

Oh Buoy! Court finds accidental damage not covered due to faulty design exclusion

Sheehan v Lloyds Names Munich Re Syndicate Ltd (2017) FCA 1340

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Summary

The Federal Court of Australia recently considered the principles surrounding proximate cause in the context of a claim for indemnity under a marine insurance policy. The Court found in favour of the insurer in concluding that the faulty design exclusion operated to exclude cover to the insured. The decision confirms that the courts will look for the most effective and dominant cause of the damage rather than multiple concurrent causes to which the *Wayne Tank* principle might then apply.

Background

Sheehan was the owner of a 2009 Sunseeker Manhattan yacht ('the yacht') which was programmed with a number of safety systems including audible and visual alarms that activated in the event of an engine failure. These safety systems were set out in the yacht's operating manual.

On 17 September 2015, Sheehan had been operating the yacht for approximately 20 minutes when an alarm was activated. The yacht had only been serviced the day before.

The alarm was for "low oil pressure" which was a critical alarm and often leads to engine failure. Sheehan did not check what type of alarm had been sounded and simply started making his way back to the marina. Shortly after,

the starboard engine shut down and he continued to operate the port engine until he reached the marina. Upon inspecting the yacht, Sheehan saw that both engines were damaged and covered in oil.

Sheehan made a claim on his Nautilus Marine Insurance Policy ('the Policy') held with Lloyds Names Munich Re Syndicate Ltd ('Lloyds') in relation to the damage suffered to the engine. The Policy provided cover for "accidental loss or damage to your boat and contents".

Lloyds denied indemnity on the basis that the damage to the yacht's engine was not 'Accidental' within the meaning of the Policy and if it was, the cause of the damage fell within one or more of the exclusions in the Policy, including faulty design, inherent defects, a deliberate action by the insured, structural breakdown or motor seizure and overheating.

Sheehan subsequently issued proceedings against Lloyds in the Federal Court of Australia seeking indemnity under the Policy.

The Dispute

There were two main questions in dispute in the proceedings:

1. Whether the damage to the engine amounted to Accidental Loss or Damage within the meaning of the Policy; and if so
2. whether any of the exclusion clauses operated to exclude cover.

Sheehan argued that the single cause of the damage to the yacht was his failure to turn off the engines once the alarms had activated as he was not aware that the alarm was for low oil pressure and believed he could continue to operate the yacht. On this basis, he submitted the damage to the engine was unexpected and therefore 'Accidental', as the yacht had been serviced the day before and he had been operating it for only 20 minutes.

Lloyds argued Sheehan knew of the risk of continuing to operate the engine when there was low oil pressure and deliberately chose to take the risk. It was also argued that a reasonable person would have read the safety manual, known about the alarms and acted reasonably when the alarm was activated and on this basis the damage was not 'Accidental'.

Lloyds submitted that even if the damage was 'Accidental' within the meaning of the Policy, the damage was caused by the faulty design of the gasket (a seal within the engine) and that on that basis the faulty design exclusion would apply to exclude cover.

In the alternative, Lloyds argued that if both Sheehan's actions and the faulty design concurrently caused the damage, then the *Wayne Tank* principle¹ would apply, meaning that as one cause was excluded under the policy (faulty design), Sheehan was still not entitled to cover.

The Decision

Accidental Loss or Damage

'Accidental loss or damage' was defined in the Policy as "an event that you did not expect or intend to happen".

The Court accepted that while Sheehan was a poor seaman and should not have continued to operate the yacht, the eventual result of his actions in damaging the engine was not expected or intended in that he did not deliberately set out to damage the engine and on that basis the damage was 'Accidental'. The Court reached this conclusion on the basis that it could not find that Sheehan deliberately 'courted the risk'.

What was the proximate cause?

The Court referred the technical question of what caused the damage to an independent referee who was an expert marine surveyor. The referee found that the damage to the engine was caused by the faulty design of the gasket as it allowed for oil to escape out of the engine.

The Court was satisfied that the failure of the gasket was the proximate cause of the damage to the engine and was persuaded of this by the 'rapidity and significance of the failure of the gasket'. A slow oil leak would have resulted in the Court deciding otherwise. The Court found that Sheehan's conduct of continuing to operate the engine led to what was ultimately an inevitable failure of the engine due to the faulty design of the gasket. It was held that the *Wayne Tank* principle did not come into consideration as there was only one cause of damage.

Given the finding that the faulty design of the gasket was the sole cause of the damage, the Court held that the faulty design exclusion operated to exclude any cover to Sheehan under the Policy and found in favour of Lloyds.

Implications

- When considering whether damage or loss is 'Accidental' the court will apply a high standard when assessing whether an insured 'courted the risk' or whether the consequential damage caused by the insured's actions was in fact unintended or unexpected.
- To be satisfied that an insured deliberately courted a risk, a court must conclude that the person was aware of the risk and made a conscious choice to take it.
- Courts will firstly look for the most effective and dominant cause of the damage as opposed to multiple causes that might then require application of the *Wayne Tank* principle.

¹ *Wayne Tank & Pump Co Ltd v Employers Liability Assurance Corp Ltd* [1974] QB 57

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