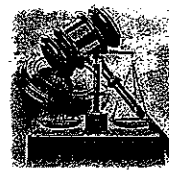




Mercante's Sea Trials

Know Your Insurance Policy (and its defects)



A marine insurance policy covers accidental physical loss or damage to your vessel with certain exceptions known aptly as "exclusions." The exclusions are listed in your policy. It is wise to be familiar with the exclusions, but I'll bet the weekend sailor cannot name three exclusions to coverage...right now! Time's up!

Exclusions

Not all marine policies are exactly alike. Not all offer the same coverage and not all contain the same exclusions. Exclusions that may be found in a marine policy include loss or damage caused by or resulting from *wear and tear, electrolysis, mold, mildew, fiberglass blistering, deterioration, ice and/or freezing, racing, design defect, latent defect, vermin, rust, corrosion, and even lack of maintenance*. Many losses can be attributed to lack of maintenance somehow or other, so you should review your policy's coverages to know what's covered and what's not covered in the event of a total loss or damage to your vessel. For example, if lack of due diligence in maintaining your vessel is one of the exclusions...well, it's time to take better care of your boat and make sure all fittings, systems, hoses, pumps, gauges, riggings, electronics, mechanics, and even "hose barbs" get checked out by a professional. More on hose barbs in a minute.

Defects

Some yacht policies cover a "manufacturer's defect", or even "design defect". Some exclude this. Does yours? Some will not cover at "latent defect" itself, but will cover any other loss resulting or ensuing from a latent defect. If you don't know what's excluded, take a look at your policy. An insured is charged with knowledge of a policy's contents even if he/she has not read it. Yet, I hear countless times from fellow boaters (cause I like testing them!) that they don't know if they ever received a copy of their policy, where it is, if it has been properly renewed for the present season, or the insurance premium paid. They might not know what insurance company insures them (most boaters will give me the name of a broker, thinking that's the insurance company when it's not) or are unaware if their boater's insurance is with a true blue "marine" insurance company. They also might know if the policy contains warranties, a lay-up warranty, a navigation restriction, a pleasure-use only requirement or if it covers salvage and emergency towing. They need to know what the deductible is and how a total loss will be adjusted, i.e. actual cash value, replacement value, or agreed value, or whether they are over-insured or under-insured. On this later point, for example, if you purchased your vessel for \$100,000 several years ago and it's worth \$40,000 today, many boaters will be paying insurance premium still on a \$100,000 boat (over-insured), when you may perhaps save significant premium dollars if you lower the agreed value of the boat as it depreciates. Also, do you know what your duties are after a loss?

These are just a sampling of the multiple issues that relate to a marine insurance policy. Having said all this, insurance disputes are not uncommon. Disputes occur when a boater expects to be paid in full for a loss or a damage only to find out that coverage is not afforded due to an express exclusion in the policy.

This sinks!

One recent dispute involved an expensive yacht that sank at a dock while undergoing engine repairs, causing over a million dollars in damages. The insured (a corporation) filed a damage claim under its marine insurance policy which covered "all-risks" with the exception of certain named exclusions. The insurer denied the claim and retained admiralty counsel to file an action in federal court seeking a ruling (*declaratory judgment*) that the loss was not covered. The insurer's position was that the loss was caused by a corroding part, and corrosion was specifically excluded from coverage.

Undefined terms

The insured and insurer hotly disputed what was encompassed by the term "manufacturer's defect", which was not defined in the policy. Some marine policies do define "defects" such as this, as well as design defect and latent defect.

Here, the trial court described a *manufacturer's defect* as a problem in the manufacturing process (covered by the subject policy), and a design defect as a problem with the design of the products (not covered by the policy).

The insured argued that the barb's "yellow brass" material was unsuitable for a part expected to be exposed to saltwater. As such, the mere use of yellow brass constituted a manufacturer's defect, according to the insured, because this choice resulted in the inevitable failure of the hose barb and ultimate seawater intrusion that sank the boat.

The insurer countered with several defenses to coverage, namely (i) that the hose barb lasted seven years and that if it had been properly inspected and maintained, it would not have corroded and corrosion is excluded; (ii) that "wear and tear" is a natural part of the service life of a material and loss due to wear and tear is excluded, (iii) the choice of yellow brass is a "design defect" (not covered), not a manufacturer's defect (covered).

Oddly, after a couple of hundred years of marine insurance, there was no case precedent to rely upon that addressed the meaning of the term "manufacturer's defect" in a marine insurance dispute. However, courts have distinguished between design defects and manufacturing defects in non-marine cases. *Harduvel v. Gen. Dynamics Corp.* ("This distinction between "aberrational defects" and defects occurring throughout an entire line of products is frequently used in tort law to separate defects of manufacture from those of design. Stated another way, the distinction is between an unintended configuration and an intended configuration that may produce unintended and unwanted results.")

The marine insurer's defenses to coverage prevailed in the trial court. After three days of testimony at trial, the federal judge determined the proximate cause of the damage was the failure of a hose barb, resulting from corrosion, that the marine policy under review excluded corrosion, and that the loss was not covered by the policy unless a manufacturer's defect relating to the hose barb could be shown. The policy did cover "loss or damage by a provable manufacturer's defect." The judge commented in *St. Paul Fire and Marine Insurance Company v. Lago Canyon, Inc.*, that the boat builder's use of yellow brass material for the hose barb knowing it would be exposed to saltwater, created a condition likely to cause corrosion, but that this was not a "manufacturer's defect." The evidence in the case did not establish that the hose barb deviated at all from the manufacturer's own design or that something went wrong during the manufacturing process. In other words, the barb functioned as intended during its useful service life.

Thus, the next step for the insured was to appeal, and it did. The main issue was the interpretation of or interplay between the policy's coverage for a manufacturer's defect *vis-à-vis* the exclusion for corrosion.

It was concluded on appeal (a) that the trial court incorrectly focused on the term "manufacturing defect" when the policy contained the broader term "manufacturer's defect", and (b) the term manufacturer's defect (as opposed to manufacturing defect) could include defects attributable to the manufacturer, whether in the manufacturer's "design" or "manufacturing" of the product. The Court of Appeals also suggested that while there is a distinct difference between a manufacturing defect and a design defect, a "manufacturer" may be liable for both types of defects. Because the trial judge did not consider this possibility in relation to the decision to use yellow brass material for a hose barb exposed to salt water, the case was sent back down (remanded) to the trial court to re-evaluate the evidence with this interpretation in mind. As of the date of his writing, the trial judge has yet to issue its written re-ruling.

Conclusion

An insurance policy is a binding contract between you and your insurance company. You can bet the insurance company knows the terms and conditions of coverage - - don't "exclude" yourself from that knowledge. Remember, knowledge is power...and there is no exclusion to that premise.

JAMES E. MERCANTE, admiralty partner with Rubin, Fiorella & Friedman LLP, and Commissioner on the Board of Commissioners of Pilots of the State of New York.

E-mail address: jmercante@rubinfiorella.com. The information in this article must not be construed as legal advice and laws may vary from jurisdiction to jurisdiction.