

CARRIAGE OF GOODS BY SEA

Carrier's liability following mis-delivery under fraudulent bills of lading

Eighteen containers of copper cathodes were shipped on board the "MSC AMSTERDAM" in South Africa for carriage to China. The cargo was discharged into a container terminal at Shanghai and a delivery order was obtained from the ship's agents by fraudsters who had obtained a fraudulent second set of bills of lading. The fraud was discovered before the containers were released and litigation ensued in the Chinese court as to which party was entitled to the cargo. In the meantime the consignees under the genuine bills of lading sued the carriers in England under the jurisdiction clause contained in the bills, claiming delivery up of the cargo or damages for conversion.

In the English litigation, **Trafigura Beheer v Mediterranean Shipping Co**, the High Court and the Court of Appeal had to consider whether the carriers were entitled to rely on limitation provisions in the bill of lading and the Hague Rules. A clause in the bill of lading provided that the shipowners should not be liable in excess of the limitation allowed under the Hague Rules or Hague Visby Rules, depending on which of these was contractually or compulsorily applicable. There was also a paramount clause providing that the bill of lading was subject to the Hague Rules or, if compulsorily applicable, the Hague Visby Rules or any compulsory legislation based on those rules. The Claimants contended that the Hague Visby Rules (which would have provided a more generous limitation regime in this case) were compulsorily applicable either by virtue of the UK Carriage of Goods by Sea Act 1971 or the South African Carriage of Goods by Sea Act 1986.

On this issue, the Court of Appeal, disagreeing with the first instance judge, held that it was the Hague Rules of 1924 which were applicable to the bill as a matter of contract. The UK Carriage of Goods by Sea Act 1971 would have made the Hague Visby Rules compulsorily applicable if the bill of lading had been issued in, or was for carriage from, a "contracting state". However it was common ground that as South Africa had not signed the 1968 Brussels Protocol it was not a "contracting state", even though it had enacted legislation based on the Rules. The judge considered that the South African legislation nevertheless fell within the wording of the relevant clause and the Hague Visby Rules should therefore apply, but the Court of Appeal overturned his decision on this point. The owners had only agreed to accept the Hague Visby Rules if they were forced to do so either by the proper law of the contract or (if different) the law of the place where the cargo owners chose to sue them. On the facts of this case, neither of those laws had this effect.

However the Court of Appeal went on to find, in agreement with the first instance judge, that in any event the Rules did not apply to the period after the cargo was discharged from the vessel. The limitation clause in the bill itself also did not have the effect of excluding or limiting the ship owners' liability for conversion during that period. The owners were therefore held liable for the full value of the cargo at the time of the judgment.

We understand that an application for permission to appeal to the House of Lords has been rejected.

TIME CHARTER – LATE REDELIVERY

We reported in a previous Newsletter the decision of the Commercial Court in the case of the "ACHILLEAS" (**Transfield v. Mercator**), upholding a decision of commercial arbitrators awarding damages to shipowners of more than US\$ 1 million in lost profits, when the charterers redelivered the vessel late and the vessel missed the cancelling date on her next fixture. The judge's decision has now been upheld by the Court of Appeal.

The charterers had argued that damages should be limited to the difference between the charter rate and the market rate for the "overlap" period of 9 days, which would have amounted to only about US\$ 158,000. They said that in order to recover more than this the owners would have to bring themselves within the second part of the so-called rule in *Hadley v Baxendale*. In other words a loss of this magnitude could not be regarded as within the parties' contemplation in the usual course of events and the owners would have to show that the charterers had some special knowledge of the particular fixture terms which had led to this loss.

The Court of Appeal agreed with the judge that this was the wrong approach. The rule in *Hadley v Baxendale* was one rule, not two, and merely prescribed two different ways in which a defendant may acquire the necessary knowledge to give rise to liability. The nature of the chartering market was well known to the charterers, whose knowledge did arise out of the ordinary nature of things and it was not necessary for the owners to prove any further or special knowledge. The court also rejected an argument that there was any relevant distinction between damages for loss of use during the overlap period and loss of profits arising from the separate subsequent fixture.

In response to suggestions by the charterers' counsel that the decision was harsh and unreasonable, the court confirmed that there will always be an exception if the claimed loss arises from an "extravagant or unusual bargain", and also pointed out that if the shipping industry regarded the result as unreasonable clauses could be created to regulate the situation.

ARBITRATION – JURISDICTION

The English Courts have recently been called on to deal with a number of procedural issues relating to an ongoing dispute between the Russian State Shipping Company Sovcomflot and a number of Russian nationals and Russian controlled chartering companies. Following a change of management in 2004 Sovcomflot started proceedings for the recovery of more than US\$300 million on the basis of allegations of conspiracy to defraud and bribery in the management of the Russian fleet. In particular the Defendants are alleged to have bribed directors or employees of Sovcomflot to enter into charterparties with companies controlled by them on terms highly favourable to the charterers. Amongst many other issues, the case has raised an issue of some importance concerning the jurisdiction of an English arbitration tribunal, and this has now been the subject of a decision by the House of Lords in **Premium Nafta Products Limited v Fili Shipping Company**.

The owners brought proceedings against the Defendants in the English Court and claimed that the charterparties

Court of Appeal upholds award of lost profits for subsequent fixture

House of Lords confirms new approach to construction of arbitration clauses

had been validly rescinded for bribery. However the charterparties were concluded on the Shelltime 4 Form and the charterers elected to refer the dispute to arbitration under the charterparty terms. The issue was whether the dispute as to the effect of the alleged bribery was within the jurisdiction of the arbitrator.

The judge at first instance decided in favour of the owners. He held that the bribery arguments impeached the whole contract and could not be said to arise “out of” or “under” the contract within the terms of the relevant clause. The Court of Appeal, in a decision now upheld by the House of Lords, disagreed and took the opportunity to clarify the correct approach to the interpretation of arbitration clauses. The decision makes it clear that any jurisdiction or arbitration clause in an international commercial contract should be liberally construed. It should no longer be necessary, as some of the previous case law suggested, to analyse closely the linguistic nuances between clauses referring to disputes “arising under” or “arising out of” or “in connection with” a particular contract or transaction. The construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they entered, or purported to enter, to be decided by the same tribunal.

On the facts of the present case, a dispute as to whether the contract could be rescinded for bribery did fall within the arbitration clause on its true construction. Under Section 7 of the Arbitration Act an arbitration clause was a separate contract which survived the termination of the main contract unless the validity of the arbitration agreement itself was directly impeached for some specific reason.

The charterers were therefore entitled to a stay of the owners’ court proceedings under Section 9 of the Act and the dispute as to whether the charters were validly rescinded for bribery should be decided by the arbitration tribunal.

CHARTERPARTIES

Tanker Time Charters – Effect of change in MARPOL Regulations

In **Golden Fleece Maritime v ST Shipping and Transport Inc** the dispute was between the owners and charterers of two oil tankers, the “ELLI” and “FRIXOS”, which were time chartered under Shelltime 4 terms. Clause 1 provided that the vessel at the date of delivery “shall be in every way fit to carry... crude and/or dirty petroleum products” and Clause 3 required owners “whenever the passage of time, wear and tear or any event... requires” to exercise due diligence to maintain or restore the conditions stipulated in Clause 1.

New MARPOL Regulations were adopted in December 2003 which were to come into force as from 5th April 2005 and would seriously restrict the range of cargoes that the vessels could carry. Following redelivery of the vessels in 2006 the owners brought claims for unpaid hire payments but the charterers counterclaimed for damages for breach of the charters arising from the vessels’ inability to carry the full range of cargoes following the coming into force of the new regulations.

The court held that if the vessels had not complied with MARPOL requirements at the time of delivery there would undoubtedly have been a breach of Clause 1 of the charter. Under Clause 3 the owners had to exercise due diligence to maintain or restore the vessel to the conditions stipulated in Clause 1 whenever “any event” required steps to be taken for that purpose. The words “any event” covered a change in regulations and there was also a separate warranty elsewhere in the charter of compliance with “MARPOL 1973/1978 as amended and extended”. In the absence of events amounting to frustration, the owners were therefore obliged to ensure that the vessel continued to be fit, both in a physical and legal sense, to carry fuel oil cargoes.

The owners argued that there was no warranty that the vessel was to be permitted by MARPOL to carry any particular type of cargo. The vessels did comply with MARPOL, albeit that they were unable to carry fuel oil cargoes. The owners also relied on the fact that the structure and configuration of the vessels had been known to the charterers when they entered into the charter.

The court rejected the owners’ arguments. The charter contained a warranty that the vessel would be able to trade as specified in the charter and that the owners would comply with any amendments or extensions to MARPOL which might affect such trading. The owners were therefore bound to exercise due diligence to restore the vessels to a condition in which they could carry fuel oil cargoes and to obtain the necessary documentation to enable them to do so. They were accordingly in breach of the charters and the charterers’ counterclaims succeeded.

INSURANCE

In 2003 Tesco Stores began a construction project which involved bridging over a railway line and building a new supermarket on top of it. They took out public liability insurance in respect of the construction works. The insurers agreed to cover damages for death or bodily injury of any person, loss or damage to material property, and “loss of amenities, trespass, nuisance or any like cause”. There was also a contractual liability extension in respect of liabilities assumed by the insured that would not have attached in the absence of contract. There was an express exclusion of liability in respect of “fines, predetermined liability or liquidated damages clauses in any contract”. Under a deed of covenant entered into with C, the company that operated trains on the railway line, T had to pay compensation to C for losses arising directly or indirectly out of the works. In June 2005 a section of the tunnel collapsed and debris fell onto the tracks. T agreed to pay compensation to C, including a sum in respect of a loss of passenger revenue following the incident. T claimed under the insurance policy in respect of this settlement.

In the ensuing proceedings, **Tesco Stores Ltd v Constable**, the court had to consider a preliminary issue as to whether any indemnity was due under the policy on the assumption that no property interest of C had been affected and no material property of C had been lost or damaged, and that the liability arose solely out of the deed of covenant between T and C.

The court held that T was not entitled to an indemnity under the policy. The starting point was that this was a public liability insurance policy, which would generally be regarded as not providing cover against liability in contract for pure economic loss. Trespass and nuisance were well recognised torts, and although the policy was intended to cover liability for a contractual breach of a co-extensive tortious duty causing harm of the same type, the contractual liability extension did not extend the cover to purely contractual losses.

SALE OF GOODS

It is a generally accepted principle that under a FOB Contract the seller takes the risk of a failure of his intended source of supply of the goods, unless the contract contains a force majeure clause or similar provision. In the case of **CTI Group v Transclear SA** an arbitration tribunal found that in the exceptional circumstances of the case this principle did not apply and the contract of sale was frustrated. On appeal by the buyers, the court disagreed and overturned the tribunal’s decision.

The sale contract was part of a project designed to break the cartel operated in the Mexican cement market by Cemex. The intention was that the sellers would ship cement in the Far East on the buyers’ vessel for shipment to Mexico. However due to commercial pressure exerted by Cemex the

Public Liability Insurance – Contractual liability extension

FOB Contract is not frustrated by failure of intended source of supply

sellers' intended suppliers, first in Indonesia and then in Taiwan, would not supply any cargo. The buyers eventually found an alternative source of supply in Russia but by the time the vessel carrying the cement arrived off Mexico Cemex was in a position to prevent any of the cargo being unloaded. The buyers kept the vessel off Mexico for a year but finally shipped the cement to the Middle East where it was sold. The buyers claimed damages against the sellers covering their losses on the resale of the cargo and the additional expenses involved. The sellers argued that the contracts had become frustrated because performance had become commercially impossible and in any event the contracts contained an implied term discharging the parties in the events that had happened.

The arbitrators accepted that as a general rule a sale contract would not be frustrated where performance was rendered impossible by the failure of a supplier to supply the contractual goods. However they found that in this case the contract was inextricably linked to the buyers' project to break the cartel in Mexico. Although the parties had contemplated that Cemex might interfere with the project this did not mean that the sellers took the risk of what had happened.

The judge said that the key question was whether the risk of the failure of supply was on the sellers or on the buyers, and this was a question of law. Where a seller makes an unqualified promise to sell he bears the risk of a failure of his contemplated source of supply unless that source is specified in the contract or the supplier is himself excused by frustration. There is always a risk of supplier failure and as between the buyer and the seller it is the seller who is in a position to guard against this, either by making a binding and enforceable contract with the supplier or by appropriate provisions in the sale contract making his promise conditional on the goods being available for delivery. The tribunal's finding that the contracts were frustrated therefore could not stand. There was also no basis for any implied term discharging the sellers from the contract, as this would be fundamentally inconsistent with the contract's express terms.

ARBITRATION

Two recent decisions, one in the Commercial Court and one in the Court of Appeal, provide guidance on the circumstances in which the Court will set aside an arbitration award for "serious irregularity" under Section 68 of the Arbitration Act 1996 when arbitrators rely on matters which have not been fully argued before them.

Misrepresentation – Tribunal found against buyers on issue not raised by sellers

The Commercial Court decision (**OA Northern Shipping Co. v. Remolcadores de Marin**) related to a dispute under a contract for the sale of a tug, the "REMMAR". The buyers claimed that there had been a misrepresentation as to the total power rating of the vessel's engine. The alleged misrepresentation arose from the provision to the buyers of a Class certificate referring to "total rated power 1265kw". The arbitration proceeded under the Small Claims Procedure and the tribunal rejected the buyers' claim, mainly on the ground that there had been no material representation that the engine power was in fact 1265kw. The tribunal interpreted the handing over of the Class certificate not as a representation that its contents were true, but merely that it was an authentic certificate. However the tribunal went on to find that if there had been a representation the buyers would have succeeded in establishing that the representation was false and had the effect of inducing them to enter into the contract, and accordingly the buyers would have been entitled to damages.

The buyers applied for the Award to be set aside for serious irregularity under Section 68, on the grounds that the sellers had never in fact argued in the arbitration that there was no material representation. There were issues as to the level of inspection carried out by the buyers, and as to whether the buyers had proved that the 1265kw figure was

in fact correct, and also as to quantum. There had never been any denial that a representation had been made. The buyers submitted that the tribunal should not have found against them on a ground that had neither been raised or seriously disputed by the sellers, without giving the buyers an opportunity to address the issue by submissions or further evidence.

The court agreed with the buyers and remitted the case to the tribunal for further consideration. This was not simply a case of a tribunal drawing a further inference on an issue which the parties had otherwise had the opportunity to address. The buyers had proceeded on the assumption that the point was not in issue at all and therefore did not need to be addressed, and the tribunal had not invited any submissions on the issue.

The court also considered the requirements of Section 68 that in order to set aside an Award the Court must be satisfied that the irregularity was a serious one and was likely to cause substantial injustice. In this case the irregularity was clearly serious, as opposed to technical. The buyers had succeeded on all other issues and would have won substantial damages if the tribunal had not found against them on the "no representation" issue. Further, the element of injustice did not require the court to conclude that the arbitrator had come to the wrong decision as a matter of law or fact, but it was enough that the buyers had been deprived of the opportunity to advance submissions which were at least reasonably arguable.

An attempt to challenge an Award on grounds of serious irregularity was however unsuccessful in the case of **Bandwidth Shipping v Intaari**. An ice classed vessel was chartered on a time charter basis for a voyage to Antarctica with delivery and redelivery in Cape Town. Instead of being redelivered in May before the Antarctic winter the vessel was not redelivered until December because the return voyage was blocked by ice. The arbitration tribunal held that the vessel was in breach of warranties in the charterparty as to her ice breaking capabilities and the breach was causative of the delay, so that charterers were not liable for the substantial amount of hire claimed by the owners.

The owners applied to the court under Section 68 of the Arbitration Act to set aside this decision on the grounds that the arbitrators had failed in their duty under Section 33 of the Act to act fairly between the parties. It had been part of the owners' defence in the arbitration that even if the vessel did not comply with the warranty this did not cause the loss because even if not in breach of warranty she would not have been able to leave any earlier than she in fact did. The arbitrators found in the charterers' favour on this point, based on the cumulative effect of a number of short delays caused by ice. In their application to the court the owners complained that they had not fully appreciated the significance of these points and if they had done so they would have had an answer to them. They said that the tribunal ought to have drawn the point to their attention and given them a reasonable opportunity to deal with it.

The High Court and the Court of Appeal both rejected the owners' challenge to the Award. A challenge based on Section 33 of the Act must involve some criticism of the conduct of the tribunal. If it was apparent to a tribunal that one of the parties had missed a point, fairness would require them to raise this so that the party had a reasonable opportunity to deal with it. However in this case the parties had been represented at the arbitration hearing by highly experienced counsel who clearly had a detailed knowledge of the case and there was no reason for the tribunal to appreciate that the point had been missed. The court commented that the losing party often thinks that injustice has been done when his factual case has not been accepted. However it would be a retrograde step to allow appeals on fact or law from the decisions of arbitrators to come in by the side door of an application based on Section 33. The old law relating to technical misconduct or procedural mishap is no longer relevant except in rare cases.

Should Tribunal draw attention to a point that counsel has missed?

TIME CHARTER – FRUSTRATION

20 days Time Charter was not frustrated by 3 months detention

The legal doctrine of frustration was reviewed by the Court of Appeal in the case of the “SEA ANGEL” (*Edwinton Commercial Corporation v Tsavlis*). The dispute arose out of the salvage operation following the grounding of the “TASMAN SPIRIT”, a laden tanker which broke in two close to the port of Karachi in July 2003 and caused a major pollution incident. T entered into a LOF salvage agreement with the owners of the “TASMAN SPIRIT”, incorporating the “SCOPIC” (Special Compensation Protection and Indemnity) clause. T engaged a number of shuttle tankers, including the “SEA ANGEL”, to transfer the cargo from the “TASMAN SPIRIT” to a transshipment vessel. The “SEA ANGEL” was time chartered to T for a period of up to 20 days under a Shelltime 4 charterparty form.

The transshipment operations were duly completed and T gave three days notice of redelivery on 9th September. However the vessel was unable to leave Karachi because the port authority refused to issue a clearance certificate. Effectively, the vessel was detained in order to secure a demand by the Pakistani authorities for compensation for the original pollution incident. This was challenged but it was not until the end of December 2003, following a judgment by the local court confirming that the refusal of the clearance certificate was unjustified, that the matter was resolved and the vessel was finally redelivered under the charter on 1st January 2004.

The owners of the “SEA ANGEL” claimed unpaid hire under the charter for the period from September onwards, but T claimed that the charter had been frustrated because of the unreasonable and unjustified detention of the vessel by the local government authorities. In the ensuing proceedings in the High Court in London, T argued that by 13th October, at the latest, it had become apparent that the period could not be promptly resolved and that the period of delay was likely to be inordinate, in the context of a charter originally intended to last only 20 days and with only 3 days remaining until the intended redelivery date.

The first instance judge decided that the charter was not frustrated, and the Court of Appeal has upheld this decision. The court stated that the application of the doctrine of frustration required a multi-factorial approach. Among the factors to be considered were the terms of the contract, its matrix or context, the parties’ knowledge, expectations, assumptions and contemplations, in particular as to risk, as at the time of the contract, and the parties’ reasonable and objectively ascertainable calculations as to the possibilities of future performance in the new circumstances.

The court considered previous authorities, which suggested that the appropriate test to apply when considering frustration of a time charter was to compare the probable length of the delay with the unexpired duration of the charter. The court held that this was a relevant factor but was not to be considered in isolation. The contractual provisions allocated the risk of delay to the charterer, and in the context of a salvage operation of this kind the risk of unreasonable detention by local authorities was foreseeable by experienced salvors. The “SCOPIC” clause in the salvage agreement contains express provisions for difficulties in demobilising equipment caused by government action. This was relevant as part of the contractual matrix. The question was whether it would be just to relieve T of the consequences of its bargain, or unjust to maintain the bargain, in a situation where it had assumed the general risk of delay and had done so in a specific context where the risk of unreasonable detention was foreseeable. It was also relevant that there had been a delay in commencing litigation in the Pakistani court, which could have secured earlier release of the vessel if action had been taken sooner.

The court concluded that the judge’s decision showed the doctrine of frustration working justly, reasonably and fairly and T had failed to show that the judge was in error.

INSURANCE – LITIGATION

An accident in a gym in which a teenage boy suffered severe spinal injuries, rendering him a tetraplegic, gave rise to a procedural decision which has potentially important implications for liability insurers.

In *Harcourt v Griffin* the claim was made against the owners of the gym (an unincorporated association) and its coaching staff and it was estimated that on a full liability basis the claimant’s damages would be around £8-10 million. The parties agreed to settle the liability issue at 75% but the court still had to decide on the quantum of damages, and on the terms of any periodical payments. The claimant was concerned that the defendants might not be able to satisfy any award of damages and made a formal request for information under Part 18 of the Civil Procedure Rules as to the nature and extent of the defendants’ insurance cover. The defendants refused to provide this information, arguing that an outsider to a contract had no right to know the terms of the contract, and the case did not come within the statutory exception to that rule established by the Third Parties (Rights Against Insurers) Act 1930. They also said that if the request were granted in this case it would set a dangerous precedent and would become standard practice in every case where the defendant was insured, leading to procedural disputes and unnecessary cost.

The judge agreed that there had to be a very good reason before a court would enforce disclosure of the terms of a contract between a party to litigation and a third party. However there were many circumstances where such disclosure could be compelled if it was relevant to an issue in the case. Disclosure of the extent of insurance cover should only be ordered where a claimant could demonstrate that there was some real basis for concern that a realistic award in the case might not be satisfied. There had to be some real basis for suggesting that the disclosure was necessary, in order to determine whether further litigation would be useful or simply a waste of time and money. In the circumstances of this case this test was satisfied and the judge ordered the defendants to disclose the information requested.

The judge came to the clear view that Part 18 of the Rules should be interpreted liberally and was wide enough to cover a request of this kind. He commented that the whole thrust of the new approach to civil litigation enshrined in the Civil Procedure Rules is to avoid waste of time and cost and to encourage swift and economical litigation.

In making the order for disclosure, the judge acknowledged that there might well be cases where revelation of the limit of insurance cover would give a tactical advantage to a claimant, for example in settlement negotiations. He said it would be regrettable if applications of this kind became a standard piece of tactical manoeuvring in litigation.

We understand that the judgment may be subject to appeal, but if it is upheld it seems likely that there may be many other cases, not confined to the personal injury field, in which claimants will seek to argue that disclosure of the defendants’ insurance cover is necessary on the basis of this decision.

Defendants ordered to disclose information about insurance cover

For further information on any of the summarised cases and other articles in this newsletter or for initial advice on any marine legal matter, please contact in the first instance Nicholas Walser at our office.