Case and comment

CONSTRUCTIVE TOTAL LOSS—THE DIMINISHING IMPORTANCE OF THE PRUDENT UNINSURED OWNER

The Renos

Regarding the constructive total loss ("CTL") of an insured ship, resulting from damage to the same, the Marine Insurance Act 1906 ("MIA"), s.60 provides:

"(1) Subject to any express provision in the policy, there is a constructive total loss where the subject-matter insured is reasonably abandoned … because it could not be preserved from actual total loss without an expenditure which would exceed its value when the expenditure had been incurred. (2) In particular, there is a constructive total loss— … (ii) In the case of damage to a ship, 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 …"

Co-existing alongside this statutory definition is an older, common-law, test, framed by reference to the hypothetical figure of the "prudent uninsured owner".[1] Its invention is credited to Lord Abinger CB, who put it thus: "… if a prudent man not insured, would decline any further expense in prosecuting an adventure … a party insured may, for his own benefit, as well as that of the underwriters, treat the case as one of a total loss, and demand the full sum insured".[2]

How were these tests intended to relate? Commenting on the clause in their Bill which (with amendments) would become MIA, s.60, Chalmers and Owen noted: "The cases habitually refer to the 'prudent uninsured owner' test. But as decisions multiply that test becomes of diminishing importance, because the decisions tend to settle as a matter of law the course which a prudent uninsured owned would be bound to take. This, perhaps, is fortunate, because the test is not an easy one to apply …".[3]

In its recent judgment in *The Renos*,[4] the UK Supreme Court moved decisively in this direction, further diminishing the relevance of the prudent uninsured owner test

1. *Arnould's Law of Marine Insurance and Average*, 19th edn (London, 2018) (hereafter, "*Arnould*"), [29.27–29.30].
2. *Roux v Salvador* (1836) 3 Bing NC 266, 286; 132 ER 413, 421 (Exch Ch).
3. MD Chalmers and D Owen, *A Digest of the Law Relating to Marine Insurance* (London, 1901), 73.
4. *Sveriges Angfartygs Assurans Förening (The Swedish Club) v Connect Shipping Inc (The Renos)* [2019] UKSC 29; [2019] 2 Lloyd's Rep 78 (Lords Reed, Hodge, Lloyd-Jones, Kitchin and Sumption) (hereafter "*The Renos* SC"); partly reversing [2018] EWCA Civ 230; [2018] 1 Lloyd's Rep 285; [2018] Bus LR 1333 (hereafter "*The Renos* CA"); and also partly reversing [2016] EWHC 1580 (Comm); [2016] 2 Lloyd's Rep 364; [2016] Bus LR 1184 (hereafter "*The Renos* HC").

in determining whether a CTL exists, and confirming its subordination to the statutory test in s.60.

Facts and issues regarding CTL

A fire broke out in the engine room of MV *Renos* on 23 August 2012, while it was off the Egyptian coast in the Red Sea. The vessel suffered serious damage, and its owners appointed salvors under Lloyd's Open Form 2011 (No Cure—No Pay) ("LOF 2011"). The vessel was insured under hull and machinery ("H&M") policies, on Institute Time Clauses—Hulls (1/10/83) terms, with an insured value of US$12m, and under an increased value ("IV") policy, on Increased Value (Total Loss only) Clauses (1/10/83) terms, with a value of US$3m. It appeared that "the vessel was close to the cusp of being a CTL",[5] and over the ensuing months the vessel was surveyed several times, and owners, underwriters, and their respective advisors discussed numerous, conflicting repair specifications, estimates of the costs of repair, and quotations from shipyards. Owners eventually tendered notice of abandonment ("NOA") on 1 February 2013. This was not accepted by insurers, and owners commenced their claim under the policies.

Insurers accepted that the casualty was consequent upon an insured peril, but disputed the measure of indemnity sought, arguing that it should be based on a partial, not total, loss.[6] Part of insurers' defence was an item-by-item challenge to owners' estimated repair costs, a strategy which failed before Knowles J in the Commercial Court.[7] Knowles J also held that owners had not elected not to abandon the vessel,[8] and further that owners had given NOA "with reasonable diligence" under MIA, s.62(3).[9] The Court of Appeal confirmed these decisions,[10] which were not challenged before the Supreme Court.

More importantly, for present purposes, Knowles J and the Court of Appeal held that (i) the costs of recovery and repair incurred by owners before tendering NOA, and (ii) special compensation payable to salvors under the Special Compensation Protection and Indemnity Clause ("SCOPIC") (operative under LOF 2011), should be included in the CTL reckoning under s.60(2).[11] The Supreme Court's judgment concerned insurers' appeals on these two issues.

5. *The Renos* CA, [42].
6. *The Renos* HC, [4].
7. *Ibid*, [56–93]. Similar (poor) results for insurers have obtained in other recent CTL cases, eg: *Venetico Marine SA v International General Ins Co Ltd (The Irene EM)* [2013] EWHC 3644 (Comm); [2014] 1 Lloyd's Rep 349, [437–493]; *Suez Fortune Investments Ltd v Talbot Underwriting Ltd (The Brillante Virtuoso)* [2015] EWHC 42 (Comm); [2015] 1 Lloyd's Rep 651, [86–254]. The forensic risks that can be involved for insurers in challenging an assureds' estimated repair costs seem clear, particularly where precise estimation is impossible, and assureds are accorded a "large margin": *Angel v Merchants' Marine Ins Co* [1903] 1 KB 811 (CA), 816 (Vaughan Williams LJ); *The Brillante Virtuoso* [2015] EWHC 42 (Comm), [92].
8. *The Renos* HC, [6–7].
9. *Ibid*, [8–26].
10. *The Renos* CA, [42–67].
11. And under cll 19.2 and 9.2 of the H&M and IV policies, respectively: *The Renos* HC, [27–47], [48–54]; *The Renos* CA, [69–85], [85–94].

CTL and costs incurred by owners before NOA

On this first issue, insurers contended that determining whether there was a CTL should be a forward-looking exercise, performed at the time NOA was tendered. Accordingly, costs expended by owners prior to abandonment should be left out of account.[12] Owners argued that all costs of recovery and repair relating to a damaged vessel were relevant under s.60(2), whenever incurred. Lord Sumption, delivering the sole judgment in the Supreme Court, noted the important "financial and practical implications" of insurers' argument: in many cases, owners would not be able reliably to estimate the costs of repairing their damaged vessel until it had been brought to a place of safety and surveyed; thus, insurers' argument would frequently have the effect of excluding salvage remuneration from the assessment of whether there had been a CTL.[13] Against this background, Lord Sumption considered first whether the wording of s.60 gave any support to insurers' position. He held that it did not: references to costs of repair that "would exceed" the value of the ship when repaired, to "future" salvage operations and general average contributions, merely reflected "the hypothetical character of the whole exercise and not the chronology of the expenditure". Moreover, the language of s.60 begged the question as to the point in time from which the CTL reckoning was to take place, and could not be construed as an "implicit exclusion of past expenditure even for the purpose of general average, let alone more generally for the purpose of determining whether the ship is a constructive total loss".[14]

Considering next the authorities from before MIA,[15] Lord Sumption noted that pre-NOA salvage charges had been included in the CTL reckonings, "without discussion", in *Holdsworth v Wise*[16] and *Rosetto v Gurney*,[17] and by the US Supreme Court in *Bradlie v Maryland Insurance Co*.[18] However, *Holdsworth v Wise* can be distinguished, in that the pre-NOA expenditures on salvage and repairs in that case were incurred by third parties without the vessel owners' knowledge or authority, and, moreover, were secured by a charge on the vessel which the owners would have had to satisfy before retaking possession. In relation to the other English authority, *Rosetto v Gurney*, not mentioned was that the inclusion of pre-NOA salvage costs in the CTL reckoning was obiter, in that a partial loss obtained even when they were taken into account.

A conspicuous omission amongst the pre-MIA cases referred to by Lord Sumption is *Young v Turing*.[19] In that case, owners had incurred salvage expenses of £420 prior to tendering NOA. In his CTL reckoning, Lord Abinger CB included the scrap value

12. A point not taken by insurers in *The Brillante Virtuoso* [2015] EWHC 42 (Comm), [246–251].
13. *The Renos* SC, [6].
14. *Ibid*, [8]. Similarly, in the courts below: *The Renos* HC, [31] and [37–40]; *The Renos* CA, [73] and [83–84].
15. *The Renos* SC, [9].
16. (1828) 7 B & C 794; 108 ER 919 (KB).
17. (1851) 20 LJCP 257; (1851) 11 CB 176; 138 ER 438 (CP).
18. (1838) 37 US 378. In *Saurez v Sun Mutual Ins Co* (1849) 2 Sandford's NY Sup Ct R 482 (Sup Ct NY), 487, cited in W Phillips, *A Treatise on the Law of Insurance*, 4th edn (Boston, 1854), vol.2, 280, [1541], the suggestion that costs of partial repairs incurred at a port of refuge, prior to abandonment, should be added to the estimated costs of full repairs in reckoning whether the vessel was a CTL, was recorded without disapproval.
19. (1841) 2 M & G 593; 133 ER 883 (Exch Ch).

of the damaged vessel and the estimated cost of repairs, but not the salvage expenses.[20] This was clearly deliberate, reflecting his suggested "plain way of considering" the prudent uninsured owner test, which was to ask: "If the underwriters had accepted the abandonment, would they have repaired the ship themselves …?"[21] *Young v Turing* was cited in argument in the first post-MIA case referred to by Lord Sumption on this issue, *Hall v Hayman.*[22] This may explain why Bray J accepted a concession that pre-NOA expenditures were irrelevant,[23] as doing so arguably involved no inconsistency with the express language of s.60, which refers to "expenditure" and "cost" without indicating from what time these are to be reckoned.[24] In the second post-MIA case cited by Lord Sumption, *The Medina Princess*,[25] Roskill J accepted a similar submission: again, though it is not mentioned by Lord Sumption, Roskill J was referred to authority on the point.[26]

Accordingly, the latter two post-MIA cases arguably deserved more appreciative consideration than Lord Sumption gave them.[27] Instead, he discounted them, preferring to revisit the status of pre-NOA expenses in the light of "basic principles of insurance law" as "affected by the requirement for a notice of abandonment".[28] His reasoning, in summary, was as follows. First, the loss under an H&M policy occurs, and the assured's cause of action against underwriters accrues, at the time of the casualty, and not when the loss is quantified.[29] Second, CTL "is a legal device for determining the measure of indemnity": it is "a partial loss which is financially equivalent to a total loss, and may be treated as either at the election of the assured".[30] Third, under MIA, s.69, "the reasonable cost of repairs which have been carried out is treated as the measure of the depreciation of the ship's value".[31] Fourth, whether there has been a CTL "depends on objective facts", and not on "the opinion or predictions of the owner, however reasonable".[32] Accordingly, the damage to take into account in a CTL reckoning under s.60(2)(ii) is "in principle the entire damage arising from the casualty from the moment it happens", or, in other words, the depreciation of the vessel arising from the damage, "represented by the entire cost of recovering and repairing it", regardless of when (or whether) this cost was incurred.[33]

20. *Ibid*, 601–602. Lord Abinger's approach to the CTL reckoning was subsequently held to have been ratio, not obiter: *Macbeth & Co Ltd v Maritime Ins Co Ltd* [1908] AC 144, 153–154 (Lord Collins).
21. *Young v Turing* (1841) 2 M & G 593, 604–605.
22. [1912] 2 KB 5; (1912) 17 Comm Cas 81 (Bray J).
23. *The Renos* SC, [9].
24. Compare Bray J's exclusion of the value of the wreck, in this regard: *Hall v Hayman* [1912] 2 KB 5, 12–15.
25. *Helmville Ltd v Yorkshire Ins Co Ltd (The Medina Princess)* [1965] 1 Lloyd's Rep 361, 429.
26. *The Medina Princess* [1965] 1 Lloyd's Rep 361, 363, 453, citing: *"Yero Carras" (Owners) v London & Scottish Assurance Corp Ltd* (1935) 52 Ll L Rep 34 (esp 40–41) (Porter J); and [1936] 1 KB 291; (1935) 53 Ll L Rep 131 (CA) (in which *Hall v Hayman* [1912] 2 KB 5 and *Macbeth & Co v Maritime Ins Co* [1908] AC 144 were cited).
27. Or than commentators have given, viz: R Merkin, "Marine Insurance: Constructive Total Loss" (Oct 2016) Ins LM, 1–2; DR Thomas, "Constructive Total Loss in Marine Insurance and Notices of Abandonment" (2018) 24(4) JIML 267, 270. *Cf* J Hjalmarsson, "Constructive Total Losses: The Limits of Reasonableness" (Sept 2016) STL 7–8.
28. *The Renos* SC, [9].
29. *Ibid*, [10].
30. *Ibid,* [11].
31. *Ibid*, [11].
32. *Ibid*, [12].
33. *Ibid*, [13].

Finally, the requirement (in some cases) under MIA, s.62, for the assured to tender NOA before treating a loss as total, is irrelevant to the existence of a CTL. In this regard, cases are specified in s.62 where NOA is not so required; and under s.61, and as a matter of authority,[34] a CTL is a state of affairs which exists, independently and separately from the abandonment which the assured may elect to make where a CTL *does* exist.[35]

Insurers' arguments to the contrary were based on the proposition—"itself not in doubt"—that the assured cannot claim an indemnity on a total-loss basis unless there is a CTL at the time of NOA (and, indeed, at the time the action on the policy is commenced).[36] Lord Sumption distinguished the authorities relied on by insurers, in this regard, as relating, not to the CTL-reckoning exercise, but to ademption of loss, when "something happens after the casualty to reverse it" such that the assured's indemnity is limited to their actual loss at the relevant time.[37] But expenditure by the owner themselves, in recovering or repairing the insured vessel, does not act to adeem their loss: "On the contrary, it is part of the measure of loss against which [the owner] is entitled to be indemnified …"[38]

The persuasive style of Lord Sumption's reasoning should not be allowed to obscure the real jurisprudential choice being made in including owners' pre-NOA expenditures in the CTL-reckoning exercise. Such an outcome was not predetermined by "basic principles" or by the language of MIA, s.60. The Supreme Court might, instead, have invoked Lord Abinger's prudent uninsured owner,[39] giving more appreciative consideration to *Young v Turing*[40] and to the post-MIA cases descending therefrom. This would have placed greater emphasis on the moment of abandonment, when that hypothetical person would be focussed on the "real choice"—repair or abandon—to which "sunk costs" would be irrelevant.[41] Clearly, the resulting contractual balance would have been different, but not necessarily unfair: CTL would still be available, in appropriate cases; while in other cases, substantial indemnities would be available on a partial-loss basis,[42] and, where applicable, for sue and labour expenses. However, this was not the approach adopted by the Supreme Court, and the relevance of the prudent uninsured owner test is correspondingly diminished.

CTL and SCOPIC compensation

The second issue in *The Renos* was whether SCOPIC compensation ought also to be included in the CTL reckoning under MIA, s.60. Compensation under SCOPIC, as incorporated into LOF 2011, replaces special compensation under Art.14 of the International Convention on

34. *Robertson v Petros M Nomikos Ltd* (1939) 64 Ll L Rep 45; [1939] AC 371 (HL).
35. *The Renos* SC, [14].
36. *Ibid*, [15].
37. *Ibid*, [15].
38. *Ibid*, [18]. Similarly, such an expenditure by insurers does not adeem their assured's loss, for "[t]he rule of law applicable to contracts is that neither of the parties can by his own act or default defeat the obligations which he has undertaken to fulfil [viz to pay a total loss]": *Sailing Ship "Blairmore" Company Ltd v Macredie* [1898] AC 593, 608–609 (Lord Watson).
39. And MIA, s.91(2).
40. (1841) 2 M & G 593.
41. *The Renos* SC, [6].
42. Though not under the IV policy.

Salvage 1989 ("Salvage Convention"). It is intended to compensate salvors, profitably, for their efforts in fulfilling their duty to exercise due care to prevent or minimise damage to the environment under Art.8(1)(b) of the Salvage Convention.[43]

In *The Renos*, insurers conceded that the "cost of repairing the damage" under MIA, s.60(2)(ii) included the cost of recovering the vessel, but they argued that SCOPIC compensation, incurred by owners for the purpose of avoiding potential liability for environmental damage (and being indemnified by P&I, rather than H&M, insurers), was not such a cost. This argument failed in the courts below, which held that SCOPIC compensation could not be divided from the remainder of salvors' remuneration, all of which had to be paid if owners were to recover their vessel.[44]

A feature of owners' argument, which first appears clearly in the judgment of the Supreme Court, was the concession that owners could, "in theory", have contracted with salvors on terms excluding SCOPIC. They contended, nevertheless, that they were entitled to include SCOPIC compensation in the CTL reckoning because "a prudent uninsured owner would have contracted on terms that the salvors' remuneration included SCOPIC costs".[45]

Here, Lord Sumption expressly rejected this proposed application of the prudent uninsured owner test. He held that, for a cost to be included in the CTL reckoning, it was not sufficient that it be one which a prudent uninsured owner would have incurred.[46] Instead, s.60(2)(ii) requires an assessment of whether a ship is "financially worth repairing", focusing narrowly on the costs of repair, *sensu stricto*, and any further costs incurred for the purpose of "essential" or "reasonable" preliminaries to those repairs (such as salvage charges, temporary repairs near the casualty site, and towage to a repair yard).[47] The "common feature" of all costs susceptible to be included in the CTL reckoning was that "their objective purpose was to enable the ship to be repaired".[48]

Objectively considered, Lord Sumption held that SCOPIC compensation failed to satisfy these tests.[49] He argued further, that if tasks relating to environmental protection and tasks such as towing the vessel to a repair yard had been contracted to separate contractors, the charges for the tasks of the former kind would clearly be excluded from the CTL reckoning, while those for the tasks of the latter kind would clearly be included. The "entirely adventitious factor" that both types of task were undertaken by the same contractor ought not to affect the result.[50] Moreover, under SCOPIC the two types of expenditure were not indivisible, but by design were made separately identifiable so that the former could be defrayed by P&I insurers and the latter by H&M insurers.[51]

The rejection of owners' proposed application of the prudent uninsured owner test in this context, Lord Sumption maintained, was the effect of MIA, s.60(2)(ii), which

43. For the background to SCOPIC, see JM Turner QC, "*The Renos*: a Trojan Horse in the LOF Citadel?" (2018) 18(7) LSTL 3–7.
44. *The Renos* HC, [50–53]; *The Renos* CA, [90].
45. *The Renos* SC, [23].
46. *Ibid*, [26].
47. *Ibid*, [24].
48. *Ibid*, [25].
49. *Ibid*, [25].
50. *Ibid*, [25].
51. *Ibid*, [27].

had resurrected the Court of Appeal's decision in *Angel v Merchants' Marine Ins Co*.[52] Lord Sumption explained *Angel v Merchants' Marine Ins Co* as deciding, broadly, that "only the comparison between the repaired value of the ship and the cost of repair (including steps preliminary to repair) was relevant" to determining whether a damaged ship was a CTL.[53] This explanation seems to obscure a further jurisprudential choice made by Lord Sumption in *The Renos*. Post-MIA decisions on the effect of s.60(2)(ii) have cited *Angel v Merchants' Marine Ins Co* for a much narrower proposition, viz that the value of the wreck on the day of abandonment should not be accounted for in the CTL reckoning.[54] There would seem to be no authorities, prior to *The Renos*, which credit s.60(2)(ii) with as comprehensive an exclusion of the prudent uninsured owner test in this context, as that recognised by Lord Sumption, thereby severely restricting the types of "cost" and "expenditure" to be accounted for in the CTL reckoning.

On Lord Sumption's construction of s.60(2)(ii),

> "the prudent uninsured owner is assumed to be interested only in the comparison between the cost of repair and the repaired value, and his hypothetical choices are relevant *only to the quantum of the repair costs*. The statutory solution has sometimes been criticised as illogical, but the world of marine insurance has accommodated it and moved on … The result is that it is necessary to identify the purpose of the expenditure which it is proposed to take into account, and to *apply the prudent uninsured owner test only to expenditure for the purpose of repairing the ship* in the larger sense …".[55]

Again, the decision to relegate the prudent uninsured owner test to such a subordinate role in this area was not dictated by the wording of MIA, or by authority. It should be recognised as a novel jurisprudential choice. The fairness of the result to owners seems questionable: SCOPIC is very commonly employed, and in considering whether a vessel to be recovered and repaired is "financially worth saving", owners would surely expect SCOPIC compensation to be included in the reckoning.[56] That said, removing SCOPIC compensation from the CTL reckoning should reduce H&M insurers' exposure to CTL claims, which may address some concerns about support for SCOPIC, and LOF salvage more generally, in the London insurance market.[57]

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52. [1903] 1 KB 811.
53. *The Renos* SC, [26].
54. *Arnould*, [29.31–29.32], citing: *Hall v Hayman* [1912] 2 KB 5, 12–15; *Yero Carras v London and Scottish Assurance Corp Ltd* [1936] 1 KB 291 (CA), 305 (Lord Wright MR), 311 (Slesser LJ).
55. *The Renos*, [26–27] (italics added). The "quantum of the repair costs" must refer to the liberty accorded to the prudent uninsured owner not always to repair in the cheapest possible way: *The Brillante Virtuoso* [2015] EWHC 42 (Comm), [93–94], [124–142].
56. In relation to which, *per* Lord Sumption, it should be irrelevant to the CTL-reckoning question that H&M insurers would not indemnify SCOPIC compensation on a partial loss basis: *The Renos*, [24]. In this, Lord Sumption implicitly approved the position taken by the courts below that the inclusion of a cost in the CTL reckoning is not a claim for an indemnity in relation to that cost: *Renos* HC, [47]; *Renos* CA, [93]. *Cf* Turner (2018) 18(7) LSTL 3–7, referring to this position as "not wholly convincing".
57. See Turner (2018) 18(7) LSTL 3–7.

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