The implications of the “OCEAN VICTORY” case

On 10 May 2017, the Supreme Court delivered its judgment on the much anticipated appeal of the "OCEAN VICTORY" case (Gard Marine and Energy Limited v China National Chartering Company Limited and another 2017) .

The anticipation was warranted as the Court grappled with three key issues of English shipping law. Whilst none of the Court's findings may have been surprising following the Court of Appeal's judgment, one in particular has far reaching consequences and potentially severe financial implications for Owners and their insurers.

Facts
The events giving rise to this case occurred in October 2006 when the "OCEAN VICTORY" ran aground, and later broke apart, whilst attempting to leave the port of Kashima, Japan, in a gale. The vessel was on a ten year bareboat charter, on Barecon 89 as amended, from Ocean Victory Maritime (Owners) to Ocean Line Holdings (Charterers), which were a related company. Charterers chartered the vessel to China National Chartering Corp. (Time Charterers) on time charter, and Time Charterers sub-chartered to Daiichi (Voyage Charterers) on a time charter trip. Each charterparty contained a safe port warranty.

Insurers' losses resulting from the incident exceeded US $137 million in total, which included the value of the vessel, loss of earnings, salvage costs and wreck removal costs.

Gard, Owners'/Charterers' insurers, claimed these sums against Time Charterers, who claimed against Voyage Charterers, arguing that Kashima was unsafe as the casualty had been caused by a combination of severe northerly gales and a swell caused by long waves, both of which were known to be problems at the port.

Key Issues
The key issues, and those which the parties agreed the Supreme Court should decide, were:
1. Was there a breach of the safe port undertaking in the charterparties?
2. Did the co-insurance regime in clause 12 of the Barecon 89 form, prevent a claim from being brought for losses resulting from breach of the safe port warranty? This turned out to be the most contentious question for the Supreme Court and the aspect which would have the most far-reaching consequences.
3. Were Voyage Charterers entitled to limit their liabilities for loss of the vessel under the 1976 Limitation Convention/Merchant Shipping Act 1995?

First Instance Decision
At first instance, the Judge found that the casualty was caused by long waves and severe northerly gales, each of which was not uncommon at Kashima. He concluded that the cause was therefore a "characteristic of the port" and not an "abnormal occurrence". Charterers were, therefore, in breach of the safe port undertaking.

He also found that clause 12 of the Barecon 89 form did not preclude a claim by Owners against Charterers, and so the claim could be passed on to Time Charterers.

Owners/their insurers were awarded over US $137 million at first instance.

Court of Appeal
The Court of Appeal, however, took a very different view, finding that the port of Kashima was safe. The Judge had been wrong in his approach as he had decided that, because the two causes of

the casualty were each common in themselves, he did not need to consider whether they were common in combination, yet it was this combination that had caused the loss. In addition, he had taken an excessively theoretical approach, considering what was theoretically foreseeable rather than looking closely at the history of the port in relation to the actual cause.

In relation to co-insurance, the Court of Appeal found that, even if Kashima had been unsafe, Charterers would not have been liable, as Owners had agreed to look to their insurers and not Charterers to compensate them for their losses. Charterers would, therefore, have had no indemnity claim against Time Charterers.

Owners and their insurers appealed.

Supreme Court
The Supreme Court dealt with the first and third issues easily coming to unanimous decisions on both.

Safe port warranty
The Judges upheld the decision of the Court of Appeal finding that the port was safe, and there had been no breach of the warranty. The first instance Judge had been incorrect to decide that because each cause of the incident (long waves and severe northerly gales) was, in and of itself common, they constituted a characteristic of the port and not an abnormal occurrence. Nor did the Supreme Court agree that the unsafety had to be simply "reasonably foreseeable". The Court held that this was an incorrect test, and shared the view of the Court of Appeal that the correct test, in this case, was to decide whether the coincidence of long waves and severe northerly gales was a characteristic of the port or an abnormal occurrence. They saw no reason to disagree with the Court of Appeal in its finding that the cause was an abnormal occurrence, and said that this term should be given its ordinary meaning, which is something rare and unexpected.

Limitation of liability
The Supreme Court found it equally straightforward to deal with the question of limitation of liability, endorsing the Court of Appeal's decision in the "CMA DJAKARTA" (CMA CGM SA v Classica Shipping Co Ltd 2004), finding that Voyage Charterers would not have been entitled to limit their liability for the loss of the vessel under the 1976 Limitation Convention/Merchant Shipping act 1995.

Co-insurance
The most fascinating aspect of this judgment was how the Judges dealt with the co-insurance issue. The question arose as to whether - assuming there had been a breach of the safe port warranty - Gard, as Charterers' assignee, could claim the insured value of the vessel from Time Charterers, on the basis that Charterers would have been liable to the Owners for breach of the safe port undertaking This complex question split the Judges who upheld the Court of Appeal's view on the slimmest of majorities 3:2.

Under clause 12, Charterers were responsible for arranging and maintaining insurance approved by the Owners, in their joint names for an agreed value. Charterers were responsible for effecting all repairs (whether covered by the insurance or not). The clause provided for how insurance monies would be dealt with in the case of a total loss.
Lord Toulson, Lord Mance and Lord Hodge were of the view that the provisions of clause 12 of the demise charter precluded a claim between co-insureds so that the Owners could not claim against the Charterers. There was, therefore, no claim against Time Charterers.

The question that arose was whether the parties had intended to create an insurance fund which was the only avenue to be compensated for the relevant loss and damage, i.e. had they created a comprehensive regime for dealing with such losses? Alternatively, did the existence of this insurance fund somehow co-exist with an independent right of action for breach of the terms of the charter which caused the loss?

The three Judges in the majority were very clearly of the view that this was a comprehensive regime which left no avenue, under the contract, for a claim against a co-insured. One of the criticisms of this analysis is that it leaves the party which has suffered the loss without any avenue for recourse. This was, however, countered by an argument that a claim could have been brought on a different basis, e.g. bailment, which would have fallen outside of the contract and would, therefore, not have been precluded by the co-insurance regime. However, this was not a claim that was pursued by the Claimants in this case. With the benefit of hindsight, this was obviously a mistake, although few would have anticipated the implications of clause 12 when the claim was brought.

The approach taken by the dissenting Judges was particularly interesting. Lord Sumption and Lord Clarke agreed that the co-insureds could not claim against each other in respect of an insured loss. However, having answered this question, Lord Sumption posed a further question: *"... when we say that one co-insured cannot claim damages against another for an insured loss, is that because the liability to pay damages is excluded by the terms of the contract, or is it because as between the co-insureds, the insurer's payment makes good any loss and thereby satisfies any liability to pay damages?"*

His answer was that insurers' payment to Owners makes good Owners' losses, as between insurers, Owners and Charterers, and that this satisfies, but does not exclude, Charterers' liability for the loss of the ship under the charter. Charterers would, therefore, be able to claim against Time Charterers.

Comment

Whist this discussion may seem academic, it has very real financial consequences for insurers. Whilst part of the argument related to how clause 12 interacted with an amended clause 29 (safe port warranty), other causes of action could arise under the charter which could fall foul of this judgment.

Insurers now face the problem that there are many long term bareboat charters in existence which could be "ticking time bombs" with the potential for significant losses. Owners and insurers would be wise to take a long hard look at the co-insured regimes in their charterparties (and their interaction with other clauses) to avoid situations where insurers are devoid of contractual recourse for losses paid out.

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