Shipping

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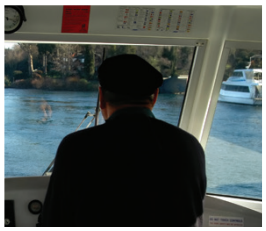
MARINE INSURANCE BULLETIN



Welcome to the January edition of our Marine Insurance Bulletin.

In this edition, we consider the implications of the recent English Supreme Court decision in the *ALEXANDROS T*, where the Court ruled that an English settlement agreement should bring a full stop to a dispute between the underwriters and their assureds. The Court decided the settlement agreement should not be capable of being unravelled by a foreign court. We look at the basis of the decision.

In another recent case, the English High Court has reconsidered both underwriters' fraudulent devices defence and the scope of perils of the sea. We look at how the widening of the definition of perils of the sea may well make it easier for assureds to claim.

With the entry into service of a number of mega-container vessels and others still to be delivered, many questions have been raised about the shipping industry's readiness to deal with such vessels. We review the proposed marine insurance general average solution for large containerships and then look at the implications of these mega-container vessels for cargo insurers.

Finally, we include our regular Case Update, a summary of recent key marine insurance case law.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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hfw Judgment call: ALEXANDROS T

After much to-ing and fro-ing between the English High Court, a Greek court, the Court of Appeal in London and the Supreme Court, we now thankfully have some clarity around the issue of the finality of an English settlement agreement. In a landmark decision the Supreme Court has ruled that an English settlement agreement should bring a full stop to a dispute and should not be capable of being unravelled by a foreign court.

The case settled for 100% of the principal sum claimed. Subsequently Starlight issued a fresh claim against the insurers in Greece, sending a shock wave through the London insurance market, where their action was seen as potentially undermining the very concept of finality (key to legal and business certainty) in settlement agreements.

JONATHAN BRUCE

The facts of the story have been well publicised: after the sinking of the *ALEXANDROS T*, owners Starlight Shipping Company became embroiled in a bitter dispute with its insurer, launching a claim against them in the High Court in London in 2006. The case settled for 100% of the principal sum claimed. Subsequently Starlight issued a fresh claim against the insurers in Greece, sending a shock wave through the London insurance market, where their action was seen as potentially undermining the very concept of finality (key to legal and business certainty) in settlement agreements. Starlight was using arguments that evidence had been fabricated and witnesses bribed in the course of the English proceedings, to persuade the Greek court to review the circumstances of the case and effectively unpick the settlement agreement. In response, the insurers sought the assistance of the High Court in enforcing the settlement which was in turn resisted by Starlight who applied for these English proceedings to be stayed while the Greek proceedings were ongoing. So a classic turf war over the jurisdiction of the dispute. The High Court concurred with the insurers and stayed the Greek proceedings, but the to-ing and fro-ing continued with the Court of Appeal reversing this position. The insurers then took the matter to the Supreme Court, which issued its judgment late last year.

The sound of the insurance markets breathing a collective sigh of relief is audible. In its judgment the Supreme Court underlined that it was important not to prevent a final decision of the English court where this was the jurisdiction that governed the contract. “Once there is a final judgment of the English court, it will be recognisable in Greece, as elsewhere in the EU and will assist the Greek courts.” The Supreme Court determined that Article 27 of the EU Jurisdiction Regulation, which obliges any Court other than the first seised (in this case Greece) to order a stay, did not apply because the English and Greek proceedings did not involve the same “cause of action”. This is a highly technical argument, and possibly the result is counter-intuitive to what the man on the street would have thought, but this was an essential determination if there was to be a victory for common sense in this case. The outcome is that both proceedings can in theory continue, but the Greek action is now pointless as any recovery will be automatically indemnified in England.

Commentary so far on the long term impact of the ruling has focussed on the point that it increases certainty and confirms that English settlements cannot be unravelled easily by a foreign jurisdiction. But is the position really as well shored up as many commentators would have us think? Looking at the detail of the case it was actually a very close call. The critical question was whether the two arms of the dispute - ie a) upholding the settlement agreement in contract, and b) seeking tortious damages effectively on the basis that the action that led to the

agreement was tainted by fraud - were completely separate causes of action, or whether they were actually part of the same one. The Supreme Court decided they were separate causes of action, which is the main reason it determined the case in the way that it did. But the facts would not have to be that different in another case for the court to come to a different conclusion, at which point we could well find ourselves in a similar position to where we were after the Court of Appeal's decision in this case. For example, fraud could make the settlement voidable, or the jurisdiction in the settlement agreement might not be expressed as exclusive. Also, what gave this case extra dimension is the fact that damages for late payment by insurers are not available in England (unlike in Greece), whereas the Law Commission looks like it may change that. Further, not all settlement agreements will be subject to English law and jurisdiction: if they are subject to another law or jurisdiction, all the questions that were examined in the chain of proceedings we saw in the Starlight case might be viewed differently elsewhere, in any country in the EU.

Yes it certainly is good news that we have some more certainty about the integrity of settlement agreements in England, but perhaps this is not the last word we have heard on these issues.

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English High Court reconsiders fraudulent devices and perils of the sea

Background

In this case[1], the *DC MERWESTONE* (the vessel) was insured for 12 months from 1 April 2009 under a policy which included the Institute Time Clauses – Hulls 1.10.83 (ITC) and the Institute Additional Perils Clauses (IAPC).

In January 2010, the vessel called at Klaipeda, Lithuania, to discharge. The weather was exceptionally cold and the hatch covers and gangways froze over with ice. The vessel's crew had to chip the ice off the hatch covers and then used the vessel's emergency fire pump to blast the chipped ice away. The crew then drained the deck lines, but did not drain the pump of seawater and failed to close the sea valve. As a result, some seawater remained in the hose and its filter. Given the extremely low temperatures, the water in the pump froze and expanded, causing the casing to crack and the strainer lid to become distorted so that it no longer functioned as a seal. The crack and distortion caused an open space between the seawater outside the vessel and the bowthruster space. While the vessel remained in the port, no water entered through this open space because the ice had frozen and created a barrier. However, after the vessel left the port, she entered warmer waters and the ice melted, allowing water to enter the bowthruster space. The main engine became submerged in water and the vessel was rendered incapacitated while off the coast of Poland.

1 Versloot Dredging BV v HDI Gerling Industrie Verischerung AG and others [2013] EWHC 1666.

The bowthruster room should have been able to withstand the ingress of water. However, the bulkhead between the bowthruster space and the duct keel was not watertight, and therefore the water was able to ingress the duct keel tunnel. The duct keel tunnel should also have been watertight, however, it was not and, as a result, water was able to enter the engine room. The vessel's engine room pumping system was also deficient, which prevented the crew from stemming the ingress of water.

Owners' claim

The Owners brought a claim for €3,000,000 under the H&M policy. The Owners' main argument was that the proximate cause of the loss was the ingress of seawater into the bowthruster room. Such a loss was a peril of the sea pursuant to ITC Clause 6.1.1. The Owners also put forward the argument that coverage was available under ITC Clause 6.2.3 or IAPC Clause 1.2 on the grounds that the loss was caused by crew negligence in relation to the emergency fire pump, which was not the result of want of due diligence on the part of the Assured/Owners/Managers; and/or by contractors' negligence in failing to seal the duct keel at both ends, which did not result from want of due diligence by the Assured/Owners/Managers.

Underwriters' defences

The Underwriters denied all liability, arguing that the loss was not caused by a peril of the sea, but rather by crew negligence through the crew's failure to drain the emergency fire pump and to close the sea valve. The Underwriters further argued that the loss fell outside ITC Clause 6.2.3 and IAPC Clause 1.2 because the loss resulted from separate instances of want of due diligence by Owners and/or Managers through their failure to make available

appropriate cold weather procedures; to have in place a proper and effective system for testing and maintaining the bilge alarm system; to inspect and maintain the bulkheads in the duct keel; and to have a fully functioning system for the maintenance of the bilge and ballast pumping system. The Underwriters also argued that the vessel was unseaworthy with privity of the Owners as per section 39(5) of the Marine Insurance Act 1905 (the Act). Lastly they argued that the claim was forfeit on the grounds that it was supported by fraudulent evidence given by the Owners when they presented the claim to Underwriters in 2010 and 2011.

Decision

The Court held that that the loss was caused by a peril of the sea and therefore the Owners had a valid claim under the policy.

A peril of the sea is comprised of two elements:

- There must be a fortuity giving rise to an event which is not bound to happen; and
- This fortuity must be *"of the seas"* (i.e. of a marine character).

The Court decided that the seawater ingress could be considered a fortuity since it arose from an unexpected incident and it could further be considered *"of the sea"* because the accident was specific to the maritime nature of the adventure (despite the Underwriters' argument that the events leading to the issue with the emergency pump could have happened on land). It was reiterated that the fortuity element was designed to *"rule out losses resulting from wear and tear"* as per *THE MISS JAY JAY 1985*.

On the Underwriters' argument that the negligence provisions were rendered ineffective by the want of due diligence on the part of the Assured/ Owners/Managers, the Court found that although there was very little by way of cold weather guidelines and procedures available to assist the crew in times of extreme weather, there had not been a causative want of due diligence. The loss was therefore proximately caused by a peril of the sea.

The Court rejected the unseaworthiness defence. Under Section 39(5) of the Act, where a vessel is sent to sea in an unseaworthy state and the assured was privy to the unseaworthiness, the insurer is not liable for any loss arising out of the unseaworthiness. Underwriters argued that Owners were aware of the deficient condition of the engine room pumping system. Specifically, Underwriters argued that Owners knew about the blockages in the bilge pipes and requested that the ballast line be cut rather than connected to the bilge system while attempting to empty the water from the engine room. This argument was rejected on the grounds that the ballast lines were cut in order to create a new source of suction given that the pumps were not functioning at full capacity. There was insufficient evidence that the Owners knew about the blockages and the Court did not consider that the blockages caused the loss.

In light of the above, Owners' claim for the cost of repairing the main engine would have been recoverable in full, since the loss had been caused by an insured peril under the H&M policy. However, the Underwriters still had one defence available to them: the fraudulent device defence. This defence was successful and Owners' claim therefore failed entirely.

Underwriters' fraudulent device defence was that a crew member had deliberately or recklessly given a false account of the causality in a letter to Underwriters' solicitors. The false account was to the effect that the crew had not investigated the bilge alarm that had sounded shortly after the ingress of water because the vessel was rolling in heavy weather at the time. It later emerged that the bilge alarm had not sounded and therefore the explanation as to why the alarm had not been investigated was false. The Court found that this evidence was false and misleading and that the particular crew member in question had no reason to believe it was true, and that he was reckless in his actions. The Court also found that the false account was intended to promote the claim.

Lastly they argued that the claim was forfeit on the grounds that it was supported by fraudulent evidence given by the Owners when they presented the claim to Underwriters in 2010 and 2011.

ALEX KEMP



The Court decided that the seawater ingress could be considered a fortuity since it arose from an unexpected incident and it could further be considered "of the sea" because the accident was specific to the maritime nature of the adventure (despite the Underwriters' argument that the events leading to the issue with the emergency pump could have happened on land).

Accordingly, the Court rejected the Owners' claim, expressing regret at having to do so since it was considered that the Owners' fraudulent conduct was only mildly culpable. It was not a carefully orchestrated deceit, but rather a reckless untruth told on one occasion only and abandoned well before the case went to trial. The Judge in this case considered that the forfeiture of the claim was disproportionately harsh in the circumstances and expressed the view that a more flexible test of materiality should be adopted which would permit the Court to consider whether it was just and proportionate to deprive an assured of his substantive rights in light of all of the circumstances of the case. However, as the law currently stands, the Court had no choice but to reject the claim in full.

Appeal

This case illustrates the draconian effect of the fraudulent device principle. An appeal is expected to be heard between January and April 2014 and will focus on the fraudulent device principle, for which there is little recent authority.

Analysis

On the surface this case is a victory for the underwriting community on the basis that the fraudulent device defence has been confirmed and applied. It remains to be seen whether this application of the fraudulent device principle will be upheld by the Court of Appeal. However, this decision is another example of the Court taking a wide view as to what the proximate cause of a loss is and when it is caused by *"perils of the sea"*. This widening of the definition is likely to make it easier for assureds to prove that their loss falls within an enumerated peril. It also confirms that it is harder for underwriters to establish that the proximate cause was unseaworthiness or crew negligence (either under Clause 6.2 or Section 39(5) of the Act).[2]

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2 There were two further reported decisions arising out of this litigation, in respect of access to experts and Underwriters' application to re-re-amend their defense submissions. These are covered in the Marine Insurance Case Update in this Bulletin.

General Average for mega-containerships: a new solution?

With the arrival of mega-container vessels into the shipping market, many questions have been asked about the shipping industry's readiness to deal with the repercussions of a casualty involving a vessel of this size.

There is a growing drive in both the salvage industry and insurance market to try and find a practical financial solution to the challenges presented by major casualties of the new generation of mega-containerships. The general average principle of cost sharing with the aim of minimising losses as far as possible is a sound one. But it is the mechanics and cost of how to carry out this process when there are far more cargo owner interests that raises many questions. The procedures for general average have largely been unchanged for many years and arguably have not kept up to date with the increasing size of ships and number of parcels. This is very much a live issue, illustrated once again by the recent containership casualty of the *MOL COMFORT*, which would have presented huge ramifications for the market and a potentially enormous general average claim had the two halves not sunk.

There is a fear that the current practical difficulties of obtaining general average security for all those involved in major general average incidents and the cost and time of doing so render the current system impractical. Alternative insurance products available at the moment are not suitable for the inevitable casualty of one of these mega-containerships, where the general average values may be so high that they would exceed policy limits. One possible solution to this would be to expand the general average absorption clause in the H&M Policy but

this would still mean that any general average claim would be recorded under the H&M policy and thereby impact future premiums, which will harden shipowners' rates requirements. Alternatively, which may be more beneficial to shipowners, a separate general average insurance policy could be taken out which would cover all claims beyond the H&M absorption clause.

The Swiss Re led Landmark Consortium is currently looking at an insurance policy to replace the traditional approach to general average for large containerships. This obliges the shipowner to assume cargo interests' liability for their proportion to general average/salvage guarantees. The Landmark Consortium's idea is to replace the cargo interests' contribution to general average by a US$500 million insurance cover, bought by the shipowner. Each container would be covered for a notional value of US$30,000, the cargo value agreed at the time of sailing rather than when a casualty occurs. With a limit of US$500 million, the total cover on offer would be suitable for vessels carrying up to 16,666 TEU.

The proposed policy provides for one guarantee for cargo interests with the knock-on effect of a smaller administrative burden to both salvors and average adjusters and should allow the immediate release of undamaged containers at a safe port. The insurance would also provide cover for those consolidated and uninsured containers.

It remains to be seen whether this proposed marine insurance general average solution will be accepted by the market and, if so, what repercussions it will have.

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Mega-containerships: impact on cargo underwriters

The last 12 months have seen the entry into service of the mega-container vessels the *CMA CGM MARCO POLO* and her sister-ships, with a capacity of 16,020 TEU, and the *MAERSK MC-KINNEY MØLLER*, and her sister-ships, with a capacity of 18,270 TEU.

With these, and another six mega-container vessels still to arrive, many questions have been asked of the shipping industry's readiness to deal with such vessels; whether they can safely enter certain ports, whether the landside infrastructure in place is sufficient, and the International Salvage Union has expressed a concern that operations to salvage a mega-container vessel would stretch even the largest salvor.

As discussed in the previous article, the London underwriting community has produced a new insurance product which it suggests will alleviate some of the problems that are likely to be faced by the declaration of general average on one of these new mega-container ships.

Little has been said of the impact of these new container vessels on the cargo insurance market, a large proportion of which is already operating on small profit margins. The areas of greatest concern arise out of risks that are in existence today, but are amplified by the size of the mega-container vessels. We consider some of these further below.

Given the industry speculation that mega-container vessel casualties will be too difficult to salvage, it stands to reason that there will be either increasingly expensive payments to professional salvors or an increase in the number of total losses of vessels and cargo. The cost of both would be covered under the most commonly used cargo insurance wordings, the Institute Cargo Clauses (ICC).

Larger salvage payments?

The factors which are considered by an LOF arbitrator in determining an Article 13 Salvage Award (the salvor's remuneration under the "no-cure, no-pay" LOF contract) will all be directly affected by the difficulties in salvaging the mega-containerships. Professional companies engaged to salvage such large vessels are likely to have to work longer and utilise more resources in order to do so. These factors, along with the potentially enormous salved funds, and the fact that salvors are expected to invest in more equipment to deal with such casualties, are likely to weigh heavily on a arbitrator's mind and could well result in much more encouraging awards, which will come at a cost to cargo insurers.

More total losses?

Even a comparatively small 8,000 TEU container vessel on a Far East to Europe service is likely to commence its voyage with roughly US$500,000,000 of cargo value onboard. Given this, it is not unreasonable to assume that a mega-container vessel on the same service could be carrying cargo with a value in excess of US$1,000,000,000. The total loss of such a vessel would therefore result in the cargo insurance industry as a whole facing claims at a level very close to the cost of the entire 2012 UK floods. More than one such event in an underwriting year would surely be close to catastrophic for some of those in the cargo insurance industry.

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MATTHEW WILMSHURST

Claims for delay?

Longer and more complex salvage operations and potentially delays in discharge due to general average security issues could also result in cargo insurers facing more claims for losses and expenses caused by delay. Prior to the Supreme Court's decision in the *CENDOR MOPU*, these would not have been covered by most cargo insurers as they would be excluded under the ICC terms, but in light of that decision, there is now a risk that insurers would not be able to rely on the exclusion if the proximate cause of the losses were the perils of the sea.

The advent of mega-containerships has resulted in a lot of debate as to the potential impact on many sectors of the worldwide shipping industry, and the cargo insurance market is certainly not the only one to be potentially affected, but the effect goes beyond just the shipping and insurance industry. The natural reaction for insurers would be to protect themselves against the risk of higher claims by raising the premiums charged, which is normally passed directly onto the last person in the supply chain – the high street consumer.

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Quarterly Case Update

1. Metall Market OOO v Vitorio Shipping Ltd (*The LEHMANN TIMBER*)[1]
   Appeal from an arbitration award regarding the exercise by Owners of a general average lien over cargo.

2. Les sociétés de droit Allemand Vega Reederei Freidrich Dauber Gmbh & Co KG (Hambourg) Partenreedererei M/S Heidberg (Hambourg) v La SAS Société des Pétroles Shell Assurances Mutuelles Agricoles Groupama
   The French court finally recognises shipowner's right to limit liability 22 years after the event.

3. Bank of Scotland Plc v Owners of the *M/V "UNION GOLD"*; Owners of the *M/V "UNION SILVER"*; Owners of the *M/V "UNION EMERALD"*; Owners of the *M/V "UNION PLUTO"*[2]
   Guidance on the Admiralty Marshall's power of sale and when the process of sale by appraisement and advertisement can be derogated from.

4. Beazley Underwriting Ltd and others v Al Ahleia Insurance Company and other companies[3]
   Whether a settlement made by the broker, underwriters and lead re-insurer will bind the following reinsurers.

5. CHS Inc Iberica Sl & Anor v Far East Marine SA *(M/V DEVON)*[4]
   This case concerns a cargo claim made under a bill of lading by cargo owners against the shipowners in respect of damage to a cargo of corn.

1 [2013] EWCA Civ 650
2 [2013] EWHC 1696
3 [2013] EWHC 677 (Comm)
4 [2012] EWHC 3747 (Comm)

6. Ust-Kamenogorsk Hydropower Plant JSC v AES Ust-Kamenogorsk Hydropower Plant LLP[5]
   This decision offers useful guidance on the jurisdiction of the English court and in particular whether it is able to offer relief, including an anti-suit injunction, to protect a party's rights under an arbitration agreement in circumstances where there are no on-going arbitral proceedings and where none are intended pursuant to the agreement.

7. Versloot Dredging BV v HDI Gerling Versicherung AG *(THE DC MERWESTONE)*[6]
   Consideration of "perils of the sea" and whether an Assured's reporting of the casualty was fraudulent.

8. Versloot Dredging BV v HDI Gerling Industrie Versicherung Ag and others[7]
   Guidance on the extent of the "no property in a witness" rule and questions of confidentiality and privilege.

9. Versloot Dredging BV v HDI Gerling Industrie Versicherung Ag and others[8]
   Guidance on refusing an underwriter's application for permission to re-re-amend its defence submissions

Conferences and events

Shipping Disputes in West Africa
HFW London
5 February 2014
Presenting: Stanislas Lequette and Xavier McDonald

Informal Tanker Operator Safety Forum
London
18 February 2014
Presenting: Richard Neylon

OSV Chartering Contract Management
Houston
24–25 March 2014
Presenting: Paul Dean

5 [2013] UKSC 35
6 [2013] EWHC 1666 (Comm)
7 [2013] EWHC 581 (Comm)
8 [2013] EWHC 1667 (Comm)

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