

Compulsory Insurance for Shipowners' Cargo Liability: A Heresy or Logical Step?

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Introduction

1. If someone wants to introduce an innovation, he has to give arguments against prevailing standpoints that support current *status quo*. In this article we shall try to give an answer to the question whether the time has come to introduce compulsory insurance for shipowner's liability for cargo?

Current position of shipowner's liability insurance

2. Over 90% of the world's merchant fleet is entered with the P&I clubs which provide third party liability insurance to the shipowners. The shipowners not entered with P&I clubs are some large shipping companies that have their own insurance arrangement (like captive insurance) and those shipowners who insure their liability with the commercial insurance market together with hull insurance or separately.
3. The question: "Is the shipowners liability insurance voluntary?", could be answered: "Yes, it is, but as a rule of thumb, a shipowner will not be able to trade his ship without purchasing such insurance". Namely, in principle, the charterers as a precondition to chartering a ship require evidence of valid liability insurance, which is regularly given in the form of P&I certificate of entry, by the shipowners or directly by the respective P&I club. The financing banks require such insurance as a precondition to grant a loan secured by mortgage over a ship.
4. In order to obtain ITF¹ Blue Card for a ship the shipowner must insure his liability for payment of sums agreed in contract with the union for death or permanent disability of the crew.
5. Some states (Greece, Australia, Sri Lanka) request evidence of liability insurance for wreck removal (they accept P&I certificate of entry) to allow ships to enter their territorial waters. Other states as United States of America (under *Oil Pollution Act 90*) and California (under *State law, California S.B. 1644*) require evidence of financial responsibility (*Certificate of Financial Responsibility*) for oil pollution. Compulsory insurance for ships above 400 GT (except for tankers covered by CLC) is prescribed in Australia from 2001. Alaska by its *Financial Responsibility Act of 7.06. 2000* require evidence of

¹ International Transport Workers' Federation

insurance of oil pollution liability for non tanker ships over 400 GT for permission to enter its territorial waters. It could be P&I *Certificate of Entry*, bank guarantee, surety, deposit or similar instrument. From 1 March 2005 Japan has introduced compulsory insurance for non tanker vessels larger than 100 GT which enter its territorial waters. From 20 April 2005 those ships must possess original polices of insurance (P&I *Certificate of Entry are acceptable*) as evidence of financial securities. Taiwan did the same under *Marine Pollution Control Act* which entered into force on 1 July 2005.

6. International maritime conventions have introduced compulsory insurance for the shipowner's liability. The first was International Convention on Civil Liability for Oil Pollution Damage, 1969 ("CLC"); followed by International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea, 1996; International Convention on Civil Liability for Bunker Oil Pollution Damage, 2001; Nairobi International Convention on the Removal of Wrecks, 2007. All of these conventions require compulsory insurance for **tortuous**, non contractual, liability towards third parties. The Athens Convention relating to the Carriage of Passengers and their Luggage by Sea, 1974 is the first convention to introduce compulsory insurance for **contractual** liability of the shipowner. In this case liability towards the passengers is based on the contract of transportation concluded between the shipowner and the passenger. Maritime Labour Convention 2006 introduced compulsory insurance for contractual liability of the shipowner towards the seafarers based on the employment agreement. ML Certificate and Declaration are requested as prima facie evidence of conformity with the rules of the Convention.
7. IMO has recommended to the shipowners to insure their liability.² It is acceptable that the insurer pays insurance money only if shipowner's liability has been established by law (by a judgement or in other way) and if the shipowner as insured has fulfilled all his obligations towards the insurer under the insurance contract.³
8. The European Parliament adopted the dossiers that form the Third Maritime Safety Package on 10 March 2009, including the Directive on the civil liability and financial guarantees for ship-owners (the "Insurance Directive") which will require Member States to obtain proof of insurance from ships flying their flag or entering their maritime territory of the type provided by International Group Clubs, and that such cover is in place up to the limits of liability as established by the 1996 LLMC⁴ Protocol. Cargo claims are maritime claims, therefore insurance relates to liability for cargo.

² IMO Resolution A.898 (21) Nov. 1999.

³ (Art 4.) ... the insurance need respond only if:

1. the shipowner's liability has been established at law, and
2. the shipowner has complied with all the conditions of cover prescribed under the insurance contract

⁴ Convention on Limitation of Liability for Maritime Claims 1976

Arguments against compulsory liability insurance

9. One of the arguments against compulsory insurance for cargo liability is that the contracts for carriage of cargo and insurance contracts covering cargo liability are private businesses without the need for public intervention.
10. Therefore, public protection of a claimant is required in case of the tortious liability, where the claimant is not in contractual relation with the shipowner and is not in position to protect his interest. For example in case of an oil pollution, where a fish farmer whose cages are polluted by an accidental oil spill from a ship, must get indemnity for the losses and damages suffered because he has nothing to do with the ship, apart from the fact that by a bad luck the wind and currents drifted the spilled oil towards his fish farm. As he was not in position to protect his interests, the public policy must intervene and make sure he gets the proper compensation. On the other hand, in contractual relations, a party could assess its risks; choose the partner, negotiate the terms of the contract and therefore is in position to protect its interest.
11. This line of thinking is illustrated in the following examples. In an unpublished London arbitration award the arbitrator rejected claim of a shipyard against the *mother company* of a buyer who breached the shipbuilding contract. The arbitrators explained that the yard and the buyers entered into a contractual relationship and that the yard in negotiations could have protected its interest, for example, by asking for a performance guarantee of the mother company or some other security for the buyer's liability. The yard did not do that and took the risk for buyers default. To the contrary, in the case of *Amoco Cadiz*⁵, liability in tort was at stake, caused by a rudder problem and consequent grounding of a tanker that released huge quantities of oil into the sea. The damage by the oil was done to third parties who had nothing to do with the ship and transportation of its cargo. The court pierced the corporate veil and awarded damages against the mother company that controlled the shipowning company and had benefit from its trading.
12. At the turn of 19 to 20th century the same argument of freedom of contract prevailed until, firstly, the Harter Act 1893 and then International Convention⁶ have intervened and introduced mandatory the (minimum) liability regime for the carriage of cargo.
13. In the eighties of the last century a number of countries introduced compulsory liability insurance for *intermediaries* and for many professions.
14. The maritime conventions did not stop at regulating liability regime, but tried to enhance the claimant's chances of recovery. The *Hamburg Rules*⁷, (by copying

1984, American Maritime Cases, 2123-2199.

⁶ International Convention for the Unification of Certain Rules of Law relating to Bills of Lading ("Hague Rules"), 1924

⁷ United Nations Convention on the Carriage of Goods by Sea (The Hamburg Rules) Hamburg, 30 March 1978

- aviation *Guadalajara* aviation convention 1961⁸) introduced the concept of the **actual carrier** who is liable beside the carrier. The idea was to allow the claimant to sue the contractual carrier (who entered into the contract of carriage with the shipper) and the actual carrier (who carried the cargo and caused the damage).
15. As we see, the maritime law has intervened into freedom of contract of carriage by prescribing the minimum liability regime and widening the scope of the persons who could be sued for loss of or damage to cargo.
 16. Further argument against compulsory insurance is that the claimant would get **direct action** against liability insurance providers (i.e. P&I clubs) in which case the insurers might lose their defences under the insurance contract which they might otherwise have against insured for payment of the insurance money. Defences are for breach of the conditions such as: the ship not being in class, insurance contract has been terminated for non payment of premium, insurance money has to be set off against unpaid premium, the insured did not notify the insurer of the accident or claim, the insured did not pay the claim (*pay to be paid* rule) and so forth.
 17. The English law entitles P&I Clubs in cases where they are sued directly by third parties [under *Third Party (Rights against Insurers) Act-u 1930* that applies in the case of bankruptcy] to use defence from the insurance contract and those from *Marine Insurance Act 1906*. In the cases of *The Fanti* and *The Padre Island*⁹ defence under the club's rule "*pay to be paid*" was allowed. That rule requires the insured (the shipowner) to pay the claim to the third party in order to acquire the right to claim insurance money from the insurer (the club). Of course if the insured is bankrupt he will not be able to pay the claim. Consequently, the claimant who would subrogate in the rights of the insured (under *Third Party (Rights against Insurers) Act-u 1930*) in order to satisfy „pay to be paid rule“ would have to pay damage to himself, and then to claim insurance money from the insurer. Legally this is an impossible condition. In spite of that impossible condition *House of Lords* accepted defence based on "*pay to be paid*" rule. However, Lord Justice Goff has warned the clubs not to try to use that defence against the claims for loss of life or personal injury. By their rules the P&I Clubs, under certain terms and conditions, have abandoned "*pay to be paid*" defence for crew claims.
 18. Introduction of the compulsory insurance would change the nature of P&I insurance. It would cease to be an *indemnity insurance* and would become *liability insurance*. First type of insurance makes good the loss in the asset of the insured caused by payment of the damage to the claimant, and the latter type, by payment of the insurance money makes good damage sustained by the claimant itself.¹⁰

⁸ Convention supplementary to the Warsaw Convention for the Unification of Certain Rules Relating to International Carriage by Air Performed by a Person Other Than the Contracting Carrier, signed in Guadalajara, on 18 September 1961 (Guadalajara convention 1961)

⁹ [1990] 2 Lloyd's Rep 191 (H.L.)

¹⁰ Steven J. Hazelwood: P&I Clubs – Law and Practice, London 1994, p. 323.

19. Under CLC, P&I Clubs issue certificates of insurance („*The Blue Card*“) to the governments of the convention countries who in turn on basis of such Blue Cards issue their state certificates to the ships. As the insurer is liable under the articles of the Convention, he cannot in principle, which has exceptions, use defences from the insurance contract against the claimant.

Any claim ... may be brought directly against the insurer In such case the defendant may, irrespective of the actual fault or privity of the owner, avail himself of the limits of liability prescribed in Article V, ... He may further avail himself of the defences (other than the bankruptcy or winding up of the owner) which the owner himself would have been entitled to invoke. Furthermore, the defendant may avail himself of the defence that the pollution damage resulted from the wilful misconduct of the owner himself, but the defendant shall not avail himself of **any other defence which he might have been entitled to invoke in proceedings brought by the owner against him.**¹¹

20. According to the compromise reached in the drafting of CLC the insurer can use *wilful misconduct* of the shipowner as a defence, not only against the insured, but even against the claimant.¹² Therefore *wilful misconduct* risk falls onto the claimant.
21. Further, in order to prevent the defence that the insurance contract has been cancelled before the expiry date shown in the Certificate of insurance placed on board the ship CLC provides that an insurance shall not satisfy the requirements of that convention if it can cease, for reasons other than the expiry of the period of validity of the insurance specified in the certificate, before three months have elapsed from the date on which notice of its termination is given to the authorities, unless the certificate has been surrendered to these authorities or a new certificate has been issued within the said period¹³.
22. The P&I Clubs have adapted to loss of certain defences which they might have used before introduction of CLC and continued to provide liability insurance for oil pollution liability regulated by the CLC. We can assume that the Clubs shall adapt to the other conventions which call for compulsory insurance when they enter into force. The evidence of that is the Bunker Convention for which the Clubs started issuing their certificates. It will be seen whether the clubs will change their rules to avoid certain risks, for example requiring advance payment of the premium for the whole period of validity of the certificate in order to avoid situation were liability attaches and premium is not paid. Maybe future convention will give more defences to the liability insurer, allowing them to use some defences from the insurance contract against the third party claimant.

United Nations Convention 2009 (The Rotterdam Rules)

23. From the first draft The new “United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea”, (the Rotterdam

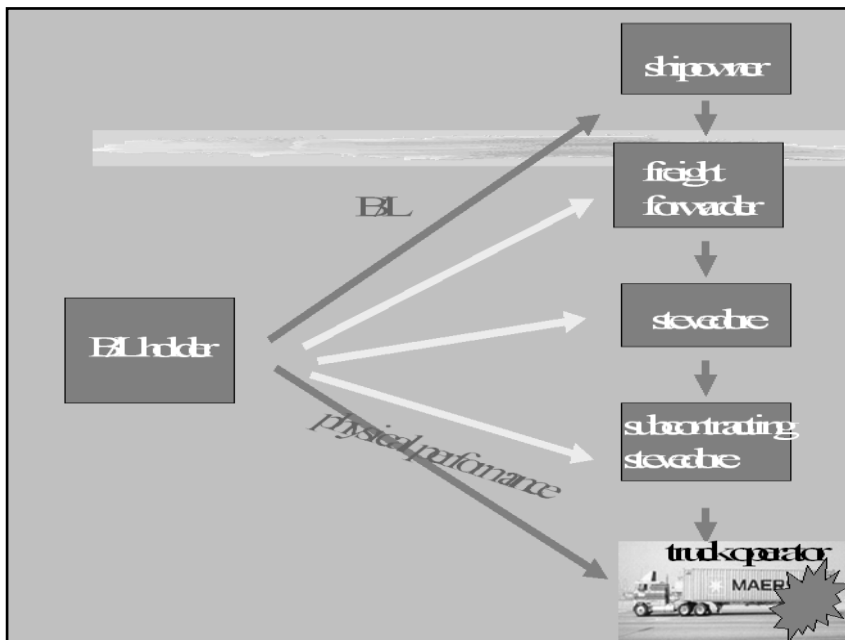
¹¹ CLC Čl. VII (8)

¹² Wu Chao: *Pollution from the Carriage of Oil by Sea: Liability and Compensation*, London 1966. p. 70-72.

¹³ CLC, Čl. VII (5)

Rules) intended, like the Hamburg Rules, to make easier for the claimant to enforce his claim by allowing claims against two parties. This time the concept of the *Actual carrier* was replaced by the *Performing part* concept copied from Draft COGSA 99¹⁴. Later a concept of *Maritime performing party* was added which means a *Performing party* to the extent that it performs or undertakes to perform any of the carrier's obligations during the period between the arrival of the goods at the port of loading of a ship and their departure from the port of discharge of a ship. An inland carrier is a *Maritime performing party* only if it performs or undertakes to perform its services exclusively within a port area.¹⁵

24. However, the *Performing party* is not only liable for the loss or damage caused by his own acts, but for acts of any other person to whom he entrusted performance of work.¹⁶ If such person meets criteria of a performing party the claimant may, beside the carrier, claim against the *Performing party* and its sub-contractor (let's call it sub-*Performing party*) and so on indefinitely down the chain.



25. At CMI working group meeting in Madrid in November 2001 the Croatian delegation together with FIATA¹⁷ proposed changes to the *Performing party* definition. According to the proposal the *Performing party* would not be "... a person other than the carrier that performs or undertakes to perform any of the carrier's obligations under a contract of carriage ..." but a person that *physically*

¹⁴ US Carriage of Goods by Sea

¹⁵ Article 1 (7).

¹⁶ Art. 19. Maritime performing party is liable for the breach of its obligations ... caused by the acts and omissions of any person to which it has *entrusted* the performance ...

¹⁷ International Federation of Freight Forwarders Associations

performs ...¹⁸. Thus the problem with non performance of a contract would be avoided. For example if a stevedore has concluded a contract for discharge of cargo with the shipowner, but did not discharge a perishable cargo on time because the shipowner failed to pay the stevedore in advance as provided for in the stevedoring contract or because the working conditions on board the ship were not reasonably safe, and the cargo perished, the question rises whether or not the stevedore may use against the claimant defences from the stevedoring contract. If he cannot, that would be unjust; and if he can, then the claimant cannot rely on his right to sue the stevedore as he gets defence from the stevedoring contract about which he had no knowledge. Besides, how would the claimant prove the existence of the stevedoring contract, i.e. undertaking to perform, if the stevedore did not show up? Can he ask the court for search of the stevedore's or shipowners office where the contract could be found?

26. There is a further problem. Stevedore, truck operator, warehouse operator and other maritime performing parties conclude their standard contracts and do not have to know whether Rotterdam Rules apply or not (to some containers among all of them discharged from a ship). The cargo might be carried in the short shipping trade, or carried under a *charter party* and so on. Dragging the performing parties under the terms prescribed by the Rotterdam Rules is not a happy solution, as they have their own contractual terms and liability regimes.
27. On the other hand, the Rotterdam Rules intend to provide to all these parties protection which carrier enjoys under the Rules. It might seem attractive, in particular, when faced with the problem of liability in tort which is well depicted in two famous cases: *Adler v. Dickson* 1955¹⁹ and *Midlands Silicones v. Scruttons* 1962²⁰. In the first case a lady passenger was injured while climbing the gangway of a cruise ship berthed in the port of Trieste when the ship suddenly moved away from the pier under a gust of north wind Bora. As her ticket carried an exonerating clause protecting the shipping company, the passenger sued the master in tort for negligently mooring the ship. The court ruled that the exonerating clause did not expressly or by implication protect the master.
28. To remedy the situation *The Visby Rules* (1968)²¹ have extended the protection onto the carriers' employees:

If such an action is brought against a servant or agent of the carrier (such servant or agent *not* being an *independent contractor*), such servant or agent shall be entitled to avail himself of the defences and limits of liability which the carrier is entitled to invoke under this Convention. (Art. 3(2))

29. In *Midlands Silicones v. Scruttons* 1962 the position of an *independent contractor* was at stake. A London stevedore while unloading a drum of chemicals dropped it, the drum broke and the content spilled. Because the cargo

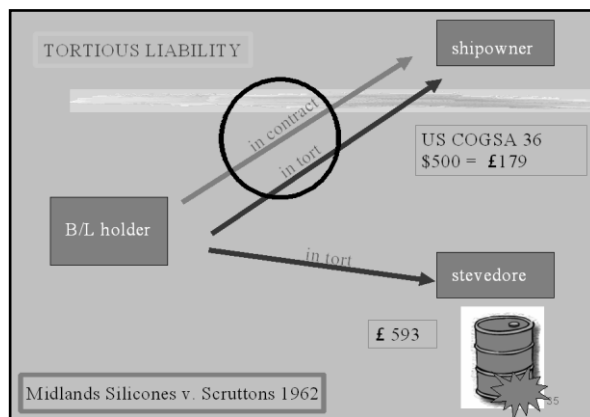
¹⁸ Report on International Sub Comitee (ISC) CMI Madrid, 12-13 Nov. 2001.

¹⁹ *Adler v. Dickson (The Himalaya)*, [1954] 2 Lloyd's Rep. 267, [1955] 1 Q.B. 158 (C.A.);

²⁰ *Midland Silicones Ltd v. Scruttons Ltd* [1962] AC 446 HL

²¹ The Hague-Visby Rules - The Hague Rules as Amended by the Brussels Protocol 1968.

arrived from New York the Bill of Lading called for COGSA 36, that limited carrier's liability at \$500 per package which at the time amounted to £179. The cargo owner sued the stevedore in tort for full damage in amount of £593. The court ruled that the stevedore was not a party to the contract of carriage, and therefore could not enjoy protection provided by that contract which included COGSA 36 terms.



30. The Rotterdam Rules extend the protection to the *independent contractor*. The defences and limits ... apply if an action is brought against carrier or a Maritime performing party ... whether the action is founded, in contract, in tort, or otherwise. (Art 4)
31. Of course the Rotterdam Rules protect employees of the *Carrier* and Maritime performing party.²²
32. It seems that the basic idea of the Rotterdam Rules is to embrace all the parties and persons who perform the carriage in its liability regime. In other words to impose on them liabilities, but at the same time give them protections provided by the Rules.

EQUATION
Maritime Performing Party

Protection against third party
=
Obligations to third
(from the fact that it entered into a contract with the carrier)

²² If an action is brought [against an employee or agent of the carrier or a maritime performing party] that person is entitled to the defences and limits of liability available to the carrier under this Convention (Art. 19)

33. This approach breaches the principle that contractual relations exist only between the parties. The Latin lawyers expressed it: *Pacta tertiis nec nocent nec prosunt*. Anglo-Saxon law has *Privity rule*: “A contract cannot effectively confer rights or impose duties on those who are not parties to it.”

34. Now, on above there are some questions and answers.

Question: Why the Rotterdam Rules has introduced concept of Performing and Maritime Performing party which complicates the convention and might be a source of many future disputes?

Answer: In order to enhance the claimant's chances of recovery.

Question: Is there any other way to achieve that?

Answer: Yes, compulsory insurance of the carrier's/shipowner's liability.

35. Nothing is perfect. If introduction of *Performing* and *Maritime performing party* concepts breaches the principle that a contract creates rights and obligations only between contracting parties, then introduction of compulsory insurance of shipowner's liability breaches that very same principle, because a *private* contract of insurance concluded between the shipowner and his insurer makes available to the third parties who acquire rights against the insurer, independently of the contract of insurance. Again, a *res inter alios acta*, creates obligations towards a third party.

36. Now, we face a dilemma. What is more practical? To create by a convention rights and obligations for third parties participants in the transport process (actual carriers, stevedores, warehouse operator, truck operators, freight forwarders and so on) or introduce compulsory insurance of the shipowner's liability. It seems that the second option is more practical and makes easier the recovery than the concept of possibility of suing two or more persons. Logic is the same like with CLC. One person is liable (channelling of liability); the liability regime is clear, and in the end insurer guarantees payment of claim. There is no need to prove who caused the damage, competition of jurisdictions and applicable laws etc.

37. If the *Carrier* under the Rotterdam Rules is not a shipowner or operator on whose ship the cargo is carried, than, under compulsory insurance option discussed in this article, such a carrier would have to insure its liability. Weather P&I clubs would accept such members (carriers not being shipowners or ship operators) under a separate scheme (like they have done for charterers' liability cover) or such carriers would form their own clubs or purchase cover from the commercial market would be a technical and commercial matter.

38. Professor Jakaša²³ used to say to his students: "Study the insurance law that is law of the future" This prophesy is becoming true in shipping. Beside the international conventions that already introduced the compulsory insurance of shipowner's liability, a number of states require such insurance to allow the ship to sail into their territorial waters or economic zone. IMO has recommended insurance of shipowner's liability and EU has passed its directive on shipowner's liability. Should we expect the amended Rotterdam Rules, or a future convention, to cross the line?

Compulsory insurance



contractual liability for cargo

liability in tort +
contractual liability for
passengers

IMO Guidelines on Shipowners
responsibility in respect of
Maritime Claims

EU Civil Liability Directive in
Erika 3

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Petar Kragić has an MA and PhD in maritime law. He is author of a legal textbook Tanker Charters and a number of articles on maritime law topics. He is speaker at maritime conferences. Currently he is chairman of the Croatian Maritime Law Association and titular member of CMI. He was a member of CMI drafting committee for Rotterdam Rules and a member of the Croatian delegation to UNCITRAL. He is former chairman of the legal committee of Croatian Chamber of Shipping and a member of the drafting committee for Croatian maritime. For a number of years he was director of a major P&I Club and SIGCo.

Tankerska Plovidba operates as an independent shipping company in Croatia. It operates a fleet of tankers and bulk carriers. The company's fleet comprises Suezmax and Aframax size crude oil carriers and handysize bulk carriers.. Tankerska Plovidba was founded in 1955 and is headquartered in Zadar, Croatia.

²³ Late famous professor at Faculty of Law, University of Zagreb