The Polar – Reading between the lines

The English Court of Appeal upheld the Commercial Court in finding that the charterer's payment of additional premium did not insulate cargo owners as the bill of lading holders from their contribution in general average. Our co-authors exchange views on a question the Appeal Court discussed but did not answer – was the Commercial Court correct in deciding that the charterer was a beneficiary of the war risk and kidnap and ransom policies?

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The English Appeal Court has concluded cargo underwriters are not excused from contributing in general average towards a ransom payment, notwithstanding the fact the voyage charterers contributed under the terms of the charter towards the additional war risk premium payable to owners' war and K&R insurances, and the charter was incorporated into the bills of lading. The Appeal Court decision raises the question, but still leaves open for debate, whether reimbursement of an owners additional operating costs by the mechanics of a financial contribution towards additional K&R or war risk premium inevitably leads to a conclusion that vessel insurers have agreed to waive subrogated rights.

Background

This was a claim by the owner of the M/V POLAR and its subrogated underwriters to recover cargo's proportion of general average consisting of a ransom payment to pirates who had detained the vessel in the Gulf of Aden. The ransom payment of USD 7.7 million was funded by the owner's kidnap and ransom (K&R) cover up to their limit of USD 5 million, and then by their war risk underwriters. Following an average adjustment, cargo's portion of GA was determined to be USD 4.7 million.

The vessel had been voyage chartered by Clearlake Shipping Pte. for carriage of a fuel oil cargo. The voyage charterparty was on an amended BPVOY4 form. Its additional clauses contained a detailed series of War Risks clauses (with additional premiums for charterers' account). The additional premium for kidnap and ransom cover was to be for charterers' account up to a maximum of USD 40,000. Gunvor International BV, a related company to Clearlake, was the holder of the bills of lading at the time the vessel was detained by pirates. Gunvor, and their cargo insurers, issued GA security.

As holder of the bills of lading, Gunvor contended that because the voyage charter terms were incorporated in the bills of lading, the payment of the additional premium for war risks and kidnap and ransom cover by the charterer meant that owners could only look to the K&R and war risk insurance and that it did not have to pay the cargo portion of general average. Gunvor also argued that the charterer paid the additional premium for its benefit. Gunvor prevailed in arbitration, but the award was reversed in the Commercial Court. The Court of Appeal upheld the Commercial Court, and in so doing made a number of observations about how the parties' insurances impact the outcome. The full judgment in Herculito Maritime Ltd and others v. Gunvor International BV and others *(the* **Polar** *)* can be found here .

General average, piracy and insurance

General average has operated as a form of collaborative property sharing risk for maritime adventures since Rhodian times. General average requires all property interests to share in the sacrifices and expenses resulting from a casualty. A ransom payment to pirates falls into such a category as it achieves the release of ship, bunkers and cargo, as well as enabling any freight at risk to be earned.

The shipowner's portion of GA is usually insured under the Hull and Machinery (H&M) policy. Piracy, however, is considered a war risk. War is a specialist package cover which wraps up standard H&M, LOH and P&I excluded risks into a single policy.

How you read the judgment depends on your perspective – A discussion

The Appeal Court again faced the prospect of analysing concepts involving general average, co-insurance, waiver of insurers' rights of subrogation, and the scope of protection (if any) afforded to a third party who reimburses owners' insurance premium. We agree (Kim and Adrian) that the outcome of the appeal is probably correct – (the case may yet be subject of a further appeal). Where we differ is in how to interpret the language with respect to the first premise – that the voyage charterer by paying the additional premium was entitled to the benefit of the owner's K&R and War Risk insurance. The question whether the charterer had a defence to a demand for a GA contribution was never necessary for decision; unlike under a time charter, Clearlake had no property interest in the bunkers and it is assumed freight was pre-paid so there was no freight pending.

Kim : As an American lawyer, I have to say that I have a hard time following judgments coming from the English courts and with this case, I did not actually know which way the appeal court would go until I got to the last paragraph:

In reality this is a case where both parties were insured against the risk of piracy and where allowing the shipowner to claim will mean that each set of insurers will bear its proper share of the risk which it has agreed to cover. In contrast, the effect of construing the bills of lading to exclude a claim by the shipowner will mean that the loss is borne entirely by the shipowner's insurers and that the cargo owners' insurers escape liability for a risk which they agreed to cover.

This seems to me to be completely rational, and it led me to wonder how eminently qualified arbitrators would determine otherwise. Standing back and looking at the question from Gunvor's point of view, however, I can see why there is some appeal to the argument that Clearlake, in paying the additional premium, did so for the benefit of Gunvor.

The Appeal Court noted that they were related companies, although found this fact to be irrelevant to the issues on appeal. In my experience, many commodity trading companies are organized similarly. The trader buys and sells commodities and uses its related chartering arm to arrange the transportation to comply with the particular sale or purchase contract. In this case, it looks like Gunvor was the buyer on terms that required it to transport the cargo. Gunvor likely intended to on sell the cargo but was holder of the bills at the time of the piracy attack.

Freight is usually pre-paid or said to be pre-paid in the bills of lading so in most cases, a voyage charterer would not be making a contribution in the GA adjustment. Thus, the argument that Clearlake paid the AP for the benefit of Gunvor makes some sense. Where the argument falls down is when you look at it from the owner's point of view. While the voyage charterer often has no skin in the game when it comes to the GA adjustment, cargo's portion in many instances is greater than the owner's portion as it was in this case. Why would an owner agree to forego cargo's contribution?

Adrian: And there would be difficult discussions with the owner's underwriter if, by entering a charter with onerous terms, the owner did waive the cargo contribution without first obtaining consent from insurers, otherwise they risk prejudicing cover. Of course, Kim, the extract from the decision you quote might apply equally to *charterers'* insurers escaping a liability they had agreed to cover!

Kim: Point taken with respect to time charterers and contributions to GA based on the value of charterer's bunkers. Charterers bunker insurance is a type of property cover that includes charterer's GA contributions and Gard's charterers liability product does not exclude war risks and does include bunker's contribution to GA. However, for our trader clients that buy charterer's liability policies with cargo owner's legal liability cover for damage to hull and other P&I liabilities, we specifically exclude cargo's contribution to GA. So, cargo owners need to insure such a risk under their cargo policy and with respect to the fact pattern in the *Polar* case, the cargo cover is where to look for GA contributions based on the value of the cargo.

Adrian: So Kim, whilst we agree on the outcome, where you and I part ways is with the premise that payment of additional premium necessarily or inevitably insulates the charterer. This payment method is merely one formula to compensate an owner for his enhanced costs whilst the vessel is employed by his charterer in a high-risk area. Equally effective financially would be for owners and charters to agree an enhanced hire supplement payable during the vessel's transit through such an area to cover increased OPEX cost. Digital technology enables this voyage duration easily to be tracked. Why should the parties' insurance position suddenly alter dependent how owners receive compensation for following charterers orders? In the offshore market, there is invariably a provision in the charter itself that a mutual waiver of insurers' subrogated rights has been procured: it appears to me very hard for a court to divine the parties' intention from silence, or without viewing policy terms.

In my view, the Court has made it clear that mere payment of additional insurance premium by a charterer does not *automatically* lead to an implicit waiver by owners of subrogated rights of claim, nor does it constitute a 'complete code' indicating the owner will only look to its insurances. Other provisions in the charterparty must also be present. The breadth of comments made by Longmore LJ in the Appeal Court in the case of *Ocean Victory* were distinguished by the *Polar* Appeal Court. The first instance judge had considered himself bound by earlier authority in *The Evia (No 2)* which, unlike *Polar,* was a time charter case involving Baltime clause 21.

At least two subsequent charterparty war risk cases, *Concordia Fjord* and *Chemical Venture* have not followed the "complete code" approach adopted by *The Evia (No 2),* so the issue is not free from doubt. Indeed, there remains a residual tension with ice damage cases such as *Helen Miller* , where reimbursement by charterers of additional premium charged to owners for proceeding outside IWL/INL warranty limits does not provide protection to charterers from subrogated claims for ice damage.

The Appeal Court decision also addressed the decision in *Ocean Victory* , a case involving co-assureds*.* The *Polar* judgment states*: '... there was no provision for the charterer (let alone the bill of lading holders) to be named as joint insured with the shipowner. Moreover, the charterer's obligation was to make a contribution to the cost of additional war risks and K&R insurance up to a maximum of USD 40,000 which might or might not be sufficient to cover the full cost. It is, therefore, a weaker case than either The Evia (No. 2) or The Ocean Victory for concluding that the shipowner agreed not to seek a general average contribution **from the charterer'** *.

Indeed, it was expressly conceded in the *Ocean Victory* , that whilst demise charterers had paid all insurance premia, nevertheless P&I risks such as SCOPIC and wreck removal were not caught by any such insurance code. Equating payment of premium by a charterer with discharging him from liability by virtue of an incoherently formulated code does, to my mind, lack intellectual honesty and vigour. In the past, we all had a far easier life when the courts decided each party's individual insurance arrangements were of no concern to anyone else.

Kim: Well Adrian – you certainly raise some forceful arguments. Insurance is a risk mitigation device that enables our members and clients to sustain and develop their businesses. Insurance takes into account risk allocation in contracts and by law. The insurance should respond to the legal developments that establish liabilities. I think it is unrealistic to expect the courts to ignore insurance arrangements entirely, but I do agree that inferring intent based on insurance arrangements may lead to some unexpected results at least from the insurer's perspective.

By a Respondent's Notice, the shipowner in the *Polar* contended that the Commercial Court was wrong to have concluded that the effect of the charterparty (and payment of additional premium) was to prevent the shipowner from seeking a GA contribution from the charterer. While the Appeal judge found it logical to first consider whether, in the charterparty, the shipowner had agreed not to seek a general average contribution from the charterer, in the end he decided that it was unnecessary to decide the question. So, I am not so sure as you are Adrian that the question remains open to debate. Certainly, from a charterer's perspective, there is every reason to argue that payment of additional premium does have the effect of precluding claims for the very risk insured against.

Maybe we can agree that the current state of the law in this area can be summed up by paraphrasing the Rolling Stones – *You can't always get what you pay for, but if you try sometime, you just might find you get what you need* .

Important notice – Gard was not involved in the Polar case. Gard was involved as the Hull and Machinery underwriter in the Ocean Victory case. The views expressed by the co-authors are theirs alone and cannot be taken as either legal advice or as a reflection of Gard's position on the interpretation of marine insurance contracts.