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The "reasonable cost of repairs" when repairs are undertaken after the policy expires.

INTRODUCTION

At the AGM of the Association of Average Adjusters in May, 2014, two new Probationary Rules of Practice were introduced and accepted. These Probationary Rules are currently only voluntary but assuming that they get fully accepted at the AGM in May, 2015, they will then become the accepted practice for Average Adjusters of the Association.

One of the Probationary Rules is of little practical effect and only obliges Adjusters to stipulate the particular York / Anwerp Rules they are making allowances under when adjusting General Averages.

The other Probationary Rule, however, deals with a more everyday situation of ship's being repaired after the expiry of the policy during which the damage was sustained and recent legal suggestions that the current practice of Adjusters and most insurance markets is not necessarily correct.

THE ISSUE

Section 69 of the English Marine Insurance Act, 1906 and equivalent sections of the national Marine Insurance Acts of most countries, deals with the measure of indemnity when there is a partial loss of ship.

Section 69(3) states (*subject to any express provision in the policy…….)*:

Where a ship has not been repaired, and has not been sold in her damaged state during the risk, the assured is entitled to be indemnified for the reasonable depreciation arising from the unrepaired damage, but not exceeding the reasonable cost of repairing such damage computed as above.

Where a vessel is covered by the Institute Time Clauses Hulls or the similar Institute wordings, Clause 18 confirms that the above formula applies for claims for unrepaired damage.

The legal argument which has been suggested in the UK is that where there is unrepaired damage at the end of the "risk" (i.e. when the policy year ends), in the absence of the policy otherwise providing,

that the correct and only way to handle such clams is under Section 69(3). This would apply even when the repairs are subsequently done at (say) the next routine docking. The proponents argue that passages in two well-known cases (*The "Medina Princess"* and *The "Catariba"*) support of their argument.

The members of the Association of Average Adjusters do not agree with the argument for the following reasons:

- The sections of the *"Medina Princess"* and *"Catariba"* judgements have been taken out of context given that neither of the vessels were ever repaired.
- There is other case law (notably *Irvine v Hine (1950)*) in which the comments of the judges clearly anticipate insurers paying for repairs to the vessel after the policy in which the damage was incurred has expired.
- When Sir Mackenzie Chalmers drafted the Marine Insurance Act, great care was taken with the wording and punctuation. To put the interpretation proposed in the subsection requires it to be read *"Where the ship has not been repaired during the risk"* which is not what the punctuation of the section suggests.
- At the time the Act was written in 1906, Voyage (as opposed to Time) policies were more common and the interpretation would make little sense in that context as the "risk" ended on completion of the voyage and repairs would commonly be effected after the risk had ended.
- The Marine Insurance Act was never intended to create new law and was a codifying Act which attempted to bring together the relevant strands and precedents from Common Law on the subject. Putting the interpretation proposed on the Act would have the effect of creating "new law".
- The interpretation has never been the practice of adjusters or insurers. Whilst establishing that something is "usage" to the standards required by the law is known to be very hard, it is believed that the practice of settling claims where a shipowner can claim the full reasonable cost of repairs even if the repairs are done after the policy expires has general acceptance.

WHAT ARE THE PRACTICAL IMPLICATIONS?

Ships commonly have unrepaired damage at the end of the policy year on which the damage was sustained.

- Owners delay non-essential repairs until a scheduled routine docking period every year or two. This results in cost saving for both Owners and Insurers as the cost of drydock the vessel and certain general services are shared.
- The damage may have happened towards the end of the policy year and there is not time to undertake the repairs before the end of the policy.

- The repairs may require the sourcing or manufacture of a specific part which may take time to repair.
- The vessel may not be at a location at which repairs can physically or economically be done and there is a delay until she can get to a more suitable repair port.

If the legal argument were to be confirmed, then insurers could **INSIST** that the claim is resolved as an unrepaired damage claim at the end of the policy year.

Section 69(3) and Clause 18 of ITC (Hulls) ask you to compare the depreciation in the market value of the vessel as a result of the unrepaired damage and the estimated cost of repairs - with the insurer being liable for lower amount.

The estimated cost of repairs is exactly that – an estimate. It is common for additional damage to be found once a vessel is slipped or when an engine is finally opened up such that initial estimates of the cost of repairs prove to be inadequate.

With regard to the depreciation in the value of the vessel, in many cases the depreciation in the market value of the vessel will be the same or more than the estimated cost of repairs as a buyer of a vessel will say “I would have paid $X is she had been undamaged but I know she has $300,000 worth of damage and so I will offer $X–300,000.” In fact he may offer a little less to account for the fact that the vessel may be out of action during the repairs and not earning freight.

However, where an older or more specialised vessel is involved, the issue can be more critical.

Take the situation where, at the end of the policy year, the market for the vessel has dropped (or, in the case of a specialised vessel there is no real “market”) so that, undamaged, the vessel is worth $500,000 but her scrap value is $280,000. The depreciation in the value of the vessel can never be more than $220,000 ($500,000 - $280,000) and this would be the most the shipowner is entitled to as an unrepaired damage claim even if he has repairs resulting from an insured casualty to undertake for $300,000 or more.

The shipowner will potentially be left in a situation where he is fully insured but due to fluctuations in the market or scrap value of his vessel or because the full extent of the damage and the cost of repairs cannot be ascertained, he is significantly out of pocket when he comes to actually do the repairs.

You can see situations where Owners take vessels out of service just to do damage repairs at the end of the policy period in order to ensure that they are fully paid for. It may have been in insurers’ best interest to have the repairs done concurrently with a routine docking at some later date. This may then run in to arguments as to what is “reasonable”.

Whilst, as mentioned above, the Association of Average Adjusters do not believe that the legal argument is correct and that most claims will be handled as before (at least until such time as someone runs the argument through the Courts), it has to be accepted that it has created a level of uncertainty which is potentially damaging for insurers, brokers and shipowners.

THE NEW PROBATIONARY RULE A4(2)

The new Probationary Rule of Practice which has been accepted by the Association and which, in the absence of major issues will likely be confirmed in May, 2015, states:-

A4 *COST OF REPAIRS*

1) *That in adjusting particular average on ship or general average which includes repairs, it is the duty of the adjuster to satisfy himself that such reasonable and usual precautions have been taken to keep down the cost of repairs as a prudent shipowner would have taken if uninsured.*

2) ***Where a claim for particular average arises and the Assured has elected to repair the vessel, the Assured is entitled to:***

a) ***recover the reasonable cost of repairs in terms of section 69(1) of the Marine Insurance Act 1906, irrespective of whether repairs are carried out before or after the expiry of the policy.***

b) ***defer repairs, subject to Class approval, to the first reasonable opportunity which is likely to be the next routine overhaul or dry-docking period. Any increase in the overall cost of repairs arising from deferment beyond the first reasonable opportunity will be for the account of the Assured.***

Whilst it may be hoped that it will not be necessary, any insurers, brokers or shipowners who want to ensure certainty on this issue going forward, may want to consider the insertion of a clause in their policy based on (or to similar effect) as the above Probationary Rule so that their policy does *"otherwise provide"*.

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