due diligence is a matter of mixed law and fact to which a standard of correctness applies. Counsel argued that the proper definition of "due diligence" is whether the "thing" insured has been "subjected to all known and customary tests" and whether the assured "used all of the proper, reasonable tests available to him" in maintaining it. With respect, I do not accept counsel's definition in the context of the marine insurance policy being considered in this case. The "all known" tests approach suggested by the appellants arises out of the latent defect cases, that is damage that could not be detected by "all known" tests. That is not what occurred here. Such an analysis has nothing to do with the due diligence requirements in the Liner Negligence clause of this policy. In my opinion MacLellan, J. correctly adopted the proper definition of "due diligence" from **Strathy and Moore,** *supra* at pp. 120-121:

> "Due diligence" is a legal term used in a variety of contexts, including marine insurance. It essentially means "reasonable care in the circumstances". In determining "due diligence", the court will consider all the surrounding circumstances, including those known or reasonably to be expected. In setting a standard of due diligence, the court will consider the practice of others involved in the same industry, although a court may find that the industry practice is itself negligent. In *Charles Goodfellow Lumber Sales Ltd. v. Verrault*, the Supreme Court of Canada considered the concept of "due diligence" in relation to the carriage of goods by water and adopted the following definition in *Maxine Footwear v. Canadian Government Merchant Marine Ltd.*:
>
> > "Due diligence" seems to be equivalent to reasonable diligence, having regard to the circumstances known, or fairly to be expected, and to the nature of the voyage, and the cargo being carried. It will suffice to satisfy the condition if such diligence has been exercised down to the sailing from the loading port. But the fitness of the ship at that time must be considered with reference to the cargo, and to the intended course of the voyage; and the burden is upon the shipowner to establish that there has been diligence to make her fit.
> >
> > While the Goodfellow was a case under the Carriage of Goods by Water Act, the test of "due diligence" under the Inchmaree clause is likely the same. Unlike the carriage of goods by water, however, the shipowner has no burden of proving the exercise of due diligence. The legal burden or onus will be on underwriters to establish a lack of due diligence.

This is the definition McLellan, J. applied to the factual findings he made on the evidence. He was right to do so.

[51] I will turn now to a consideration of the final principal question that arises on appeal.

(iii) Did the trial judge err in finding that Secunda exercised due diligence in the maintenance of its vessel, such that the appellants were liable under the terms of the policy to indemnify the owners for the full amount of their loss?

[52] In his reasons for judgment, the trial judge said:

> [58] The issue in this case is whether the plaintiff exercised due diligence in ensuring that the tail shaft of the Chebucto Sea was maintained properly prior to the shaft breaking.
>
> . . .
>
> [60] I conclude that the plaintiff did exercise due diligence. I conclude they (*sic*) complied with all statutory requirements and used reasonable care in the maintenance of their vessel. I reject the suggestion that in 1996 they were negligent when they did not have the tail shaft removed and re-tested.
>
> [61] There was no evidence that would lead them to require that. Mr. Trysgaard inspected the shaft and detected nothing which would make him suspect that the shaft or the rope guard should be removed for inspection. At that point they were only one year after the testing done in 1995. The testing done on the broken shaft indicated that the shaft was heavily corroded. That clearly was not the case in 1996. I accept Mr. Trysgaard's evidence that he did not see that type of corrosion when he visually inspected the shaft in 1996. There would be no reason for him not to investigate if he had concerns about the tail shaft at that point. The claim as being covered by the insurers of the Charterer and would result in no additional costs to the plaintiff.
>
> [62] I conclude based on the evidence from Peter Johnson that the practice in the shipping industry was to not have a coating on portions of a shaft which had a continuous liner and it was reasonable for the plaintiff to follow that practice.
>
> [63] I find in favour of the plaintiff on the major claim.

[53] In challenging this result, the appellants allege a variety of errors, all of which in my view are challenges to various factual determinations made by the trial judge.

[54] In assessing these complaints, it is important to recall the proper standard of review. In assessing the merits of Secunda's breach of contract claim against the appellants, Justice MacLellan was required to carefully review the evidence and make certain findings of fact. The standard for appellate review of such findings is one of "palpable and overriding error". The standard of review applicable to inferences drawn from fact is no less and no different than the standard applied to his findings of fact. Again, such inferences are immutable unless shown to be the result of palpable and overriding error. If there is no such error in establishing the facts upon which the trial judge relied in drawing the inference, then it is only when palpable and overriding error can be shown in the inference drawing process itself that an appellate court is entitled to intervene. Thus, we are to apply the same standard of review in assessing Justice MacLellan's findings of fact, and the inferences he drew from those facts: **Housen,** *supra*; **H.L. v. Canada (Attorney General)**, [2005] 1 S.C.R. 401, 2005 SCC 25; **McPhee v. Gwynne-Timothy,** *supra*; and **White v. E.B. F. Manufacturing Ltd.**, 2005 NSCA 167.

[55] An error is said to be palpable if it is clear or obvious. An error is overriding if, in the context of the whole case, it is so serious as to be determinative when assessing the balance of probabilities with respect to that particular factual issue. Thus, invoking the "palpable and overriding error" standard recognizes that a high degree of deference is paid on appeal to findings of fact at trial. See, for example, **Housen,** *supra*, at ¶ 1-5. Not every misapprehension of the evidence or every error of fact by the trial judge will justify appellate intervention. The error must not only be plainly seen, but be "overriding and determinative." **Delgamuukw v. British Columbia**, [1997] 3 S.C.R. 1010 at ¶78 and 80.

[56] After carefully reviewing the record and Justice MacLellan's decision, I am satisfied that he made no such error.

[57] The appellants argue that there was a want of due diligence on the part of the respondent because Secunda conducted a dye penetrant test on the exposed portion of the tail shaft, as opposed to administering a magnetic particle test, in

1995. There is no merit to that submission. Transport Canada Regulations provide that a dye penetrant test is an acceptable method of non-destructive testing for the purposes of certification. In this case, a dye penetrant test was ordered by Transport Canada. That was the test that was administered. Complying with Transport Canada Regulations hardly supports a claim of want of due diligence. Further, there was no evidence to suggest that conducting a magnetic particle test in 1995 would have shown any cracks. Dr. Cliff Thornley, P.Eng., the metallurgist who inspected the tail shaft after failure, concluded that it was impossible to date the cracks in the tail shaft that led to its failure, and further that if the shaft had been adequately cleaned at the time it was inspected in 1995, the cracks - if they existed - would have been detected using the dye penetrant test. The evidence was not contradicted that the shaft was thoroughly cleaned when the dye penetrant test was performed in 1995, and that it looked to be in very good condition. One can infer, on the basis of Dr. Thornley's analysis, that the cracks were not present at that time.

[58] Next, the appellants say that the trial judge erred in finding that Secunda ought to have protected the exposed portion of the tail shaft by use of anodes or with an epoxy, or other suitable coverings. Here the appellants suggest that if the exposed part of the tail shaft had been coated, the shaft would not have broken. However, there was evidence presented on which the trial judge could reasonably conclude that the respondent followed standard practice in maintaining the tail shaft. Mr. Trysgaard testified that the Canadian Coastguard regulations only require such a coating if the tail shaft had a non-continuous liner. He said the shaft of this vessel had a continuous liner and therefore the exposed part did not have to be coated. Interestingly, the appellants' own expert Mr. Roy agreed that the shaft of this vessel had in fact a continuous liner, but suggested that his interpretation of the regulations meant that there should be a coating for both a non-continuous or a continuous liner. Peter Johnson of Transport Canada testified that there was no regulation which required that this part of the shaft be coated, and that he would not recommend that coating be put on this particular type of shaft because it might actually cause weakness in the structure. In saying so, the appellants now complain that Mr. Johnson was not qualified, or exceeded the limits of his expertise, and that the trial judge erred in relying upon such evidence. I reject the appellants' submission. First, the testimony to which the appellants now object was elicited during their cross-examination of Mr. Johnson. Further, considering Mr. Johnson's experience in having inspected approximately 2,500 vessels, of

which as many as 75 had this particular type of tail shaft, it was certainly open to Justice MacLellan to accept his evidence and find, as he did, "that the practice in the shipping industry was to not have a coating on portions of a shaft which had a continuous liner and it was reasonable for the plaintiff to follow that practice."

[59] Dr. Thornley did not suggest that anything done or not done by the respondent, or those under its control, caused or could have prevented the loss. Further, the evidence established that when the ship was drydocked in 1996, Secunda actually added extra annodes to enhance cathodic protection.

[60] Next, the appellants say the trial judge erred in failing to assign blame to the respondent for not pulling the tail shaft and subjecting it to a non-destructive test when the vessel was drydocked in 1996. On this point, MacLellan, J. held at ¶ 60-61:

> 60 ... I conclude they complied with all statutory requirements and used reasonable care in the maintenance of their vessel. I reject the suggestion that in 1996 they were negligent when they did not have the tail shaft removed and re-tested.
>
> 61 There was no evidence that would lead them to require that. Mr. Trysgaard inspected the shaft and detected nothing which would make him suspect that the shaft or the rope guard should be removed for inspection. At that point they were only one year after the testing done in 1995. The testing done on the broken shaft indicated that the shaft was heavily corroded. That clearly was not the case in 1996. I accept Mr. Trysgaard's evidence that he did not see that type of corrosion when he visually inspected the shaft in 1996. There would be no reason for him not to investigate if he had concerns about the tail shaft at that point. The claim as being covered by the insurers of the Charterer and would result in no additional costs to the plaintiff.

There is no basis for challenging his findings.

[61] Further, the evidence before the trial judge was that the Salvage Association (SA) representing the appellants, together with a representative from the charterer, and a representative from Transport Canada, all participated in SA's drydock inspection of the vessel in 1996. Neither the SA nor any other officials in attendance recommended that the tail shaft be pulled for inspection.

[62] In light of this evidence, there is no merit to the appellants' assertion that Secunda failed to exercise due diligence by not pulling the shaft.

[63] The appellants complain that the trial judge failed to give proper, or any weight to the views of its expert, Mr. Avijit Roy. Mr. Roy is a marine surveyor and first class engineer who prepared a written appraisal and report regarding the circumstances and conditions that led to the subject loss. In his professional opinion the respondent failed to maintain the required protective measures to avoid corrosion to the tail shaft, which resulted in the shaft failure.

[64] MacLellan, J. rejected Mr. Roy's testimony and expert opinion. He used strong language in doing so. In his decision the trial judge explained in some detail his reasons for dismissing Mr. Roy's evidence including:

> [55] Based on the cross-examination of Mr. Roy, I conclude that his credibility has been seriously challenged and I reject totally his opinion about the cause of the breaking of the shaft. ... I think his report lacks balance and was designed to support the position of the party asking him and paying him for the report.
>
> ...
>
> [57] I am not prepared to give any weight to Mr. Roy's report.

[65] In his decision the trial judge carefully reviewed Mr. Roy's report and found that it contained a number of factual errors, overlooked key evidence, and was misleading and deceptive to readers. As I have already explained, great deference is owed to a trial judge's conclusion on matters of fact. Similar deference is accorded a trial judge's findings on credibility, including the assessment of the credibility of expert witnesses. See for example **N.V. Bocimar S.A. v. Century Insurance Co. of Canada,** [1987] 1 S.C.R. 1247; **Watt v. Thomas**, [1947] 1 All E.R. 582; and **Sunrise Co. v. Lake Winnipeg (The)**, [1988] F.C.J. No. 918 (C.A.).

[66] The appellants have failed to satisfy me that the trial judge's rejection of Mr. Roy's evidence and expert opinion is reflective of palpable and overriding error. This ground of appeal must be dismissed.

[67] There is no merit to the appellants' argument that the trial judge erred in refusing to draw an adverse inference against the respondent for its "failure" to provide full documentation. MacLellan, J. considered and accepted Secunda's explanation regarding its missing documents, and declined to draw an adverse inference against the respondent in those circumstances. Such a ruling was clearly within the trial judge's discretion and I am not about to second guess his judgment.

[68] Neither is there any merit to the appellants' complaint that the trial judge should have blamed the respondent for not pulling the tail shaft to test it, after finding nicks in the propellor blades. Mr. Trysgaard testified for the respondent. His extensive experience comprised more than 50 years at sea, including time spent as a chief engineer on Canadian Coast Guard ships, supervising construction of research vessels, and maintaining Secunda's fleet since 1983. His familiarity with this vessel was acute. He inspected the propellor shaft in 1995 and saw nothing that caused him concern. A dye penetrant test was administered to detect any faults in the shaft not observed by a visual inspection. Tests were negative. The shaft was reinstalled. In 1996 Mr. Trysgaard said that while the tug was under charter he received a report that the vessel had sustained some damage because of a grounding. He and officials from the Salvage Association and other principals travelled to Quebec to inspect the vessel. Again he examined the shaft for damage. Nothing caused him any concern. The propellor was repaired and the vessel was put back into service. Mr. Trysgaard said he was not alarmed by scrapes and nicks on the propellor blades. He explained that it was "very slight damage and you can haul any boat out of the water and you're going to find this." Thus, there is no merit to the appellants' assertion that the respondent was at fault for not subjecting the tail shaft to further non-destructive testing after seeing nicks and scrapes on the propellor blades. Neither was there evidence to establish a nexus or connection between such an alleged "failure" on the part of the respondent, and the ultimate loss.

[69] Finally, the appellants argue that because the vessel was under charter to John E. Canning Limited for a period of time, the trial judge erred in failing to either impose a due diligence requirement upon Canning as charterer, or declining to fault the respondent for its "failure to provide proper evidence of John E. Canning's due diligence . . ."

[70] I reject these submissions for several reasons. First, there was never an allegation, and certainly no evidence presented, that the shaft broke because of a grounding that may not have been reported by the charterer, or because of any other incident that was not before the court. Second, it was open to the appellants at any time to attempt to secure and present the evidence of Canning. Canning was not under the respondent's control. Third, all of the evidence with respect to maintenance, inspection and surveys in relation to this vessel was before the court. Fourth, during the time that the vessel was on charter to Canning, there were no inspections or dry dockings required that were not performed. Fifth, the evidence at trial showed that there was only a brief period of time when the vessel was on a true bare boat charter to Canning without Secunda crew on board. Mr. Trysgaard testified that during that interval in the 1998 season (approximately May to October), he would have audited the vessel, but those reports were unfortunately contained in the lost documentation. I have already rejected the argument that the trial judge erred in his handling of the adverse inference issue. For all of these reasons the appellants' complaint that the respondent ought to be denied indemnification because of some unproven fault or incident involving the charterer Canning, is entirely without merit.

[71] Having now disposed of all of the appellants' submissions, I find that the appeal ought to be dismissed.

Disposition

[72] I would decide, as a matter of law, that when dealing with a claim for indemnity under the Liner Negligence clause of an Institute Time Policy (Hulls), the onus of establishing that the breakage of the tail shaft and resulting damages has not resulted from want of due diligence by the assured, is upon the insurer(s). While it was not necessary for the trial judge to decide the issue in view of the submissions made by counsel and the manner in which the case was presented, I have chosen to dispose of the question since it was raised as a principal ground of appeal. Our disposition ought to be recorded as this court's ruling for the purposes of marine insurance claims in this jurisdiction, unless or until otherwise determined by a higher authority.

[73] As to the merits, the appellants have not satisfied me that the trial judge erred in law or in fact when concluding that Secunda exercised due diligence in

maintaining its vessel. Accordingly the appellants failed to displace the burden upon them to show that the subject loss was the result of a want of due diligence on the part of the respondent. Justice McLellan's decision awarding damages of $699,135.80 together with costs, disbursements and pre-judgment interest to the respondent, should not be disturbed.

[74] I would dismiss the appeal. I would award the respondent its costs on appeal based on 40% of the costs awarded at trial, plus disbursements here as agreed or taxed.

Saunders, J.A.

Concurred in:

Roscoe, J.A.

Fichaud, J.A.