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Constructive Total Loss

MV Renos[1]

The English Court of Appeal recently had occasion to consider the meaning of "reasonable diligence" where it concerns the giving of a notice of abandonment by a shipowner and whether salvage remuneration incurred prior to the notice can be considered "cost of repairs" in determining whether there has been a constructive total loss (CTL).

In August 2012, the *MV Renos* was on a laden voyage in the Red Sea when a fire broke out in the engine room, causing extensive damage. Salvage operations commenced shortly after. Fire was an insured peril. It was common ground that for the vessel to be a CTL, the cost to repair the damage would have to exceed USD8 million.

Within the four months following the casualty, the respective surveyors for the owners and the insurers conducted their investigations to ascertain the extent of damage and the repair specifications required. In December 2012, the owners received three quotations based on their surveyor's specifications and all of them were above USD8 million. In January 2013, the insurers obtained three different quotations based on their surveyor's specification: USD4 million, USD7 million and USD9 million.

In February 2013, some five months after the casualty, and less than two months after receipt of the repair quotations, the owners tendered their notice of abandonment. The insurers rejected it on the grounds that it was "given far too late".

Notice of abandonment

Section 62(3) of the Marine Insurance Act 1906 (MIA)[2] provides:

> "Notice of abandonment must be given with reasonable diligence after the receipt of reliable information of the loss, but where the information is of a doubtful character the assured is entitled to a

reasonable time to make inquiry."

The court held that "reliable information of the loss" required that the owners should have reliable information on:

(i) the extent of the damage and the scope of repair; and

(ii) the cost of such repair.[3]

As long as the requisite information remained "doubtful", it would not be "reliable".[4] In such a case, the owner will be allowed a reasonable time to make inquiry before deciding whether to give a notice of abandonment.

The court found that:

- During the period between the casualty and the issuance of the notice of abandonment, the owners were in receipt of conflicting information from experienced sources on the estimated cost of repairs.

- It was not realistic to take one source in isolation, particularly where there were conflicting estimates from experienced sources that undermined the reliability of any one particular source.

- Based on the nature of the casualty, it was not only a complex task, but also a time-consuming one to ascertain the extent of loss.

The court went on to conclude that the owners had no reliable information, even at the date of the notice of abandonment.

On the question of "reasonable diligence", the court held that where there is no urgency or immediate danger to the vessel, as seen in the present case, there is no need for an immediate decision to be made on whether to issue a notice of abandonment.[5] However, once the owners have made a decision to give notice, the decision must be promptly communicated to the insurers so that the insurers can take over the interest of the assured in whatever may remain of the vessel and all proprietary rights incidental thereto.

The court found that the owners in the present case had acted with reasonable diligence in issuing the notice of abandonment and had not lost the right to abandon the vessel and claim on a CTL.[6]

Recovery cost before notice

Section 60(2)(ii) of the MIA provides that:

> "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.
>
> In estimating the cost of repairs, no deduction is to be made in respect of general average contributions to those repairs payable by other interests, but account is to be taken of the expense of future salvage operations and of any future general average contributions to which the ship would be liable if repaired..”

The court held that recovery costs which are necessarily incurred in order to repair a vessel will form part of the “cost of repairing the damage”, even for recovery works carried out before the issuance of the notice of abandonment.[7]

The word “future” in this provision of the Act simply meant that expenses incurred in the future are also to be taken into account in determining whether there is a CTL and should not be read as excluding expenses incurred prior to the notice of abandonment.[8] On that basis, the court held that salvage remuneration incurred prior to the notice of abandonment in the present case would be taken into account as “cost of repairs”.[9]

Conclusion

Where the situation is not urgent and there is no immediate danger to the vessel, owners are required to act with reasonable diligence upon receipt of reliable information and are entitled to reasonable time to make inquiry. If, in fact, the owners have doubt about the information available, such doubt should be expressed to make it clear to the insurers that the owners are not in a position to decide whether to issue a notice of abandonment.

Whether the information available is reliable or not is an objective test, and owners should therefore ensure that they act promptly once they have sufficient reliable information.

In determining CTL, the owners may take into account recovery cost in determining cost of repairs whether incurred before or after the notice of abandonment.

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[1] *Sveriges Angfartygs Assurans Forening (The Swedish Club) v Connect Shipping Inc* [2018] EWCA Civ 230 ("*MV Renos*")
[2] Marine Insurance Act 1906 (Chapter 41 6 Edw 7)
[3] Paragraph 50 of the *MV Renos* judgment
[4] *Ibid*, para 42
[5] *Ibid*, para 62
[6] *Ibid*, para 68
[7] *Ibid*, para 73
[8] *Ibid*, para 83
[9] *Ibid*, para 85