Using the Northern Sea Route – achieving contractual certainty

Contractual certainty – deciding what you want the contract to say and ensuring that it says it - is essential in any commercial venture. This is especially the case when considering whether to use the Northern Sea Route (NSR).

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The NSR is a relatively new route; it is very different in many respects to the normal or customary routes and unless using the NSR is agreed beforehand and set out in the contractual documents, its use may well constitute a deviation.

As described in the Insight article " Climate change creates new trade route ", using the NSR has recently become more viable because of changing weather conditions. In 2014 the route opened on 21 August - two weeks earlier than the previous year. It is much shorter and therefore cheaper than the normal or customary route between Europe and Asia. For example, one study, 1 making a cost comparison between a general cargo ship sailing the NSR route from Yokohama to Hamburg and using the Suez route, suggests that fuel consumption is reduced by some 20 per cent and the sailing time is cut from 34 to 23 days. As the world economy struggles, the pressure to save time and money becomes more acute. The earlier Insight article focussed on issues such as navigation, permits, ice class and other advice for operators considering using the NSR. This article focusses on some of the legal issues in relation to shipping in arctic regions, and the NSR in particular.

What constitutes a deviation and the consequences of the same A deviation is a departure from the "agreed route" or the "normal and customary route". The "agreed route" is identified in the contract of carriage, typically evidenced by the bill of lading. A deviation from the contractually agreed voyage can take different forms. It can be geographical. For example, it may have been agreed that the ship will load a cargo at port A and discharge it at port B, but instead of sailing directly between the two ports, the ship calls at port C, which is hundreds of miles off the normal or customary route between A and B. On her way to port C, the vessel suffers a casualty which would not have arisen had the vessel taken the normal or customary route. Deviation can also arise when the ship takes the normal or customary route between the ports of loading and discharge, but the way in which the ship performs the carriage is different from the method of performance agreed.

It is difficult at present to state that the NSR is the normal or customary route between Europe and Asia, so changing the vessel's route to sailing the NSR is likely to give rise to particular issues and challenges. One of the main concerns is the issue of an unjustified deviation. A deviation is justified under common law only for saving life at sea and the Hague-Visby Rules extend this somewhat to allow deviations to save life or property at sea. Any other deviation is consequently considered an unjustified deviation. Owners and operators committing an unjustified deviation risk losing the right to rely on exclusions and exceptions such as those provided by the Hague-Visby Rules as well as the benefit of their P&I cover, see below.

In the case of *Reardon Smith v. Black Sea Insurance* 2 the English court concluded that "it is not the geographical route but the usual route that has to be followed". Therefore, even though commercial traffic along the NSR is increasing it still cannot be considered the "normal or customary route". As a result, in order to sail the NSR, the route has to be agreed beforehand and specified in both the charterparty as well as bills of lading. Otherwise, the shipowner may find himself in a situation where he is found to be in breach of the contract of carriage and - because he loses his right to rely on defences or rights of limitation which would otherwise have been available to him - his P&I cover is prejudiced.

Where the vessel is voyage chartered, the agreement to use the NSR should be reflected in the charter, but it is imperative that this is also reflected in the bills of lading. Gard considers it would be prudent to clause all bills of lading on the front page to reflect the choice of route, even if the bills incorporate the voyage charter. Whilst difficult to achieve in certain trades, it would be preferable for the shipowner if the bills of lading were marked “non-negotiable” or - better still, sea waybills - and the receivers consented in advance to the choice of route, thus avoiding the difficulty arising under a negotiable bill of lading, whereby the receiver may be unaware of the proposed use of the NSR. See below.

Cargo claims Use of the NSR may lead to an increased risk of cargo claims. The most obvious and serious risk is damage to the ship/cargo due to grounding or ice. But there are other risks such as delay and the fact that many cargoes behave differently in cold conditions.

Given these risks and the fact that it is the charterers who will gain the most from this new trade corridor, Gard recommends owners to consider how they may contract out of these risks.

In theory, a shipowner could reach an agreement with a charterer allocating all the NSR risks to the charterer, as there is complete freedom of contract under a charter. The position with cargo receivers under the bills of lading is more difficult because the Hague Visby Rules will often apply by force of law to bills of lading and may well strike down the agreed exclusion clauses in the charter. 3 The solution, should the trade allow and charterers agree, is to use a sea waybill rather than a bill of lading. Ideally an agreement is also reached with cargo receivers/cargo underwriters whereby the increased risk of cargo claims is covered under the cargo insurance policy and cargo underwriters would not exercise any rights of subrogation against the shipowners.

If charterers insist on the Hague-Visby Rules applying to both charters and bills of lading, shipowners using the route need to exercise care. They will need to prove that they exercised due diligence to ensure that the vessel was both seaworthy and cargo worthy for the particular cargo on the contemplated voyage.

Issues relating to a time charterparty As regards charterparties, it is important to note that a time charterparty will give rise to a different set of issues than a voyage charterparty. According to the BIMCO Ice Clause for time charterparties, the vessel in question shall not be obliged to force ice. However, subject to owners’ prior approval and with due regard to its size, construction and class, the vessel may follow ice breakers. Furthermore, the vessel shall not be required to enter or remain in any icebound port or area and any delay or deviation caused by or resulting from ice shall be for the charterers’ account. This also means that the vessel shall remain on hire during such periods.

It goes without saying that if these liabilities are not dealt with under the charterparty, the contractual position will remain uncertain.

Damage and delay to the ship As noted in the earlier Insight article, 4 Gard's position as a Hull and Machinery insurer is that a vessel which is about to use the NSR should prepare a proper voyage plan that ensures a safe voyage. The Northern Sea Route Administration (NSRA) is the Russian authority which evaluates requests from shipowners to use the NSR and, where considered appropriate, grants permission. Since 2012, the NSRA appears to have relaxed the transit requirements concerning ice class, which makes it even more important for the insurer to undertake a proper and thorough risk assessment. It seems that a substantial number of ships, which received permission from the NSRA to use the NSR in 2013, had no ice class at all, although statistics provided by the NSRA indicate that very few, if any, ships with no ice class have so far used the NSR. 5 Given the additional hazards posed by using the NSR, Gard believes that damage and delay to the ship are real possibilities. The remoteness and lack of infrastructure add considerably to the risk picture in a variety of ways. The risk of such damage and delay is arguably increased if the vessel has no ice class.

It is, therefore, important that charterparties expressly provide for these risks. In Gard's view it would not be sufficient or appropriate to simply rely on the standard BIMCO Ice Clauses for voyage or time charters together with other standard terms in the charter, such as the safe port warranty. The risks involved with the NSR are so high that a specific clause should be agreed. There are also other legal issues that have to be kept in mind such as:

- Who is responsible for obtaining the approvals to sail the route

- What will be the legal consequences if approval is not given

- Who is responsible for paying the extra costs for ice pilotage, permissions etc.

- Who is responsible for the engagement of the ice pilots and their actions

- What quantity of bunkers should be on board at the beginning of the voyage

- Should the speed and performance clause in the charterparty apply

- Who is responsible for loss of coating and/or damage to the vessel's hull/propeller

- When should such damage be assessed and how and at whose time and cost

- What about the time lost effecting such repairs? Should repairs take place at the next drydocking if they can wait or are owners entitled to do them when they wish and claim lost hire.

Trading limits in marine policies The starting point is that each party agrees to accept, mitigate and pay for their share of the risk picture. Marine insurance policies (Hull and Machinery, Loss of Hire, Increased Value etc.) contain limits relating to where the ship may trade. These limits may be related to Arctic and Antarctic Trade (excluded areas) or to areas which are seasonally covered by ice. Some of these areas may be excluded or conditional for parts of the year only. Shipowners will have no cover, or limited cover for damage, if trading outside these limits without giving notice to their marine insurers. Full cover may be agreed against the payment of additional premium and compliance with any conditions imposed by the insurers. Trading limits often find their way into trading clauses in time charterparties and can include the Institute Warranty Limits (IWL) or Institute Navigating Limits (INL). The NSR falls outside agreed trading areas and are included in excluded trading areas in virtually all insurances policies, so if owners agree to use the NSR, additional premium and increased deductibles will probably be agreed. According to the BIMCO Ice Clause for time charters, any additional premium required by the vessel's Hull and Machinery insurers due to the vessel entering or remaining in any icebound area will be for charterers' account. Another issue for consideration is who should pay for any increased deductible. As it is the charterers who stand to gain the most from using the NSR, most owners will take the view that any increased deductible should be paid by or be reimbursed by the charterers. What is important from an insurer's perspective is that the risks are identified; it is agreed who should be responsible for them; and which insurance should respond.

It should be noted that under English law, 6 even when charterers pay the additional premium required by the ship's underwriters, this does not relieve them of their obligation as to the safety of the ports (outside those limits) to which they ordered the vessel. This is another reason why parties using the NSR should try to expressly agree the allocation of risk.

Summary: Insurance and contractual considerations As highlighted above, many of the issues may affect a Member's insurance cover.

Owners and operators committing an unjustified deviation risk losing the right to rely on exclusions and exceptions set out in the Hague-Visby Rules and elsewhere. Consequently, Members may lose the benefit of their P&I cover for liabilities arising as a result of the deviation. 7 Therefore, it is of utmost importance that both the charterparty and the bill of lading name the route as the NSR.

Regarding cargo and potential delay claims under P&I insurance, any operator considering the NSR should be aware that there is a duty on the Member to disclose circumstances which result in an alteration of risk. 8 The use of the NSR may well represent an alteration of risk and depending on the relevant risks and contractual terms, the Association may be willing to extend P&I cover for the use of the NSR only on certain conditions and for additional premium.

Finally, shipowners wishing to trade outside trading limits should always notify their Hull and Machinery insurers before so doing. Any ship sailing outside of the limits, without the owner notifying his insurer, may risk losing his insurance cover.

There are also numerous contractual issues to bear in mind when planning a voyage along the NSR. Gard may assist in achieving contractual certainty and reducing potential exposure, and any Member considering sailing the NSR is therefore

recommended to contact Gard before entering into a contractual obligation to do so.

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Questions or comments concerning this Gard Insight article can be e-mailed to the Gard Editorial Team .

1 Tor Wergeland, 2010, Arctic Shipping Routes - Cost Comparisons with Suez. link: http://www.arctis-search.com/Arctic+Shipping+Routes+-+Cost+Comparisons+with+Suez&structure=Arctic+Sea+Routes#Comparisons_with_NEP_-_General_Cargo_Ship_Yokohama-Hamburg_via_NSR 2 *Reardon Smith Line Ltd v. Black Sea Baltic General Insurance Co Ltd* (1939) 64 Lloyd's Rep 229.3 The ship owner may be able to claim an indemnity from the charterers in this situation, but would charterers be good for the money and would they secure the cargo claim?4 Gard Insight: Climate change creates new trade route 5 http://arctic-lio.com/docs/nsr/transits/Transits_2013_final.pdf 6 *St Vincent Shipping Co Ltd v Bock, Godeffroy & Co (The Helen Miller)* [1980] 2 Lloyd's Rep 95.7 Gard Rule 34.1.xi.8 Gard Rule 7.