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CONSTRUCTIVE TOTAL CONFUSION

Constructive Total Loss (CTL) is a well-known concept in marine (and a number of other) forms of insurance.

In Hull and Machinery (H&M) insurance, the essence is that a ship can be treated as a total loss when it is not worth repairing. That is to say *"where she is so damaged by a peril insured against, that the cost of repairing the damage would exceed the value of the ship when repaired"* [UK Marine Insurance Act, 1906 (MIA) Section 60(ii)].

However, a couple of recent Court decisions in the UK have challenged some of the "traditional" thinking as to how the calculation should be done and what can be included.

Clause 19.2 of the Institute Time Clauses (Hulls) 1.10.83 modifies the MIA position and provides that:-

No claim for constructive total loss based upon the cost of recovery and / or repair of the Vessel shall be recoverable hereunder unless such cost would exceed the insured value.

Up until recently, I think most practitioners would have assumed that, in comparing the "cost of recovery and / or repair" to the insured value, one would only consider those costs and expenses which could be claimed on the H&M policy if the vessel was not a CTL. I.e. if a cost could not be claimed from the H&M insurers if the vessel was a partial loss, then the cost could not be included in the calculation as to whether the vessel was a CTL.

The first case to challenge this with the 2015 case of the "*Brilliante Virtuoso Pt. 1*". This is a very complex case relating to an alleged attack on the vessel by pirates in 2011. The parties disagreed on the cost of repairs to almost all aspects of the damage and this included the cost of repainting the vessel's bottom after she had sat motionless for eight months awaiting decisions on her disposal. Whilst it was agreed that the bottom may been complete repainting, the insurers pointed to clause 15 (Bottom Treatment) of the Institute Time Clauses (Hulls) 1.10.83 which states that:

In no case shall a claim be allowed in respect of scraping gritblasting and / or other surface preparation or painting of the Vessel's bottom except that…..

Whilst the clause goes on to provide some limited exceptions to the rule, none of them were applicable to the *"Brilliante Virtuoso"* case.

The judge found that the full cost of repainting the vessel's bottom could be included in the CTL calculation on the basis that clause 19.2 only talks about the *"cost of recovery and / or repair of the Vessel"* without stipulating that such costs would have to be recoverable in the event of a partial loss.

Whilst the case caused some commentary, the reality is that the Bottom Treatment clause will rarely be a factor which will "make or break" and CTL calculation.

However, in the second case (the *"Renos"*) from the English High Court in July 2016, the stakes are much higher.

In the case of the *"Renos",* the vessel was salvaged under Lloyd's Open Form (LOF) with the Special Compensation Protection and Indemnity Clause (SCOPIC).

LOF is an agreement for the salvage of a vessel and her cargo whereby the salvor agrees to undertake the salvage services on a "no cure, no pay" basis. On the successful completion of the salvage, the salvage award (known as an Article 13 award) is determined by arbitrators in London. It is fair to say that LOF awards are often quite "generous" but they are there to encourage salvors. The system also exists so that, in emergency situations, salvors can get started on the salvage confident

that they will get reasonable compensation on success. Having the shipowners, cargo owners and salvors haggle over day rates or amounts for lump sum salvage whilst a ship and her cargo are aground or about to founder is in no-one's interest.

The salvage award takes in to account the value of the ship and goods recovered, the danger they were in, the skill and equipment required and the efforts of the salvor to prevent or minimise damage to the environment.

However, where there is a ship in serious difficulty, the degree of difficulty of the salvage operation may be in doubt or the likely salved value of the ship and cargo will not be high, the salvor may be reluctant to undertake the job as he risks not being to even recover his expenses if:-

- There is no significant value in the ship and goods recovered.
- The cost of the salvage and environmental protection measures are likely to be higher than any award.

It is in everyones' interest that the ship and cargo be salved and environment protected and so the LOF Agreement allows the salvor to invoke SCOPIC. By doing this, a strict record of the equipment and resources used by the salvor is kept. SCOPIC provides for standard rates for men and equipment and so a "cost price" of the salvage can be calculated.

If the Article 13 award is less that the SCOPIC costs plus a margin, then the salvor can claim the balance of his costs and margin from the shipowner and this is generally paid by the shipowners' P&I Club (since the costs are assumed to have been there to mitigate pollution for which they would have been liable). This balance is known as the Article 14 award.

On the other hand, since the salvors now have a "safety net" to at least recover their costs and a margin, to insure that they do not invoke SCOPIC needlessly, if the Article 13 is more than their SCOPIC costs and margin, their award is reduced by 25% of the difference.

In the case of the *"Renos",* the ship's proportion of the Article 13 award was US$ 1.25m. The additional SCOPIC liability on the shipowner was a further US$ 1.35m.

When the insurers argued that the SCOPIC liability should not be included in the vessel H&M CTL calculation as it was covered by the P&I Club, the judge, once again, pointed to ITC Clause 19.2 and MIA Section 60(ii) and pointed out that was a part of the cost of recovering and repairing the vessel and that is all that was mentioned.

CONCLUSION

The two decisions potentially lead the way to some interesting scenarios whereby, for instance, a vessel may be determined a CTL following a sinking due to the cost of repairing the engines but the policy excludes machinery damage. One can think of many other such scenarios.

It remains to be seen whether insurers will seek to amend their wordings to account for these decisions.

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