

The Wire: Focus on classification societies

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Introduction

Welcome to this edition of ITIC's electronic newsletter, The Wire, which focusses specifically on ship classification societies.

A ship classification society is an organisation that, inter alia;

- develops and publishes rules and technical standards for the design, construction and evaluation of ships and offshore structures;
- issues certificates of classification on satisfactory completion of the relevant surveys;
- certifies, being delegated and instructed by flag states, that the construction of individual ships complies with the relevant safety and environmental international conventions to which virtually all nations are party.

Classification societies can face various legal claims, primarily related to breach of contractual duties and negligence. The main types of claims are:

- Contractual claims by shipowners or shipbuilders for negligence or breach of duty in performing surveys, inspections, or certification services. These claims allege that the classification society has failed to exercise reasonable care and skill in carrying out its contractual obligations.
- Claims by flag states when a classification society acts as a Recognized Organization (RO) on their behalf. If negligent acts or omissions by the RO in performing statutory duties on behalf of a flag state lead to liability for the state, the state can seek compensation from

the classification society.

- Third-party tort claims, such as (a) claims by purchasers of ships, charterers, cargo owners, ships' crews and other parties who may have relied on inaccurate advice or classification certificates issued negligently, and (b) claims by parties suffering losses due to maritime accidents, alleging that the classification society is negligent in certifying an unseaworthy ship.

Although it is shipowners who typically pay for their services, classification societies have experienced a significant increase in exposure to third party claims which may be attributable to a number of related factors including:

- The growth in litigation generally.
- The difficulty to sue successfully "one-ship" shipowning companies.
- The legal and financial presence of classification societies in different jurisdictions around the world.
- The perception that classification societies are attractive "deep-pocket" defendants because of their accumulated wealth and professional indemnity insurance cover.

In contractual claims, claimants must prove a breach of contract and consequent damages. In third party tort claims, claimants must prove damages, negligence and a causal link between the two.

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Case studies

Shipbuilder's claim

A naval architect designed a series of fast pilot boats. They completed the designs and submitted them to a classification society who advised that the forward stringers should be strengthened.

Typically, such advice would be given as comments inside speech bubbles on the relevant plans, but in this instance, the classification society failed to do this, and the advice was missed by the naval architect. As a result, the stringers were not strengthened on the final plan. The classification society approved the final plans, but did not spot that their initial advice had not been acted on.

Ten boats were built in total. After three years in service, cracking appeared on all but one.

The boats that were showing cracking were lifted out of the water and the forward stringers were strengthened. This cost US\$50,000 per boat for the nine affected. The total cost was US\$450,000.

The shipbuilder made a claim against the naval architect for this sum. There was clear evidence both that the naval architect had missed the advice from the classification society and that the classification society did not notice on the final plans that the stringers had not been strengthened and had approved the design.

The classification society made a settlement contribution which was covered by ITIC.

Shipowner's claim

A classification society classed a ship from the time she was built until the end of 2015 when the ship switched to a new classification society.

Four years later, the new classification society determined that the ship's construction did not comply with SOLAS requirements.

The ship owner filed a claim against the former classification society.

Investigations revealed that glass originally installed in certain areas of the ship did not have the required safety rating and had to be replaced.

The glass, from a manufacturer in the Netherlands, would need to be specially ordered and shipped to the Far East for installation.

The former classification society contributed to the costs of doing so on the basis that their surveyor should have noticed this while it was under their class.

The original shipbuilder had gone out of business and so was unable to contribute to the settlement.



Case studies – continued

Shipowner's hull and machinery insurer's claim

In 2016, a bulk carrier suffered a stern shaft breakage during a voyage, causing the engine room to be flooded with seawater and leaving the ship out of control. The shipowner immediately arranged for emergency rescue and repairs, incurring significant repair costs, time charter hire losses and fuel losses, which exceeded US\$7m in total.

After paying the insurance claim and related expenses to the ship owner under the insurance contract, the ship's hull and machinery insurer filed a recovery action for defects of marine products against both the manufacturer of the broken stern shaft and the classification society of the ship, claiming joint and several liability of the manufacturer and the classification society.

The court of first instance held that:

1. the stern shaft was a product that had been produced and processed for sale, and therefore disputes over its quality should be subject to product quality law, and

2. the classification society was only required to carry out the tests and survey in accordance with their published classification rules, and to exercise due diligence in the course of the classification survey. Since the classification society was not able to monitor the whole manufacturing and processing stage, and since the defects on the equipment could not be detected by the scope of inspection methods available and the inspection methods specified in the rules, the classification society could be considered to have exercised due diligence and not to be at fault.

Accordingly, they should not be liable for the losses incurred. This judgement was then upheld on appeal.



Charterer's claim

A charterer alleged to have suffered losses as a result of misleading and deceptive conduct by the classification society in the classification of an offshore supply vessel.

The charterer alleged that they had relied on the notations on the vessel's classification records (which were available on a searchable database maintained by the classification society at the time when the charter party was entered into) to assess the suitability of the vessel for the charter and in setting a purchase price to buy the vessel at the end of the charter.

The charterer also alleged that during the course of the charter, they discovered that the vessel was not constructed in compliance with the classification society's rules.

During a survey of the vessel, the charterer allegedly found defects and non-conformance which, while not capable of detection on a diligent inspection of the vessel, would have been apparent through inspection during her construction.

The classification society engaged in extensive discussions with the charterer about the necessary repairs and modifications to bring the vessel in compliance with the flag state's requirements.

At the end of the charter, and in accordance with the charter party, the charterer purchased the vessel. The vessel then had repairs and modifications under the classification society's survey.

The related costs and expenses incurred were settled by the classification society.



Case studies continued

Crew members' claim

There was an explosion and fire aboard a ship causing the death of two crew members. A classification society classed the ship and issued an ISM certificate for it. The source of ignition had not been identified.

The flag state concluded that the shipowner's maintenance and safety management of the ship was ineffective. Furthermore, it deemed the inspections and surveys, by both the Coast Guard and the ship's classification society, also ineffective.

The classification society was sued by the deceaseds' families in two separate proceedings. The shipowner was also a named defendant.

The classification society's lawyers sent a letter tendering the defence of both actions and requesting indemnity from the shipowner according to the contractual terms governing the classification society's services. The shipowner declined to accept the defence and indemnity and later filed for bankruptcy.

The classification society incurred expenses of US\$1m and paid a settlement contribution.



Yacht purchaser's claim

A classification society surveyor had given an 80 foot steel hulled motor yacht a periodical special survey and had passed the yacht as "100 A1".

The surveyor knew that a purchaser was interested in the yacht and that the purchaser had decided to rely on the class certificate as confirming the yacht's good condition at the time of purchase. Subsequently, after delivery, the purchaser discovered substantial defects with the yacht which were enough to put the yacht out of class. The purchaser looked to the classification society to reimburse them for the substantial repair costs.

The classification society declined to reimburse the purchaser as the purchaser was not their client. Their client was the owner at the time of the survey, and the case went to court. The court accepted that the surveyor had been negligent. The court, however, decided that the classification society did not owe a duty of care to this purchaser, or indeed to any future purchaser of a ship who was likely to rely on their own pre-purchase survey.

The classification society successfully defended the claim.



Case studies continued

PRESTIGE

In November 2002, the Bahamas-flagged oil tanker PRESTIGE, heading from the Baltic to Asia with a cargo of heavy fuel oil, began to break up in bad weather in the Bay of Biscay.

Upon seeking refuge in a Spanish port, she was instead ordered by the Spanish authorities to be towed out to sea, where she sank in deep water, causing a large quantity of her cargo to pollute the French and Spanish coasts.

The Spanish State filed a US\$5b lawsuit in May 2003 at a District Court in New York against the American classification society, American Bureau of Shipping (“ABS”), alleging that ABS’ negligence played a part in the sinking of the PRESTIGE.

The claim in tort was made up of the estimated clean-up costs as well as the government’s administrative costs in respect of the incident. The claims were dismissed.

The Court stated that it was unwilling to accept the Spanish Government’s proposed rule that “a Classification society owes a duty to refrain from reckless behaviour to all coastal States that could foreseeably be harmed by failures of classified ships;” finding that that would amount to an “unwarranted expansion of the existing scope of tort liability.”

The Court also held that such an expansion would be inconsistent with a shipowner’s non-delegable duty to provide a seaworthy ship.

Spain appealed against the judgment of the District Court.

The Court of Appeal did not address the legal issue of whether ABS owed a duty to coastal states to avoid reckless behaviour. Instead, the Court held that Spain had not proved that ABS had acted in a reckless manner in this particular instance.

Spain has not appealed against the judgment and therefore, the judgment is final and this matter is closed.

The French government filed a claim in France against ABS in 2010, arguing that the failings of ABS in its activity of classification of ships had contributed to the occurrence of the incident.

ABS opposed this action relying on the defence of sovereign immunity, arguing that its activity of classification was closely linked to the certification activity which is related to the sovereignty of states, in particular the Bahamas (the flag State of the PRESTIGE). In 2014, the French Court issued a decision in favour of ABS on a motion to dismiss on the grounds of sovereign immunity.

The French government appealed the decision. In 2017, the Court of Appeals reversed the decision of the Court of First Instance, concluding that ABS cannot invoke immunity from jurisdiction, and ordered the lower court to proceed with the procedural issues and the merits.

The incident remains an open case due to ongoing legal proceedings in France.

ERIKA

The Maltese-flagged oil tanker ERIKA broke apart off the west coast of France and severely polluted the French coastline in December 1999.

Alongside others, the French State sued the Italian classification society RINA, which had certified the ship both privately on behalf of the shipowner and statutorily on behalf of Malta, for damages caused by the oil pollution, arguing that the pollution was caused by RINA’s negligent certification activities.

The cause of the incident was examined by experts, appointed to investigate the matter by the French Courts. They concluded that the fate of the ERIKA was the inevitable consequence of the serious corrosion of the internal structures of the ship’s No2 ballast tanks, which resulted in their collapse.

The experts stated that the level of corrosion was well beyond acceptable standards for a classification society and that RINA should have been able to detect the level of corrosion when undertaking its surveys in 1999.

The French courts, including the French Court of Cassation, found RINA liable for negligent certification. RINA and the other defendants were held jointly and severally liable for the damages that had occurred.

The overall damages arising out of the casualty had been approximately assessed in the region of €500m.

RINA paid €35.8m to the civil claimants according to the judgement of the Court of Appeal.

A global settlement was reached in 2011 between the IOPC Fund, Steamship Mutual (acting on its own behalf as P&I Club and also on behalf of the ship owner’s interests), RINA and Total (an oil company engaged as a contractor to deal with the disposal of the recovered waste in respect of the Erika incident).





Litigation management

The shipping industry is one of the most litigious in the world. Most classed ships are owned by international shipowners and trade internationally. Classification societies are regarded as a legitimate litigation target because of their size, assets, legal presence in overseas jurisdictions, insurance cover and general good financial strength. They are not immune from litigation.

How can Classification Society reduce the likelihood or risk of being sued?

- Employ good engineers, naval architects, and some lawyers;
- Maintain a good quality management system and regularly review this;
- Maintain technical records;
- Enter into written service contracts with clients which at least contain:
 1. scope of work
 2. enforceable limited liability clause
 3. indemnity clause
 4. jurisdiction clause
 5. time-bars
 6. force majeure clause
 7. payment clause
 8. relevant disclaimers

What should you do if sued?

- Notify your insurers.
- Find, select and manage external lawyers and expert witnesses.
- Negotiate the lawyers' scope of work and fees - including any expert witnesses and other third parties. Obtain estimates and fixed fees. Avoid hourly rates, if possible. Do work in-house where possible.
- Respond promptly and carefully to complaints and threats of legal claims. Do not ignore them. Do not try to hide mistakes internally from managers, lawyers and insurers. Remember, once litigation is contemplated some documents may attract legal privilege. Check with your lawyers.
- Preserve and collect all relevant records, photographs and other data.
- Maintain access to all relevant employees and ex-employees.
- Keep insurers, managers and directors informed of all significant developments in the case.
- Follow the advice of your lawyers and other advisers.

What ITIC can offer

- ✓ Access to an international network of correspondents and lawyers.
- ✓ A team experienced in handling claims against classification societies including 6 qualified lawyers.
- ✓ The ability to review contracts from an insurance perspective and provide advice on contractual risk management.
- ✓ An ability to structure policies so as to cater for the needs of individual clients, working with local insurers where required.

ITIC facts & figures at a glance

All figures US\$
All facts and figures correct as of 31st January 2024

Gross premium

\$69m

for the year

Claims paid

\$465m

since 1992

Members

3,616

Security rating

Backed by at least "A-" rated reinsurance programme



Worldwide insurance cover

ITIC is able to provide professional indemnity insurance, without restrictions, worldwide. An ITIC account executive is responsible for each country and will be your first point of contact. The ITIC team speaks French, German, Greek, Japanese, Mandarin and Spanish.

Credits paid

\$189m

surplus funds have been paid out to the members in the form of continuity credit since 1994

Disbursements & commissions

\$240m

of disbursements and commissions collected for members since 1992

Free reserves

\$243m

for ITIC and TIMIA combined

Annual premium

from **\$1,500**  **\$1.8m**

ITIC is committed to consistently providing competitively priced professional indemnity insurance (and related insurance covers) with valuable and high quality loss prevention advice to businesses servicing the marine, aviation, rail and general transport industry. The ITIC team have a wealth of experience and knowledge.

24

Staff

A full time team to provide you with the best service possible.

19

Years

Average staff member's experience in the insurance/transport industry.

12

Years

Average staff member's time with ITIC. Several staff have over 25 years of service.

6

Lawyers

6 lawyers and a dedicated claims team.

See more online at itic-insure.com

Call our team on +44 (0)20 7338 0150

 or follow us at: @ITICLondon

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