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Charterers' Bulletin

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The Standard
for service and security

Standard Club

Club cover for charterers

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Club cover

The Standard Club has a long history of providing cover to some of the largest charterers in the world as well as to smaller traders and operators, including members supplementing their owned fleet with chartered vessels.

The club provides cover for the protection and indemnity (P&I) liabilities of time, voyage and slot charterers incurred in direct connection with the operation or trading of the vessel. In the case of cargo owners and traders, the club covers liabilities arising in respect of cargo bought and sold by assureds and carried on a ship.

The principal P&I risks are:

- Cargo
- Crew/third party personal injury
- Property damage (fixed and floating objects (FFO))
- Wreck removal
- Collision
- Fines
- Pollution

The cover is provided on a fixed premium basis with a combined single limit for P&I and damage to hull, typically of $350m any one event, but limits up to $1bn can be arranged. If Defence cover is required, the club is able to offer a maximum limit of $5m. The premium is generally rated by volumes such as per vessel, per gt or per mt of cargo carried and open covers are available with declarations in arrears if required.

Whilst the cover provided is on a fixed premium basis, chartered members receive the same standard of service as owned entries and have access to the same network of correspondents, offices and teams of in-house claims and loss prevention specialists.

Chartering a ship where charterers and traders are parties to contracts related to the ship or voyage inevitably entails certain risks that can lead to legal and contractual liabilities. It is therefore important that charterers take appropriate measures to protect themselves and their balance sheets in the event of these liabilities arising.

The following example incidents outline the potential exposure to a charterer and how The Standard Club cover would respond.

In this edition

The club offerings to charterers are as varied as they are flexible. Where required, bespoke covers may be arranged. If you have further queries, please contact the authors or your designated underwriter to discuss.

P&I cover
After striking an uncharted submerged object near the entrance to the port, a chartered ship collides with another ship. The other ship sinks. The port authority orders the removal of the wreck. Following a finding by the arbitration tribunal that the port was unsafe under the terms of the charterparty, the assured is held to be responsible to the owner of its chartered ship for substantial indemnity claims in respect of the owner's exposure to the other ship for wreck removal, pollution liability, crew injury, collision liability, losses to the port, and cargo loss and damage on the other ship.

The member's P&I cover would respond to the charterer's liability to the shipowner for:

- crew injuries on both ships
- costs of the removal of the wreck and the cargo and bunkers inside
- lost and damaged cargo on the other ship and the bunkers on board
- collision liability to the other ship, including costs of repair
- pollution prevention/clean-up costs ordered by the local authorities
- claims by the port authority for loss of use.

Cargo owners' legal liability extension
The member charters a ship for the carriage of oil from California. Shortly after loading, while still in US waters and passing through an environmentally sensitive area, the ship collides with another ship in thick fog. The chartered ship sinks. The submerged ship and its cargo are deemed to be a serious risk to the environment. Even though the owner of the other ship is considered to be most likely liable for the incident, individual states in the US have been able to enact their own legislation in respect of oil pollution and some state laws provide for concepts such as 'transporter of oil' and 'person accepting responsibility for the oil', so that a charterer can be at risk.[1]

Cargo owner's legal liability extension cover indemnifies the member for its legal liability to the state authority in respect of measures reasonably taken to prevent an imminent escape of oil from the ship, any clean-up costs and any related legal or other fees.

Charterers' P&I war
The assured voyage charters a ship to load cargo at a port that has suffered from intermittent activity by rebel terrorist forces. Whilst performing loading operations, terrorists attack the ship. Various crewmembers are killed and injured, and some of their belongings are stolen. The court finds the port to have been unsafe under the terms of the charterparty and holds that the shipowner has a valid claim for indemnity against the assured.

The club's P&I cover excludes liabilities arising out of war and terrorism risks. Charterers' P&I war risk cover, however, would respond to claims for indemnity against the assured in respect of the following:

- repatriation of deceased crew, funeral expenses and compensation to their families in accordance with the governing law and contract
- claims by crew for injury
- reimbursement in respect of loss of crew personal belongings.

Charterers' liability for damage to hull
The assured's time-chartered ship strikes the berth during bad weather as a consequence of there being no tugs available to assist. Significant damage is caused to the ship. The owner arranges for salvage services and declares General Average. The lack of tugs in a port known for its frequent bad weather is deemed by the court to render the port unsafe under the terms of the charterparty for which the assured is held to be responsible.

This cover is wide in scope and is capable of responding to claims for:

- physical damage to or loss of the chartered ship
- salvage, salvage charges and General Average contributions in respect of charterers' bunkers and charterers' freight at risk. Cover can also respond to the ship's contributions in salvage and General Average to the extent the member has a liability for these as charterer
- expenses reasonably incurred in averting/minimising physical damage to/loss of the ship
- demurrage/loss of use/loss of hire/damages for a period during which the use of the ship is lost or performance impaired as a result of physical damage
- surveyors' fees and expenses, legal fees and disbursements, etc.

In this example, the club's cover will respond to protect the assured against the owner's claim for:

- physical damage to the ship
- losses/damage caused following detention/delay to the ship
- salvage costs/General Average contributions in respect of the member's bunkers and freight at risk
- survey, legal and other costs.

The club's damage to hull cover is automatically extended to include war and terrorism risks.

Defence
Defence cover assists charterer members with the costs of legal representation and expert support in relation to certain claims and disputes that are not covered by P&I or any other form of insurance. Examples of the types of dispute that are covered are:

- disputes about the validity of voyage instructions under the charterparty
- disputes about the failure of the charterer to provide cargo
- breach of warranty of description of the ship
- disputes about deviation and delay
- disputes about freight, demurrage and detention
- disputes with port authorities, ship's agents, customs authorities or terminal owners
- disputes about the loading, stowing and discharge of cargo
- disputes under charterparties, contracts of affreightment, bills of lading or other contracts.

Defence claims are by their nature discretionary in that the club must be satisfied as to the merits and quantum of the case and that the expenditure will have a beneficial result. Cover is limited to $5m per claim.

Our philosophy is simple: to support the reasonable legal costs of a member who has a valid claim, or who is facing an invalid claim. The club also believes that commercial settlements that maintain the working relationship between the parties are usually preferable to court judgments, which can often destroy a relationship. If, however, there is no option other than to litigate or arbitrate then (so long as the merits are favourable and the steps to be taken are proportionate to the quantum and costs involved) so be it.

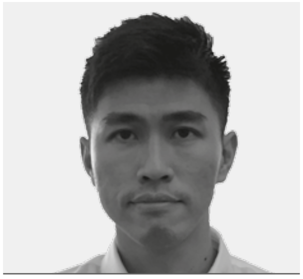
The Standard Club has more than 50 qualified lawyers and barristers working in house on Defence class claims, spread across London, Piraeus, New York, Singapore and Hong Kong.

1 For example, the Lempert-Keene-Seastrand Oil Spill Prevention and Response Act was enacted in September 1990 to regulate all aspects of oil spill prevention and response. The Act defines 'responsible party' for the oil spill to include 'the owner or transporter of oil or a person or entity accepting responsibility for the oil': California Government Code § 8670.3(o) (West 1994).

Market update: dry bulk rates

Will the Baltic Dry Index (BDI)[1] rebound or further decline? What issues do P&I clubs and their members need to consider in the event that the slowdown continues?

This article considers some of the issues.



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Tracking the BDI

After a depressed period of almost eight years, some predicted the dry bulk market to recover, or to at least improve, in 2017 from its record low of 291 points in February 2016.[2] The BDI began this year promisingly near the 1,000-point mark and rose to 1,300 points by April 2017.[3] However, there has since been a decline. At the end of July, it was hovering at around 960 points.

The long road to recovery

There are some signs of improvement. On the demand side, the dry bulk trade is predicted to grow about 2% this year. The key driver of this growth is the iron ore trade, which is estimated to grow by 4% in 2017.[4]

On the supply side, ship-scrapping activity has seen an overall increase in recent years. According to Clarksons, in the case of bulk carriers, around 28.8m deadweight tonnes were scrapped in 2016 alone.[5]

The average age of the bulkers scrapped has also decreased. The average age was 24 years in 2016, as compared to 26 in 2015, 30 in 2014 and 31 in 2013.[6]

With the increase in demand for bulkers following the stepping-up of the iron ore bulk trade and the reduction of the world's bulker fleet pursuant to the overall increase in demolition of bulkers of recent years, one might reasonably expect a positive realignment in dry bulk freight rates in the not too distant future, all things being equal.

Recent changes in the Indian and Chinese economies have particularly had an impact on freight rates.

Slowdown in China's economy

The demand for building materials in China has for some time significantly impacted freight rates in respect of capesizes, which trade in cargo related to steelmaking, such as iron ore and coking coal.

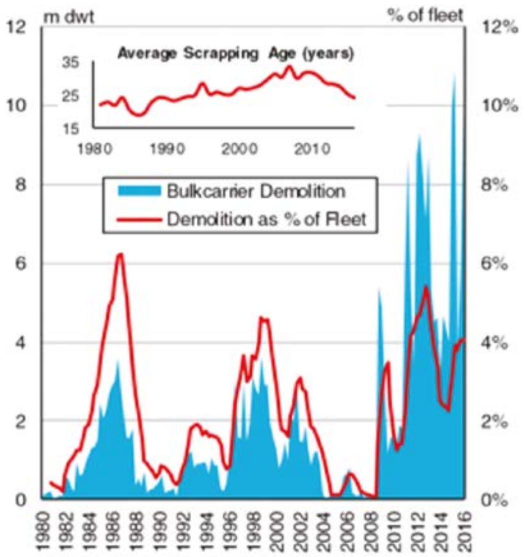
Traditionally, the BDI peaks during the spring and summer seasons when China's construction activities peak. Steelmakers import many steelmaking products during the period ahead of the anticipated increase in construction activities.

1 The BDI is compiled by the Baltic Exchange and tracks changes in the costs of transporting seaborne cargoes such as iron ore, coal and grains.
2 Bloomberg BDI graph: https://www.bloomberg.com/quote/BDIY:IND
3 Bloomberg: https://www.bloomberg.com/quote/BDIY:IND
4 Opensea.pro: https://opensea.pro/blog/dry-bulk-forecast-2017
5 Seeking Alpha: http://www.hellenicshippingnews.com/vessel-scrapping-in-2016-record-year-for-container-ships/
6 According to Lloyd's List Intelligence data. Ship&Bunker: https://shipandbunker.com/news/world/741276-2016-sees-record-year-for-container-ship-scrapping

par with the levels of demand from China and Japan, accounting for around 20% to 25% of Australian coking coal exports on a monthly basis.

Bulker Demolition - Owners Get Tougher On Old Ships

The graph shows quarterly bulkcarrier demolition in dwt (area, LHS) alongside bulkcarrier demolition over the most recent four quarters expressed as a percentage of the fleet at the start of that period (line, RHS). The inset graph shows the average age of bulkcarriers scrapped in each year.



Source: Clarksons Research, March 2016

In the first quarter of 2017, the BDI movements matched anticipated seasonal demand trends, with freight rates peaking in April 2017. However, economic indicators such as the IHS Markit Caixin's Purchasing Manager Index (PMI) fell to a seven-month low of 50.3 in April 2017.[7] This was below economists' estimates of 51,[8] and was thought to be due to a decreased appetite for these materials and a deceleration in China's economy.

China's economy has been sending mixed signals in the last few years. Recently, a clear pattern indicating a slowdown has emerged. In the second quarter of 2017, economic indicators such as the Caixin PMI suggest that China's private industrial sector is still growing, but at a slower pace and below economists' previous estimates.[9]

Likewise, China's growth in the service sector also decreased to 54.0 points in April 2017 as compared to 55.1 points in March 2017, based on the country's official services PMI. Consequently, China is likely to reduce its imports of raw materials. This is likely to lower freight rates, which in turn may negatively impact shipowners' profit margins.

India

While China's economy seems to have slowed down, India's appears to be gaining momentum, evidenced by the steady strong demand for high-quality coals. India has long been a coal-producing nation, but the country's local supply of coking coal – essential for steelmaking – is of lower quality than the premium-quality coals found in various locations outside India, hence the need to import.

Based on World Steel Association (WSA) figures,[10] India's steel production grew 9.3% between March 2016 and March 2017, which is in line with its aspiration to become the second-largest producer of steel by 2018, just behind China. India currently accounts for around 9% of the total steel global output. The Indian Steel Association has forecast the country's steel output to double by 2031 to 240m tonnes, up from its current 120m tonnes, due to the rapid growth in its economy and urbanisation.

India is therefore expected to import significant amounts of high-quality coking coal from Australia in the coming years to fuel its growing steel sectors. Currently, its imports of Australian coking coals are almost on par with the levels of demand from China and Japan, accounting for around 20% to 25% of Australian coking coal exports on a monthly basis.

Conclusion

Overall, despite challenging market conditions, the dry bulk market is in better shape than it was in 2016 and there is reason for optimism. In the first half of 2017, the prices of iron ore and coal stabilised, hinting that a stronger dry bulk market may be looming just ahead. Despite the slowdown in the Chinese economy seen earlier this year, the country's policymakers remain confident of economic growth of 6.5% in 2017 and have further approved an infrastructural stimulus plan in line with this goal.

Meanwhile, India's ramping-up of its steel production with the resultant increase in the import of steelmaking materials bodes well for the dry bulk market.

How the club can help

In a depressed market, a shipowner may be under significant financial pressure, yet, at the same time, shipowners remain obliged by law to maintain operational standards in the maintenance of ships, the training of crews, etc. The club continues to work together with the members to help them meet the challenges of operating in a tough market in order that they may continue to meet their obligations

To that end, the club's input and assistance include:

- day-to-day advice on operational and loss prevention issues
- initiatives to assist members to train and develop the knowledge of their crew
- ongoing reviews to monitor maintenance level and operational/ safety standards on entered ships.

The author acknowledges data from World Steel Association, Clarkson Research Services Limited, Lloyd's List, the Baltic Exchange and Credit Suisse in respect of the market figures referenced in this article. The comments expressed herein remain the personal views of the author.

7 The PMI is often used as a barometer in measuring expansion or contraction in manufacturing. Thus, a reading above 50 points indicates expansion in manufacturing activity, while a reading below 50 points indicates a contraction in the same.
8 CNBC: http://www.cnbc.com/2017/05/31/caixin-china-manufacturing-pmi-for-may-falls-to-11-month-low.html
9 CNBC: http://www.cnbc.com/2017/05/31/caixin-china-manufacturing-pmi-for-may-falls-to-11-month-low.html
10 Business Insider: http://www.businessinsider.com/cba-says-demand-for-australian-iron-ore-and-coking-coal-will-continue-to-increase-2017-5?IR=T&r=US&IR=T

Setting up a limitation fund using a club LOU – *The Hansa Brandenburg*

The club has recently successfully assisted a member to set up a limitation fund in the High Court of Singapore using a club letter of undertaking (LOU).

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Introduction

When the English Court of Appeal decided in early 2014 in the case of *The Atlantik Confidence*[1] to permit a limitation fund under the Convention for Limitation of Liability for Maritime Claims 1976 (LLMC 1976) to be constituted by a P&I club letter of undertaking, many awaited with interest to see if the courts of any other jurisdiction applying the LLMC 1976 would take the same position. Now, some three years after that case, the Singapore Court has recently had the opportunity to consider this issue for the first time in Singapore in the case of *The Hansa Brandenburg*.

The Events

The Hansa Brandenburg had on board a consignment of calcium hypochlorite which was misdeclared by the shipper. This cargo was listed as a dangerous good under the International Maritime Dangerous Good (IMDG) Code, and should have been handled and stowed accordingly to avoid incident.

> For more on the misdeclaration of dangerous goods, refer to the club's special edition of Standard Cargo.

During the voyage, a fire occurred on board. The member, who was the time charterer and the named carrier pursuant to the bill of lading, received claims from numerous interests for miscellaneous losses as well as claims from cargo interests. The total aggregate of all cargo claims exceeded the amount of a limitation fund calculated under the LLMC 1976. In the circumstances, the member decided to obtain a decree of limitation under the LLMC 1976 and to constitute the limitation fund but without any admission of liability.

As the member is incorporated in Singapore and its bill of lading terms provide for Singapore law and jurisdiction, Singapore was the chosen jurisdiction for the limitation fund. The member as a party seeking the limitation decree was a plaintiff in the limitation action.

1 [2014] 1 Lloyd's Rep 586

Article 11(2) LLMC 1976

Article 11(2)[2] permits the limitation fund to 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 competent authority.

In order for a P&I club letter of undertaking to satisfy the requirements in Article 11(2), the guarantee must be acceptable under the legislation of the jurisdiction where the fund is constituted and considered adequate (in this case) by the court.

Acceptable under legislation

In Singapore, as is the case in England, there is no specific legislation enacted to clarify what would satisfy the provisions of Article 11(2). However, the English Court of Appeal in *The Atlantik Confidence* decided that the requirement does not require specific additional enabling legislation expressly defining what is acceptable. Given this, if a guarantee does not contravene any local legislation and is not regarded as unacceptable under any local legislation, it is compliant. The English Statute of Frauds is a piece of legislation which was considered in this context.

Similarly, Section 6(b) of the Singapore Civil Law Act (Cap 43) requires a guarantee to be in writing and signed by the guarantor or some person lawfully authorised by him. In this matter, Section 6(b) needed to be and was easily complied with.

Considered adequate by the court

In *The Atlantik Confidence,* the English Court of Appeal decided that the requirement for the guarantee to be considered adequate by the court means that the court will need to be satisfied that the guarantee provides adequate security for the fund, having regard to the financial standing of the guarantor, the practicality of enforcement and the terms of the guarantee instrument itself. The guidance given there is:

"this is the type of question which judges of the Admiralty Court or the Commercial Court consider every day when deciding issues such as the adequacy of a cross-undertaking in damages..."[3]

The Singapore Court's decision in *The Arcadia Spirit*[4] had previously established that a P&I club letter of undertaking can, in an appropriate case, be accepted as satisfying the concerns of practicality of enforcement and, as to this requirement, is therefore good security in lieu of arrest of a ship.

As regards constituting a limitation fund, the position is, arguably, no different. The Singapore Court was careful to consider at length any impact which the current shipping market conditions may have on this issue and the financial standing of the P&I club providing the letter of undertaking, and decided in favour of permitting a letter of undertaking by The Standard Club Asia Ltd to constitute the limitation fund.

Further interest

In addition to interest provided in the LLMC 1976 from the date of the occurrence giving rise to liability until the date of constitution of the fund, the Singapore Court ordered interest to continue thereafter at the rate of 5.33% per annum until payment (which is the prescribed rate pursuant to the Singapore Rules of Court).

Rules of Court

The existing Rules of Court were drawn up whilst Singapore was a signatory to the previous 1957 Convention for Limitation of Liability and not with the LLMC 1976 in mind. Hence, the Rules of Court may not have provided for some matters under the LLMC 1976. However, an application may be made to court for an order on all issues arising in the limitation action.

Conclusion

The club is pleased to be able to further support its members with this recent decision by the Singapore Court, permitting a letter of undertaking issued by The Standard Club Asia Ltd to constitute the limitation fund under the LLMC 1976. Given the current market conditions, the shipping community will also welcome this positive new development.

Augustine Liew and Eric Wong of Haridass Ho &Partners, Singapore, represented the member and the club in proceedings before the High Court of Singapore.

Source: *MV Hansa Brandenburg*, Leonhardt & Blumberg

2 Article 11(2) states: *'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.'*

3 [2014] 1 Lloyd's Rep 589 at 594

4 [1988] 1 SLR(R) 73

NAABSA[1] clauses and safe ports

The Standard Club's damage to hull (DTH) policy is offered as an extension to the charterers' liability cover. This article reviews ways in which the charterer's damage to hull cover can respond.

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Safe ports

It is the charterer's obligation to nominate a safe port. A charterer may be legally liable to indemnify an owner for hull damage if the ship was ordered by the charterer to proceed to a port that was unsafe.

What is a safe port?
In *The Eastern City*[2] a safe port was held to be one that the ship could reach, use and return from without, in the absence of some abnormal occurrence, being exposed to danger which could not be avoided by good navigation and seamanship.

It is important that the nominated port is safe at the time of nomination and not merely likely to be safe when the ship arrives. If, however, the port was safe at the time of nomination but becomes unsafe prior to the ship's arrival at the port, the charterer is under a secondary obligation to cancel the original order or nominate an alternative safe port.

In order to succeed with a claim for an unsafe port, it is important that clear factual evidence of the unsafety is established.

Express or implied warranty of safety
The majority of time charterparties contain an express warranty clause which gives the charterer the right to order the vessel to a safe port or safe berth. For instance, clause 1(b) of the New York Produce Exchange form 2015 (NYPE 2015) provides that the ship is to be employed between *'safe ports and safe places'*.

If there is an express term in the charterparty that the port must be safe, the charterer has an absolute obligation to nominate a safe port. This means the charterer is liable for any damage resulting from the unsafe port even if the charterer lacked knowledge of the unsafety.

Some charterparties, for instance Shelltime 4, reduce the absolute obligation of safety to one of due diligence, whereby the charterer is to use due diligence to ensure that the ship is only nominated to a safe port.

If the charterparty does not contain an express warranty in respect of the safety of the port, the English courts have been willing to imply a term of safety in certain circumstances.[3] However, if the charterparty expressly names the port but does not contain an express warranty as to safety, it is unlikely that the court will imply a term that the port must be safe.[4] In the absence of a warranty of safe port from the charterers either express or implied, the owner now bears a greater proportion of the risks in the event the port turns out to be unsafe and loss is suffered.

NAABSA ports

Certain ports are suitable for the hull of the ship to rest on the seabed. These ports are often referred to as NAABSA ports, an abbreviation for 'not always afloat but safely aground'. A NAABSA port may have characteristics such as a soft seabed which allows the ship to rest on the seabed without causing damage to the hull. Estuaries and rivers such as the Thames and the Humber in England, and the River Plate in South America are some examples of the locations for NAABSA ports.

1 Not always afloat but safely aground.
2 [1958] 2 Lloyd's Rep 127
3 *The Evaggelos Th* [1971] 2 Lloyd's Rep.200
4 *The Reborn* [2008] 2 Lloyd's Rep.628 and [2009] 2 Lloyd's Rep. 639 (C.A.)

BIMCO NAABSA clause
BIMCO has developed a NAABSA clause[5] which gives the charterer the right to seek an owner's approval to order the ship to a safe berth or place where it is customary for ships to lie. This is on condition that the ship lies on a soft bed without suffering damage.

In the event that damage is caused to the ship's hull, the clause provides for the charterer to indemnify the owner for any loss, damage, costs, expenses or loss of time caused by the ship lying aground.

A charterparty may specifically incorporate the BIMCO NAABSA clause, or a recap fixture or charterparty can simply allow for the charterer to order the ship to a NAABSA port without reference to specific NAABSA charterparty wording.

Damage to the ship after being ordered to an unsafe NAABSA port
If the ship's hull is damaged as a result of resting on the seabed at a NAABSA port and the ship is under a time charterparty, it is important to consider the specific charterparty terms. If the charterparty contains an absolute warranty that a NAABSA port is safe and the ship suffers damage to the hull when resting on the seabed after being ordered to the port by the charterer, the charterer may be held liable for any resulting loss. Should this be the case, The Standard Club's DTH cover may respond to cover the member for any losses incurred.

Conclusion

The charterer is obliged to nominate a port that is safe for the ship to enter, carry out normal cargo operations and leave. The price of nominating an unsafe port can result in damage to the vessel and loss of time, to say the least.

Safety is an evolving concept and there are many factors which can render a port unsafe such as:

- physical characteristics of the port and its approaches in relation to the size of the ship
- temporary dangers to navigation, including exceptional weather and ice
- political or civil unrest
- lack of navigational aid
- inappropriate tugs, incompetent pilots
- wash damage from passing ships
- unusually high congestion at a port.

Accordingly, whether a port is safe or not is as much a matter of law as of common sense and may vary from ship to ship or over time. Whilst clauses such as the NAABSA clause allocate risks between owners and charterers in the nomination of a safe port, the master is nonetheless expected to exercise reasonable navigational skills and seamanship to ensure the safety of the ship.

Damage to hull cover
The DTH cover responds to claims for damage to the hull of the ship caused by the charterer's employment of the ship. Liabilities include physical damage to the chartered ships, off-hire arising from damage claims, and loss of or damage to charterers' bunkers.

Other scenarios where DTH cover responds to a charterer's liability to the shipowner:

- Where the charterer's appointed stevedores cause damage to the ship's crane or deck during loading or discharging operations and the charterparty states that the stevedores are the responsibility of the charterer.
- Where the charterer fails to properly load and stow the cargo, resulting in stowage or cargo collapse and damage to the ship's hull.
- Where the charterer supplies off-specification bunkers or cargo to the ship so that there is damage to the engines or cargo tank coatings.

5 *'...Always subject to Owners' approval, which is not to be unreasonably withheld, the Vessel during loading and/or discharging may lie safely aground at any safe berth or safe place where it is customary for vessels of similar size, construction and type to lie, if so requested by the Charterers, provided always that the Charterers have confirmed in writing that vessels using the berth or place will lie on a soft bed and can do so without suffering damage.*
The Charterers shall indemnify the Owners for any loss, damage, costs, expenses or loss of time, including any underwater inspection required by class, caused as a consequence of the Vessel lying aground at the Charterers' request...' (originally published in BIMCO Special Circular No.6, 22 December 2011 – BIMCO recommended wording for NAABSA). Note: This wording is to be added to the existing berthing provisions in charterparties.

Ad valorem bills and references to letters of credit in bills of lading: a practical guide

The club has recently received a number of queries from members in respect of the potential impact a reference to a letter of credit (L/C) in a bill of lading might have on their liability towards a cargo interest and on their club cover. This article explores the issue and offers some practical tips for carriers and charterers.

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The issue

Why do shippers ask for references to a letter of credit in a bill of lading?

Commonly, in the context of a sales contract transaction, the buyer (or one of the banks involved in financing the transaction) insists on the insertion of a reference to an L/C in the bill of lading.

The object is to ensure that the bill of lading issued matches and represents the same goods which form the subject of the credit facility. The buyer may also have an ulterior motive: to use the extra time needed for checking compliance with the requirement as a means to extend the period of time before the buyer must make the payment.

For the bill of lading carrier, this creates a potential problem: a reference to an L/C may render a bill of lading an *ad valorem* bill of lading, which in turn, by virtue of rule 3.13.3(12) of the club rules[1], prejudices the member's right to limit its liability for cargo loss or damage.

This article addresses the following questions:

- What is an *ad valorem* bill of lading?
- Why does a shipper ask for a reference to an L/C in a bill of lading?
- Does a reference to an L/C make a bill of lading an *ad valorem* bill of lading?
- How should a member react to a request by a shipper to insert a reference to an L/C in a bill of lading?

What is an *ad valorem* bill of lading?

An *ad valorem*[2] bill of lading is one that expressly states the value of the subject cargo on the face of the bill of lading. The purpose is to sidestep the package/unit limitation set out in Article IV Rule 5(a) of the Hague or the Hague Visby Rules (the Rules), which limits the amount of damages recoverable by a cargo claimant 'unless the nature and value of [the] goods have been declared by the shipper before shipment and inserted in the bill of lading'. In the event that cargo loss or damage is suffered, a cargo claimant which ships valuable goods will want to recover the maximum amount of damages recoverable at law and, to that end, the Rules allow him to break limitation by issuing an *ad valorem* bill of lading. As a result, an *ad valorem* bill of lading deprives the carrier of his valuable right to limitation of liability per package or unit.

However, the Rules are not entirely clear about what amounts to an ad valorem bill of lading. The Rules provide that the shipper needs to declare the value and the nature of the goods in the bill of lading before shipment.

1 *'... goods carried under a document containing or evidencing the contract of carriage where the value per unit, piece or package has been stated to be in excess of $2,500, or the equivalent in any other currency, which may deprive the member of the right to rely on defences or rights of limitation which would otherwise have been available to him, to the extent that such liabilities exceed that sum'.*

2 Latin *ad valorem*: 'to the value'

This creates two additional points of potential difficulty:

- It is not always clear what constitutes the nature of the goods and what exactly needs to be declared for the shipper to fulfil this requirement.
- Bills of lading are often issued *after* shipment: this raises a question as to the status of a declaration of value and nature made *after* shipment, but before the bill of lading is issued.

Leaving to one side these additional areas of difficulty, the key point is that issuance of an *ad valorem* bill of lading deprives the carrier of its valuable right to limitation of liability per package or unit. *Ad valorem* bills of lading are therefore generally bad news for carriers.

It is with this in mind that the International Group Pooling Agreement excludes cover where the effect of an *ad valorem* declaration takes the value of the goods beyond the relatively modest figure of $2,500 per unit.[3]

A member may, therefore, find itself in a difficult position, faced with the conflicting expectations of its cargo interest counterparties and its P&I club. On the one hand, a shipper is insisting that a bill of lading be issued stating a specific value for the goods shipped, whilst on the other, the P&I cover is compromised if the resultant value of the cargo declared exceeds $2,500 per unit.

Why do shippers ask for references to a letter of credit in bills of lading?

The shipper's request is likely to be rooted in the commercial demands of the cargo receiver or one of the banks involved in the sales contract transaction. The intention may be innocent enough: to ensure that the bill of lading that has been issued marries up with and represents the same goods for which the sum payable under the L/C is due. The *effect* of the requirement may, however, cause more trouble than was intended. Difficulties might potentially arise if the L/C number is incorrectly transposed onto one or more ancillary documents or an ancillary document does not carry the L/C number.

These are problems that a document checker may need time to deal with, checking with documentary supervisors what a particular bank's policy is in such cases, or checking back with the buyer of the goods to see whether a waiver of the discrepancy can be obtained. This is where the intention of requiring such a reference may not, in fact, be as benign as one might think: the requirement might just be – and sometimes is – simply a ruse put in place by the buyer of goods in order to delay payment for the goods, possibly until after they are discharged at destination. The result is that it is now the *shipper* who is between a rock and a hard place: the bank will not pay unless the shipper presents a bill of lading referring to the L/C by number, but on the other hand, the carrier is reluctant to issue such a bill of lading, inspired no doubt by the cautionary advice given by its club against *ad valorem* bills of lading.

Does a reference to a letter of credit make a bill of lading an *ad valorem* bill of lading?

This brings us to the central question in this article. Money turns on this question because if the answer is yes, then the carrier loses its limitation under the Rules; and *may* lose its P&I cover. A carrier will therefore argue that the answer to this question is no, claiming that:

- an L/C number is not a declaration of the nature and value of the goods, as per the Rules formulation
- the actual value of the goods will be found in the L/C itself, so this is not a value inserted in the bill of lading.

On this basis, a reference to an L/C in a bill of lading does not make a bill of lading *ad valorem* – and a carrier need therefore fear no loss of its limitation and that clubs need not deprive cover from carriers issuing such bills of lading. The difficulty is that, perhaps somewhat curiously, there is no decided case confirming such an approach. Carriers – and clubs – inevitably therefore have to ask themselves: what if this approach is not upheld by the courts when tested in an actual case?

To that end, at the International Group level, a further key exception to cover has been inserted in the Pooling Agreement.[4]

This exception to cover provides that if a reference to an L/C were to be considered as an agreement by the carrier to contract on terms less favourable than the limitation of liability

3 Pooling Agreement 2016, Appendix V, para.14(f):
'...The following losses shall be Excluded Losses save only as they may be treated as sue and labour expenses or expenses incurred by direction of an Association...14. Cargo Claims...Liabilities, costs and expenses in respect of the carriage of cargo arising out of any of the following save insofar and to the extent that the Insured Owner satisfies Directors of an Association that it took such steps as appear to those Directors reasonable to avoid the event or circumstance giving rise to such liabilities, costs and expenses...
(f) Carriage under an ad valorem bill of lading or other document of title, waybill or other contract of carriage in which a value of more than two thousand five hundred Dollars ($2,500) (or the equivalent in any other currency) is declared and/or inserted by reference to a unit, piece, package or otherwise, where the effect of such a declaration/ insertion is to deprive the carrier of any right or rights of limitation to which he would otherwise have been entitled and cause him to incur a greater liability than he would have done but for such declaration/insertion, to the extent that such liability thereby exceeds two thousand five hundred Dollars ($2,500) (or the equivalent in any other currency) in respect of any such unit, piece or package.'

4 Pooling Agreement 2016, Appendix V, para. 13(a):
'The following losses shall be Excluded Losses save only as they may be treated as sue and labour expenses or expenses incurred by direction on an Association...'
'...Liabilities, costs and expenses in respect of the carriage of cargo arising out of the following (save insofar as an Association shall exercise a discretion under its Rules):
(a) Contracts for carriage by sea on terms less favourable than those of the Hague or Hague Visby Rules, provided that insofar as concerns liabilities, costs and expenses arising out of any such contract for carriage, the reference to discretion in the preamble to this paragraph 13 shall be deemed to be a reference only to a discretion as to whether to accept the claims in respect of such liabilities, costs or expenses exercised after the occurrence of the event which gives rise to them...'

allowed by the Rules under the law applicable to the contract of carriage, then any resulting liability is an excluded loss under the Rules and cover will only be available on a discretionary basis – so carrier beware!

The result of both exceptions (paras. 13(a) and 14(f) Appendix V, Pooling Agreement) when read together is, therefore, that if the bill of lading declares, whether in terms or through a reference to an L/C, a value of the goods at less than $2,500 per unit, then cover will not be compromised. If, however, the value of the cargo is higher than that figure, then it is likely that cover will be prejudiced and will only be available on a discretionary basis.

How should a member react to a request by a shipper to insert a reference to a letter of credit in a bill of lading?

The response of the member will depend on whether the member (either as owner or charterer) is the carrier under the bill of lading.

If the member is a carrier, it will be directly liable to cargo interests in respect of any cargo claims.

In this position:

1. A member should first notify its liability insurer in order to clarify whether, in the club's view, on the basis of the circumstances as they have transpired, cover is at risk.

2. The carrier should resist and query the reason behind the request to include in the bill of lading a reference to an L/C. The carrier should also consider whether compliance with the request would delay the issue of the bill of lading and possibly payment. This allows the carrier some time to obtain advice regarding cover from its club – and may give the shipper pause for thought and reconsideration.

3. If the shipper persists, then the carrier may counter with a request for *ad valorem* freight, on the basis that if they must suffer complications, so must the shipper.

If the member is a charterer but is not a carrier under the bill of lading, it is unlikely to face claims from cargo interests directly. However, members in this position should be aware that their charterparties may include indemnity provisions in favour of their owner counterparties (eg express clauses or incorporation of the Inter-Club Agreement) for liabilities that have been incurred as the result of the member ordering insertion of a reference to an L/C into a bill of lading. The same provisos as to club cover detailed above would apply to a charterer member in these circumstances.

Conclusion

This is a somewhat unhappy area for carriers: increasing demands for references to L/Cs in bills of lading; uncertainty in the Rules as to what exactly amounts to an *ad valorem* bill of lading and, in particular, whether reference to an L/C makes a bill of lading *ad valorem*; and, finally, the risk of the loss of P&I cover if the member issues *ad valorem* bills. The bottom line is: take care, exercise caution and refer to your club, if in doubt.

Demystifying DTH cover

Charterer's liability for damage to hull (DTH) cover responds to a charterer's liability to a shipowner for physical damage to the vessel during the period of charter due to responsibilities that have been assumed under the charterparty. Both time and slot charterers can benefit from this cover.

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P&I cover provided to shipowners does not respond to physical damage to the insured vessel, this being the purview of the hull & machinery (H&M) insurers. Charterer's cover also provides regular P&I insurance, but extends to include charterer's liability for damage to hull (DTH).

Charterer's DTH cover will also respond where a charterer fails to direct the ship to a safe port or berth so that the ship grounds or is stranded – see the article on page 7.

Scope of cover

The DTH clause in The Standard Club rules states that cover responds to a member's liability, as charterer of a ship (other than as bareboat or demise charterer) for:

1. loss or damage to the ship
2. damages for detention or loss of use or hire or demurrage paid or due to the owner for a period during which the use of the ship is lost or the performance impaired as a result of physical damage to the ship
3. salvage, salvage charges and/or General Average contributions in respect of charterers' freight at risk and/or charterers' bunkers and/or the ship, following loss of or damage to the ship
4. (as an extension) loss or damage to the bunkers on the chartered ship as a consequence of a casualty including fire, grounding, stranding, collision or total loss of the chartered ship.

A case study

A ship on a time charter suffers an explosion on board just after departing from the first load port. Unfortunately, the fire spreads rapidly despite the crew's firefighting efforts. There is damage to the main engine and accommodation, and bunkers are partially lost to the fire. The crew on board quickly abandon ship unharmed and there is no pollution (both of which liabilities would be covered under a charterer's regular P&I cover).

The master signs a salvage agreement and the shipowner declares General Average. During firefighting, the remaining bunkers are contaminated by salvors' firefighting water.

Due to the severity of the damage, the H&M insurers declare the ship to be a constructive total loss. Investigations confirm that the cause of the explosion is misdeclared dangerous cargo provided by the charterer member.

The claims

The shipowner and its H&M insurers submit claims for breach of the charterparty terms, which include a provision excluding the carriage of dangerous cargo. These claims include:

a) loss of the ship
b) hire that would have been earned under the time charterparty
c) the shipowner's liability under the salvage agreement in respect of salvage costs
d) various related expenses incurred by the shipowner as a result of this incident.

What is covered

DTH cover will respond to all of these claims raised by the shipowner. Further, while DTH cover does not ordinarily respond to the loss of a time charterer's bunkers, cover can be extended to indemnify the member as charterer in respect of loss or damage to his bunkers on the chartered ship (as above). Accordingly, in this particular scenario, the value of charterer's bunkers lost in the casualty will also fall within the scope of DTH cover.

Conclusion

Given that DTH covers a broad range of exposures, charterers should strongly consider adding this into their existing insurance programme if they have not already done so.

Cyber security risks for charterers

Cyber security has been a growing concern for the shipping industry in recent years. As the use of technology on board ships increases, so does the risk of cybercrime. This article focuses on the effect of cybercrime on charterparties.

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What is cybercrime?

A cybercrime is the intentional infiltration of a technology system by a third party without consent. For charterers, the major risks are financial loss and data theft, which can lead to reputational damage, lawsuits, business interruption and regulatory action.

Diversion of payments

The fraudulent diversion of hire and freight is becoming increasingly common. Hackers infiltrate an email system to find out the details of business contacts. They then email the charterer impersonating the accounts department of a payee to redirect payment, either attaching an invoice with a specified bank account or specifically requesting hire to be paid into a different account than normal. Often the email address used by the hacker is almost identical to the email address of the true counterpart, with only a small variation which can easily go unnoticed.

It is not always apparent that a charterer has fallen victim to cybercrime until the owner complains that hire is unpaid. Generally, hire is only considered paid when the funds have been received in the owner's designated bank account. Therefore, if the charterer makes a payment which does not reach that account within the payment date, the charterer will be in breach of the charterparty. The owner may then be entitled to withdraw the vessel from service if the charterer does not pay again pursuant to the terms of any anti-technicality clause. This can result in the charterer paying twice.

Protecting your position

Whilst members cannot always prevent a cyber-attack from occurring, members can seek independent legal advice to protect their position contractually, for example, by:

- making 'Cyber Event' a defined term
- including a clause allowing more time to pay in the event of a Cyber Event
- including 'Cyber Event' as an off-hire event in the off-hire clause
- excepting 'Cyber Event' from laytime and demurrage.

i

A 2016 PWC Global Economic Crime Survey recorded cybercrime as 'the fastest growing global economic crime', with Forbes projecting the cost of cybercrime to reach $2 trillion by 2019.

Spotting cybercrime
Members should remain alert to the risk of cybercrime at all times.

- Always check email addresses carefully, especially when discussing payment details.
- Be aware. Treat any changes in the communication style or form with suspicion.
- Cross-check any bank account provided in the email against the bank account details contained in the charterparty.
- If you have any suspicions, do not respond by email as it may be intercepted.
- Always telephone the payee to verify the bank details.

BIMCO has published guidelines aimed at preventing cyber security breaches. Though the guidelines focus on shipboard risks, they nonetheless highlight the need for senior management to co-ordinate risk assessments and develop contingency plans. The guidelines can be found on the BIMCO website.

Club cover
Costs incurred in respect of a charterparty dispute relating to cybercrime can be covered under the club's Defence cover, subject to the war risks exclusion found in P&I rule 4.3.

Where charterers incur a P&I liability arising from cybercrime, poolable P&I cover can respond, subject to the paperless trading and war risks exclusions.

For further information on cyber risks and implications on club cover, please refer to the club's Standard Bulletin March 2017 edition.

Award-winning global maritime cyber security awareness campaign, Be Cyber Aware at Sea, has collaborated with Fidra Films to launch a new film which aims to highlight the vital and increasing importance of cyber security across the maritime industry. The project has been supported by The Standard Club, along with NSSLGlobal, a global maritime satellite communications provider, Oil Companies International Marine Forum (OCIMF) and Teekay.

The film uses real-life case studies to highlight how easy it is for cybercriminals to target individual employees, who are often the weakest link in the security chain. Lots of people still fail to spot the signs of simple phishing emails, and accidentally give away secure information to hackers via email or social media. Even something as simple as charging a phone using the ECDIS[1] could allow hackers to gain access to the ship's navigation system. The video therefore focuses on tips to avoid being a target for cyber criminals.

This release is particularly timely given the recent reports of a widespread cyber attack affecting companies around the world, including Maersk.

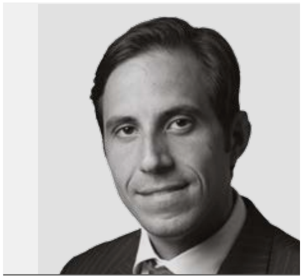
The video is freely available on youtube. Members are encouraged to distribute it to their fleets and reinforce its messages.

Members requiring further information on this topic should direct their enquiries to either their usual contact at the club or to the authors of this article.

1 Electronic chart display and information system.

Mumbai seminar

As part of the club's ongoing commitment to the Indian market, on 4 May 2017, The Standard Club held a seminar for its members at The Taj Mahal Palace Hotel in Mumbai.



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The focus of the event was charterers' liabilities – highlighting the main risks and the insurance solutions that are available in the market.

The talk drew participants' attention to the fact that charterers have a very real exposure to claims which the charterers' liability cover is tailored to meet, even as those needs evolve.

Although losses are lower in frequency than owners' claims, they can be significant in value. The presentations examined the main risks faced by charterers and the cover solutions available from the club, which remains committed to meeting the evolving needs of our charterer members. These are outlined in more detail in this special edition bulletin.

The presentations raised many relevant issues for all participants and sparked an engaging question and answer session, with conversations on the subject continuing over drinks during the reception that followed the seminar.

Above: Rupert Banks, Regional Claims Director of Standard Asia speaking on charterers' liabilities in Mumbai.

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