International Commerce

October 2013

MARINE INSURANCE BULLETIN

Welcome to the October edition of our Marine Insurance Bulletin

In this edition, we look at the implications for insurers of the Maritime Labour Convention (MLC), which entered into force internationally on 20 August 2013. We highlight the repatriation provisions of the MLC and the potential risks for insurers.

The deployment of armed guards on board vessels has increased, but despite this their deployment is not entirely straightforward and new issues are continuing to arise, including in respect of the rise of attacks in West Africa, fraudulent certificates and the continued need for thorough vetting.

A recent English Court of Appeal case has confirmed that there will be no appeal allowed to a decision of the English High Court that a continuing warranty to insure at a specified insured value will mean owners cannot declare the charterparty frustrated where the cost of repair will be less than the vessel's insured value. This will be the case even when the repairs cost more than the repaired vessel will be worth. The case has also illustrated the very limited rights of appeal available from arbitration decisions and we discuss the implications.

Finally, we look at the meaning of the ISM warranty in the Institute Time Clauses - Hulls 1995 terms, in light of a recent English High Court decision which considered the warranty for the first time. It has now been established that owners will have complied with the warranty if they can show documentary compliance (e.g. valid Document of Compliance and valid Safety Management Certificate), even if the vessel is not actually compliant.

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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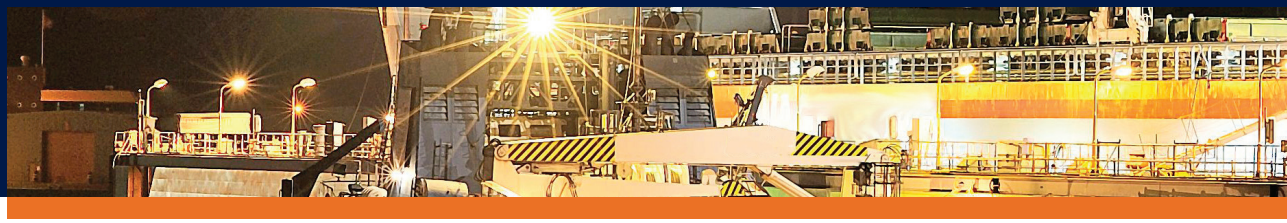

MLC – implications for insurers

What has been referred to as the "Seafarers' Bill of Rights", the Maritime Labour Convention 2006 (MLC), came into force internationally on 20 August 2013, initially applying to the 30 countries which had ratified the MLC by 20 August 2012. There are now 46 ratifications to the Treaty (with others pending), representing over 76% of the world's gross tonnage of ships, and for those countries which registered their ratification after 20 August 2012, the MLC comes into force 12 months after ratification.

The MLC aims to achieve universal ratification and 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. The MLC replaces and consolidates 68 international labour standards relevant to the maritime sector and 36 existing ILO conventions and one protocol dating from 1920 to 1996.

MLC applies to:	MLC does not apply to:
■ Commercial vessels (vessels over 500grt require certificates of compliance)	■ Vessels trading exclusively in inland waters
■ Trading internationally	■ Traditional vessels such as dhows and junks
■ Publicly or privately owned	■ Warships and naval auxiliaries

Financial security and compensation

One of the key areas of the MLC which has caused concern amongst shipowners and their insurers is the question of repatriation, particularly in cases of insolvency.

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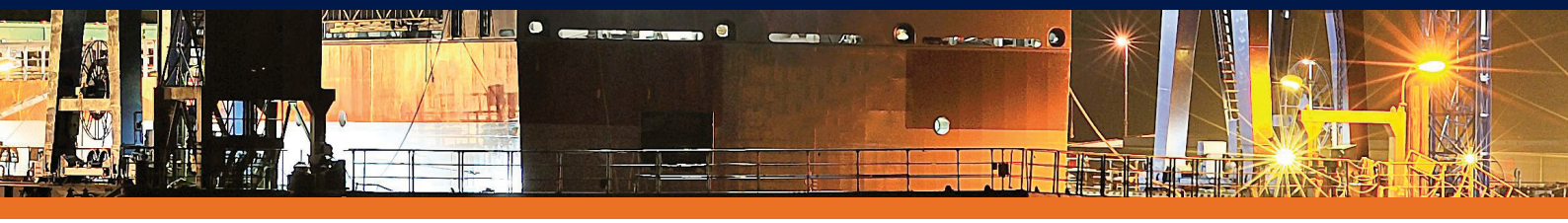
Under the MLC, shipowners are required to demonstrate that they maintain financial security to ensure that seafarers are repatriated in accordance with the MLC requirements, at no cost to the seafarer. This applies in cases of termination of employment, in the event of illness or injury, in the event of shipwreck and in the event of insolvency. It is not specified in the MLC what financial security is required and no amount of coverage is specifically prescribed. Insolvency is of particular concern as it is not a typical marine liability, and may leave insurers out of pocket with no chance of recouping their outlay from their assured (although this may be different where a crew manager is named as joint assured). This is illustrated by recent high profile insolvency cases, particularly those such as the Liberia-flagged vessel *A Whale*, whose crew of 20 was left stranded earlier this year due to cashflow problems.

As an international convention, the MLC does not apply directly to shipowners and seafarers, but requires implementation by ILO Member States. The flag state will therefore decide how the financial security requirements will be interpreted, and determine the form of security. It may be that a certificate of insurance will suffice for most. But it remains up to the flag state to determine whether a policy document or certificate of entry is sufficient to constitute a form of "financial security".

The International Group of P&I Clubs has agreed that IG Clubs will provide repatriation cover, although it will not be poolable, and Lloyds Syndicates have also received permission to extend their underwriting cover and avoid the ban on financial-guarantee business. Some repatriation requirements (such as for illness or injury) may in any event be covered by a shipowner's existing P&I policy.

Shipowners must also provide compensation for seafarers in relation to sickness, injury or death occurring while they are serving under a seafarer's employment agreement or otherwise arising from their employment. They are also required to provide financial security to assure such compensation in the event of death or long-term disability due to an occupational injury, illness or hazard. Seafarers are also entitled to "adequate compensation" for injury, loss or unemployment arising from the ship's loss or foundering. This is limited to 2 months' wages at their usual salary.

New insurance products are being developed to cover shipowners' liabilities under the MLC, and some cover unpaid wages in the event of



insolvency (an inherently open-ended amount). However, reports indicate that take-up of new products has been fairly limited so far.

Application

Seafarers are broadly defined as *"any person who is employed or engaged or works in any capacity on board a ship to which this Convention applies"*. Where there is doubt as to whether a category of person is regarded as a seafarer, the flag state will decide, but this definition may include a wider class of people than before, potentially including armed guards or guest entertainers on board a cruise ship. Owners must therefore consider carefully whether they have adequate financial security and/or insurance policies in place to meet their requirements under the MLC.

The ILO aims for this convention to have near universal acceptance, thus potentially affecting a much wider range of owners and seafarers than the conventions it replaces. It will affect shipowners and seafarers around the world, and have important consequences for their insurers as well. There have already been proposals to amend the MLC to require financial security for unpaid wages in the event of insolvency, and it remains to be seen whether and when these are adopted. Until the MLC is amended or extended, shipowners and their insurers must grapple with the requirements of the MLC as currently drafted, and it may take some time for the industry to fully determine how these requirements should be addressed.

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Armed guards: due diligence

With high profile hijackings slipping from the mainstream news agenda, people might be forgiven for thinking that the introduction of armed guards has solved the problem of piracy in Africa and in turn, that the deployment of armed guards is now a trouble-free process. This article looks at just three recent developments which demonstrate that whilst important steps forward have been taken, the international approach to the deployment of privately contracted security personnel is still not consistent or always straightforward. Meanwhile, new issues to continue to arise.

Piracy in West Africa: a solution in sight?

It is generally believed that shipowners and operators fail to report attacks in West Africa because authorities in the region are unlikely to respond. Shipowners and operators have previously been left to develop their own self-defence measures, which are thought to create greater vulnerability to attacks.

It may be that this situation will soon change, with West African leaders calling for the deployment of an international naval force to curb the growing threat of piracy, at a meeting of West and Central African leaders in June 2013.

It is reported that more seafarers were affected by piracy off the West coast of Africa in 2012 than off the coast of Somalia, which has seen a dramatic reduction in the number of attacks due to the introduction of armed guards and the continued patrols of international taskforces and national navies. According to the report *"The Human Cost of Maritime Piracy 2012"*, armed attacks off the West coast of Africa affected 966 seafarers compared to 851 in Somalia.

However, it would be misleading to say that West Africa is overtaking Somalia in terms of the overall scale of the threat. Instead, piracy in West Africa is increasing in effectiveness whilst the number of incidents in Somalia continues to decrease.

Piracy attacks in West Africa have tended to be more diverse and less predictable than those off Somalia, making a consistent and comprehensive response in the region difficult. Many experts cite the lack of coordination and cohesion from West African states as a reason why piracy levels have continued to rise. The deployment of privately armed security personnel on board commercial ships continues to be problematic and in some territorial waters, impossible.

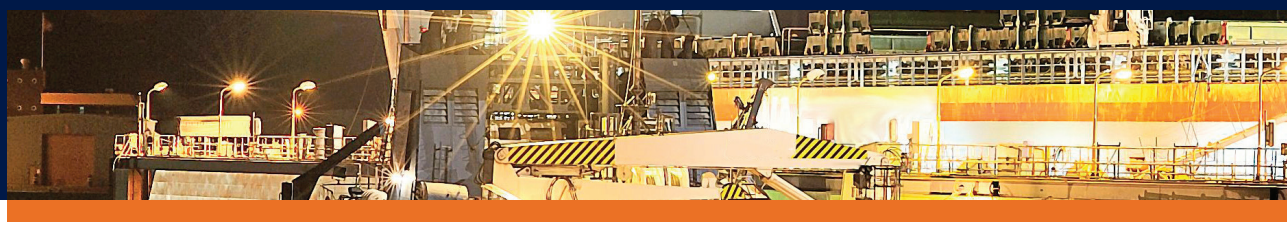
It has been reported that BIMCO will publish an amended standard GUARDCON contract for private maritime security companies (PMSC's) operating in West Africa later this year.

Vetting of armed guards: a continuing obligation

The maritime security standard, ISO/PAS 28007, was introduced in 2012 and contains guidelines which PMSC's can implement to demonstrate that they provide appropriate security services on board commercial ships.

The pilot scheme for the ISO accreditation is underway in the UK, and the UK Accreditation Service (UKAS) reportedly commenced assessment of PMSC's in June 2013. UKAS is currently the only organisation recognised by the UK government to assess and evaluate PMSC's against the ISO standard.

Some nations are implementing laws and regulations that go beyond the ISO standard. Germany is one example, where it is reported that the ISO accreditation will be a substantive step towards PMSC's being permitted



to provide security services on board German flagged vessels but all PMSC's will need to go through a further separate process in order to be accredited.

In any event, contracting with a PMSC with the ISO accreditation will not relieve shipowners from their responsibility to carry out due diligence altogether, although it should reduce the due diligence workload and provide the degree of comfort that accompanies an ISO accreditation. In the meantime, shipowners, charterers and insurers must remain vigilant and continue to vet PMSC's carefully.

Reported widespread use of fraudulent training certificates

Effective due diligence on PMSC's is particularly pertinent in light of recent reports that training certification has been fraudulently produced and sold to individuals who have used those fraudulent certificates to gain employment with private security companies.

The list of fraudulent certificates available for sale allegedly covers various qualifications. An armed guard must hold the IMO Standards of Training, Certification and Watchkeeping for Seafarers (STCW). In addition, and according to Flag State rules, various certification will be required. For example, the checklist for armed guards serving on board Panamanian flagged vessels reportedly requires 23 documents. Such documentation can be expensive and time-consuming to acquire.

GUARDCON provides good protection for shipowners against any certification fraud perpetrated by the security personnel or the company itself. GUARDCON clearly places the requirement on the PMSC to undertake that all permits and licences are valid.

Effective due diligence on PMSC's is particularly pertinent in light of recent reports that training certification has been fraudulently produced and sold to individuals who have used those fraudulent certificates to gain employment with private security companies.

SALLY BUCKLEY

To the extent that a PMSC does not provide suitably qualified, trained and experienced security personnel, the company would be contractually bound by GUARDCON to indemnify the shipowner for their breach of their undertaking.

But in the event of such a breach, who would pay for the consequences? Perhaps the greater practical concern is whether PMSCs' insurance policies would be affected by the employment of guards with fraudulent certification. Section 41 of the Marine Insurance Act 1906 provides that there is an implied warranty that the insured adventure is a lawful one and that the adventure shall be carried out in a lawful manner. The key question would then become: who perpetrated the fraud?

If it was not the PMSC (as opposed to the individual who may have obtained fraudulent certification) or the shipowner, it may be that the insurance would remain intact but this would be a call for the relevant insurers involved to make.

If the PMSC or the shipowner had any knowledge regarding the fraud or were complicit, the answer could be very different. If a PMSC's insurers were discharged from liability from the date of the breach of the warranty of legality contained in the Marine Insurance Act, this could leave security firms and shipowners in potentially very difficult situations.

Accordingly, it is imperative that private maritime security companies continue to vet their security personnel carefully and that shipowners continue to carry out their own thorough due diligence.

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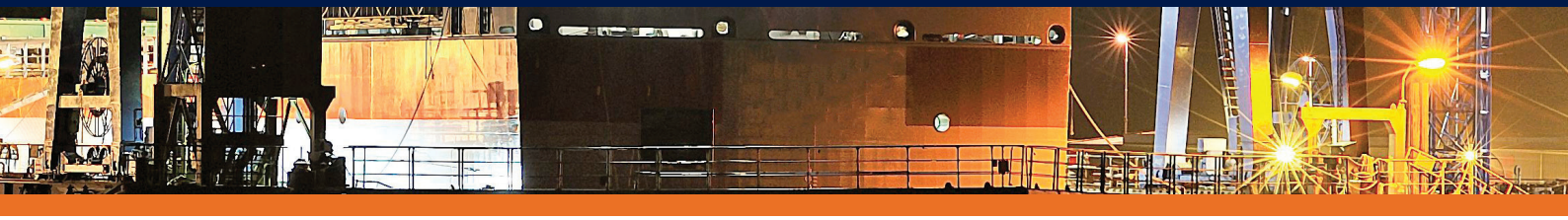


Uneconomic costs of repair: an update on the *Kyla* case

In arbitration, if an appeal is made to the High Court on a question of law and a party wishes to appeal the High Court's decision, it can be difficult to obtain permission to appeal further. This is because the appealing party must usually demonstrate that there is a point of law of general public importance at stake.

Recently, an attempt was made to appeal to the Court of Appeal against a High Court judge's decision where he refused to grant permission to appeal on a point of law in relation to an arbitration award.

The response of the Court of Appeal has highlighted the limited rights of appeal against an arbitration award.

As permission to appeal has been refused in the *Kyla* case, the High Court decision in the case stands in respect of uneconomic costs of repair, which has surprised many insurers as well as owners.

Background

The Kyla was under time charter when she was badly damaged in a collision whilst docked at a Brazilian port. Owners argued that since the cost of repairs would exceed the vessel's value once repaired, the charterparty was frustrated. The arbitrator agreed, saying that the Owners' obligations under the charterparty became radically different or commercially impossible since the repairs were uneconomical.

High Court decision

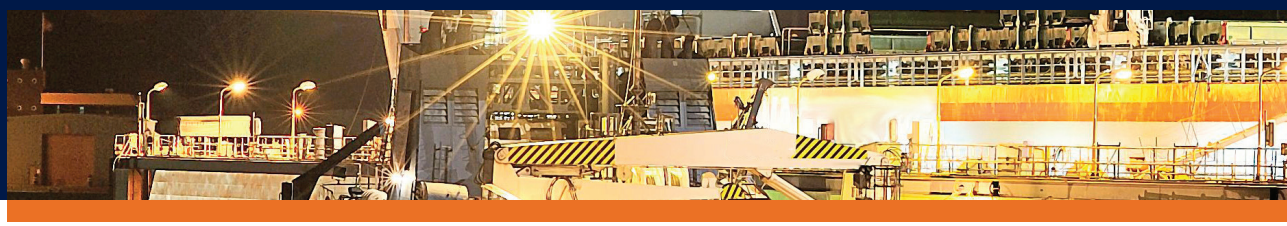
Charterers appealed to the High Court on a point of law. The main issue on appeal was the effect of a clause in the charterparty by which Owners warranted that, throughout the currency of the charterparty, the vessel's hull and machinery would be kept fully insured up to a stated limit. Charterers argued that this clause, read in combination with the repairing obligation in the NYPE 1946 charterparty, amounted to an allocation to the Owners of the risk of damage to the vessel costing less than the insured value to repair.

The High Court judge agreed with Charterers' assessment. He found that the charterparty went a good deal further than the equivalent clauses in the NYPE standard form document. It was impossible for Owners to argue that the damage had been sufficient to frustrate the charterparty because the charterparty contained an express continuing warranty as to the insurance and the limit of liability. The parties allocated the risk in the charterparty such that where the vessel was damaged and the cost of repair was within the insured value, the repairs would be covered by the Owners (through their insurers). Therefore, contrary to the arbitrator's findings, the contract was not frustrated; rather, Owners were in repudiatory breach of contract for failing to carry out the repairs and return the vessel to Charterers' service to perform the balance of the charter period.

This decision gives rise to a number of practical difficulties for owners of a time-chartered vessel, who will be required to commence repairs as quickly as possible. Owners are likely to be entitled to an indemnity under their hull and machinery insurance. However the requirement to get on with the repairs is unlikely to synch with the investigations hull and machinery insurers will undoubtedly wish to make as part of their claims-handling procedures. The most common standard London hull clauses allow insurers to decide (and to veto) the place of repair. The Court held that issues of this nature were part of the commercial risk borne by Owners.

The Owners then made an application to the High Court for permission to appeal to the Court of Appeal. The High Court judge refused permission, stating that the case was not one of general importance. He said the real reason why the dispute arose was because Owners chose to walk away from the charterparty, without repairing the ship, in circumstances where underwriters were *"quite prepared and amenable to repair the ship"*. He called it a 'self-induced frustration'.

As permission to appeal has been refused in the *Kyla* case, the High Court decision in the case stands in respect of uneconomic costs of repair, which has surprised many insurers as well as owners.



...the residual jurisdiction to set aside a refusal of permission can only be exercised where that refusal has come about as a result of unfair or improper process, so that the decision to refuse cannot be categorised as a decision at all.

JENNY SALMON

The Court of Appeal decision

Owners then decided to appeal to the Court of Appeal directly in respect of the High Court decision to refuse the right to appeal.

The Court of Appeal declared that the Court of Appeal had no jurisdiction to decide whether to actually grant permission to appeal to the Court of Appeal. In addition, the residual jurisdiction to set aside a refusal of permission can only be exercised where that refusal has come about as a result of unfair or improper process, so that the decision to refuse cannot be categorised as a decision at all. A litigant complaining about the refusal of permission to appeal under the Arbitration Act accordingly has an extraordinarily high hurdle to overcome.

The Court of Appeal recognised that the decision was very disappointing for Owners, and advised that if shipowners wanted to have "readier access to the expertise of this court, they should agree to the High Court resolving their disputes in the first place". Had this been an appeal from a judgment of the High Court under a litigation clause, rather than an appeal of an arbitration award, Owners would automatically have had the right to appeal to the Court of Appeal for permission to proceed to an appeal.

Conclusion

The Court of Appeal decision in *The Kyla* demonstrates the limited rights of appeal in respect of decisions in arbitration.

The outcome of the application to the Court of Appeal means that where a charterparty contains a *Kyla*-type repairing obligation and a stated insured value, owners will usually be obliged to repair the ship, even if the repairs are wholly uneconomical, provided they are within the insured value. This decision has been surprising to both owners and insurers.

HFW acted for Owners in the *Kyla* case – Simon Chumas and Jenny Salmon were the case handlers.

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ISM warranty in hull policy requires documentary compliance only

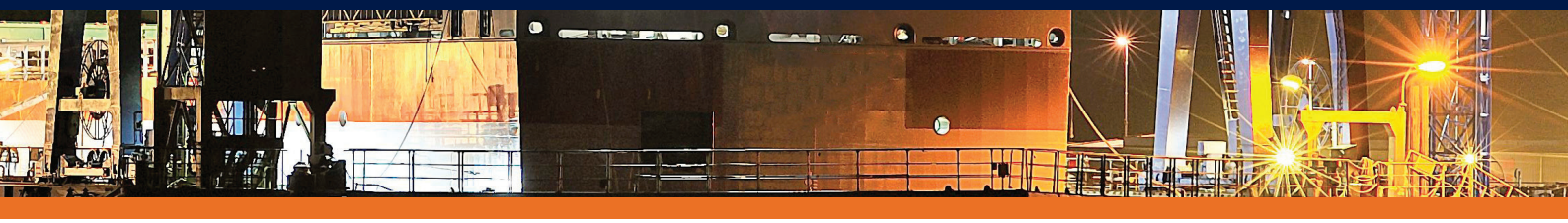
A recent Commercial Court decision, *Sea Glory Maritime Co and another v Al Sagr National Insurance Co M/V "Nancy"[2013] EWHC 2116 (Comm)*, has considered, for the first time, the meaning of the term "ISM compliant" in a hull insurance policy.

Facts

The claimant owners sought an indemnity from their hull underwriters after a fire rendered their vessel, the *Nancy,* a constructive total loss.

The underwriters declined the claim and sought to avoid liability under the marine insurance policy, arguing that:

- There was a misrepresentation or non-disclosure as to the true manager of the vessel.
- There was a non-disclosure in respect of port state control detentions.
- There was a non-disclosure in relation to a conflict of interest.
- There was a breach of an ISM warranty.
- That the claim was tainted by an illegality under US Iranian sanctions law arising from the issuance of US dollar freight invoices for a shipment of sulphur from Iran to China.



Judgment

Of the five defences put forward by the underwriters the following two are of the most interest:

Breach of ISM warranty

This was the first time that the ISM warranty, *"vessels ISM compliant"*, had been considered by the courts. The Owners argued that such a warranty only required documentary compliance and that compliance would be achieved if the vessel owning company held a valid Document of Compliance and the vessel itself held a valid Safety Management Certificate. The hull underwriters argued that the warranty required actual compliance with the ISM Code at the inception of the policy and throughout the period of the policy.

Mr Justice Blair agreed with Owners and held that the ISM warranty should be interpreted in the same manner as a class warranty and that documentary compliance was sufficient. Blair J found that the underwriters' interpretation of the ISM warranty *"would be difficult to apply, difficult to evaluate and would give rise to commercial uncertainty"*.

Misrepresentation of PSC detentions

Also of interest was the underwriters' argument that the Owners had failed to disclose the full PSC detention of the vessel over many years and that this amounted to material non-disclosure. The Owners argued that a vessel's PSC detention history is available online from various sources and was therefore common knowledge or a matter which an underwriter ought to know in the ordinary course of his business and did not therefore need to be disclosed.

Blair J held that the underwriter had not been induced to agree the policy by reason of any non-disclosure by the Owners concerning the vessel's PSC detention history. Blair J added, however, that the fact that information is available online to an underwriter may not necessarily give rise to a presumption of knowledge. It is also worth noting that Blair J also accepted the evidence of the Owners' underwriting expert that a prudent insurer would only be concerned with recent PSC detentions, namely around 12-18 months before the inception of the policy and that any prior detentions would not be material and would therefore not need to be disclosed.

Blair J rejected the remaining arguments put forward by the underwriters and held that the Owners were entitled to succeed in their claim for an indemnity under the policy.

Whilst the decision does not establish the precise information an underwriter will be deemed to have known at the inception of a policy, it is a helpful demonstration to both underwriters and assureds as to the importance of obtaining quality expert evidence and brings the application of ISM warranties in line with those for class.

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Conferences & Events

ILS Bermuda Convergence 2013
Hamilton, Bermuda
13–14 November 2013
Attending: Richard Spiller

27th Marine Community Golf Tournament
Jumeirah Golf Estates Earth Course, Dubai
24 November 2013
Attending: Simon Cartwright

London Market Claims Conference
Dexter House, London
24 October 2013
Presenting: Paul Wordley (morning panel session) – Defining and achieving the outcomes that will deliver client value. HFW will be the legal sponsors at this annual insurance event.

For more information about any of these events, please contact events@hfw.com

The Owners argued that such a warranty only required documentary compliance and that compliance would be achieved if the vessel owning company held a valid Document of Compliance and the vessel itself held a valid Safety Management Certificate.

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