

## **A LEGAL ANALYSIS OF THE LIMITATION OF LIABILITY OF CLASSIFICATION SOCIETIES**

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In recent years, the maritime world has undergone several changes which in turn have altered the working environment of Classification Societies. Perhaps the recent economic crisis was one of the main factors which intensified competition within the shipping industry. Many shipping companies had to cut operation costs in their fight for survival.

Alas, as Newton's law predicts, to every action there is always an equal and opposite reaction. This is precisely what happened in the shipping industry during the economic crisis – there was a rise in shipping accidents, as the shipping market fell.<sup>2</sup> This is where classification societies play an essential role.

Classification societies have been in existence for more than 200 years and have played a fundamental role in improving and securing safety in the maritime industry though their expert surveyors and their knowledge of vessels. These societies have developed rules and standards, through scientific research and by gathering empirical data over decades, which if followed will ensure that vessels are seaworthy and fit for their intended purpose. Miller observes that as vessels become more complex, as the demands for prompt and efficient service grow, and as the pressure of operating vessels as economically as possible increases, the maritime industry is growing to depend heavily on their role.<sup>3</sup>

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<sup>2</sup> International Maritime Organisation; International Shipping Facts and Figures – Information Resources on Trade, Safety, Security, Environment, Maritime Knowledge Centre, 6th March 2012, p. 8.

<sup>3</sup> Miller, Machale A.; Liability of Classification Societies from the perspective of United States Law, Tulane Maritime Law Journal, Vol. 22, Tulane University, 1997, p. 3.

Every classification society has a dual role, that is, on the one hand to express its opinion mainly towards shipowners about the degree of their ships' compliance with the classification society's technical rules, while on the other, to execute a public service by ascertaining, on the basis of an authorisation by the flag State, the compliance of national ships with the national and international regulations in relation to the ships' safety and the issuance of relevant certificates.<sup>4</sup>

Indeed, by ensuring the ongoing seaworthiness of ships, the role of classification societies is considered as one of the preventive measures of maritime safety. This role no longer constitutes a simple private matter as between themselves and the contracting party<sup>5</sup>, but also seeks to protect the general interest of society.<sup>6</sup>

If classification societies do their task well, there would be an automatic reduction of risk of catastrophe. However, when classification societies fail to perform their job as required, serious consequences are inevitable. That being said, a classification certificate should not be construed as a warranty of safety, fitness for purpose or seaworthiness of the ship. It is merely an attestation that the vessel is in compliance with the rules that have been developed and published by the society issuing it.

Classification societies are not guarantors of safety of life or property at sea, or the seaworthiness of a vessel. Although classification is based on the understanding that the vessel is loaded, operated and maintained in a proper manner by competent and qualified personnel, the society has no control over how a vessel is operated and maintained between the periodical surveys it conducts.<sup>7</sup> The responsibility to ensure the vessels' seaworthiness ultimately rests with the shipowner.

The non-delegable duty of the shipowner is of particular relevance when dealing with the liability of the ship's classification society in maritime claims. Indeed, the liability of classification societies may arise from three main claimants: the contracting party, a third party or a State.

The most clear cut situation is, by far, the liability that arises out of the contractual relationship between parties and classification societies – which can take the form of either a breach of contractual duty or a breach of an implied duty to exercise skill and care.

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<sup>4</sup> Antapassis, Anthony M.; *Liability of Classification Societies*, Netherlands Comparative Law Association, Vo. 11.3, December 2007, p. 1.

<sup>5</sup> The shipowner, the charterer, the new buyer, the ship's insurer or another person interested in the ship.

<sup>6</sup> Antapassis, Anthony M.; *op. cit.*, p. 2.

<sup>7</sup> International Association of Classification Societies; *Classification Societies – Their Key Role*, <[http://www.iacs.org.uk/document/public/explained/CLASS\\_KEY\\_ROLE.pdf](http://www.iacs.org.uk/document/public/explained/CLASS_KEY_ROLE.pdf)>

In terms of third party claims, the situation is rather ambiguous. Since there is no contractual relationship protecting the third party, disputes mostly arise out of tort. Indeed, Lux comments that '[t]he obligations of classification societies towards third parties raise the largest number of problems, and are some of the most difficult to solve'.<sup>8</sup> However, for a classification society to be held liable to a third party, three elements should subsist: damages, negligence and a causal link between the two.

In the *Morning Watch*<sup>9</sup> the Court found that the claimant purchaser had not been able to prove a sufficient relationship of proximity and stated that '[t]he primary purpose of the classification system is, as Lloyd's Rules make clear, to enhance the safety of life and property at sea, rather than to protect the economic interests of those involved, in one role or another in shipping'.<sup>10</sup>

Additionally, in the *Nicholas H*<sup>11</sup> the Court held that NKK owed no legal duty to the cargo interests in order:

[to avoid] the outflanking of the bargain between shipowners and cargo owners; the negative effect on the public role of NKK, and the other considerations of policy...It would also be unfair, unjust and unreasonable towards classification societies, to impose a legal duty of care to the claimant notably because they act for the collective welfare and unlike shipowners would not have the benefit of any [statutory] limitation provisions.<sup>12</sup>

Conversely, the US Courts are more willing to find classification societies liable for negligent misrepresentation towards third parties. A successful claim was brought by the new purchaser of a vessel in the *Speeder*.<sup>13</sup> The US Court of Appeals for the Fifth Circuit affirmed a District Court ruled that 'general maritime law cautiously recognises the tort of negligent misrepresentation as applied to classification societies'.<sup>14</sup>

<sup>8</sup> Lux, Jonathan; *Classification Societies*, Lloyd's of London Press Ltd, London, 1993, p. 16.

<sup>9</sup> *Mariola Marine Corporation vs. Lloyd's Register of Shipping*, 1990, 1 Lloyd's Rep. 547 ('Morning Watch').

<sup>10</sup> Kennedy, Andrew; *Classification Societies & the Law – The Inside Story*, Lecture at the Institute of Maritime Law, Southampton University, 9th December 2009, p.9.

<sup>11</sup> *Marc Rich & Co. AG and Others vs. Bishop Rock Marine Co. Ltd Bethmarine Co. Ltd and Nippon Kaiji Kyokai*, 1995, 2 Lloyd's Rep. 299. ('Nicholas H').

<sup>12</sup> *Ibid*, p. 28-29.

<sup>13</sup> *Otto Candies LLC vs. Nippon Kaiji Kyokai Corp*, US Court of Appeals, Fifth Circuit No. 02-30842, 2003 ('Otto Candies'). The Court held that the following criteria must be satisfied in order for Otto Candies to bring a claim for negligent misrepresentation: (1) NKK, in the course of its profession, supplied false information for Otto Candies' guidance in a business transaction; (2) NKK failed to exercise reasonable care in gathering the information; (3) Otto Candies justifiably relied on the false information in the transaction that NKK intended to influence; and (4) Otto Candies thereby suffered pecuniary loss.

<sup>14</sup> *Ibid*, p. 1.

Being delegated by States to certify vessels in terms of the various international safety conventions, classification societies could also be found liable in tort or contract (depending on the type of relationship at hand), should a State incur any liability for the issuance of incorrect certification due to reliance on certification and surveys issued by the societies.

The increasing number of lawsuits against classification societies should have served as a wakeup call to classification societies to be more cautious and responsible. Regrettably, in the aftermath of the *Erika* and *Prestige*, and the several lawsuits that followed claiming compensation for damages, their role and credibility has been seriously undermined. These cases in particular have demonstrated that third party claims against classification societies can give rise to potential considerable liability exposure.

Needless to say, due to a variety of services they provide and the growing trend of claimants to seek compensation from them, classification societies are increasingly exposed to be sued for negligence. Since no internationally liability regime or harmonised legal framework exists, the liability of classification societies depends on which State has jurisdiction over the claim. Such discrepancy in approaches, even between civil and common law jurisdictions, may lead to undesirable 'forum shopping'.

Vaughan precisely opines 'that the stage is being reached where the question of liability of classification societies will no longer be a question of "if", but rather of "when" and thereafter, "to what limit?"'.<sup>15</sup>

This paper will consider the possibility of limiting the liability of classification societies once it has been carved in stone that indeed civil liability can be attributed; and the salient features that should be taken into consideration when proposing the promulgation of a new international convention or the amendment of an already existing one.

#### *Shielding classification societies from liability: is this possible?*

Classification societies are frequently in the limelight especially when a shipping incident leaves hundreds of casualties, or devastating effects on the environment, and are considered by claimants to be easy targets. To date, attempts at regulating this issue have been few and far between, although the CMI and, on a more regional level, the EU have tackled this issue several times.

#### *Limitation of liability regimes in maritime law*

The concept of limitation of liability evolved with the shipping industry itself. In the early shipping days, shipowners had no or inadequate means to

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<sup>15</sup> Vaughan Barbara; *The Liability of Classification Societies*, University of Cape Town, LL.M (Shipping Law) Class of 2006, p.12.

ensure safety of navigation or to forecast the weather. Not only did vessels face the perils of the sea, but were also prone to accidents.<sup>16</sup> In the event of loss of cargo during a shipping incident, cargo owners would turn on shipowners to satisfy cargo claims. In that day and age, vessels carrying cargo were of a lower value than the cargo itself, and could have been the only asset the shipowner had, in which case the latter would be unable to entertain the claim due to lack of funds.

Having envisioned the potential bankruptcy of shipowners faced with hefty maritime claims, the shipping industry, as the main means of international trade at the time, had to develop a system of distribution of losses in the form of marine insurance and general average contributions.

Notwithstanding such development, some shipowners were still faced with bankruptcy. In order to safeguard the position of shipowners in the industry, the concept of limitation of liability had to be devised, whereby a shipowner would be able to limit his liability irrespective of the actual amount of the claim.

Connected to limitation of liability, there is the phenomenon of ‘legal channelling’, that is, liability will be channelled to the registered shipowner while other members of the shipping industry, are exempted from liability.<sup>17</sup> Hence, only one person or a small group of persons, are held accountable for damages. The notion of channelling of liability on the registered shipowner, who manages, controls and derives revenue from the operation of the ship, is mostly evident in the CLC<sup>18</sup> and HNS Convention.<sup>19</sup> Ultimately the shipowner is responsible for the operation and seaworthiness of the ship.<sup>20</sup> Thus, by implication, the channelling of liability on the shipowner reflects his responsibilities.

With regards to the limitation of liability in the maritime field, the LLMC<sup>21</sup>, HNS Conventions and CLC are of paramount importance. Having

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<sup>16</sup> Martínez Gutiérrez, Norman A., *Limitation of Liability in International Maritime Conventions: The relationship between global limitation conventions and particular liability regimes*, Routledge, Oxon, 2011, p. 1.

<sup>17</sup> In contrast, there exists ‘economic channelling’ whereby an injured person prefers, for economic reasons, to sue a person other than the one who is primarily liable under the law. Thus, an injured person might sue a classification society instead of the shipowner knowing very well that their liability is not limited.

<sup>18</sup> International Convention on Civil Liability for Oil Pollution Damage (CLC), 1969 replaced by 1992 Protocol.

<sup>19</sup> International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea (HNS), 1996 superseded by the 2010 Protocol.

<sup>20</sup> Lagoni, Nicolai; *The Liability of Classification Societies*, Springer, 2007, p. 259.

<sup>21</sup> International Convention on Limitation of Liability for Maritime Claims (LLMC), 1976 and the 1996 Protocol.

internationally recognised Conventions and Rules creates harmonisation and uniformity rather than having different claims brought in various jurisdictions.

The LLMC Convention sets specified limits of liability for two types of claims against shipowners – claims for loss of life or personal injury, and any other claims such as damage to other ships, property or harbour works. Taking into account the experience of incidents, as well as inflation rates, the limits set in the 1996 Protocol have, in recent years, been seen to be inadequate to cover the costs of claims, especially those arising from incidents involving bunker fuel spills; hence the revision in 2012.<sup>22</sup>

Under the LLMC Convention, which provides a ‘global limitation system’, limitation of liability is not only afforded to the shipowner but also the charterer, manager or operator of a seagoing ship; that is, those people included in the definition of ‘shipowner’ as well as all person for whose act, negligence or default those persons are responsible<sup>23</sup>, such as crew members and other servants. However, the LLMC Convention does not envisage classification societies, since they are not included in the definition of ‘shipowner’, and considering that they are independent contractors, they do not fall under Article 1(4).<sup>24</sup>

In turn the CLC, as amended in 1992, channels liability on the registered shipowner in the event of pollution damage caused by persistent oil, which liability is strict. Certain third parties are exempted from direct liability to victims of pollution damage unless compensation for damage is sought where such damage emanates from personal act or omission, committed with intent and recklessness. Article III.4 provides a list of other parties against whom no claim for compensation for pollution damage under the CLC may be made. Amongst the listed parties, the phrase ‘performs services to the ship’ in paragraph (b)<sup>25</sup> is of particular relevance to classification societies.

This provision came into play in the proceedings brought against RINA and ABS in the *Erika* and *Prestige*, respectively. Both classification societies attempted to submit to the French and the US Courts the thesis that Article III.4 of the CLC protects classification societies by channelling liability to the shipowner. Although providing different reasoning, the Courts in both cases reached the same conclusion – CLC did not apply to classification societies in those particular scenarios.

In the *Prestige*, Spain hit ABS with a ‘gross negligence suit’ for failing

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<sup>22</sup> For a full discussion on the revision to the 1996 Protocol’s limits see Norman A. Martínez Gutiérrez, ‘New Global Limits of Liability for Maritime Claims’, 2013 International Community Law Review, 15(3) pp 341-357.

<sup>23</sup> Article 1(2).

<sup>24</sup> Martínez Gutiérrez, Norman A., *op. cit.*, p. 208.

<sup>25</sup> ‘the pilot or any other person who, without being a member of the crew, performs services for the ship’.

to detect corrosion and other defective materials; to which ABS reacted by relying on the CLC (although the US had not ratified the Convention). The Southern District Court of New York in 2008 accepted the fact that ABS fell within the faction provided by Article III.4(b) and thus could enjoy protection similar to pilots. However, the Court could not rely on the CLC and dismissed it on jurisdictional grounds. Had the Spanish State, as a signatory to the CLC, pursued the claim before its own Courts then this would have been successful.

On the other hand, in the *Erika*, RINA was prosecuted before the Criminal Section of the Court of Cassation in France where it was held criminally liable for imprudence in renewing the *Erika*'s classification certificates. With regards to civil liability, the Court of Cassation disagreed with the decision of the Court of Appeal where it had held that classification societies could not benefit from the provisions contained in Article III.4 of the CLC, and decided that RINA was not protected by the channelling provisions of the CLC since it did not participate in the navigational or nautical operation of the *Erika* on the incident voyage.<sup>26</sup> Nevertheless, it still could not rely on these provisions since the damage was a result of RINA's personal act or omissions, committed with the intent to cause such damage, or recklessly and with knowledge that such damage would probably result.

Furthermore, to date there have been no reported cases of classification societies found civilly liable in relation to claims for damages arising from noxious and hazardous substances. That being said, since Article 7(5) of the HNS Convention is a replica of Article III.4 of the CLC, courts may find that classification societies can channel their liability under the HNS Convention.

Despite the fact that exposure to liability exists, the position is still unclear as to what extent classification societies can be hit by a suit. Against this backdrop, it is pertinent to consider the reasons why societies should be protected.

#### *Why protect classification societies?*

Firstly, the activities of classification societies are carried out to assets of very high value which are exposed to even higher liabilities. However, more often than not, these societies do not charge fees related to such an exposure, but the charges for the services performed, and fees are not related to the size or value of the asset. The fees for services rendered to a particular piece of equipment do not vary from one type or size of ship to another.

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<sup>26</sup> Foley, J. Vincent and Nolan, R. Christopher, *The Erika Judgment – Environmental Liability and Places of Refuge: A sea changing in Civil and Criminal Responsibility that the Maritime Community must heed*, Tulane Maritime Law Journal, Vol. 33, Winter 2008, No.1, p. 69.

Secondly, classification services do not contribute to the risk level. Classification societies contribute to reduce risk, and they do not take the place of other participants in the industry. It is true that the society is paid by the shipowner, but the shipowner retains the operation of the ship itself. Therefore, it might be challenging to prove that a classification society caused or is responsible for an incident. This not to mention the fact that the ultimate responsibility for seaworthiness cannot rest on organisations with only fleeting contact with and brief opportunity to observe the vessel.

The potential error or default by the classification society in most cases is the omission on its part to discover and recommend what should have been discovered or if it wrongly certifies a vessel.<sup>27</sup> Classification societies survey ships at determined intervals. Shipowners should be controlling them at all times. This notwithstanding the fact that they have no control over the level of maintenance, training, manning, and supervision of the vessel and the areas the vessel trades, or the cargo it carries. This is the shipowner's sole responsibility. It would be quite unjust to expose two parties with such an unequal part of the risk to the same level of liability.<sup>28</sup>

Thirdly, there has been an increase in exposure of classification societies to multiple third party actions. Although the shipowner contracts and pays the society, the service rendered does not only affect the shipowner but all those who ultimately rely on the classification certification. Underwriters, charterers, cargo owners, vessel purchasers, government authorities all rely in one way or another on proper certification. Indeed, the higher the number of parties linked with classification societies is, the higher the risk of exposure becomes.

Fourthly, there is an element of public interest. If the exposure to liability of serving the public interest rises, classification societies will be forced to discontinue their activities. Government authorities, which are afforded sovereign immunity, would be forced to take over their tasks. Unfortunately, most governments do not have the necessary expertise or the right mechanisms in place to replace these societies. Consequently, should a calamity occur, governments are protected by immunity.

It is often argued that higher exposure will lead to higher quality. However, Skou is of a different view:

[t]he highest motivating factor for class societies is our dependence on the trust and confidence of the market. If customers, flag authorities,

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<sup>27</sup> Skou, Amund; Presentation on behalf of IACS to the Centenary Conference of the CMI', paper submitted to the CMI Centenary Conference (Antwerp, Belgium), 9-13 June 1997, CMI Yearbook 1997, p. 181.

<sup>28</sup> Boisson, Philippe; Are classification societies above the law? [http://www.maritimeadvocate.com/classification/are\\_classification\\_societies\\_above\\_the\\_law.htm](http://www.maritimeadvocate.com/classification/are_classification_societies_above_the_law.htm).



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underwriters and others do not have confidence in the individual society, that society will wither and die. That is the driving force behind all quality-driven classification societies.<sup>29</sup>

These are strong arguments for the establishment of a limitation regime, but still do not address the problem of fixing an appropriate level of limitation. The potential risk and loss is the same for levels of service and fees which can vary from less than 1,000 USD to over 1 million USD. It is almost inevitable that a potential claim will be higher than the fee. Yet the international community, and the CMI, seem to accept the fee charged as an acceptable basis for setting liability limits. The major classification societies certainly accept this principle.

Moreover, there has been a suggestion that limitation should be based on the tonnage of the ship.<sup>30</sup> This would be unacceptable to all the major classification societies, as ship size has is of no relevance to the value of a class service and there would be the fear that the societies become the insurers of shipowners.<sup>31</sup> However, the status of ‘insurers’ should never be attributed to classification societies. As things stand today, the insurance industry is already a major driving force in the shipping industry and classification societies should not be pawns in the hands of insurers!<sup>32</sup>

*Initiatives on the limitation of liability for classification societies*

In principle, contracts between classification societies and their clients, besides defining the obligations of both, also lay down the liabilities of the parties to the contract and restrictions as to the amount of compensation payable in case of negligence. A classification society can exclude its contractual liability through special clauses inserted in its general rules. The risk of unlimited liability is therefore beyond the contractual relationship a classification society has with the shipowner, and mostly relates to their exposure to third parties.

*The Comité Maritime International Initiatives*

## The Joint Working Group on a Study of Issues regarding Classification

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<sup>29</sup> Skou, Amund; *op. cit.*, p. 182.

<sup>30</sup> The limitation of liability regime for shipowners is based on tonnage.

<sup>31</sup> Kröger, Bernd; Presentation on behalf of the German Shipowners’ Association and of the Maritime Law Committee of ICS, paper submitted to the CMI Centenary Conference (Antwerp, Belgium), 9-13 June 1997, CMI Yearbook 1997, p.188.

<sup>32</sup> In the *Great American Insurance Co. vs. Bureau Veritas* (‘The Tradeways II’), US District Court New York, 333 F. Supp. 999, 1972, the Court held: “Not only is the liability not commensurate with the amount of control that a classification society has over a vessel; it is also not in accord with the intent of the parties, the fees charged or the services performed”.

Societies (CSJWG)<sup>33</sup> was formed in 1992<sup>34</sup> upon an initiative of the Executive Council of CMI.<sup>35</sup> The issues taken into consideration centred upon the legal rights, duties and liabilities of the classification societies, and the relationship between the societies and the shipowners. The Group was concerned with the increasing number of claims against these societies due to their reputation as ‘deep pocket’ defendants. The thought behind this concern was that if the claims against societies were to rise, the societies would be forced to withdraw some of the services leading to a deterioration in maritime and environmental safety.

Hence, Wiswall, the Chairman of the CSJWG, contended that disastrous results could ensue should classification societies not enjoy limited liability. He explained that, should limited liability not be provided, insurers would apply pressure on classification societies to adapt their operations so as to minimise their exposure to ‘danger areas’.

The CSJWG drafted ‘Principles of Conduct for Classification Societies’, setting out standards which could be applied to measure the conduct of a society in a stipulated case. The Principles of Conduct cover the activities of the societies with respect to statutory, as well as classification surveys; and in order to achieve the desired end, the Principles are intended to be applicable to all classification societies including those who are not members of IACS.<sup>36</sup> The CMI’s project was viewed as ‘breaking new ground’ as it provided an internationally recognised ‘yardstick’ to assess classification society performances.<sup>37</sup>

From the outset of its work, the Group has considered whether these societies should be brought within the ambit of the LLMC Convention, since the Group believes that classification societies should be put on an equal footing and afforded protection like other presently-covered persons in the industry. That being said, since neither an international instrument on

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<sup>33</sup> Hereinafter also referred to as ‘the Group’.

<sup>34</sup> The Group discussed the proposed Model Contractual Clauses, examined hereunder, between 1992-1999.

<sup>35</sup> Representatives from the IACS; the International Group of P & I Clubs; the International Chamber of Shipping (ICS); the International Chamber of Commerce (ICC); the International Association of Dry Cargo Shipowners (INTERCARGO) participated in the discussions, with IMO; and the International Union of Marine Insurers (IUMI) attending as observers.

<sup>36</sup> Likewise, the Principles must apply whether or not a given society is organised as a privately-owned corporation, or is established and/or owned by a Government and organised as a public corporation. see Clause 2 of Annex A of the Principles of Conduct for Classification Societies.

<sup>37</sup> Durr, Sean; *An Analysis of the Potential Liability of Classification Societies: Developing Role, Current Disorder & Future Prospects*, Master of Laws in Maritime Law, Faculty of Laws, Cape Town, p. 32.

limitation of liability for classification societies, nor the inclusion of the societies under the umbrella of the LLMC Convention were foreseeable, the CSJWG had produced a set of Model Contractual Clauses,<sup>38</sup> which, *inter alia*, regulate and limit the liability of the societies. The proposed set of clauses are recommended models for use by individual societies, which may wish to modify them in accordance with commercial practice, particular national law and regulation.<sup>39</sup>

The Model Clauses are divided into Part I, dealing with agreements between the societies and Governments concerning statutory surveys and certification work; and Part II dealing with the Rules for classification of ships, which enumerate the responsibilities of the societies and the shipowners respectively on the one hand, and the liability and contractual limitation of the societies on the other.

In developing the Clauses, which provide some limitation of civil liability, a number of alternatives were considered. Owners and insurers contend that classification society liability should be based upon the tonnage of the ship as under the LLMC Convention. But while the classic limitation of shipowner's liability has been based on the value of the ship, tackle and pending freight, this is not a proper yardstick to measure the risk of classification societies which perform the same service regardless of the size or value of the vessel. It is not the ship, but the service rendered by the society which, in the judgement of the Group forms the fairest and most accurate basis upon which to calculate a limitation of liability.<sup>40</sup>

Since the classification societies and shipowners could not agree on a maximum limit of liability to be inserted in the Clauses, either being a fixed sum or one based on fees, the Model Clauses serve as mere guidelines for classification societies when drafting their General Conditions.<sup>41</sup> Another perceived weakness in the CMI initiative was that, although it focuses on the contractual relationships, it does not deal with third party claims. Indeed, such claims are increasing and enjoy less legal certainty than contractual claims.<sup>42</sup>

### *The European Union Initiatives*

Following the Erika tragedy in 1999, the EU reacted by adopting the Erika Packages intended to improve safety in the shipping industry and reduce environmental damage by ensuring that substandard vessels no longer ply our

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<sup>38</sup> Annex B of the Group's Report found in CMI Yearbook 1995, p. 103.

<sup>39</sup> Joint Working Group; A study of issues re classification societies, Hamburg, 16 January 1996, CMI Yearbook 1995, p. 96.

<sup>40</sup> Joint Working Group; CMI Yearbook 1995, p. 98.

<sup>41</sup> Lagoni, Nicola; *op. cit.*, p. 299.

<sup>42</sup> Durr, Sean; *op. cit.*, p. 34.

seas. However by 2005, it was clear that much remained to be done and that the matter could not be deferred any longer.

The third maritime safety package came into effect in November 2005 and included two Regulations and six Directives which had to be transposed between November 2010 and January 2012. The scope of this package was, *inter alia*, to amend inadequate legislation aimed at harmonising the financial liability regimes of classification societies working in EU Member States<sup>43</sup>, since not having a detailed and clear liability regime for classification societies created ambiguity.

Indeed, the purpose behind the enactment of Directive 2009/15/EC was precisely to ensure that a harmonised legal regime is in place.<sup>44</sup> The Directive establishes measures to be followed by Member States in their relationship with organisations entrusted with the inspection, survey and certification of ships for compliance with the international conventions on safety at sea and prevention of marine pollution.<sup>45</sup> It also includes clauses to express certain amounts as minimum liability to be compensated by classification societies to Member States in the case of a casualty caused by a negligent or reckless act or omission of classification societies.<sup>46</sup>

At any rate, these measures have no bearing on the liability of classification societies to buyers of second-hand tonnage, since the legislation addresses the contractual relationship between the societies and EU flag States. Therefore, the Directive only concerns the limitation of liability of classification societies where a government has recovered against a society after having compensated injured parties.<sup>47</sup>

*How realistic is the promulgation of a convention on classification societies?  
The best approach – International or European?*

The ideal scenario would without any doubt be a convention under the

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<sup>43</sup> Directive 94/57/EC was re-cast in two different Community legal instruments namely Directive 2009/15/EC of the European Parliament and of the Council of 23 April 2009 on common rules and standards for ship inspection and survey organisations and for the relevant activities of maritime administration, and Regulation (EC) No 391/2009 of the European Parliament and the Council of 23 April 2009 on common rules and standards for ship inspection and survey organisations.

<sup>44</sup> Paragraph 17 of the Preamble: “Divergence in terms of financial liability regimes among the recognised organisations working on behalf of the Member States would impede the proper implementation of this Directive. In order to contribute to solving this problem it is appropriate to bring about a degree of harmonisation at Community level of the liability arising out of any marine casualty caused by a recognised organisation, as decided by a court of law.”

<sup>45</sup> Article 1.

<sup>46</sup> Article 5(2)(b)(i)-(iii)

<sup>47</sup> Lixin Han and Ping Yu, *New Developments regarding the liability of classification societies*, *International Maritime Law Journal*, 2006, Vol. 12, Issue 4, No. 22 p. 249.

auspices of the IMO since it has the competence to draft conventions and to convene conferences when necessary, on matters concerning shipping. That being said, since there are currently 170 Member States such a convention would take a considerable time to promulgate and a consensus would most probably never be reached.

Perhaps, on a regional level an EU Directive or a Regulation would seem more plausible. The EU has the competence for sea transport as conferred to it by Article 100(2) TFEU<sup>48</sup> and can adopt regulation pursuant to Article 288 TFEU. Similar to the law-making process of international conventions, EU regulation is also a lengthy process. However, the number of EU Member States, which presently stands at 28, is merely a fraction of that of IMO; thus, once discussions are finalised and a regulation or directive is adopted, it would be binding on all the Member States.

If opting for a more regional approach, one must bear in mind that shipping operates at an international level. What might work out well between EU Member States might not satisfy the various international demands. This besides the fact that classification societies, even if established in a particular Member State, are not confined to only render their services there. Indeed, classification societies are known for being virtually in every port.

Therefore, one might have to reconsider the international approach. Lixin and Ping opine that a limitation of liability regime for classification societies will eventually need to be established.<sup>49</sup> Martínez proposes that this can be achieved if classification societies are ‘recognized as persons falling under Article 1(4) of LLMC Convention or by expressly extending to them the right to limit their liability’ under the said Convention.<sup>50</sup> Hence, he proposed that a new paragraph follows the current Article 1(6) of the LLMC Convention:

A classification society shall, in respect of claims subject to limitation in accordance with the rules of this Convention, be entitled to the benefits of this Convention to the same extent as the shipowner himself.<sup>51</sup>

This seems to be a way forward, but it is not plain sailing. The LLMC Convention has not been ratified by all the States in which a classification society can be sued, although some States enacted it in their national law without ratification. Against this background, Lagoni believes that ‘[o]ne should, therefore, start with a clean slate and envisage a new international convention which is confined to the liability of classification societies’,<sup>52</sup>

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<sup>48</sup> Treaty on the Functioning of the European Union, 2010, OJ C 84/47.

<sup>49</sup> Lixin and Ping; *op. cit.*, p. 249.

<sup>50</sup> Martínez Gutiérrez, Norman A., *op. cit.*, p. 209.

<sup>51</sup> *Ibid.*

<sup>52</sup> Lagoni, Nicola; *op. cit.*, p. 317.

perhaps one which ‘...adopts the minimum standard of limitations which are laid down in the LLMC – however without its protocols...’<sup>53</sup>

*Level of Liability – Strict or Fault based?*

The ideal scenario would be that where a convention would be promulgated harmonising the liability of classification societies and providing for the limitation of such liability. From the outset what would need to be determined would be whether the liability is strict or fault-based. Although classification societies have various responsibilities, these should not undermine those of shipowners.

Under the CLC and the HNS Convention, the shipowner is strictly liable for damage to the environment even in the absence of fault or negligence. It is understood that strict liability would be prejudicial to classification societies since the activities performed by classification societies are merely related to the inspection and classification of vessels, ensuring that there are no deficiencies; whereas shipowners have the non-delegable duty of seaworthiness. Against this background, it would seem unfair for classification societies to be strictly liable for an event beyond their control. Perhaps fault-based liability would be more appropriate.

In relation to contracts between classification societies and their clients, the determination of strict or fault-based liability is superfluous, since the liability between them is generally regulated by contract law. Third parties cannot resort to contract law even if the damage arises from breach of contract since there is no contractual relationship with classification societies. Thus, this lacuna must be catered for in a convention which would expressly define the classification societies’ duty of care toward third parties, and make provision for repercussions in the event of a breach of duty. This would not only provide a framework by which third parties are protected, but classification societies would foresee their possible exposure; provided a causal link between the damage or loss and the breach of duty of classification societies is found.

Once the legal instrument contains clear parameters of liability in tort for third parties, reasonable levels of limitation would have to be in place.

*Basis of limitation – tonnage or classification fee?*

The CSJWG had for long considered whether tonnage or fees charged by the classification society should be the determining factors for the calculation of maximum amount of liability. The classification societies were in favour of a system based on classification fees since it was opined that a tonnage based system would turn them into insurers of the vessel or similar to shipowners.<sup>54</sup>

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<sup>53</sup> Ibid.

<sup>54</sup> Skou, A.W; *op. cit.*, pp. 182-183.

On the other hand, shipowners believed that the limitation should be based on the tonnage of the ship.

Conversely, in the case of compensation to third parties, who are not afforded protection as contracting parties, the classification fee structure would be inappropriate, the reason being that such limitation will vary depending on the classification society involved. Whereas, if the limitation is based on tonnage, then there would be unvarying amount for vessels with comparable tonnage.

A tonnage system, the system upon which limitation of liability under LLMC Convention is based, seems to be the most plausible system. However, the author believes that ultimately, IACS should have the final say on which system would protect them best in an era where classification societies no longer remain ‘untouchable’.

### *Conclusion*

#### *Current challenges facing classification societies*

As the world demands higher standards of ship safety, operation and environmental protection, the burden of making it happen will inevitably fall primarily on classification societies. Nonetheless, as the scope of classification societies work grows, so do the potential liabilities they expose themselves to. It is very tempting for some to see classification societies as ‘deep pocket’ defendants to satisfy their claims. If liabilities grow too great and the societies are sued too often, they could be forced to withdraw or limit some of the services they presently perform in the public interest.<sup>55</sup>

Where the liability of classification societies is concerned, one should first carefully consider the important role of the societies. The potential financial liability of classification societies should be proportionate to its limited role. It must be borne in mind that they do not design, install, operate, manage, manufacture, control, repair, maintain or derive commercial benefit from the vessels, its equipment or any installations being surveyed. International treaties and case law have established a system of liability apportionment, which primarily places responsibility for the safe operation of ships, and for damage and losses arising from failure to operate them properly, on the shipowner.<sup>56</sup>

At law, the person who is ‘primarily responsible for the danger shall have to bear the consequences and not a person who is remote and does not possess similar means to control the risk.’<sup>57</sup> However, with the emergence of the

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<sup>55</sup> Boisson, Philippe; Are classification societies above the law?, *op. cit.*

<sup>56</sup> Hidaka, Masataka; The Legacy of the “Erika” – A vision for marine safety, IUMI Liability Workshop, 12th September 2000, p. 6.

<sup>57</sup> Lagoni, Nicolai; *op. cit.*, p. 303.

possibility of ‘economic channelling’, classification societies are being forced to answer for risk instigated by others. This is unjust since classification societies are liable to an unlimited amount, whereas shipowners may limit their liability.

This goes contrary to the limited control these societies have over a vessel and the fact that the shipowner is responsible for seaworthiness. Indeed, there is no international statutory rule which imposes such a responsibility on classification societies. If the non-delegable duty of seaworthiness rests on the shipowner, one can conclude that if the classification societies are to be held accountable for unseaworthiness of a vessel, then they should enjoy the same protection of the shipowner; that is, allowed to limit liability.

If classification societies’ risk is too high and their liability cannot be limited, they will either have to increase their fees or ‘wither and die’.<sup>58</sup> Indeed, one of the main reasons why courts are generally reluctant to find these societies liable is because they are unable to limit their liability. That being said, the *Erika* judgement has shown that classification societies can be held liable. However, in terms of contractual relationships, classification societies have protected themselves from liability by inserting exemption or limitation clauses in contracts for services.

Having a culture of liability against classification societies, will not necessarily set them back from any other player in the shipping field. On the contrary, this will encourage them to maintain or improve their standards provided they are adequately protected by a limitation to liability especially invoked by third parties in tort.

After more than 20 years since the establishment of CSJWG, the issue of limitation of liability has not been settled. Conceivably, the first step towards this regime was the EU Directive but, needless to say, there still remains a long way to go.

Perhaps, the limitation of liability regime must be amended to incorporate and protect classification societies. Nonetheless, a logical question arises: ‘why should a shipowner, who is said to have the responsibility of providing a seaworthy vessel, be protected financially by a limitation regime, whereas the classification society which he employs to survey his vessel enjoys no such cover?’<sup>59</sup> Consequently, third parties sue classification societies because of their unlimited liability exposure.

Classification societies expressed their desire to fall under a limitation of liability regime, but rightly argue that this may not be achieved in the near future. At the same time, however, classification societies do not want their liability to be based on a ship’s tonnage, as under the LLMC Convention, since

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<sup>58</sup> Skou, Amund; *op. cit.*, p. 182.

<sup>59</sup> Durr, Sean; *op. cit.*, p. 37.



this does not reflect the amount of work undertaken by them.

In this light, a dilemma arises: should classification societies be afforded limitation, exemption from liability or unlimited liability, especially in respect to third party claims?

A complete exemption from liability is perhaps the ideal situation since classification societies would no longer need to insure their risks. In turn, this could lead to insufficient compensation where such risk would not be entirely insured by the shipowner. Lagoni believes that should this approach be favoured, then this 'would most probably cause lack of accountability and credibility of these societies'.<sup>60</sup>

Conversely, unlimited liability would not be economically viable for classification societies since in order to insure such liability the premium would be costly. Consequently, the classification societies would have to increase their fees in order to balance out the expenses. An increase in the fees might stimulate shipowners to seek the services of a competing society.

In view of these approaches, the most reasonable choice seems to be to limit the liability of classification societies. This would balance out the interest of the injured party and his right to claim compensation, whilst keeping classification societies in business.

Promulgating an international convention which establishes a fault-based liability, the right to limit liability, the circumstances in which such right is to be forfeited, and in certain cases, specific limitation amounts, would be ideal. However, the author believes that at a time when the shipping industry is still recovering from the aftermath of recession, embarking on an international project to promulgate such a convention will probably not feature prominently on the agenda of any Government or international institution.

In this day and age, classification societies no longer remain 'untouchable' within the shipping industry. Ultimately, it is purely in the interest of IACS to come up with the best solution, preferably before another major tragedy strikes!

*Practical solutions for these challenges: the way forward*

The CMI initiatives relating to the formulation of 'Principles of Conduct for Classification Societies' and 'Model Contractual Clauses' and the regulatory framework set out by the EU were undeniably a positive step forward. Durr believes that 'to cut the Gordian knot that, since 1880, has bound classification societies to their shipowner clients is an unrealistic view and it is furthermore doubtful whether marine insurers would once again be in a position to 'employ' classification societies.'<sup>61</sup>

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<sup>60</sup> Lagoni Nicolai; *op. cit.*, p. 315.

<sup>61</sup> Durr, Sean; *op. cit.*, p. 37.

Insurers are not willing to ensure the unlimited risk of classification societies. Indeed, no insurance company would be willing to subject itself to unlimited liability arising from claims against classification societies, which claims can vary from pollution to passenger claims. Indeed, it appears highly improbable that any insurance company will offer cover to classification societies if their liability is unlimited. That being said, like any entity within the shipping industry, classification societies should have the possibility of insuring themselves against the potentially disastrous effects of liability.

It has been suggested that perhaps mutual insurance through an institution similar to Protection & Indemnity Club could offer higher coverage. The members of the P&I Clubs would be classification societies which form an association to protect one another against large financial losses. That is, if a loss occurs to one of the societies as members, all others have to contribute accordingly. Therefore, the thought behind P&I Clubs is specifically to cover liabilities and claims which are otherwise not insurable.

However, sharing the risk mutually between classification societies might prove to be challenging since classification societies vary, as between themselves, when it comes to the types of vessels they classify.<sup>62</sup> In the event that IACS wishes to establish such a club, it would then have the intricate task of agreeing on a minimum amount as premium. That is, the more different the risk structure, the more difficult it is to establish a consistent premium which is accepted by all members of the club.<sup>63</sup> A solution to this might be by having classification societies contribute according to the tonnage they class.

The most prominent concern when there is a shipping accident revolves around the impact of the incident on the environment. This could be seen in the *Erika*, which maritime claim mainly concerned the detrimental effect on the environment from an oil spill. In these cases, the shipowner is, in some way or another, able to limit his liability by means of international funds<sup>64</sup> which compensate for such damage. The concept behind these funds is that '[t]here is no single legal entity that should have to shoulder all consequences of a casualty even if it was responsible for the incident' and they ensure that no one would be 'liable to an unlimited amount even if his responsibility for the incident was proven'.<sup>65</sup>

Against this background, it is reasonable to say that the consequence for any damage emanating from a maritime incident is to be borne by the perpetrator. Therefore, whether it is the shipowner, the classification societies or any other person, liability should be attributed. However, if the same degree

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<sup>62</sup> For instance, one may appreciate, passenger vessels and container vessels vary in risk.

<sup>63</sup> Lagoni, Nicolai; *op. cit.*, p. 305.

<sup>64</sup> Such an international fund is provided by the CLC.

<sup>65</sup> Lagoni, Nicolai; *op. cit.*, p. 307.

of exposure to liability is allowed, then by implication there should be an equivalent regime of protection from this liability.

The author believes that classification societies should be found liable in so far as they are negligently involved in a maritime incident through a fault-based system of liability. Nonetheless, the societies should be allowed to cap such liability to an extent which, on the one hand, does not discourage them from remaining in business, while on the other, will not allow them to get too comfortable with the thought of being protected.

Indeed, the *Erika* ruling provides a compelling and persuasive basis upon which courts can structure existing precedent to hold classification societies liable for damages caused, negligently and recklessly through their services, to third parties. If courts decide to take that route, a strong message will be sent to the classification community that they ‘require higher ethical standards from their surveyors actively to prevent succumbing to the pressure of financially based shipowner demands’.<sup>66</sup> This is logical, considering that classification societies have the most historical knowledge in ship structure and surveyors with highly specialised expertise.

Therefore, in conclusion, it is indispensable that the work within CMI continues in regulating classification societies so that the necessary changes can be made without delay. The role of classification societies is still very relevant and crucial in securing a proper maritime regime operating under meaningful concern for shipping safety and environmental consideration.

Classification societies are, and remain, a vital link in the chain of interests and responsibilities in modern day shipping. Severing that link would have wide-spread repercussions on the state of maritime affairs for years to come. The author believes that it is imperative that full efforts be made by those concerned to ensure that classification societies will be assured a viable future for the proper exercise of their important functions, within a widely-endorsed legal framework.

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<sup>66</sup> Foley, J. Vincent and Nolan, R. Christopher, *op. cit.*, p. 72.