



INDIA BULLETIN

Welcome to the latest edition of our regular India Bulletin.

Our first article considers the Maritime Labour Convention (MLC), which is coming into force on 20 August 2013. The MLC will affect Indian commercial shipping companies and their insurers, even though India has not yet ratified the MLC, and we look at what shipping companies must do before 20 August 2013.

Our second article examines a major recent decision in relation to ship sale and purchase and sets out what sellers and buyers of new and second hand vessels need to know. We then turn to environmental regulation and review the recent changes to Marpol Annex V, acceded to by India in 2003.

Finally, this edition of our Bulletin turns to marine insurance and comments on two recent cases in this area. We analyse the impact of a recent English High Court decision which has held that a continuing warranty to insure at a specified insured value in the charterparty means an owner cannot declare a charterparty frustrated where the cost of repair will be less than the required insured value. We also consider a second recent Court of Appeal decision showing how the English court will treat insurers' attempts to apply multiple deductibles.

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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Introduction of the Maritime Labour Convention

The Maritime Labour Convention (MLC) will come into force internationally on 20 August 2013, and will affect Indian commercial shipping companies and their insurers, even though India has not yet ratified the MLC. The MLC was established by the International Labour Organisation (ILO) in 2006 and is designed to be the “fourth pillar” of the international regulatory regime for shipping, alongside the STCW, SOLAS and MARPOL, acknowledging that the shipping industry “requires an international regulatory response of an appropriate kind - global standards applicable to the entire industry”¹.

The MLC is coming into force 12 months after ratification by 30 ILO member states representing 33% of the world’s gross shipping tonnage. The tonnage requirement was met in 2009, and the ratification in 2012 by the Russian Federation and the Republic of the Philippines fulfilled the 30 states requirement. 36 countries have now fully ratified the MLC (most recently Serbia, in March 2013), representing nearly 70% of the world’s gross shipping tonnage, so the MLC will affect the majority of the world’s seafarers.

Implementation by India

India has not yet ratified the MLC, but the Indian Government’s Directorate General of Shipping has stated that the process of ratification is at an advanced stage. Ratification will involve procedural, legislative and regulatory formalities by way of amendments to the Merchant Shipping Act 1958 and formulation of specific rules for the purpose of the MLC².

Key aims of the MLC

The MLC aims to provide comprehensive rights and protection for the world’s 1.2 million seafarers and has been referred to as the seafarers’ Bill of Rights. In doing so, it will replace 68 international labour standards relevant to the maritime sector adopted over the last 80 years and consolidates 36 existing ILO conventions and one protocol dating from 1920 to 1996.

It aims to achieve a level international playing field for those countries and shipowners which are committed to providing acceptable global conditions of work for seafarers, thus ensuring secure economic interests in fair competition for shipowners. It applies to all commercial vessels over 500 grt, trading internationally, whether publicly or privately owned. It does not apply to vessels trading exclusively in inland waters, to traditional vessels such as dhows and junks or to warships and naval auxiliaries. If there is doubt over whether the MLC applies to a vessel, the flag state will decide.

As a consolidating convention, in some states the changes may be fairly small. In fact, the MLC provides that if a national provision implements the rights and principles of the convention in a different manner, it may be considered “substantially equivalent” to the MLC provisions as long as the member state satisfies itself that it gives effect to the general object and purpose of the provision.

Seafarers covered by the MLC are defined as “any person who is employed or engaged or works in any capacity on board a ship to which this Convention applies”. This definition is broad, and could potentially include armed guards, guest entertainers

based on board for a period or scientists onboard a research vessel, even if they are not employed by the shipowner. Where there is doubt over whether a category of person is to be regarded as a seafarer, the flag state will decide, and clarification at national level may be required.

The MLC covers conditions of employment, hours of work and rest, accommodation, recreational facilities, food and catering, health protection, medical care, welfare and social security protection, with principle areas of concern, dealt with under 5 “Titles”:

- **Title 1:** Minimum requirements for seafarers to work on a ship.
- **Title 2:** Conditions of Employment.
- **Title 3:** Accommodation, recreational facilities, food and catering.
- **Title 4:** Health protection, medical care, welfare and social security protection.
- **Title 5:** Compliance and enforcement.

Application of the MLC

As part of the MLC, vessels of 500 grt or over which are engaged in international voyages, or vessels which fly the flag of one country while operating from or between the port or ports of another must be certified as being in compliance with the MLC, requiring a “Maritime Labour Certificate” and a “Declaration of Maritime Labour Compliance”. Certificates last for a maximum of 5 years and there must be an interim review between years 2 and 3. The certificates will cease to be valid,

1. Source: ILO website following 2001 joint resolution by seafarers’ and ship owners’ organisations.

2. M.S. Notice No. 7 of 2013, Implementation of the Maritime Labour Convention, 2006 – Voluntary Inspection of Indian flag ships – reg. Dated 01.02.13.



with new certificates required, on a change of owner, a change of flag or a substantial change to the structure of the vessel. Smaller vessels do not have to obtain these certificates, but they can do so on a voluntary basis.

Inspections required under the MLC, and prior to implementation may be done by appointment or at the next survey, following which the vessel is issued with interim paperwork and a Statement of Maritime Labour Compliance, pending entry into force of the MLC. Most cargo and passenger vessels will need to obtain such a Statement before the international implementation date. There may be a shortage of trained surveyors in some locations to begin with, and therefore it is advisable to make appropriate preparations sooner rather than later, to avoid missing the deadline.

Inspectors will examine employment policies and agreements, health and safety policies and the other documents required under the Convention. The inspection will also include a physical inspection of the vessel and private interviews with selected crew.

Once the Convention has come into force, all ships, regardless of whether their flag state has ratified the Convention, will be subject to inspection by Port State Control in ratifying states for MLC compliance when calling in the port of a country that is party to the Convention. Member states are obligated to implement the Convention in such a way as to ensure that the ships that fly the flag of a state that has not ratified the Convention do not receive more favourable treatment than the ships that fly the flag of a member state, although the vessels flying the flag of a

non-ratifying state are subject to lesser requirements. A detailed inspection of one or more of the fourteen key areas may be carried out if the Port State Control officer has clear grounds for believing that the vessel may not comply with flag administration requirements.

Implications

Owners of Indian flagged cargo and passenger ships must ensure that all policies required by the MLC are in place before the Indian implementation date, the appropriate certificates are in hand and that all Seafarer Employment Agreements fulfil the requirement to be between the shipowner and seafarer (and meet the requirements of the MLC). Indian operators with vessels flagged in a country that has already ratified the MLC will of course need to meet these requirements by 20 August 2013.

In advance of the ratification of the MLC by India, it has been announced that the Indian Register of Shipping (IRS) has been delegated the responsibility of inspection of Indian-flagged ships. Upon satisfactory completion of an inspection by the IRS, a "Statement of Compliance" will be issued to the ship, which may be used by the ship to demonstrate to Port State Control in ratifying countries its compliance with the MLC until the Convention is formally ratified by India³.

Conclusion

The ILO aims for the Convention to have near universal acceptance, thus potentially affecting a much wider range of owners and seafarers than the conventions it replaces. Whilst for some shipowners, there may seem to be few changes (particularly where

there are "substantially equivalent" provisions applicable in their flag state), this Convention is a major restructuring of maritime labour conventions and will have implications for all employers of seafarers in the shipping industry. For other shipowners, there may be some bigger changes as standards and requirements change, and the MLC strives for universal ratification. Owners will also need to be aware that the broader definition of seafarer will affect more workers.

Even though India has yet to ratify the MLC, the Port State Control of member states will demand a certain degree of compliance with the MLC regardless and may subject vessels of non-ratifying countries (including India) to inspections. Coupled with the fact that Indian authorities have announced that they will inspect vessels before India ratifies the MLC, it is plain that Indian operators and owners and Indian flagged ships will need to move to comply with the MLC as soon as possible, regardless of whether the Convention has been ratified.

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“Upon satisfactory completion of an inspection by the IRS, a “Statement of Compliance” will be issued to the ship...”

³ M.S. Notice No. 7 of 2013, Implementation of the Maritime Labour Convention, 2006 – Voluntary Inspection of Indian flag ships – reg. Dated 01.02.13.



Satisfactory quality in vessel sales: the Union Power

In The “Union Power” (*Dalmare SpA v Union Maritime Ltd*) [2012] EWHC 3537 (Comm), the English High Court has given judgment on an important question arising out of a Memorandum of Agreement (MOA) for the sale of a ship on the Norwegian Saleform 1993 (NSF 93). NSF 93 is a standard form contract for the sale and purchase of ships which is widely used in the market. In this case, Flaux J. decided that the express words of NSF 93 are not inconsistent with, and therefore do not exclude, the term implied by the Sale of Goods Act 1979 section 14 (2) that goods sold are to be of “satisfactory quality”, meaning that they meet the standard that a reasonable person would regard as satisfactory. The judgment further gives guidance that the addition of the words “as is, where is” is not sufficient to exclude the statutory implied term. The case is important because, on the bare wording of NSF 93, without the implied term, the rights of the buyer to complain about defects in the ship after delivery are rather limited; whereas if the obligation of “satisfactory quality” is implied, then the buyer’s rights are potentially much wider and, indeed, of uncertain extent. Both for sellers and buyers of ships, whether new or second hand, this judgment is of considerable importance.

The facts

Before signature of the MOA, the Buyers inspected the vessel and also inspected her Class records. The MOA was then signed on the NSF 93. The relevant parts of the MOA provided as follows:

Clause 4. Inspections

a) The Buyers have inspected the Vessel

and the Vessel’s classification records. The Buyers have also inspected the Vessel in Piraeus, Greece on August 18, 2009 and have accepted the Vessel following this inspection and the sale is outright and definite subject only to the terms and conditions of this Agreement...

Clause 11. Condition on delivery

The Vessel shall be delivered and taken over as she was at the time of inspection, fair wear and tear excepted. However, the Vessel shall be delivered with her class maintained extended to 30 September 2009 without condition/recommendation, free of average damage affecting the Vessel’s class. The Vessel’s continuous survey cycles of machinery are to be as per current machinery continuous status attached hereto (attached “A”). Her International, National, Class and Trading Certificates clean, valid until 30 September 2009, except ISSC and SMC to be valid at time of delivery only...”.

The Vessel’s class records showed an incident in 2002 resulting in damage to the main engine no. 2 crankpin, but this was not picked up or commented on in the buyer’s inspection of the records. The Vessel was duly delivered to the buyers at Tuzla, where she underwent special survey, not involving any inspection of no.2 crankpin. The Vessel completed special survey. About 30 hours after leaving Tuzla however, she suffered a main engine breakdown as a result of defects to the no.2 crankpin, which proved to be undersized and ovalised. The defects had been present at the time of inspection and delivery, and were likely to result (as they did) in failure

of the main engine within a short time of delivery.

The buyers claimed damages on two bases: (1) that the damage to the crankpin was “average damage affecting Class”, which the tribunal rejected; and (2) for breach of the Sale of Goods Act implied term of “satisfactory quality”, which the tribunal upheld. The sellers appealed to the High Court, on the basis that this was a question of law of general public importance and that the tribunal’s decision was open to serious doubt.

The relevant provisions of the Sale of Goods Act

The relevant provisions of the Sale of Goods Act 1979 (SOGA) as amended are as follows:

“14. Implied terms about quality or fitness.

(1) Except as provided by this section and section 15 below and subject to any other enactment, there is no implied term about the quality or fitness for any particular purpose of goods supplied under a contract of sale.

(2) Where the seller sells goods in the course of a business, there is an implied term that the goods supplied under the contract are of satisfactory quality.

(2A) For the purposes of this Act, goods are of satisfactory quality if they meet the standard that a reasonable person would regard as satisfactory, taking account of any description of the goods, the price (if relevant) and all the other relevant circumstances.

(2B) For the purposes of this Act, the quality of goods includes their state and condition and the following (among



others) are in appropriate cases aspects of the quality of goods-

- (a) fitness for all the purposes for which goods of the kind in question are commonly supplied,
- (b) appearance and finish,
- (c) freedom from minor defects,
- (d) safety, and
- (e) durability.

(2C) The term implied by subsection (2) above does not extend to any matter making the quality of goods unsatisfactory-

- (a) which is specifically drawn to the buyer's attention before the contract is made,
- (b) where the buyer examines the goods before the contract is made, which that examination ought to reveal, or
- (c) in the case of a contract for sale by sample, which would have been apparent on a reasonable examination of the sample.

55. Exclusion of implied terms.

(1) Where a right, duty or liability would arise under a contract of sale of goods by implication of law, it may (subject to the Unfair Contract Terms Act 1977) be negated or varied by express agreement, or by the course of dealing between the parties, or by such usage as binds both parties to the contract.

(2) An express term does not negative a term implied by this Act unless inconsistent with it."

The issues

Because of section 55 (2) of SOGA, set out above, the sellers could only succeed if they could show the express terms of the MOA were "inconsistent with" the statutory implied term. Their argument involved two steps:

1. First, sellers argued that the words "*the Vessel shall be delivered and taken over as she was at the time of inspection...*" (emphasis added) had the same effect in a sale contract as the words "as is, where is".
2. Second, that in a number of cases the words "as is, where is" had been recognised as being incompatible with the statutory implied term as to quality, because the words meant that the buyer takes the goods as he finds them.

Thus there were two issues in the case:

1. Were the words in NSF 93 quoted above equivalent to "as is, where is"?
2. If they were, were these words inconsistent with the statutory implied term of "satisfactory quality"?

As will be appreciated, strictly speaking the second issue only arises if the sellers are successful on the first issue.

The first issue: is the NSF 93 wording equivalent to "as is, where is"?

Agreeing with the arbitrators and with the buyer, the judge rejected the first stage of the seller's argument. He thought that the obligation that the Vessel was to be delivered "*as she was at the time of inspection*" was essentially saying that there should be no change

in the condition of the Vessel between the two points of time marked by inspection and delivery. It said nothing about what the content of the seller's obligation was as to the condition of the vessel on inspection, or indeed on delivery. It was only directed to the possibility of change in condition.

This in itself was enough to dispose of the appeal. However there are a number of reasons why the judge came to this conclusion which are of wider significance.

The first step in the judge's reasoning was that the implied terms in SOGA are of universal application unless excluded, and apply with as much force to commercial contracts and to the sale of ships as to any other contract: "*The suggestion that SOGA somehow does not apply to contracts for the sale of second hand ships which are governed by English law is contrary to the terms of the statute. Ships are 'goods' within the statute like any other piece of machinery or equipment.*" There is no room for any kind of presumption that the SOGA implied terms are inappropriate to a commercial contract, nor even that they are easily excluded in a commercial contract. The seller's somewhat vague suggestion that the intrusion of the SOGA implied terms into the context of the sale of second hand tonnage would be contrary to "market expectations" thus found no favour. If commercial parties wanted to exclude the statutory implied term, they were free to do so by express and clear words; as indeed is done by the most recent edition of the Norwegian Saleform, as a BIMCO document, in 2012.

The possibility that the implied term could be excluded by evidence of market custom or usage was left open by the judge, as indeed was



required by SOGA section 55 (1), set out above, which establishes that a statutory implied term can be excluded by “such usage as binds both parties”. However, this means of escape from the implied term is likely to be more illusory than real in the present context. Custom or usage is a matter of fact which must be proved by evidence - e.g. by witness evidence from market participants or brokers. However, to be of legal effect, custom must be certain, universal and considered by market participants as binding. In reality, sellers, buyers and brokers are (or perhaps, were until the present case) far from certain as to whether the SOGA implied term applies. In general, it is probably truer to say that if pressed, they were agnostic, and would refer the question to their legal advisors. As it was said in argument, “the market” does not speak with one voice. If this is put in evidence, it is fatal to the existence of any binding usage or custom.

The judge, secondly, laid stress on the fact that the SOGA implied terms are “conditions” in the legal sense, meaning obligations, for any breach of which, the other party may terminate the contract; which in the context of a sale of goods, implies, reject delivery of the goods. SOGA elevates the “satisfactory quality” term to this degree of importance. Accordingly, so this reasoning implies, this valuable right cannot be excluded except by clear words.

Third, the judge would, if necessary, have applied the principle that where words are reasonably capable of more than one meaning, it should be presumed that the parties intended the meaning which would not exclude the statutory implied term. This is essentially an application of the

idea that clear words are needed to exclude the implied term. In clause 11 of NSF 93, the words “as she was at the time of inspection” certainly do have the function of stating that there is to be no change in the condition of the Vessel (fair wear and tear excepted) between the two points in time: which the sellers conceded. Once this first meaning is conceded, it becomes difficult to argue that the wording must *also* mean “as is, where is”.

The fact that NSF 93 expressly states two respects in which the condition on delivery may need to be better than the condition on inspection,, namely that the Vessel must be “class maintained” and “free of average damage affecting class”, did not, it was firmly decided, prevent the application of the statutory implied term as to quality. The implied term could happily co-exist with these express obligations. And in general, in a commercial or any other sale of goods contract, the mere existence of express and detailed terms as to condition on delivery is not inconsistent with, and therefore will not exclude, the overarching statutory implied term of satisfactory quality.

The second issue: are the words “as is, where is” inconsistent with the statutory implied term of satisfactory quality?

This is perhaps the more controversial part of the case. Strictly, it did not need to be decided and the judge made clear that he was expressing only a provisional view on the point. He considered that there was “considerable force” in the buyer’s position that the words did not exclude the statutory implied term, essentially for three reasons. First,

none of the English cases in which the words had been considered ruled decisively that they had this effect. Second, there was no evidence that the words had a customary meaning in relation to the sale of ships or in general usage. The judge expressly left open the possibility that the parties in some subsequent dispute might wish to call evidence as to custom or market meaning. Third, the statutory implied term could only be excluded by clear words, and the effect of these words was obscure.

If the words “as is, where is” did not exclude the statutory implied term however, that left a puzzle as to what, if anything, the words did achieve. The judge considered that there was some attraction in reading the words as excluding the right to reject the Vessel for breach of the statutory implied condition, but leaving unaffected the right to claim damages.

Discussion

The SOGA implied term of satisfactory quality considerably enlarges the rights of the buyer beyond the express rights contained in NSF 93 and other usual forms of contract of the sale of ships. In a certain sense it reverses what would otherwise be the balance of risk between seller and buyer with respect to significant defects in the vessel existing at the time of delivery. Furthermore, the precise limits of the implied term are highly unpredictable. As can be appreciated from the text of section 14 (2) set out above, the application of the implied term requires a complex exercise of judgement in each and every case, the result of which will differ depending on many factors, including the composition of the arbitration tribunal.



For this reason, whilst the non-exclusion of the implied term will be a great bonus for buyers who discover defects in a vessel following delivery, most sellers will wish to exclude it. This case underlines both the danger of not excluding the implied term, and the need to use clear and effective language in order to do so. The expression “as is, where is” may give the impression of having a well-known and legally certain meaning, but it can now be seen that these words are false comfort to the seller.

One solution for sellers is to use the new NSF 2012, which contains the following effective exclusion: “*Any terms implied into this Agreement by any applicable statute or law are hereby excluded to the extent that such exclusion can be made*”. If NSF 93 or another form is used however, buyers may well wish to include these or equally effective words of exclusion as an additional clause.

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Marpol Annex V Regulations - a new Regulation for owners, operators, charterers and shippers to contend with

There have been some discussions concerning whether BRICS nations (including India) and some of the developing world, would sign up to Marpol Annex VI, concerning regulations for the prevention of air pollution from ships. Ultimately, we understand that seventy countries, including India, will implement these regulations.

As well as Marpol Annex VI Regulations, which came into force on 1 January 2013, Marpol Annex V Regulations also came into force on the same date. Marpol Annex V was acceded to by India on the 11 September 2003, at the same time as Annexes III (Harmful Substances carried in Packaged Form) and IV (Sewage).

Marpol Annex V concerns the disposal of garbage from ships at sea and largely prohibit the practice. As a result it will become common practice for ships to send their garbage to shore-based reception facilities.

Marpol Annex V Regulations not only impact on what could be classed “traditional garbage” but also concern the issue of hold washing water removal and discharge of “cargo residues”. Cargo entrained in wash water is defined in the regulations as “cargo residues.”

Summary

As the Marpol Annex V Regulations are voluminous, this article will only focus on its impact in relation to discharge of cargo residues and hold

washing water. As this is very new legislation the law is yet to develop fully.

The starting point

The starting point to understanding how this new regulation impacts on shipowners, operators, charterers and shippers is to consider the nature of the (1) cargo carried; and (2) the hold cleaning chemicals used.

It is necessary to consider if:

1. The cargo is “harmful” to the marine environment?
2. Whether the hold cleaning chemicals are “harmful”?

If the answer to either question is positive then Marpol Annex V will have an impact.

Is the cargo harmful?

The Annex V guidance notes state that, if the cargo meets certain criteria listed in the UN Globally Harmonized System for Classification and Labelling of Chemicals, then the cargo is harmful to the marine environment.

IMO Guidelines state the shipper has an obligation to declare whether or not the cargo is harmful when providing the information required by section 4.2 of the IMSBC Code.

If the cargo is classified as harmful to the marine environment, then the hold washing water (i.e. “cargo residues”) have to be kept onboard and safely discharged into reception facilities ashore in all cases.

If cargoes that are harmful are carried, then this has to be fully



documented in onboard records/the garbage book.

Non harmful cargo and bilges

If the vessel is laden with non harmful cargo and liquid is being collected in the vessel's bilges whilst laden, then this liquid can be discharged at sea, subject to any other Marpol requirements.

Harmful cleaning chemicals

Whether hold cleaning materials are harmful depends on whether they contain any carcinogenic, mutagenic or reprotoxic components. This should be clear from the Material Safety Data Sheet (MSDS)/product information.

If the cargo was not harmful, but the holds were cleaned with hold cleaning chemicals, which are harmful, then it is likely that the hold washing water would have to be kept onboard and discharged into reception facilities ashore.

Non harmful cargo and cleaning chemicals

If the cargo (and any cleaning chemicals used) are not harmful to the marine environment, then hold washing water can be discharged at sea, within areas in which discharge is allowed, subject to any other Marpol requirements.

If the ship is in a Marpol "Special Area", discharge into the sea is only permitted (i) if the port of departure and next port of destination are both within a Special Area AND (ii) no adequate reception facilities are available at the port of departure and destination.

Marpol Special Areas are the Baltic Sea, North Sea, Mediterranean, the Gulfs Area, Wider Caribbean Region and the Antarctic Sea. Eventually, once shore reception facilities are available in the Black Sea and Red Sea, these regions may be classified as Special Areas for the discharge of garbage.

Developing standard clauses

It is clear that that this regulation will have a major impact on owners, operators, charterers and shippers. As a result, over time new clauses will be created to try and clarify between the parties whose risk non-compliance with Marpol Annex V falls to.

Owners, operators and charterers may be aware of BIMCO's August 2006 "BIMCO Hold Cleaning/Cargo Residue Clause", however, as this was produced prior to Marpol Annex V coming into force, it does not address the new issues raised by this particular Annex.

BIMCO have acknowledged the issues with their Hold Cleaning/Cargo Residue Clause and have developed some suggested amendments. In late May 2013 the Documentary Committee of BIMCO will be invited to formally adopt the suggested amendments and issue a revised clause.

In the meantime, the North of England P&I Club has produced specific clauses for both voyage charters and time charters that aim to respond to the new Annex V.

In due course it is naturally likely that either the amended BIMCO clause will be widely adopted or further

bespoke clauses will be created that will reflect both the risks of non-compliance, as it comes to be understood, and the negotiating strengths of the parties to the contracts.

Practical steps

For owners and operators it will be important that a proper protocol is put in place not only to ensure that the precise nature of the cargo is known, but also the hold cleaning chemicals used. Ideally this protocol would require the shippers to not only provide a declaration that the cargo is not harmful, but also provide supporting data such as MSDS.

Owners and operators will also have to maintain a proper and detailed record of this information (and the usage of any hold cleaning chemicals) onboard the vessel.

While shippers are obliged to declare whether the cargo is harmful, in some circumstances, it may be prudent for owners and operators to obtain expert verification of the cargo.

If, on the other hand, you are the shipper (or for that matter a charterer passing on the cargo designation from a shipper to an owner) you should recognise that this declaration of cargo is important information and that you may have an exposure if inaccurate information is given to the owner.

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Marine insurance issues: two recent cases to know

We analyse below two major recent marine insurance-related cases that it is important to be aware of. The first case is a recent English High Court judgment which has held that a continuing warranty to insure at a specified insured value in the charterparty means an owner cannot declare a charterparty frustrated where the cost of repair will be less than the required insured value. The second Court of Appeal decision shows how the English court will treat claims where multiple insured perils occur and insurers seek to claim multiple deductibles should apply.

Continuing warranty to insure: The Kyla¹

Facts

On 4 May 2009, the 27 year old MV “KYLA” (the Vessel) was struck by another vessel while berthed at Santos, Brazil. The Vessel was not at fault for the collision. At the time of the collision, the Vessel was just over three months into a 12 - 15 month time charter. The Vessel’s owners obtained surveyors’ reports following the collision which indicated that the cost of repairing the Vessel would be in excess of both her sound repaired value and her insured value.

On 3 July 2009, Owners notified Charterers that the charterparty had been frustrated as a result of the collision. Owners also declared the Vessel a constructive total loss and abandoned the vessel to hull and machinery underwriters. Charterers disputed that the charterparty was frustrated and claimed against

Owners for the losses they had suffered as a result of Owners declaring the charterparty to be frustrated.

The claim went to arbitration and the arbitrator held that where (as here) the cost of repair far exceeded the value of the Vessel, no prudent owner would repair the Vessel. Performance of the charterparty after the casualty had become radically different to that which the Owners had agreed, and the charterparty was frustrated as a result of the collision.

Charterers appealed the arbitrator’s decision to the English High Court.

High Court Appeal

The charterparty between Owners and Charterers was on an amended NYPE 1946 form, which included the usual obligation on Owners at Clause 1 to “keep the vessel in a thoroughly efficient state”. The charterparty also included an express term at Clause 41 which provided that owners would keep the vessel insured for US\$16 million.

Charterers argued before the High Court that Clause 41 formed part of a scheme in the charterparty requiring Owners to repair any damage to the Vessel during the currency of the charterparty which would cost less than or up to the Vessel’s insured value of US\$16 million and the arbitrator had therefore been wrong to say that the charterparty had been frustrated. Owners disagreed that such a scheme existed, or that Clauses 1 and 41 amounted to any allocation of risk to Owners of the events which had occurred.

Decision

The Court held that Clause 1 NYPE 1946 and Clause 41 of the “KYLA” charterparty amounted to an allocation of the risk of damage up to the Vessel’s insured value to Owners. The Court held that the presence of the warranty at Clause 41 made it impossible for Owners to say that what had occurred (namely a casualty giving rise to repair costs of US\$7 million less than the Vessel’s insured value) amounted to something radically different to the performance of the contract which had been contemplated when the contract had been concluded. The usual principle that insurance is irrelevant to the charterparty contract had been displaced by Clause 41.

In reaching this decision, the Court said that the numerous practical difficulties which such an allocation of risk would cause to Owners (such as having to fund the repairs themselves if insurers were slow to pay or if the Vessel’s mortgagee bank were loss payee) were to be disregarded. The case is currently being appealed.

Clauses containing a continuing warranty to insure at a specified insured value are common and the Court’s decision in this case makes clear that, where a charterparty contains such a clause, an owner cannot declare a charterparty frustrated where the cost of repair will be less than the vessel’s insured value. Instead, the shipowner must repair the vessel and continue to perform the balance of the charterparty, even if the repairs cost more than the repaired vessel will be worth such that no prudent owner would otherwise undertake the repairs. This is a charterer-friendly decision which is likely to surprise shipowners.

¹. *Bunge SA v Kyla Shipping Co Ltd* [2012] EWHC 3522 (Comm).



Multiple deductibles - what happened in TOISA PISCES?²

At first instance the Owners of the specialist well-drilling vessel “TOISA PISCES” (the Vessel) were successful in their claim against their loss of hire insurers. The unsuccessful Underwriters appealed to the English Court of Appeal.

Facts

Owners were claiming the maximum \$2,100,000 indemnity under the loss of hire insurance policy, which represented 30 days loss of hire at the insured amount of US\$70,000 per day.

The Vessel was propelled by two azimuth thrusters, each of which was driven by an electrical motor. These two motors were referred to in the judgment as the PAM (the port azimuth motor) and the SAM (the starboard azimuth motor). The first and primary incident was the breakdown of the PAM, which occurred on 25 February 2009. The Vessel was put off-hire as a result of the breakdown. The PAM did not return to service until 19 May 2009, and it was this period of off-hire which formed the basis of the Owners’ claim.

The Owners attempted to mitigate their losses by installing the SAM in place of the PAM and using a Louis Allis motor where the SAM would ordinarily have been. This work enabled easier access for maintenance in areas that were usually difficult to reach. During this maintenance, a hydraulics failure occurred (the second occurrence), with the result that the vessel had to go to drydock for repair. The Vessel was in drydock for just over a month.

Decision

If the second occurrence broke the chain of causation then the Owners’ claim would be reduced from US\$2,000,000 to just over US\$1,940,000. However, the Court of Appeal held that the chain of causation had not been broken. Both the reasonableness of the Owners’ decision to undertake the maintenance work which was underway at the time of the second occurrence and the close relationship between that maintenance work and Owners’ attempts to mitigate their loss pointed against a break in the causal chain. It was noted that the decision to carry out the repairs which gave rise to the second occurrence could be regarded as itself caused by the first occurrence.

However, less than a week after departure from drydock following the second occurrence, the SAM failed (the third occurrence). The Vessel proceeded to port for further repairs, during which time the now repaired PAM was reinstalled and the Louis Allis motor installed on the starboard side in place of the SAM. The Vessel then went back into charterers’ service.

The third occurrence was relevant to the question of whether one, two or three deductibles should be applied. The Court looked on this as a question of construction of the loss of hire policy, and held that after the application of the 21 day deductible,

the first occurrence gave rise to a claim to the policy maximum. There was no need to consider whether further deductibles would have been applied if the Owners’ claim had hinged on the second and/or third occurrences. It was irrelevant that H&M cover, which was closely linked to the loss of hire cover, had treated the three occurrences as three separate events. The Underwriters’ attempt to suggest that a claim based upon the occurrence of a single insured peril should attract the application of multiple excess periods was described by the Court as “to say the least *unorthodox*”.

In this case, as the Owners’ claim was successfully established on the basis of the first occurrence, the fact that two insured perils occurred after the first was ultimately irrelevant to the claim. In such cases, and subject always to the policy wording, it would seem unlikely that multiple deductibles and/or excess periods could be applied. Owners will doubtless welcome this judgment.

Simon Chumas and Jenny Salmon of HFW acted for Owners in the Kyla case.

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² *Valiant Insurance Company v (1) Sealion Shipping Ltd & (2) Toisa Horizon Inc* (“The Toisa Pisces”) [2012] EWCA Civ 1625.



Conferences & Events

Oil & Gas Asia Dispute Resolution Conference

Jakarta
(5 June 2013)
Speaking: Paul Aston

IMEDIPA

Athens
(7-8 June 2013)
Speaking: Konstantinos
Adamantopoulos

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