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THE ARBITRATOR

SOCIETY OF MARITIME ARBITRATORS, INC.

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PRESIDENT'S CORNER

As I pen this, my last "President's Corner", I do so with an odd mixture of emotions. My term as SMA President does not come to an end until May, but as this newsletter appears quarterly, this is going to be my last column. It has been four years, but it is hard to believe how quickly the time has passed.

This has been an exhilarating experience, particularly on a personal basis. If it has shown me anything of lasting value, it is that if one works with a great team of dedicated people, anything is possible. And the SMA is blessed with dedicated people, lots of them, who give their personal time and resources to make this organization what it is. There is so much talent and individual enthusiasm among the membership! I will cherish having had the privilege of heading this Society for the past four years, an immense fun ride for which I shall always be grateful.

I believe we have made great strides toward advancing the SMA's standing and recognition here and abroad and I shall do whatever I can to assist with and continue those efforts with the incoming leadership. I wish to take this opportunity to sincerely thank all those friends at the Bar, my colleagues, my fellow members and the many friends internationally who have made my tenure such an enjoyable term.

Klaus Mordhorst

IT AIN'T WHAT YOU SAY …

by Chris Hewer

If you use a fountain pen to make lists of the jobs you have to do, you are probably old enough to not really understand the world in which you live, but still young enough to pretend that you do. Chances are that you have said, at least once in your life, 'It must have got caught in my spam filter', or 'I'll have to reboot'. If anybody had told you, two years ago, that you were going to say that sort of stuff, you would have asked for a second opinion.

All of this simply goes to show that it ain't what you say but the way that you say it. This applies to language, dialogue, accent and vocabulary. A Croatian, say, speaking very bad English in a brave attempt to reach an international audience, may as well talk to himself. It is better to employ the English method of communicating to a foreign audience – speak in your own tongue, but very LOUDLY.

Sometimes, nothing helps. It is impossible, for example, to speak with a Birmingham accent (Birmingham, England, as opposed to the impostor in Alabama) and to be taken seriously, even if you have split the atom. For those readers not familiar with the Birmingham accent, a story involving Noddy Holder, lead singer and guitarist with the 1970s Birmingham-based chart-topping rock band Slade, will provide a clue as to how they speak in that part of the world. Noddy went to pick up a new suit from his local tailor. The tailor, looking admiringly at Noddy in his new three-piece pinstripe and white shirt, said, "Very nice, Mr Holder. Would you like a nice kipper tie to go with that?"

"Ooh, ta very much," said Noddy. "Milk and two sugars, please."

This is the funniest story anybody knows about Birmingham, although somebody might think of a funnier one. There is room for a funnier one.

Subject matter can help, of course. For example, anybody speaking about the worldwide credit crunch at the moment will find an instant and attentive audience, even if speaking in Esperanto with a lisp. It is the single subject of conversation in most parts of the world. Children travelling in the back seats of their parents' cars no longer ask, "Are we there yet, Dad?" They say, instead, "Is the credit crunch over yet, Dad?" Whatever shall we talk about when there are once more two dollars to the pound?

At the other end of the subject matter scale, you will find insurance, and especially marine insurance. There is no subject under the sun which is less interesting than marine insurance. Tyro journalists on shipping newspapers are always given the marine insurance page to write, because nobody reads it and nobody notices (or cares) if you make a mistake. At least, that was the case until recently. Until, that is, the advent of Deirdre Littlefield, whose offices are in Park Avenue, New York, and who, in the unlikely event that you did not already know it, is the current president of the International Union of Marine Insurance (IUMI), a deservedly overlooked organisation for most of its unremarkable life.

IUMI has been trying, unsuccessfully, to get its message across to the international press twice a year, every year since 1874 – once before its annual conference, and once after it. That message has unfailingly been the same – rates are too low, casualties are either up or down on the previous year, and insurance is a cyclical industry. Down the years, legions of underwriters have tried to get IUMI's message into the press. Some of them have been dynamic and engaging speakers, such as the UK's charismatic Tony Nunn, and some have even been from the United States, such as Allen Schumacher and John Hickey and Tom Fain, speaking American, which passes for English in polite company. The result? Nothing.

Now along comes Deirdre Littlefield, and it is difficult to open a journal of maritime record without seeing acres of newsprint devoted to her message, complete with a winsome photograph. A quick check of the message confirms that there has been no change since 1874. Marine insurance is still a cyclical industry, and this year casualties are down. Interestingly, however, the reduction in casualties is due to the credit crunch, or rather to its impact on shipping. Fewer ships and fewer cargoes equal fewer casualties – not exactly the sort of thing which frock-coated underwriters had in mind when debating the merits of loss prevention in Edward Lloyd's Lombard Street coffee house, but a step in the right direction, nonetheless.

Those of us who wear hats must take them off in the presence of Deirdre Littlefield, who is currently commanding more column inches than the IMO secretary-general and Barack Obama combined. So far as the public face of marine insurance is concerned, she is the goods, or - as

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the newly reworded Institute Cargo Clauses have it - the subject-matter insured.

We must leave it to readers with a more worldly view than our own to explain why Deirdre has succeeded where so many of her equally able predecessors have failed. She undoubtedly knows her stuff, but perhaps in the end it is just another example of it being not what you say, but the way that you say it. That, and working in a quote about the credit crunch. It is as well to remember that, despite the high cost of living, it is still very popular.

Tada for a bit, as they say in Birminham.

PUBLICATION OF SMA AWARDS

As previously announced (October 2008 issue), the SMA Award Service is now available through Westlaw as well as Lexis/Nexis.

The Thomson Reuters subsidiary has provided the following announcement.

SMA Awards: now available on Westlaw®

We are pleased to announce that SMA Award Service is now available in a Westlaw SMA Awards subscription. Westlaw now offers SMA's respected arbitration decisions—including SMA's indexing as well as links to cases and other court documents that are referenced within SMA document text. ResultsPlus® automatically links SMA Awards coverage to treatises, briefs, ALR articles, and West Key Numbers. Westlaw adds more than 5 million links every year.

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Headquartered in Eagan, Minn., USA, West is the foremost provider of integrated information solutions, software and services to the U.S. legal market, and is part of Thomson Reuters.

After the March 11 SMA luncheon, Tracy Becker of Thomson Reuters presented a demonstration of the various programs relating to the SMA award searches.

FIRE CASE WON BY TKO!

by James E. Mercante, Esq.
Partner, Rubin, Fiorella & Friedman LLP

It's certainly a bummer when your brand new yacht catches fire and is destroyed before your eyes. What's worse is when you can't figure out what caused the fire despite many theories.

When a vessel burns to the waterline leaving mostly charred fiberglass, it is often difficult, even for fire experts, to determine the cause and origin of the fire. In one recent total loss by fire, the vessel owner could be thankful that he had a marine insurance policy in place that paid him for the loss. On the other hand, the marine insurer was not as fortunate in trying to recover what it paid out because a federal judge determined that the theories as to what caused the fire were only speculative and that the option chosen to salvage the vessel left little evidence to determine the cause of the fire.

The fateful voyage

The vessel owner set sail from Staten Island aboard the new vessel for a short trip to Horseshoe Cove to have lunch aboard and swim. His crew included his wife, teenage son and his friend, and the two family dogs. They anchored in about 10 to 15 feet of water and began to enjoy a summer day marveling over the new yacht and the pristine ocean waters off Staten Island. When it came time to heave anchor and return, the owner started the two diesel engines. Using a boat hook, the son attempted to lock the anchor into position on the bow, but lost his grip on the boat hook and dropped it into the water. As they tried to retrieve it, the boat drifted into shallow water, but apparently nobody noticed. By the time the owner returned to the cockpit, the bow had run aground on a sandbar. The owner cut the engines and engaged the stern and bow thrusters to try to swing away from the sandbar. The owner testified in deposition that he engaged the stern thruster 3 or 4 times for about 15 seconds, but did not personally notice if the stern thruster responded. His wife said she did not see any water churning near the stern as a result of the thruster operating and therefore concluded that it was not working.

Fire!

About a minute later, the wife and children smelled something burning and saw smoke rising out of the port engine vent. The owner radioed the Coast Guard for help and in the meantime, directed everyone to put on life jackets and gather on the stern platform. Everyone mustered on the stern as directed, except for one of the dogs that did not make it before the decks began to melt. The family was taken off the yacht by another vessel.

This was a ferocious fire that within 10 minutes from abandoning ship, engulfed the vessel in flames. The Coast Guard tried in vain to put out the fire but the yacht burned to the waterline and the skeleton drifted into a rock pile and laid to rest there.

Then came the lawsuit

The marine insurer/plaintiff initiated a "subrogation" suit in federal court against several defendants including the vessel manufacturer, yacht dealer, and the supplier of the stern thruster. In this type of suit, the insurer can bring an action in the name of the insured (vessel owner) to seek to recover the insurance payment and related expenses from others who may be responsible for causing the loss. The claims asserted in the case entitled *Fanok v. Carver Boat Corporation, LLC, Staten Island Yacht Sales, Inc. and Volvo Penta of the Americas, Inc.* included negligence, strict products liability, breach of contract and breach of warranty. The plaintiff also claimed that the "risk of loss" remained with the dealer at the time of the fire because the owner had not yet taken title or registered the vessel. The insurer was seeking only economic damages to recover the money it paid out for the total loss of the vessel, over $1 million dollars, because fortunately, no one was injured in the fire except for the family dog which did not make it off the vessel in time for evacuation.

After discovery and deposition testimony of all witnesses and parties to the lawsuit was completed, each of the defendants made an application (motion) to the court asking that the case be dismissed because no evidence had been developed to show a defect in the design of the yacht or in any of its equipment including the stern thruster or fire extinguishing system. The court agreed that plaintiff had produced no evidence that there was anything wrong with the yacht or any of its components that caused the fire. One reason for this, as federal judge Brian M. Cogan put it, was because the insurance carrier had to make a tough decision as to which of two options to choose in salvaging the yacht out of Horseshoe Cove. One option for the salvage at a cost of over $300,000 and 2 weeks time, called for construction of a cradle with the goal to raise the yacht in one piece. The other option was to use a crane, remove the wreck in pieces in 2 to 3 days, and dispose of it at a cost of about $52,000, plus pollution containment costs. Because of the potential for pollution and Coast Guard pressure to remove the wreck quickly, the insurance company chose the second option to remove and dispose of the wreck. The combination of the intense fire and this method of salvaging the hull left the evidence according to the court, "*substantially destroyed*" even though certain components including part of the stern thruster were recovered.

The lack of evidence left the plaintiff essentially with its bare assertions as to what caused the fire and without proof to support the theories of liability such as a claimed defect in the yacht and an automatic fire extinguishing system that allegedly failed to trigger. For example, even if the court accepted the plaintiff's conclusion that the stern thruster did not activate (based on the wife's reported observation that no water was churning), the judge said that just because it did not turn on, does not mean it burst into flames on this boat at this particular time. And, the judge concluded that it does not logically flow, without evidence, "*that an inoperative machine is an incendiary machine*." There was just no rational basis to conclude that on this one occasion, the thruster not only failed to activate, but ignited.

Warranty

Even on the warranty issues, the plaintiff had to offer some evidence of a "causal relationship" between the fire and the yacht's performance. Moreover, the yacht dealer issued no warranty and specifically stated so in the purchase paperwork. The reverse side of the purchase agreement had some fine print that the dealer was making "no warranties express or implied" and "no warranties of merchantability or fitness for any particular purpose" and finally, that any warranty "shall be solely the warranty given by the manufacturer". The manufacturer provided only a limited express warranty that the yacht would be "free from defects in material and workmanship for one year from delivery to the original retail owner". However, for the warranty to be valid, the manufacturer had to receive a "Warranty Registration Form", signed by the owner, within 15 days of delivery of the yacht. Here, the owner had not returned the signed form. Nonetheless, the purchase agreement stated that "your acceptance of delivery of the warranted Marquis yacht constitutes acceptance of the terms of this limited warranty."

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Judge Cogan acknowledged that plaintiff had an appealing intuitive argument that "something" must have gone wrong with the yacht to cause the fire, but an appeal to a jury's intuition without more evidence than plaintiff offered here "*is too speculative to support a verdict in his favor*."

This left plaintiff with basically circumstantial evidence that the judge found did not warrant continuing with the case because the theories would be "too speculative to submit to a jury" and could not "reasonably support a determination in [plaintiff's] favor." If this sounds complicated, just think of it as the judicial equivalent of a boxing referee stopping a fight before the final round and declaring the other fighter the winner by TKO [technical knock out].

A yacht is not a 'life jacket'

Judge Cogan also gave short shrift to the "risk of loss" argument in which the owner suggested that the vessel wasn't his yet when the loss occurred. The gist of the argument was that he had not yet taken delivery or "received" the yacht. The vessel owner had purchased the new 59-foot Marquis yacht on Staten Island entering into a purchase agreement with the dealer. The yacht passed all inspection and the dealer completed a "pre-delivery service record" confirming the proper operating condition and seaworthiness of the yacht. When the vessel owner signed the purchase agreement, the dealer agreed to install some after-market features and make certain repairs from a "punch list" the buyer had compiled, but had not yet been completed.

To this, the judge simply noted that "*a yacht is not like a life jacket; it cannot be picked up and carried away*." The "physical" part of possession had been readily met because the owner had unfettered access to the boat when he wanted it and indeed he actually took the yacht out on several occasions, putting his entire family and a friend and his dogs on it on at least one occasion. In addition to that, the facts showed that the owner already paid the bulk of the purchase price, asserted dominion and control over the vessel taking it out when he wanted during the delivery phase as he did on the day of the fire, and he held himself out as the owner even buying insurance on it, putting in an insurance claim for its loss (and accepting payment) and obtaining a Certificate of Documentation in his name from the Coast Guard.

In conclusion, it can be extremely difficult to determine the cause of a fire that completely consumes a vessel. Also, it is important for the buyer of a new boat to pay attention to and comply with all paperwork, including warranty forms. Having marine insurance in place from day one is extremely important as this case demonstrates.

THE ROTTERDAM RULES – SIMPLER THAN THEY APPEAR

by Chester D. Hooper, Esq.
Member, Holland & Knight LLP; Past President, The Maritime Law Association of the United States; member of the United States Delegation to the United Nations Commission on International Trade Law (UNCITRAL) Transport Law Working Group

The Rotterdam Rules[1] have in a sense evolved from the Hague/Visby Rules which evolved from the Hague Rules/COGSA.[2] The Rotterdam Rules' evolution modernizes the previous Hague regimes, corrects some of our courts' misinterpretation of the Hague regimes, clarifies some points of the Hague regimes, and provides for electronic commerce and other modern advances in the transportation industry. The law usually lags behind industry advances and has certainly lagged behind the transportation industry. The Rotterdam Rules should bring the law up to date with the transportation industry.

CHARTERPARTIES

Charterparty law should remain unchanged. The Rotterdam Rules will not govern charterparties or other contracts for the use of a ship or any space on a ship, just as the various Hague Rules did not. The Rotterdam Rules will govern other contracts for the international carriage of goods that include an international sea leg.

DEFENSES – LOSS OF ERROR IN NAVIGATION OR MANAGEMENT

The Rotterdam Rules maintain the catalog of defense of the Hague regimes, but eliminates the error in navigation or management defense. The Rotterdam Rules also weaken the fire defense.

In exchange for eliminating the error in navigation or management defense, the Rotterdam Rules change the burden of proof. The Rotterdam Rules describe in some detail the "ping-pong" burden of proof, which remains the same as the Hague regime with one significant exception.

A. First Volley – by Cargo

Our courts have interpreted the Hague regime to require cargo plaintiff first to prove a *prima facie* case – that it delivered cargo in good order and condition to the carrier, and that the carrier either failed to deliver the cargo or delivered it in damaged condition.

B. Second Volley – by Carrier

Once the first volley goes over the net from cargo's side, the carrier interests have the burden to show that the damage was caused by one of the catalog of defenses, i.e. insufficient packaging, a peril of the sea, etc. If the precise cause of the damage is known, i.e. leaking hatch covers, the carrier could prove that it exercised due diligence to make that cause seaworthy.

C. Third Volley – by Cargo

Once the carrier puts one of those defenses over the net or proves an exercise of due diligence to make a certain condition seaworthy, cargo has the burden to prove that something else for which the carrier would be liable, caused or contributed to the cause of the damage. For example, if yams rotted partly because of insufficient packaging and partly because of improper ventilation, the carrier would have the insuperable burden under the Hague regimes, of proving which precise damage was caused by insufficient ventilation and which precise damage was caused by insufficient packaging. This yam by yam burden would make the carrier liable for 100% of the damage.

D. The New Rotterdam Rules Fourth Volley – with an Equal Burden on Both Sides of the Net

The Rotterdam Rules add a new volley. In it, the carrier and the cargo interests would bear equal burdens to prove the percentage of blame that should be attributed to each cause, i.e. the carrier would try to prove that most of the fault lay with insufficient packaging and cargo interests would try to prove that most of the fault lay with improper ventilation. The damage would be apportioned as it is now apportioned in collision cases. Only if the court could not apportion the damages or if the court thought that the damages should be apportioned 50/50 would the damages be apportioned 50/50. In that event, cargo would recover 50% of its damages rather than 100%.

DUTY TO EXERCISE DUE DILIGENCE WILL BE A CONTINUING DUTY

The due diligence requirement has been extended from the duty to exercise due diligence before and at the beginning of the voyage to continue throughout the voyage. An example may help explain this difference. Let us assume that the carrier exercises due diligence to make a vessel seaworthy before she sailed from Norfolk, Virginia to New York, New York. Let us further assume that the vessel's radar failed between Norfolk and New York, but that the carrier did not delay the ship in New York to have the radar fixed before the vessel sailed from New York for Rotterdam. Let us further assume that because of the faulty radar, the vessel had a collision, which damaged cargo, during the voyage from New York to Rotterdam. Under the Hague regime, the cargo that was loaded in Norfolk would not be able to recover from the carrier. The carrier had exercised due diligence before and at the beginning of the voyage from Norfolk. The cargo loaded in New York, however, would be able to recover from the carrier, because the carrier did not exercise due diligence in New York to fix the radar. The continuing nature of the duty under the Rotterdam Rules would permit the cargo loaded in Norfolk to recover as well. The continuing duty to exercise due diligence would require the carrier to exercise due diligence to keep the ship in seaworthy condition after the vessel had loaded the Norfolk cargo and sailed from Norfolk.

SHIPPER'S LOAD AND COUNT

The Hague regimes have been misinterpreted in the United States not to honor a shipper's load and count clause on the face of the bill of lading. Even if a carrier receives a sealed container, which it may not open and inspect, the bill of lading quantity description of that cargo will be treated as *prima facie* evidence and possibly as conclusive evidence that the cargo described on the bill of lading was in fact in the container when the carrier received the container. The carrier will thus be held liable for missing cargo even if the cargo had never been loaded into the container and delivered to the carrier.

The Rotterdam Rules specify when the carrier may clause a bill of lading, shipper's load and count or shippers' weight, load, and count or similar wording and thus avoid the *prima facie* or conclusive effect of the bill of lading quantity description. The Rotterdam Rules explain, in essence, when the carrier would not have the opportunity to check the quantity of cargo either by count or weight,

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and thus when those clauses will be upheld. A carrier may not use such clauses if the carrier did check the quantity or the weight.

PERFORMING PARTIES

The Rotterdam Rules recognize that many other parties participate in the performance of a contract of carriage, particularly a multimodal contract of carriage. The Rotterdam Rules define maritime performing parties and non-maritime performing parties. The Rotterdam Rules will govern maritime performing parties, but will not govern non-maritime performing parties.

Maritime performing parties participate in the carriage from port to port and within the port. Maritime performing parties would include, but would not be limited to, parties such as stevedores, terminal operators, watching services, and trucks and trains operating only within a port. Non-maritime performing parties would not be governed by the Convention. Non-maritime performing parties would include, but would not be limited to, trucks and trains that carry the cargo from the port to an inland destination in the United States, or from one inland destination to another. The absence of non-maritime performing parties may create some problems.

The perfect transportation law would apply the same law to all modes of transportation in all parts of the world and would thus apply to all performing parties. The Rotterdam Rules have not achieved perfection, but they have come close to unifying the law that will apply between cargo interests and carriers throughout most of the world.

NON-MARITIME PERFORMING PARTIES

Railroads, particularly U.S. railroads, as well as trucking companies, did not want to be governed by the Convention. As a result of this resistance, the Convention will not govern inland carriers directly. The Convention will govern the contract between cargo interests and the carrier during the door-to-door carriage in the United States, but will not govern a direct claim by cargo interests against a railroad or trucking company that was acting as a sub-contractor of the carrier. That railroad or trucking company would attempt to depend on the carrier's Himalaya Clause to obtain the carrier's defenses. It might also attempt to rely on its own contract. National law might, however, take precedent over the Himalaya Clause or the inland carrier's own contract.

JURISDICTION AND ARBITRATION

The United States courts have, after the case of *Vimar Seguros y Reaseguros, S.A. v. Sky Reefer*, 515 U.S. 528, 1995 AMC 1817 (1995), upheld choice of forum and arbitration clauses even if they were placed on the reverse side of the bill of lading, and even if cargo interests were unaware of their existence. Even if the contract of carriage included a choice of forum clause, the Rotterdam Rules would basically allow cargo interests the choice of suing the carrier under a contract of carriage that does not include an arbitration clause at the place of the carrier's domicile, the place at which the cargo was originally delivered to the carrier or performing party, the first port of loading onto a ship, the last port of discharge from a ship, and the place of destination.

If the contract of carriage governed by the Rotterdam Rules included an arbitration clause, cargo interests would have to arbitrate, but cargo interests could demand arbitration at the same places that cargo interests could bring suit under a contract of carriage that did not include an arbitration clause. Cargo interests could also choose, if they wished, the place chosen in the arbitration clause to arbitrate.

Parties to charterparties are, of course, not governed by the Rotterdam Rules and are completely free to choose wherever they wish to litigate or arbitrate. The holder of a charterparty transport document or electronic record will be bound by the charterparty arbitration agreement if the charterparty, including the arbitration agreement, are specifically incorporated into the transport document or electronic record. Parties to volume contracts may also choose wherever they wish to litigate or arbitrate. Parties to volume contracts may extend the volume contract place to litigate or arbitrate to third party holders of transport documents or electronic records if the chosen place is one of the places listed above, domicile of carrier, place of origin, first port of loading, last port of discharge, or place of destination. Other requirements must also be met including "timely and adequate notice" to the holder.

Under the Rotterdam Rules, cargo interests could demand arbitration in New York if the cargo were destined to New York and if the transport document or electronic record included an arbitration agreement. Arbitration could also be conducted in New York if a charterparty called for New York arbitration, and the bill of lading issued pursuant to that charterparty specifically incorporated the terms of the charterparty including the arbitration clause.

PACKAGE LIMITATION

The Rotterdam Rules will use the Hague/Visby kind of package or weight limitation system. This limitation will increase the amount of the package limitation and the weight limitation above the Hague/Visby limit and even above the Hamburg Rules limit. It will also increase the number of packages above the number of COGSA packages.

The Hague/Visby Rules limit the carrier's liability to 666.67 SDR's[3] per package or 2 SDR's per kilo, whichever is greater. The Rotterdam Rules increase those limitations to 875 SDR's per package or 3 SDR's per kilo, whichever is greater.

The Rotterdam Rules, as do the Hague/Visby Rules, increase the number of packages. COGSA generally treats a pallet as a package when the Hague/Visby Rules or Rotterdam Rules generally will not. If the number of packages on a pallet are enumerated on a transport document or electronic record those packages rather than the pallet will constitute the limitation package. That difference may increase the limitation more than the increase from $500 per package to 875 SDR's.

N.B. The views expressed in this paper are the personal views of the author. They are not necessarily the views of the MLA or of the United States

1. The Rotterdam Rules may be found at: http://www.hklaw.com/File.aspx?id=3102&inline=1.

2. The Hague Rules, International Convention for the Unification of Certain Rules Relating to Bills of Lading, signed at Brussels, Aug. 25, 1924, 51 Stat. 233, 247, 120 L.N.T.S. 155 ("Hague Rules"), *reprinted in* 6 Benedict on Admiralty, Doc. No. 1-1 (7th rev. ed. 2007); the Carriage of Goods by Sea Act (COGSA), Ch. 229, 49 Stat. 1207 (1936), reprinted in note following 46 U.S.C. § 30701 (formerly codified as 46 U.S.C. App. §§ 1300, et seq.); and the Hague/Visby Rules, Protocol to Amend the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Signed at Brussels on Aug. 25, 1924, Feb. 23, 1968, 1412 U.N.T.S. 128, *reprinted in* 6 Benedict on Admiralty, Doc. No. 1-2 (7th rev. ed. 2007), when referred to together will be referred to as the "Hague regimes," or the "various Hague Rules."

3. Special Drawing Right of the International Monetary Fund. As of March 13, 2009, 875 SDR's were worth $1,289.93 and 3 SDR's were worth $4.42.

WHO'S SWIMMING NAKED?

by Bill Rooney
Managing Director, Hanjin Shipping

We have all heard the expression "the rising tide raises all boats," and this phenomenon was proven true at least twice in the past 15 years with the dot com boom and then the housing boom. Many people and businesses, some deserving and some not, saw their boats rise in these periods of strong economic growth. However, we are now in the worst economic crisis since the Great Depression and are witnessing a global economic contraction as the US and world economies work their way out of ten years of debt- funded spending on everything from inappropriately large homes, flat screen TVs and vacations to over-valued businesses and highly risky, exotic financial derivatives. Who would have thought that investment banks could lever themselves 30 or 40 to 1 and not expect a reckoning at some point? All this profligate behavior would make a drunken sailor blush. Well, the world is now in "de-leveraging" mode. The Dow lost more than half of its value at the peak in October of 2007, home values are down anywhere from 15% to 40% across the US and many experts expect the global GDP to drop by 1% in 2009.

It's time to start applying the expression on the flip side of "a rising tide raises all boats" – "A falling tide identifies those who have been swimming naked." Those people, families, business and institutions that were "swimming naked" during the flush times have now been uncovered and are exposed to the worst the recession has to offer. If you are over levered, if you have a weak balance sheet, if you bought a house you couldn't afford with a "liar loan," if you have a weak product or if you didn't ask the right questions before giving your money to Bernie Madoff, you are most likely lying naked on the sand at low tide.

The good news is that these times also offer opportunities for people and companies to change and improve in response to significant changes in the economic climate. This is appropriate on the 200th anniversary of Charles Darwin's birth and the 150th anniversary of the publication of his "On the Origin of Species". We live in a time of the survival of the fittest and where the ability to adapt to the environment will define which companies, countries and people prosper and which do not.

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We have a front row seat to one of the biggest shifts in business and economic activity the world has ever seen. The winners and losers are being decided as a much more integrated world economy adjusts to new conditions and new priorities.

It is encouraging to see people and companies in the US adapting to the new conditions quickly. People are modifying the way they live their lives, how they shop, how they save and how they plan for the future. Companies are already responding to changing markets and the generally increased frugality of the population. (The savings rate in the US has gone from being negative to 5% in pretty short order. This is actually a problem given that consumer spending has fallen off a cliff. However, in the longer term, this is a good thing. Americans have to learn to save more and spend less so we can fund needed investment ourselves rather than relying on the Chinese to buy US debt.) While some markets are dying, new ones are springing to life. While many of my customers in the international containerized ocean transportation business have seen their business shrink others are doing just fine because they were positioned correctly to capitalize on changing tastes and consumers moving back to basics and to lower price points.

While it is refreshing to see the people, companies and institutions reacting quickly and effectively in an environment of "creative destruction," the US's proven system of free-market capitalism is suffering through an extended period of bad publicity. Free-market capitalism has gotten quite a bit of bad press over the past year and a move in the US toward a higher level of government involvement in business and commercial activities has me and many others concerned. While most people, including those in the financial industry, accept that the well-publicized abuses over the past ten years could have been prevented or mitigated with a more comprehensive regulatory regime in the financial industry, I fear that there will be a rush toward government involvement where none is required and would actually be harmful. We are in danger of throwing the free-market capitalism baby out with the dirty bath water from the clean up of the financial markets.

In my industry, the containerized ocean transportation business, we deal with thousands of customers, many of them right in the middle of the current economic craziness. Some of our most prominent customers are retailers (check out the list of Chapter 11 filings), furniture companies (closely tied to housing which is at the center of the economic crisis), consumer electronics companies (think of all those flat screen TVs funded via second or third mortgages that are no longer being offered by banks) and tire and auto part companies (look at what's happened to auto sales). We talk to these companies every day and they have been reacting and re-tooling their operations since last year in response to the new economic realities. This is what is so encouraging. They are not asking for bail-out money, you don't see them on the front page of newspapers. They are doing what companies have been doing in the US for several hundred years . . . going about their business, reacting to market conditions, searching for new customers, becoming more efficient, worrying about the competition. Some fail (probably while swimming naked), some succeed and some succeed wildly. A direct by-product of this churning process of birth, growth, failure, decay and re-birth is the fantastic wealth that has been built by this country.

In times like this, this creative destruction-rebirth process proceeds like it is on steroids and we've been witnessing it for the past year. I see companies reducing their inventories and managing them much more closely, reducing costs, looking for and finding new customers, re-positioning products, dropping brands, closing stores, opening new markets. Pay a bit more attention to the ads you see on TV, it's amazing how quickly companies have modified their pitch (and products) to better reflect the current environment and customer needs. The companies that will succeed are nimble, well managed, have a solid balance sheet and are close to their customers. Success in these times is not an accident – it's the product of preparation, execution and hard work.

If you're swimming naked in these times, you don't stand a chance, but if you were prepared and had sound fundamentals, chances are you're going to do just fine.

MEET INCHMAREE

I recently came across an "old" copy of RESOLUTION, the official publication of the Vancouver Maritime Arbitrators Association (VMAA). There were two items in the June 2008 issue which attracted my attention. The first was VMAA arbitration rule 48 which speaks for itself:

> *An award may be published unless either party notifies the Tribunal in writing, on or before the first hearing date, that it objects to publication. If there is no such objection, any publication will be so drafted as to preserve anonymity as regards the identity of the parties, their legal or other representatives, the Tribunal and the concerned vessel or vessels.*

The second was an article authored by Peter L. Wright (Founding Director of the VMAA) on the Inchmaree Clause. It reminded me of years gone by, of reading Buglass, Winter, et al. Many of our readers have heard the lame pun about General Average – in which battle did he fight? But how many know about the Inchmaree Clause? In case anyone wonders why I bring this up, it is part of the Average Clauses and also a nearly forgotten insurance term.

THE INCHMAREE CLAUSE RE-VISITED

It was when I was a young man acting in the role of a marine insurance underwriting trainee that I first heard of the Inchmaree Clause. Over many ensuing years I became familiar with its intricacies and, in fact, paid many claims because it was included in the applicable Hull and Machinery policies.

The Inchmaree Clause had its beginnings in 1887 when a steamer "INCHMAREE" suffered an explosion and subsequent damage as a result of a crew members' negligence.

The vessel owners claimed for this damage under their Hull & Machinery policy, but the marine underwriters denied liability. This led to a lawsuit and subsequent appeals through the English Courts up to the House of Lords, which decided that the denial of liability by the underwriters was correct.

As a result of this decision, marine underwriters were persuaded to extend their standard "maritime perils" wordings to cover a number of additional perils along the following lines:

"This insurance includes loss of or damage to the Vessel directly caused by:

- *Explosions on shipboard or elsewhere*
- *Bursting of boilers, breakage of shafts or any latent defect in the machinery or hull*

Provided such loss or damage has not resulted from want of due diligence by the Assured, Owners or managers."

These additional perils became known as the Inchmaree Clause and were gradually introduced into Hull & Machinery policies. The Clause was considered in a recent Vancouver mediation. The dispute concerned a fishing vessel, whose owners, throughout their long and established history, had consistently made a practice of maintaining all of the vessels in their fleet in an immaculate condition.

The vessel was proceeding from its moorage in the Port of Vancouver when the port engine suddenly seized.

On inspection, it was determined by the marine surveyor that the damage was caused by water particles which had entered into the engine by way of the water intake while the vessel was running. This blockage reduced the flow of cooling water, which in turn resulted in a hose being exposed to higher temperatures than normal, as there was less water able to pass through the hose. It was not a split but a burn hole. Therefore, it may have been that the hose itself did not fail due to wear and tear but was caused by extreme heat.

The hose in question was located in the extreme outboard, port aft, end of the vessel and would have only been visible with the use of a strong light; consequently, it was extremely difficult to examine closely, even by a qualified eye, during the course of a full inspection.

Ultimately, the dispute resulted in a difference of opinion between the assured and the insuring company as to the cause of loss.

The assured contended that the loss was due to a "latent defect in the machinery which had not resulted from want of due diligence" by them, while the insurers contended that the loss was due to "wear and tear".

The dispute was amicably resolved by mediation and a fair settlement acceptable to both parties was achieved.

THE 2009 TANKER MARKET – WHAT TO FOCUS ON DURING THE GLOBAL RECESSION

by Robert J. Flynn
President, Jones, Lynch, Flynn & Associates

The tanker industry is the foundation of the world's logistical chain for transferring oil from the few producers/exporters to the many users. In an orderly environment, the driver of tanker demand is the supply of oil; more oil – more demand, and this is either augmented or diminished by issues, such as pricing, which provide an incentive to build or diminish inventory levels. Demand and supply, while rarely being in sync, are also rarely significantly disparate, continually circling each other except if a market shock/disruption occurs, such as it presently has. After such an event, supply either attempts to play catch-up to skyrocketing demand (i.e. 2004) or, if there is an evaporation of demand, as is the current reality, producers attempt to contract supply to catch the "falling knife." Production cuts are a metaphorical equivalent of wearing gloves; the question is how thick are the gloves and how sharp is the knife.

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Pricing along the futures curve has been in a contango[1] shape for the last few months, ever since prompt WTI (West Texas Intermediate – the NYMEX crude contract) fell below $70/bbl in October of last year. At times, this has been an extremely steep contango, particularly during the December and January period. The impact on the tanker market, much discussed in the media, has been to charter tankers for storage (as one can buy cheap oil prompt and sell it in the future at a significant profit). The estimated tally as of mid February is that the crude in storage totals approximately 80 million barrels, which is being kept in about 35 VLCC's and about a dozen smaller tankers. This has shielded VLCC owners from the full effect of the OPEC production cuts which we estimate to be about 30 less cargoes per month or the loss of demand for 40 to 50 VLCC's (based upon an average VLCC voyage). However, whatever shield this temporary support for the VL sector has provided, it has not had particularly long legs for the rest of the tanker sectors. After initial strength in the early part of the New Year, the earnings for Suezmax/Panamax tankers have fallen steadily. Comparing the first half of January to the last half of February, we see approximate decreases of 20%, 30% and 45% for the VLCC, Suezmax and Aframax sectors, respectively.

The shield to earnings, provided by vessels going into storage, has a limited life-expectancy, much like the shield that collapsing oil prices provided during the fourth quarter of 2008. Then, the reduced expenses associated with vessel bunkers were greater than the reduced revenue, as the freight paid also fell, but there was a limit to how far bunker costs could fall. In a similar fashion, there is a limit of time (charter length) as to how long the vessels can remain in storage before they discharge and re-enter the "job-market". The mid part of 2009 is expected to produce low earnings across all tanker sectors. However, unless we are truly in 1932 (or the 1979 to 1983 period from an oil demand point of view), the market has operated in a volatile and ever-changing environment and the 2009 experience will likely become a memory in the not too distant future, although not unlike a hurricane leaving significant damage to the "financial fitness" of the ownership community in its wake.

The impact on tanker demand that prices along the crude oil futures curve exert is often not fully appreciated by many industry pundits. There have been two dramatic examples of this impact since the beginning of 2007 – one a contango and one a backwardated market. The impact from the backwardated[2] market period occurred from the end of July 2007 to early January 2008, an approximate five-and-a- half-month period during which U.S. crude stocks fell by nearly 70 mm barrels. The contango period occurred from October 2008 through the end of January, and is still ongoing. If one goes back to the latter part of September when U.S. inventories bottomed, the result is an approximate 56-million-barrel build over a four-and-a-half-month period. In both cases, the impact on crude being transported was about 415k barrels per day (bpd), the latter in excess of demand and the former was a deficit to actual demand. A typical VLCC (AG to U.S. Gulf) or Suezmax (from West Africa to the U.S – Atlantic Coast or the Gulf) tanker provides 26,000 to 28,000 bpd on a round-trip basis and an Aframax from Venezuela to the U.S. Gulf about 30,000 to 33,000 bpd of crude. This implies that U.S. crude stock build-up or depletion has had an impact on the employment of 12 to 15 tankers compared to what would have happened if stocks remained flat. The swing between contango and backwardation, therefore, has had an implied impact on tanker employment of 25 to 30 vessels during the last two-year period.

U.S. crude stock levels as of mid February are approximately 350 million barrels; near the June/July 2007 peak that preceded the flip from a 2.5-year contango market into backwardation. Ironically this flip also occurred as prompt prices crossed the $70 level, not unlike the price threshold for inverse flip that occurred this past fall (the last time stocks were higher than 2007 level was May of 1998). The combination of refinery turn-around season and the approximate 80 million barrels in floating storage provides a rationale to assume that the crude futures curve could be returning to backwardation (at least in the front end of this curve) in the near term. This would imply a break with the prompt price of crude being the driver of the contango/backwardation decision; it will require the nowhere-to-put-it issue becoming the driver of the moment. If this transpired, the tanker market would ease further, but it would also reduce inventories. The latter may not occur as rapidly as in the past, given the reduced demand environment, but it still should provide the foundation for crude prices to rise, OPEC to increase production and the tanker market to recover; the quantification of these events, *i.e.* how much prices, production and earnings actually recover, though is subject to much speculation.

In order to form one's expectation of future development, issues to watch going forward, in addition to crude pricing/inventory levels, include:

- The oil demand status of key countries/regions, using the traditional year-on-year metric, but also noting month-on-month differentials to try and gain a sense as to if/when an inflection point is approaching.

- ❍ U.S. information continues to be ambiguous; there is information that the drop in demand may be beginning to flatten – October demand was revised up by about 1 mm bpd; the year-on-year decrease for January appears to have fallen significantly to about 1 mm bpd from about 1.5 m bpd for November. However, December revisions recently indicated an approximate 800k decrease compared to preliminary weekly information. This results in the month-on-month December to January comparison showing a growth in demand, but the January numbers are preliminary and, after the December revisions, I would be hesitant to put much weight into this information just yet. An additional point to keep in mind going forward, for the U.S. in particular, is that 2009 comparisons will be on a lower base than they were in 2008, which could lead to a relative flattening in demand.
- ❍ European demand could plummet in 2009; the region appears to be on an economic precipice and could be the largest anvil holding back a world recovery during the current calendar year.
- ❍ China may be returning to positive demand growth due to their infrastructure stimulus package, just as the majority of analysts are writing them off for 2009.
- ❍ Japan and India – The demand in Japan fell 5% in 2008 and preliminarily 8% for the first month and 12% for the second month of this year. Conversely, India has been the lone holdout of strength – demand grew at a level of 6% in the fourth quarter of 2008 as well as preliminarily for January of 2009.

◆ Not only does the total demand number of country/region need to be tracked, but also the component make-up of the demand and its change, as this provides insight into the state of the economy

- ❍ This will feed into the issue of two-way trading. Regulatory issues and surging diesel demand (particularly during the 2007/’08 period) on a global basis increased the transport of refined products by tanker as countries/regions became less self-reliant in their ability to meet their “product” needs once they were in possession of the “raw crude”.

  China’s Pre-Olympic accumulation of diesel and European growth for diesel particularly in Germany are two examples of this.
- ❍ This assisted the handy sector in particular – not only were these tankers carrying excess diesel from the U.S. to Europe and South America, they were carrying excess gasoline produced in Europe to the U.S. Contrary to what many intuitively think, crude oil is not a Lego or an Erector set that one can employ to produce any desired product. If one refines product “X”, they also get a significant amount of product “Y” as a byproduct. Additionally, since not all grades of crude oil are equally efficient at producing the various types of refined products, this can create problems for refiners and opportunities for tanker owners.
- ❍ Ironically, the surge in diesel demand likely harmed the profitability that refiners had come to enjoy in recent years. In fact, there is a school of thought that the surge in diesel production/demand may have been the major culprit that caused oil prices to surge during the 2007/2008 period. The issue is believed to have been magnified by U.S. and European environmental regulations that restricted aspects of diesel, such as sulfur content as well as other mandates.

  As large refinery projects were being built in India and the AG in particular, the expectation was that this MR tanker benefit might begin to accrue to coated Panamax and even Aframax tankers as well.
- ❍ The reduced demand that has occurred over the last six months increases regional self-sufficiency and reduces the opportunity that had arisen, but as the demand recovers and self-sufficiency again gets strained, support for refined product transport should recover, although this component of the tanker market will likely be the last part to recover.
- ❍ The impact from the financial crisis on energy consumption has not as yet impacted the consumer as greatly as the U.S. media in particular would have one believe – it has been on the industrial production side that the momentous shifts in demand have occurred as economies slow – the status of demand of the various refined products may provide insight as to what stage in the current financial crisis a particular region is at.
- ❍ A caveat to the above is that in the U.S. the consumer may be the second shoe to drop as unemployment increases and day-to-day usage is reduced due to a smaller active work force – in

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the U.S. gasoline consumption represents approximately 45% of total oil consumption – giving consumer behavior particular power in impacting national consumption numbers. Decreased gasoline consumption represented only 25% of the drop in 2008 U.S. demand.

- OPEC production levels – there is a possibility that another cut will be announced in March at the next cartel meeting, although given the magnitude of cuts thus far, an 80% to 85% compliance still leaves a 600k to 800k bpd reduction in supply that could be achieved by increased compliance rather than additional cuts. Going forward, do they appear to be complying with quota levels and as prices recover is there slippage from the prior compliance levels?
  - Recognize that in key areas such as the U.S. there is a likely six-week delay from when cuts are made until their impact will be felt in the U.S. and Europe in terms of reduced crude imports.
- Tanker supply – January 2010 is the IMO phase-out for single-hull tankers, and the VLCC and Aframax sectors in particular have significant amounts of vessels that will have limited trading options next year (the Suez fleet has a smaller proportion of single-hull vessels). These vessels are far from being equivalent to double-hulled vessels in supply terms currently, but will be even less so next January; the degree that these vessels are scraped/removed from circulation is a medium-term issue to monitor.
- Financial situation – When will credit access ease, and in the OCED, will retail/consumer spending levels recover such that industrial production can follow?

The problem in situations such as this is that the floor is transparent, meaning no one knows how far demand can/will fall. It could be a small step further down or one could be at the edge of a cliff. There is contradicting information as to what the situation will be 9 to 12 months hence, although in the short-term (the next 2 quarters) a recovery appears highly unlikely.

NOTE: Mr. Flynn acknowledges the valuable assistance of Jerry Lichtblau in the research and preparation of this February 2009 paper.

1. Contango is a financial term and industry specific. It refers to prices in the future being higher than they are currently.

2. Backwardated is the opposite of contango. It refers to future prices being less than the current ones.

WHAT'S NEXT? ETHANOL-BLENDED GASOLINE DAMAGES BOATS

by James E. Mercante, Esq.
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Exxon, Chevron, Conoco Phillips, BP and Shell, all defendants in a proposed Florida class action lawsuit, were dealt a huge blow recently when a Federal Court in the Southern District of Florida issued an order denying their joint motion to dismiss a lawsuit filed by three Florida residents, Erick Kelesceny, John Egizi and Todd Jessup. The Plaintiffs allege that the world's largest oil companies failed to warn them, as well as all Florida boat owners, that the gasoline they purchase at the pump, which is blended with ethanol, may destroy fiberglass tanks and tends to absorb water and that phased separation of ethanol from gasoline could cause damage to all boats, regardless of whether they have a fiberglass tank.

The lawsuit was filed by consumer protection lawyers, Jeffrey Ostrow, David Ferguson and Jonathan Streisfeld of The Kopelowitz Ostrow Firm, P.A. (TKO), a litigation firm in Fort Lauderdale, Florida. The oil companies argued that the proposed class action lawsuit is preempted by federal and Florida law. By denying the motion to dismiss, the Court has allowed the Plaintiffs to proceed with their lawsuit.

The basis for the Court's ruling is that federal law encourages, but does not require, the use of renewable fuels such as ethanol, while Florida does not require it be used by boat owners. If successful, the oil companies will be forced to place a warning label on all pumps at all gas stations in Florida, notifying the boating public that usage of gasoline blended with ethanol may be hazardous to their boats.

Further, the Plaintiffs seek compensation for all Florida boat owners who have been damaged as a result of the oil companies' failure to warn of the destructive tendencies of fuel blended with ethanol when used in boats. Boat owners have been forced to spend thousands to tens of thousands of dollars to repair their boats.

"Denial of the motion is a significant step toward redressing the wrong perpetrated on Florida's boating population," said TKO Managing Partner, Jeffrey Ostrow. "Florida is the boating capital of the world and it is reprehensible for oil companies to enjoy significant profits while knowingly paralyzing Florida's boaters. We hope to have the opportunity to represent all aggrieved boaters throughout Florida."

Denial of the motion is particularly notable in light of the fact that a similar lawsuit in California was previously dismissed at the same stage.

LESSONS IN LIENS – THE SEPARATE NATURE OF IN PERSONAM AND IN REM CLAIMS

by Jeremy J.O. Harwood, MA (Oxon)
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The nature of a maritime lien and difficulties surrounding lawsuits in respect of them was aptly described some fifty years ago by the distinguished law professors Gilmore and Black in their seminal "The Law of Admiralty" as follows:

> *The law of maritime liens might well have been worked out more satisfactorily than it has been if the unfortunate term "lien" had not come into use during the nineteenth century. The possibilities of confusion may be greater today than in the past because of the gradual disappearance of a specialized admiralty bar and even more because the federal judge sitting "in admiralty" is almost never, at the outset of his judicial service, a maritime lawyer. The beginning of wisdom in the law of maritime liens is that maritime liens and land liens have little in common. A lien is a lien is a lien, but a maritime lien is not.*[1]

This article addresses two recent Circuit Court "book-ends" to the concept of a maritime lien as an *in rem* claim separate and apart against the "thing," usually a vessel, as opposed to its owner. The starting point for the discussion is the Supreme Court's statement: "A maritime lien and a proceeding *in rem* are correlative; where the one exists, the other can be taken, and not otherwise" *The Rock Island Bridge,* 73 U.S. 213, 215 (1867). Under United States' rules, as embodied in the Supplemental Rules for Certain Admiralty and Maritime Claims of the Federal Rules of Civil Procedure, to enforce or "foreclose" on a maritime lien by way of an *in rem* action there must be a Rule C arrest of the property on which the lien applies. As such the Court can adjudicate the *in rem* liability of the Vessel to the lienor (provided it obtains jurisdiction by way of an arrest) independent of jurisdiction over and the liability of the Vessel's owner. This nineteenth century legal proposition is much criticized by authorities such as Profs. Gilmore and Black.[2] This notion of separate claims was the subject of the Second and Third Circuit decisions discussed below in the context of arbitration.

THE MARKOS N[3]

This case involved a cargo claimant, Thyssen, which brought claim for damage to steel coils in the Southern District of Texas, where a warrant for the arrest of the MARKOS N was issued. The vessel's P&I Club issued a letter of undertaking. The vessel's owner was also a named defendant. The parties agreed to transfer the action to New York, where the vessel's owner answered the complaint both on its own behalf and for the vessel. The owner, Calypso, subsequently sought to stay the entire action in favor of London arbitration. That motion was granted, including in respect of the asserted arbitrability of *in rem* claims under a broad arbitration clause in the charter.

Once the claims got to London the issue of their timeliness was referred, by agreement, to the English High Court. That court decided they were time-barred and refused to exercise a discretion to extend the time limitation.

Thyssen then returned to the New York Court to attempt to revive its timely filed *in rem* claim. Thyssen argued that its *in rem* claim was separate from its claim against Calypso and that, as the English arbitrators had no *in rem* jurisdiction under English law, a contractual provision claiming to enforce London arbitration of *in rem* claims was a violation of COGSA. The District Judge disagreed, stating that "Thyssen fails to demonstrate that the loss of its *in rem* claim deprives it of anything more than an additional means of enforcing liability." The Court continued: "Thyssen here has failed to demonstrate any meaningful distinction between its *in rem* suit against the vessel and its in personam suit against the owner." Its attempt to revive its timely commenced *in rem* suit was denied. On appeal the Second Circuit stated that "[a]lmost all maritime disputes generate both an *in personam* and *in rem* claim; if plaintiffs were able to bring *in rem* claims in court after the failure of their *in personam* claims before an arbitrator, parties would have no incentive to arbitrate matters."[4] The Court continued that the "*in rem* claim serves as a way of making sure that the plaintiff can recover if it wins in arbitration" and to interpret the Federal Arbitration Act to allow the "*in rem* claim to proceed after the failure of the *in personam* claim would undermine the purpose of the [Arbitration] Act with respect to maritime proceedings. All maritime contracts that called for arbitration of *in personam* claims could be sidestepped simply by bringing in rem claims."[5]

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The Court also denied application of the arbitration clause to *in rem* claims as a violation of COGSA.

The Second Circuit's decision would suggest that provided there is a broad arbitration provision that would include *in rem* claims, as most clauses relating to disputes under a charter would, the *in rem* claims not only must be arbitrated but stand or fall with the *in personam* claims and cannot be adjudicated separately.

THE KING A

The Third Circuit's recent precedential decision in *Petroleos Mexicanos Refinacion v. M.T. KING A,*[6] reversing the New Jersey District Court took a different tack altogether.

In 1992 Pemex chartered the M/T TBLILISI (renamed M/T KING A after her sale) to carry diesel oil and unleaded gasoline between several Mexican ports. The cargoes become cross-contaminated upon discharge, in December 1992, because of the fault of the Vessel, which was undisputed. Pemex withheld $530,320 of charter hire as security for its cargo claim.

In April 1993, the shipowner demanded arbitration to obtain the withheld hire. Pemex was aware at that time that its claim, including for mitigation costs, would exceed the withheld hire. Accordingly, in agreeing to accept a club LOU in standard wording in exchange for payment of the hire (and to avoid the award against it) Pemex specifically reserved the right to arrest the Vessel to the extent the cargo claim exceeded the hire withheld, which at that time it knew it would.

The charter was governed by the U.S. COGSA and the one year statute of limitations. Approximately seven months of that prescription period remained for Pemex to arrest the Vessel or otherwise secure the balance of the claim. It failed to do so.

While Pemex's claim was adjusted in Mexico with its Mexican cargo underwriter, the New York arbitration stagnated. In 1995 the shipowner sought to have that proceeding dismissed. The tribunal ruled that Pemex's nomination of an arbitrator in respect of the shipowner's claim of withheld hire preserved its own claim. Pemex finally submitted that claim, for approximately $2 million, in 1996.

During the course of the arbitration the Vessel had made at least ten documented port calls in the U.S. and had been delivered to her new owners in Houston in 2000. Only in 2002 did Pemex, in its own name, file a complaint in New Jersey naming solely the Vessel, *in rem*, and seeking its arrest. To avoid that arrest the new owner and its P&I Club, which happened to be the same, posted a second LOU for $707,819 to cover the balance of (reduced) claim plus all interest, costs and attorneys' fees.

In 2006 the tribunal awarded Pemex $434,896 on its principal claim plus interest of $411,821 and attorneys' fees of $100,000. After application of and payment under the first LOU, this left the award to be satisfied in respect of the balance of the principal, interest and fees against the second LOU. A consent judgment in the sum of $395,265 with interest was entered in order to perfect the Vessel's right of appeal from an earlier decision from the New Jersey district court denying its motion to dismiss the complaint, discussed below.

After the New Jersey arrest action the new shipowner, making a limited appearance to defend its vessel, sought to vacate the arrest and dismiss the *in rem* complaint on the basis that Pemex's claim was governed by COGSA's one year period which had expired in 2002 so that no lien existed and, therefore, there was no admiralty *in rem* jurisdiction.

The lower court's ruling upholding the arrest relied on the *MARKOS N*, *supra*, to hold that the "*in rem* and *in personam* claims are closely intertwined" so that "the Court agrees with [Pemex's] assertion that the action was timely filed as it was initiated pursuant to an ongoing arbitration and pursuant to the [first] LOU … [a]n arbitration was timely commenced and the arrest was sought in order to protect [Pemex's] interests during that arbitration."

In summary, the District Court's ruling would permit the *in rem* arrest of a vessel, irrespective of any statute of limitations, provided that a proceeding, arbitral or otherwise, had been timely commenced. This "extension" of the inseparability of the *in rem* claims from the *in personam* claims for time-bar purposes would appear, on its face, to be the same situation in reverse of the *MARKOS N* ruling, *i.e.*, that the timely *in rem* claim was barred by the untimely *in personam* arbitration claim. Charterers or cargo interests could, under that reasoning, arrest a vessel in the U.S. to collect on an arbitration award at any time, irrespective of whether they had timely perfected their *in rem* rights.

On appeal the Third Circuit, by a majority, reached the important and precedential holding that the COGSA statute of limitations is "one which extinguishes the cause of action itself, and not merely the remedy" (quoting a New York district court decision, reversed on other grounds). Their conclusion was that if the *in rem* action was time-barred by COGSA the lower court had "no grounds upon which to issue a warrant of arrest."

Turning to the arguments of Pemex and the Lower Court, the majority addressed the law relating to LOUs, as developed by case law: (1) LOUs are usually a complete substitute for the *res*; and (2) if the LOU is insufficient to satisfy a judgment re-arrest may only be ordered if there was fraud or mistake of the court in the posting of the original security.

The first LOU obtained by Pemex had the "unique" provision allowing for later arrest. "Pemex, however, failed to take such action to increase its security until nine years had passed." This "seemingly unlimited right to later arrest the vessel," the majority reasoned, had to be reconciled with the "reservation-of-rights clause." In the District Court's decision asserting that the arrest was "pursuant to the LOU," the majority noted that the lower court "did not explain what it meant" by that and had entirely ignored the "critical" reservation-of-rights clause. In considering the issue they first reviewed the "interact[ion]" between the reservation clause and "late arrest" provision and concluded that, read together so as not to conflict, the right of later arrest was "subject to the well-known one-year COGSA statute of limitations."

Next, the majority reviewed the holding in *MARKOS N*, agreeing that *in rem* and *in personam* claims are often closely linked. However, the lower court's extrapolation of that decision to permit some sort of "relation back" or "tolling" statute of limitations for the 2002 *in rem* action to the 1993 *in personam* arbitration was entirely without support in "any case law." The majority agreed with the shipowner that the "arbitration and *in rem* proceeding are separate actions" – a crucial holding. They discussed the law relating to vessel arrest under the Federal Arbitration Act and the rationale in *MARKOS N* of preventing "two bites of the apple" but concluded that "*Thyssen* did not sanction relation back of these distinct, albeit related, actions" and "close interrelation" of claims provided no grounds to do so.[7]

In contrast to the *MARKOS N*, the majority concluded that the "personification theory" of the vessel, "remains fundamental to American admiralty practice and is the theoretical foundation of the maritime lien" [citation omitted]. In holding that the *parties*, *i.e.*, the shipowner and the vessel, are different, the majority restated a "formalistic distinction" that remains good law.

CONCLUSION

As with all things relating to maritime liens, the "possibilities of confusion" are ever present. One thing is certain: as much as the theory of the personification of the ship has been reviled as an irrational and illogical "legal fiction" that theory journeys on intact into the new century and, thanks to the Third Circuit, with fresh wind in its sails.

1. Id. (2ed 1975) at p. 589.
2. *Id*. at 616.
3. 2001 U.S. Dist. LEXIS 11560, aff'd, 310 F.3d 102 (2d Cir. 2002).
4. 310 F.3d at 106.
5. Id. at 107.
6. 554 F.3d 99 (3d Cir. 2009).
7. Likewise, Third Circuit precedent made clear an earlier, timely filed action in one court, could not make a later untimely action on the same claims against different parties. *Claussen v. Marie Grande Oil Co. C.A.*, 275 F.2d 108 (3d Cir. 1960).

YOU GET WHAT YOU BARGAIN FOR (at least most of the time)

by Manfred W. Arnold

After I read the decision by the Court of Appeals for the First Circuit in Eastern Seaboard Construction Co. Inc. v. Gray Construction, Inc.; Travelers Casualty and Insurance Co. of America (decided December 31, 2008 No. 08-1679), I decided also to look at the underlying District Court's decision (2008 WL 1803781 D.Me 2008).

Gray, the contractor for a construction project at the Portsmouth Naval Shipyard, sub-contracted with Eastern to carry out the actual work. When Eastern encountered unexpected conditions which enlarged the scope of the project and created delays, compensation claims for the additional work were filed against the Navy. When the Navy refused to pay Gray and Gray failed to pay its sub-contractor, Eastern temporarily abandoned the job and was ultimately terminated by Gray. Gray then hired another sub-contractor to complete Eastern's unfinished project. Eastern filed a complaint in the Federal District Court in Maine. Gray submitted a counterclaim, at the same time filing a motion to stay the proceeding subject to arbitration, to which the parties had agreed in their sub-contract. The parties proceeded with the arbitration, which was conducted under the Rules of the American Arbitration Association's Construction Industry Arbitration and Mediation Procedures.

The arbitrator's award addressed and awarded claims and counterclaims, ultimately leading to an application by Eastern for Clarification of the Arbitration Award. The arbitrator agreed that the award could have been clearer and then issued an amended award addressing the parties' concern. Gray moved to vacate the award and Eastern *i.a.*

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filed a cross-motion to confirm the award. On April 18, 2008, the magistrate judge recommended granting Gray's motion to vacate; on May 23, 2008, after a *de novo* review, the District Court affirmed the magistrate's decision. Eastern filed an appeal.

Justin Kelly of ADRWorld (an independent subsidiary of the AAA) summarized the First Circuit decision as follows:

> *The issue before the court involved the functus officio doctrine, which provides that an arbitrator's jurisdiction ends when a final award is issued. Prior cases in the First Circuit have distinguished between a fundamentally different second award and one that fleshes out the remedy in the first award.*
>
> *The First Circuit noted that the functus officio doctrine is riddled with exceptions and seems quite limited. It cited cases by the Third, Seventh, Ninth, and Tenth Circuits that have all allowed arbitrators to go back and explain or clarify awards where there is ambiguity or confusion about the exact nature of an award.*
>
> *Turning to the case at hand, the court noted that although the arbitrator issued what was intended to be a complete award, the award was not clear. The arbitrator himself acknowledged this in the amended award.*
>
> *Calling it a close case because the record was sparse, the court nevertheless held that the arbitrator clarified an ambiguous award, which did not exceed his authority under Rule 47, or violate the functus officio doctrine.*
>
> *The First Circuit observed that "even seemingly complete awards" might omit information or overlook contingencies, failures that AAA Rule 47 would allow an arbitrator to remedy.*
>
> *In finding that the arbitrator acted within his authority in taking the $66,613 into account in the amended award, the court relied on the arbitrator's assertion that Gray did not contest this figure. Because of the deferential standard of review of arbitration awards, the court said it was not its role to question the assertion by the arbitrator (which was supported by Gray's own statement to the appeals court that it did not contest this figure and that the original award did not need clarification).*
>
> *Accordingly, the court ruled that the arbitrator's omission of the $66,613.89 contract balance in the initial award was the type of error that AAA Rule 47 permitted the arbitrator to amend or clarify. For this reason, the amended award did not reopen the case; rather it "clarified a latent ambiguity."*

What was puzzling about this case was not the result but why the parties pursued the matter to the Court of Appeals. The arguments have focused on the common law doctrine of *functus officio* and the powers of the arbitrator as defined in the Federal Arbitration Act (FAA). Both subjects have been extensively dealt with in established case law and nevertheless are still frequently argued, probably in the eternal hope that one day a square peg fits into a round hole.

In this particular case, the parties ultimately agreed to arbitrate their dispute as provided for in their contract, and then agreed that the proceedings would be conducted under the American Arbitration Association's Construction Industry Arbitration Rules and Mediation Procedures, which included Rule 47, reading as follows:

> *Within twenty calendar days after the transmittal of an award, the arbitrator on his or her initiative, or any party, upon notice to the other parties, may request that the arbitrator correct any clerical, typographical, technical or computational errors in the award. The arbitrator is not empowered to redetermine the merits of any claim already decided.*

When adopting the AAA Rules, the parties specifically agreed to deviate from the provisions of the FAA by permitting *i.a.* the arbitrator to make corrections (albeit limited in scope) on his own initiative or any party to the proceeding to request the arbitrator to make such changes. Even from the scant source material, it would appear quite obvious that the facts of this case fell squarely within stated reasons for a correction.

In the past, I have written about curiosity and how much I believe in the positive aspects of that notion. Recently, there has been a bit of coverage on class action in arbitrations, and on a recent rainy weekend, I did some reading on the subject.

I scanned the SMA Award Service and did not find a case in point, but I did find one reference. In SMA Award

3983 (LACERTA). The majority stated: "Consolidated does not equate to the right of combining parties in sub-charters to create the effect of a class action."

This procedure had been quite acceptable to the judiciary, but fell out of favor with the 1993 Second Circuit decision in The Government of the United Kingdom v. The Boeing Company (988 F.2d 68). For the 2003 fourth edition of its rules, the SMA created Section 2 (Consolidation) and it was pursuant to that rule and prior consolidation decisions that the LACERTA was decided (see THE ARBITRATOR October 2008 at p. 28).

Most recently, Section 2 has been amended to read:

> *The parties agree to consolidate proceedings relating to contract disputes with other parties which involve common questions of fact or law and/or arise in substantial part from the same maritime transactions or series of related transactions, provided all contracts incorporate SMA Rules. However, claims on behalf of or against a class are prohibited from being submitted to arbitration under these Rules.*

I then had a look at the AAA Rules and their policy on class actions, which had the following entry:

> *On October 8, 2003, in response to the ruling of the United States Supreme Court in Green Tree Financial Corp. v. Bazzle, the American Arbitration Association issued its Supplementary Rules for Class Arbitrations to govern proceedings brought as class arbitrations. In Bazzle, the Court held that, where an arbitration agreement was silent regarding the availability of class-wide relief, an arbitrator, and not a court, must decide whether class relief is permitted. Accordingly, the American Arbitration Association will administer demands for class arbitration pursuant to its Supplementary Rules for Class Arbitrations if (1) the underlying agreement specifies that disputes arising out of the parties' agreement shall be resolved by arbitration in accordance with any of the Association's rules, and (2) the agreement is silent with respect to class claims, consolidation or joinder of claims.*

The website entry (at www.adr.org) also includes a commentary to the American Arbitration Association's Class Action Policy.

This is how far I have gotten. I am quite certain that there is much more out there to read up on and to learn, but that will have to wait for the next issue and a few more rainy weekends.

What has become clear is that even if you have a standard arbitration agreement in your contract but agree to adopt supplementary procedural rules, such as those of the AAA or the SMA, you want to make sure that you have fully reviewed those rules and their potential consequences. As I said at the beginning, "You get what you bargain for."

COMMENTARY ON THE INDIAN SUPREME COURT JUDGMENT IN VENTURE GLOBAL ENGINEERING V. SATYAM COMPUTERS SERVICES LTD.

by Sarosh Zaiwalla, Esq.
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The Indian Supreme Court sets aside the order of the lower court and grants leave to challenge a LCIA final Award, which was concerned with the transfer of shares in an Indian company. If the foreign Award required the performance in India, but was seen to have disregarded or breached Indian laws and regulations, the Indian Court would grant leave to challenge the award under section 34 of the Arbitration and Conciliation Act 1996. The Award was one to which the New York Convention would apply.

The Supreme Court of India ushered in the New Year with a judgment, which, from a certain point of view, could have a significant bearing on any international commercial arbitration having a nexus with India. On January 10, 2008, a bench of the Apex Court comprising Justice P. Sathasivam and Justice Tarun Chatterjee ruled [in Civil Appeal No. 309 of 2008 – Venture Global Engineering LLC v. Satyam Computer Services Ltd. & Anr., *2008 S.C.A.L.E. 214]* that an award debtor can bring an independent action in India to set aside a foreign arbitral award (an award rendered outside India) on Indian public policy grounds when the successful party seeks enforcement under the New York Convention against that award debtor in his home state.

Looking at this judgment, in one sense it does open the door for challenges to an international arbitration award rendered outside India before Indian courts under the Arbitration and Conciliation Act, 1996, section 34, which it was believed, did not apply to New York Convention Awards. However, the judgment has arisen out of unusual facts in this case, where there were questions of illegality

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under Indian law involved in the performance of the award in India by the unsuccessful party.

At the outset it must also be noted that, interestingly, in this case it was the non-Indian arbitral party who was permitted to challenge a London Court of International Arbitration (LCIA) award in India, after the successful Indian party had chosen to enforce the same in Michigan, U.S.A. (not only because that was the award debtor's place of registration and business, but also perhaps because it wished to circumvent any argument about illegality in India or Indian public policy.)

The award in question was an LCIA award rendered in London, in a dispute between the partners of an Indian joint venture, Satyam Venture Engineering Services Private Ltd (SVES). The Indian partner, Satyam Computer Services Ltd. (Satyam), claimed that its overseas partner in SVES, the Michigan based Venture Global Engineering LLC (VGE), had breached the shareholders agreement between the parties (governed by Michigan law), thereby entitling Satyam to exercise its option to purchase VGE's shareholding in SVES at book value. The sole arbitrator appointed by LCIA ruled in favour of Satyam and directed VGE to transfer the concerned shares to Satyam at book value, as well as to make certain payments to Satyam.

The award directed VGE to transfer its shares in SVES and thus, the transfer of shares in the company would be effected in India by SVES. Logically, enforcement of the award should therefore have been brought to India, as a New York Convention Award, to be enforced under section 48 of the Arbitration and Conciliation Act, 1996 (the 1996 Arbitration Act). However, Satyam sought the assistance of a Michigan court to compel the performance of the award, i.e. the transfer of shares by VGE as required under the award. (The petition was filed before the U.S. District Court for the Eastern District of Michigan for recognition and enforcement of the award – Civ. 2:06-x-50351).

VGE objected to the enforcement of the award in Michigan, which it claimed was in violation of Indian laws and regulations, specifically the Foreign Exchange Management Act, 1999. At the time of the enforcement proceedings by Satyam in Michigan there was also a live injunction in place from the High Court of Andhra Pradesh restraining Satyam from seeking to enforce a transfer of shares until further orders of the High Court.

So far as the post award proceedings are concerned it went thus: VGE challenged the award in an Illinois court, but subsequently withdrew the challenge. Satyam initiated enforcement proceedings in district court in Michigan, as the concerned share certificates were held by VGE in Michigan and Michigan is where VGE had assets to satisfy the monetary component of the award. Satyam did not seek enforcement of the award in India. VGE resisted enforcement by filing a cross petition in the Michigan district court. The Michigan district court dismissed the cross petition and enforced the award. *233 Fed.Appx. 517, 2007 WL 1544160 (C.A.6 (Mich))*. VGE's appeal against the Michigan district court's order was dismissed by the court of appeals for the 6th Circuit. *233 Fed.Appx. 517, 2007 WL 1544160 (C.A.6 (Mich))*.

Simultaneous with the filing of its cross petition in the Michigan court, VGE filed a suit in the City Civil Court, Secunderabad, India, seeking a declaration to set aside the award and a permanent injunction on the transfer of shares under the award. Satyam filed an application in the suit seeking rejection / dismissal of the suit as being barred, which application was allowed. VGE appealed to the High Court of Andhra Pradesh, but the appellate court dismissed the appeal and confirmed the rejection / dismissal of the suit by the trial court. VGE challenged the orders of the lower courts before the Supreme Court. The Supreme Court set aside the orders of both the lower courts holding that a party aggrieved by a foreign award is entitled to challenge the award in India by virtue of the parties' contract and because the award was concerned with the transfer of shares in an Indian company.

To better analyse the Indian court's decision, it is necessary to briefly discuss the 1996 Arbitration Act which governs the field in India. The provisions dealing with arbitration are divided into two Parts – Part I which "shall apply where the place of arbitration is in India" (Foreign Exchange Management Act, S.2[2]) and Part II, dealing with enforcement of foreign awards under the New York Convention (Chapter 1) and under the Geneva Convention (Chapter II). Section 34, falling under Part I of the 1996 Arbitration Act, provides for recourse to a court against an award and sets out the limited grounds on which the award can be set aside. There is no provision in Part II of the 1996 Arbitration Act similar to section 34. Sub-sections (1) and (2) of section 48 in Part II of the 1996 Arbitration Act, which are identical to clauses 1 and 2 of Article V of the New York Convention, set out the grounds on which enforcement of a foreign award under the New York Convention may be refused. Under section 48(1)(e) of the 1996 Arbitration Act, as well as article V (1)(e) of the New York Convention, one of the grounds for refusal is "proof that the award … has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made". Interpreting Article V (1)(e) of the New York Convention, courts in the U.K. and the U.S. have consistently held that an action seeking to set aside a foreign award would lie only to the competent court of the country in which the foreign award was made or of the country of the curial law of arbitration, in the extremely rare situation where the parties choose a curial law other than the law of the country of the seat of arbitration. [*C. v. D*, [2007] EWHC 1541 (QBD); International Standard Electric Co. v. Bridas Sociedad Anonima, 745 F.Supp.172; M & C Corporation v. ERWIN BEHR Gmbh & Co., 87 F.3d 844; Yusuf Ahmed Alghalim & Sons v. Toys "R" Us, Inc., 126 F.3d 15; *Karaha Bodas Co., L.L.C.v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara, (C,A.5 (Tex.), 2004). 364 F.3d 274*]

Relying on the aforesaid U.K. and U.S. decisions, Counsel for Satyam argued that, in the circumstances of the case, VGE could only have challenged the LCIA award in the competent court in the U.K. Satyam's counsel also brought to the notice of the Apex Court several decisions of the various High Courts in India, [Bombay Gas Company v. Mark Victor Mascarenhas 1998 I LJ 977; Inventa Fischer v. Polygenta Technologies Ltd. 2005 (2) (Bom.) CR 364; Trusuns Chemical Industry Ltd. v. Tata International Ltd. AIR 2004 Guj 274; Bharat Aluminium v. Kaiser Aluminium A.I.R. 2005 (Chh.) 21; Bulk Trading SA v. Dalmia Cements (2006) 1 ArbLR 38 (Delhi)], which had taken a view consistent with that of the U.K. and U.S. decisions discussed above. VGE's counsel argued that, in view of the decision of a three judge bench of the Apex Court in *Bhatia International v. Bulk Trading S.A.* ([2002] 4 S.C.C. 105). Part I of the 1996 Arbitration Act applies to foreign awards and consequently an application under section 34 of the 1996 Arbitration Act would lie to set aside the LCIA award.

In *Bhatia International,* the question was whether a party to an arbitration being held outside India could approach an Indian court for interim measures during the pendency of the arbitration. Section 9 of the 1996 Arbitration Act, which permitted recourse to a court for interim measures, fell in Part I of the 1996 Arbitration Act and there is no similar provision in Part II of the Act. The Apex Court answered the question in the affirmative holding that in cases of "international commercial arbitrations held outside India, provisions of Part I would apply unless the parties by agreement, express or implied, exclude all or any of its provisions". The court, however, clarified that general provisions contained in Part I of the 1996 Arbitration Act will not apply to other parts if the statute expressly states so, or where, in respect of a matter, there is a separate provision in a separate part (para 26 of the judgment).

The Indian Supreme Court interpreted *Bhatia International* as holding that unless parties exclude the application of the provisions of Part I by express or implied agreement "the whole of Part I would apply" to a foreign award. Based on the above interpretation of *Bhatia International*, the court accepted VGE's counsel's argument and held that it was open to VGE to challenge the LCIA award in India on grounds set out in section 34 of the 1996 Arbitration Act.

In reaching its decision, the Indian Supreme Court made clear that its decision is confined to the case where an International Commercial Arbitration Tribunal has made an award which requires performance in India, but such performance is based on disregard of Indian Law or breach of Indian Law, then the Indian Court will give leave to challenge the award under section 34 of the 1996 Arbitration Act.

The Indian Supreme Court also paid regard to the fact that Satyam had consciously and deliberately sought to avoid the provisions of the Indian Arbitration Act, 1996 as well as the Indian Companies Act, 1956 and Foreign Exchange Management Act, 1999 by seeking to use the contempt jurisdiction of the U.S. Courts (Satyam had initiated contempt proceedings in the Michigan District Court against VGE for non-con-compliance of the judgment and order of the court dismissing the cross petition and enforcing the award) to obtain transfer of the shares of an Indian company, to be affected by the board of directors of the company in India. The Indian Supreme Court obviously also took into account that, according to Indian law, a breach of an order of the High Court would result in civil contempt and render the action in violation of the order a nullity (see DDA vs. Skipper Construction Co (Pvt) Ltd, 4 SCC 622 (1996).

The attempt to over reach the Indian courts, including the avoidance of Indian law, was a material fact, which caused the Indian Supreme Court to permit the invoking of the jurisdiction of the Indian court to set aside the award. This is because the performance by illegality in India is contrary to the public policy of India.

Central to the judgment of the Indian Supreme Court, however, was its interpretation of a term of the parties' agreement which provided that "notwithstanding anything to the contrary in this Agreement, the shareholders shall at all times act in accordance with the Companies Act and other applicable Acts/Rules being in force, in India at any time". The court construed this term to include measures taken to enforce the award and that it was a violation of the parties' agreement for Satyam to apply to enforce the award in Michigan as enforcement could only be sought in India. That is a somewhat unusual construction indeed and the Supreme Court's judgment itself gives no satisfactory explanation for it.

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In its judgment, however, the Indian Supreme Court made it clear that the Indian Arbitration Act had provided that where the arbitration had not taken place in India, all or some of the provisions of part I of the 1996 Arbitration Act, which permits challenge to an arbitration award, may be excluded by an express or an implied agreement of the parties. So it would be open for the parties in the future to expressly provide in an arbitration agreement that any of the provisions of Part I of the 1996 Arbitration Act should not apply to the award.

In my view therefore, the strong criticism which the Indian Supreme Court judgment has attracted from the international arbitration community needs to be muted. This was a judgment on the facts of a particular case. The message, which the Indian Supreme Court has effectively sent in this judgment, is that it is important for the arbitrators or the parties not to overreach themselves so as to ignore any obvious illegality, which would be involved in the performance of an award in India. Further, when an award concerns performance by parties in India, the Indian courts will at least be receptive to the argument that they should be reluctant to allow parties to circumvent Indian public policy by not standing in the way of enforcement of an award taking place outside India when such enforcement requires some act to be carried out in India. This is not out of the ordinary because most national courts would consider it a serious lacuna in an award if the award required performance in a manner which would be illegal under the law of the country where the award had to be enforced. That approach is not dissimilar to the principle adopted by the English Court in the case of *Ralli Brothers* ([1920] 2 K.B. 287).

Finally, let me say this. Although the Indian Supreme Court's judgment in the Satyam case is justifiable on the peculiar facts of that case, there is a risk that this judgment could potentially open up the floodgate to challenges to international arbitration awards under section 34 of the Indian Arbitration Act. That would be a most undesirable consequence for those sections of the international business community seeking to do business with India, who would prefer the certainty of finality of arbitration awards. Perhaps the Indian Supreme Court would do well to make it clear in a future judgment that only in the rarest cases would a challenge under section 34 be allowed in respect of international arbitration awards.

Another significant route might be for the Indian Supreme Court to constitute a "Special Bench" to deal with all matters connected with international arbitration. Such a Bench could deal with all applications relating to final arbitration awards summarily, without delay on paper but in a rare case directing brief hearing. That would enable the principle "finality is good but justice is better" to be married somewhat happily with the sanctity of recognizing the need to enforce international awards as final and binding.

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UNITED STATES v. IONIA MANAGEMENT S.A.

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Act to Prevent Pollution from Ships requirement with continuous duty "to maintain" Oil Record Books complies with international law and found necessary to advance aims of the MARPOL Convention.

On January 20, 2009, the United States Court of Appeals for the Second Circuit decided the case of *United States v. Ionia Management S.A.* (2009 WL 116966), upholding a criminal vessel pollution conviction and a $4.9 million criminal fine against a vessel management company. The Court adopted the reasoning of a significant recent case in the Fifth Circuit, *United States v. Jho*, *534 F.2d 398* (5th Cir. 2008), on substantive maritime issues, and provided guidance on general corporate criminal law principles that pertain to all industries.

Facts of the Case

In *Ionia Management*, the manager of the foreign-flagged oil tanker was convicted on a number of counts, including conspiracy, obstruction of justice, and violating the Act to Prevent Pollution from Ships (APPS). The Court found that the vessel's crew, under the direction and participation of the chief engineer and second engineer, had routinely discharged oily waste water into the high seas through a "magic hose" designed to bypass the vessel's pollution control equipment. While the discharges occurred on the high seas, the government successfully prosecuted the company because the vessel's crew maintained falsified records in U.S. waters and obstructed justice.

Impact on the Shipping Industry

The Second Circuit's *Ionia Management* decision reinforces the position of the U.S. Department of Justice that the United States criminal enforcement jurisdiction is appropriate in vessel pollution cases, even where discharges occurred on the high seas.

The Act to Prevent Pollution from Ships (33 U.S.C. § 1901 et seq.) implements two international pollution prevention treaties (collectively referred to as MARPOL) to which the United States is a party: (1) the 1973 International Convention for the Prevention of Pollution from Ships (Nov. 2, 1973; 1340 U.N.T.S. 184), and (2) the Protocol of 1978 Relation to the International Convention for the Prevention of Pollution from Ships (Feb. 17, 1978; 1340 U.N.T.S. 61). The U.S. Coast Guard has issued regulations to implement MARPOL. The relevant regulation here is one that requires vessels "to maintain" an accurate Oil Record Book and keep it "readily available for inspection" (33 C.F.R. § 151.25(a)). APPS and the regulation have two important limitations, however. First, while they apply to U.S. flag vessels anywhere in the world, they apply to foreign-flagged ships only "while in the navigable waters of the U.S." Second, any action is required to be taken "in accordance with international law." Shipowners and vessel management companies have argued that those limitations require the United States to refer enforcement actions to a foreign vessel's flag state where the discharges and entries were made outside U.S. waters.

In *Ionia Management*, the Second Circuit adopted the Fifth Circuit's holding in *United States v. Jho* (534 F.3d 398) and rejected the defense argument that the United States lacked jurisdiction where the discharges occurred at sea and the false entries in the vessel's required Oil Record Book were not made within the waters of the United States. The Court agreed with the government's argument that the requirement to "maintain" the record while in U.S. waters meant that the records must also be accurate "or at least not knowingly inaccurate." The Court therefore held that the United States had no obligation to refer the matter to the vessel's flag state for enforcement.

The practical effect of the *Ionia* decision for shipowners and managers is that the criminal vessel pollution enforcement initiative of the U.S. government is alive and well. This is the second Circuit Court of Appeals to consider and reject the defendant's jurisdictional argument, and the decision will not be ignored by other Courts that consider the issue. The *Ionia Management* decision might well lead to more frequent prosecutions against foreign-flagged vessels that arrive in U.S. with falsified records on board. It will be increasingly important for shipowners and managers to be vigilant in enforcing their environmental compliance programs, identifying and correcting improper discharge practices, and ensuring that a vessel's required records are accurate and verifiable.

Broader Implications for the Corporate Community

The Court considered and rejected three defense arguments that have broad implications for the corporate community at large. First, the Court rejected the defense argument that the evidence was insufficient to convict the company on a "respondeat superior" theory of corporate liability, i.e., that the company is responsible for illegal conduct by its employees who were working within the scope of their employment. The defense argued that the vessel's crew members were not acting within the scope of their employment when they made the discharges and entries in the Oil Record Book. The Court found "ample evidence" that the crew acted in the scope of their employment because they were responsible for maintaining the engine room, discharging waste and recording relevant information when they made the discharges. Further, the Court found that the crew acted at the direction of their supervisors when they made the discharges, made the false entries and lied to the Coast Guard.

The Court also rejected the defense argument that the company could only be prosecuted for the acts of "managerial" employees. The Court cited its contrary view in a 1989 case and found, in any event, that the government presented "overwhelming evidence" that supervisors directed the crew to take the actions at issue.

Finally, the Court rejected an argument made in *amicus curiae* briefs filed by major U.S. business interest groups that the government must prove as an element of the offense that the corporation "lacked effective policies and procedures to deter and detect criminal actions by its employees." In other words, the existence of a corporate compliance program might be relevant to whether an employee was acting within the scope of its employment, but the government need not prove its absence in the prosecution of a company.

Compliance programs are still important, and sometimes crucial, in responding to criminal allegations. Although absence of a compliance program is not a required element in the government's proof of intent, an effective and fully implemented compliance program can be used to persuade the government not to prosecute in the first place. As a matter of Department of Justice policy, federal

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prosecutors are required to consider whether a company has an effective compliance program as part of their decision whether or not to bring charges against a company. The standards used by prosecutors in this analysis are outlined in the United States Sentencing Commission's guidance on effective compliance and ethics programs.

In addition to the pre-charging analysis required of prosecutors, effective compliance and ethics programs can also be presented to the trier of fact as evidence of the company's lack of intent to commit the violations. Compliance programs can also be used as evidence that the specific employees who committed a violation were "rogue" employees, acting against company policy and outside the scope of their employment.

THE ROLE OF THE FLAG ADMINISTRATION IN DIFFICULT TIMES

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The worldwide credit crunch has placed many burdens on shipowners and their financiers. Needless to say, difficult markets will lead to increased controversy and venues to resolve disputes.

While no one wants to be perceived as "talking down" the market, it would be irresponsible for flag administrations not to be examining their obligation to assist.

Let's begin with a short question and answer -

Has the Liberian Registry been approached to lay-up ships? Yes.

Have Recognized Organizations/Class Societies called to discuss withdrawal of class on ships free of recommendation for failure of an owner to pay outstanding fees? Yes - one.

Are any Liberian flag ships presently subject to arrest proceedings? Yes - Two..

Are nervous financiers calling to check on the status of their mortgages?

Yes.

Has the Liberian Registry started to conduct seminars on 'The Role of Flag in Difficult Times?

Yes.

The Liberian Registry considers it essential to support its clients in these uncertain times when the global economic crisis and the sudden downturn in freight markets threaten the shipping industry. In order to mitigate the burden and financial strain placed on the ship owning and financial institutions in the shipping industry the Registry is considering entering into agreements with shipowners and lenders permitting the deferral of certain annual and operational fees until the vessel is removed from Laid-up status or until it is sold.

In difficult times, parties must look for alternatives to reduce costs. One alternative ship-owners and financiers are considering is to register the ship under construction. In the case of Liberia, a flat fee ($2,500) is charged and annual registration fees are waived until the ship is subsequently registered on delivery.

To proceed with a Registration under Construction, the following documents are required: Registration Application, Corporate Authority of the Registrant, ISM Declarations for 'Person' and 'Company' and a letter from the shipyard.

Furthermore, a newbuilding or a ship transferring from another flag can enter the Liberian Registry and be immediately placed in Laid-up Status. In such case, the Registry will need to be provided with Proof of Ownership in the form of a Builder Certificate's or Bill of Sale. For ships transferring from another flag to be Registered in Laid-up Status, evidence that the Ship is 'Free and Clear' of liens and mortgages in the prior flag and a Deletion Certificate from the prior flag are required.

Liberia is also in the process of outlining procedures to reduce operational requirements for ships to be registered in Laid-up Status. In doing so, it has been important to distinguish between "hot" lay up (a short term lay up for a period of less than one year.) and "cold" lay up (an extended term of lay up of over one year during which time the vessel will not be engaged in any trade and will not get underway, except in emergency cases. During a "hot" lay up period all classification certificates will remain valid, so that the vessel can be transferred from "Laid Up" into "Active" status without any loss of time in case chartering opportunities become available on a short notice. During "cold" lay up, the vessels statutory certification will expire and the ships class will be suspended.

In analyzing short term/hot lay up requirements, all of the following must be closely considered: emergency response plans (fire, collision, pollution, hurricane, floods etc.), navigation watch schedules (if at anchor), ISPS and ISM issues, maintenance planning and completion and status of class surveys and audits.

Looking closely at minimum safe manning requirements, the flag administration must differentiate between a) ships at anchor or moored which may be required to get underway on an as needed basis and b) for ships at anchor or safely moored which are NOT required to get underway.

The minimum safe manning requirements for ships possibly required to get underway will include a navigation crew of a Master, one Watch Officer, one Able Seaman and two Ordinary Seamen and an engineering crew of either one Chief Engineer or 2nd Engineer and two Engine Ratings (including one Oiler), if the ship is UMS certified. On the other hand, if the ship is not UMS certified one Chief Engineer or 2nd Engineer, one Engine Watch Officer and two Engine Ratings (including one Oiler) will be required.

The Liberian Registry has determined that the manning requirements for ships not required to get underway (example for a ship at anchor and/or in a moored position, which will not be required to get underway), the ship should have at least a security watch and stand by crew for emergencies on board. A permanent security watch schedule does not have to be arranged in case the vessel is safely moored in an area which is protected in accordance to the requirements of the ISPS-Code.

While Liberia has begun to work with various port states regimes to assess local requirements, Liberian flag ship owners are being cautioned to contact local port authorities for additional requirements and to provide to the flag state for review and approval a security watch/ emergency crew plan.

Regarding Liberia's Annual Safety Inspection requirement, a determination has been made that during lay up ships will NOT be required to have an ASI until just before the ship recommences trading.

Regarding ISM and ISPS Audits and Certification during Lay Up, external full term and intermediate audits should NOT be performed during lay up. Therefore, the ship's SMC and ISSC will expire if audits are not conducted. However a short term extension for the certificates / audits may be provided in case of a temporary lay up.

However, extending an Interim SMC will be possible, if an Interim ISSC expires during the lay up period. New certificates will need to be subsequently issued once an audit is conducted prior the ship getting underway.

Internal Audits may be postponed with flag state approval. However, it is recommended that the ship keep up with the Internal Audits, as a ship may be required to have an External Audit before getting underway again.

If Statutory Certificates expire during the lay up period, an extension may be granted by the Liberian Registry on a case by case upon consultation with the responsible Recognized Organization (Class Society). For ships in "hot" Lay Up status it is recommended to perform the classification inspections to ensure the quick ship's quick activation in response to positive changes within the charter markets. Liberia will be available for short-notice-reactions and offers an efficient and unbureaucratic support service for its clients.

Overall, buyers and mortgagees in possession should feel encouraged to continue a ship's Liberian registration or arrange to re-register the ship in Liberia to take advantage of the Registry's existing knowledge of the ship and its condition, the continuation of Seafarer licenses, recognition of the ship managers and owners DOC and the administration's worldwide services through regional offices.

In addition, a ship registry's reputation for maintenance of established mortgage recording procedures, a positive enforcement record, fixed lien priority, and submission to jurisdiction outside of Liberia need to be considered.

Mortgagees are well aware that venue of the enforcement is crucial and related to 'location, location, location'. While mortgagees will always try to position a ship in procreditor jurisdiction prior to enforcement, working with a large flag state with representatives worldwide can be essential

It must be emphasized that prior to a ship transferring out of the Liberian Flag to a foreign flag, all mortgages recorded against the ship must be released. In the event a shipowner requests a Permission for Transfer prior to all existing mortgages being released, the Permission for Transfer will set forth all existing Mortgages of record. However, as a fully electronic registry mortgage discharge instruments can be recorded worldwide through any LISCR regional offices. Of course, all Mortgages must be released and all Liberian fees paid prior to transfer to another flag and issuance of a Certificate of Cancellation

In the event of an Admiralty sale, the Registry will exercise due diligence in identifying and examining the legal proceeding (including its possible role as a claimant). Once satisfied, Liberia will record the Admiralty Bill of Sale.

Difficult times require creative thinking. The Liberian Registry stands ready to assist shipowners, operators and financiers to ease a ship's operational requirements once placed in Laid-up Status while maintaining its reputation as the largest white listed flag administration with established and recognized mortgage recordation expertise.

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NOTE: This article was originally prepared for the January 2009 issue of MarineMoney and was the basis for Brad Berman's presentation at the January 14, 2009 SMA luncheon.

FIFTH ANNUAL SMA MARITIME ARBITRATION COURSE A SUCCESS

by Donald J. Szostak

The SMA's well-received maritime arbitration course entitled **"MARITIME ARBITRATION IN NEW YORK"** was held for the fifth consecutive year in downtown Manhattan on February 26 and 27, 2009. Seven students traveled from around the world to take advantage of this unique opportunity to learn about maritime arbitration in general and New York maritime arbitration in particular. The students were mostly commercial people representing diverse activities in the maritime transportation field, such as cargo brokers, ship operators, cargo traders and a meteorologist. The group also included a lawyer from Michigan with an arbitration and mediation practice who wanted to learn about maritime arbitration in New York. I should also mention that one of our members (Bill Quinn) attended the seminar as a refresher course.

Based on the feedback, this year's sessions met or exceeded previous versions of this seminar. The curriculum, organized and presented by Jeffrey Weiss, Esq., Professor of Maritime Law at New York Maritime College, was, in the words of one attendee, "… *well structured and although a large amount of information was imparted and exchanged in the two days, it was not overwhelming. Professor Weiss's knowledge and presentation of the course material were outstanding."*

Another student observed, *"I found the seminar very helpful in terms of understanding the arbitration process in general. In addition, the details that were provided on various topics through Professor Weiss's lectures were augmented by pointed comments and questions from attending arbitrators as well as seminar attendees. This provided an excellent opportunity for all to take advantage of not only Prof. Weiss's extensive experience and that of the attending SMA representatives, but also the experience of the attendees, which included shipping companies, various aspects of ship brokering and those who provide legal, weather and speed/consumption claim support to shipping companies."*

I was fortunate to be able to attend as an observer during the two-day presentation. Professor Weiss did indeed cover the myriad of topics promised in the course content description (see SMA Maritime Arbitration Course button on our website at www.smany.org). The presentation was professional, it was thorough and it was entertaining. The bonus, for me, was not only the active exchange between the professor and the students, but the interchange among the students themselves. There were actual experiences related and hypotheticals presented. The students were intelligent and knowledgeable in their individual fields and were veritable inquisitive sponges in their attempts to learn all they could about the practical application of the maritime arbitration process as a means for settling, and avoiding, problems encountered everyday in their business lives. And the coffee breaks were filled with legal sea stories!

The SMA markets this course to be valuable to professionals in the shipping business who are users of the maritime arbitration process and newly admitted maritime attorneys. One of the students unequivocally stated, *"I would recommend this seminar to **anyone** involved in commercial shipping."* I wouldn't disagree at all!

UPDATES

Andorra Services, Inc. v. M/T EOS. In the January 2009 issue, we reported on the EOS award itself (at p. 10) which was followed by a commentary on the court confirmation (at p. 13). The matter is now on appeal in the Third Circuit and a scheduling order has been issued to complete full submission to the court of mid June.

USCG and Passenger Weight Standards. In the January 2009 issue, we reported on the proposed increases for average passenger weights from 160 to 185 pounds (at p. 18). The Coast Guard has extended the period until March 20 in which to submit comments on its proposed rule.

LETTERS TO THE EDITOR

When my friend and critic told me that he wanted to make a brief comment about Carl Jung and my reference in the last issue of THE ARBITRATOR, I started to ready the defenses. If the quotes were wrong, I would blame it on having used my cheap and cheesy reference book; if the logic was faulty, I would mention that since Carl Jung was Swiss, there were bound to be some holes in it.

Not to worry – here is the letter. Enjoy it – I can always count on Chris for some levity and a little jolt of reality check.

. . . .

SIR: I refer to the article headed 'Hatfields v McCoys' in the January 2009 issue of *The Arbitrator,* in which you claim that Carl Jung stated in *Contributions to Analytical Psychology* that, "The shoe that fits one person pinches another."

With respect, what Jung actually said was, "If the shoe does not fit, pinch another", but this has become bowdlerised over time. Most of what Jung said, including all of it, is open to misunderstanding. This goes to prove that a lie can travel halfway round the world while the truth is still putting on its shoes, which is something else Jung didn't say. Other things which Jung didn't say about shoes include, "If you want to sell shoes, you've got to have a shop on Shoe Street."

As for 'Eight Ways to Irritate Counsel', don't get me started.

Carl Jung was Swiss.

Your etc

Chris Hewer
The Count's Hedge
Visby

SOME PERSONAL NOTES

Exceptions to the Rule

Somebody once described journalists as people with no ideas and the ability to express them. But there are exceptions to every rule.

Not many maritime journalists would entice a full house - including the secretary-general of the IMO and the former head of P&O – out of their armchairs on a cold and wet January night in London. But that is what Michael Grey, MBE did recently when the great and the good jostled for admission to the *HQS Wellington*, moored at Temple Stairs on the inky Thames. The event marked his retirement from his desk at *Lloyd's List*.

Michael fled to sea at the age of seventeen to avoid domesticity. He spent eleven years with Port Line before coming ashore with a master's certificate and taking up a post in the technical department of the General Council of British Shipping. After two years he left to embark on a career in journalism which took him from the technical editor's job on *Shipbuilding & Shipping Record* to the editorship of both *Fairplay* and *Lloyd's List*, and a regular column in a host of other maritime publications. Let me not forget that Michael also co-authored a book with my old friend, Chris Hewer, back in 1982 – On the Rocks – Tales of Shipping and Insurance.

There is a danger that we take such people for granted, and realize it only too late. But in Michael's case, I would suggest that he will never really retire. He will no doubt continue to write for all sorts of maritime publications (maybe even an article for THE ARBITRATOR), and lead the debate on a variety of platforms. Michael has strong views, which he expresses with style, elegance and wit. It will be a pleasure to continue to agree and disagree with him, in whatever measure seems most appropriate, throughout his "retirement."

. . . .

The Good Old Days

Since I like soccer, I read Jack Bell's column of February 17, 2009 in *The New York Times*. Since it had its genesis in an arbitration, I thought I would share it with you.

President's Day

Monday was Presidents' Day in the United States, but in Paraguay, the notion that Americans do not honor Rutherford B. Hayes is a bit hard to believe.

Hayes, the 19th president of the United States, is ranked No. 33 among 42 presidents in the new 2009 C-SPAN Historians Leadership Survey. He lost the popular vote to

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Samuel Tilden in the 1876 election and was named president by a Congressional commission.

But he made an indelible mark on Paraguay in 1878 after the United States was asked to arbitrate a territorial dispute that resulted in war among Paraguay, Uruguay, Brazil and Argentina. When Hayes signed the arbitration document, Paraguay gained the Chaco region and increased its land mass by 60 percent.

A holiday, a town, a province and a soccer team, Presidente Hayes, were named for him. The club, known as Los Yanquis, plays in Asunción, the capital, in a uniform of red socks, blue shorts, and a red and white striped jersey. It has won the title in the top division only one time, in 1952. This season, Presidente Hayes is in last place in the second division, headed for relegation to the third.

THE ARBITRATOR

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