ISM, PSC and the HKF

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"Has the time come for English law to take a fresh look at unseaworthiness in the context of time charters, given the new regulatory regime of ISM and PSC?"

ISM

International Maritime Organisation ("IMO") statistics record that in the period from 1980 to 1997 no less than 167 bulk carriers were lost with the lives of some 1,352 souls. It is hardly surprising then that by the late 1980s many in the industry had reached the conclusion that the existing international regulatory environment was insufficiently strict to improve ship-operating standards. By 1993 the IMO Assembly had formally adopted a resolution which led directly to the International Safety Management Code ("the ISM Code").

The introduction of the first stage of the ISM Code – applying to oil and chemical tankers, gas carriers, bulk carriers and cargo-carrying high speed craft of 500 gross tons and upwards - came into effect on 1st July 1998 and was intended to herald a new approach to ship operations.

Lord Donaldson summarised the underlying intention of the ISM Code in the following terms:-

> "*In the short and medium term it is designed to discover and eliminate sub-standard ships, together with sub-standard owners and managers, not to mention many other who contribute to their survival and, in some cases, prosperity … In the longer term its destination is to discover new and improved methods of ship operation management and regulation which will produce a safety record more akin to that of the aviation industry. But, as I readily admit, that is very much for the future …*"

The Code itself consists of only sixteen short sections, contained in fifteen A5 sized pages. Yet it has been described by Dr Philip Anderson in his illuminating work *"Cracking the Code"* † (to which I gratefully acknowledge my indebtedness in preparing this paper) as "*arguably the single most important and influential piece of maritime legislation ever to have been enacted on an international scale*".

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† "*Cracking the Code"* – published 2003 by The Nautical Institute; ISBN No. 1 8700 77 63 6.

The approach adopted by the ISM Code is controversial. Its approach is essentially philosophical. At its heart is the Safety Management System ("SMS") which must be set up by every ship operating company to which it applies. Yet the Code does no more than set out the component parts of a SMS and give broad indications of what constitutes proper management. It does not prescribe any absolute standards, nor does it state how its objectives are to be achieved. In essence, all that it provides is that every company to which it applies must obtain a Document of Compliance ("DOC") and each of the ships which it is operating must obtain a Safety Management Certificate ("SMC"). Any company to which it applies must appoint a 'designated person', who must have access to the highest level of the company's management and be closely involved with putting the SMS into practice.

It is the fact that there is no recognised pro-forma SMS which can be used either to formulate the SMS for a particular operating company, or to judge the adequacy of any SMS when it is in force, that has led to criticism of the ISM Code. The original intention was that individual operating companies would be given the scope to produce a SMS which was appropriate to the particular requirements of the particular company and the vessels which it operated. Doubtless certain features will emerge in time as standard for companies operating particular types of vessel. For the time being I can do no better than quote Dr Anderson in "*Cracking the Code*" when he says that *"describing a good, working, dynamic SMS may be as difficult as describing an elephant – but like an elephant, once one has seen one, it is easily recognised when encountered subsequently*".

PSC

The origins of Port State Control ("PSC") lie as far back as the 1929 SOLAS Convention, but it was only with an agreement between eight North Sea states in 1978 that the concept of regional port state control agreements began its modern course of development.

There are seven Memoranda of Understanding ("MOU"), each relating to regional groupings of port states (such as those covering Mediterranean or Indian Ocean states, for example). Although the USA remains outside any regional MOU grouping and undertakes control measures on a unilateral basis, there is now essentially a worldwide regulatory regime governing PSC.

Detailed consideration of the workings of the PSC regime are outside the scope of this paper. The IMO has promulgated guidance as to how PSC inspections should be conducted and as to how deficiencies in a ship, its equipment or its crew are to be identified. Although these are not mandatory, they form the basis of the procedures adopted by most regional groupings of port states.

A Port State Control Officer ("PSCO") will inspect a vessel to ensure that she complies with the requirements of all relevant international conventions. If a particular vessel is found to be non-compliant, the PSCO may require the deficiencies noted to be rectified before allowing her to sail. Alternatively, he can clear a vessel to sail on condition that the deficiencies are rectified either at a named 'repair' port or within a specified period of, say, fourteen days.

A further international convention of relevance, the International Ship and Port Facility Security Code ("ISPS"), comes into force on 1st July 2004. The powers given to Port States under the ISPS Code extend to the waters of the port approaches. Vessels intending to enter a foreign port may be required to submit security-related information to the Authorities ashore before they are cleared to enter that port. Thus, the process of inspection under PSC will in future start even before a vessel comes alongside in the port.

The PSCO will seek to establish that a particular vessel is complying with the ISM Code at an early stage of his inspection. On the face of it, the industry therefore now has both the theoretical basis (in the ISM Code itself) and the practical means of ensuring compliance with higher standards (in the PSC regime) so that we should all be able to look forward with confidence to a process of steady improvement in ship operating standards - and an end to the sequence of maritime disasters (from the "*Herald of Free Enterprise*" in 1987 to the "*Exxon Valdez*" in 1989 to the "*Aegean Sea*" in 1992 and the "*Estonia*" in 1994 – to name but a selection) of recent times.

The HKF

The leading authority on unseaworthiness in the context of time charterparties under English law is the decision of the Court of Appeal in The "***Hong Kong Fir***" **[1961] 2 Lloyds Rep 478** ("the HKF"). If ever an illustration were needed of the maxim that 'hard cases make bad law', it is surely this case. Delivery into service under a 24-month time charter took place on 13th February 1957. The vessel proceeded from Liverpool to Newport News to Cristobal - and then set off for Osaka. Having been off-hire due to engine breakdowns for approximately thirteen days thus far, she was then obliged to put into San Pedro (near Los Angeles) as a port of refuge. There she was off-hire for a further period of almost 23 days. When she finally arrived at Osaka on 15th May 1957 she broke down – yet again – and was not ready for sea until 15th September, further repairs having been carried out to her main engine and auxiliaries as a result of the fact that she was found to be in "a very bad state due chiefly to corrosion".

According to my rough and ready calculations, these events can be summarised in the statement that from the time of delivery at Liverpool until arrival at Osaka she been at sea for about eight and half weeks, had been off-hire for about five weeks, and by the time that she was ready for further service following completion of repairs at Osaka, approximately 20% of the entire value of the vessel herself had been spent on repairs – all in this short period.

The case was made the more memorable by the fact that Mr Justice Salmon at first instance found that the Chief Engineer was a "hopeless drunkard" and described the second engineer as someone "not having much enthusiasm for hard work". Despite the fact that the vessel had no less than five engineers, three fitters and seven greasers as her engine room staff, they were found to be insufficient in numbers – as well as incompetent!

The Court of Appeal upheld the decision of Mr Justice Salmon who (astonishingly – to me at least) had concluded that the owners' breaches of their obligations with regard to the seaworthiness of the vessel were not sufficiently serious as to amount to a repudiation of the charterparty. The charterers were not therefore entitled to terminate the charterparty for repudiatory breach, as they had done. The underlying reasoning of the Court was that the delays which had the vessel had suffered were not such as to deprive the charterers of substantially the whole of the benefit of the use of the vessel under the charterparty.

It is, of course, a fundamental principle of English law that the sanctity of contracts must be upheld whenever possible. It was also thought by some to be the case in earlier days that English maritime law generally inclined towards sympathy with shipowners rather than charterers (Britain being in former times a leading ship-owning nation). Whether such considerations subconsciously affected the English Courts of an earlier period or not, the decision in the HKF proved to be the foundation of a line of authority in English law which I would argue has made it almost impossible for Courts or arbitrators to conclude that even the most obvious unseaworthiness of a vessel can entitle a charterer to terminate a time charterparty.

The justification for this position is usually put on the basis that the obligation of seaworthiness in English law is so wide-reaching that it may easily be breached in ways which are comparatively trivial. If unseaworthiness in itself were viewed as a ground for termination of a time charter, it could mean (so it is argued) that a charterer was entitled to terminate for minor breaches which had little or no significance in terms of the ability of the charterer to use a particular vessel profitably.

The "*HERMOSA*"

The other leading case in English law, which built on the foundations established in the HKF, was that of The ***"Hermosa"*** **[1980] 1 Lloyds Rep 638**, a decision of Mr Justice Mustill.

The vessel was time chartered for a minimum period of two years and sub-chartered on the same terms for a similar period. Serious cargo damage was sustained on her first voyage as the result of unseaworthiness in December 1974. Repairs were carried out from mid-January to the end of March 1975, as a result of which the sub-charterers lost their intended next employment for the vessel.

The owners had refused the sub-charterers permission to have the ship surveyed after the first voyage but eventually, in August 1975, the sub-charterers obtained a Court order permitting them to do so. The result of their survey was to establish the fact that the deficiencies in the vessel's hatch covers which had caused the damage to cargo on the first voyage remained unrepaired. The condition of the vessel was also criticised in other respects.

The head charterers (responding from to an ultimatum from the sub-charterers) were unable to obtain any reassurances from the owners that they were attending to these defects. The sub-charterers then terminated the sub-charter. Unfortunately for the sub-charterers, the owners had arranged for the repair of these defects prior to the termination of the sub-charter in August 1975 and the repairs were indeed completed by the end of October 1975.

Mr Justice Mustill concluded that the sub-charterers had not been justified in treating the charter as discharged by reason of the vessel's unseaworthiness because the defects which still existed were capable of being remedied within a relatively short time, which would have left 16 to 20 months of the charter to run. That view was upheld by Lord Justice Donaldson when the case went to the Court of Appeal. Mr Justice Mustill had taken the view that the sub-charterers had been justified in their suspicions that the hatch covers might not be properly repaired but he nevertheless held that this was insufficient to justify the termination of the sub-charter because the conduct of the head charterers was not regarded as being such as to lead a reasonable person to conclude that they did not intend to fulfil their contractual obligations.

The decision in that case was complicated by the fact that the charter terminated was a sub-charter and it was clearly the case as a matter of basic legal principle that the conduct of the owners themselves could not necessarily be taken as the conduct of the head charterers in such a situation, so as to justify the termination of a time charterparty. Although both Courts followed the 'HKF line', the judgment of Mr Justice Mustill contained the following interesting passage:-

> *"Finally, there is the argument of Nitrates [the sub-charterers] that it is permissible to add together the actual breaches and the conduct which threatened further breaches in the future to yield the state of affairs amounting to a repudiation, even if the individual elements were not in themselves repudiatory. Whether actual and anticipated breaches can be treated as cumulative in this way has yet to be decided. I need say nothing about the matter here. I have rejected the argument on renunciatory breach, not because the breach with Nitrates anticipated was insubstantial, but because the conduct of MTC [the head charterers] and the owners did not justify a firm inference that there would be a further breach. This being so, there is nothing to add to the actual breaches which had already occurred."*

I venture to suggest that in this passage Mr Justice Mustill may have been recognising, impliedly at least, the injustice which could result from a strict application of 'the HKF line' on unseaworthiness in the context of time charterparties.

The Way Ahead

The initial reaction of charterers has been to protect themselves against the consequences of non-compliance with the ISM Code by including in charterparties clauses such as the "BIMCO ISM clause" - which reads as follows:-

> *"From the date of coming into force at the International Safety Management (ISM) Code in relation to the vessel and thereafter during the currency of this Charter Party, the Owners shall procure that both the vessel and 'the company' (as defined by the ISM Code) shall comply with the requirements of the ISM Code.*
>
> *Upon request the Owners shall provide a copy of the relevant Document of Compliance (DOC) and Safety Management Certificate (SMC) to the Charterers.*
>
> *Except as otherwise provided in this Charter Party, loss, damage, expense or delay caused by failure on the part of the Owners or the company to comply with the ISM Code shall be for the Owners' account."*

Including such a provision expressly making it clear that the consequences of non-compliance with the ISM Code must be a matter entirely for the account of owners is an obvious and understandable reaction to the new situation created by the coming into force of the ISM Code. However, a point for reflection is the possibility that such an express provision might be taken by a Court or arbitrator as evidence of the fact that the parties intended that any unseaworthiness constituting a breach of the ISM Code (and possibly leading to sanctions by PSC) was to be dealt with in damages alone. If so, I would suggest that that would be most unfortunate. The most effective way of getting shipowners and operators to take the new standards underlying the ISM Code seriously is surely the possible threat of losing a time charter.

An obvious problem facing anyone arguing for a more critical approach to unseaworthiness is that the concept of unseaworthiness in English law is arguably not as precise as might be hoped for, or as imagined, because of the differing contexts in which it has had to be defined.

The following definition given by *Carver* on "*Carriage by Sea*" and cited with approval by Lord Justice Scrutton in the decision of the Court of Appeal in ***F C Bradley & Sons Ltd –v – Federal Steam Navigation Co*** **[1926] Vol 26 Lloyds List Law Reports at page 454**, is probably as helpful as one can expect:-

> *"The ship must have that degree of fitness which an ordinary careful owner would require his vessel to have at the commencement of her voyage having regard to all the probable circumstances of it. Would a prudent owner have required that it should be made good before sending his ship to sea, had he known of it?"*

A further definition is to be found in Section 39(4) of the Marine Insurance Act 1906:

> *"A ship is deemed to be seaworthy when she is reasonably fit in all respects to encounter the ordinary perils of the seas of the adventure assured."*

These two attempts to define the concept of seaworthiness in English law seem to me to be sufficiently imprecise as to enable any Court or arbitrator considering a particular case to do justice in the circumstances of that case. I would suggest that considering issues of seaworthiness in the context of a contract of insurance may well involve different considerations to those which arise when considering seaworthiness for the purposes of a charterparty or other contract relating to the employment of a vessel. Whether that is so or not, it is surely implicit from the implementation of the ISM Code that a stricter standard of seaworthiness is to be required from shipowners and operators in the future.

When the ISM Code was first published it was anticipated that it was likely to have an effect on shipowners' liabilities in two principal respects. The first of these was in relation to the 'crew negligence defence' under the Hague/Hague-Visby Rules (Article IV, Rule 2(q) of the Hague-Visby Rules). The second likely effect was seen as being in relation to the Limitation Convention and the effect of Section 39(5) of the Marine Insurance Act 1906 - under which a shipowner may be deprived of his insurance cover if a vessel is allowed to proceed to sea in an unseaworthy condition with the privity of the assured

The only two reported cases of which I am aware in which the English Courts have as yet had reason to consider the significance of the ISM Code have indeed arisen in the insurance rather than the time charterparty context. In both cases the Court was concerned with allegations that the defendant shipowners were in breach of their obligations under Article III, Rule 1 of the Hague/Hague-Visby Rules to exercise due diligence to provide a seaworthy ship "*before and at the beginning of the voyage*".

In the first of these cases, The ***"Eurasian Dream"*** **[2002] 1 Lloyds Rep 719**, Mr Justice Cresswell was concerned with a fire on a dedicated car carrier which resulted in the vessel and all her cargo becoming a total loss. Such car carriers are covered by ISM Phase Two, which did not become mandatory until July 2002 - whilst the incident occurred in July 1998. However, the vessel's operators were also operators of vessels to which the Code already applied and had produced ISM procedure manuals which were placed on board all the vessels which they managed – including The "***Eurasian Dream***". Mr Justice Cresswell was critical of the voluminous, irrelevant documentation placed on board the vessel, but it is clear from his judgment that he had in mind the requirements of the ISM Code – and indeed thought that these could not have been met in the case of a specialised vessel by the distribution of a manual applying to vessels of all types. He referred in his judgment to the fact that:-

> *"Seaworthiness must be judged by the standards and practices of the industry at the relevant time, at least so long as those standards and practices are reasonable".*

There can be no doubt from the terms of his judgment that he took the view that the ISM Code reflects the contemporary yardstick by which any particular vessel, or those operating her, must be judged.

In the second case, The ***"Torepo"*** **[2002] 2 Lloyds Rep, page 535**, Mr Justice David Steel was concerned with an attempt by cargo interests to recover their contribution in general average when a vessel grounded and had to be salvaged. The vessel was a product tanker but the incident occurred before Phase One ISM compliance became mandatory.

Mr Justice Steel held that the cargo interests had failed to establish that the casualty was caused by unseaworthiness. The owners were fortunate in that case in that a vetting inspector on behalf of an oil major had attended on board shortly before the incident and had commented favourably on the operational procedures in place on board. The Court seems to have taken the view that the cause of the casualty was understandable human error and the owners were exonerated from liability because they were able to show that appropriate systems were in place.

Although the ISM Code was not mandatory, it certainly appears that the Judge approached the conduct of the owners and those for whom they were responsible on the same basis as he would have done had the ISM Code in fact been mandatory. On the (admittedly limited) evidence of these two decisions it must be assumed that even though the ISM Code does not set absolute standards, failure to comply with the requirements of the ISM Code will amount in the eyes of an English Court to at least prima facie evidence of unseaworthiness.

That may be an uncontroversial conclusion in the context of cases such as The ***"Eurasian Dream"*** and The ***"Torepo"***. More controversial is the effect of the ISM Code in cases where a charterer seeks to terminate a time charter on the grounds of unseaworthiness. Although it may be argued that the underlying motivation of the ISM Code is the protection of human life, I would suggest that experience leads to the conclusion that it is difficult – if not impossible – to draw a meaningful distinction between poor operating standards insofar as they are likely to present a threat to the safety of crews and those concerned with the operation of a vessel and poor operating standards as they are likely to adversely affect a vessel's cargo and the environment in which the vessel is operating. Can any contemporary charterer really be expected to endure the disruptions to his operating plans for a particular vessel which were endured by the hapless charterers of the HKF? The answer to me seems obvious.

In addressing President Roosevelt in February 1941, the British Prime Minister, Winston Churchill, memorably exhorted the American President:-

"Give us the tools, and we will finish the job."

The ISM Code may be criticised for its failure to lay down specific requirements when it comes to defining a SMS but those specific requirements will surely become clear with time. As they do, the ISM Code and the PSC regulatory regime which assists in enforcing it will 'give us the tools'. Mr Justice Mustill in The "***Hermosa***" seems to me to have provided a signpost in the development of the English common law as to how a series of breaches of the obligation as to seaworthiness could be held to amount to a repudiatory breach entitling a charterer to terminate a time charterparty. It is now for arbitrators and Courts to 'finish the job' of consigning the HKF to history.

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