

## LIABILITY OF CLASSIFICATION SOCIETIES – CURRENT STATUS AND PAST CMI INITIATIVES

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### *Preamble*

Why are we here in Hamburg talking about Classification Societies a mere ten months after the subject was so comprehensively dealt with in Dublin?<sup>2</sup> There has of course been an enormous amount written on classification societies over the last few decades but the suggestion to put class onto the program this year again came initially from the DVIS - because of the DNV/GL presence in Hamburg, class is a relevant topic in this city. I picked up the suggestion because it seemed to me that in relation to the issue of the liability of class, we going nowhere and rather slowly. While there has been some progress in terms of EU directives and the IACS internal guidelines, the broader issues of what liability class has for its errors and negligence have not been resolved, nor has the issue of possible limitation of that liability. Not surprisingly, there is little or no harmony in the approaches of the world's courts.

I was on the CMI EXCO when a Joint Working Group of the CMI under the leadership of Frank Wiswall produced its report which was published in the 1996 year book. The Group tabled Model Contractual Clauses for contracts between class and both shipowners and governments, and Principles of Conduct for Classification Societies. But neither document has ever been used. It occurred to me that this is an ideal example of a situation where the CMI and an enormous number of participating experts spent a decade working on a

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<sup>2</sup> Dr Denise Micallef's paper can be found at [www.cmi2013dublin.com/download/file/191/](http://www.cmi2013dublin.com/download/file/191/).

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project and produced instruments but the matter then went to rest - though they may have had bearing on class's own general internal guidelines. To get to the end of the story at the beginning - the recommendation of the CMI working group was that it favoured a convention imposing liability on class in appropriate circumstances in tort and in contract, without immunity. But the group also favoured some form of limitation and this was where the project ground to a halt: no agreement could be reached on the extent or method of limitation. Would the measure be a factor of the fee or a factor of the tonnage or combination? In the end the project was filed.

It is clear that both sides are unhappy with the present situation where undoubtedly there is a hole in the law - though one should not talk about 'sides' because this should be a combined effort of class, shipowners/charterers and governments to close that hole. And it thus seemed to me that this was possibly a valid project that might well warrant revival by the CMI through its planning committee. The purpose of these sessions on the liability of class is thus to ask you to consider whether the CMI should start work on the liability of classification societies anew.

This audience is ideally suited to debating the issue: Past CMI President Karl-Johan Gombrii, CMI Council member Alex von Ziegler, and the doyen of the German maritime law fraternity, Dr Bernd Kröger all served on the Joint Working Group, and all are present. This formidable Working Group which included Dr Allan Phillip, Charles Goldie, Jim Horrocks, and representatives of IACS, ABS, and the ICS produced documents that remain as useful and significant as the day they were written. And especially so, because nothing has changed since. We have access to their research, and we can surely make use of it in order to try and see whether there is some support for an initiative to try again to close this hole in our maritime laws.

*The basic law of liability of class*

Owing to time constraints, let me gallop across the basic issues the law faces in relation to the liability of class. You will all be aware of the generally recognised dual function of classification societies. The first is their *public function* in which they act on behalf of flag states, generally through the maritime safety department of those states. For those flag states as their clients they class exercises a delegated governmental authority and issue compliance certificates with SOLAS and other international regulations.

Then there is a second string to class's bow which is the more *private function* I say 'more' because as we will see with a quick glimpse through some of the cases, the distinction between the public and private function of class is not as defined as it used to be. Essentially, the private function is where shipowners ask and employ class to certify the condition of their vessel and to issue some form of a certificate with which they can trade their vessels.

In both the private and the public function, it is generally accepted that

the world at large and business in particular should be able to make use of and rely upon the veracity of the certificate. And this is where much of the blurring of the two functions arises.

Where class acts or fails to act in dereliction of its duty (either to the shipowner client or the government principal, or perhaps even to the maritime world at large) then the issue of liability arises. Direct client claims from whoever has employed class are relatively simple. It's not much different from clients claiming from solicitors for professional negligence: generally the solicitor will stand responsible for his/her action measured against contractual requirements or the performance norms of society. But the liability with which we are particularly concerned - and clearly the most problematic - is the liability of class against third party claims from those outside the contractual *nexus* of the parties. The reality is that the sort of claims that come out of damage to or done by vessels are so colossal that any enthusiastic lawyer will grab whoever they can to join as co-defendants to a claim. It has happened frequently. And what must be most disquieting to class, is that the world's maritime courts have no uniform approach.

#### *Significant cases on liability*

On this occasion I can only skip through a few of the leading cases.<sup>3</sup> *The Tradeways* is perhaps the starting point. In a claim against BV which had inspected a vessel for both owners and charterers, a breach of duty of care was alleged after the vessel sank. The court recognised (albeit *obiter*) that there were two duties of care: surveying and classifying in accordance with class rules where owners cannot delegate their responsibility for the condition of the vessel even where class has erred; and the duty to detect and notify class related defects, where third parties suffering loss could possibly claim against class. This recognised the private/public functions of class.

Next, and more significant, was *The Sundancer*. Here a claim was brought against class based on the tort liability of US misrepresentation law. The claim was disallowed, but the interesting thing about *The Sundancer* is that the owners had relied on what they averred to as an incorrect class report as the factual cause of the loss of the vessel. The court finding, which was signal and which established a trend in Anglo-American Law was that class does not

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<sup>3</sup> This is a selection of cases that illustrate the variety in the approach of courts to the issue: *The Tradeways* (USA); *The Sundancer* (USA); *The Morning Watch* (UK); *The Nicholas H* (UK); *The Spero* (Belgium); *The Paula* (Belgium); *The Elodie II*; *The Cap de la Hague* (France); *The Erica* (France); *The Prestige* (everywhere – but especially the French decision on immunity from jurisdiction); *The Redwood* (Genoa). For full citations and analyses of these and other cases, see Micallef *supra* and the author's *South African Shipping Law & Admiralty Jurisdiction* (Juta, 2<sup>nd</sup> Ed 2009 §6-3.1) and works referred to therein.

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in any way guarantee the condition of the vessel and that the shipowner's responsibility in relation to the condition of the vessel was absolute and non-delegable. The shipowner could not then hide behind the class certificate and leave the claimant to sue class direct. Presiding Judge Pratt put the issue very simply: the purpose of the classification certificate is not to guarantee safety but merely to permit the owners of the vessel to take advantage of the insurance rates available to a vessel in class. This is a very narrow interpretation of what class does. The consequence of *The Sundancer* was that to my knowledge there has never since been a successful claim against class in the United States.

The English courts followed the same trend, and *The Morning Watch* probably set the bar. In *The Morning Watch* there was a defective yacht survey and the court analysed the duty of care that applied to the actions of class in relation to that survey. The court set out the three basic requirements for liability to arise in English law: reasonable foreseeability, proximity and that the outcome should be fair, just and reasonable. *The Morning Watch* found the claim lacking in all three and ruled that the primary purpose of class is to enhance safety of life and property at sea rather than to protect the economic interests of those involved in shipping.

This was clearly a convenient approach for the courts at that time and it is an approach that carried through to the celebrated case of *The Nicholas H* where a claim against class was similarly disallowed. Steyn LJ in his judgment however made it quite clear that he preferred to come out with a result that was comfortable within the workings of the shipping industry and it was completely unthinkable to transfer the sort of risks that this sort of liability and exposure would put onto classification societies. He debunked in that judgment the fact that class is a deep-pocket defendant: to be sued when you have no possibility of a successful claim against anyone else. The learned Judge of Appeal tried to tailor the outcome of the case to what he perceived to be a good business solution. That is not unusual in English common law, and though in most in such judgments there is a satisfactory outcome, it is quite difficult to anticipate and indeed to advise a client on what that outcome is likely to be. If the trial judge takes a purely business view and in the process ignores some established legal principles, new law can emerge. But so be it: that is how the common law evolves.

Now that is the western side of the English channel. This common law/civilian divide with which we are burdened depending on whether we are common lawyers or civilian lawyers (or some of us sitting somewhere in the hybridized middle) can give rise to different outcomes in similar disputes. The liability of class is perhaps an example - because whereas the English side of the channel (English Law, United States law and to an extent some Australian and New Zealand Law) has ruled class out of bounds, classification societies have not enjoyed the same comfort in Europe.

I cannot unfortunately go through these in any other detail than to alert you to the Belgian cases of *The Spero* where liability was allowed, and *The Paula* which held that a clause in which class tried to contract out of liability was unenforceable - and therefore presumably the same fate would suffer a contractual limitation clause. Neither case can give class much comfort.

The French cases of *The Elodie II* and *The Cap de la Hague* (the latter with the criminal element to it) also seem to me to produce results that raise the possibility of a claim against class. We have no time here to debate these cases.

But then we come to more recent cases. *The Erika* and *The Prestige* produced more than their fair share of litigation but there were two issues that interest me in recent decisions concerning each vessel. The first was in *The Erika* Court of Cassation finding that over-ruled the Court of Appeal and accordingly found that the channeling provisions of CLC<sup>4</sup> could have been applied to the claim against RINA but for the presence of gross negligence and recklessness (the presence of which rules channeling out). The implication was therefore that class was grossly negligent or reckless.

And the *Prestige* too has produced an interesting recent decision: When it was the French government's turn to claim its losses from class, the French sued ABS for its "failure to detect an important structural defect in vessel" and for "allowing flag registration certificates to be issued without establishing that the vessel complied with required safety standards". Is this the private or public function or was there overlap of the two? The latter does appear to be how the French court viewed the actions of class. The Bordeaux Court found that ABS's functions all related to the classification and certification of vessels. "They are mandated to monitor compliance with the rules applicable to the design, construction and maintenance of ships, and to evaluate the resistance of the ship's structure and the viability of their engines". This would appear to be recognition of the two separate functions as linked activities. And then came the really interesting issue: whether ABS could claim to be an organ of the Bahamas government. Was it acting simply as a contractual appointee, was it acting as an independent contractor or was it an organ of the government of a nature and to an extent that it could rely on the principles of immunity from jurisdiction? The court's decision in March 2014 was that this principle of immunity from jurisdiction was an established part of the customary law of France that enables entities other than government or administrative bodies including private companies to rely on the immunity provisions of the law and therefore be exempt from claims, where they act for and on behalf of a foreign state. The French claimed that immunity can only arise where class acts in the

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<sup>4</sup> Article III.4 of the 1992 Civil Liability Convention.

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exercise of a public authority, safety authority or flag authority or in the interest of a public service. Further, said France, to rely on this immunity, class must be a genuine extension of the state and cannot simply be a commercial operation performing a contractual obligation for the state. ABS should not therefore be regarded as an organ of the state of the Bahamas because in issuing classification certificate they were acting in a purely private capacity.

The Bordeaux Court in March ruled that the criteria for immunity is that the perpetrator may be a private company provided that it is acting for and on behalf of the state as an agent acting for the state. An entity that is thus appointed and who certainly has delegated powers, acts then in the exercise of a public authority. The court's opinion was that "classification activities and the activities delegated by Bahamas concerning inspection and certification of vessels constitute in reality one and the same activity, and at the very least, are very closely connected activities". This decision seems to blur the separation of the two functions - private and public - and looks at them together as indivisible functions. "The distinction between certification and classification activities is impossible in practice as both activities are indivisible in nature", said the court. Consequently, notwithstanding that there was a private element to ABS issuing certificates this did not defeat the right of ABS to rely on immunity, which was upheld. ABS was off the hook, not because it was neither reckless nor negligent, but because in issuing its certificates an organ of the state of the Bahamas, and acting as such it was immune from claims.

The EU measures<sup>5</sup> which may have influenced the outcome of the case (with which Prof Jessen is dealing in his paper to follow) did not apply because the Bahamas are not part of the EU - and the Directive only applies to EU countries. This is perhaps evidence of a weak link which does little to fill the hole in the law: commendable steps by the EU in relation to classification are not applicable to non-EU classification societies. Similarly IACS's guidelines on the conduct of classifications apply only to IACS members and not to the more delinquent of classification societies.

I must in the limited time left to me draw your attention to the Genoa case of *The Redwood* which I picked up from the company note of Maurizio Dardani. There has in this case been a judgment against Lloyds in relation to defective surveys of a vessel that were done three years before loading in Hamburg on a voyage to Libya. The claimant averred that the vessel should not have been cleared by class because she had defects which resulted in losses during cargo discharge. An appeal to the judgment has been filed by Lloyds, and a further appeal could follow.

All of this points to a singular lack of consistency of approach in the world's courts. And leaves the liability of classification societies in a great

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<sup>5</sup> For example the EU Directive, 23 April 2009 and Directive 94/57/EC 22 Nov 1994.

state of uncertainty. This is the hole in the law that I would ask if we in the CMI should again seek to address.

#### *Past & Future role of the CMI*

The CMI's Joint Working Group laboured from 1992 to 1997 over 13 sessions to find a compromise. The Group was chaired by Dr Wiswall, and the CMI duly adopted its two instruments: Principles of Conduct for Classification Societies, and Model Contractual Clauses, of which Part I deals with Statutory Surveys for governments and Part II, Classification of ships for shipowners and charterers. The Group in its report came out in favour of the recognition of a liability of classification societies for dereliction of their duties, without immunity such as was claimed in *The Prestige*. It favoured limitation of that liability, and absent any other formula such as a factor of the fee or the tonnage, it suggested fall-back on LLMC 1976. It suggested that contractual limitation should be recognised. One should note that there was sound representation on the group of shipowners, insurers and class.

What are the possibilities of a way forward? Should we as a body of maritime lawyers not again recognise that there is a hole in the law. That we are failing our constituency of the societies themselves, owners and charterers, cargo, business and the courts if we ignore the problem in the vain hope that it will go away. It will not. Class will continue to be sued, and that suit could happen in jurisdictions where there is perhaps a lack of understanding of the business of shipping and of insurance. Class cannot in today's world and particularly in jurisdictions new to shipping law, expect the courts to be as accommodating as Pratt J and Steyn LJ. Shipping litigation has become increasingly visible, emotive and public. Crippling judgments could result which could ruin otherwise sound societies. Class is an essential player in our industry, yet there is no consistent internationally harmonised approach on whether they should be liable for errors and omissions, and to what extent. Fallacious as it may be, claimants regard class as having deep pockets. The bigger the claims, and the more far-removed the jurisdiction, the more likely it is that class would be joined to an action against a penniless or unavailable shipowner. IMO measures dealing with classification do not settle liability nor limitation. EU measures do not reach beyond the EU nor do IACS controls affect the very classification societies that we would seek to bring to book. Uncertainty of this scale is bad for the shipping, freight and insurance markets. Only the lawyers benefit.

Yet it is we as lawyers who do recognise the inadequacies in the law as it stands. And I suggest that we should not give up the attempts that were made by the CMI with the industry in the 1990's that came so close to an agreement between classification societies and the industry they serve. I would have thought that the starting point would be to form an ad hoc committee within the CMI, hopefully served by Karl-Johan Gombrii and Alex von Ziegler, and

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then consult with the industry and see whether the main players would like the CMI again to become involved.<sup>6</sup> But we would then need all their participation and help - because to go at alone would be a hiding to nothing: we would go still further nowhere and probably even slower.

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<sup>6</sup> After an enthusiastic response to this talk and to the subsequent presentation of Prof Henning Jessen, the CMI EXCO in Hamburg established an ad hoc committee to look into the issue further.