

P&I COVER IN ENGLAND AND IN NORWAY:  
A COMPARATIVE ANALYSIS OF CURRENT PROBLEMATIC ISSUES



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*This thesis is dedicated to the loving memory of my father, T. Esteban Costas.*

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# **1. Introduction**

## **1.1. Purpose of the thesis**

The aim of this document is to analyse the peculiar features of the English and the Norwegian P&I Clubs from a comparative perspective. In particular, this study approaches how the following three topics are dealt with by P&I Clubs in the named jurisdictions: i) the "Pay to be paid rule"; ii) the possibility of third party claimants to file recovery actions directly against P&I Clubs; and iii) the P&I Clubs' position regarding cover when letters of indemnity are accepted by the assured in exchange of delivering cargo without presentation of a bill of lading. It is my personal view that these topics are of great importance for a shipowner because they have an impact on their business and even though much has been written about these topics, little is said from a comparative perspective. Apart from the market impact, these issues are connected because P&I Clubs are usually vested with discretionary powers that entitle them to make decisions on the application of cover irrespective of what the standard rules exclude. Ideally, the present text will provide further insight to this type of insurance which shipowners and insurance brokers may utilize when choosing a P&I Club.

This work intends to focus on the legal and regulatory matters which have an effect on the practical usage of the P&I insurance cover. The objective is to leave aside the financial performance of the P&I Clubs, an aspect which is logically prioritized by shipowners when choosing a liability insurer, and to focus on other practical implications of choosing a Club. I believe that a comparative approach will provide an additional dimension to the issues in question aiming to be used as an innovative tool for any interested party.

## **1.2. Legal sources**

### **1.2.1. English Law**

Under English Law, where the common law system governs, rights and obligations of the parties to a contract are regulated by the contract itself in principle. Though statute establishes limits and guidelines to certain activities that need a common framework due to their impact on industry and society. Legislators enacted the Marine Insurance Act of 1906 to regulate the extent of the freedom of contract between insurers and insured parties, and to codify maritime law principles established by the English Courts. Up to the present date, P&I Clubs are subject to the provisions of this act.

For the purposes of this paper, focus is placed on the Third Parties (Rights against insurers) Act 1930, and its successor: the Third Parties (Rights against insurers) Act 2010. These statutes have and still regulate the rights that third parties have to file a claim against an insurer with whom they do not have a contractual relationship. The act grants third parties rights in case the insurer becomes insolvent, and these rights will be analysed in detail hereunder.

### **1.2.2. Norwegian Law**

To the effect of protecting the rights of the assureds and securing the obligations of the insurers, in 1930 legislators issued the Insurance Contract Act of 1930. Said act was later superseded by the Insurance Contract Act of 1989 (ICA) which is currently in force and whose provisions are in principle mandatory to all insurance contracts. However, only some sections of the ICA are of mandatory application to marine insurance contracts given the fact that the ICA allows the parties to contract out of its terms in certain provisions. According to Section 1-3, 2nd paragraph (c), in all types of marine insurance contracts relating to a ship or installations<sup>1</sup> the contractual parties are free to contract out of all but one of the provisions of the 1989 ICA. The only section that is mandatory for marine insurance contracts is section 7-8 which deals with liability insurance. The ICA will be discussed in relation to the rights of third parties against insurers, and in particular P&I Clubs.

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<sup>1</sup> The ICA makes a reference to definitions of the Norwegian Maritime Code section 33, 1st paragraph, and sections 39 and 507: installations constructions not regarded as ships such as floating cranes, fixed installations for use in exploration, drilling platforms and similar mobile constructions.

All other types of marine insurance cover (Hull & Machinery, Loss of Hire, etc.) are regulated by the Norwegian Marine Insurance Plan of 1996 (version 2010).

For the purposes of analyzing the legal framework applicable to Letters of Indemnity the Norwegian Maritime Code is cited.

### **1.2.3. International sources**

The laws governing marine insurance contracts applicable in the United Kingdom and in Norway compose the legal basis of this piece. Thus, the main focus is made on the legislation of these two countries given the fact that there is no international unanimous legislation that applies to both countries when it comes to protection & indemnity insurance contracts.

The international instruments utilized for the purposes of this paper and which both nations have ratified are: i) regarding rights of direct action against marine insurers, the Convention on Civil Liability for Bunker Oil Pollution Damage 2001 and the Convention on Limitation of Liability for Maritime Claims, 1976, as amended; ii) regarding transport of goods by sea and the function of the bill of lading, the Hague-Visby Rules<sup>2</sup>.

The Comité Maritime International (CMI) has intended to harmonize the rules concerning marine insurance contracts through the formation of an International Working Group (IWG). The IWG has been working thoroughly on different international concerns since 1998 in order to produce international guiding lines for the marine insurance industry. The harmonization process is currently stopped and therefore nations rely on their national rules when it comes to Marine Insurance.<sup>3</sup> The IWG has only worked on Hull & Machinery insurance contracts and no focus has been placed on the Protection & Indemnity insurance contracts up to the present date. Therefore, the present work relates almost solely to national legislations while there is no international instrument that applies to P&I insurance uniformly.

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<sup>2</sup> International Convention for the Unification of Certain Rules of Law relating to Bills of Lading, 1924. After being amended by the Brussels Amendments in 1968, the Rules became known as the Hague-Visby Rules.

<sup>3</sup> Wilhelmssen, Trine-Lise, "*Marine insurance regimes and their impact on shipping competition*", Simply Nr. 394, 2009. P. 35



Even though national legislations differ, it is worth stressing at this initial point that P&I conditions are very similar given the fact that the P&I Clubs obtain reinsurance by the same re-insurers while using a common reinsurance scheme. This is strengthened by the agreement entered by the International Group of P&I Clubs which establishes a common standard for the clubs participating (See 2.1. for more details on the International Group).

### **1.2.5. Jurisprudence**

Decisions of the Courts in England and in Norway have led to legislative modifications and their interpretation of the statutes is essential in both countries when applying legal concepts. In particular, under the English common law system caselaw plays a main role and no valid legal analysis can be made without following the Court's precedent.

Caselaw is discussed extensively in the chapter concerning the rights of third parties to file a direct action against a marine insurer as court verdicts have stated the extent of said rights, which were later inserted in regulations in England and Norway. In addition, the author comments on the leading case on this topic from his country of origin, Argentina, in order to make a brief connection with his main legal background.

### **1.2.6. Legal literature**

The work of prestigious authors from both jurisdictions, England and Norway, provides insight into the reasoning of the different legal systems (Common Law in England and Civil Law in Norway) and their historical background. The studies made by various authors guarantee a better understanding of how the marine insurance market works in both countries and what the current worries of the Shipping industry are. Legal literature points out the current problems and risks at stake in each country hopefully enabling the present paper to focus on key issues using the valuable perspective of experienced professionals in the maritime law and marine insurance field.

## 2. P&I Clubs

### 2.1. Definition

The traditional Hull & Machinery (H&M) insurance provides physical damage protection and loss coverage for vessels and the machinery which is part of them caused by a peril of the sea or other covered perils while the vessel is in transit over water.

Among other marine related types of insurance the insurance market offers most commonly we find: i) war risk: covers perils of war, uprising and hostility, deprivation and inhibition on use and derelict weapons of war<sup>4</sup>; ii) loss of hire: covers the payment due from the charterer to a shipowner under a demise charterparty<sup>5</sup> or a time charterparty<sup>6</sup>; iii) loss of freight: covers *“the benefit derived by the ship-owner from the employment of his ship”* (*Flint v. Flemyng* (1830) 1 B. & Ad. 45.)<sup>7</sup> when the ship-owner is deprived of utilizing the vessel; and iv) freight, demurrage and defence cover (known as *“Defence”*): covers legal costs, provision of legal advice, and claims handling services<sup>8</sup>.

On the other hand, **"P&I"** stands for **"*protection and indemnity*"** and is a form of marine insurance that covers the liability of a shipowner and that of the charterer of a vessel. This type of insurance covers most of the risks not covered neither by Hull & Machinery insurance nor by Loss of Hire insurance, focusing on third party liabilities relating to the use and operation of ships (personal injury to crew, passengers and others on board, cargo loss and damage, oil pollution, wreck removal and dock damage).

It is worth stressing that P&I cover is meant to cover strictly indemnity and does not mean direct liability. This is because the member is meant to be legally liable to pay for risk covered by the P&I Club and he must have paid in full said compensation before seeking

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<sup>4</sup> Bennett, Howard *“The Law of Marine Insurance”*, 2<sup>nd</sup> edition, Oxford, 2006. P. 404

<sup>5</sup> Contract containing all the terms and conditions for the hire of a ship during a set period of time, entered into between a shipowner and a charterer.

<sup>6</sup> Rose, F.D., *“Marine Insurance: Law and Practice”*, 1<sup>st</sup> edition, 2004. Chapter 2.37

<sup>7</sup> Geoffrey Hudson & Tim Madge, *“Marine Insurance Clauses”*, 4th Edition, 2005. Chapter 6.

<sup>8</sup> *Idem* 4, p. 490

recovery from the Club.<sup>9</sup>

Approximately 90% of the world's ocean-going merchant shipping tonnage is entered in mutual P&I associations or clubs which are members of the International Group of P&I Clubs ("IGPANDI").<sup>10</sup> There are 13 members of the IGPANDI situated in the U.K., Norway, Sweden, Japan and in the U.S. These vary in size and type of vessels insured (tankers, cargo vessels, small yachts, etc.)

The United Kingdom has the largest amount of P&I Clubs that are members of the International Group of P&I Clubs, and this is the country where the first clubs were created. The list includes: The Britannia Steam Ship Insurance Assoc. Ltd., The London Steam-ship Owners' Mutual Insurance Association Ltd, The North of England Protecting & Indemnity Assoc. Ltd, The Shipowners' Mutual Protection & Indemnity Assoc., The Steamship Mutual Underwriting Assoc. Ltd, United Kingdom Mutual Steam Ship Assurance Assoc., and The West of England Ship Owners Mutual Assoc. Despite the fact that some of these clubs have in recent years moved their legal domicile to other jurisdictions like Luxembourg, they remain operating from England and are considered by the industry as English Clubs because of their history, nationality of their staff and law applicable to their contracts.

These clubs have quite similar rules and therefore the author refers to clauses of the most influential actors in terms of market share, Britannia and the North of England, as well as the terms of The Steamship Club as it targets smaller vessels.

In Norway there are two P&I Clubs, namely Gard and Skuld. The General Rules drafted by these Clubs have been reviewed and compared, as well as other policies offered by these insurers for special needs of their members.

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<sup>9</sup> Patrick J. Bonner, Marine Insurance Considerations, *Maritime Law Reporter*, Vol. 11, Nr. 4, page 42. 04/09/2011. (<http://www.freehill.com/articles/marineinsurance.cfm>)

<sup>10</sup> International Group of P&I Clubs official website (<http://www.igpandi.org/Home>)

### 2.1.1. P&I Clubs organization

P&I Clubs are incorporated as mutual associations integrated by ship-owners and/or charterers<sup>11</sup> who share their risks. These mutual associations are incorporated as non-profit organizations which means that the insurance premium calls are calculated to cover the expenses they expect to pay in the future.<sup>12</sup>

Every member contracts with a corporation rather than with his fellow members. This implies that in case of a dispute a member will direct his claim against the association and not against each other member.

The members are neither shareholders nor subscribe any capital, which also means that they do not participate in the profits of the association. Under the Articles of incorporation of each association it is prescribed that every member has to contribute to the damages suffered by the other members, which is a mutual obligation. However, the liability of each member is limited to the calls and premiums set by the club's authorities. The main feature of these associations is that the members are "*both insured and insurers, contributing to claims via so-called calls*".<sup>13</sup>

The Members agree to share the costs of liabilities, losses, expenses and costs incurred by the other members in direct connection with the operation of the ships entered in the insurance policy of the P&I insurance club. Every year the members decide to what extent the Rules governing their mutual obligations will be applied in the following policy year, so that everyone is well aware of the terms of their insurance cover and may propose amendments.<sup>14</sup>

A committee or board of directors elected by the members holds the control of the club, while management is vested to the club managers or to a separate management company.<sup>15</sup>

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<sup>11</sup> A charterer enters a contract with a shipowner to take a vessel on charter for a period of time and trades the ship to the destinations and schedules he wishes.

<sup>12</sup> Bonner, Patrick J., "*Marine Insurance considerations*", Maritime Law Reporter, Vol. 11, Nr. 4, pp. 42-48.

<sup>13</sup> Hazelwood, Steven, "*P&I Clubs Law and Practice, Lloyd's*", 4<sup>th</sup> edition, 2010. Chap. 1.1.

<sup>14</sup> Williams, Richard, "*Gard Guidance to the statutes and Rules*", Gard AS, Oslo 2008. Pp. 11.

<sup>15</sup> Bennett Howard, *The Law of Marine Insurance*, Clarendon Press, Oxford. 1996. Pp. 8-9.

Directors are usually elected for a three year period, and they meet between three to four times yearly. They are mainly responsible for determining which liabilities are to be covered, setting the premium amount for each year, elaborating a financial strategy in respect to the protection of reserves and investment, as well as the overall evaluation of the managers and the use of their discretionary power when applying the club's rules.<sup>16</sup>

A particular aspect that makes P&I Clubs distinct from other insurers is that those associations that are members of the IGPANDI have all agreed on the use of the so-called "Release calls". When the entry of a member in a Club is terminated for whatever reason, the Club determines an individual additional premium named "release call" based on the anticipated rate of contribution for the year. Once this call is paid, the member is allowed to join another club and no other calls are to be claimed by the former insurer.<sup>17</sup>

The purpose of requesting release calls is to remove any potential liability for further calls to the Club, after termination of membership in a P&I Club. The member is then released from paying any supplementary calls to the insurer. Market analysis report that there has been "...a tendency to use them (the Release Calls) as much as a commercial penalty for leaving, rather than purely as a reasonable estimate of future exposure to the Club." In this regards, it has been published that the English based insurer, Shipowners Club, can be distinguished for being the first one to reduce the release call estimates to zero back in 2008.<sup>18</sup> This is one clear example of how clubs may differentiate themselves from the financial side, together with the use of their wide discretionary powers.

### **2.1.2. P&I Club specialties**

The Clubs who integrate the IGPANDI vary in their areas of specialty as they can be distinguished by their expertise. Their core businesses may be distinguished by the type of vessels and/or geographical areas where their membership is located.

For example in England, 48,9% of Britannia P&I Club's tonnage is managed by Asian managers, 21,4% by Scandinavians and 20,3% by other Europeans. The tonnage entered

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<sup>16</sup> Prof. Merkin Robert & others, "Maritime Law", 2<sup>nd</sup> edition, 2011. Pp. 530.

<sup>17</sup> Hazelwood, Steven "P&I Clubs law and practice", 4<sup>th</sup> Edition. Chapter 8.64.

<sup>18</sup> "Protection and Indemnity Market Review 2010/2012", Willis 2010. Pp 29. (<http://www.willis.com/Documents/Publications/Industries/Marine/AnimatedPDF/dec2010/index.html>)

by Britannia is composed by 43% of tankers, 27% bulk carriers and 26% container vessels. On the other hand, Shipowners P&I Club offers insurance to smaller vessels and their members are composed by nationals of Asia & Australasia (36%), Europe (31%), Latin America (12%), North America (12%), etc. While their tonnage insured is integrated by harbour ships (27%), barges (17,9%), fishing vessels (17,9%), passenger ships (13,4%), offshore ships (10,7%), etc.

In Norway, Gard's members are composed by tonnage managed by Europeans (23%), Asians (22%), Norwegians (18%), Germans (16%) and Greeks (11%). While the type of vessels Gard insures are quite varied: tankers (35%), container vessels (16%), bulk carriers (17%), Mobile offshore (10%), etc.<sup>19</sup>

### **2.1.3 The risks covered**

P&I Club's rules offer a wide range of cover for different risks. The members may choose whether they wish to contract cover for all the risks or for some of them. Individually, the members agree the deductible applicable to the risks the Club covers. P&I is a type of indemnity insurance whereby the insurer is obliged to hold the assured harmless as long as the assured has actually been liable for the loss/damage and that he has discharged his liability. Therefore, the insurer will only be bound to pay compensation to the assured once the latter has fully compensated the third party claimant.<sup>20</sup>

P&I cover can be subject to conditions or exceptions, as well as the approval of the Management or the committee. To name one of these situations, in the case of contracts for supply of services to a ship the member will be covered against liability for death, personal injury and illness during the performance of said contract, but usually such contracts must be previously approved by the managers in order to have the cover in place.<sup>21</sup>

As an example, Gard P&I Club's Rules provide cover for the following risks:

*Rule 27. Liabilities in respect of Crew*

*Rule 28. Liabilities in respect of passengers*

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<sup>19</sup> idem supra note 18

<sup>20</sup> Hazelwood, Steven, *"P. & I Clubs Law and Practice"*, 4<sup>th</sup> Edition, 2010. Chapter 9.5.

<sup>21</sup> Bennett, Howard. *"The Law of Marine Insurance"*, 2<sup>nd</sup> edition, Oxford, 2006. p. 485

- Rule 29. Liability for other persons carried on board*
- Rule 30. Liability for persons not carried on board*
- Rule 31. Diversion expenses*
- Rule 32. Stowaways, refugees or persons saved at sea*
- Rule 33. Life salvage*
- Rule 34. Cargo liability*
- Rule 35. Extra handling costs*
- Rule 36. Collision with other ships*
- Rule 37. Damage to fixed or floating objects*
- Rule 38. Pollution*
- Rule 39. Loss for obstruction and wreck removal*
- Rule 40. Liability for obstruction and wreck removal*
- Rule 41. General average*
- Rule 42. Salvage*
- Rule 43. Towage*
- Rule 44. Legal costs*
- Rule 45. Enquiry expenses*
- Rule 46. Measures to avert or minimize losses*
- Rule 47. Fines*
- Rule 48. Disinfection and quarantine expenses*
- Rule 49. Confiscation of the Ship*
- Rule 50. Damage to Member's own property*<sup>22</sup>

Most Clubs offer the so-called "Defence cover", also known as "FDD cover" which stands for "freight, demurrage and defence". It implies that the Club will cover the appointment of both in-house and external lawyers, legal related costs, provision of legal advice and claim handling services usually directly by the Club's internal team. The Club has extensive discretionary power to decide on the course of action, and whether or not to defend a claim at court. To such extent, they will generally evaluate whether the legal costs of initiating a law suit and the feasibility of obtaining a positive verdict are worth it, or if they

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<sup>22</sup> Williams, Richard. "Gard Guidance to the Statutes and Rules", Gard. AS, Oslo 2008. p.5

should rather settle the claim at an earlier stage.<sup>23</sup>

## **2.2. History**

### **2.2.1. Birth of P&I Clubs in London**

The present English P&I Clubs descend from the Hull insurance clubs that were formed by British shipowners in the 18th century. Shipowners gathered themselves from different geographical areas intending to find an alternative to the hull insurers. Two companies, the Royal Exchange Assurance (“The Society of Lloyd’s”) and the London Assurance had been granted a statutory monopoly which excluded other companies from the marine insurance business. These companies had the power to force high premiums on the ship-owners, and to fight this unfair situation ship-owners created their own self-governing hull Clubs which managed to provide hull cover on a mutual basis, and which were governed by the ship-owners themselves.

The members shared their risks on a mutual basis, being both an insured and an insurer of others – which remains the concept of the current P&I clubs.

In 1824 the company monopoly was removed and this provoked increased and healthier competition in the marine insurance market. Shipowners were led to set up new mutual insurance associations given that the cargo owners and cargo insurers were more interested in seeking recovery of their losses from ship-owners, and due to the steady increase in the liability to third parties placed on ship-owners. Crew members who had suffered injuries sought compensation from their employers, and claims by the next of kin of deceased crew members were made available by the “*Lord Campbell's Act of 1846*”. This act provided personal representatives the right to initiate a lawsuit for damages whenever the deceased crew member had said right at the time of his death. This also increased the possibility of claims by passengers, all of which resulted in a significant increase in ship-owners' liabilities. Besides, Ship-owners understood that their cover for damage caused by vessels colliding with other vessels was insufficient as the cover excluded one fourth of the damage and was the compensation amount was limited.

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<sup>23</sup> idem supra note p. 490



In 1855 the first protection association was formed, namely the “Shipowners' Mutual Protection Society”, the predecessor of the “Britannia P&I Club”.<sup>24</sup> It was created after the enactment of the UK Merchant Shipping Act of 1854 which enabled insurers to cover liabilities for loss of life and personal injury with a limitation of liability, due to the fact that injured crew members were increasingly seeking compensation from shipowners. In 1874 the risk of liability for loss of or damage to cargo carried on board an insured ship was first added to the policy offered by a Protection Club.<sup>25</sup> Given the fact that cargo values had increased and cargo owners were now expecting to obtain compensation from shipowners, the Clubs were somehow impelled to insert an “indemnity class” to secure the required financial strength to cover said risks.

In 1899 the first pooling agreement was formed by six British P&I clubs (UK Club, Britannia, Standard Club, London Club, Newcastle Club and Sunderland Club) due to the growth of mutual P&I business. This way they “shared amongst themselves any covered claim in excess of £10,000”.<sup>26</sup>

### **2.2.2. The evolution in Scandinavia**

Scandinavia has three P&I Clubs which are members of the IGPANDI, namely Skuld and Assuransforeningen Gard (“Gard) both situated in Norway, and The Swedish Club in Sweden. While they secure an important share of the Nordic and international P&I market nowadays, Gard is today the world’s largest P&I Club “as measured by gross premium calls, assets, and free reserves”.<sup>27</sup> This is why the Norwegian legal perspective is key in an international context considering the main role this nation occupies in the global marine insurance market.

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<sup>24</sup> Noussia Kyriaki, “*The Principle of Indemnity in Marine Insurance Contracts*”, Springer, 2007. Pp 5.

<sup>25</sup> Idem 24

<sup>26</sup> Britannia P&I Club, “*Britannia profile: History*”, 2008.  
(<http://www.britanniapandi.com/en/Britannia-profile/history/index.cfm>)

<sup>27</sup> Standard & Poor’s, *Ratings Direct on the Global Credit Portal*, January 22, 2010. Pp 2.  
(<http://www.gard.no/ikbViewer/Content/619601/Standard%20and%20Poors%20report%20for%20Gard%20Group%202010.pdf>)

During the second half of the 19th century a large number of Scandinavian vessels were employed in cross-Atlantic trade, including the United States, where the U.S. Harper Act (1893) imposed a new and more onerous standard for liability concerning loss of and damage to cargo. This increased the local need for liability insurance to protect Scandinavian shipowners who were trading with the US. Impulsed by the developments in the U.S., Skuld was the first Club in the Nordic countries being established in 1897 in Christiania (former name of the city of Oslo). It was followed by Gard in 1907 in Arendal, Southern Norway and by the Swedish Club which had been functioning as a hull insurer, and started underwriting P&I risks in 1910.

The Norwegian clubs used the English rules as a model but they decided not to use an external manager as the English clubs did. During the first years these clubs would only offer insurance to members domiciled in the nordic countries, while at present most of their membership is domiciled outside the Scandinavian countries.<sup>28</sup>

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<sup>28</sup> Christen Guddal, *100 years, Reflections*. CEFOR, Oslo 2010. Pp 119/20.

### **3. The ‘Pay to be Paid’ rule: how it functions in England and in Norway**

#### **3.1. Concept**

Generally, a shipowner is not entitled to be indemnified by his P&I Club until he has fulfilled all his duties as set out in the contractual relationship. This means that the member must be held liable for a claim and must have paid the compensation amount in full before he can seek reimbursement.<sup>29</sup> Such obligation has its origin in a “pay to be paid” clause, which restricts reimbursement to the assured until the latter has been proven liable and has effected payment to the third party claimant.<sup>30</sup> In particular, as is expressly prescribed by the clauses of Skuld and Gard (see 3.2.2. under), the shipowner’s liability must be established, for example by a judgment or an arbitral award, and in addition the member must have paid the claim. If such a contractual obligation is not observed, the Club is not obliged to pay, even though the member has already paid the claim (without a judicial decision ordering payment by the member). When an arbitral award or a final judgment determines the member’s, the Club’s duty to reimburse its member is regularly created. The criteria for this rule is that if the liability of the member is not established, Clubs might end up paying for claims when there are still chances of rejecting the claim, and most importantly, it would be the member himself deciding whether to pay a claim and the compensation amount. This would seriously affect the mutuality principle by which members support losses on an equal basis. The requirement of having liability established places somehow the membership on equal terms as they all need to demonstrate that there are sufficient legal grounds to pay for a claim.

In practice, most of the claims are settled out of court by the Clubs through negotiation led by their claim handlers. This way there is no need to incur lawyer’s fees and precious time is saved when the liability of the member is clear.<sup>31</sup> It is thus seen in practice that the pay to be paid principle is not always strictly applied by the Clubs, but instead it functions

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<sup>29</sup> Merkin Robert and others, “*Maritime Law*”, 2nd Edition, Sweet & Maxwell, 2011. Pp 534.

<sup>30</sup> Bennett Howard, “*The Law of Marine Insurance*”, 2<sup>nd</sup> Edition, Oxford, 2006. Pp 621.

<sup>31</sup> *Idem* 29, p. 535

mostly as a defence mechanism to protect the Club from paying compensation when it does not agree with the amount and/or that the member was actually legally bound to reimburse the claimant.

The essence of P&I cover is insurance against third party liability and it operates as an indemnity insurance, as opposed to a liability insurance. Whereas the risks covered comprise a wide range of third party liabilities, all P&I club rules contain pay to be paid clauses by virtue of which the club's liability is restricted to reimbursing the member in respect of sums paid to third parties in respect of covered liabilities. Payment first by the member is the general rule unless the Club's committee decides otherwise as we may see in all the P&I rules, for example clause 5(1) of the Britannia Rules reads:

*"...unless the Committee in its discretion otherwise determines, it shall be a condition precedent of a Member's right to recover from the funds of the Association in respect of any liability, costs or expenses that the Member shall first have discharged or paid them."<sup>32</sup>*

The Norwegian Clubs also enable their authorities to use their discretionary powers to waive the paid to be paid requirement (see 3.2.2. under).

Summing up, the "Pay to be paid" basis prevents the member (assured) from recovering from the club until he has actually paid the sum that he is legally obliged to pay to the third party who claimed damages.

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<sup>32</sup> Idem supra note 19, p. 484

### 3.2.1 Application by English Clubs

Generally, English P&I clubs will only waive the requisite of prior payment by the member when they have started handling the claim directly from the beginning and decide to arrange a prompt settlement.<sup>33</sup>

The Rules of the North of England P&I Club state that:

*“Rule 20 (1): Unless the Directors in their discretion otherwise decide, it is a condition precedent of a Member’s right to recover from the funds of the Association in respect of any liabilities, costs or expenses that he shall first have discharged or paid the same.”*<sup>34</sup>

This is in line with most of the international IGPANDI Clubs, however North of England inserts an exception to this rule which is not common to many P&I Rules:

*“Rule 20 (2) where a Member has failed to discharge a liability to pay damages or compensation for death, personal injury or illness of a Seaman, the Association shall discharge or pay such claim on the Member’s behalf directly to such Seaman or dependant thereof.”*<sup>35</sup>

Through the insertion of this clause North of England takes a step forward towards the prompt satisfaction of crew claims which are in their essence quite sensitive. Of course the member will be indebted to the Club for the monies paid, but this clearly implies that the crew working for the member will be content and this will have an effect on the performance of the crew.

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<sup>33</sup> Hazelwood Steven, *“P&I Clubs, Law and Practice”*, 2<sup>nd</sup> Edition, Lloyd’s of London Press, 1994.

<sup>34</sup> North of England P&I Club, *“Rules 2011/12”*, Pp 44.

<sup>35</sup> Idem 34

### 3.2.2 Application by Norwegian Clubs

Rule 87 of Gard's Rules contains a "Pay to be paid" rule which reads that:

*"Unless the Association shall in its absolute discretion otherwise determine, it is a condition precedent to a Member's right to recover from the Association in respect of any liability, loss, cost or expense that he shall first have discharged or paid the same."*<sup>36</sup>

Similarly, Skuld's Rules state that:

*28.5.1: "Pay to be paid. Unless the Association shall in its absolute discretion otherwise determine, it shall be a condition precedent of the member's right to claim against the Association that the liabilities, losses, expenses or costs (which are the subject of the claim) have actually been paid or discharged by the member, joint member or co-assured and that, in the event of a liability, the liability has been discharged pursuant to:*

- a) a court order or judgment, other than a default judgment,*
- b) an award, other than a default award, of an arbitration tribunal appointed with the consent of the Association or in accordance with an arbitration agreement entered into before the event giving rise to the claim arose, or*
- c) a settlement approved by the Association."*

That is to say, that it is essential for the member to discharge his liability to the third party claimant if he intends to be indemnified by the Association. Gard rules have the same approach as Skuld (see above section 28.5.1 of the Skuld Rules) to the "pay to be paid" rule as it also mentions that the Association may determine otherwise in its absolute discretion. Gard is then entitled to settle a claim directly with the third party if it considers that this should facilitate matters and reach a prompt solution. This represents a clear advantage for members when their own P&I Rules state that their Club may advance funds in a particular situation.

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<sup>36</sup> Richard Williams, "Gard Guidance to the Statutes and Rules", Gard AS, Oslo, 2008, p. 445

On the other hand, Rule 87 (pay to be paid rule) represents a risk for Gard as well taking into consideration that a Member may try to force the Association to utilize their discretionary powers when cash flow is short and/or just because it may be easier to have the Club dealing with payment directly. A powerful member may use its influence and the size of its entered fleet as leverage to obtain prompt payment of a claim directly to a third party. Interpretation of the term “discretionary” is subjective and opens the door to the possibility for the Club to advance funds in order to make prompt payment of a claim.

Richard Williams stresses on the “*Guidance to the Statutes and Rules*” that “...*the fact that this may occur [compensate a third party directly on behalf of the Member] in individual cases cannot be treated as a general waiver by the Association of the ‘pay to be paid’ principle.*”<sup>37</sup>

Similarly, Skuld P&I Rules say:

*“5.3.1 In exceptional cases, the Board of Directors may cover, in its absolute discretion, all or part of the member's liability which would otherwise be excluded by Rule 5.2.1-5.2.8, Rules 5.2.10-5.2.16 or Rule 5.2.18, provided that the Board is satisfied that the member took all reasonable steps to avoid the event or the circumstances giving rise to such liability.”*

Under Chapter 5-1 of the Contracts Act of 15 April 1687 (“Contracts Act”) Norwegian law grants general freedom of contract. This allows a Norwegian P&I insurer to insert clauses where limitless discretionary faculties are granted and to which it appears the contracting party (shipowner) has no interference. However, clause 36 of the Norwegian Contracts Act 1918 prescribes that said freedom of contract may be restricted when unfair contract terms are inserted in a contract by stating that: “*A contract may be wholly or partially terminated, changed, amended or otherwise adjusted ex ante or ex post, in whole or in part - if the contract in effect is unreasonable - [...]*”. The Courts are thereby authorised to adopt a “discretionary test of reasonableness” in a private law contract, such as a liability insurance contract (P&I). The clause extends not only to the moment of the conclusion of the contract, but also to the “*actual effect estimated at the time when it is being invoked -*

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<sup>37</sup> Idem supra note 36

or even negative consequences occurring after the contract has been performed”<sup>38</sup>. A troublesome scenario would arise where ship-owner “A” discovers, for example, that his P&I club is covering certain claims of ship-owner “B” which are not usually covered under the standard cover and in fact, the Club has denied to cover similar claims to A. This could lead A to feel that he has been put in a disadvantageous position and that the Club has discriminated A without grounds. Consequently, A could then try to request a court to order the Club to cover A’s claims in the same manner as the Club has covered B’s claims on the basis of §36.

§ 36 may also be invoked when it is considered that a choice of law clause is inserted in a contract to avoid application of the law that would otherwise be applicable to the dispute in terms that place one party in a disadvantageous position<sup>39</sup>. That is to say, that if a Norwegian P&I Club signs a contract with a member which is to be governed by the law of a country which turns out to be to the detriment of the member, the latter could eventually invoke §36 before a Norwegian court and seek that said choice of law clause is modified. The choice of law will have to be considered unreasonable in the eyes of the court considering for example that the agreed law and/or jurisdiction has no maritime law expertise, no connection with the parties of the claim, etc.

In the “*Wingull*”<sup>40</sup> case an arbitration tribunal disregarded a guarantee clause by which liability for consequential damages<sup>41</sup> was excluded. The claim arised due to shortcomings of a marine propelling driving belt machinery that replaced a worn-out marine diesel engine. This gear did not work properly and caused long delays to the ship-owner, which would not have been recoverable under the clause excluding consequential damages. Arbitrators applied § 36 to strike out the guarantee clause understanding its terms were

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<sup>38</sup> Kai Krüger, “*Norsk kjøpsrett* [Norwegian Sales Law]”, Bergen, 4<sup>th</sup> ed. 1999. Chapter 26.7

<sup>39</sup> Knut Boye, “The international comparative legal guide to: Commodities and Trade Law 2006”, Simonsen Advokat firma, Global Legal Group, 2006, Chapter 20.

<sup>40</sup> ND 1979. 231 No Voldgift

<sup>41</sup> Consequential damages (also sometimes referred to as indirect or “special” damages), include loss of product and loss of profit or revenue and may be recovered if it is determined such damages were reasonably foreseeable or "within the contemplation of the parties" at the time of contract formation.



unreasonable, together with §1, 2<sup>nd</sup> paragraph in the 1907 Sale of Goods Act (as amended in 1973) which contains a similar wording to § 36.<sup>42</sup>

Following this line of thought, a member could eventually request a court to exclude the discretionary power of the P&I Club wholly or in part, or request that a court obliges a Club to use discretionary powers in a particular situation if the terms of the liability insurance contract are proven to be to the detriment of the shipowner.

Although in reality Norwegian courts have interpreted §36 somehow restrictively, it rests to be seen what their position will be in a claim interposed by a shipowner arguing against the unreasonableness of a discretionary clause against a P&I Club.

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<sup>42</sup> Kai Krüger, “*Norsk kjøpsrett* [Norwegian Sales Law]”, Bergen, 4<sup>th</sup> ed. 1999. Chapter 26.7

## **4. Third party direct action against P&I Clubs**

In this chapter I endeavor to give an account of whether and how a third party claimant may file a claim for compensation against a P&I Club directly, considering as well the rights available to the P&I insurer in each jurisdiction. As explained in chapter 3 above, through the insertion of a "pay to be paid" clause in a liability insurance policy, the assured is prevented from obtaining reimbursement from the P&I Club for payments made to third party claimants until and if: i) he has fully paid the claim to the third party claimant; ii) compensation paid to the third party was determined by court or at arbitration proceedings, or agreed with the P&I Club. This widely used clause represents a major hurdle for third party claimants when trying to claim damages from a shipowner who is in financial difficulties. The P&I Club will use the "pay to be paid" clause as a defence at court to state that there is no obligation to pay to a third party until the member has discharged liability first. Does the third party need to exhaust all instances against his contracting party, namely the shipowner first, or may he direct his action against the P&I Club instead? Is it the same conclusion when the shipowner becomes insolvent? What is the position in each jurisdiction?

Together with the issues discussed in chapter 3, this analysis will hopefully result in a comprehensive comparison of practical matters that P&I consumers face on a daily basis.

### **4.1. Treatment of the third party action under the different legal systems**

#### **4.1.1. International status**

At present there are few international instruments that grant a third party the right to file a direct action against a P&I Club. Among the regulations currently in force in the United Kingdom and in Norway, we find the International Convention on Civil Liability for Oil Pollution Damage 1969 ("CLC Convention"), and the 1971 International Convention on the Establishment of an International Fund for Compensation for Oil Pollution Damage ("Fund Convention"). In 1992 two protocols increased the compensation limits and broadened the scope of the original conventions. In 2000 the limits of the 1992 CLC and of the Fund Convention were increased by over 50% with effect from 1st November 2003. In

May 2003 a Supplementary ('third tier') Fund was established that increases the amount of compensation. This regime is currently in force in the jurisdictions under discussion. The CLC Convention states that:

*"VII - 8. Any claim for compensation for pollution damage may be brought directly against the insurer or other person providing financial security for the owner's liability for pollution damage. [...]"*

The right of direct action under this Convention is general which means that there is no prior requirement that the claimant must comply with before filing a lawsuit against the insurer. In particular, it is not necessary that the assured is declared bankrupt or is somehow insolvent before the injured party can pursue his claim. The Convention requires ships covered by it to maintain insurance or other financial security in sums equivalent to the owner's total liability for one incident. However, only ships carrying more than 2,000 tons of oil are required to maintain insurance in respect of oil pollution damage.

Respectively, the International Convention on Civil Liability for Bunker Oil Pollution Damage 2001 (*"The Bunker Convention"*), ratified by both Norway and the United Kingdom, also grants the right to claim directly against the insurer in Section 7 (10). Additionally, this Convention requires those vessels which are over 1,000 gross tonnage to maintain insurance or other financial security, such as a bank guarantee, to cover the liability of the registered owner for pollution damage in an amount equal to the liability limits under the applicable limitation regime, but in all cases, not exceeding an amount calculated in accordance with the Convention on Limitation of Liability for Maritime Claims, 1976, as amended.<sup>43</sup> P&I Clubs currently play a key role regarding compliance of the Bunker Convention. The legal text demands that the ships registered in a State party to the Convention need to obtain a State certificate from that State. This certificate will be treated as evidence of insurance when calling at any port in any State party. The State certificate will be issued against the provision of a "Blue Card", which is a document issued by a P&I Club in a specific format confirming that insurance is in place according to the Convention requirements<sup>44</sup>. Summing up, the registered owner of a vessel flying the

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<sup>43</sup> See Section 7 (1) of the Convention at <http://www.officialdocuments.gov.uk/document/cm66/6693/6693.pdf>

<sup>44</sup> Skuld, Bunkers Bulletin 2010

flag of these countries, or likely to visit a port in the territorial waters of a country that ratified the Bunker Convention will need a certificate of insurance for civil liability arising from bunker oil pollution damage.<sup>45</sup>

The purpose of these conventions is to guarantee that compensation is easily available to those who suffered oil and/or bunker-oil pollution damage. Bringing a claim against an insurer is more secure than to seek compensation from a shipowner, thus making use of the direct action right puts the damaged party in a privileged position.<sup>46</sup>

Both named Conventions are of special interest to shipowners and P&I Clubs as they represent international instruments that strictly impose the obligation to obtain insurance cover for vessels. IGPANDI Clubs have agreed to provide Blue Cards and to pool liabilities arising under them, including liabilities which would be otherwise excluded. Naturally, P&I Clubs will take all measures to ensure that risks are fully covered under the liability limits of these conventions, and that they have enough reserves to confront this type of claims. In short, P&I Clubs do understand that mentioned Conventions are in force and that non-compliance with the mandatory insurance requirement would have devastating consequences for their members. These are regulations that the Shipping industry has to accept and abide by their rules.

At present each nation decides for itself whether to create a right of direct action because there is no unified international position regarding direct actions against marine insurers (other than the Conventions cited above). This specific right has not been addressed in international conventions so far, thus rights of direct action are generally governed by national law and regulations tend to be different from country to country.

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<http://www.skuld.no/Insight/Bunkers-Bulletin/Obtaining-a-Certificate/>

<sup>45</sup> UK P&I Club, "Club Circular 6/08: Entry into force of the Bunkers Convention – certification requirements and issuance of Blue Cards and State certificates", 01/10/2010

<sup>46</sup> Ling Zhu, "Compulsory insurance and compensation for bunker oil pollution damage", Hamburg Studies on Maritime Affairs, Vol. 5, 2007. P. 172

### 4.1.2 Direct action in England

Following the Third Parties (Rights Against Insurers) Act 1930, English law does initially allow third parties to claim directly compensation from an insurer in the case of a bankrupt insured party. While Section 1(1) of the Act states that it applies to “any contract of insurance” nothing is specifically said about whether the protection and indemnity policy is to be treated as a contract of insurance. Jurisprudence gave a clear answer to this legal gap in the case “*The Allobrogia*”<sup>47</sup> and confirmed the act’s mandatory application to P&I Clubs by deciding that:

*“[...]The 1930 Act contains no definition of a ‘contract of insurance’ but, without purporting finally to decide the point for the purpose of any subsequent proceedings, because I regard this as unnecessary for my present decision, I feel little doubt that, whatever may be the general position of Protecting and Indemnity Clubs, the relevant contracts between this particular association and its members are ‘contracts of insurance’ within ordinary legal terminology and within the meaning of the 1930 Act.”*

Regarding the right of direct action, Section 1(3) of the Act provides that:

*“The third party may bring proceedings to enforce the rights against the insurer without having established the relevant person’s liability; but the third party may not enforce those rights without having established that liability.”*

This means that the bankrupt insured’s liability needs to be established and quantified before the third party’s rights against the insurer arise.<sup>48</sup> The third party is compelled to start proceedings against the assured if he intends to invoke the Act against the P&I Club. The Act operates to transfer to the third party the rights of the assured under the contract in respect of the liability, but not to create new rights or improve existing rights.<sup>49</sup> In “*Farrel v. Federated Employers Insurance*” the court stressed that third parties acquire no better

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<sup>47</sup> *Allobrogia Steamship Corporation (The “Allobrogia”)* [1979] 1 Lloyd’s Rep. 190

<sup>48</sup> Lord Justice Mance, “Insurance disputes”, 2<sup>nd</sup> edition, Hong Kong, 2003. P. 361.

<sup>49</sup> Bennett, Howard, “The Law of Marine Insurance”, 2<sup>nd</sup> edition, Oxford, 2006. P. 617

rights under the Third Parties Act than the insured had against the insurer<sup>50</sup>. However, P&I Clubs tend to be protected from any direct action by a third party by inserting a "pay to be paid" clause in their policies which would release the Club from any payment obligation towards the insured until the latter has fulfilled his obligations against the injured party.

The question now is whether a third party claimant has a direct action against the insurer when the assured becomes insolvent and the insurance contract contains a pay to be paid clause. In principle, it appears that maintaining a strict interpretation of the insurance contract and the paid to be paid rule, would leave the third party with no chance of recovery whatsoever.

The position of the English courts has been to some extent clear as per the leading case "*The Fanti and the Padre Island*"<sup>51</sup>, by which direct actions against the P&I insurer were excluded. Said case involved two appeals with similar facts: cargo owners sued shipowners who later became insolvent. Claimants then attempted to be compensated by the shipowners' P&I Clubs basing their claim on the Third Parties Act 1930. However, the P&I Clubs had "pay to be paid" clauses in their policies so they would only be obliged to pay compensation to the insured (shipowner) once the latter had fully paid the amount claimed by the third party. This argument was accepted by the English Courts.

The House of Lords was of the opinion that the rights of the assured should not be modified in case of insolvency or winding-up of the insurance company as the contractual rights and obligations should not be altered either.<sup>52</sup> Accordingly, Lord Goff of Chieveley said:

*"Following the insolvency of the member [the assured], or a winding-up order, his contractual rights remain the same; there is a contingent right of reimbursement as before, though it is one which the member is, in the new circumstances, less able to exercise."*<sup>53</sup>

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<sup>50</sup> *Farrell v Federated Employers Insurance* [1970] 2 Lloyd's Rep 170.

<sup>51</sup> *Firma C-Trade SA v. Newcastle Protection and Indemnity Association (The Fanti and The Padre Island (No 2)) (The Padre Island)* [1991] 1 AC 1; [1990] 2 Lloyd's Rep 191

<sup>52</sup> Legh-Jones, Nicholas, "*MacGillivray on Insurance Law*", Sweet & Maxwell, Cornwall, 11<sup>th</sup> Edition, 2008. Pp 890.

<sup>53</sup> [1991] 2 A.C. 1 at p.37E.

On 24 March 2010 a new act received the Royal assent: the Third Parties (Rights Against Insurers) Act 2010 which has modified the “*Fanti and the Padre Island*” position to some extent by eliminating the requirement of the first payment by the assured.<sup>54</sup> Thus, according to section 9(5), the third party’s rights “*are not subject to a condition requiring the prior discharge by the insured of the insured’s liability to the third party*”. This section makes “pay to be paid” clauses as an invalid defence for insurers, but subsection (6) introduces a relevant exception by stating that in the case of marine insurance contracts, subsection (5) only applies to cases where the “*liability of the insured is a liability in respect of death or personal injury*”. That is to say that the “pay to be paid” clauses will continue to prevent third party direct actions against a P&I Club with the exception of cases dealing with death or personal injury.<sup>55</sup> By the introduction of said exception the English legislators made a clear statement towards the protection of the English P&I Clubs.

#### **4.1.3 Direct action in Norway**

In Norway, it was not until 1954 that the Supreme Court solved the issue concerning the application of the Insurance Contracts Act (1930) to third party actions against insurers in the leading case: “*The Skogholm*”<sup>56</sup>. The provisions of the 1930 Act were in principle non-mandatory though some of the provisions in Chapters I and II were mandatory and explicit wording was introduced to that effect. Subchapter E dealt with liability insurance but nothing was explicitly stated as to the right of direct action being mandatory in cases where the assured got bankrupt. In *Skogholm* the Court decided that subchapter E applied mandatorily enabling third parties to file a claim against an insurer when the insured is insolvent.<sup>57</sup>

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<sup>54</sup> Ulfbeck, Vibe. “*Direct actions against the insurer in a maritime setting: the European perspective*”, *Lloyd’s Maritime and Commercial Law Quarterly*, 20 May 2011.

<sup>55</sup> Tony Thomas, “*The Third Parties (Rights Against Insurers) Act 2010*”, Thomas & Co., Legal & Marine Consultants, Surrey, April 2010. ([http://www.thomasmarinelaw.com/articles/the-third-parties\\_rights-against-insurers\\_act-2010.html](http://www.thomasmarinelaw.com/articles/the-third-parties_rights-against-insurers_act-2010.html))

<sup>56</sup> ND 1954.445 (NH) (Rt. 1954, 1002)

<sup>57</sup> Bull, Hans Jacob, “*Insurance law and Marine insurance: The unequal twins*”, Stockholm Institute for Scandinavian law, 2010. Pp 13

In short, the cargo vessel "Skogholm" sank on its way from Bergen to England in 1949. The vessel had technical problems before leaving the port of Bergen which implies that she was unseaworthy. Cargo owners were reimbursed by the cargo insurer, who in turn intended to obtain compensation from the vessel owner. As the shipowner had gone bankrupt, the cargo insurer filed a claim against the P&I Club (Skuld) based on the Insurance Contracts Act 1930. Even though the insurance contract contained a "pay to be paid" clause, this clause was declared non-applicable by the Supreme Court who affirmed that the Subchapter E of the Act was mandatory, thus granting the third parties rights to claim directly against the insurer.

At present, the right to sue directly an insurer under Norwegian law arises by Sections 7(6) and 7(8) of the Insurance Contracts Act of June 16, 1989 (ICA). Since the Act entered into force on July 1, 1990 it implied a meaningful change in the law by granting third parties a right of direct action against liability insurers as a general rule.

The general principle is that the ICA is mandatory law, but the parties to a marine insurance contract relating to a ship or a structure are free to contract out of the provisions of the ICA.<sup>58</sup> Moreover, the ICA allows to contract out of direct action provisions in section 7 (6) last paragraph by stating:

*"[...] The provisions of this section shall not preclude a person who does business with the Assured waiving the right to claim compensation for a business loss directly from the Insurer [...]"*

This freedom of contract is utilized by P&I clubs by inserting "pay-to-be-paid" clauses, non-Norwegian exclusive choice of law provisions whereby any legal disputes are to be submitted to a foreign court or arbitration tribunal, and/or clauses stating that the act shall not apply.<sup>59</sup> The validity of a paid to be paid clause and the possibility that a third party sues an insurer directly are closely connected and make Clubs adapt their rules in order to avoid their consequences.

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<sup>58</sup> 1989 Insurance Contracts Act, Sect. 1-3.

<sup>59</sup> Trond Eilertsen, Law Allows Direct Action to be Taken Against P&I Clubs, International Law Office, June 26, 2002. (<http://www.internationallawoffice.com/newsletters/Detail.aspx?g=a7797c1d-e039-4ecd-9ea3-98a902e5466d>)



A different scenario emerges when the assured becomes insolvent because the ICA grants the third party the right to exercise a direct action against the insurer as per section 7 (8) 2nd paragraph. Said section is mandatory and its provisions cannot be contracted out of to the detriment of the injured party. The third party's right is unequivocal and there is no discussion at Courts as to its validity. The ICA also provides that the insurer will be prevented from raising objections to the claim filed by the third party on the grounds of acts or omissions incurred by the insured after the event that originated the claim occurred. Moreover, any defences the assured could have opposed will be available to the insurer, as well as all the defences granted by the insurance policy.

The relevant consequence is that any "pay to be paid" rule previously agreed in the P&I insurance policy will be of no effect when the assured becomes insolvent.<sup>60</sup>

Where the assured is insolvent, Norwegian law enables the damaged third party to claim directly from the insurer as opposed to the current English legislation. Shipowners may appreciate that their clients will have a secure right to recover from the P&I Club any pending liabilities in case they (the members) become insolvent. This might be used by Shipowners as a valuable marketing tool when having difficulties gaining the trust of their customers who fear an economical debacle. Particularly, in times of global financial crisis and the ongoing risk of companies becoming insolvent. Those contracting with a shipowner insured by a Norwegian P&I Club have the tranquility that they will have a financially strong P&I Club who may be held liable in case the shipowner becomes insolvent.

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<sup>60</sup> Bull, Hans Jacob, "Insurance law and Marine insurance: The unequal twins", Stockholm Institute for Scandinavian law, 2010. Pp 33.

## 4.1.4 A look overseas: what happens in the Americas?

### 4.1.4.1 Direct action in the US

In the United States there are 50 states and several territories, and each jurisdiction can choose independently whether to create a right of direct action or not.<sup>61</sup> Consequently, the discussion about direct actions varies significantly while existing different laws and court interpretations in every jurisdiction. Furthermore, even when a direct action is viable the claimant will discuss if action should be filed before a state court or a federal court. In principle Maritime Law cases (called "Admiralty Law" in the US) are to be brought before federal courts, while disputes arising out of private contracts are to be brought before a state court, though this distinction is not easy to make when treating a claim against a marine insurer. Due to federalism established in the United States, both each of the state governments and the federal government have their own court systems<sup>62</sup>. This distinction is of significance because on the one side, State courts do not depend on the federal court system and apply their own choice of law<sup>63</sup> rules; while on the other hand, a federal court may apply either its own rules or choice of law rules of the forum state in a maritime direct action. As a consequence there is no unanimous criteria regarding the rights of third parties against insurers, and positions vary from State to State, and from State to Federal courts.

Marine insurance contracts are considered in the US as "*maritime contracts*".<sup>64</sup> However, there is no federal statute that creates a direct action against marine insurers: "*Maritime common law confers no general right to sue an insurance company directly, nor does it*

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<sup>61</sup> Sharpe, David, "*Jurisdiction and choice of law in direct action against US insurers*"; The Journal of International Maritime Law, Vol 17, 2011. Pp 41.

<sup>62</sup> United States Courts, "Comparing federal and state courts", (<http://www.uscourts.gov/EducationalResources/FederalCourtBasics/CourtStructure/ComparingFederalAndStateCourts.aspx>)

<sup>63</sup> Choice of law concerns the area of law in which the court where an action is filed decides whether to apply the law applicable in that Court (forum state law) or to apply the law applicable in another jurisdiction which has an interest in the controversy.

<sup>64</sup> *Wilburn Boat Co. v. Fireman's Fund Insurance Co.* [1995] 348 U.S. 310, 313: "*Since the insurance policy here sued on is a maritime contract, the Admiralty clause of the Constitution brings it within federal jurisdiction*"

*contain any specific bar against such an action*".<sup>65</sup> Each state has the liberty to enact rights of direct action against marine insurers as long as *"the state action is not in conflict with any feature of substantive admiralty law or any remedy peculiar to admiralty jurisdiction"*.<sup>66</sup>

Given the fact that state and federal courts in the United States have concurrent jurisdiction over marine insurance matters, and that direct actions are created by state law and not by federal law, analyzing the choice of law is far from easy. Leaving aside the discussion about which court is to treat a certain dispute, a state court will always apply the law of the state in question *"if the state law does not displace well-established federal law"*.<sup>67</sup> Consequently, when state law entitles a third party to act against an insurer directly the lawsuit will move forward provided that: i) said action is filed according to the requirements of such state law; and ii) the terms of the state law are do not contrast with federal law.<sup>68</sup>

Louisiana is known for being the state with a very straightforward direct action act. The Louisiana Direct Action Statute, R.S. 22:1269, grants a third party claimant a right of direct action against an insurer provided that the insurance contract was issued or delivered in Louisiana or if the accident or injury that originated the claim occurred in Louisiana. The action may be brought against the insurer alone when:

- "a) the insurer has been adjudged a bankrupt by a court of competent jurisdiction or when proceedings to adjudge an insured a bankrupt have been commenced before a court of competent jurisdiction;*
- b) the insured is insolvent; [...]"*

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<sup>65</sup> *Steelmet, Inc. v. Caribe Towing Corp.* [11<sup>th</sup> Cir. 1986] 779 F.2d 1485, 1487

<sup>66</sup> *Cushing v. Maryland Cas. Co.*, [5<sup>th</sup> Cir. 1952] 198 F.2d 536, 539.

<sup>67</sup> *Farmers Home Mutual Ins. Co v. Insurance Co of N. Am.* [Wash. Ct. App. 1979] 583.

<sup>68</sup> David Sharpe, *"Jurisdiction and choice of law in direct action against U.S. insurers"*, *The Journal of International Maritime Law*, Vol. 17, Issue 1, Pp 49. January-February 2011

#### 4.1.4.2 Status in the author's jurisdiction: Argentina

The choice of using England and Norway as the basis for the present analysis was made in the belief that these nations represent the most experienced and knowledgeable jurisdictions in maritime law and marine insurance law matters. Nevertheless, I believe that it is worth adding a comment on the situation in my home country in order to reflect that the legal thinking of the major maritime nations has been spread to other far away nations like Argentina.

In Argentina, while the liability insurance legislation in force (Resolution SSN N° 18.077/84) remains silent concerning the rights of a third party to sue an insurer directly, the National Chamber of Appeals in Federal Commercial and Civil Disputes has set a criteria in the decision issued in "*Compañía de Seguros La Franco Argentina, S.A. c. Cap. y/o Arm. y/o Prop. Bq. Catamarca II*"<sup>69</sup> ("*La Franco Argentina*"). This is a so-called "*fallo plenario*" (joint decision) which means that all the Courts of Appeals were gathered to issue a common decision regarding a legal issue which has been thoroughly discussed in previous conflicting decisions. This type of decision has to be followed by the courts belonging to that chamber of appeals and the lower courts.

In "*La Franco Argentina*" the Court agreed that a third party claimant has the right to file a direct action against a P&I Club when the insured member has become insolvent. The insured shipowner was a member of Gard P&I Club therefore their clauses were analyzed in the light of local law and jurisprudence as well as the English law leading cases "*The Fanti*" and "*Padre Island*".

The court acknowledged that the pay to be paid rule is one of the key elements of P&I insurance that distinguishes P&I from the provisions regarding civil liability that form the local insurance scheme. In Argentina, the insurer is obliged to provide the necessary funds to the assured to cover the claim, while under P&I insurance the right to obtain reimbursement arises only once the insured has paid the for the claim in full. However, the court considered that a strict application of the pay to be paid rule in cases where the insured becomes insolvent would not make sense. The court reasoned as follows: if the insured is unable to make payment to the third party and the insurer will not pay either

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<sup>69</sup> Camara Nacional de Apelaciones en lo Civil y Comercial Federal, causa 12.383/94 (Fallo Plenario).

until the insured has paid first under the pay to be paid contractual clause, this will only result in exempting the P&I insurer from payment due to an unexpected situation which is strange to the insured risk.

Additionally, the Court agreed that even though P&I Clubs are non-profit mutual organizations they are also destined to be complied with the same economical function that insurance companies have.

## 5. Letters of Indemnity (LOIs)

This final chapter is dedicated to provide an account of two different types of letters of indemnity<sup>70</sup> most commonly used in Shipping, and with which the P&I Clubs have a direct involvement. P&I provisions granting the Club discretionary powers play also an important role in relation to coverage for claims when a LOI is involved. As we have seen, Clubs may decide discretionarily whether to follow strictly the pay to be paid rule or to advance funds before liability is determined by a court and make direct payment to a third party claimant. Similarly, Clubs have the power to choose under their own discretion whether to cover a claim that arises out of the delivery of cargo without the presentation of a bill of lading which would otherwise be excluded under the rules.

Through the comparison of the approach of the Clubs to this industry practice and the legislation in the respective countries I intend to point to the reader how and if choosing a Club based in a different jurisdiction may bring different results.

### 5.1. Club Letters of Indemnity

One exception to the “pay to be paid” rule was discussed in Chapter 4: the direct action against a P&I Club when the member becomes insolvent. Another exception to the “*pay to be paid rule*” is found when a Club discretionarily decides whether to protect the Member directly against a third party arises when the Member is in desperate need of some sort of letter of guarantee or undertaking. This may occur when a vessel is arrested in a remote country where the member has no agent or trusted contacts, and the P&I Club is the best alternative to obtain the release of the vessel. The third party claimant requesting the arrest order may have a valid liability claim against the shipowner (member) and the Club may decide to offer security by the issuance of a letter of guarantee despite the fact that the claim has not yet been discharged by the member. Although this letters are not usually officially recognized in procedural legislation, they are “*tacitly recognised by virtue of coming within the wide phrase “sufficient bail or other security” as used in a number of international maritime conventions.*”<sup>71</sup> This form of guarantee is widely accepted in most

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<sup>70</sup> A LOI is a letter one party issues to another party agreeing to protect him from any liability arising out of the performance and/or non-performance of certain acts.

<sup>71</sup> Steven J. Hazelwood, P. & I Clubs Law and Practice, 4th Edition, 2010. Chapter 14.3

maritime nations and are increasingly replacing bank guarantees in those jurisdictions where only these were accepted by the local courts.<sup>72</sup>

A Club would normally issue a bank letter of guarantee, as the case may be under local requisites, though a mayor problem arises if the Member is owing prime payment to the Club. Most P&I Rules insert a clause stating that the Club will incur no liability if the Member has not fully paid its calls.<sup>73</sup>

Here, the Club will have to analyze whether or not to cover its Member's risk even though the Member has not fulfilled its contractual obligations on a timely manner. Gard's Rule 88 states that even though the Association has no obligation *"to provide any guarantee, certificate, bail or other security or undertaking for or on behalf of a Member, or to pay the costs of such provision"*. It goes on to say that: *"The Association may at its discretion provide security or pay the cost of such provision in relation to liabilities within the scope of a Member's cover, and may recover any costs incurred thereby from the Member."*

Other Club Rules add a provision by which the Club is entitled to provide a security on behalf of the Member only in exchange of an undertaking given by the member. In said undertaking the member is committed to pay immediately any liability incurred by the Club in respect of the security provided.<sup>74</sup> That is to say, that the Club is strongly interested in securing that payment will be made by the member himself if the Club incurs expenses and/or is obliged to pay under the terms of the security following the order of the local authorities. We can appreciate here that the Club is only slightly departing from the "pay to be paid" rule, as eventhough it accepts by the issuance of a security that it may have to make a payment on behalf of his member, it secures that no such payment is made without the member's commitment to reimburse the insurer immediately.

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<sup>72</sup> idem supra note 71

<sup>73</sup> Steven J. Hazelwood, P. & I Clubs Law and Practice, 4th Edition, 2010. Chapter 14.54

<sup>74</sup> idem supra note 73, Chapter 14.52

## 5.2. LOIs issued by the person taking delivery of cargo

Any claim arising out of the delivery of cargo without the presentation of an original bill of lading<sup>75</sup> is not covered by neither the English nor the Scandinavian P&I Club rules. However, P&I clubs use their discretionary powers when related claims arise and may opt to cover a claim over cargo delivered without the production of an original bill of lading. The problem arises because under the legal regimes governing in both jurisdictions it is only the legitimate holder of an original bill of lading the person entitled to take delivery of the cargo<sup>76</sup>. Norway and the United Kingdom have ratified the Hague Visby Rules. Section 3 (3) this Convention states that the carrier must issue a bill of lading properly describing the goods, while Section 3 (8) prohibits any agreement whereby the responsibilities of the carrier are reduced and therefore a letter of indemnity would be “null and void and of no effect”.<sup>77</sup> This means that under the Hague-Visby Rules the carrier is allowed to increase his obligations freely though it is forbidden to contract under the standards set by the Rules. Agreeing on lower levels of responsibility will only make said terms invalid.

Thus, if a third party takes delivery without the corresponding document (as Hague-Visby demands), the carrier is at risk that the legitimate holder will file a claim for non delivery of the cargo and claim for the full value of the goods and damages. The approach each of

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<sup>75</sup> Bill of lading is defined in the Norwegian Maritime Code Sect. 292: By a bill of lading is meant a document:

1) which evidences a contract of carriage by sea and that the carrier<sup>1</sup> has received or loaded the goods, and

2) which is designated by the term bill of lading or contains a clause to the effect that the carrier undertakes to deliver the goods in exchange for the return of the document only.

A bill of lading may be made out to a named person, to a named person or order, or to bearer. A bill of lading made out to a named person is regarded as an order bill of lading unless it contains a reservation in such terms as “not to order” or similar.

A bill of lading governs the conditions for carriage and delivery of the goods in the relation between the carrier<sup>1</sup> and a holder of the bill of lading other than the sender. Provisions in the contract of carriage which are not included in the bill of lading cannot be invoked against such a holder unless the bill of lading includes a reference to them.

<sup>76</sup> Section 302 NMC: “The person who presents a bill of lading and, through its wording or, in the case of an order bill, through a continuous chain of endorsements or through an endorsement in blank, appears as the rightful holder, is prima facie regarded as entitled to take delivery of the goods. [...]”

<sup>77</sup> Prof. William Tetley, Q.C., *Letters of indemnity at shipment and letters of guarantee at discharge*, ETL 287-344, 2004. Pp 11.



the Clubs has towards this issue may play an important role for carriers who may be forced by commercial pressure to accept letters of indemnity issued by their clients in exchange for delivering cargo without surrendering an original bill of lading. This is another aspect that I believe the reader may find interesting when utilizing this text to the effect of comparing P&I Clubs from a non-financial perspective, in conjunction with the two other features analyzed in Sections 3 and 4 above. As already mentioned, the Clubs may use their discretion to cover these liabilities.

Delivery without presentation of the corresponding document may result in onerous claims against the carrier who delivers the goods. That is to say, that if the carrier delivers goods to someone who is not entitled to take delivery, then the actual receiver who holds an original bill of lading will have a strong claim against the carrier for non-delivery.

Delivery without presentation of the original bill of lading occurs daily in many jurisdictions for various reasons, time constraints, documents which have not arrived and ultimately: commercial pressure effected on the Master of the carrying vessel. This brings no problems if the person taking delivery without the bill of lading is the right consignee to whom the shipper intended to deliver the cargo. However, P&I Clubs tend to have quite strict regulations in order to prevent delivering goods to the wrong person.<sup>78</sup> The P&I rules in general do not put weight on the good intent or the misconduct of the Member in cases of misdelivery, as in many occasions the Master may believe in good faith that the receiver is entitled to the goods eventhough it may turn out to be a forged bill of lading. Furthermore, charterers may request ship-owners to agree clauses in charterparties which provide for the delivery of cargo without presentation of original bills of lading and/or at ports other than those stated in the document of transport against letters of indemnity. Members are strongly advised not to accept such clauses and it is recommended that Members seek advice from the Managers before responding to such requests. Therefore, Clubs try to keep away from this common practice and avoid leaving a door open to numerous claims from deceived receivers.

In practice, when an alleged cargo owner intends to take delivery of cargo without presentation of an original bill of lading, he must either: i) apply for a judicial

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<sup>78</sup> Hazelwood, Steven J., *"P&I Clubs Law and Practice"*, 4<sup>th</sup> Edition, 2010. Chapter 10.95

authorization; ii) provide the carrier with sufficient security according to the carrier's requirements, though the carrier is by no means obliged to accept delivery in exchange for security mainly because the law does not force the carrier to do so, and because obtaining security does not mean that claims will be avoided.<sup>79</sup> It will be a commercial decision whether to accept security from the cargo interests or not. The carrier has no reason to deliver the cargo to someone who is not able to surrender original bills of lading and moreover due to the fact that he would be at risk of losing P&I cover regarding any claims related to said cargo. In view of the current trend that quite often receivers intend to take delivery without presentation of a bill of lading and the Master of the vessel receives pressure to release cargo promptly, the IGPANDI prepared a set of recommended wordings for the so-called "letters of indemnity". Letters of indemnity are widely used in Shipping, and in the analyzed situations they are issued by the party intending to take delivery of cargo without presentation of the original bill of lading. Instead of a bank guarantee or other type of security, these letters are used as a guarantee for the carrier when delivering cargo under said circumstances. For the sake of clarity: the letter is issued by the receiver (alleging a right to take delivery) at the port of delivery. However, the IGPANDI recommends that these letters have the support of a reputed bank as well. The IGPANDI has issued recommended wording of letters of indemnity to be given in return for:

- (A) Delivery of cargo without production of the original bill of lading.
- (B) Delivery of cargo at a port other than that stated in the bill of lading.
- (C) Delivery of cargo at a port other than that stated in the bill of lading and without production of the original bill of lading.

P&I Club rules may enable a Club to cover liabilities arising out of misdelivery of cargo on a case to case basis under an "omnibus clause" which permits the insurer to cover liability not usually covered under the standard cover "in its absolute discretion"<sup>80</sup>. Such cover is granted by the Club's discretion and "*members should not rely upon this leniency as being regularly exercised*"<sup>81</sup>. Here again, a shipowner might find that the terms of the

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<sup>79</sup> "*Motis Exports Ltd. -v- Dampshibsselskabet af 1912*" [1999] Lloyd's Law Reports [2000] Vol 1, page 211.

<sup>80</sup> Falkanger, Bull & Brautaset, "Scandinavian Maritime Law", 2<sup>nd</sup> edition, Oslo 2008. Pp 534

<sup>81</sup> Hazelwood, Steven J., "*P&I Clubs Law and Practice*", 4<sup>th</sup> Edition, 2010. Chapter 10.94

insurance contract providing absolute discretion to the Club are unreasonable and put them in a position of disadvantage, and base a claim on the provisions of clause 36 of the Norwegian Contracts Act 1918 (see 3.2.2. above).

### **5.2.1. England: Court's position and P&I Rules**

To understand the position in England towards concerning delivery of cargo without presentation of an original bill of lading, we must refer to the leading case "Sze Hai Tong Bank v. Rambler Cycle Co." [1959] A.C. 576; [1959] 2 Lloyd's Rep. 114 (P.C.). In this case, the plaintiff had shipped from England to Singapore evidenced by a bill of lading which required the goods to be delivered "unto order of his or their assigns", and which also added that the responsibility of the carrier would cease after discharge of the goods. After discharge, the carrier's agent in Singapore released the cargo to the consignee against a letter of indemnity signed by the consignee as the latter did not surrender the bill of lading. The consignee did not pay for the cargo, and the shipper filed a claim against the carrier for damages for breach of contract. The Court sustained that a shipowner who delivers without production of the original bill of lading does so at his own risk. As Lord Denning said:

*"It is perfectly clear law that a shipowner who delivers without production of the bill of lading does so at his peril. The contract is to deliver, on production of the bill of lading, to the person entitled under the bill of lading...The shipping company did not deliver the goods to any such person. They are therefore liable for breach of contract unless there is some term in the bill of lading protecting them. And they delivered the goods, without production of the bill of lading, to a person who was not entitled to receive them. They are therefore liable in conversion unless likewise so protected."*

The Court stated that a carrier has the obligation to deliver goods in exchange of delivery of original bills of lading, failing which any misdelivery will be at the carrier's own risk and peril. Attempting to escape the carrier's liability by inserting clauses in cases of misdelivery of cargo without the presentation of an original bill of lading is considered invalid. Otherwise, the commercial value of the most used document that evidences

maritime international transport would be undermined and this could impulse fraud in overseas trading.

The English courts maintained their strict position (only accepting original bills of lading) in "Kuwait Petroleum Corp. v. I. & D. Oil Carriers Ltd., (*The Houda*)"<sup>82</sup> in which the carrier delivered cargo against presentation of forged bills of lading. The Master was unaware of the forgery and was deceived involuntarily. However, the Court of Appeals held the carrier liable by stating that goods are to be delivered only against presentation of the bills of lading, while acting to the contrary would deprive them of all legal protection granted under the bill of lading and applicable laws.

In the case of the UK P&I Club, Rule 2, Section 17 c, ii states that the delivery of cargo without production of a bill of lading prejudices the Member's cover. There is a possibility that a claim for liabilities arising out of such misdelivery might be covered by the Club but this would only be at Directors' discretion.

Similarly, North of England P&I Club prescribes that:

*"Rule 19-17 (D) unless the Directors in the exercise of their discretion shall otherwise determine no claim on the Association shall be allowed in respect of a Member's liability arising out of:*

*[...](iii) delivery of cargo carried under a negotiable bill of lading or similar document of title without production of that bill of lading or document by the person to whom delivery is made;"*

### **5.2.2. Norway: P&I Rules and legal status**

The Norwegian Maritime Code 1994 (as amended in 2010), Section 304 prescribes that the consignee can only receive the goods "*if he or she deposits the bill of lading and issues receipts as and when the goods are delivered[...]*". Accordingly, if the carrier delivers the goods without the production of the original bill of lading, the carrier will be liable in case the rightful holder of the bill of lading appears and demands delivery of the goods. Additionally, Norwegian law places responsibility on the carrier for the period while the goods are in his custody and until he has delivered the goods to the receiver, or when the

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<sup>82</sup> [1994] 2 Lloyd's Rep. 541

goods have been delivered to a third party or authority following the laws or regulations of the port of discharge<sup>83</sup>. If cargo is not delivered under these circumstances (by delivering without a bill of lading to a third party against a letter of indemnity), the carrier will be breaching the law and the bill of lading terms. The NMC grants no defences to the carrier in such a case.

The carrier will have to try to enforce the letter of indemnity against the person who issued it and took delivery of the cargo. Note that Defence cover under P&I insurance does not cover the legal fees incurred in pursuing this recovery action.

The standard Rules of Gard P&I Club prescribe that:

*Rule 34: [...] provided that unless and to the extent that the Association in its discretion shall otherwise decide, the cover under this Rule (Cargo liability) does not include: i) liabilities, costs and expenses arising out of delivery of cargo under a negotiable bill of lading without production of the bill of lading by the person to whom delivery is made...*

To assist its members with this difficult issue, Gard P&I Club offers extra protection under their “*Comprehensive Carrier’s Liability Cover*” against liability arising out of the delivery of goods without production of negotiable bills of lading or other documents subject to certain conditions. For example, The Club will cover a misdelivery claim placed by the genuine holder of a bill of lading against the carrier (Member) who delivered the goods upon presentation of forged documents (on the premise that the Member understood that the bill of lading presented was original). However, the carrier must have obtained an indemnity from the person who took delivery of the cargo in the standard form of undertaking as set out by the Club, and such indemnity must have failed (eg. guarantor under LOI being insolvent).<sup>84</sup> This means that before delivering cargo without production of a bill of lading, the carrier must have requested an undertaking by the person taking delivery on the terms recommended by Gard. Once the holder of the bill of lading files a claim against the carrier/Member, the latter must try to obtain payment by the issuer of the letter of indemnity, and only if such pursuit is unsuccessful, Gard will cover the claim.

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<sup>83</sup> See Section 274, Norwegian Maritime Code 1994 (version 2010)

<sup>84</sup> “*Gard additional covers Terms and Conditions 2011*”, *Comprehensive Carrier’s Liability Cover*, Section 17, 5)

Gard's extra cover will also cover claims when the member is required by law to deliver or relinquish custody or control of the cargo without production of the bill of lading, and those claims arising when delivery of cargo is made against a forged version of the bill of lading

All Club members can seek for cover for an agreed extra premium. The cover is governed by Norwegian law and any disputes between the Assured and the Club is to be resolved by arbitration in Oslo.<sup>85</sup>

### **5.2.3. A probable solution: the electronic bill of lading**

The late or non arrival of a paper bill of lading problematic consequences can be avoided by the implementation of electronic bills of lading. This may as well eliminate the question as to whether a P&I Club offers cover or not when an original bill of lading is not presented, thus reducing their discretionary faculties. All in all, clearer P&I rules and a safer trading practice. Shipping has evolved dramatically thanks to the massive use of the Internet and many services are offered on-line including booking and cargo tracking. This speeds up trading and modern Shipping companies are normally equipped with all the necessary IT applications and devices to deal with on-line work.

BIMCO<sup>86</sup> has recently published that in January 2010 the first electronic bill of lading was issued by a private company and it was used to cover a shipment from the Ineos Finnart Terminal to BP's terminal in Belfast. BIMCO comments that the new cargo systems *"provides a simple and secure web-based interface with a central "registry" where key documents such as bills of lading are stored under rigorous security."* BIMCO is aware of further testing taking place throughout 2011 with liner and dry bulk Shipping.<sup>87</sup>

In July 2011 a company named Bolero (an independent payments platform provider)

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<sup>85</sup> *"Gard additional covers Terms and Conditions 2011"*, Gard AS, November 2009. Page 14/15. (<http://www.gard.no/ikbViewer/Content/10363345/Gard%20terms%20and%20conditions%20for%20additional%20covers%202011.pdf>)

<sup>86</sup> Baltic and International Maritime Council (BIMCO)

<sup>87</sup> BIMCO's website, *"Update on Electronic Bills of Lading Solution"*, 03.05.10. ([https://www.bimco.org/en/News/2010/05/03\\_Electronic\\_BLs.aspx](https://www.bimco.org/en/News/2010/05/03_Electronic_BLs.aspx))

announced the successful completion of a live pilot program to perform fully electronic presentation of documents under a Letter of Credit which also included an electronic Bill of Lading.<sup>88</sup> Cyber trading has arrived and P&I Clubs have to offer adequate and innovative solutions to their members in order to adapt to the current commercial trends.

When the abovementioned company, Bolero, launched its first initiatives towards electronic bills of lading at the end of the 1990s, carriers started to consider up to what extent their P&I cover would suffice to cover liabilities arising from the use of electronic systems. Consequently, in 1998 the IGPANDI coordinated a response from Group Clubs and a “Paperless Trading Endorsement” was introduced for the 1999 policy year in order to exclude from normal cover any liabilities which would not have arisen under traditional paper bills, such as claims against the carrier arising out of the delivery of cargo to an illegitimate receiver without presentation of a paper bill of lading. Consequently, Clubs were only able to provide cover for those liabilities which would have arisen on the basis of conventional paper documentation. Clubs were reluctant to cover risks that were not inherent to the Shipping industry, and they considered this technological leap something belonging to the computer sciences.<sup>89</sup>

At the same time, the IGPANDI agreed on offering extra insurance for any Members using electronic systems such as Bolero or ESS. Availability of this cover depended on the timely notice given to the Club managers.<sup>90</sup>

Fortunately, in September 2010 the IGPANDI agreed that standard P&I cover would be available to cover liabilities arising in respect of the carriage of cargo under electronic/paperless systems from 20 February 2010 (provided that the system had first been approved by the IGPANDI). In this connection, we may appreciate that Rule 63 1 (j) of Gard’s Rules states that:

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<sup>88</sup> “*Bolero leads with the World’s first Electronic Bill of Lading*”, Trade & Finance Magazine, July 26, 2011. (<http://www.tradefinancemagazine.com/Article/2874116/Bolero-leads-with-first-electronic-Bill-Of-Lading.html>)

<sup>89</sup> Gaskell, Nicholas, “*Bills of lading in an electronic age*”, Lloyd’s Maritime and Commercial Law Quarterly, Part II, 2010. Pp 264.

<sup>90</sup> UK P&I Club, Circular 9/07 (August 2007) “*Paperless Trading - Electronic Shipping Solutions*”. (<http://www.ukpandi.com/publications/article/circular-9-07-august-2007-paperless-trading-electronic-shipping-solutions-1953/>)

*“The Association shall not cover under a P&I entry [...] : j) liabilities, losses, costs and expenses arising from the use of any electronic trading system, other than an electronic trading system approved in writing by the Association,[...].”*

As a cautious measure the IGPANDI added in its circular that:

*“Members should also be aware that participation in an electronic trading system may expose them to certain liabilities which are not of a traditional P&I nature. These may arise through shipowners or charterers [...] being required to be party to particular contractual arrangements under which they assume obligations necessary for the system to operate. [...] Members should be aware that, in so far as such risks are not of a traditional P&I nature, other insurance arrangements may be required.”<sup>91</sup>*

#### **5.2.3.1. English law impediments**

Under English Law, liabilities and derivative rights under contracts of carriage are governed by the Carriage of Goods by Sea Act 1992 (“COGSA 1992”), the same applies in conjunction with the Carriage of Goods by Sea Act 1971 (“COGSA 1971”) under which the Hague-Visby Rules apply automatically to certain carriage contracts. COGSA 1992 applies to various transport documents, including bills of lading. Title to sue under COGSA1992 *“is not linked to property in the cargo but is vested in the lawful holder of or consignee mentioned in the transport document, without the need of establishing that such holder or consignee is the owner of the cargo represented by the document”*. Therefore, it is through the physical transfer of a bill of lading that a new holder obtains the right to sue the carrier under the contract of carriage terms. The problem in England is that this Act is not applicable for electronic bills of lading.<sup>92</sup>

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<sup>91</sup> International Group Circular: “Electronic (paperless) trading systems”, September 08, 2010. (<http://www.skuld.com/templates/newspage.aspx?id=3165>)

<sup>92</sup> Goldby, Miriam, “Legislating to facilitate the use of electronic transferable records: A case study”, paper prepared for the UNCITRAL Colloquium on Electronic Commerce New York 14th to 16th February 2011. ([http://www.uncitral.org/pdf/english/colloquia/EC/Legislating\\_to\\_facilitate\\_the\\_use\\_of\\_electronic\\_transferable\\_records\\_-\\_a\\_case\\_study\\_.pdf](http://www.uncitral.org/pdf/english/colloquia/EC/Legislating_to_facilitate_the_use_of_electronic_transferable_records_-_a_case_study_.pdf))



Back in 2007 the UK P&I Club evidently thought introducing Electronic bills of lading was a right decision and they stated publicly that “...until computer systems are widely recognised, the shipowner, and Master, will still face the headache of what to do when a ship arrives at the discharge port and bills of lading have not arrived, or are not presented.”<sup>93</sup>

Now all the IGPANDI Clubs in the England offer cover for paperless trading, however the problem arises at Court where no decisions have been made as to the validity of Electronic bills of lading.

#### 5.2.3.2. Reception in Norway

The Norwegian Maritime Code (NMC) has not yet introduced amendments to grant efficacy to the use of Electronic bills of lading, probably due to the fact that it follows the Hague-Visby Rules<sup>94</sup>, and said Rules do not contemplate the usage of Electronic bills of lading. Section 294 of the NMC provides that:

*“The shipper’s right to a bill of lading: When the carrier has received the goods, the carrier shall at the request of the shipper issue a received for shipment bill of lading.*

*When the goods have been loaded, the shipper can demand a shipped bill of lading. If a received for shipment bill of lading was issued, it shall be returned when the shipped bill of lading is issued. [...]”*

This section states that the shipper has a right to request a bill of lading and the carrier the obligation to issue one, and nothing is said about paperless versions of the document of transport. Therefore, the current legal framework in Norway needs modernization in order to protect this type of trading.

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<sup>93</sup> Bill Kirrane, “Letters of indemnity”, UK P&I Club. (<http://www.ukpandi.com/knowledge-developments/article/letters-of-indemnity-1161/>)

<sup>94</sup> The Hague-Visby Rules are a set of international rules for the international carriage of goods by sea. The official title is "International Convention for the Unification of Certain Rules of Law relating to Bills of Lading" and was drafted in Brussels in 1924. After being amended in 1968, the Rules became known as the Hague-Visby Rules.

The Norwegian Shipowners Association ("Reederiforbundet") has expressed its strong support to the implementation of the so-called "Rotterdam Rules"<sup>95</sup> (*United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea*) in a letter addressed to the Ministry of Justice in May 2009. This Convention comprises international rules that revise the legal and political framework for the carriage of goods, and even though Norway is a signatory to this Treaty it has not ratified it yet. The Convention makes provisions for and regulates Electronic trading and provides functional equivalence to traditional bills of lading and Electronic bills of lading<sup>96</sup>. Thus, the rights of a shipper to require a paper bill of lading from the carrier will no longer exist and e-commerce will be allowed, and also carriers will be entitled to deliver cargo without presentation of an original bill of lading. Norway would have then an updated legal framework to face the challenges of this modern globalized economy.

Both Gard and Skuld are members of the IGPANDI, therefore they are offering cover as informed after the IGPANDI agreement on this point a year ago. (*See 5.4.1.*)

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<sup>95</sup> <http://www.regjeringen.no/upload/JD/Høringsuttalelser/LOV/UNCITRAL-konvensjon%20om%20sjøtransport/Norges%20Rederiforbund.pdf>

<sup>96</sup> *Article 8 Use and effect of electronic transport records.* Subject to the requirements set out in this Convention: (a) Anything that is to be in or on a transport document under this Convention may be recorded in an electronic transport record, provided the issuance and subsequent use of an electronic transport record is with the consent of the carrier and the shipper; and (b) The issuance, exclusive control, or transfer of an electronic transport record has the same effect as the issuance, possession, or transfer of a transport document.

## **GENERAL CONCLUSION:**

P&I Rules in England and in Scandinavia are not fundamentally different since all their clubs are active members of the IGPANDI, and they contract reinsurance to a great extent with the same reinsurers. However, the defenses granted to P&I insurers vary in each jurisdiction and the possibility to claim compensation directly from the P&I Clubs can be distinguished.

In England the "pay to be paid" rule and its sustained enforceability have prevented direct claims against a marine insurer for a long time, and even now where legislative changes were made in 2010 this has not been enough to revert the exceptions for marine insurers. In fact, the exception introduced to marine insurance curtails the real objective of a law of this kind: the protection of the third parties. On the other hand, England did take a step in the direction of a more flexible approach in regards to direct actions by allowing these type of actions in cases of personal injury claims and death. We can see here a move towards a more protective legal system where the rights of the weaker party to a contract are privileged.

The Norwegian position towards third party claims is different and firm: when an insured party (a shipowner or a charterer) becomes insolvent, the third party claimant has a right to file a direct action against the marine insurer. Even though Norwegian P&I Clubs insert a "pay to be paid" clause in their Rules, when the insurer is incapable of paying due to insolvency, said clause is of no effect. In my opinion the Norwegian legal framework strengthens the reputation of the country as a strong maritime nation with a solid and growing marine insurance market able to adapt to changing circumstances and to deal with their assureds' claims directly in case of need.

P&I Clubs are to remain key actors in the marine insurance market, and they may have to expand their scope of cover in case the "*Rotterdam Rules*" come into force as this Convention would increase third-party liabilities. Hopefully, the near-future international trend is one where the clubs take the initiative to help secure safer commercial trading.

In the last chapter of the paper attention was given to the problematic of using paper bill of lading in a modern world where transit times have been shortened drastically and any type of delay in international trade involves considerable monetary losses. This enormous time

pressure has led to the extended issuance of letters of indemnity and consequently increased litigation against carriers that may not seek assistance from their P&I clubs (unless Clubs choose to provide support at their own discretion). As we all know, technology evolves at an extremely fast pace in the globalized Shipping industry and one could only wish that laws would adapt at the same speed. Paperless trading is already a fact and all the Clubs in the IGPANDI have acknowledged that this modern method is here to stay. P&I Clubs will have to focus their efforts in promoting appropriate legislation to provide electronic bills of lading a legal framework in every jurisdiction, specially now that they are covering these type of documents under their Rules.

Neither the United Kingdom nor Norway has adapted their legislation to the needs of these modern times in terms of electronic trading, therefore many questions remain unanswered as to the validity of this method in said jurisdictions. However, Norway has signed the "Rotterdam Rules" which include the regulation of electronic transport documents thereby filling the legal gap once, and if, the Rotterdam rules are ratified and enter into force.

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