Flaw in the law no more – limitation fund can be constituted by Club Letter of Undertaking

The Court of Appeal held that English law allows a limitation fund to be constituted by way of a guarantee, including a P&I Club LOU.

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We refer to our previous Insight article in which we reported on the English High Court decision in the *ATLANTIK CONFIDENCE* case, where the owners' P&I Club had sought to constitute a limitation fund in England by providing a Club Letter of Undertaking (LOU), rather than paying the required amount into court, as is usually done. While expressing some understanding of the owners' and the Club's position, the High Court judge held that, as a matter of English law, a limitation fund could not be constituted by way of a guarantee. The only means of constituting a limitation fund was cash payment into court of the limitation amount. He therefore refused to grant the application sought by the owners and the Club that a limitation fund could be constituted by a P&I Club LOU, but accepted that the point was arguable and allowed them to appeal. This appeal has now been heard by the Court of Appeal.

By a unanimous decision, the Court of Appeal allowed the appeal and held that English law allows a limitation fund to be constituted by way of a guarantee, including a P&I Club LOU.

The English courts are among the most widely used fora for the resolution of shipping disputes and this decision will be welcomed by many shipping interests, not just owners and their P&I Clubs. The decision may also have an effect in jurisdictions other than England – in particular those that rely on English court decisions in their own jurisprudence – as well as others with a similar legal system and where there is no appellate court ruling on the issue. It should be noted in this regard that, although it was not determinative, the International Group's letter of support for the appeal was found by the Court to be 'helpful'. Giving the leading judgment, Lady Justice Gloster commented:

"The issue is one of considerable importance to the shipping industry, including P&I Clubs and others who provide insurance and reinsurance in respect of maritime claims. Because of concerns that had arisen in shipping circles about the consequences of the judgment, this court was provided with a helpful letter from the International Group of P & I Clubs, dated 8 November 2013. This letter explained the financial and practical benefits both for P&I Clubs, and for those who need to constitute limitation funds, of the use of guarantees, as opposed to cash deposits paid into court. The letter also informed the court that numerous countries throughout the world, including states which are parties to the 1976 Convention, and states which are not, readily accept Club LOUs as an acceptable method of constituting limitation funds. The judge did not have the advantage of this additional material at the date of the hearing before him."

Lady Justice Gloster's approach was firstly to look at the part of the Convention for the Limitation of Liability for Maritime Claims (LLMC) 1976 which deals with how a fund is to be constituted. Chapter III, Article 11 (2) of the Convention says:

"A fund may be constituted, either by depositing the sum, or by producing a guarantee acceptable under the legislation of the State Party where the fund is constituted and considered to be adequate by the Court or other competent authority."

In reaching his decision, the High Court judge noted the "either/or" provision, but found that there is no English legislation (legislation of the State Party) which

expressly allows a limitation fund to be constituted by a guarantee. Gloster LJ said this was the wrong approach and stated that:

"In my judgment the judge was wrong to reach the conclusion which he did and to hold that a limitation fund could not be constituted by means of a guarantee, and in particular a Club LOU. The error in his analysis was to take as his starting point the proposition that he would have expected to find clear wording permitting the provision of a guarantee "if such a change to the long-standing previous practice were to be made", rather than focusing on the meaning and effect of Article 11.2. The judge's approach appears to have reflected the structure of the arguments before him.

In my view the correct starting point of the analysis is the construction of Article 11.2 - as incorporated into United Kingdom law by the 1995 Act - in its proper context."

Gloster LJ decided the right approach was to ask whether the Convention itself contains any wording or provision for a fund to be constituted by a guarantee, rather than to ask if there is any express provision in English law which allows this. Her Ladyship also indicated that, even if English law did not contain any such provision, this was not necessarily fatal to the appeal, as (in the light of the "either/or" provision in Article 11.2); the real question was not "does English law expressly allow a fund to be constituted by a guarantee", but "does English law expressly say that a fund cannot be constituted by a guarantee."

She noted that the LLMC Convention was not drafted by English draftsmen, with English law in mind.

Instead, it was a convention drafted with input from different interested state parties, with the purpose of having international application *"...intended to be applicable in a uniform way across legal boundaries"* . Therefore, it was important to adopt a broad, purposive, interpretation of its terms. The task of the court was to *"...construe the Convention as it stands without any English law preconceptions."*

Looked at in this way, she found that the provisions of Article 11.2 were clear. There was an "either/or" option as between payment into court or provision of a guarantee to constitute the limitation fund. The party constituting the fund could choose one or the other. The only restrictions as concerned provisions of a guarantee were that it had to be acceptable under the legislation of the State Party and considered to be adequate by the Court. In this regard, the word "acceptable" was not held to predicate, or require, specific additional enabling legislation, but rather more simply a guarantee that did not contravene any relevant statutory provision and issued by a party with legal authority to do so. The word "adequate" was held to mean that the court approving the constitution of the limitation fund would need to be satisfied that the guarantee provides "adequate" security for the fund, e.g. as to the financial standing of the guarantor, the practicality of enforcement and as to the terms of the guarantee instrument itself. A P&I Club LOU offered by a member of the International Group would arguably be both acceptable and adequate, but it would be for the Court in the case at hand to consider.

As part of her legal analysis, Gloster LJ noted that virtually all the legal textbooks indicate that English law requires a limitation fund to be constituted by a payment

into court only. According to the textbooks, there is no provision under English law for a fund to be constituted by an LOU. The judge disagreed and it would seem that the authors of these textbooks may have to revise them accordingly.

The fact that the Appeal was essentially uncontested by the Respondents, only one of whom appeared at the hearing, suggests that the decision is welcome to the shipping industry as a whole. It demonstrates the practical, purposive, approach the English courts will adopt when construing what appear to be clear words in an international convention incorporated into an English statute. The decision reinforces the value and validity of the P&I Club LOU system, which, as was noted by the International Group of P&I Clubs in its letter of support to the appeal, "...enables the Clubs to provide security at minimum expense and without unnecessary delays...".

The full judgment can be found here:

http://www.bailii.org/ew/cases/EWCA/Civ/2014/217.html

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