NEWSLETTER

June 2003

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Introduction

This edition of the M@ritime Review contains a broad selection of pieces. The first is a detailed article on maintenance obligations under bareboat charterparties, of interest to both the offshore and the shipping industry. We have a short case note on whether a notice of abandonment is necessary in the context of the Marine Insurance Act 1906. There is a further update on the progress of Basel II, a note on recent developments in mediation, and a note on changes to the UK tonnage tax regime. Finally, we have the first part in a series written by Brian Rolf, our Master Mariner, dealing with the collision regulations. As always, the intention is to cover the range of subjects which are of interest to our clients.

Your feedback on our newsletter and/or suggested topics would be appreciated. Please email me at mark.morrison@cliffordchance.com

Maintenance Obligations under Bareboat Charters

Bareboat charters are used in the offshore industry, for both drillships and semi-submersibles, as the basis for not only commercial, but also financing arrangements.

Owners' interest in condition

The interests of commercial owners and finance owners, at least in so far as the condition of the vessel is concerned, are the same: to ensure that the value of the asset is preserved through appropriate maintenance, repair and insurance.

The term of a bareboat charter may be substantial, and (in the case of finance charters) can be for the full life of the vessel. Combined with the often inhospitable environments in which the vessels work and the continuous and ongoing nature of the drilling business, it is possible for the condition of a vessel to deteriorate quickly. The changing demand for drilling work means that vessels may be laid up during the currency of a charter, or between engagements. While the vessel is not drilling, will charterers be inclined (or indeed able to afford) to maintain the condition of a non-productive asset?

The maintenance, repair and insurance provisions of bareboat charters are therefore critical, coupled with the provisions which allow owners to monitor the condition of the vessel effectively and to enforce compliance with stipulated maintenance and repair requirements.

Barecon

For the purposes of this article we focus on the maintenance and repair provisions of the Barecon 2001 form of charterparty. The Barecon standard form is the most popular bareboat charter used in shipping, and Barecon 2001 is the current edition of the form. It is important to note that this form is designed for use with conventional cargo ships. It does not take into account the special equipment to be found on drill ships, the unique design of semi-submersibles, the often continuous nature of their employment and their relatively high value. Notwithstanding this, it is common to see amended versions of this form, or in the case of finance linked agreements - which are often bespoke - substantial portions of the form's wording, being used.

The Barecon maintenance and repair provisions

Barecon 2001 provides at Clause 10(a)(i) that "*The Charterers shall maintain the Vessel, her machinery, boilers, appurtenances and spare parts in a good state of repair, in efficient operating condition and in accordance with good commercial maintenance practice...they shall at all times keep the Vessel's Class fully up to date …. and maintain all other necessary certificates in force at all times ….*"

The Barecon withdrawal provisions

Barecon 2001 provides at Clause 28 (a) that "*The Owners shall be entitled to withdraw the Vessel from the service of the Charterers and terminate the Charter with immediate effect by written notice to the Charterers if: ….(iii) the Charterers fail to rectify any failure to comply with the requirements of sub clause 10(a)(i) (Maintenance and Repairs) as soon as practically possible after the Owners have requested them in writing so to do and in any event so that the Vessel's insurance cover is not prejudiced.*"

Barecon imposes three separate maintenance/repair obligations upon charterers.The three obligations are cumulative and therefore all must be complied with.

Meaning of Clause 10(a)(i)

Barecon imposes three separate maintenance/repair obligations upon charterers. Those are obligations to maintain (i.e. keep) the vessel: -

(a) In a good state of repair. This is an obligation primarily concerned with remedying damage and defects once they have arisen.

(b) In an efficient operating condition. This obligation is primarily concerned with the functioning of the vessel.

(c) In accordance with good commercial maintenance practice. This is primarily concerned with taking steps to prevent damage, defects and breakdowns occurring.

The three obligations are cumulative and therefore all must be complied with. Charterers will not be in breach of these obligations merely because a defect has occurred, but will be in breach where they have failed to act promptly to restore the condition of the vessel where a defect or inefficiency has occurred. Charterers will also be required to put in place a preventative maintenance system. The maintenance obligation requires charterers actually to achieve the stipulated goal (i.e. to maintain the vessel in a good state of repair, etc). It is not sufficient for charterers merely to take reasonable steps to achieve this goal. The obligation of repair does not depend on knowledge of the defect, but there is no obligation to repair defects that could not reasonably have been discovered. It should be added that maintenance and repair obligations are not influenced by commercial considerations. If essential maintenance or repair work cannot be carried out without interruption to the vessel's operations, charterers are not entitled to postpone such work until completion of those operations.

There is an additional requirement to keep the vessel's Class up to date, and to maintain all other necessary certificates in force at all times.

The right of withdrawal can be used to the owners' advantage during times when the charter market is hardening and rates are rising. However, the owners' position becomes complicated at times when the market is soft.

Termination / Withdrawal

Owners may, by written notice, withdraw the vessel and terminate the charter if the charterers fail to remedy any failure to comply with their maintenance and repair obligations as soon as practically possible after the owners have given them a written request to do so and, in any event, so that the vessel's insurance cover is not prejudiced. The owners would also be entitled to claim from the charterers the costs of repair.

Claim for loss of charter income resulting from withdrawal of vessel

The right of withdrawal can be used to the owners' advantage during times when the charter market is hardening and rates are rising. However, the owners' position becomes complicated at times when the market is soft. In the latter case, it may be that substitute employment cannot be found or, if it can be found, then only at a lower rate. The owners' financial losses suffered, as a result of their withdrawing the vessel, are not always recoverable from the charterers. The extent to which they would be able to recover will in many cases determine whether the owners decide to exercise their right to withdraw the vessel.

Owners are not entitled to recover their financial losses arising out of the substitute employment of the vessel merely because they validly withdrew the vessel pursuant to Clause 28. To succeed in such a claim, the owners must be able to show that the charterers' breach was one which would entitle them to terminate at common law. As was recently confirmed by the Commercial Court in the ROWAN GORILLA V case (as yet unreported), the common law remedy of termination operates independently of the existence of an express termination clause.

Owners are not entitled to recover their financial losses arising out of the substitute employment of the vessel merely because they validly withdrew the vessel pursuant to Clause 28.

For owners to justify termination at common law as result of a breach by the charterers of their Clause 10(a)(i) maintenance obligations, it would be necessary to show either that (a) the charterers, by their breach, demonstrated that they did not intend to continue with the charterparty; or (b) the effect of the charterers' breach was so serious that it deprived the owners of substantially the whole benefit of the contract. In both cases, the owners would have to be able to point to a breach of contract which has significant and serious consequences.

In assessing the seriousness of a breach, the other contractual provisions may give a pointer as to which obligations the parties regarded as important (the breach of which might give rise to the right to terminate) and which they did not. For example, if the charterparty provided for a system of compensation in circumstances where the performance of the vessel becomes inefficient, then in such a case it would be difficult to argue that any reduced efficiency, although a breach of the contract, would give grounds for termination. In cases (as with Barecon) where the contract provides for the right of withdrawal, termination at common law will usually only be justified in situations where the breach is considered to be substantially "worse" than the types of breach envisaged in the withdrawal provisions.

In times when the alternative employment prospects of the vessel are not good, owners would be well advised not to withdraw the vessel unless they have a clear right to terminate the contract at common law. In such circumstances, owners should take steps to improve their record position by documenting the breach as best possible (by way of independent surveys if necessary), and giving the charterers notice of the breach and requiring them to remedy it. Although this will not in itself give owners the right to terminate at common law, it may be that with the course of time (and the occurrence of further breaches) that a pattern can be established which would demonstrate that the charterers have no intention of performing the contract in accordance with its terms.

When negotiating a bareboat charterparty, owners should therefore consider whether the standard Barecon withdrawal provisions offer adequate protection. Owners may improve their withdrawal/termination position by, for instance, amending the standard Barecon so to make the charterers' maintenance obligations conditions of the contract, to be more specific as to the types of breach which would give rise to the common law right of termination (and hence the right to claim for damages for loss of hire in the event that the vessel is withdrawn on a falling market).

In times when the alternative employment prospects of the vessel are not good, owners would be well advised not to withdraw the vessel unless they have a clear right to terminate the contract at common law.

Loss of the right to withdraw

It is important to note that the right of termination/withdrawal may be lost through inaction by the innocent party, after the time when it becomes aware of the breach. The innocent party should therefore take steps to preserve its position, immediately after it becomes aware of a breach by the other party.

Advantages and disadvantages of using the standard Barecon wording

The advantage of the Barecon maintenance and repair provisions is that (a) they have been in use for over 25 years and their meaning is generally accepted and understood within the industry (so much so that few disputes as to their meaning have come before the courts); and (b) their meaning is sufficiently wide to cover all equipment (both drilling and marine) on the vessel.

A disadvantage is that the wording was not drafted with drillships or semi-submersibles in mind. This is not so much a problem with the marine aspects of such vessels - which in broad terms bear similarity to conventional cargo ships. However, when it comes to the drilling equipment, the general provisions become more uncertain in their application.

A further disadvantage is that the withdrawal provisions do not adequately protect owners in cases where they wish to withdraw the vessel in circumstances where the alternative employment opportunities are less profitable than the original charter, as the owners' financial losses may not be recoverable.

Further, the Barecon maintenance repair provisions are couched in general terms. The parties would therefore be well advised at the negotiation stage to consider whether a more specific regime is required. In particular consideration should be given to owners' expectations at the end of the charter period. Will owners expect the drilling equipment to have been upgraded in line with technological advances or to meet changing regulations? If the vessel at delivery is able to work in a variety of jurisdictions, will the owners expect that on redelivery the vessel will still comply with the regulations of all relevant jurisdictions? Will owners accept deterioration in the condition of the drilling equipment in line with fair wear and tear (as the standard Barecon wording provides) or do they require drilling equipment to be maintained in an "as new" state? Charterers' expectations may be different. In the case of finance charterers (who may have purchase options over the vessel) it is not unusual to find a real commitment to the investment of capital in upgrades to machinery, whilst with commercial charterers this is less often the case.

Barecon 89

As mentioned, Barecon 2001 is the current edition of the form. However, many existing charters will be based on the previous edition of the Barecon form (Barecon 89). The comments made in this article apply equally to Barecon 89 for the reason that the maintenance and repair provisions are identical in both the 89 and 2001 forms. The withdrawal provisions are also similar, the only difference being that Barecon 2001 identifies the steps that owners would have to follow to withdraw the vessel. In practice, similar steps would have to be followed to withdraw under Barecon 89, so to reduce the risk of owners' withdrawal being held to be a repudiatory breach of contract.

The parties would therefore be well advised at the negotiation stage to consider whether a more specific regime is required. In particular consideration should be given to owners' expectations at the end of the charter period.

Summary

There is nothing fundamentally wrong with using the Barecon maintenance and repair wording and there are many advantages in using it. However before negotiating a bareboat charter it is necessary to first give careful consideration in particular to owners' expectations as to condition at redelivery, and whether specific terms are needed to ensure that these expectations are realised.

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Is a Notice of Abandonment always necessary?

The Marine Insurance Act 1906 (the "Act") Section 61 states:

> *"Where there is a constructive total loss the assured may either treat the loss as a partial loss, or abandon the subject matter insured to the insurer and treat the loss as if it was an actual total loss".*

Section 62 states:

> *"(1) … where the assured elects to abandon the subject matter insured to the insurer, he must give Notice of Abandonment. If he fails to do so the loss can only be treated as a partial loss".*

If a loss is treated as a partial loss, the assured can make a claim for particular average, if the repairs have been carried out, or a claim for unrepaired damage if they have not on expiry of the policy. In the rare case where a vessel sinks before the expiry of the policy in an unrepaired state it would not be possible for the assured to claim a partial loss. The assured must, therefore, claim for constructive total loss. Under Section 62(1) of the Act quoted above the assured must, therefore, have given notice of abandonment.

So what would happen if a vessel suffered serious damage as a result of a peril insured against and almost immediately thereafter sank for reasons unknown? The assured could not give notice of

abandonment in the time available between the original insured peril and the subsequent loss. On the face of it he could not claim for a partial loss (either particular average or an unrepaired damage) because the vessel had sunk before she was repaired and before the expiry of the policy, and he could not claim for constructive total loss because notice of abandonment had not been given. These were the facts faced by the owners of the "KASTOR TOO" when they sought to make a recovery from their hull underwriters in the recent case of *Kastor Navigation Co Ltd and Another -v- AGF Mat and Others* [2002] EWHC 2601 (Com).

The "KASTOR TOO" was on loaded passage from Aqaba to Vizagapatnam on 9 March 2000 when fire was discovered in the purifier flat in the main engine room. Efforts to extinguish the fire failed and the crew abandoned ship. Some 15 hours later the vessel sank. The owners claimed from their underwriters for an actual total loss as a result of the fire and/or explosion (which were insured perils), which caused entry of seawater into the vessel. This was resisted on the grounds that there was more water in the vessel when she sank that could have been caused by the engine room fire. Thus the fire was not the cause of the total loss.

The fire damage alone was estimated at US$3 million and was sufficient to render the vessel a constructive total loss. The claim for constructive total loss was resisted quite simply because no notice of abandonment had been given or could have been given once the vessel became an actual total loss.

Mr. Justice Tomlinson held that, as of the moment when the damage to the vessel caused by the fire reached the point at which cost of repair would exceed its insured value, the claimant had an accrued cause of action against underwriters for a constructive total loss. He also said that service of a notice of abandonment was not in itself an essential ingredient of the cause of action - rather, it was the notification of an election between two alternative remedies, either payment for partial loss, or payment for a total loss.

The claim for constructive total loss was resisted quite simply because no notice of abandonment had been given or could have been given once the vessel became an actual total loss.

Having reviewed the various authorities Mr. Justice Tomlinson further commented that where a constructive total loss caused by an insured peril (of which loss the insured was unaware) was followed (before he acquired such knowledge) by a total loss caused by an insured peril, or even by an excepted peril, the insured could for the constructive total loss. Neither authority nor reason supported a contrary position.

He went on to say that such a problem would only arise in a very rare case where the insured peril which caused the constructive total loss could not be shown to have been causative of the sinking. The owner's claim therefore succeeded.

Finally, the Court stated that an insured who wished to claim for constructive total loss must be prepared to abandon his vessel to underwriters. However, a claim for a constructive total loss could still be maintained however where there had simply been no opportunity to give notice of abandonment.

As an interesting aside, the owner's claim for an actual total loss failed as it was unable to identify an insured peril as the proximate cause of the sinking, but the original claim for an actual total loss did not prejudice the subsequent amendment of the claim for a constructive total loss.

Whilst it may be that future cases where the "KASTOR TOO" can be relied upon as a precedent will be few and far between, this case does clarify the law.

It is not known whether underwriters will appeal.

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Basel II update

The Basel Committee has issued a third consultative paper on the New Basel Capital Accord with comments due by 31 July 2003. The aim is still to have a final version agreed by the fourth quarter of this year.

Hamburgische Landesbank (HLB) has developed (jointly with other landesbanks) a new rating process under the Basle II regime for loans secured through ship mortgages. Ship financing differs from other forms of financing in that typically it is the ship and not the owning company that produces the income stream needed to repay the loan. The rating system will measure the probability of any "loss" to the bank by reference to the ship. According to HLB's chief executive Alexander Stuhlmann, the "loss" is defined as a situation when the ship is not earning enough income and the loan's performance is massively interrupted, while at the same time the ship's value does not cover the outstanding loan.

HLB and the other landesbanks have developed a procedure which simulates the future development of a loan within a set period and measures the influence of charter rates, ship values, operating costs, interest rates and exchange rates. A number of different scenarios are considered and the greater the number of scenarios resulting in loss, the greater the probability that the bank will suffer a loss on its loan. Various other factors, such as the management of the vessel and financial state of any parent group, as well as the general movement of the global economy, will also be considered. A loss ratio will also be calculated, based on a bank's past experience, which predicts the size of loss they would have suffered in each simulated loss. Then by using a multiplication of probability and loss, the individual risk costs for a transaction is found and translated into a scale from 1 to 15.

HLB are already using this method for all new loans and test runs show compatibility with the market environment.

Implementation of Basel II has again been pushed back and HLB and its associates hope to have sufficient experience of their internal system in time for the implementation of the new framework now expected to commence at the end of 2006 or the beginning of 2007.

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Mediate You Must!

An analysis of recent cases dealing with the enforceability of an agreement to mediate and the cost consequences of failing to do so.

There have been three recent decisions relating to the question of mediation. The first, *Cable and Wireless PLC v. IBM United Kingdom Ltd* [2002] EWHC 2059, dealt with the enforceability of an agreement to mediate. The other two, *Dunnett v. Railtrack PLC* [2002] 1 WLR 2434 and *Societe Internationale de Telecommunications Aeronautiques SC v. Wyatt (UK) Ltd (Maxwell Batley, Pt. 20 Defendant)* [2002] EWHC 2401, dealt with the cost consequences of a party refusing to take part in mediation proceedings.

Enforceability of an agreement to mediate

An agreement to mediate (unlike an agreement to arbitrate) has in the past been considered an agreement to negotiate, and hence too uncertain to be enforceable. Alternative dispute resolution techniques such as mediation are increasingly acknowledged as sophisticated and popular means of resolving disputes - as can be seen from the recent decision in *Cable and Wireless v. IBM*. In this case the Court held that agreements to mediate are both binding and enforceable.

Cable & Wireless and IBM had entered into a long term international supply agreement which provided that in the event of a dispute there would be a staged escalation in negotiations, ending in mediation under the auspices of CEDR (The Centre for Effective Dispute Resolution). A dispute arose and Cable & Wireless, without first seeking to resolve the dispute by mediation, commenced proceedings in the London Commercial Court. IBM applied to stay those proceedings on the basis that the parties had agreed to first seek to resolve their dispute by way of mediation.

The Court held that the parties must comply with the mediation clause, and stayed the proceedings until after the parties had referred their dispute to mediation. This was notwithstanding that the CEDR

Rules allowed for either party to withdraw from the mediation at any time - a quality which, in the past would have been seized on as demonstrating that a mediation agreement is only an agreement to negotiate, and hence unenforceable. The Court held that the CEDR Rules "*..envisaged a certain minimum participation in the procedure*" (such as participation in the appointment of a mediator), which could not be avoided without a party being in breach of the agreement. The Court remarked that even in cases of an unqualified reference to mediation (i.e. where no procedural rules were agreed) "*… a sufficiently certain and definable minimum duty of participation should not be hard to find.*"

Parties would therefore be well advised to comply with any compulsory mediation clause in their contracts. By failing to do so, a party will run the risk of an adverse costs order (see below) and might also find that it was in breach of contract. If parties wish to include a mediation clause in their agreement, and intend the process to be optional, then they should specifically state this in the clause.

Cost consequences of a failure to mediate

In the case of *Dunnett v. Railtrack*, the Court of Appeal held that a defendant should not be awarded its costs of certain court proceedings, as it had refused to take part in a mediation. This is a curious decision, particularly given that the defendant had not only been successful at first instance, but had also made a nuisance value Part 36 offer which the claimant had failed to better on appeal. The Court based its decision on the CPR's overriding objective, which requires the court to manage cases actively by, amongst other things, encouraging the use of ADR. The parties have a duty to further the overriding objective.

...Court of Appeal held that a defendant should not be awarded its costs of certain court proceedings, as it had refused to take part in a mediation.

The defendant had refused to participate in the mediation for the reason that it was not prepared to offer more than the nuisance value settlement which it had earlier proposed (and which the claimant had not accepted). A quite understandable position, given that they had succeeded at first instance, and went on to succeed again on appeal. The Court however took the view that the mediation might have been able to achieve a solution, notwithstanding that the defendant did not intend to make an offer any higher than its earlier offer, and cited as examples claims against the police which had been settled by way of an apology by a senior officer. (The claim in this case was for compensation for three horses killed on the railways, and it was acknowledged by the Court that emotions were running high on part of the litigants). In the circumstances, the Court held that it was appropriate that there be no order as to costs.

In *SITA v. Wyatt*, the defendant brought proceedings for a contribution against a third party. In the course of those proceedings, the defendant proposed that the dispute be referred to mediation. The third party refused to participate in the mediation. The Court found that the third party had no liability to the defendant. The defendant, on the basis of *Dunnett v. Railtrack*, argued that the third party should be denied its costs (which it would ordinarily have been awarded) for the reason that it had refused to participate in mediation. However, the Court held that it would have been unjust to do so given that the defendant, in proposing mediation, (i) was not really interested in settling the case; (ii) took a disagreeable approach; and (iii) had advised the third party that the mediator had already formed a view against them.

In the face of these two decisions, it is difficult to advise with certainty as to the costs consequences of a failure to take part in mediation. However, it is at least clear that a party who refuses to agree to a reasonable mediation request may incur negative cost consequences.

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Collision Regulations - Part I

The purpose of this article and those that follow is to examine various aspects of the International Regulations for Preventing Collisions at Sea, 1972 (the "Rules") and their application in collision cases. This particular article is intended to explain briefly the development, format, and status of the Rules.

Codes of conduct for navigation for collision avoidance have been in existence for hundreds of years but, surprisingly, it is only during the last 150 years or so that international conventions and the giving of statutory force have been involved. The present version of the Rules is the International Regulations for Preventing Collisions at Sea, 1972 (as amended). These Rules implement the Convention on the International Regulations for Preventing Collisions at Sea 1972 (as amended) and have the force of English law as the Merchant Shipping (Distress Signals and Prevention of Collisions) Regulations 1996. The Rules are used as the code or regulatory scheme by which vessels are required to conduct their navigation in order to avoid collision. But they are also used as the standard against which the navigation of vessels which have collided is measured, and in accordance with which the degree of fault and liability for the resulting damage is apportioned between them.

The Rules are used as the code or regulatory scheme by which vessels are required to conduct their navigation in order to avoid collision. But they are also used as the standard against which the navigation of vessels which have collided is measured, and in accordance with which the degree of fault and liability for the resulting damage is apportioned between them.

The importance of the application of International Convention is clear. The success of the Rules depends very heavily on their being interpreted and implemented in a uniform manner, on a global basis, and by seafarers of different nationality and background, often with entirely different navigational considerations and objectives. For instance, although there are many ways by which an encounter between a deeply laden tanker and a local fishing vessel or ferry can be avoided or resolved, the greatest degree of certainty will be achieved by the same set of rules being consistently applied by both. A mutual understanding of the obligations of each vessel in any particular set of circumstances is essential to the effectiveness of any avoiding action that may be required.

The Rules apply to all "vessels" upon the high seas, and in waters which are navigable by seagoing vessels. Although the Rules allow local authorities to make special rules for roadsteads, rivers and harbours etc, such special rules are required to conform as closely as possible to the Rules themselves. Also, the government of any state is allowed to make special rules for additional lights, shapes or whistle signals for ships of war and vessels proceeding under convoy but, in this case, they should so far as possible be such that they cannot be mistaken for the lights, shapes or signals authorised under the Rules.

It is obvious that the Rules must deal with the conduct of vessels in terms of navigational manoeuvres. It is also necessary for them to prescribe in detail the lights, shapes and whistle signals used to indicate a certain condition, type or activity of a vessel, and its size and aspect (an indication of the other vessel's heading). A common understanding of all such matters is necessary if navigators are to correctly identify each other's vessel type and likely movements. This is pre-requisite to an accurate analysis of the situation and hence the selection of the correct (collision avoidance) measures required by the Rules.

The Rules also include details of signals for use in distress. The relevance of such signals to collision avoidance is not as immediately obvious but is historic - they were first included in the 1884 version of the Rules. Their inclusion undoubtedly promotes a better knowledge of such important signals amongst navigators and their inclusion in the Rules affords them some protection from confusion with other signals, such as any special rules made with respect to additional station or signal lights etc.

The format of the Rules comprises thirty eight numbered rules and four annexes. The annexes deal with the distress signals, technical details of lights, shapes and sound appliances, and additional signals for fishing vessels in close proximity. The thirty eight numbered rules are divided into five lettered Parts, A-E. Of these, although the other parts set out lights and signals to be used by vessels, it is only Part B, comprising Rules 4-19, which deals with the conduct of vessels in terms of their respective responsibilities and physical manoeuvres for collision avoidance. Part B is known as

the "Steering and Sailing Rules" and is itself subdivided into three sections according to the prevailing conditions of visibility.

Section I of Part B applies in any condition of visibility and sets out general requirements such as standard of lookout, safe speed, assessment of the risk of collision and action to avoid collision. It also provides particular requirements for navigation within narrow channels and traffic separation schemes.

The Rules of Section II of Part B apply only to the conduct of vessels which are in sight of one another, and they assign obligations to each vessel in a developing encounter. Action is prescribed for an encounter between two sailing vessels. Also, priorities are established between different types of vessel or vessels engaged in various activities. Otherwise this section of Part B identifies three types of encounter on an angle of approach basis. This classifies any encounter as either an overtaking, a head on, or a crossing situation. The distinction between different types of encounter can be critical and the ability to differentiate can change from daylight to darkness. For instance, a vessel is deemed to be an overtaking (as against a crossing) vessel when coming up on another vessel from a direction more than 22.5° abaft her beam. This can be more difficult to identify by day than by night when, as mentioned by the rule concerned, the overtaking vessel would see only the stern light of the other vessel but neither of her sidelights. The precise angle of the sectors of the vessel's lights (as defined by the rules) do not provide the same assistance during daylight hours.

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In the head on situation, both vessels are required to alter course to starboard and, as such, an identical obligation is assigned to each vessel. However, it is important to recognise that, although other situations involve a give way and a stand on vessel, the action required by each is defined and, therefore, although different, there are obligations assigned to each vessel under the Rules. It is also worth noting that the obligations on the stand on vessel are, in fact, more complex than the obligations on the give way vessel. The give way vessel has the same simple obligation to keep clear throughout the encounter. However, unless the give way vessel takes avoiding action early and substantially enough to satisfy the stand on vessel, the obligations on the stand on vessel change with time as the situation develops. The obligation changes from *take no action* (keep course and speed), through *may take action* as soon as non-compliance by the give way vessel is apparent, to *must take action* when so close that collision is unavoidable by action of give way vessel alone. This is reflected in the fact that the Rules deal with the obligation on the give way vessel within two lines but require eleven lines, subdivided (a)(i), (a)(ii), (b), (c) and (d), to articulate the obligations on the stand on vessel.

Section III of Part B applies to the conduct of vessels in restricted visibility. In this case, although the general requirements of Section I (such as safe speed and assessment of collision) do still apply, the stand on or give way status assigned to each vessel in Section II according to vessel type or angle of approach does not.

It must be understood that the Rules perform two very different functions. Arguably, their primary function is to enhance maritime safety by *preventing* collisions. However, they are also used after a collision to analyse the degree of fault of the vessels involved and, on that basis, to apportion liability between them.

The wealth of contributing experience during the long evolution of the present Rules has led to a set of rules which are comprehensive in that they cover any conceivable combination of visibility, vessel type and angle of approach as well as specific geographical considerations such as narrow channels or traffic separation schemes. They are also well structured and carefully drafted. The Rules allow a detailed analysis of the cause of a collision but, subject to the quality of evidence available, it may be easier in some instances for a lawyer or judge to determine, after the event, whether or not one vessel was approaching another from a direction more than 22.5° abaft its beam in daylight, than it was for the navigator to make such assessment reliably enough in the time allowed before the event to apply the correct avoiding action. The continuing occurrence of collisions confirm that the Rules

are far from foolproof. It is not suggested that the average navigator is any more foolish than his counterparts in other industries, but there is an argument that the Rules are now too sophisticated and require simplification to enable successful application on a worldwide scale to an industry with so many wide ranging variables. Some proposals for change consist of clarifying amendment to the present Rules whereas others involve radical alteration of the fundamental concepts involved.

It is not the purpose of these articles to explore any proposals for change or to argue in favour or against the present Rules. In later articles we shall however expand upon various aspects of the present Rules and discuss some specific situations which can give rise to particular difficulties.

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Changes to the UK Tonnage Tax Regime

The UK tonnage tax regime was introduced pursuant to the Finance Act 2000. The basic premise behind the regime is that a shipowner can elect to have tax liability assessed on the basis of a ship's tonnage, rather than on the operating revenue generated from the ship's activities.

The legislation sets out special rules for ships leased to a company which is within the regime, pursuant to a finance lease. A lessor under a finance lease is entitled to capital allowances in respect of expenditure on the provision of a ship leased to a company within the regime on the following basis:

- first £40m of the cost of providing the ship: 25% p.a. on the reducing balance;
- between £40m and £80m: 10% p.a. on the reducing balance; and
- in excess of £80m: no allowance permitted.

However, in respect of "defeased leases", the lessor under a finance lease is not entitled to these capital allowances. The legislation defines a defeased lease as one which provides for the removal of the whole, or the greater part, of any non-compliance risk under the lease which might fall on the lessor. Certain types of security provided by the lessee are excluded from consideration of what might constitute a reduction of the non-compliance risk. These include a mortgage over the ship, an assignment of the ship's earnings or insurances, security over rental rebates arising from the arm's length sale of the ship or any other form of security arising directly from the operation of the ship or from arm's length transactions involving the ship. In addition, the lessor is not entitled to capital allowances if the lease is part of a sale and lease-back arrangement; this does not however apply to ships which are less than four months old.

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The Inland Revenue has recently announced changes to the regime as it applies to leasing structures, as it recognised that although many leases had characteristics of finance leases, they were not finance leases in substance when subjected to closer examination. As a result, such leases were used by lessors to claim more in capital allowances available under the regime than had been intended when the regime was introduced.

Subject to two exceptions, the Inland Revenue has decided that the restrictions on capital allowances set out above applying to finance leases (i.e. defeased leases, sale and leaseback transactions and the reduced allowances for ships costing more than £40m) now apply to all leases entered into on or after 19 December 2002. The exceptions are:

- where the lessor remains responsible for operating the ship at all times throughout the duration of the lease; or
- where the lessor grants the lease as a result of short term over-capacity in a fleet of ships owned by the lessor and the term of that lease does not exceed three years.

As the availability of capital allowances to lessors will be more restricted, it is likely that the changes

will, in particular, affect the financing of high-value ships such as cruise ships where the construction costs will exceed £40m. Lessors of ships will not be able to offer as attractive lease financing deals as before. It is too early to ascertain whether there has yet been an impact on the number of ships coming into the regime but it seems likely that the changes will result in a decrease in the number of ships coming into the regime, as they significantly alter the attractiveness of the UK tonnage tax regime as compared to other tonnage tax regimes.

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