

| WHAT HAPPENED WHEN AND WHO PAYS?

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Turning now towards my address, entitled “What Happened When, and Who Pays?”. Upon learning of my nomination, my first thought was, “What will be topic of my paper?”, laced, of course, with a few expletives. However, I decided early on that I wanted to tackle a technical adjusting subject. One issue that has consistently arisen during my career involves determining under which policy or policies the claim lies, particularly if the damage, or damages, occurred on multiple dates or progressed over time, and then apportioning the claim, as well as the deductible, over the policy years involved, as appropriate.

Before getting into progressive damage, I would like to discuss what is known as “superimposed damage” and the “death blow theory”, as well as when the date of damage is unknown. However, one cannot discuss date of loss without first addressing Proximate Cause. As we know, the topic of Proximate Cause can form the basis of an entire Chairman’s Address, so, for today’s purposes, we will accept the definition of Proximate Cause provided by the U.S Supreme Court in *Standard Oil Co. Vs. U.S.*, 340 U.S. 54 (1950) as “that cause which is most nearly and essentially connected with the loss as its efficient cause.”

Superimposed damage is commonly seen in connection with contact damage to shell plating, particularly with barges. For example, a vessel sustains damage to her shell plating with an estimated cost of repairs of \$10,000 and repairs are deferred until her next scheduled maintenance period. Prior to effecting repairs, further damage is sustained, unrelated to the first incident, in the same area, this time with an estimated repair cost of \$15,000. If this final repair cost of \$15,000 includes repairing the damage sustained in the first incident, then the first incident is charged with repairs in the amount of \$10,000, and the balance, \$5,000, is charged to second incident. The same theory would apply if both incidents required renewal of plating instead of repairs (Buglass, 1991).

In the event that the first incident was minor and only required repairs to the plating and was followed by a more severe incident in the same area resulting in the need for renewal of the plating, then

the second incident would absorb the full cost of repairs. On the other hand, if the second incident was relatively minor but, because of the extensive damage sustained during the first incident, renewal of plating is now required, then the first incident would be charged with the cost of repairs at the time they were deferred, and the balance charged to the second incident (Buglass, 1991).

Another scenario involving superimposed damage is when a part is damaged in one incident, and prior to repairs being effected, the same part is lost due to a separate accident, in which case the claim would fall entirely on the second incident (Buglass, 1991). For example, if a propeller damaged due to the vessel touching bottom is subsequently lost due to striking a submerged object, prior to the propeller being repaired, then the entire claims falls under the second incident.

The “Death Blow” Theory refers to those instances such as when shell plating which has been reduced in thickness over time through the course of normal wear and tear, but is still capable of performing its function, is damaged by heavy weather to the point of requiring replacement. Had it not been for the heavy weather, the plating would not have required immediate repairs, but has now sustained a “death blow” resulting in a claim on Underwriters, not subject to any deductions “new for old”, even though its weakened condition may have contributed to its failure. This principle was supported in the English court case *Phillips and Another v. Nairne and Another*, (1847), involving heavy weather damage to the vessel BROXBOURNBURY. In determining if the vessel was a total loss, the judge was not bound to tell the jury to deduct from the necessary repairs the cost of those repairs resulting from the decayed condition of the vessel.

In his Memorandum of March 31, 1970, Raymond Hicks, as Claims Manager of the American Hull Insurance Syndicate, applied the Death Blow theory to claims involving continued acts of negligence resulting in progressive damage. In the memo, Mr. Hicks stated:

“The ‘death blow’ theory can operate to exclude all but the last act of negligence from consideration, if two conditions are met:

- a. The damage sustained prior to that attributable to the last act of negligence would not have required permanent or temporary repair (i.e., the part or unit could reasonably have been expected to perform its function in damaged condition for an indefinite period in the future),

and
- b. The damage as ultimately found results in the condemnation of the part and its renewal, (i.e., there must be a “death blow”)

The concept of Damage Date Unknown is perhaps the easiest to understand and adjust. These claims often arise when a vessel undergoes her regularly scheduled drydocking, and once on the blocks, damage may be discovered in way of the propeller, rudder or bottom plating that can be attributed to a soft grounding or striking a submerged object. As was frequently implored by former Chairman and fellow Average Adjuster Leo A. Walsh, it is the Average Adjuster’s responsibility to carefully review the log book entries from when the vessel was last known to be free of damage (often her last drydocking or dive survey), to identify any entries or incidents which indicate possible grounding or striking a submerged object. If no such entry or incident is found, then, subject to Underwriters’ Surveyor’s agreement, the claim will be adjusted as damage date unknown, and the cost of repairs and the deductible apportioned over the policies in effect from when the vessel was last known to be free of damage until the damage was discovered. When apportioning the claim, policies only contribute for the number of days on that policy the damage may have been sustained. The Adjuster should also deduct any significant periods of time that the vessel was out of service during which she was unlikely to suffer damage of the given nature, be it bottom damage or machinery damage. The Adjuster, with input from the Surveyor, needs to also

consider that environmental conditions can affect the progression of damage, and apportion according to amount of damage sustained during different periods. As the damage is apportioned over the multiple years, so too is the deductible so that the Assured is not charged with multiple deductibles, but rather the portion attributable to that year, realizing that the deductible may change from one year to the next. In addition, if there is an applicable Additional Machinery Deductible, or AMD, it should also be apportioned based upon the damage attributable to that year, even if not all the policy years involved contain an AMD.

Turning now to Progressive Damage, and when and how it requires apportionment. Unlike claims involving an unknown date of damage, with progressive damage claims there is more certainty around the date or dates damage originated and was sustained, however, determining if the claim should be apportioned over multiple policy years requires careful consideration. Damage can originate in one policy year but may not result in the culmination or discovery of damage until a later year. Depending on the circumstances, the claim may fall exclusively under the first year when the event giving rise to the damage occurred, it may require apportioning over all the policy years from the original event until the damage manifested or was discovered, or the claim may fall exclusively under the final year.

I adjusted a claim some time ago involving the discovery of cracks in the rudder stock during a routine drydocking. A few years before, the vessel encountered heavy weather causing shell plating and bilge keel damage. The claim for repairs to the shell plating and bilge keel were adjusted and settled accordingly. Cracks were also noted in the rudder assembly at the time, but the cost of repairs were not included in the claim. Going forward now a few years to the discovery of the new rudder stock cracks, vessel Owners engaged a consulting engineer, and it was concluded that the cracks could be attributed to the earlier heavy weather conditions and had progressed over time until the discovery on drydock. Underwriter's Surveyor agreed, and I proceeded to adjust the rudder stock cracks as a Supplemental Claim to the original heavy weather adjustment. As the damage was progressive, the initial instinct was to apportion the supplemental claim over the policies in effect from the time of the heavy weather until her

drydocking. However, Underwriter's Surveyor, following further discussion, advised that "once the incipient cracks had developed, it would have been considered inevitable." The Supplemental Claim for the damage to the rudder stocks was accordingly stated on the initial policy year when the heavy weather occurred. Had the damage not been inevitable at the time of the heavy weather, then an argument could have been made that it was progressive and subject to apportionment over the various policy years.

As another example, our colleagues in the UK in 1995 were charged with determining the applicable policy, or policies, when the Association of Average Adjusters' Advisory Committee was asked by insurers to review a claim under the Institute Additional Perils Clause. The case involved a manufacturing defect in a propeller that progressed over the three policy years commencing from delivery of the vessel, year one, until the loss of a propeller blade and consequential damage to the main engine gearing in the third year. It was determined by a metallurgist that loss of the propeller was the result of a casting defect which went undetected until the blade fractured. The Average Adjuster stated the entire claim under the third year. While underwriters were satisfied that the consequential damage to the main engine gearing fell under the third year, they had been advised by their surveyor that the propeller would have been condemnable before the third policy year commenced, and accordingly, underwriters felt the propeller loss was progressive and should be apportioned over the three policy years. The Advisory Committee relied upon the policy wording of the Institute Time Clauses Hulls 1/10/83 to which was attached the Institute Additional Perils Clauses – Hulls, 1/10/83 (CL294), "This insurance is extended to cover...any defective part" and concluded that the entire claim, as stated by the Average Adjuster, should fall under the third policy year.

The important distinction between these two claims is that in the aforementioned rudder stock cracks claim I had adjusted, although there was a discovery of damage during the final policy year, the damage was initially sustained in the first year during heavy weather, and the cracking was inevitable. In the second example from our friends in the UK, there was an actual accident in the third year, the

fracturing of the propeller blade. So, when then, is progressive damage apportioned over multiple years? Leslie Buglass in his third edition of *Marine Insurance and General Average in the United States* (1991) provided the following general summary:

- “1. The date of the negligent act (if any) is not *necessarily* controlling in determining the policies on which the claim falls.
2. In the vast majority of cases, the date on which the *damage* is known to have been sustained is controlling in determining the policies on which the claim falls.
3. When the *damage* is known to have been originated by an insured peril under one policy but culminates in a breakdown under a subsequent policy, the resultant claim is shown under the first policy provided there was no lack of due diligence on the part of the insured in not effecting repairs immediately. (This is particularly true in those cases where one of the basic insured perils has operated, as opposed to the additional perils covered by the Inchmaree clause).
4. However, when, without any prior warning or known history, an insured peril results in a breakdown in operation, the claim falls on the policies operative *at the time of the breakdown* or culmination of the *damage*. (In these cases the breakdown and the damage are assumed to have been simultaneous).
5. In cases where an insured peril results in progressive or cumulative damage but does not result in a breakdown in operation, it is usually (but not always) necessary to apportion the claim over the various policies during which the *damage* was progressing. (This method is chiefly resorted to in connection with claims arising out of the Inchmaree clause.)”

Once it has been determined that the claim should be apportioned over multiple years, the Adjuster needs to consider how the damage should be apportioned. The number of days on the risk, such as applied in cases of damage date unknown, would be appropriate if the surveyor can confirm that the damage progressed evenly over time. However, the rate at which damage occurs is not always constant, in which case, the claim should be apportioned over the amount of damage sustained under each individual policy. Again, any environmental conditions that can accelerate the progression of damage should be considered. In *Diamond Shamrock Chemicals Co. v. Aetna Cas. & Sur. Co.*, 258 N.J. Super. 167, 609 A.2d 440, 466–67 (App. Div. 1992), involving environmental pollution claims and litigation brought by Vietnam veterans with respect of Agent Orange, the court stated that allocation based upon the period of time each insurer was on the risk should only be used as a last resort, when proper allocation cannot be approximated.

Turning now towards Admiralty law, the *Natalie* arbitration (1959 AMC 2379) is often referenced in respect of progressive damage claims and, supports that policies in effect when the damage is sustained should respond, regardless of when the insured peril occurred. In this case, after the purchase of the *Natalie*, Owners had her drydocked and the tailshaft withdrawn, following which she was undocked on March 24, 1956 and departed New Orleans on March 29, at which time her port risk cover terminated and the annual hull policy commenced. The vessel continued in service until she was next drydocked fourteen months later on June 1, 1957 in Long Beach, California for unrelated work. While on drydock, water was found leaking from the propeller hub in way of the external gland seal ring. The propeller hub void was also filled with water, and the external gland seal ring was noted to be oversized and poorly fitted. The tailshaft, upon being withdrawn, was found corroded and fractured, and was ultimately condemned.

The damages were attributed to ship repairers' negligence in installing the wrong seal resulting in progressive damage to the tailshaft due to sea water corrosion from March 24, 1956 until June 1, 1957. Despite conflicting opinions from surveyors regarding the rate of progression from the corrosion damage, the arbitrator found that the port risk underwriters were liable for the entire cost of replacing the defective seal, but were only liable for the number of days they were on risk during which the corrosion damage to the tailshaft progressed, March 24 to March 29, 1956 or 6 days out of 435. Hull Underwriters on for the next twelve months were relieved of liability due to a breach in the implied warranty of seaworthiness. However, the following year's hull policy was not subject to the implied warranty of seaworthiness and were liable for the corrosion to the tailshaft for the days there were on the risk, March 29 to June 1, 1957, or 64 days out of 435. Accordingly, aside from the wrinkle in respect of the seaworthiness warranty, the Arbitrator apportioned the claim based upon the number of days on the risk during which damage was progressing.

The approach to apportioning liability over when the damage was sustained is supported by *Export S.S. Corp. v. American Insurance Co.* (AMC 1905). This case involved a shipment of tobacco on board the vessel EXMOOR that was damaged due to improper stowage of dried acorns near the tobacco which produced excessive heat and moisture. The damage to the tobacco commenced a few days after stowage and continued without interruption until the tobacco was discharged. Vessel owners were covered by successive time policies against legal liability for damage to cargo, and each policy was found responsible for the damage sustained during their respective policy.

The non-marine case of *Northern States Power Co. v. Fidelity and Cas. Co. of New York*, 523 N.W.2d 657, 662–63 (Minn. 1994) also addressed damages occurring over consecutive policy periods. The insured sought to recover from their liability insurers for the costs they were ordered to incur in connection with

soil and groundwater cleanup of property. The insured settled with all but one insurer, and the court entered summary judgment in favor of the remaining insurer. However, on appeal, the court ruled that :

1. The liability for the pollution damage should be apportioned over the insurers according to the damages which occurred during each policy period, and
2. When the damages are continuous, the apportionment should be pro rata according to the time on the risk.

Once the Average Adjuster has determined if the damage is considered progressive, and the most equitable division of said damages, be it on a days on risk approach, or the amount of damage estimated to have occurred under each policy, the deductible needs to be considered. Much to my dismay, it had been suggested that the full deductible can arguably be applied to each policy year, which is contrary to accepted adjusting practice of apportioning the deductible over the multiple years on which the claim is being made, accounting, of course, for any differences in the deductible amount over the various years.

Fortunately, I have found a legal case in support of one deductible. *PECO Energy Co. v. Boden*, 64 F.3d 852, 857, 42 Fed. R. Evid. Serv. 1354 (3d Cir. 1995) involved a series of thefts of fuel oil insured under consecutive all risk cargo transit policies. The case made it to the Court of Appeals that held that the series of thefts constituted one occurrence, and as the policy provided for a deductible per occurrence, the insured should only pay one deductible. The fact that the occurrence was ongoing and continued over separate consecutive policies is irrelevant. The Court further stated that the appropriate and equitable manner of treating the deductible was to apply the percentage of the deductible in line with the percentage of the damage that occurred over each policy year.

When apportioning the deductible over multiple policy years, it is important for the Adjuster to apportion the deductible in accordance with the amount of damage sustained during each year, and not purely on a “days on risk” basis. For example, a claim may have damages that fall exclusively under the first policy, as well as a component of progressive damage apportioned based upon the “days on risk” over multiple years. If the deductible is apportioned purely on “days on risk”, the underwriters on the first year do not get the benefit of the higher proportion of the deductible to reflect those damages that are not considered progressive and fall exclusively on their policy.

While U.S. and U.K. practice and case law similarly address and adjust progressive damage, The Nordic Plan (nordicplan.org) takes a different approach and avoids apportioning damage over multiple policy years. The purpose of Clause 2-11, Causation. Incidence of Loss, is to clarify which insurer is liable. Sub-clause 1 states “The insurer is liable for loss incurred when the interest insured is struck by an insured peril during the insurance period.” It is important to note the reference to insured interest, rather than the insured object, typically, the vessel. Accordingly, the damage to the vessel may not have commenced, but, as per the Plan Commentary, “It is sufficient that the operation of the peril has advanced to a stage which makes future loss of the kind covered by the relevant insurance contract almost inevitable unless extraordinary preventive measures are taken”. The commentary provides examples such as a vessel grounding during one policy period, but not suffering any damages until the subsequent policy. Under the Plan, the claim would fall on the policy during which the peril operated. Sub-clauses 2 and 3 address losses arising from an unknown defect or damage. According to the Pan Commentary, these sub-clauses provide that “any unknown defect or damage, irrespective of its origins, must be regarded as creating a marine risk”, and accordingly, would fall under the policy when the damage commenced. While I appreciate that this approach might be more pragmatic, I would consider it to be somewhat less equitable.

In closing, claims involving superimposed damage or progressive damage can be complicated. While I hope that this address provides some guidance, each claim is unique and the facts surrounding the loss must be carefully considered when determining under which policy or policies coverage lies. However, at the end of the day, the prevailing principles of equity and common sense apply, as they do in most, if not all, matters of adjusting practice.

Reference

Buglass, L. (1991). *Marine insurance and general average in the United States*. Cornell Maritime Press, Centreville, Maryland.