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**INHERENT VICE & FORTUITOUS EVENTS IN MARINE  
“ALL RISKS” POLICIES:**

***A Case Comment On Nelson Marketing v. Royal & Sun Alliance***

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July 2005

On May 25, 2005, Cullen J. released reasons in *Nelson Marketing International Inc. v. Royal & Sun Alliance Insurance Co. of Canada*, [2005] B.C.J. No. 1235 (hereinafter, “**Nelson**”), which decision may be regarded as inconsistent with the industry’s prior understanding and application of both the “inherent vice” exclusion, and the necessity for the occurrence of a fortuitous event in order to trigger coverage under marine “all risks” policies.

**Legal Background**

Marine cargo insurance is frequently written on an “all risks” basis. It is well established, however, that “all risks” does not mean “all losses”, but losses caused by **fortuitous circumstances**; namely, accidental losses as opposed to losses that are bound or certain to happen given the nature of the property insured or the voyage in question.<sup>1</sup>

The requirement that the cause of the loss be “fortuitous” excludes the natural and inevitable action of wind and waves, ordinary wear and tear, **inherent defects**, and intentionally caused losses. What is essential in order to establish that the loss is “fortuitous” is an accident caused by the intervention of negligence, or adverse or unusual conditions without which the loss would not have occurred – there must be some casualty, something which could not be foreseen as one of the necessary incidents of the adventure.<sup>2</sup>

Further, marine “all risks” policies contain a specific exclusion for loss caused by “**inherent vice** or nature of the subject-matter insured”. The term “inherent vice” refers to a loss “stemming from qualities inherent in the thing lost”.<sup>3</sup> One of the most frequent applications of the term is in cargo insurance, where it refers to the inherent tendency of the cargo, shipped as it is, to sustain damage. The insurer does not agree to insure against damage that is bound to happen as a result of the natural tendency of the cargo to deteriorate or sustain damage.

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<sup>1</sup> *British and Foreign Marine Insurance Co. v. Gaunt*, [1921] All E.R. 447

<sup>2</sup> *C.C.R. Fishing Ltd. v. Tomenson Inc.* (1990), 45 B.C.L.R. (2d) 145

<sup>3</sup> *C.C.R. Fishing Ltd. v. British Reserve Insurance Co.*, [1990] 1 S.C.R. 814

The “inherent vice” exclusion is also used to describe a loss that, due to the manner in which the cargo is shipped, is regarded as inevitable. For example, fresh eggs shipped without any packing or protection are likely to sustain damage no matter how carefully they are handled. Chocolates shipped in an ordinary container in the summer are bound to melt. Damage that occurs in the course of ordinary handling and transportation of cargos, without the intervention of fortuity, is due to inherent vice and must be excluded from coverage.

### **The *Nelson* Decision**

#### **(a) Background**

In *Nelson*, three shipments of laminated truck flooring (hereinafter, “LTF”) were sent from Malaysia to California via Singapore in the late spring and summer of 1999. The shipments belonged to the Plaintiff who insured them for their declared value against damage while in transit through underwriters represented by the Defendant, Royal and Sun Alliance Insurance Company of Canada (the “Insurer”).

At one point in the voyage, feeder vessels were used to transport the LTF between Malaysia and Singapore. At all material times it appears that it was known to the relevant parties arranging the transportation of the LTF that temperatures inside the holds of the feeder vessels could reach upwards of 45 degrees centigrade.

When the shipments arrived in California, the LTF was rejected by the end-purchaser due to damage to the LTF consisting of water staining and cracking and/or delamination of boards.

The Plaintiff made a claim on its insurance policy, but coverage was denied by the Insurer. Accordingly, the Plaintiff commenced the Action seeking coverage under the policy.

All parties agreed that the relevant policy of insurance was to be interpreted according to English law and usage.

#### **(b) Factual Cause of Loss**

The Court in *Nelson* found that the dominant cause of the wetting of the cargo was the absorption and condensation of moisture by the LTF. First, immediately after manufacture, it was found that the LTF absorbed moisture while being stored in the plants prior to transportation. Later, the LTF was placed in the holds of the feeder vessels in high heat conditions that constituted a drying environment, which environment permitted the process of repeated moisture loss through condensation. After moisture was released from the LTF through condensation, the released water was trapped under plastic sheeting that covered the cargo. It was the moisture released through condensation and trapped under the plastic sheeting that eventually settled back on the LTF and caused the water staining.

The Court also found that the same drying process – the loss of water from the wood during transportation in the holds of the feeder vessels – caused the cracking and delamination of the LTF.

### (c) The *Nelson* Decision – Discussion & Analysis

At the end of the day, Cullen J. in *Nelson* found that the loss was covered under the policy of insurance, stating that the proximate cause of the damage was the heat in the holds of the feeder vessels.

The heat and equilibrium moisture content which the cargos were exposed to in the holds were significantly different and more extreme than those in the surrounding **natural environment**, which is why... they dried dramatically and repeatedly... In that I see a meaningful distinction between the cargos at bar and [other cargo in prior inherent vice cases], because in the [prior inherent vice cases] it was a situation where the [other cargo]... simply interacted with the surrounding **natural environments** they were exposed to in the normal course of their voyage. In the case at bar, on the other hand, the environments the cargos interacted with were abnormally and unnaturally amplified in the hold...

I conclude, in the case at bar, the damage leading to the loss claim was not due to the inherent vice or nature of the cargos, as pleaded by the defendants, but rather was caused by the fortuity of being put in holds which substantially altered the **normal environment** to which the cargos would be exposed between [Malaysia] and Singapore.

This decision leaves several questions that the industry must now turn its mind towards when responding to claims that involve inherent vice and fortuity issues; why is the decision focusing on the “natural environment” between Malaysia and Singapore generally as opposed to the known, typical environment that the cargo would be exposed to throughout the voyage? Does an unusual event sufficient to attract coverage occur simply because cargo is shipped in an environment different than the surrounding environment, external to the vessel’s hold?

Prior to *Nelson*, insurers may have viewed the drying process of the LTF, or the absorption and condensation of water from this LTF in the environment that the LTF was exposed to, as an inherent vice as such behaviour stems from qualities inherent in the LTF. The drying process was something that was bound to happen as a result of the natural tendency of the cargo, particularly when considering the manner in which the cargo was shipped. LTF transported in the holds of feeder vessels that typically reach temperatures of 45 degrees centigrade will inevitably lose moisture through condensation, which moisture will be trapped if the cargo is wrapped in plastic sheeting and will then settle back on the LTF, all of which resulting in water staining and cracking. Was the drying process not an inherent vice that should have been excluded from coverage?

Further, where was the fortuitous event in the *Nelson* case? There was no accidental loss, but only a loss that was bound or even certain to happen given the nature of the LTF **while on the known voyage in question**. The temperatures within the holds of the feeder vessels were not abnormal in that they were more extreme than expected. In fact, it appears that the temperatures were exactly those in which all parties arranging the voyage knew would be present at all relevant times. The temperatures could only be considered as extreme or different when compared with the general, surrounding environment; but the cargo was never intended to be transported in the surrounding environment.

Prior to *Nelson*, insurers would have likely responded to this claim by advancing an argument denying coverage because the natural and inevitable action of wood drying, even to the point of excessive moisture loss and cracking, in a known environment with temperatures exceeding 45 degrees centigrade is a foreseeable incident that should not attract coverage. The shippers knew that the LTF would be transported in the holds of the feeder vessels, and knew the temperatures of

those holds; there was no intervention of any fortuitous external accident or casualty, but only a loss resulting from the natural behaviour of the cargo in the ordinary course of the contemplated voyage.<sup>4</sup>

### **Further Reading**

See *Star-Rite International Food Inc. v. Maritime Insurance Co.*, [1986] O.J. No. 542, and *T.M. Noten B.V. v. Harding*, 2 Lloyd's Rep. 283, both of which decisions seem to be in direct opposition with *Nelson*, lending support to the argument that *Nelson* fails to conform to the industry understanding and application of the "inherent vice" exclusion, and the necessity for the occurrence of a "fortuitous event" in order to trigger coverage. It will be interesting to observe the effect that *Nelson* will have on the industry.

The *Nelson* case is currently under appeal.

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<sup>4</sup> *T.M. Noten B.V. v. Harding*, 2 Lloyd's Rep. 283