Insight Article

Charterers' liability for damage to vessels

Charterers represent about one third of the total tonnage entered with Gard for P&I cover. This issue of Gard News focuses on charterers' liabilities and includes articles on cargo claims, personal injury, damage to chartered vessels, bunkers, as well as an outline of Gard's additional covers which may be of interest to charterers.

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Introduction

Gard has seen a continued increase in charterers' P&I entries, which at present exceed 30 million GT and equals about one third of the total tonnage entered. Gard's portfolio of charterers above all comprises operators of liner services, oil companies and oil traders. During recent years risk managers within other categories of industrial companies have become more aware of maritime risks. Such companies are often traders, to whom transport by sea has become an essential part of operation, although shipping is not their core business. The tendency is for this category of charterers to become increasingly aware of their exposure to maritime claims and the need for P&I cover especially designed to suit their needs.

The use of a vessel often gives rise to incidents that physically affect it. Some wear and tear is unavoidable in the operation of vessels, but there are limits to what a shipowner has to accept as inevitable wear and tear. Incidents that reduce the value of the vessel and/or prevent the shipowner from using it as planned will normally give rise to claims for compensation. If the vessel is chartered, three different points will have to be established in order to determine whether the charterer's liability is involved. Firstly, one must establish whether any physical damage to the ship has occurred. Secondly, the extent of the damage will have to be determined. The final step will be to decide whether the charterer is responsible for the damage in question, either under the charterparty or in tort.

Physical damage or ordinary wear and tear?

Most charterparties stipulate that the charterer will be liable to pay damages if, as a result of a breach of any of his obligations under the charter, he redelivers the ship in a worse condition than when delivered, ordinary wear and tear excepted. Therefore, often it will be necessary to decide what degree of physical change will constitute "ordinary wear and tear" and what will constitute "damage" for which the charterer will be liable. The nature of the particular trade for which the vessel is chartered and the purpose of the charterparty will be relevant factors.

The rule in this respect is that where the vessel is engaged in a trade where the risk of physical damage to the ship is high, the room for physical damage being referred to as ordinary wear and tear increases. 1 In trades considered safe, the requirements as regards the physical condition of the vessel at the time for redelivery are adjusted accordingly. There are a number of circumstances which may increase or reduce the degree of usage of the ship permitted under the charter. Some of the most important relate to the cargo, i.e., what kind of cargo is carried, what methods are used for loading and discharge of cargo and the frequency of loading and discharge operations. Statistics show that carriage of some categories of cargo causes damage to the vessel more frequently than others and the reasons for this vary. The cargo itself may cause physical damage to the coating in the cargo holds, or the vessel's winches or derricks may be damaged in connection with loading or discharge performed by stevedores. In other cases the nature of the cargo may simply cause a higher degree of wear and tear without causing any actual physical damage. At some times, but not always, it may be justified to assume that in trades where physical damage to the vessel occurs relatively frequently, wear and tear of the ship is high.

1 - Canadian Pacific Railway v. Board of Trade (1925)22 Lloyd's Rep.1.

However, the charterparty as a whole must be considered. Accordingly, as is usual, where the charterparty imposes on the shipowner responsibility for maintaining the ship, the charterer will not be liable for defects in maintenance present at the time of redelivery of the ship.

There also seems to be ground for concluding that the charterer incurs no liability as regards defects in the condition of the ship unless those are a result of his negligence. For instance, clause 13, section 2 of the Baltime form stipulates that "the Charterers to be responsible for loss or damage to the vessel (...) by improper or careless bunkering or loading, stowing or discharging of goods or any other improper or negligent act on their part or that of their servants". However, if a charterparty contains both clause 13 and an "employment and indemnity" clause, negligence may not be required in order to hold the charterer liable. An "employment and indemnity" clause added as a rider clause to the Baltime charter gives the charterer the right to give a wide range of instructions to the shipowner, but also gives the shipowner the right to be held harmless by the charterer for having complied with such orders. Under English law the "employment and indemnity" clause has been referred to frequently in the context of bills of lading as well as matters involving damage to hull due to dangerous cargo.

The fact that the vessel must be redelivered in the same good order as when delivered means not only that the vessel shall be without physical damage. It further means that, for instance, cargo holds and other areas used by the charterers should have the same level of cleanliness as they had in the beginning of the charter period. This is essential for some vessels, such as vessels involved in the oil and chemical trades, whereas other vessels are less sensitive from this point of view.

A charterer's responsibility?

Whether the shipowner or the charterer will bear the risk of damage to the vessel will depend upon who and/or what has caused the damage and the terms of the governing charterparty. Following are some examples.

Loading, stowage and discharge of cargo

Charterparty clauses often provide that charterers have responsibility for loading, stowage and/or discharge of cargo and that they will be liable for any loss or damage caused to the vessel as a consequence.

Under English law, clause 8 of the NYPE 1946 form, when unamended, has the effect of transferring the primary responsibility for loading, stowing and trimming of the cargo from the owners onto the charterers. 2 The clause is frequently amended with the words "and responsibility" and a trilogy of cases in the 1980s 3 held that the addition of these words had the effect, prima facie, of transferring from the charterers back to the owners the liability for the loading, stowing and trimming operation. That transfer of liability can be displaced where it is shown that the charterers have intervened, and by doing so, that intervention has caused the relevant loss, i.e., the interference of, say, a port captain in the above operations. It is important to note that not only do the words "and responsibility" transfer liability for loss in respect of the cargo, but they also extend it to damage caused to the vessel itself, i.e., stevedore damage. Lastly, the addition of the "and responsibility" also affects the apportionment of liability for any cargo claim by reason of the Inter-Club Agreement (where incorporated): paragraph 1 (II)(c) of the Inter-Club Agreement defines the words "and responsibility" as a material amendment insofar as liability for cargo claims is concerned.

2 Court Line v. Canadian Transport (1940)67 Lloyd's Rep.161.
3 The SHINJITSU MARU NO. 5 (1985)1 Lloyd's Rep. 568, the ARGONAUT (1985)2 Lloyd's Rep. 216 and the ALEXANDROS P (1986)1 Lloyd's Rep. 421.

Unsafe ports/berths4

Sometimes failure to nominate a safe port/berth may result in dangerous situations for the vessel (and also a wide range of other P&I-related liabilities). Where a charterparty provides that a ship shall go to a safe port or berth nominated by the charterer, in nominating the port or berth the charterer warrants that the port or berth is safe. It may be that this warranty will be implied where the charter provides for the nomination of a port or berth but is silent as to its safety. The classic test of safety is that a port will not be safe unless, in the relevant period of time, the particular ship can reach it, use it and return from it without, in the absence of some abnormal occurrence, being exposed to danger which can not be avoided by good navigation and seamanship. 5

If the charterers order the ship to a prospectively unsafe port they will be in breach of the charter. A port may be deemed unsafe due to a wide range of different circumstances affecting the physical safety of the vessel. Examples of facts rendering a port unsafe are lack of adequate weather forecasting systems, unavailability of adequate pilots and tugs, lack of sea room to manoeuvre, etc. Although the reasons for a port being unsafe are usually its physical features as well as tendency to climatic changes, it is nevertheless well established that obligations regarding safety also extend to political safety.

The owners will be entitled to damages if the master reasonably obeys the charterers' order and the ship is lost or damaged as a result of the unsafety of the port. The ship may be physically damaged in numerous different ways, including incidents such as groundings and collisions, as well as damage caused by dysfunctional loading equipment at the berth.

4 See article "In search of a safe heaven" elsewhere in this issue of Gard News.
5 The EASTERN CITY (1958)2 Lloyd's Rep. 127.

Engine breakdown or partial damage caused by bad bunkers6

Under a time charter the charterer normally provides and pays for bunkers. It is the master's responsibility to determine what quantity of fuel shall be brought on board the vessel (which at least must be adequate for the ship to perform the voyage the charterer has instructed him to undertake). As regards the quality of the fuel, the standard time charterparties contain more or less detailed provisions concerning technical specifications for the fuel. Under English law, even if the charterparty does not contain a bunker quality clause or fuel specification, charterers may still be obliged to provide bunkers which are reasonably fit for the vessel's engines. At the same time, where the parties have agreed to include specifications in the charter as to the type or quality of the fuel to be used, the charterer will be liable for any losses resulting from the use of the fuel which does not meet the charter description. However, even though in the first instance the shipowner may succeed in showing that the fuel supplied does not meet the agreed standards, in order to succeed in a claim he must also show a causal link between the defective fuel and the alleged damage. This is not always easily done and the charterers' points of defence often include allegations that an engine breakdown was caused by the crew, a pre-existing condition of the engine itself or other causes.

6 See articles "The quality of bunkers" and "Charterers' liabilities and bunkers" elsewhere in this issue of Gard News.

In a recent case which was subject to arbitration in the US, the charterparty described the fuel the charterer was to furnish as "IFO 1550 SECS and MDO". The shipowner claimed that the fuel supplied was off-specification, improperly blended or contained excessive contaminants. The panel of arbitrators agreed with the shipowner but did not find the charterer liable, since the shipowner failed to show that it was the fuel which caused the engine breakdown. In order to handle this burden of proof shipowners often take so called "drip samples" of the delivered bunkers, which may serve as evidence against charterers in case of a dispute.

The consequences of supplying defective bunkers are often serious and may include physical damage to the engines, reduced levels of performance and loss of time.

Damage to hull caused by cargo

A charterer may also incur liability for damage caused by cargoes carried during the charter period. Depending on the nature of the incident and what different interests are involved, claims for compensation may be brought by the shipowner, other cargo owners, as well as other third parties (for instance in connection with oil spills).

There are numerous cargoes that, depending on their character and other circumstances, may be more or less "dangerous". Some goods, such as toxic chemicals or acids, are inherently dangerous but if packed and sealed in accordance with guidelines, will give rise to minimal risk. On the other hand, there are categories of goods which may never be described as having inherently dangerous carriage characteristics. In between these two categories, however, there are many types of goods which normally would not be described as dangerous, but which may cause damage if not handled properly.

Some coals for instance may, depending on its particular properties, be more prone to heating or explosion than others. Sulphur cargoes can cause corrosion to the vessel on which they are carried, although many such cargoes are carried without incident. The word "dangerous", when referring to cargoes, has no exact legal definition in the context of contracts. The International Maritime Organization (IMO) has published two codes, the International Maritime Dangerous Goods Code (IMDG) and the Code of Safe Practice for Solid Bulk Cargoes, which provide a categorisation of potentially hazardous substances. The codes are not mandatory and, as far as contractual responsibility is concerned, they will only apply if the terms of the contract provide for their requirements to be met. They are, however, often used by way of evidence in order to establish whether goods should be regarded as dangerous or whether appropriate packaging and segregation standards have been complied with.

Whether or not the shipper or charterer is aware of the dangerous nature of the goods shipped, generally he will be under an absolute obligation to notify the carrier. The purpose of the notification of the dangerous characteristics of the cargo is to enable the carrier to take necessary precautions to ensure its safe carriage, or to reject it where he is not contractually obliged to carry it. 7

There will usually be an implied warranty under English law that the charterer will not ship goods of a dangerous nature without advising the owner. This duty does not arise, however, if the shipowner is already aware of those characteristics. On the same principle, where both parties agree in a contract that a specific cargo shall be shipped, and where the parties know the characteristics and risks connected to it, the charterer will not be liable for any damage or delay caused by that cargo. However, the situation may be different where the cargo possesses some special and obscure qualities that increase the danger beyond what a carrier of that type of cargo should foresee and guard against. 8

7 See articles "Shippers' obligation not to ship dangerous goods without notifying the carrier is absolute" in Gard News issue No. 143 and "Shippers' absolute obligation to notify confirmed by the House of Lords" in Gard News issue No. 149.
8 Atlantic Oil Carriers v British Petroleum Co. (1957)2 Lloyd's Rep. 55

Measure of damages

When charterers are liable for the condition of the ship upon redelivery, the normal measure of the damages that the shipowner may recover is any consequent reduction in the value of the ship. More specifically, the claim will be for the cost of repairs or alternatively for the cost of replacement parts. In accordance with prevalent damage calculation principles, an added economic value of these new replacement parts will normally be deducted from the claim.

The shipowner is further entitled to compensation for loss of income, which normally results from detention through repairs. When not governed by the demurrage rate, the damages for detention of or delay to the ship resulting from a breach by the charterer are prima facie the amount which the ship could have earned at market rates during the net period of detention, less any expenses saved by the detention. In the absence of better evidence, the demurrage rate may be taken as evidence of the market rate.

Gard's Comprehensive Charterers' Liability Cover

Gard's Comprehensive Charterers' Liability insurance was introduced in 1989 with a separate reinsurance arrangement. The purpose was to provide an alternative to the standard P&I concept offered to charterers by the P&I Clubs within the International Group of P&I Clubs (IG). The Comprehensive Charterers' Liability Cover (CCLC) has now grown into one of Gard's single most important products and accounts for an absolute majority of the Club's charterers' entries. The traditional P&I cover concept, which is still offered by Gard, is available under the claims-sharing and collective reinsurance agreements (the Pooling Agreement) of the IG. Gard's CCLC, on the other hand, is not subject to any such cost or risk-sharing arrangement with the Clubs in the IG. The product as such resulted from an on-going dialogue between the Association and its members and brokers and was instigated by detection of the need for a wider and more cost-effective cover capable of serving as sufficient protection in case of a catastrophe. Gard's CCLC, which is charged on a fixed-premium basis, offers single limits from USD 50 million up to a maximum of USD 500 million. In contrast to the traditional cover offered by the IG Clubs, there are no sub-limits, no aggregate limitation for pollution liabilities, and no restrictions relating to the shipowner's contractual right to limit liability, which may be crucial for charterers in certain jurisdictions. Some important risk elements that are excluded from protection under the standard P&I cover for charterers are covered by the CCLC arrangement. Thus, Gard's CCLC may include cover for damage to the chartered ship, for liability for freight and bunkers contributions in general average, and for war risk liabilities, including damage to or loss of the ship. It may further include cover for liability for pollution in the charterer's capacity as cargo owner.

Gard's Damage to Hull Cover

The damage to hull (DTH) cover provided by Gard is one of the products available as a part of the Comprehensive Charterers' Liability Cover. The maximum limit for the DTH cover corresponds to the maximum limit that has been agreed for the Comprehensive Charterers' Liability Cover, which is between USD 50 and 500 million any one accident or occurrence, with deductibles individually agreed. The DTH insurance covers claims for damage to or loss of the vessel and claims for consequential losses (which may be equally important). "Vessel" includes the vessel's hull, engines and equipment used in its operation. "Consequential losses" refer to losses a shipowner may suffer as a result of the damage to the vessel, as long as there is a causal link between the damage to the vessel and the loss. As indicated above, at times claims for consequential losses may substantially exceed the value of the damage to the vessel itself.

The DTH insurance will only cover physical damage to the vessel. So, for instance, if at the time of redelivery the cargo holds are not sufficiently clean, although the shipowner may have a claim against the charterer, there is no physical damage as such, and therefore any resulting liability will not be covered by the DTH insurance.

Accordingly, physical damage to the vessel is also a pre-requisite for cover for claims relating to consequential losses. So, for instance, charterers' liability for consequential loss which results from an arrest of the ship will not be covered under the DTH insurance. Another example is a claim for breach of the charterers' obligation to nominate a safe port where the ship suffers no physical damage (for instance if it suffers delay because of some obstacle to safe entry or departure).

Conclusion

The standard P&I cover for charterers reflects the fact that many times charterers are exposed to the same risks as shipowners are. It is, however, well known that charterers are exposed more often to some liabilities and less often to others. The risks in each specific case must be assessed in view of contractual obligations and applicable legal regimes. Just as for shipowners, cargo-related claims are one of the most important risk categories. However, experience from the daily P&I claims handling work shows that charterers are exposed to all sorts of risks involving liability to interests that are part of the operation of the ship (shipowner, cargo owners, crew, stevedores, etc.), as well as other third parties. Failure to nominate a safe berth or port may result in a wide range of P&I-related liabilities, such as damage to or loss of cargo, damage to or loss of the vessel, personal injury and death, pollution, wreck removal and consequential losses.

Further information about DTH insurance and Gard's Comprehensive Charterers' Liability Cover can be obtained from Gard Services' website at www.gard.no.

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