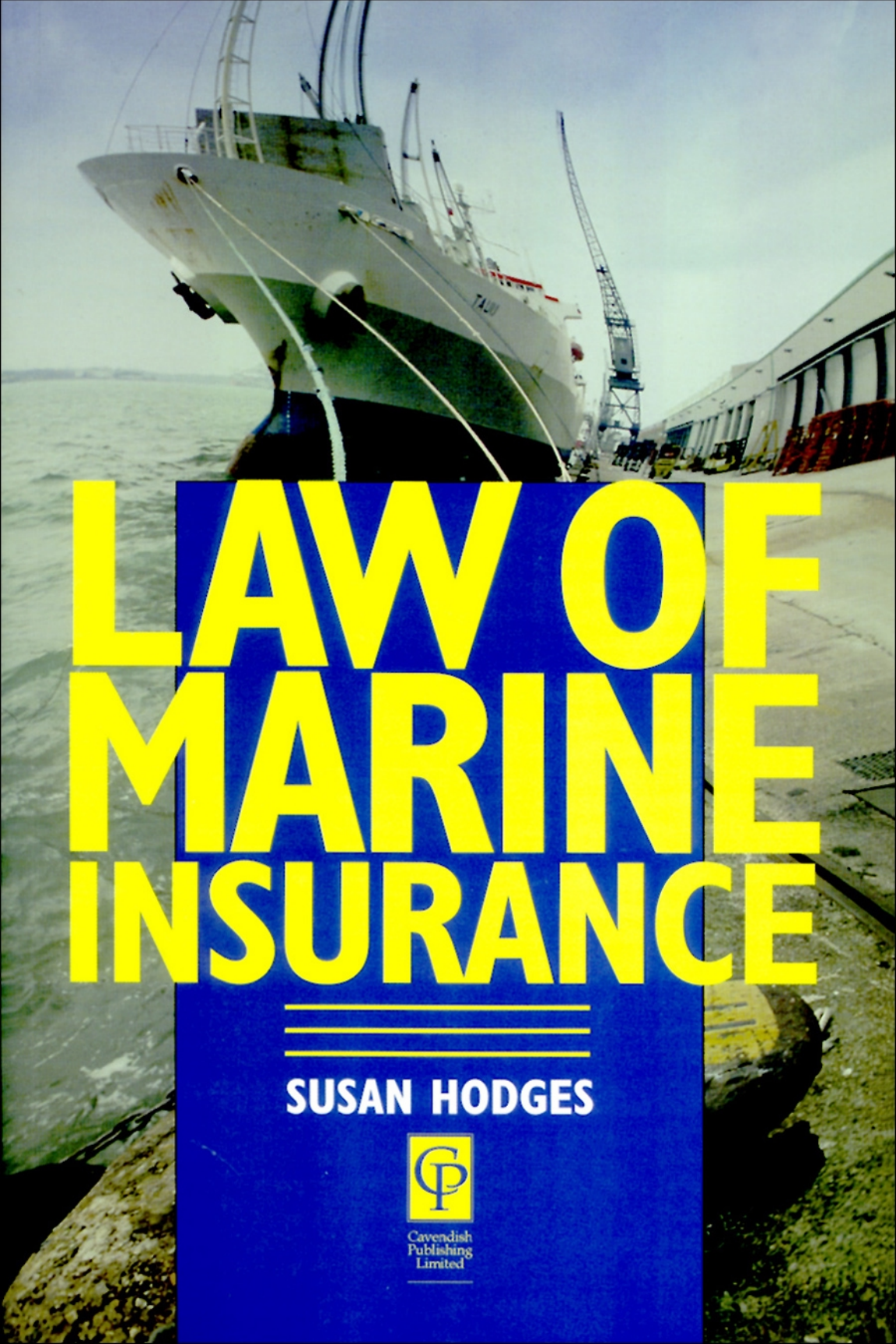

LAW OF MARINE INSURANCE

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CHAPTER 13

3/4ths COLLISION LIABILITY

INTRODUCTION

When two ships collide, both are bound to sustain some degree of damage, and this raises questions as to the rights and liabilities of their owners which, assuming that one or both of them are insured, could in turn actuate legal issues relating to marine insurance. There are two aspects to the problem: first, the matter has to be looked at from the position of the owner of the insured vessel in relation to the damage sustained by his own vessel and, secondly, in relation to his liability to the third party whose vessel has been damaged as a result of the collision with the insured vessel.

The insured vessel

The owner of an insured vessel (vessel A), should be able to recover from his own insurer for any damage sustained by his own vessel as a loss caused by a peril of the sea.[1] The fact that the master or crew of the insured vessel, vessel A, may have been negligent in the navigation of the ship and is partly or wholly responsible for the collision is immaterial, for s 55(2)(a) provides that the insurer is liable for any loss proximately caused by a peril insured against, 'even though the loss would not have happened but for the … negligence of the master or crew'. Moreover, both the ITCH(95) and the IVCH(95) (cll 6.2 and 4.2 respectively, also known as the Inchmaree Clause) expressly states that:

> 'This insurance covers loss of or damage to the *subject-matter insured*[2] caused by – negligence of master, officers, crew or pilots.'

The 'subject-matter insured' refers to the assured's own vessel (vessel A), not the vessel which vessel A has collided with.

In so far as the insured vessel is concerned, there has never been any problem as regards recovery: subject to the limits set out in his policy, the assured is entitled to recover the full extent of the loss sustained by his own vessel as a loss caused by a peril of the seas.[3]

The Pollution Hazard Clause

Clause 7 of the ITCH(95)[4] on pollution hazard allows an assured to recover for any loss of or damage to the insured vessel caused by 'any governmental authority acting under the powers vested in it to prevent or mitigate a pollution hazard or *damage to the environment or threat thereof*, resulting directly from

1 Collision is a peril of the sea: *The Xantho*, (1887) 7 HL Cas 504.

2 Emphasis added.

3 It needs to be recalled that in so far as the policy subscribed by the owner of vessel A is concerned, the subject-matter insured is his own vessel (vessel A), and not the vessel (vessel B) belonging to the third party.

4 Cl 5 of the IVCH(95). Cl 7 was introduced in the ITCH in 1983; but it was in use since 1973 following *The Torrey Canyon* disaster of 1967.

damage to the Vessel for which the Underwriters are liable under this insurance …'.[5]

The purpose of this clause is to provide additional cover for the assured in the event of action taken by any governmental authority, to avoid or reduce a pollution hazard and damage to the environment or threat thereof, which has caused loss or damage to the insured vessel.

First, it needs to be mentioned that cl 7 is not restricted to a claim in connection with the 3/4ths collision liability clause. It is of general application, allowing the assured the right to recover for any loss of or damage to the insured vessel sustained in the course of action taken for the prevention or mitigation of pollution. Nevertheless, it is convenient to discuss this clause here because such loss or damage could well arise when a collision occurs; furthermore, it is particularly relevant to the new amendments made to the exclusion clause (cl 8.4.5) of the 3/4ths collision liability clause (cl 8) of the ITCH(95) which will be discussed in this chapter.

Secondly, it is to be noted that the wording of the clause is precise: recovery for such a cause of loss of or damage to the insured vessel will only be allowed if it resulted 'directly from damage to the Vessel for which the underwriters are liable under this insurance …'. This means that the original damage to the vessel must be proximately caused by an insured peril. Provided that the underwriters are liable for the original damage, they will also be liable for any loss or damage suffered by the insured Vessel caused by governmental action taken to prevent or mitigate a pollution hazard or damage to the environment or threat thereof.

Finally, it is also to be noted that there is a proviso to cl 7 to the effect that the action taken by the governmental authority must not have resulted from the want of due diligence by the 'assured, owners, or managers' to prevent or mitigate such hazard or threat thereof.[6] This proviso is similar to the old proviso in cl 6.2 of the ITCH(83). It is observed that the want of due diligence by 'Superintendents or any of their onshore management' is not included in this proviso, whereas it has recently been included in the proviso to cl 6.2 of the ITCH(95).[7]

Third party liability

Assuming for convenience that the insured vessel (vessel A) is wholly to be blamed for the collision, her owners would be legally liable to pay damages to the third party (owner of vessel B) for the damage sustained by vessel B. This then raises the following question: has the owner of the insured vessel (vessel A) the right to recover from his own insurer his liability to the third party? This question was answered in 1836 in the case of *De Vaux v Salvador*,[8] where the

5 The words in italics were added by the ITCH(95).

6 Clause 7: 'Masters Officers Crew or Pilots not to be considered Owners within the meaning of this Clause 7 should they hold shares in the Vessel.'

7 Whether the failure to amend cl 7, so that it may be brought in line with cl 6.2, is an oversight is unclear.

8 (1836) 4 A & E 420.

court decided that liability for collision damage incurred by an assured was not recoverable under the terms of what was then an ordinary form of marine policy on a ship. The effect of the decision meant that an assured would be out of pocket to the extent of the amount of damages which he had to pay to the third party.

As a consequence of *De Vaux v Salvador*, the running down clause was introduced which over the years was developed and enlarged. Its present form is now contained in the 3/4ths collision liability clause, often referred to simply as the 'collision liability clause', and can be found in both the ITCH(95) and the IVCH(95).[9]

THE COLLISION LIABILITY CLAUSE

Insurance against liability to a third party is expressly countenanced by s 3(2)(c) of the Act, the relevant parts of which state:[10]

> 'In particular there is a marine adventure where – Any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils.'

It may be helpful to divide this study of the clause into two main parts. First, the meaning of the word 'collision' will be considered, followed by a discussion on the extent of the liability of the insurer and matters relating thereto.

Collision

The assured will only be indemnified under cl 8 of the ITCH(95) and cl 6 of the IVCH(95)[11] when the liability of the assured arises in consequence of the insured vessel 'coming into collision with any other vessel'. The two words here that require close examination are 'collision' and 'vessel'.

The word 'collision' conjures in one's mind a picture of two vessels coming into direct physical contact with one another, and some impact on the hulls is generally expected.[12] However, actual bodily contact of hulls is not necessary, and this was made clear in *The Niobe*[13] and *Re Margetts v Ocean Accident*,[14] both cases relating to damage caused by a tug whilst towing another vessel.

In the first case, the tug which was towing *The Niobe* came into collision with and sank another vessel, *The Valetta*. The owners of *The Valetta* recovered damages both from *The Niobe* and the tug, whereupon the owners of *The Niobe* instituted this action against their insurer seeking an indemnity for the amount which they had to pay to the owners of *The Valetta*. The insurer's defence was

9 Clauses 8 and 6 respectively.

10 See also s 74.

11 As cl 8 of the ITCH(95) and cl 6 of the IVCH(95) are identically worded, it would be more convenient simply to refer only to cl 8 for this discussion.

12 In *Union Mar Insurance Co v Borwic*k [1895] 2 QB 279, at p 281, Mr Justice Mathew said: 'I cannot distinguish collision with from striking against'.

13 *David M'Cowan v Baine & Johnstone & Others* [1891] AC 401, HL.

14 [1901] 2 KB 792.

that under the policy he was only liable for damage arising from a 'collision'.[15] They argued that because *The Niobe* herself did not at any time come into physical contact with *The Valetta*, there was no 'collision' and, therefore, the collision liability clause did not apply.

The above contention was rejected by the House of Lords which held that the tug and tow must be regarded as – one and the same vessel – a single entity. The accident, albeit indirect, was nonetheless, a 'collision'. As regards the words 'come into collision with any other vessel', the Earl of Selborne said:[16]

> 'I should also hold them to cover an indirect collision, through the impact of the ship insured upon another vessel or thing capable of doing damage, which might by such impact be driven against the ship suffering damage.'

Lord Morris considered the tug as a 'part of the apparatus for moving the ship *Niobe*, and that a collision by the tug whilst so towing *The Niobe* was a collision of *The Niobe*' within the meaning of the clause in the policy.[17] Whether tug and tow be considered as one single item, or as a part of the other, the result is the same.

In *Re Margetts v Ocean Accident*,[18] the court had to consider whether an accident caused by a tug striking upon a vessel's anchor was a 'collision'. Though an anchor may be a considerable distance away from the vessel, it is 'not the less a portion of the vessel'.[19] Citing *The Niobe* as authority, the court held that the tug had come into collision with a 'vessel'.

In *Bennett SS Co v Hull Mutual SS Protecting Society*,[20] an assured took the matter one step further by arguing that fishing nets, which were attached to and extending from a fishing vessel about a mile away from the steamship, were part of a ship. The argument was along the lines that as a tug and an anchor have been considered as parts of a ship, there was no reason why fishing nets could not be considered likewise. This submission was rejected by Lord Reading CJ, who said that, 'Nets … are not a part of the ship in that sense, nor are they things which it is necessary for her to have and without which she could not prudently put to sea'.[21]

The navigation clause

The principle laid down in the above authorities in relation to tug and tow must be applied with caution. It is noted that in the first two cases, it was made clear to the insurer from the terms of the cover that the insured vessel could be under tow: that the insured vessel could at some stage of the adventure be towed or be

15 The term of cover was, 'If the ship hereby insured shall come into collision with any other ship or vessel and the insured shall in consequence thereof become liable to pay, and shall pay, to the persons interested in such other ship or vessel, any sum or sums of money …'.

16 [1891] AC 401 at p 404, HL.

17 *Ibid*, at p 411.

18 [1901] 2 KB 792.

19 *Per* Ridley J, *ibid*, at p 795.

20 [1914] 3 KB 57, CA.

21 *Ibid*, at p 61.

under tow was understood between the parties to the contract of insurance. In this regard, the position in these cases is different from that under the ITCH(95) and the IVCH(95) where each contains a warranty to the effect that:

> '… the vessel shall not be towed, except as is customary or to the first safe port or place when in need of assistance, or undertake towage … under a contract previously arranged by the Assured and/or Owners and/or Managers and/or Charterers.'

In such an event, the insurer does not have to rely on the collision liability clause, or the arguments raised in the above cases, to refute liability under the policy. All that they need plead is that a breach of a warranty had been committed the effect of which is that they are automatically discharged from liability as from the date of breach.[22]

'Vessel'

The collision liability clause can only be invoked if the insured vessel collides with another 'vessel'. Thus, a collision with a brick wall, lighthouse, dock, buoy, pier or quay will not attract the operation of the clause.

Sunken vessels and wrecks

Whether a sunken vessel or wreck can still be called a 'vessel' was considered in *Chandler v Blogg*,[23] and *Pelton SS Co v North of England P&I Association*,[24] respectively. In the former, the test of navigability was applied, and a sunken barge lying at the bottom of the sea was held to be a 'vessel', because she was capable of being raised and navigated. In the latter case, the test of navigability was rejected by Mr Justice Greer who preferred to apply his own test of 'whether or not any reasonably minded owner would continue salvage operations in the hope of completely recovering the vessel by those operations and subsequent repair'. He said:

> 'A ship may remain a ship or vessel even though she be damaged and incapable of being navigated, if she is in such a position as would induce a reasonably minded owner to continue operations of salvage …'

A pontoon with a crane fixed in it was held in *Merchants Marine Insurance Co v North of England P&I Association*[25] to be neither a ship nor a vessel. A host of considerations were taken into account before the members of the Court of Appeal were prepared to come to their decision. Both Lords Justice Bankes and Scrutton did not think that it was possible to give an exhaustive definition or an exhaustive test which will be of assistance to each and every case. Whether a particular object is or is not a vessel is a question of fact.[26]

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22 Section 33(3) read with *The Good Luck* [1991] 2 Lloyd's Rep 191, HL.

23 [1898] 1 QB 32.

24 (1925) 22 Ll L Rep 510 at p 512.

25 (1926) 32 Com Cas 165, CA.

26 See *Gas Float Whitton (No 2)* [1897] AC 337, in which a gas float used as a floating beacon was held neither a ship nor a vessel; *The St Macher* (1939) 64 Ll L Rep 27; (1939) 65 Ll L Rep 119 CA, where a newly constructed but unfinished ship was held to be a 'vessel used in navigation' within the meaning of the Merchant Shipping Act 1894; and *Polpen Shipping Co v Commercial Union* [1943] 1 All ER 162, where a flying boat on the water was held neither a 'ship' nor a 'vessel'.

A third vessel

A collision could involve more than two vessels: the insured vessel (vessel A) could collide with vessel B which could in turn collide with vessel C. Such an accident took place in *France, Fenwick & Co Ltd v Merchants Marine Insurance Co Ltd*,[27] where the third vessel, vessel C, suffered the most damage as a consequence of the collision between the insured vessel A and vessel B. Though there was no actual physical contact between the insured vessel A and vessel C, nevertheless, the Court of Appeal held that there was a 'collision' attracting the operation of the running down clause. The insurers were held liable to pay the assured the damages arising out of both collisions. Lord Justice Swinfen Eady said:[28]

> '... according to the true construction of a clause such as the present, an assured may become liable to pay damages in consequence of a collision between his ship and another ship, although the damage is not immediately and directly caused by the actual impact between the two colliding vessels.'

Provided that there is no *novus actus interveniens* to break the chain of causation, the collision between vessels B and C may be regarded as 'the attendant incidents of the collision' between vessels A and B. In the words of the Lord Justice,[29] 'although not the direct and immediate consequence of the impact – although one ship was not, by the force of the impact, driven directly against the other,' the damage occasioned to vessel C arose in consequence of the collision between vessels A and B. In other words, as the 'first collision was the cause of the second collision', the insurers were liable under the said clause for both.

Liability

Some of the details of the collision liability clause require close examination and it is necessary therefore to highlight the relevant parts of the clause:

> 'The underwriters agree to indemnify the assured for *three-fourths* of any sum or sums *paid* by the Assured to any other persons or persons by reason of the assured becoming legally *liable by way of damages* …'[30]

Three-fourths of damages

The insurer is not liable for the full amount, but only three-fourths of the sum paid by the assured to the third party. It was thought that by compelling the assured to run one-fourth of the risks, that might encourage him to exercise due care and attention. This is now, of course, meaningless, for, in practice, the remaining one-fourth is absorbed by P&I cover.

27 [1915] 3 KB 290, CA.

28 *Ibid*, at p 301.

29 *Ibid*, at p 302.

30 Emphasis added.

Three-fourths of the insured value

There is, however, an overall ceiling up to which the insurer may be made liable, and this is set out in cl 8.2.2:

> 'In no case shall the Underwriters' total liability under cll 8.1 and 8.2 exceed their proportionate part of three-fourths of the *insured value* of the Vessel *hereby insured* in respect of any one collision.'[31]

It is to be observed that it is three-fourths of the insured value of the insured vessel, and not the value of the third party vessel, which is to be considered.

Three-fourths of the legal costs

Clause 8.3 provides that:

> 'The Underwriters will also pay three-fourths of the legal costs incurred by the Assured or which the Assured may be compelled to pay in contesting liability or taking proceedings to limit liability, with the prior written consent of the Underwriters.'

The word 'also' is to emphasise the fact that, in addition to third party liability for the collision damage, the insurer is liable to pay three-fourths of the legal costs incurred by the assured. Like most of the special provisions of the Institute Clauses, cl 8.3 was inserted in the aftermath of a judicial ruling – on this occasion, that of *Xenos v Fox*,[32] which categorically held that legal costs do not fall within the sue and labour clause, because they are not incurred to avoid or minimise the damage sustained by the insured vessel. Furthermore, as they do not fit within the description of 'damages', they are not recoverable under the then running down clause.[33] Clause 8.3 was thus inserted into the collision liability clause to overcome this difficulty.

Costs of attack and costs of defence

Legal costs may be divided into two broad categories: 'costs of attack' and 'costs of defence'. Costs of attack are legal costs incurred by the assured in instituting or prosecuting an action against the owners of the colliding vessel, for the purpose of recovering the loss sustained by his vessel. Such costs are in fact of no concern to this clause because they have very little, if anything, to do with third party liability. Provided that they are incurred in relation to loss or damage which is recoverable by the assured under the policy, either by way of particular average or otherwise, such costs, it has been said,[34] are generally recoverable in full from the underwriters. To this, it is contended, an additional condition should perhaps be added, to the effect that prior consent of the underwriters should first be obtained by the assured before he commences legal proceedings against the owners of the other vessel. Whether he could bind his

31 Emphasis added.

32 (1868) LR 3 CP 630.

33 See also *Cunard v Marten* [1902] 2 KB 624. Now cl 11.2 and cl 9.2 of the ITCH(95) and of the IVCH(95) on sue and labour, expressly states that '... collision defence or attack costs are not recoverable under this cl 11'.

34 See Templeman, pp 408-409, and O'May, p 236; it is the view of both authors that such legal costs are recoverable in full. Nothing, however, is said about whether prior consent of the underwriters is a necessary pre-requisite to recovery.

own underwriters with expenses, without first obtaining their consent, is questionable.[35] Further, unless the policy otherwise provides, it is difficult to see how legal costs of attack can ever be considered as an inherent part of a partial or total loss sustained by the subject-matter insured, or, more significantly, as a loss having been 'proximately' caused by a peril insured against.

'Costs of defence' are legal costs incurred by the assured in defending an action brought by the third party for collision damage. Unlike costs of attack, it appertains directly to third party liability for collision damage. It is the only cost which is relevant to and governed by the collision liability clause.

There are two parts to cl 8.3: the first relates to 'legal costs incurred by the assured', and the second to costs which he may be forced to pay in defending the action instituted by the third party in respect of the collision damage. As a rule, the successful litigant is entitled to his costs: the expenses incident to a suit or action are generally paid by the defeated party. Thus, should the assured wholly fail in his defence, he will be 'compelled to pay' legal costs for contesting liability. This is covered by the latter part of the clause which relates to costs as between party and party (the third party's costs). Needless to say, he would also have to bear his own legal costs, which is covered by the first part of the clause. All in all, an assured who has failed in his defence is entitled to recover from the underwriters three-fourths of the total legal costs for defending the suit.

A court of law has, of course, the power to award legal costs to reflect the degree of blame to be apportioned to the parties.[36] Thus, depending on the degree of the apportionment of blame, the assured may have to bear some of his own costs and also some of the third party's costs.[37] However apportioned, the assured is entitled by cl 8.3 to recover from the underwriters three-fourths of his over-all legal costs of defence.[38]

Unlike liability for damages, cl 8.3 has not set an upper limit for which an insurer could be made liable for legal costs. As prior written consent from the underwriters is required, they would naturally have some control over the amount that may be expended. In the light of this, it would be difficult for the underwriters to argue at a later date that a particular sum is exorbitant.

'In addition to'

It is significant to note that cl 8.2 also states that:

> 'The indemnity provided by this cl 8 shall be *in addition to* the indemnity provided by the other terms and conditions of this insurance …'

The insurer could be made liable not only for the full extent (of the insured value) of the damage sustained by his own vessel, but also up to three-quarters of the insured value in relation to third party liability. All in all, the insurer

35 With the exception of sue and labour expenses. If costs of defence are not recoverable as sue and labour, costs of attack are likely to be treated in the same way. See *Xenos v Fox* (1868) LR 3 CP 630.

36 The right of apportionment of blame is conferred by the Maritime Conventions Act 1911.

37 The third party would also have to bear a share of the costs.

38 In practice, however, no distinction is likely to drawn between costs of attack and costs of defence; costs is generally awarded as a single sum.

could be made liable in respect of up to 175% of the insured value of the vessel which he has agreed to insure. To this, an additional sum of three-quarters of the legal costs incurred by the assured has to be added.

'Legally liable by way of damages'

These words have been interpreted to mean liability in tort and not in contract. This interpretation of the words was first suggested in the case of *Furness Withy and Co Ltd v Duder* in which Mr Justice Branson said:[39]

> '… the clause means that where in consequence of a collision there arises a legal liability upon the shipowners to pay a sum which can properly be described as damages for a tort, then the underwriters will indemnify them. The expression "… by way of damages" indicates … a liability which arises as a matter of tort, and not as a matter of contract.'

Later, in *Hall Brothers SS Co Ltd v Young*,[40] the above principle was confirmed and applied with approval by the Court of Appeal. As the payment made by the assured was not made by way of damages in tort, but in consequence of the application of French law, it was held not recoverable.

Exclusions

In addition to the 'paramount' exclusions listed in cll 24 to 27 of the ITCH(95)[41] in relation to war, strikes, malicious acts and radioactive contamination, cl 8.4 stipulates five payments which are not covered by the 3/4ths collision liability clause. They relate to sums which the assured shall pay for or in respect of:

- removal or disposal of obstruction, wrecks, cargoes or any other thing whatsoever;[42]
- any real or personal property or thing whatsoever except other vessels or property on other vessels;[43]
- the cargo or other property on, or the engagements of, the insured vessel;
- loss of life, personal injury or illness;[44] and
- pollution or contamination, and damage to the environment.[45]

Damage to the environment or threat thereof

The new cl 8.4.5 of the ITCH(95) has excluded from the scope of the 3/4ths collision clause any sum which the assured shall pay for or in respect of not only pollution or contamination but also for 'threats thereof'. 'Damage to the environment or threat thereof' has been added to complement cl 7, the pollution

39 [1936] 2 KB 461 at p 468.

40 [1939] 1 KB 748, CA.

41 Clauses 21–24 of the IVCH(95).

42 Clause 8.4.1 of the ITCH(95). See *The North Britain* [1894] P 77; and *The Engineer* (1898) AC 382.

43 Clause 8.4.2 of the ITCH(95).

44 Clause 8.4.3 of the ITCH(95). See *Coey v Smith* (1860) 22 Dunlop 955; and *Taylor v Dewar* (1864) 5 B & S 58. Liability for loss of life and personal injury is generally covered by P&I Clubs.

45 Clause 8.4.5 of the ITCH(95).

hazard clause, which allows recovery for 'loss of or damage to the Vessel caused by any governmental authority acting under the powers vested in it to prevent to mitigate a pollution hazard or *damage to the environment or threat thereof …*'.[46]

It is to be observed that cl 7 allows recovery for loss of or damage to the insured vessel, whereas cl 8.4.5 excludes recovery for any sum which the assured may pay for or in respect of pollution or contamination (or threats thereof) or for damage to the environment (or threat thereof).

The new cl 8.4.5. has also taken pains to clarify that it (the exclusion) does not apply to any sum which the assured shall pay for or in respect of salvage remuneration where salvors have worked to prevent or minimise damage to the environment as is referred to in art 13(1)(b) of the International Convention on Salvage 1989. This qualification has been inserted to tie in with the new cl 10.6 on general average and salvage of the ITCH(95), under which it is specifically declared that such an enhanced salvage award made under the said art 13(1)(b) is not excluded from recovery as general average or salvage.[47]

'Paid by the Assured'

It is apparent from the opening words of cl 8.1 that there is a prerequisite which has to be satisfied before the assured could be indemnified for third party liability for collision: the assured has to provide proof of payment before he would be indemnified. He has to 'pay to be paid'. This principle which is well-known in P&I cover is, as can be seen shortly, of crucial importance not only to the assured, but also to the third party in relation to his rights under the Third Parties (Rights Against Insurers) Act 1930.[48]

THIRD PARTIES (RIGHTS AGAINST INSURERS) ACT 1930

A third party, though he may legally have a right of claim against 'the insured'[49] for the damage sustained by his ship, may well find himself unable to recover his loss because of the insolvency of the insured. This problem of the unsatisfied third party is addressed in the above-named Act which third parties had believed, for a period of time, was enacted to aid them in the recovery of their losses. This Act describes its objective as:

> 'An Act to confer on third parties rights against insurers of third party risks in the event of the insured becoming insolvent, and in certain other events.'

Section 1(1) of the 1930 Act states that the rights of the insured (against the insurer under the contract in respect of the liability) 'shall … be transferred to and vest in the third party to whom the liability was so incurred …'. Subsection

46 The words in italics were added by the ITCH(95).

47 When clause 8.4.5 is read with clause 10.6, it becomes clear that an enhanced salvage award made under art 13(1)(b) of the International Convention on Salvage Convention 1989, is recoverable: further discussed in see Chapter 17.

48 Hereinafter referred to simply as the '1930 Act': see Appendix 3.

49 In accordance with the 1930 Act, and for consistency, the expression 'the insured' will under this part be used to refer to the owner of the insured vessel who is legally liable to pay damages to the third party.

(4) then proceeds to spell out the effect of the transfer thus: 'Upon a transfer under subsection (1) … of this section, the insurer shall … be under the same liability to the third party as he would have been under to the insured …'. Until one examines the finer points and implications of the whole scheme of things, this may initially appear, from the point of view of the third party, to be an attractive and generous concession. But, when read in the light of the decision of the House of Lords in *The Fanti and Padre Island*,[50] the position of the third party is not as rosy as it might seem. The question is essentially: exactly what rights against the insurers are transferred from the insured to the third party?

As is revealed by its name, two cases, namely, *The Fanti*[51] and *The Padre Island*,[52] were heard together in the House of Lords (and in the Court of Appeal) because the legal issues raised in them were the same. The facts of the cases were similar and may be briefly summarised as follows. In both cases, the cargo owners had instituted claims against the shipowners for the loss of their cargoes. Though judgments were entered in their favour, the shipowners did not honour them: nothing was paid in or towards the satisfaction of the judgment. Later, as a result of the claimants' petitions, the shipowners' businesses were ordered to be wound up, whereupon the claimants commenced arbitration proceedings against the association (of which the shipowners were members) pleading their rights under the 1930 Act.

Lord Brandon of the House of Lords, in a most methodical manner, condensed the issues into three main questions, though it is noted that the whole controversy of the case can effectively be said to have revolved around a single issue, that of the effect of the 'pay to be paid' rule. In the light of this it would be helpful, before proceeding to consider these questions, to say something here about that rule.

'Pay to be paid'

The rules of most, if not all, P&I associations (clubs) are based on what is commonly known as the 'pay to be paid' system. This means that, to be entitled to an indemnity in respect of liabilities or expenses incurred by a member (the insured), he must first prove that he himself has discharged the liabilities or expenses. In other words, before he could be paid by the association, he has first to prove that he had paid the third party.

The relevance of the above authority, relating to P&I association rules and the 1930 Act, to the question of collision liability may not at first be obvious. It is noted that, though not couched in so many words, the scheme of the collision liability clause is, in effect, also based on a 'pay to be paid' basis of indemnity: only if the assured had in fact paid the third party would he be indemnified for the loss under cl 8. In this respect, its scheme of operation is similar to the P&I 'pay to be paid' rule and, therefore, the comments made in *The Fanti and Padre*

50 [1990] 2 Lloyd's Rep 191, HL.

51 [1987] 2 Lloyd's Rep 299, on appeal [1989] 1 Lloyd's Rep 239, CA; [1990] 2 Lloyd's Rep 191 HL.

52 *Ibid*.

Island (No 2) pertaining to the said rule and the scope of the 1930 Act are also relevant to the collision liability clause.

If a case be required to confirm this point, it can be found in *Re Nautilus Steam Shipping Co Ltd*,[53] where the Court of Appeal had settled beyond doubt that the 1930 Act was applicable to the running down clause, the predecessor of the collision liability clause. Moreover, there is nothing in the 1930 Act prohibiting its application to a claim arising under the collision liability clause.

Rights of the insured

Lord Brandon started on the right footing, first, by questioning what rights, if any, the members had (before they were ordered to be wound up) against the clubs under their contracts of insurance in respect of their liabilities to the third parties.[54] In order to determine the nature of the rights which the third party is to derive from the insured under the 1930 Act, it is first necessary to ascertain the rights of the insured.

The answer to this question is to be found in the 'pay to be paid' rule, but in the words of Lord Brandon:[55]

> '… the members were not entitled to be indemnified by the clubs in respect of liabilities to third parties which they had incurred, unless and until the members had first discharged those liabilities themselves. In other words, payment by the members to the third parties was a condition precedent to payment by the club to the members.'

The rights of the insured before they were ordered to be wound up were only contingent rights: until the condition precedent, that is, payment to the third party, is fulfilled, the insured has no claim under the policy. In similar terms, Lord Goff said:[56]

> 'That right is, at best, a contingent right to indemnity, the right being expressed to be conditional upon the member having in fact paid the relevant claim or expense. Here the relevant claim or expense was never paid, by the member or indeed by anybody else on his behalf. That condition not having been fulfilled, the member had no present right to indemnity …'

The same can be said of the position of an assured under the collision liability clause. By cl 8.1, he must show that a sum of money has been 'paid by the assured to any other person or persons by reason of the assured becoming legally liable by way of damages …'.

Relevance of the 'pay to be paid' rule

To respond to the contention raised by the third party, Lord Brandon was forced to address the problem regarding the relevance of the 'pay to be paid' *vis-à-vis* the 1930 Act. It was submitted by counsel for the third party that the

53 (1935) 52 Ll L Rep 183, CA.

54 In the context of the collision liability clause the word 'members' should be substituted for 'the insured', and the 'clubs', for 'the insurer'.

55 [1990] 2 Lloyd's Rep 191 at p 197, HL.

56 *Ibid*, at p199.

condition of prior payment offended s 1(3) of the 1930 Act, the relevant parts of which state that:

> 'In so far as any contract of insurance … in respect of any liability of the insured to third parties purports, whether directly or indirectly, to avoid the contract or to alter the rights of the parties … the contract shall be of no effect.'

Lord Goff, who confessed that he was 'startled' by this proposal, could not see how the condition of prior payment could be rendered of no effect by s 1(3) of the 1930 Act. He said:[57] 'The rights of the parties remained exactly the same; all that happened was that, following the member's insolvency, and *a fortiori* following the winding-up, the member was no longer able to fulfil the condition of prior payment …'. There is clearly no merit or substance in this contention.

Admittedly, upon being ordered to be wound up, a member is prevented from discharging his liability to a third party. But in no sense does this '… result, directly or indirectly, from any alteration of the member's rights under his contract of his insurance', but rather from 'the member's inability, by reason of insolvency, to exercise those rights.'[58] The same holds true of the collision liability clause.

Rights of the third party

The rights of the third party is by far the most important aspect of the case. Lord Brandon proceeded to ask the question of what rights against the clubs, if any, were transferred from the members to third parties upon the members being ordered to be wound up. Referring to ss 1(3) and 1(4) as authority, Lord Brandon's reply was:[59]

> 'The effect of these provisions is that, in a case where the insurer would have had a good defence to a claim made by the insured before the statutory transfer of his right to the third party, the insurer will have precisely the same good defence to a claim made by the third party after such a transfer.'

The statutory rights of the third party is dependent on the rights of the insured. He definitely has no better rights than the insured. According to Lord Goff,[60] 'The statutory transferee of the member's right is in no better position than the member; and so, if the condition is not fulfilled, he too has no right to be indemnified.' In this sense, his position is similar to that of an assignee.

Before the delivery of this decision of the House, third parties had high hopes that the 1930 Act would promote their cause and protect their interests in relation to the insurer. The decision of the House is in one sense welcomed, because it had settled a 'central question' which had troubled maritime lawyers since 1930. Its outcome, however, must leave many a third party disappointed. Its effect on the collision liability clause is equally damaging; there is now no chance of a third party ever recovering their loss directly from the insurer of the shipowner whose vessel is legally liable for the collision.

57 *Ibid*, at p 203.

58 *Per* Lord Brandon, *ibid*, at p 197.

59 *Ibid*, at p 198.

60 *Ibid*, at p 200.

In the final analysis, it can to be said that it is not the 1930 Act itself which has fallen short; it is the interaction between the 'pay to be paid' rule with the terms of the 1930 Act which has rendered its application impossible. To conclude this part of the discussion, reference should be made to the colourful and perceptive remarks of Lord Jauncey on the matter:[61]

> '… it is difficult to see how it could be said that a condition of prior payment would drive a coach and horses through the Act; for the Act was not directed to giving the third party greater rights than the insured had under the contract of insurance.'

THE PRINCIPLE OF CROSS-LIABILITIES

There are two methods by which claims for collision damage may be adjusted: single liability and cross-liabilities. The latter is imported into the collision liability clause; and provided that both vessels are to be blamed for the collision and that the liability of one or both vessels is not limited by law, this method of calculation is to be used. Though the mathematical formula is not spelled out by the clause, nonetheless it appears to be well-known, even in the early days when the principle of single liability was in favour, as is evident in the cases of in *Stoomvaart Maatschappy Nederland v Peninsula & Oriental Steams Navigation Co, The Khedive*[62] and *London SS Owners' Insurance Co v The Grampian SS Co, The Balnacraig*.[63] For a proper understanding of the subject, a comparison between these two methods of adjustment has to be made. As will be seen, each method produces a different result.

Single liability

In legal terms, the basis of single liability was explained by Lord Esher MR in *The Balnacraig* in the following terms:[64]

> 'But if the damage to one ship exceeds the damage to the other, there will be a monition that the owners of the ship least damaged shall pay to the owners of the other ship half the difference between the amounts of damage sustained by the two ships respectively. The case determines point blank that there is only one liability, and therefore there can be only one payment.'

The basis of the principle is one liability, one payment. In the end, only one sum of money passes from one owner to the other: the owner who has suffered the lesser of the damage shall have to pay. Employing this method of calculation, the assured in this case did not have to pay anything to the third party; by reason of this fact, his claim under the policy failed. Consequently, this led to the introduction of the principle of cross-liabilities in the collision liability clause.

61 *Ibid*, at p 204.

62 (1882), 7 App Cas 795.

63 (1889) 24 QBD 663, CA.

64 (1889) 24 QBD 663 at pp 666 and 667, CA.

Adopting the figures used by Arnould,[65] the mathematical formula for single liability is to be worked out as follows:

> 'Assuming that ship A and ship B have come into collision, and both are equally to blame –
>
> A sustains damage to the extent of £10,000
>
> B sustains damage to the extent of £ 6,000
>
> As each is liable for 50% of the damage sustained by the other –
>
> A is liable for 50% of B's damage [50% of £6,000 = £3,000]
>
> B is liable for 50% of A's damage [50% of £10,000 = £5,000].
>
> The net result is that B, the owner of the ship which has suffered the lesser of the damage, has to pay A £2,000 [£5,000 – £3,000]. The single liability of B to A is £2,000. A owes B nothing.'

Liability of A's insurer

A's insurer would pay A £10,000 for the damage sustained by vessel A, whereupon the insurer would, by way of subrogation, receive the £2,000 from B. As A does not have to pay anything to B for the collision, he cannot recover anything (except the £10,000) from his insurer under the 3/4th collision liability clause. Net loss to A's insurer is £10,000 - £2,000 = £8,000.

Liability of B's insurer

B's insurer would pay B £6,000 for the damage sustained by vessel B *and* 3/4ths of the £2,000 which B has had to pay A [3/4 of £2,000 = £1,500]. Net loss to B's insurer is £6,000 + £1,500 = £7,500.

B himself will have to bear a loss of £500 which amount is usually recoverable from his P&I association.

Cross liabilities

Liability of A's Insurer

A's insurer would pay A, for the damage sustained by –

Vessel A –	£10,000
Vessel B –	£ 2,250 [3/4 of half of B's damage (£3,000) = £2,250]
Total	**£12,250**

A's insurer to recover from B, by way of subrogation, 50% of A's damage (£10,000) = £5,000. Net loss to A's insurer is £12,250 – £5,000 = £7,250.

65 Arnould, para 801.

Liability of B's insurer

B's insurer would pay B, for the damage sustained by –

Vessel B –	£6,000
Vessel A –	£3,750 [3/4 of half of A's damage (£5,000) = £3,750]
Total	**£9,750**

B's insurer to recover from A, by way of subrogation, 50% of B's damage (£6,000) = £3,000. Net loss to B's insurer is £9,750 – £3,000 = £6,750.

B himself will have to bear a loss of £1,250 which amount is usually recoverable from his P&I association.

THE SISTERSHIP CLAUSE

When two ships belonging to the same owner collide with each other, the shipowner would find himself in a difficult position in so far as suing the 'other' ship or party for the loss: for under the common law a person cannot bring an action against himself.[66] The same applies to salvage services rendered to a sistership; he cannot claim salvage in respect of the services to the ship and freight, but can claim salvage from the owner of the cargo.[67]

As he is unable to sue himself, this means that he can only recover for the loss of or damage sustained by each of his ships from the insurers under the respective policy which he has taken out for each ship. The claim under each policy, however, is subject to the deductible clause, meaning that he has to suffer two separate sets of deductions, one from each policy.

The objective of the sistership clause is to put the assured in exactly the same position as if their vessel had collided with, or rendered salvage services to, a vessel belonging to a third party. The assured are conferred with: '… the same rights under the insurance as they would have were the other entirely the property of owners not interested in the vessel hereby insured'. In addition to stating how the matter may be resolved, it also lays down that the dispute should be referred to a sole arbitrator to be agreed upon between the underwriters and the assured.

THE PARAMOUNT CLAUSE

A collision, whether between sisterships or ships belonging to different owners, could, of course, occur during a time of war, as a result of an act of hostility, or, for that matter, under any one of the circumstances enumerated in the war; strikes, malicious act, or radioactive contamination exclusion of the ITCH(95).[68] One need only refer to the long line of cases on the construction of the term 'warlike operations' of the old 'f c and s' clause to realise that it is not always

66 See *Simpson v Thompson* (1877) 3 Asp MLC 567.

67 See *Cargo ex Laertes* (1887) 6 Asp MLC 174.

68 The nuclear exclusion of the IVCH(83) and the ITCH(83).

easy to classify a loss as a marine or a war risk. It is necessary to inquire whether such a loss is covered by 3/4ths collision liability clause or is excluded by the relevant exclusion clause of the ITCH(95) or the IVCH(95).[69]

The answer to the above question can be found in a clause (in bold print, commonly referred to as the paramount clause) appearing before the said exclusion clauses (cll 24-27). It declares that the exclusion clauses 'shall be paramount and shall override anything contained in this insurance inconsistent therewith'.

It should also be noted that each of the exclusion clauses commences with the phrase: 'In no case shall this insurance cover loss, damage, liability or expense[70] caused by …'. The words which are relevant to the present discussion are 'liability' and 'caused by'. The former would cover collision liability; and, the phrase 'caused by' has to be construed to mean 'proximately' caused by.

The paramount clause is of relevance only when there are two proximate causes of loss: an included loss and an excluded loss falling within the terms of one of the enumerated risks of the war, strikes, malicious acts or radio active contamination exclusion of the ITCH(95).[71] Only in the event of such a conflict is the paramount clause applicable. The said exclusions will prevail to disentitle the assured from recovering for the loss. Thus, even though a collision is a peril of the seas and, as such, recoverable as a marine risk under the standard hulls policy, nevertheless, the assured will not be able to claim for the loss if one of the risks enumerated in the exclusions is also regarded as a proximate cause of loss. Needless to say, if collision is the sole proximate cause of loss, the paramount clause will not come into play.

69 But may be covered by the Institute War and Strikes Clauses, Hulls, discussed in Chapter 14.

70 'Expense' relates to sue and labour charges.

71 The nuclear exclusion under the IVCH(83) and the ITCH(83).