

CHARLES TAYLOR CONSULTING

PRIZE ESSAY

What would be an effective deterrent to sub-standard shipping?

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Introduction

For most outside the shipping industry, the issue of sub-standard tonnage is raised only when there is a major disaster in the oil industry. Disasters such as the “Torrey Canyon”, the “Exxon Valdez”, the “Brea” and the “Erika” from time to time occupy our television screens and the front pages of our newspapers, bringing the spotlight of publicity on the issue of sub-standard tonnage.

My own career in shipping has been predominantly in the dry cargo industry, and the purpose of this essay is to address the problems of sub-standard drycargo tonnage, and how an effective deterrent might be provided in this side of the shipping industry. The problem of sub-standard tonnage has had to be addressed by the wet side of the business much more publicly, and the oil industry has taken considerable steps down this road, many of them successful. The problems of sub-standard tonnage are both common to the wet and dry sides of the industry, but also different. Not least in the manner of publicity – oil disasters bring front-page pictures of tar covered seagulls and polluted holiday beaches, whilst the impact of dry cargo incidents are not so photogenic. But the problem does exist in the dry cargo industry and there are lessons that the dry trades can learn from the wet industry, and more specifically in the way that the oil companies and tanker owners have responded to these special problems.

Definition of sub-standard tonnage

It would be helpful at the outset to try and define what is meant by sub-standard tonnage. The simple answer is that a sub-standard ship is one that simply does not do and/or is not capable of doing the job for which she is chartered.

In the office where I started my career as a shipbroker was proudly displayed the oldest charterparty in existence, dating from the 1760s, for a carriage of tallow from Archangel to London. The language used in this document is very similar to charterparty forms still in use today. It was as relevant then as it is now that vessels much be “tight, staunch and in every way fitted for the voyage...”. A simple and more recent definition is found in the judgement of the “Arianna”¹, where it was held that there was a presumption of unseaworthiness if “*there is something ... which endangers the safety of the vessel or its cargo or which might cause significant damage to its cargo*”.

What are the practical effects of a sub-standard vessel? Typically, a ship might be substandard in one of three ways. She might be structurally sub-standard, a ‘rust-bucket’ as such ships are colloquially known. I have in the past visited ships in port and been grateful to get back on dry land in one piece. Many older and poorly maintained ships (although poorly maintained vessels do not have to be

¹ Athenian Tankers Management SA v Pyrena Shipping Inc. (The Arianna) [1987] 2 LI L R 376

old) will show one or more of the obvious problems; for example leaking hatchcovers, unclean or rusty holds, gear which is broken or incapable of maintaining its SWL, engines which would seem to struggle to move the ship without the assistance of a fleet of tugs. The list is endless.

Alternately the vessel may be sub-standard in terms of manning. As an example, the crew may be inefficient and not capable of carrying out their basic duties².

The Master and/or Officers may not be English speaking (as is required in most charterparties), and be incapable of dealing with the documentation necessary for the cargo, and of keeping proper records. Clearly the ship's officers and crew are as important to the successful prosecution of a voyage as the ship itself, and their inefficiency will make a vessel sub-standard as much as any structural defect.

Finally, the vessel's management may be sub-standard. The vessel's certificates may be out of date or not available. Every vessel requires a sheaf of certificates to pass muster – classification, gear tests, IMO, and the absence of a relevant certificate for all or part of the ship will delay or prevent a voyage just as easily as a damaged engine or inefficient Master.

Without the headline stories which accompany the oil disasters, it is tempting to ask of sub-standard dry cargo vessels; is there a problem? A glance at reports in

² A very good example is in the case of the "Hong Kong Fir", quoted below.

the shipping press, Lloyds List or Tradewinds, will turn up every day in the casualty reports examples of ships detained or held up for reasons which clearly put the vessel into the category of sub-standard tonnage. There has recently been an increase in port state controls on sub-standard tonnage. Countries (usually the more advanced economies such as the EC and the USA) are now far more rigorous in checking ships which call at their ports. The nature of international trade is that voyages frequently start or finish in one of these countries, so 'rogue' vessels are far more likely to be picked up than was the case even 10 years ago. Clearly if a ship is delayed in port, there will be delay to the cargo with all the obvious problems down the line and, if the cargo is perishable, all the attendant risks of physical damage.

Does the law help?

The purpose of any voyage is the carriage of cargo in the pursuit of international trade, and it is the maritime charterer who provides the impetus for most voyages. They drive international trade, and without them shipping would be a very small world. It is important to remember that the charterparty for these voyages represent merely the 'F' element in a C & F sale.

In the absence of proper controls, the maritime charterer may be faced with the inevitability that sometimes he will charter a sub-standard vessel. What then are the remedies open to this hapless victim? It is probable that in the first instance

he will call upon his lawyer for a solution. However, in this situation, it is my suggestion that he will not find a very satisfactory answer to his problems, and certainly not the redress which he hopes for.

In such a situation the maritime charterer will want one of two things, or most probably both. He will want to be able to cancel his ship and to terminate the contract, and he will want damages. A closer look at ways in which the law might help him achieve these twin objectives provides, in my opinion, a view rather of obstacles that might be placed in his path, obstacles that to a commercial man might come as a rather unpleasant surprise.

There are various international conventions which govern the carriage of goods by sea. English law has adopted the Hague-Visby Rules (1968) which replaced the earlier Hague rules (1924), and are incorporated into our law via the Carriage of Goods by Sea Act (1971). As a result, the Shipowners' duty to provide a seaworthy ship, while absolute at common law, is replaced by one from the Hague-Visby Rules, Article III Rule 1, which reads:

“The carrier shall be bound before and at the beginning of the voyage to exercise due diligence to: -

- (a) Make the ship seaworthy;*
- (b) Properly man, equip and supply the ship;*

(c) *Make the holds, refrigerating and cool chambers, and all other parts of the ship in which goods are carried, fit and safe for their reception, carriage and preservation.*”

The use of the phrase “*due diligence*” is an interesting one. Effectively this means that where unseaworthiness has been found the shipowner can escape liability if he can show that he did exercise due diligence in providing a seaworthy vessel at the start of the voyage. Only if he cannot do that he will lose the benefit of the many exclusions of liability found in the Rules. However, if he can show that he exercised due diligence then his excluded liability is far ranging.

Consider Article IV Rule 2. (a), which states;

“Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from Act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship”.

This seems to me to be a fairly wide ranging exemption which works in favour of the owners, rather than the maritime charterer.

A further question of what might exercise the maritime charterers’ mind when faced with a substandard ship is how can he get out of his contract. He is saddled with a ship which is not performing the task for which he has chartered it, and he wants out; or in other more legal words he wants to repudiate his contract. Here again the law does not help him in the way that he might wish for.

A charterer can only repudiate a contract for breach of a condition of a contract, but not for breach of a warranty, where the remedy lies only in the way of damages. Although this may be a potentially attractive remedy, at the same time it will tie the charterers' hands in the way he continues the commercial purpose of his activities. Even more unhelpfully, it may not be clear at the critical moment whether the shipowner is in breach of a condition or a warranty. A leading case on this is "Hong Kong Fir - v - Kawasaki Kisen Kaisha"³. The "Hong Kong Fir" was built in 1931, and in 1956 (when she was 25 years old) she was chartered for a period of 24 months. Her engines were old and only efficient when given constant attention. A further problem was that the Chief Engineer was a drunk, as were (apparently) most of the others on board. The manning in the engine room was insufficient and she kept breaking down. She sailed from Liverpool to Newport News in ballast to pick up a cargo of coal for Osaka. On that voyage she was at sea for 8_ weeks, off hire for 5 weeks and underwent repairs which cost £21,400. At Osaka further repairs were required which took 15 weeks and cost £37,500.

When the case came to court, it was found that these delays were "*not sufficient to frustrate the commercial purpose of the contract*". I would suggest that this might have come as a nasty surprise to a maritime charterer, who is more likely to have a commercial (as opposed to legal) background. The vessel was in fact off hire for 4 months in the first 7 months of a 2 year charter. Whatever the

³ "Hong Kong Fir - v - Kawasaki Kisen Kaisha" [1962] 2 QB 26

charterer reckoned he was getting when he entered into the charter, one thing he would have thought that he was sure of was that he was getting the use of a ship. In this case what he clearly did not get was the use of the ship, and he therefore felt – reasonably one might feel on a purely commercial analysis – that he was entitled to treat the contract as at an end, and move on with his commercial activity and charter a replacement vessel.

However, the courts decided that the Owners' breach did not "*deprive the other party of substantially the whole of the benefit of the contract*". Furthermore the Owners' obligation to provide a properly maintained and seaworthy ship was (on the facts of this contract) not "*a sufficiently binding obligation the breach of which would allow the Charterers to treat the contract as at an end*", but merely a breach for which they could pursue a remedy in damages. Lord Diplock called it an "*innominate term*", which although may be legally helpful to explain the ratio of the decision really does nothing to address the problems of what was clearly by any lay definition a sub-standard vessel.

I once read a book which tried to explain the Rules of the game of Golf, which can to many seem far more Byzantine than any pronouncement of the House of Lords! The writer cleverly distilled these down to the very simple underlying principle that, wherever possible in any way at all, the ball should be played as it lies. I don't think it is stretching the analogy too far to liken this to the courts' approach to commercial contracts; after all, I suspect many of our learned judges

are also golfers! But put in similar words, the contract, wherever possible, should be performed as it was originally intended by the parties, and that any party injured by a breach should seek recompense in damages.

For a trader or merchant, this brings serious problems of practicality. A charterer faced with a vessel that needs repairs, such as in the Hong Kong Fir case, is simply not getting what he bargained for. He has to make contingency plans to continue his business, to keep his customers satisfied. He doesn't know how long the repairs may take, and at what point they might in fact be of so serious a nature and take so long to repair that they might even lead a modern day Lord Diplock to begin to think that the charterer had been "*deprived of substantially the whole of the benefit of his contract*".

This case illustrates very clearly a situation where the law as applied by the courts is quite probably at odds with the commercial expectations of a maritime charterer who has chartered a substandard ship, and I would suggest that it is not a unique example. The maritime charterer might believe that there are regulatory bodies who are responsible for ensuring that vessels are fit to sail, and to carry cargo – i.e. seaworthy and cargoworthy. If a properly certified vessel proves subsequently to be unseaworthy, or sub-standard, he might perhaps expect that he could obtain some remedy from these bodies. However, this apparently promising avenue also turns out to be a fruitless cul-de-sac.

In the case of the “Nicholas H”⁴, the ship loaded cargoes in Peru and Chile for Italy. On voyage, cracks developed in the vessel’s hull and she went to Puerto Rico and was surveyed at anchor by her Classification Society, NKK. They recommended some permanent repairs. Owners objected to making permanent repairs and carried out some temporary repairs and called on NKK to make a further survey. The NKK surveyor made a further survey, changed his mind and allowed the “Nicholas H” to sail without the permanent repairs being carried out. Had all gone well, there would have been no story, however the ship sailed, the temporary repairs failed, and the ship sank. The cargo owners sued NKK. The case went to the House of Lords, who held by a majority that there was “*no duty of care by Class towards Cargo Owners*”.

On commercial analysis and in the context of sub-standard tonnage the decision seems unsatisfactory and unhelpful. Charterparties stipulate that performing vessels should be classed “Lloyds 100A1 or equivalent”. If the decision of a class surveyor cannot be relied upon, what is the purpose of requiring vessels to be in class? The facts of the case did not involve the issue of a vessel’s rolling survey position (the maritime MOT) but a specific survey to determine whether the ship could undertake a specific voyage. She had been passed fit by the class surveyor when she turned out to be quite palpably unfit. It might seem

⁴ The “Nicholas H”. (1995) 2 Lloyd’s Rep 299 (HL)

there could not be a clearer case for implying a duty of care. But according to the House of Lords, no such duty exists.

I suspect that the decision was made more for policy reasons than commercial considerations; it could clearly lead to all kinds of problems if Classification Societies were to be held liable in cases where vessels they have passed fit proved not to be so. The facts of the “Nicholas H” facts seems fairly clear-cut, but it might be difficult to limit how far down the line a duty of care might be implied on another set of facts.

But whatever the reasons behind this decision, again charterers and cargo owners appear to have no remedy in this area. Once again the charterer of a vessel that proves to be sub-standard seems to be on his own in the minefield that is the law, and unlikely to get a satisfactory remedy from the courts.

This analysis may perhaps be rather bleak, perhaps to make the point, and obviously in some cases a legal approach can of course provide some satisfaction, most obviously in the payment of damages. But it can, I suggest, be unhelpful in areas where the maritime charterer of substandard tonnage might most need help; most specifically in putting his contract at an end.

Above all legal solutions are by their nature reactive, rather than proactive. A good commercial operator will try and avoid problems, rather than solve them

when they arise. The modern jargon for this is risk assessment, and risk avoidance.

Risk assessment; drafting of contracts

One solution open to Charterers is to ensure charterparties are more rigorously drafted in their favour. Every charterparty contains a cancelling clauses which gives the Charterers the clear option to cancel a ship if she arrives after an agreed date. In these clauses, time is explicitly agreed to be of the essence of the contract, and the Charterers' right to cancel the contract is clearly spelt out.

It should be possible to construct similar clauses which would address other eventualities deemed by the charterer to be of equal significance to the commercial purpose of the voyage. Although there is authority that is will probably not be sufficient merely to label a clause as a condition to give a clear right to repudiate in case of a breach⁵, it should not be too difficult to draft clauses which give Charterers the right, explicit, agreed and unambiguous, to cancel a charter in cases where, for example, a vessel is off hire for a specified period of time, or perhaps does not have the necessary certification to load an agreed intended cargo.

⁵ Schuler v Wickman Machine Tools [1974] AC 235

Risk assessment; Pre-screening of tonnage

However, in the context of risk assessment there is, I suggest, a way in which maritime charterers and cargo interests can provide themselves with an effective deterrent to sub-standard shipping, and it is a way that is already successfully in operation in the oil industry. This is a self-imposed exercise by the charterer to pre-screen tonnage before fixing, and to ensure that they fix only tonnage that passes their own self-imposed standards.

The oil industry has been forced to react to widely publicised incidents such as the “Erika” or the “Exxon Valdez” by introducing internal screening of tonnage to filter out the kind of ships that are most likely to prove to be substandard. This has been largely successful, and has overcome initial reluctance from the owning fraternity. John Hughes, who after 30 years with Exxon following a career at sea, is now the very well qualified Director of OCIMF, the Oil Companies International Maritime Forum said in a recent conference speech *“one effect of the “Erika” has been to raise awareness of the charterer’s role in deciding what quality of tonnage is acceptable for employment. The European Commission has stated that one of the criteria for considering whether a civil liability and compensation system is fully satisfactory is that it should discourage ship operators and cargo*

interests from transporting oil in anything other than tankers of impeccable quality.”

This of course touches on the question of who pays for the consequences of oil spills, as much as the commercial problems of sub-standard tonnage, and in this respect and others the circumstances of the oil trade are different from dry cargo. However, with some effort, the dry cargo industry could and, in my opinion, should address this process far more rigorously, and would reap considerable benefit from doing so. Some of the larger trading houses have put such a system into place, and I have been lucky enough to observe the very impressive results of one such system. It is instructive to see how the company went about tackling the need for such a procedure, and to review the results.

The first step is to identify the problem, and having done so, so see how it adversely impacts on the company's commercial activities. There is adverse publicity for the Charterer attached to the chartering of substandard tonnage; I suspect that almost everyone can recall the name of oil company involved in the “Erika” disaster. Dry cargo problems are not front-page news, but equally industry gossip about unreliable deliveries can be commercially harmful. Delays caused by substandard tonnage held up on the voyage will cause interruptions to customers' supply chain, and in these days when there is increasingly frequent reliance on ‘just-in-time’ delivery such delays are not acceptable. A reputation for unreliability may well tell against a tenderer for repeat business; a company who

is known to have an effective screening programme in place will be looked on more favourably. Moreover, charterers will be seen to be taking a responsible position commercially, environmentally and gain industry respect.

There are clear cost implications. An obvious benefit of improvement in the quality of chartered tonnage will be a fall in the cost of insurance premiums. As with all types of cover, the cost of premiums is directly affected by the claims record.

There are also clear benefits for staff. In the case of substandard tonnage staff become involved in claims and disputes when they could be freed up for more profitable tasks. Handling disputes is not only time consuming but also frustrating, and cutting out the problems that substandard tonnage causes can bring direct benefits to staff both in terms of costs and productivity.

The benefits may seem very obvious, but how does a charterer go about addressing the problem? It is critical that there is a corporate decision to screen chartered tonnage pre-fixture, and a corporate will to make it work. It is fundamental that the policy is seen to be consistent throughout the company and must be respected down the line with no exceptions. There must be no easy excuses for a trader to charter an unapproved vessel simply because of the superficial attraction of a cheap freight rate. The commitment has to be absolute, and a corporate culture of screening must become ingrained. It is vital that long-

term benefits must be recognised and short-term problems sidelined in favour of the bigger picture.

Having made the decision to pre-screen all tonnage before chartering, what practical steps should the maritime charterer take? Many steps are obvious. They should build up a database of information by monitoring the casualty reports (for example those published in Lloyds List). They will get internal feedback from brokers which is important even in today's market which is increasingly conducted across screens, rather than face to face. In the past when a majority of charters were concluded in London, the Baltic Exchange used to exist as a fairly effective self-regulatory body, and acted as an informal register of substandard tonnage and owners. Today the market is so internationally diverse that a far more comprehensive system of contacts is needed. An effective system will include strict monitoring of perceived 'rogue' tonnage and/or owners.

There must also be a strict insistence on detailed pre-fixture questionnaires. Amongst drycargo owners' brokers this has always seemed to cause problems. I suspect this is largely simply due to laziness, but also the fact that the habit has not become ingrained. In the oil industry, majors like BP and Shell will simply not consider a tanker for charter without their detailed questionnaire being completed to the satisfaction of their operations department. A well constructed questionnaire will cover not only the physical aspects of the vessel and

confirmation of where she is insured, but also look at its trading history, detailing records of recent surveys and dry-docks, accidents or breakdowns, and even such information as the Owners' regular bunker suppliers, with whom checks might be made for payment records. Whether the vessel is classed with a classification society in the IACS group, or whether her P&I cover is with a club within the International Group can often give a clue to the type of Owners and ship that the charterers are considering. The answers must of course then be incorporated in the charterparty as part of the warranties given by the Owners.

Pre-screening should also incorporate rigid age control of chartered tonnage. Insurance companies will tell you that it is statistically proven that the age of a vessel is in direct proportion to its performance. A good scheme will set thresholds – 15, 20, 25 years old – beyond which a vessel will simply not be considered, or alternately will be subject to more rigorous tests. In some cases, charterers will even go as far as a physical pre-fixture survey of marginal tonnage. This may sound drastic and expensive, but can be used as a last resort to back up the seriousness of the pre-screening exercise.

It is vital that the system is subject to continuous upgrade. Screening is a continuous process and must be treated as such. Just because a ship passed the tests a year ago doesn't mean that it hasn't changed in that time.

Clearly there are cost implications in a screening programme. At first sight the

cost of screening appears high, particularly if a physical survey is required. Staff will be required to implement the scheme, and to ensure that it is a continual process. There may be costs in freight, where traders are obliged to ignore a vessel at a cheaper freight which does not meet the standards set. However, in my opinion the benefits accruing will underwrite this. There is also the possibility that owners might participate in the costs of screening. A responsible owner will want to be an 'approved' vessel, and can gain market benefit from this status.

As outlined earlier there are cost benefits to be gained from a strict screening policy. Charterers can expect a reduction in insurance premiums, as insurance companies will deal favourably with companies who have effective screening policy. Staff are freed up from dealing with long running claims and disputes, and there is a definite business advantage flowing from increased efficiency to customers.

I have learnt that the total costs of a strict screening policy adopted by a major dry cargo trading house represents less than 0.1% of total freight bill; in simple terms just one thousand dollars for every million dollars of freight. At the same time, they calculate that 88% of dry cargo vessels involved in casualties at sea and detentions in port would not have passed their pre-fixture test. I consider this to be a quite staggering statistic, and shows that the costs of screening are well rewarded commercially.

Conclusions

In conclusion, I think that the dry cargo industry has lessons to learn from the oil industry, which has been forced to lead the way in providing a deterrent to sub-standard tonnage. The high profile coverage of disasters has given them an irresistible impetus to put this into practice. It is also a more compact industry, where a few major companies share a major slice of the market, both as charterers and also at the same time as shipowners. The debate has been held in the public domain – I think it fair to say that the single casualty of the “Erika” had a profound and policy changing effect in this area.

Owners have been forced to think the unthinkable, and now look upon questionnaires and even physical surveys as routine; having passed them, they will then describe their tanker to other charterers as being ‘Shell or BP approved’, and oil majors’ approval is now worn as a badge of pride. Most importantly the industry’s efforts in this area are ongoing, with continual attempts to raise the bar in terms of the standards asked of ships and Owners.

Perhaps most important, the move to an effective deterrent has come from within the industry, with the market users reacting to a situation, rather than having regulations forced upon them from outside. It is my opinion that the industry has been swifter to react and self regulate in order to avoid solutions imposed from

outside. That this solution to the problem has been arrived at by the market itself has made it, in my opinion, infinitely more palatable to most shipowners.

The dry cargo market is different to the oil market. It is far more diverse and fragmented, not only in terms of owners and charterers but also by the nature of the variety of cargo carried alone. It also lacks the front-page imperative that has to a large extent driven the oil industry in this area. Perhaps for a collective impetus to find a self-regulated deterrent to sub-standard tonnage the dry cargo industry needs its own "Erika". But I believe that there are strong commercial reasons to introduce screening, and dry cargo owners are gradually but increasingly prepared to accept this as routine. Problems still exist; there is still the Friday night trader who will bully his freight department to take a risk on an unknown and unchecked ship which is offering freight \$2.00 less than the market. It needs a strong corporate culture to resist this, but once in place results should flow. If this is followed through, the industry will have provided its own strong and effective deterrent to the problem of sub-standard tonnage, and will have avoided the need for unwelcome regulations imposed from outside.