ASSOCIATION OF AVERAGE ADJUSTERS OF THE UNITED STATES AND CANADA

"IS IT A WRECK OR ISN'T IT?"

Address of the Chairman, Brian Fuller – October 5th 2012

We have had many high profile casualties in recent times that have made headlines globally in the newspapers and on television. We have gone from seeing vessels miles inland after floods, the general public walking off with BMW motorcycles and other goods like they were freebies because they had been washed ashore from a container vessel hard aground and, to hundreds of passengers disembarking from a grounded cruise vessel in the dark of night. It was all interesting and intriguing and the press had a field day and we all watched or read whatever was printed. The comments keep coming, this wreck, that wreck, every high profile casualty seemed to be a wreck. Well, what is a wreck?

The simple thing to do is go to the dictionary but who has dictionaries anymore. So, go online where you will find the definition of wreck as:

1. the ruin or destruction of a vessel in the course of navigation
2. vessel in a state of ruin from disaster at sea on rocks, etc.
3. accidental destruction of a ship, a shipwreck
4. the stranded hulk of a severely damaged ship
5. the remains of something that has been wrecked or ruined

Then you find out that this is insufficient because apparently a word and its true description is only accepted if it is in written form in a published Dictionary. Hence, according to the Oxford Dictionary 1984 version:

Destruction or disablement, especially of ship, ship that has suffered wreck.

I think we could all agree that a vessel is a wreck when completely sunk, or it has broken up while aground, or so badly damaged it ceased to resemble that originally insured.

The outcome in M.J. Rudolf v Lumber Mutual Fire Insurance Co. 371.F. Supp. 1325 (E.D.N.Y. 1974) is that a sunken vessel damaged to an extent of being rendered unnavigable is a "wreck" within a marine policy covering liability for expenses of wreck removal.
So while we can discuss, and perhaps struggle, with the definition of when is a wreck a wreck, we are somewhat like the US Supreme Court Justice Stewart who in dealing with a case involving hard core pornography, quipped that I can't really define it, but I know when I see it! Well, in the US, when it comes to a damaged vessel, it is the US Government, while not precisely defining a wreck, knows one when it sees it and provides for the following when a vessel is abandoned, and must be removed from navigable waters.

The section of the Code of Federal Regulations that applies is Title 33, Navigation and Navigable Waters, Chapter II, Corp of Engineers- Part 245 Removal of Wrecks and Other Obstructions. This law provides for consultation between the Army Corp of Engineers and the US Coast Guard who will determine if a damaged vessel or its cargo, is an obstruction which presents a hazard to navigation, the following options may be considered:

- No Action.
- Charting.
- Broadcast Notice to mariners and publication of navigational safety information.
- Marking
- Redefinition of navigational area
- Removal

It is the last part of the law that we see most in practice. The responsible party must arrange for and pay for the cost of removal. The responsible party under this Federal Law means the owner of a vessel and/or cargo, or an operator or lessee where the operator or lessee has substantial control of the vessel's operation.

It is this compulsory order of removal by either the US Coast Guard or the Army of Corps of Engineers that triggers the coverage provided by Protection & Indemnity Clubs and other marine liability insurers, for the costs of removing the damaged vessel or obstruction. It is not only this Federal law which deals with removal of a damaged vessel. The Clean Water Act and also Oil Pollution Act of 1990 (OPA 90) contain provisions and requirements for removal of wrecked vessels and cargoes that present a threat to the environment. In addition to these Federal Regulations, numerous other states have laws that affect the determination of a damaged vessel as a wreck. Government intervention in both the US and elsewhere is changing long-held definitions of wreck removal. For example where a potential pollution threat remains from a vessel's bunker or cargo tanks, which are otherwise undamaged and have sunk at depths which a generation ago would have been left at the bottom of the sea have now become complicated and very expensive wreck removals.

So while we explore the question of when is a wreck, it seems to me at least that perhaps it is really the governmental authorities who solve the question for us in the US, at least where even the most minor accident brings the intervention of various Federal and State agencies, including the US Coast Guard, who like Justice Stewart, know it when they see it.

Thank you all for coming, see you at dinner.

If only it was that easy. Obviously the real question at hand is who is responsible for the damaged vessel/wreck and who pays for it?

Under the 1986 amendments to the United States "Wreck Act," 33 U.S.C. §409, et seq., quoted previously, a vessel owner is responsible for promptly marking and removing any wreck which poses a hazard to navigation or, in the alternative, the owner will be strictly liable to the United States for the cost of the Government's removing the wreck from its navigable waters.

So we know the responsibility is almost invariably, that of the vessel owner. But what if the owner has, as is usual, insurances covering the standard marine perils.

A shipowner will usually have two main coverages:

1. Hull & Machinery coverage for physical damage to the insured vessel which should include a Sue and Labor Clause (an extract from American Institute Hull Clauses, June 2, 1977) as follows:

   "And in case of any Loss or Misfortune, it shall be lawful and necessary for the Assured, their Factors, Servants and Assigns, to sue, labor and travel for, in, and about the defense, safeguard and recovery of the vessel, or any part thereof, without prejudice to this insurance, to the charges whereof the Underwriters will contribute their proportion as provided below. And it is expressly declared and agreed that no acts of the Underwriters or Assured in recovering, saving or preserving the vessel shall be considered as a waiver or acceptance of abandonment."

2. Protection & Indemnity coverage to indemnify the shipowners for liability to a third party arising in and around the operation of the insured (or entered) vessel.

A typical vessel would be entered in one of the International Group of Protection & Indemnity Clubs and subject to their Rules. For example, the U.K. P&I Club's Rules, 2011 provide cover as follows:

> Costs or expenses relating to the raising, removal, destruction, lighting or marking of the wreck of an entered ship, when such raising, removal, destruction, lighting or marking is compulsory by law or the costs thereof are legally recoverable from the owner.

The important words are "Compulsory by Law."

So who pays, and when? A common misconception is that an agreed Total Loss or a Constructive Total Loss is a wreck.

In order to fully cover the topic, I thought it would be helpful to briefly review the concept of total loss for vessels in terms of US Law and Practice. In marine insurance terms there are two types of total losses- Actual and Constructive.

An actual total loss of a vessel occurs when the vessel is destroyed or so damaged as cease to be a thing of the kind insured or of no value to the Assured for the purposes for which it is intended. An actual total loss also occurs when the Assured is irretrievably deprived of the vessel. In my day-to-day experience, I have had to deal with few actual total losses under the first test of complete destruction. In most cases the vessel, although severely damaged, is still capable of repair and thus must be dealt with as a constructive total loss- a topic that I will deal with later on.

Irretrievable deprivement- the other test- has presented some interesting cases.

There were a number of cases in the early 1980's when following the Iran-Iraq war a number of vessels were "trapped" in Persian Gulf ports by reason of the hostilities. The vessels were not damaged, as such, the Owners were simply unable to access or operate the vessels. After much debate and hand wringing by underwriters, the claims were settled as actual total losses as the assureds had been irretrievably deprived of the vessel. Not wrecks!

A more recent case my office dealt with in the 1990's involved a vessel operating on a river in Argentina. The vessel had discharged cargo and was proceeding in ballast down river in the dark of night. The river was running fast on a very high water level (snow melting off the Andes, a mini tsunami) when the vessel ran aground. The tide receded, the sun rose, and the vessel was totally aground on a small island in the middle of the river. All the experts referred to the circumstances as the "ultimate 100 year scenario".

The vessel had grounded in a fairly remote area of Argentina and the available equipment was limited and despite salvage efforts the vessel could not be refloated.

National pride precluded the necessary governmental approvals for foreign flag tugs to be allowed to assist. As time went by the river continued to recede due to one of the worst droughts in many years in Argentina. As a result, the undamaged vessel sat high and dry in the middle of the river. Various salvage methods were considered and when the final consensus was that dynamite should be used to blow up a channel from the vessel to the remaining water in the river, the hull and machinery underwriter said "no mas" and agreed that the vessel was an actual total loss as the Owner had been irretrievably deprived of the ship. I think it was the dynamite that reasonably got the underwriters attention. We all felt a bit guilty when a few months later the rain returned to Argentina, and the vessel was able to be refloated with a nudge from the local tug. So much for the experts and the 100 year theory! Also, being irretrievably deprived may be a total loss but it is certainly not automatically a wreck.

As mentioned previously, the majority of cases we deal with as average adjusters involve constructive total loss or as we say CTL. The accepted definition of the a constructive total loss under US law is that a vessel is a CTL when by reason of a peril insured against, it is damaged to more than half of the value, the assured may abandon and recover for a total loss. While this is the legal definition, most hull and machinery policies or contracts provide that a vessel is a CTL when the expense of recovering and repairing would exceed the Agreed (Insured Value.) Thus for a CTL the sound market value of the vessel is irrelevant. It is the value that the assured and underwriters have agreed for the purpose of insurance policy that is used for determining a CTL. During my career, I have had to explain this many times to both owners and underwriters and thus I thought it was worth repeating here.

While much has been written and could be said, on the law and practice of how a CTL is proven, for the purpose of my talk, I want to focus for a moment on the position of the parties-ship owner and hull and machinery underwriter- on agreement that the vessel is a constructive total loss under the terms of the policy. In other words, what happens to the vessel in her damaged condition and she has been "abandoned" to hull and machinery underwriters. Under US law and practice, upon abandonment the hull and machinery underwriters are entitled to take over the interest of the assured in whatever remains of the vessel, including all proprietary rights incidental thereto and, arguably, liabilities attaching to the vessel. It is this issue which leads to, shall we say, the excitement between the various parties in the midst of a casualty. Given the litigious times in which we live, hull and machinery underwriters are generally loathe to take over ownership or even appear to be exercising any rights in respect of the vessel during or after an accident which results in a CTL and that is because they want to avoid any liabilities which the vessel may attract. Hull and machinery underwriters are usually content to pay the CTL claim and waive any interest which may be in the eventual proceeds of sale of the damaged vessel. Having said that, underwriters are, of course, interested and entitled to the proceeds that may result from the sale of the damaged vessel. So it really depends upon the casualty. If it appears there are proceeds that can be obtained without any great risk of liabilities, then they will certainly look to exercise proprietary rights.

Even when a vessel is completely sunk it would appear it is not, in the opinion of some, a done deal. The following case raises many important stipulations relating to wreck.

The case of Zurich Insurance Company, Plaintiff v Ronald Malcolm Pateman et al, Defendants (CIV. A. No 860596) heard in the United States District Court, New Jersey involved the Fishing Vessel "Liberty."

This case concerned a dispute as to which marine underwriter was liable to pay the costs of removing the "Liberty", which had capsized and sank in the Manasquan Inlet. Plaintiff, Zurich Insurance Company, claimed that the costs of removing the vessel were covered under the "protection and indemnity" provisions of the insurance policy they provided. Defendants, various underwriters in London, who provided excess Protection and Indemnity cover only to the Zurich policy, claimed that the costs of removal were covered under the "sue and labor" and/or salvage provisions of the Hull & Machinery section of the insurance policy.

The Excess P&I Underwriters position was that a compulsory removal, is a situation in which a hull has been abandoned by the owner and its hull underwriters only after a total loss has been declared and is required pursuant to government order. The salvaging of the "Liberty" does not meet these criteria.

It was Excess Underwriters' position that the removal of the Liberty in this matter fell within either the sue and labor or salvage portions of the hull policy and should be for hull underwriters account.

On December 13, 1983 the Commanding Officer of the United States Coast Guard had forwarded a letter to concerned parties which stated in part:

"On 13 December 1983, the day after the fishing vessel Liberty capsized in Manasquan Inlet, I briefed your Supervisor of Salvage on this case of the owners or their agents' responsibilities under the law. Under Title 33 Code of Federal Regulations parts 64 and 153 and 33 U.S. Code 403 the owner is responsible to mark the wreck has (sic) a hazard to navigation, and then to remove the wreck from that channel and restore that channel for safe navigation. In addition, the owner is responsible for preventing an oil pollution discharge from occurring and if one occurs, he is responsible for the clean-up."

The Court subsequently held that:

(1) removal of sunken vessel was not undertaken to preserve ship's hull, gear and personality, and thus, the sue and labor provision of hull policy was inapplicable;
(2) removal of vessel was compulsory by law as defined in protection and indemnity policy; and
(3) vessel was "wreck" and thus, removal was covered under protection and indemnity provisions.

Judgment was made against Excess Protection and Indemnity insurers.

To sum up, in my opinion, each situation has its own set of facts and we must look at the economics and the reason the costs were incurred as follows:

1. Salvor raises vessel, removes damaged vessel to drydock. Vessel determined to be a CTL. Then cost of raising is Sue & Labor and is recoverable in addition to Insured Value, as long as abandonment was issued prior to incurring the expense.

2. If vessel not worth salvaging and accordingly abandoned to Underwriters on basis of being a CTL and Governmental body orders its removal. It is a wreck and P&I applies. Even if the vessel is inland, not in navigational waters. Hurricane Katrina provided many examples of barges washed ashore, miles from the Gulf of Mexico.

3. If the economics are such that the vessel's salved value is so great that it is obvious for the Shipowners to raise and repair this is clearly a Sue & Labor cost to the policy. In this

> case, I feel, no Government body would issue a removal order because they know ongoing efforts to raise and remove the vessel are in effect.

A recent case heard in the Federal Court of Canada before Justice Harrington, J. involved Wreck Removal – Liability of Underwriters for Expenses and Sue & Labor in the case of Universal Sales Limited v Edinburg Assurance, 2012FC418. In his Judgment dated April 12, 2012 he commented:

"It would have been helpful to the Court to have had the opinion of an Average Adjuster. These professionals deal on a daily basis with such matters as losses spread over several years and several policies, general average, particular average, deductibles, sue and labor, underinsurance, excess insurance, double insurance and reinsurance.

I can only echo Justice Harrington's comments that in situations that may give rise to a potential wreck, appoint an Average Adjuster because every case is different.