Landmark Supreme Court decision ends uncertainty as to what costs count towards a constructive total loss—The Swedish Club v Connect Shipping (The RENOS)

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Insurance & Reinsurance analysis: The Supreme Court has handed down its judgment in The Renos, which is set to be one of the landmark marine insurance decisions of the year. Neil Hart, barrister at Essex Court Chambers, who together with Steven Berry QC acted for the insured, considers the Supreme Court judgment and its practical implications for shipowners and insurers.

Sveriges Angfartygs Assurans Forening (The Swedish Club) and others v Connect Shipping Inc and another [2019] All ER (D) 45 (Jun), [2019] UKSC 29

What was the background?

On 23 August 2012 M.V. RENOS suffered a casualty when it was damaged by fire. The vessel was insured under a hull and machinery policy (H&M Policy) for an agreed value of $12m, plus a further $3m under an increased value policy.

The factual circumstances of the case were somewhat unusual in that it took an unusually long time to determine the extent of the damage reliably. During this period shipowners and insurers carried out their own respective investigations as to the extent of the damage and exchanged survey reports. The approach of the insurers was criticised by the judge at first instance, Mr Justice Knowles, for being unduly obstructive. Substantial costs continued to be incurred meanwhile.

Because of the continuing uncertainty as to the cost of repairs, the shipowners did not tender a notice of abandonment (NOA) until 5 months after the casualty. When the NOA was tendered, insurers refused to accept it, on the grounds that it was too late and that the vessel was not a Constructive Total Loss (CTL) under the H&M Policy. In the latter regard, insurers contended that in calculating whether the vessel was a CTL account should not be taken of costs incurred before the NOA was given, or of SCOPIC remuneration.

At first instance, Knowles J held that the owners had not tendered the NOA too late because the delay in doing so was not unreasonable while substantial discrepancies between competing assessments of the damage went unresolved.

Knowles J also calculated that the vessel was a CTL, ranking costs incurred before the NOA was tendered towards the total costs of recovery and repair. He held that such costs included payments under the SCOPIC clause that was annexed to the Lloyd's Open Form salvage contract, because in his view they were 'an indivisible part' of the cost of recovering the vessel.

The decision of Knowles J was appealed by insurers, but the Court of Appeal unanimously dismissed the appeals [2018] EWCA Civ 23. On the SCOPIC issue, Hamblen LJ held that 'the cost of recovery was the total amount paid' to the salvors; the fact that this payment comprised two elements (the Article 13 Award and SCOPIC) did not alter that fact. Insurers were granted permission to appeal to the Supreme Court on two issues, namely whether pre-NOA costs, and SCOPIC remuneration, should rank towards a CTL.

What did the Supreme Court decide?

Issue 1—whether costs incurred before NOA is tendered are to be included in the CTL calculation

This was the main issue for debate before the Supreme Court, as it had been before the Court of Appeal. The shipowner's case was that all costs incurred from the date of the casualty should rank, whether they had been incurred before or after the NOA was tendered.

Insurers argued the contrary on the basis of the language of s 60(2) of the Marine Insurance Act 1906 (MIA 1906), and by reference to logic, first principles and authority (of which there was very little directly on point). Insurers argued that the MIA 1906 requires that only prospective repair costs may be included in the CTL calculation; in effect, insurers contended for an implied exclusion of pre-NOA Costs on the language of s 60 MIA 1906. Insurers argued that, as a matter of logic, the costs already incurred before NOA is tendered are, in effect, 'sunk costs,' such that a prudent uninsured owner would not take them into account when estimating whether his vessel was beyond economic repair: he would look only forward, to what he had (still) to spend.

Lord Sumption gave the leading judgment in the Supreme Court, with which the other judges agreed without comment, and found for the shipowners. He considered cases both before and after the passing of the MIA 1906 into law.

Fundamental to Lord Sumption's reasoning was that, as is settled law, the liability of insurers under a H&M Policy accrues at the moment the insured vessel is damaged by an insured peril, notwithstanding that it may then take some time to establish the quantum, or that it is only after the casualty that the insured will elect his remedy (ie whether to claim a partial or total loss). The question thereafter is whether the loss has been adeemed by the date of the NOA (or claim form), and nothing the insured, or his insurer, spends on the vessel can adeem that loss.

Lord Sumption rejected insurers' argument based upon the allegedly 'forward-looking' language of s 60 MIA 1906. Although the language of that section may be read as referring to costs that 'would' be incurred, this choice of words, in Lord Sumption's view, reflected the hypothetical nature of the total repair costs – the amount of which may not be known at the moment the estimate is made. Furthermore, to the extent that section referred to 'future' costs, the section did not say from when these costs must be 'future'; the obvious answer was from whenever the estimate of repair costs is made. There was nothing in MIA 1906 to say that date must be the date of the NOA. In Lord Sumption's view it did not make any difference when repair costs were incurred, provided they were incurred for the purpose of recovering or repairing the vessel.

Issue 2—SCOPIC costs

As is normal practice, the Lloyd's Open Form salvage contract entered into between shipowners and salvors following the casualty incorporated the SCOPIC clauses. These clauses provide how salvors are to be remunerated for their efforts, even where the value of the vessel and the corresponding award under Article 13 of the Salvage Convention may be low, or indeed 'disappears' in the course of the salvage efforts—eg if the vessel is eventually consumed by fire or sinks.

The shipowner's argument, which found favour with Knowles J at first instance and with the Court of Appeal, was that SCOPIC remuneration should rank towards a CTL because it is an integral part of the sums paid to salvors to effect the recovery.

The Supreme Court, however, preferred the position taken by insurers. Lord Sumption held that SCOPIC costs were not properly to be characterised as being incurred to repair or recover the vessel, even if it was in practice impossible or very rare to engage salvors on terms which did not include the SCOPIC clause. Lord Sumption viewed SCOPIC remuneration as payable in order to prevent or reduce damage to the environment, and hence an owner's liability for that damage. As such, the owner's liability for SCOPIC remuneration is covered by P&I insurance, not H&M insurance. It is, held Lord Sumption, conceptually distinct and divisible from true costs of recovery and repair. It should therefore not rank towards a CTL. Lord Sumption was unpersuaded by the fact that SCOPIC remuneration is one of the costs a shipowner will often need to pay if he is to engage a salvor to recover his vessel; or that the same item of cost may be the subject of an Article 13 award one moment, and SCOPIC remuneration the next (as where a vessel sinks); or that SCOPIC remuneration is payable whether

or not there is any threat to the environment, and accordingly any risk of environmental pollution or liability on that account.

What are the practical implications of this?

This is an important decision in that it settles two issues that have long caused uncertainty, both for H&M insurers and for shipowners.

Previously, shipowners who needed to incur costs in order to establish how badly damaged their vessel was, and whether or when to tender NOA, faced some uncertainty as to whether such expenditure would rank. Premature, successive NOAs were an answer, but an unsatisfactory one, especially where the owner did not wish to abandon his vessel to insurers, or where it was simply too early to assess whether the vessel was a CTL or not, such that NOA could not yet properly be given under MIA 1906. The decision puts an end to that practice, and to the risk that insurers may seek to exclude prior expenditure from the CTL calculation. Shipowners need now only tender one NOA "with reasonable diligence after the receipt of reliable information of the loss", (s 62(3) MIA 1906) but not before, and the date on which recovery and repair costs are incurred will make no difference to whether they rank towards a CTL, provided NOA is given in a timely manner.

The decision also resolves the question of whether SCOPIC charges should rank towards a CTL. That the trial judge and Court of Appeal should have unanimously and in short order ruled that they should highlights the difficulty of that question. The argument is now laid to rest, albeit in terms which focused more upon which insurer covers SCOPIC charges than whether they are, in reality, part of what shipowners must pay salvors to recover their ships.

The Supreme Court has remitted the case to the trial judge to determine whether the vessel is a CTL, excluding SCOPIC but including various repair costs which were not determined at trial. It therefore remains to be seen whether insurers' limited victory on the SCOPIC issue will be decisive or pyrrhic.