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What constitutes constructive total loss?

Under section 60 of the Marine Insurance Act 1906, an assured shipowner can claim for a constructive total loss (CTL) if the costs of repairing the damage (inclusive of salvage charges and other expenses) would be more than the value of the ship when repaired.

In the case of Swedish Club v Connect Shipping Inc (the "Renos") the hull insurers challenged a claim for a CTL on the grounds that the shipowners' calculation of repair costs included two categories of expense which shouldn't be taken into account. The High Court and Court of Appeal rejected Swedish Club's challenge, but their appeal to the Supreme Court was partly successful.

Calculating the costs at the right time

The insurers first argued that the position should be assessed at the time when the shipowner gives notice of abandonment, and the calculation of costs must exclude those incurred before then. In this case the owners had incurred salvage costs and further expenses at a port of refuge before giving notice of abandonment. If those costs weren't included in the calculation, the repair costs would be less than the vessel's insured value and there would be no CTL.

The court analysed basic principles of insurance law when making its decision. In particular, the court noted the general rule that a loss under a hull and machinery policy occurs at the time of the casualty, not when the measure of indemnity is established. It followed that damage leading to a CTL was in principle the entire damage arising from the casualty from the moment that it happened, and it made no difference when the costs were incurred. On this point, the Supreme Court agreed with the lower courts that the salvage costs and other expenses incurred from the time of the casualty should be taken into account in determining whether the vessel was a CTL.

SCOPIC charges

The second issue the insurers raised was whether the relevant costs also included SCOPIC charges, the special compensation paid to salvors (under the addendum to the Lloyd's Open Form salvage contract) to prevent/minimise damage to the environment following a maritime casualty. The shipowners argued that these charges should be considered as repair costs, because they were part of the salvors' remuneration which had to be paid in order to repair the ship, and this was accepted by the lower courts. However, the Supreme Court noted that SCOPIC charges are expressly excluded from general average and are generally paid (as they were in this case) by the vessel's P&I insurers. The court considered that the objective of SCOPIC charges wasn't to enable the vessel to be repaired, but to protect the shipowner against liability for environmental pollution. That was not related to the subject-matter insured by the hull and machinery policy, and was not part of the measure of the damage to the ship. On this point, therefore, the insurers' appeal succeeded.

A distortion of the compensatory principle?

We previously reported on the decision of the Commercial Court in the case of Classic Maritime Inc. v Limbungan Makmur Sdn Bhd which concerned claims for non-performance of a long-term contract of affreightment after a dam burst at an iron ore mine in Brazil.

The judge held that the charterers, Limbungan Makmur, couldn't rely on an exceptions clause referring to "accidents at the mine" because they wouldn't have been ready and willing to provide cargoes for shipment even if the accident had not occurred. However, he went on to find that the owners, Classic Maritime, weren't entitled to recover their losses of around US$19 million.

Both parties appealed to the Court of Appeal, which upheld the judge's ruling on the liability issue, but reversed his decision on the damages issue. The court agreed with the first instance judge that the relevant clause should be interpreted as an exceptions clause, not a force majeure or 'contractual frustration' clause like those in Gafta sale contract forms.

The case differed from previous decisions which have found that the party relying on a force majeure clause didn't have to prove that they would have performed their obligations but for the force majeure event. Unlike the Gafta clauses, the clause in this case didn't discharge the parties from future obligations and didn't give Limbungan Makmur an automatic defence, regardless of whether they would otherwise have been able to perform. Since the evidence showed that they couldn't have performed their obligations in any event, the clause didn't protect them.

The wrong comparison

The appeal in relation to damages focused on the compensatory principle, whereby damages are awarded to put the innocent party in the same financial position as if the contract had been performed. The first instance judge compared Classic Maritime's actual position (being deprived of US$19 million in freight) with the hypothetical position if Limbungan Makmur had been ready and willing to perform, and concluded that, due to the dam bursting, Classic Maritime's financial position would have been no different.

The Court of Appeal found that this was the wrong comparison. Limbungan Makmur's obligation was not to be ready and willing to supply cargoes, but actually to supply them. Limbungan Makmur was not in breach because it was unwilling to perform, but because it failed to do so. The judge based his decision on previous cases (the "Golden Victory" and Bunge v Nidera) which concerned anticipatory breaches of contract, but this case concerned an actual breach. This made a difference because if a party repudiates a contract in advance then the value of the rights the other party has lost should be assessed. For this purpose it is relevant to consider whether the party which breached the contract would have been excused from performing it by later events. Those considerations don't apply where there is an actual breach, particularly a breach of an absolute obligation (such as a charterer's absolute obligation to supply a cargo).

An unexpected result

The appeal court described the judge's decision as a distortion of the compensatory principle, which would lead to the surprising result that although the exceptions clause did not protect Limbungan Makmur against liability it still protected them from paying damages for their breach. If the compensatory principle was applied correctly then Classic Maritime was entitled to be put in the same position as if Limbungan Makmur had supplied the cargoes as agreed and was entitled to the damages claimed.

Does 'capture and seizure' clause apply to piracy?

The Commercial Court recently considered an appeal against a maritime arbitration award in a dispute which arose when the vessel, "Eleni P", was hijacked in the Arabian Sea in 2010 (Eleni Shipping v Transgrain Shipping).

The vessel was detained for over 6 months and the time charterers, Transgrain Shipping, claimed that hire was suspended during that period, amounting to losses of about US$4.5 million. They relied on two clauses in the charterparty: clause 49, 'Capture, seizure and arrest', and clause 101, 'Piracy clause'. The arbitration tribunal agreed with Transgrain and found that hire was suspended under both clauses.

The shipowners' appeal

The shipowners, Eleni Shipping, appealed to the court, claiming that the award was based on an incorrect interpretation of the clauses. The judge agreed with Eleni Shipping and concluded that clause 49 didn't apply when the vessel was captured by pirates. The wording of the clause referred to the vessel being 'captured or seized or detained or arrested by any authority or by any legal process' and the arbitrators were wrong to read the word 'captured' in isolation. In the judge's view, a vessel could be 'captured' by a legal authority and the clause wasn't intended to apply to a capture or seizure by pirates.

The piracy clause

On the other hand, clause 101 expressly provided for hire to be suspended if the vessel was threatened or kidnapped by piracy, but the clause referred to transit through the Gulf of Aden. Eleni Shipping argued that it therefore applied only to seizure within the Gulf of Aden itself. In this case, the vessel had sailed through the Gulf of Aden without incident and was captured in the Arabian Sea. On this point, the arbitrators found that there was no clear geographical definition of the Gulf of Aden (a finding of fact which could not be appealed). The judge agreed with the arbitrators that the clause covered the risk of detention as a consequence of the transit through the Gulf of Aden, even if that transit had been completed before the detention occurred.

The impact of cybercrime on sale of goods disputes

The impact of cybercrime on international trading operations was illustrated by a dispute which recently came before the Commercial Court on appeal from a Gafta Appeal Board.

As arbitration is confidential the judgment is reported only as K v A. The dispute concerned a contract between A as seller and K as buyer of 5,000 mt of Romanian sunflower meal on Gafta terms, providing for payment in cash to the sellers' bank upon presentation of scanned/fax copies of original documents, including a commercial invoice. The goods were shipped and A's invoice was emailed to the intermediary broker (V) to be forwarded to K. The invoice contained details of A's account at Citibank, New York, to which US$1,167,900 was to be paid. V's email records showed that A's

email was forwarded to K with the invoice attached. However, although K received an email which appeared to come from V, the invoice attached to it contained details of a different account in the name of A at Citibank's London branch.

Identifying the fraudster

There wasn't enough evidence to prove who was responsible, but it was clear that one or more email accounts had been hacked by a fraudster so the invoice received by K was fraudulent and designed to divert the funds to the fraudster's account. K instructed its bank to pay the funds to the fraudulent account, but the fraud was discovered before the funds left Citibank. A transfer was made into A's correct account, but there was a shortfall of approximately US$161,000, apparently due to the funds being converted into sterling and then back into dollars. The issue for the Gafta tribunal was whether A was entitled to recover the shortfall from K, even though the initial misdirection of the funds was due to fraud and not K's fault.

Allocation of risk

The board of appeal proceeded on the basis that as it couldn't confirm how the fraud occurred, the matter should be decided on the basis of the allocation of risk under the contract. The contract required K to transfer the price into the account nominated by A, which it failed to do. Accordingly, the balance of the price was still payable by K to A. The award was challenged by K, who argued that the relevant obligation was only to transfer the funds to A's bank (Citibank) and not to ensure that they were credited to A's account.

The court rejected this argument, pointing out that it is commercially impossible to transfer funds to a customer's bank, without identifying the beneficiary and the destination account. A payment to the

Was deck cargo loss excluded by bills of lading?

The vessel "Elin" encountered heavy seas on a voyage from Thailand to Algeria and part of the cargo carried on deck was lost or damaged.

The cargo interests made a claim against the shipowners in the English Commercial Court: Aprile SpA v Elin Maritime Ltd. The court was asked to decide whether Elin Maritime's liability for the loss was excluded by the terms of the bill of lading, which provided that owners were not responsible for loss of or damage to deck cargo 'howsoever arising'. The Hague and Hague-Visby Rules do not apply to cargo which is stated to be carried on deck and is so carried. The court therefore approached the issue under common law, which would imply an absolute obligation of seaworthiness.

The final judgment

The claimants challenged the exclusion clause, arguing that the obligation of seaworthiness was fundamental and overriding and could only be excluded by a clearly worded clause. Relying on the 1952 Canada Steamship Lines case, they argued that since liability for unseaworthiness was not mentioned in the clause, it did not exclude that liability. Alternatively, the clause should be restricted by excluding any strict liability and leaving owners responsible for any damage caused by negligence or a failure to exercise due diligence to make the vessel seaworthy.

The judge took as his starting point the words used in the clause, which in his view were clear. The Canada Steamship judgment simply provided guidance to interpret the words used. As a matter of plain language and commercial common sense the owners' interpretation was correct and the clause was effective to exclude their liability.

When charterers fail to challenge invoices in time

The standard BIMCO Supplytime 2017 charterparty for offshore support vessels contains a 'Payments' clause which provides for owners' invoices to be paid within a specified number of days (agreed between the parties).

This also requires charterers to notify the owners promptly, and no later than the due date, if they dispute an invoice. In the case of Boskalis Offshore v Atlantic Marine (the "Atlantic Tonjer") the agreed payment period was 21 days from receipt of the invoice.

The owners, Atlantic Marine, invoiced the charterers, Boskalis Offshore, for hire and other items totalling over €1.4 million. Boskalis didn't pay or give notice of a dispute within 21 days, but raised an off-hire defence later, claiming that hire of approximately €1.1 million was not due.

At arbitration the tribunal issued a partial award in favour of Atlantic, finding that Boskalis had lost the right to raise a defence to the invoice because they didn't give notice of the dispute before the deadline. Boskalis appealed to the court, which confirmed the tribunal's decision.

Appeal dismissed

In the judge's view, the clause was clear. The time period was freely negotiated between two equal parties, and the

clause was intended to ensure that any dispute was raised promptly. It didn't prevent a charterer from not paying, provided they gave the required notice but, without notice, the owner should have been paid. The judge thought this made commercial common sense as cash flow is critical to shipowners. The award and the judgment recognised that the clause didn't stop Boskalis from submitting a counterclaim for financial loss from payment of the invoice, for example a claim for unjust enrichment. This was a separate question which the arbitrators might consider later.

A general average claim: what makes a vessel unseaworthy?

Cargo interests regularly dispute shipowners' claims for general average contributions because the casualty was caused by the vessel's unseaworthiness, arising from the owners' lack of due diligence.

In Alize 1954 v Allianz (the "CMA CGM Libra") the Admiralty Court held that this applied not only to the physical condition of the vessel, but also the documents on board and proper passage planning.

Relying on charted depths

The casualty occurred in 2011, when the vessel grounded whilst leaving a Chinese port. The owners knew it was a difficult port to navigate in and out of, and that outside the marked fairway channel there could be uncharted areas of shallow water. The ship hit an uncharted shoal outside the marked channel, in an area where there were charted depths of over 30 metres. The master had deviated from the marked channel because he was told there was shallow water in certain areas during the inward passage.

The judge found this decision was negligent. A recent notice to mariners warned it was unsafe to rely on charted depths and gave advice on the least depth in the fairway. A prudent mariner would conclude it was safe to navigate within the fairway but not outside it where they might encounter uncharted shoal areas. However, negligent navigation alone wouldn't amount to the owners being legally at fault.

The passage plan

Cargo interests claimed the passage plan prepared before departure was defective, which made the vessel unseaworthy. The judge agreed. Applying the legal test of seaworthiness, he considered that if a prudent shipowner knew his vessel was about to begin a voyage with a defective passage plan, he would require the defect to be made good before the vessel set out to sea. Producing the defective passage plan was not an error of navigation but came within the owners' obligation under the Hague Rules to exercise due diligence to make the vessel seaworthy before and at the beginning of the voyage. He also found the defective passage plan was a cause of the casualty, because the master would not have attempted the manoeuvre which led to the grounding if there had been proper warnings on the chart or passage plan.

The conclusion

Finally, he concluded that as the master and second officer were negligent when they prepared the passage plan this amounted to a breach of the owners' non-delegable duty to exercise due diligence, and accordingly owners were not entitled to recover general average contributions from the cargo insurers.

Newsletter edited by
Nicholas Walser
nicholas.walser@gateleyplc.com