Flaw in the law? P&I Club guarantee and constitution of limitation fund in England

P&I Club guarantee not accepted as security to constitute a limitation fund.

Published 26 February 2014

The case

In *Kairos Shipping Ltd & Anr v Enka & Com LLC & Ors* (The *Atlantic Confidence* – Lloyd's Law Reports [2013] Vol 2, p. 535 - 540), Mr Justice Simon of the Queen's Bench Division (Commercial Court), England denied owners' application for an interim declaration under CPR Part 25(1)(b) that the owners were entitled to constitute a limitation fund by the provision of a guarantee offered by a P&I Club that is a member of the International Group of P&I Clubs (IG). The court ruling was made on 21 June 2013 and has since been appealed. The IG has supported the appeal.

The owners commenced a limitation action on 13 May 2013 and wrote on the same day to the Admiralty Judge (Teare J) asking for permission to constitute a limitation fund by provision of a Club guarantee as had been accepted by Teare J in the *Dania Shipping Co v MSC Mediterranean Shipping Co SA (The Rena)* [2012) Folio 255. In the event, Teare J directed that an oral hearing of the issue take place before the Commercial Court.

In his consideration of the owner's application, Mr. Justice Simon (Simon J) noted that, before the incorporation of the International Convention on Limitation of Liability for Maritime Claims, 1976 (LLMC76) into UK law, limitation had been governed by Section 503 of the Merchant Shipping Act 1894, as amended to reflect the 1957 Limitation Convention. Section 503 did not contain any guidance as to how and where the fund was to be constituted but rather left it to the domestic courts of each country. In England the courts therefore required a party wishing to constitute a limitation fund to make a payment into court. The question was whether that position had changed with the incorporation of the LLMC76 into the 1995 Merchant Shipping Act. The analysis started with the following statement made by Simon J:

"It might seem surprising in today's world that it could be argued that a suitably framed guarantee in an appropriate amount from a creditworthy provider is not effective security, and therefore suitable to constitute a limitation fund and none of the cargo parties has argued that it would not be. Nevertheless it seems to me that the court must approach this as a question of principle."

Section 185(1) of the Merchant Shipping Act 1995 gives LLMC76 the force of law in the UK. As concerns the means by which a limitation fund may be constituted, Article 11(2) of the LLMC76 provides that it 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"* . Furthermore, Article 14 provides that all rules of procedure relating to the constitution (and distribution) of the fund shall be governed by the law of the State Party in which the fund is constituted.

UK statutory provisions

The key question for the Court was whether a P&I club guarantee (or any guarantee) would be "...acceptable under the legislation..." that applies in the UK. Simon J found that it would not be acceptable, because of a lack of a specific statutory provision stating that it would be acceptable:

"I have therefore come to the conclusion that without a specific statutory provision that a guarantee is acceptable the rule remains that a fund may only be constituted by making a payment into court."

Apparently it was held that, in the absence of a specific statutory provision changing the rule that applied prior to the incorporation of the LLMC76 into UK law, which was that a limitation fund may only be constituted in the UK by way of paying the limitation amount into court, that rule still had to be applied. The fact that Article 11(2) of the LLMC76 as well as the preparatory works to that Convention, clearly shows the legislative intent that a guarantee may suffice did not matter, because the Convention has left the issue to be regulated under the legislation of the State Party where the fund is constituted. Article 11(2) of the Convention does not mandate that the State Party must accept a guarantee instead of payment into court, but rather that the State Party cannot implement legislation *specifically excluding* guarantees as a means of constituting a limitation fund under the Convention.

In reaching the decision, Simon J reviewed various materials put before him by the parties to cast light on the issue, including maritime law textbooks such as: Griggs, Williams and Farr, *Limitation of Liability for Maritime Claims* , 4th Edition, 2005, p65–66; and Fogarty, *Merchant Shipping Legislation* , 2nd Edition, 2004, Informa, para 15.183. The former stated that: *"There is nothing in the MSA to indicate that the situation has changed"* – i.e. concerning the rule on payment into court as the only means to constitute a limitation fund in the UK. The latter source is quoted by the Court as follows: *"United Kingdom legislation does not provide for the acceptance of guarantee or other security in lieu of a cash payment into court for the purposes of constitution of a Limitation Fund."*

It appears therefore that the state of the applicable law on this issue in the UK compelled the Court to hold against accepting a P&I Club guarantee (or any guarantee) to constitute a limitation fund under LLMC76. The final statement in this regard appears to show that Simon J felt the issue would justify wider consideration and a possible change in the law:

"I hope from what I have said that I have made clear that consideration should be given to effecting a change in the law; and, in any event, since there is likely to be than one view of the matter, I have decided to give permission to appeal."

An appeal has since been lodged to the Court of Appeal supported by the IG. There is good reason to be concerned about the current state of affairs and the decision of the Court will be important to all members of all Clubs in the IG. There are several advantages that Club LOUs have over cash deposits such as effects on cash flow, high level security at low expense and the speed with which LOUs can be arranged.

IG Club LOUs

IG Club LOUs for covered claims have the backing of the IG Pool and Excess of Loss Reinsurance arrangements. The IG Clubs have a reputation for making rapid payments when called upon to do so by final and enforceable judgments, including providing the necessary funds on behalf of the member when the time comes for distributing a limitation fund in accordance with any decision made by the court as fund administrator. Indeed, the preparedness of the IG Clubs to fulfil the promise embodied in a Club LOU when due is a cornerstone for achieving such a wide acceptance for Club LOUs as acceptable security for maritime claims.

It may be added that there are several states, both in the EU/EEA, Asia and elsewhere which have ratified the LLMC76 (and the 1996 Protocol) which do not insist on a cash payment into court in order to constitute a limitation fund. Furthermore, some non-LLMC76/96 states which have other mechanisms for constituting a limitation fund do not insist upon a cash payment into court to constitute the fund.

Gard appreciates the support given by the IG to the appeal in this matter. The United Kingdom is an attractive and important jurisdiction for maritime claims, because of its well advanced and predictable rules of law, its support of international maritime liability and limitation regimes, the skills level of the English courts in admiralty and maritime claims, as well as easy access for parties in dispute to skilled legal assistance. For these and probably other reasons English law and jurisdiction is often the contractual choice made by the parties to shipping contracts. In addition, English law and jurisdiction is relatively often the jurisdiction chosen by the parties after a maritime casualty or other incident has occurred even in circumstances where the casualty or incident has occurred outside the United Kingdom. Indeed, the *Atlantic Confidence case* concerned claims resulting from the sinking of that vessel outside Masirah Island, Oman.

Considering that a limitation fund may be constituted by means of an IG P&I Club LOU before the courts in several other LLMC 76/96 states, it appears an anomaly that the law in the United Kingdom may preclude the acceptance of:

"...a suitably framed guarantee in an appropriate amount from a creditworthy provider..."

We will keep readers posted about the outcome of the appeal in due course.

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