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THE ARBITRATOR

SOCIETY OF MARITIME ARBITRATORS, INC.

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PRESIDENT'S CORNER

By: Jack Warfield, President, SMA

Our May Annual General Meeting marks the end of our fiscal year, as well the beginning of our new one. First let me congratulate Lucienne Bulow, Tom Bradshaw, Michael Hand, and Bengt Nergaard for their election to the SMA Board of Governors. These will be for a two year term.

Additionally, as President I am authorized to make two appointments to the Board for one year terms; Manfred Arnold and David Martowski have accepted these appointments. This gives us a strong and experienced Board to move to the next phase of growth for the Society.

At the AGM I reported on the progress we have made over the past year.

- In September we participated with the International Disputes Committee of the New York City Bar in their study regarding the publication of arbitration awards, contrasting the differing policies of several tribunals on the relative values of publication and privacy. The final report is available on the SMA website.
- Thanks to Peter Wiswell and his Salvage Committee the new U.S. Open Form Salvage Agreement, Code name MARSALV©, was finalized and made available to the industry.
- November saw the celebration of the SMA's 50th Anniversary with a an exceptional seminar at the City Bar Building and a festive dinner dance at the New York Yacht Club. Our special dinner guest was Chief Judge Loretta Preska of the U.S. District Court for the Southern District of New York. Klaus Mordhorst chaired both events establishing a very daunting standard for the future. Measures of this are the many suggestions from various channels that the seminar/dinner dance should become an annual SMA event.
- January saw two threshold actions take place: after 50 years in lower Manhattan we relocated our offices to midtown NYC and with the closing of the Ketch restaurant we also moved our speaker luncheons uptown to

the Yale Club. Without our Office Manager Patty taking charge, it would be hard to fathom how this office move could have taken place without major disruption to our members and operations.

- In February Klaus again successfully chaired the SMA course "Maritime Arbitration in New York."
- Lucienne Bulow and her Rules Committee finalized the amendments to the SMA Rules at the same time revising, updating, and arranging the printing of the Sixth Edition of the SMA Blue Book "Maritime Arbitration in New York."
- The Audit Committee has been very active this year under the direction of Michael Fackler. In addition to tightening up the various duties and responsibilities of the Board, the Committee had our 501(c)3 status reaffirmed.
- This 501(c)3 status has put a new push behind our Friends and Supporters initiative under the leadership of Manfred Arnold, which was announced at the end of April. You will be hearing much more on this in the coming months.
- And finally as the year wound down I was pleased to have the opportunity to represent the SMA in Dubai at the BIMCO AGM and participate in a mock arbitration with fellow panelists representing London and Singapore.

These are highlights. Any oversight is not meant to diminish the tireless efforts put in by so many members leading or serving on our various committees or those who represent and promote us at numerous conferences and meetings.

THE ARBITRATOR

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Much of last year was concentrated on the management and structural needs of the organization – this coming year the focus will be the marketing of the SMA as the premier venue for maritime and contract dispute resolution. A concrete example of this new emphasis can be found by visiting the recently updated/upgraded SMA website at http://www.smany.org. As the website will be continually evolving, we welcome your thoughts and suggestions. This coming year we also expect to realize the results of our efforts to recruit and train younger members with more diverse backgrounds.

We are expecting a truly exciting year. Be sure to join us for our speaker luncheons which will kick off in October. Our Luncheon Chairman Bob Flynn has assured me this will be another year of stimulating and provocative speakers along with the usual collegiality.

USING SEALED OFFERS OF SETTLEMENT IN NEW YORK MARITIME ARBITRATIONS INVOLVING DISPUTED DAMAGES

By Robert G. Shaw, Member, SMA Board of Governors

A deterrent to the pursuit of disproportionately expensive claims is the prospect that a party who loses on the merits will also have to pay, in addition to its own legal fees and expenses, all or a substantial part of the fees and expenses of its adversary. New York maritime arbitrators in most cases now award the prevailing party a contribution to its reasonably incurred legal fees and expenses. This practice has increased over the last 30 years. It is a change from the so-called "American rule" that continues to apply in most US court actions, where each party, subject to statutory exceptions, bears its own fees and expenses, regardless of outcome.

SMA panels began awarding contributions to fees and expenses where both parties had agreed expressly or by incorporation (for example by specifying that the SMA rules will govern) that the panel could make such an award. They also made such awards in cases where both parties in their submissions requested that such an award be made which effectively amounted to an agreement that the arbitrators had power to do so. In *Paine Webber, Inc., v. Bybyk*, 81 F 3d.1193 (2d Cir. 1996), the Second Circuit held that in an arbitration governed by the Federal Arbitration Act, an arbitration panel, even absent

a provision in the arbitration agreement to the contrary, has a general power to decide whether to award a party a contribution to its legal fees and expenses. As a result, New York maritime panels now regularly make awards of legal fees and expenses, even where the relevant arbitration clause does not expressly confer a power on them to make such an award or where the SMA Rules have not been incorporated into the arbitration clause.

For a recent example, in *The Atlantic Leo*, SMA No. 4181 (2012), the panel awarded the charterer damages on a claim for cargo contamination after finding that the contamination took place on the ship. The panel did not however award the charterer all of its claimed damages, because it found the charterer had not reasonably mitigated the loss caused by the contamination. The parties had presented expert evidence, among other things, on what were reasonable efforts to mitigate the contamination and on the cargo's diminished market value. The panel awarded the charterer 65% of its legal fees and expenses and of the arbitrators' fees. This was very close to the percentage of the principal amount that the panel had awarded the charterer on its claim for damages. In concluding a unanimous award, the panel expressed concern that the arbitration had given rise to 8 hearings over 16 months and to aggregate lawyers' and arbitrators' fees and expenses "amounting to more than twice the amount in dispute".

Disproportionate aggregate litigation or arbitration related legal fees expenses, especially where the both the merits and amount of damages are disputed, are not peculiar to New York maritime arbitrations. In most cases of this kind, the immediate cause of large amounts of fees and expenses is a complexity of disputed facts and issues of law and the momentum of the dispute process. It is however in the long-term collective interests of participants, funders and providers of the arbitration for procedures to be in place which encourage careful appraisals of likely outcomes and deter disproportionate legal and other expenses. This is especially true in a dispute where the parties have some understanding in common of the likely outcome on the merits but are unable to compromise on quantum.

A proportionate award of fees may not provide the fairest result where a party which has lost on the merits made a without prejudice offer to settle, except as to legal fees and expenses, before substantial legal fees and expenses were incurred, in an amount no less than the panel awarded. In such a case, a panel once made aware of the sealed settlement offer, has a reasoned basis for denying an award of contribution to the prevailing party's legal fees and expenses accruing after an offer was made and instead of awarding the party all or most of the legal fees and expenses it incurred in the same period. Apart from the possibility that such a result may be fairer than a proportionate award of legal fees and expenses, the prospect of a panel making such an award concentrates the attention of the parties and their advisors on the likely exposure of pursuing or defending a claim, especially on complex damages issues.

The use of sealed offers is an established feature of commercial litigation, including arbitration, in many jurisdictions of the Commonwealth. In Australia, Canada, England and Singapore, the rule that "costs follow the event" (i.e. that legal fees and expenses as a general principle are recoverable by the prevailing party to a dispute) generally applies. In these jurisdictions, litigants make a sealed offer of settlement of a dispute to protect against an adverse award of legal fees and expenses. It is the practice for one party to send the offer, through lawyers, in a sealed envelope to the other party. It states a without prejudice settlement offer, "except as to costs". If the offeror does not obtain in the award a better result than its offer stated it would be willing to pay or accept (as the case may be), the panel has a basis for awarding as a contribution in favor of the offeror all or a substantial part of the offeror's fees and expenses accruing from the time of the offer. The court or arbitral panel does not look at the offer until an award or judgment has been issued on the merits and damages-but not on "costs." (In English legal usage, "costs" includes legal fees and expenses and is not, as in the US, restricted to a narrow range of litigation related disbursements.)

While there in recent years has been some increased use of sealed offers in New York arbitration, it is still an emerging practice. In *The Divine Star*, SMA No. 2883 (1992), an award of fees and expenses was made following the issuance of a sealed offer in stated recognition of the principles in FRCP Rule 68. Yet in *The Namrum*, SMA No. 4156 (2011), a panel declined to consider a sealed offer made by a claimant on the ground that Rule 68 is only by its terms available to defendants. More recently, in *The Genco Carrier*, SMA No. 4156 (2013), an arbitration involving disputes over an unsafe berth and the reasonableness of bills for vessel repairs, the panel declined to award a contribution to fees and expenses accruing after a sealed offer had been made because the amount of the offer of settlement was lower than the amount of the award. It appears implicit in this reasoning that the panel would have awarded fees and expenses accruing after the date of the offer if the award had been for an amount no less than the offer.

FD&D associations which cover their members against a substantial part of the fees and expenses of charter party arbitrations, (and are therefore major funders of SMA arbitrations), favor the use of sealed offers as a tool to estimate and control expenses. Given the frequency with which they are involved in funding SMA arbitrations, it is perhaps surprising that the practice has not become better established. There is more than one possible reason for this historically limited use of sealed offers in SMA arbitration:

SMA arbitrators are not bound by rules or convention to apply a uniform "costs follow the event" approach to awarding legal fees. Rather, they are free to make, as in *The Atlantic Leo*, SMA 4181 (2012), such award of legal fees and expenses to a prevailing party as seem to them just in the circumstances, including a contribution proportionate to the percentage awarded on the principal claim. The need for sealed offers of settlement is greater where the rule that "costs follow the event," is applied consistently. This is particularly true in a case where a claimant, after much lawyers' and arbitrators' time has been devoted to issues of damages, prevails on the merits but is awarded substantially less than its full claim.

Both the Federal Rules of Civil Procedure in FRCP 68 and New York State's rules of civil procedure in CPLR Section 3221 provide for sealed offers of costs to be made by defendants, but not plaintiffs. In most such cases however the term "costs"- in accordance with US practice- does not include legal fees but covers a narrower range of litigation disbursements, such as court filings, expert witness and stenographic fees.

In *Marek v. Chesny*, 473 U.S. 1, 6-7 (1985), the Supreme Court held that legal fees should be treated as a part of "costs" under FRCP Rule 68, where a federal statute providing a cause of action for a violation of civil rights, also expressly provided that legal fees incurred making a successful claim under the statute were recoverable as "costs." Where a statute provides that legal fees are recoverable as a separate specified cause of action rather than as a result of being expressly designated as "costs," federal courts have held that an offer of settlement to be effective as to such fees must state that the settlement also covers legal fees. *See Barbour v. City of White Plains*, (2. Cir. 2012) and *Fegley v. Higgins*, 19 F.3d 1126 (6th Cir. 1994).

These complexities in the practical application of these rules, as well as the restriction on their availability to defendants and in most actions to a range of disbursements other than legal fees, have all likely contributed to a general lack of familiarity among US lawyers with the potential utility of offers of settlement.

Given however that New York arbitrators now routinely award legal fees and that in arbitrations the use of offers of settlement, except as to costs, is not subject to the limitations that apply in U.S. court proceedings, it is logical that parties to arbitrations should give greater consideration to their wider use.

Some lawyers express concerns that by notifying the panel even that a sealed offer has been made, they could create prejudice in the minds of the arbitrators as to the merits or quantum. This concern may be misplaced or exaggerated. It appears not to provoke anxiety in lawyers in the jurisdictions where the practice of sealed offers is widely used. In any event, if lawyers are unwilling to inform a panel that a sealed offer has been made on behalf of their client before all other issues have been decided - other than as to an award of fees and costs – alternative procedural devices could be used to allay this concern. For example, where liability has been relatively easy to determine but the amount of damages has required expert evidence, hearings and briefs, the arbitral panel is free, after deciding what the amounts of its award will be (other than on the issue of contributions to the prevailing party's legal fees and expenses), to ask the parties for copies of any "without prejudice settlement offers" that the parties have issued to each other. Alternatively, particularly in those cases where it clear from the initial submissions that quantum is disputed, the panel can request both sides, at that early stage of the proceeding, to submit to each other (with a copies in sealed envelopes to the panel) a without prejudice written offer of the amount which they are willing to pay or accept to settle the proceeding, except as to legal fees and other expenses of the arbitration.[1]

Either of these procedures should address concerns parties or counsel may have that by revealing to the arbitrators even the existence of a sealed offer they may adversely influence the arbitrators' decision on the merits. SMA panels are not precluded under any applicable law or the SMA rules from taking sealed offers into account in deciding contributions to legal fees and expenses. It is submitted that that lawyers should therefore be more willing to make such sealed offers in appropriate cases.

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1. See R. Smit and T. Robinson, *Cost Awards in International Commercial Arbitration: Proposed Guidelines for Promoting Time and Cost Efficiency*, 20 American Review of International Arbitration, , 267, 281 (2009). This article contains an outline and suggested principles to apply to contributions to fees and expenses in international commercial arbitration.

NATIONWIDE SUBPOENAS IN ARBITRATION? *

By: Jay Paré, McLaughlin & Stern, LLP, New York

Recent amendments to Rule 45 of the Federal Rules of Civil Procedure ("FRCP") allow for nationwide service of process of subpoenas, delete a former section requiring a subpoena to be issued "from the court for the district where the deposition is to be taken," and provide for initial enforcement by contempt of the subpoena in the "court for the district where compliance is required." Do these changes provide for nationwide service of subpoenas by arbitrators and enforcement thereof? Although no court has ruled on this to date, it is submitted that it is possible that such power may exist, at least where an arbitration clause or the governing arbitration rules are amended to provide that arbitrators may, in a special case, "sit" at a location other than the agreed location for the main arbitration to be heard. Such an amendment might take the following form:

> Notwithstanding any agreement respecting the location for conducting an arbitration contained in an arbitration clause between (and among) the parties signing below, it is hereby agreed that where arbitration has been agreed between (or among) them, then the arbitrator (or arbitrators or a majority of them) may, in its (or their) sole discretion sit and conduct a special hearing at any location wheresoever that the arbitrator (or arbitrators or a majority of them) may deem reasonably necessary for the purpose of hearing evidence from witnesses and/or obtaining documents and information from witnesses pursuant to subpoenas issued in connection with the arbitration.

Arbitration Act Background

The Federal Arbitration Act, at 9 U.S. Code § 7, provides that arbitrators, or a majority of them:

> may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document or paper which may be deemed material as evidence in the case … Said summons shall be served in the same manner as subpoenas to appear and testify before the court; if any person so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators, or a majority of them, are sitting, may compel the attendance of such person or persons … or punish said person or persons for contempt …

In the recent past, there have been 2 problems limiting the scope of this section.

Requirement for a Hearing

First, there has been judicial debate as to whether arbitrators have the power to issue a subpoena for documents alone without a hearing and attendance of a summoned witness. In *In re Arbitration between Security Life Ins. Co. of Am*., 228 F.3d 865, 870-1 (8th Cir. 2000), the Court of Appeals for the Eighth Circuit found this documentary subpoena power "implicit" in Section 7. Similar rulings are found in *American Federation of TV and Radio Artists v. WJBK-TV*, 164 F.3d 1004 (6th Cir. 1999) and *Stanton v. Paine Webber Jackson & Curtis, Inc.*, 685 F.Supp. 1241 (S.D. Fla. 1985).

Other courts have disagreed with this, including, most notably, the Court of Appeals for the Second Circuit in New York. In *Life Receivables Trust v. Syndicate 102 at Lloyd's of London*, 549 F.3d 210, 2008 App. LEXIS 24977 (2d Cir. 2008), that court took a more narrow view of § 7 of the U.S. Arbitration Act. It found that at the time § 7 was drafted, it contained language similar to that then contained in FRCP Rule 45. At that time, FRCP Rule 45 allowed a subpoena to "command each person to whom it is directed to attend and give testimony" and the subpoena "may also command" the person to whom it is directed to produce documents and tangible things." (emphasis added). According to the Second Circuit, no court suggested that that version of Rule 45 sanctioned a subpoena for records alone without an accompanying witness until Rule 45 was later changed in 1991 to specifically allow for the issuance of a document subpoena alone. The court further reasoned that since there had been no corresponding change to §7 of the U.S. Arbitration Act, arbitrators have no power under § 7 to issue subpoenas for documents alone without a witness producing these at a hearing. The court, however, recognized the wastefulness of this and went on to note that a third party witness may waive the need for a hearing or the arbitrators might schedule a hearing and immediately adjourn it after the third party witness attends with the requested documents. The court said (549 F.3d at 218):

> As then-Judge Chertoff noted in his concurring opinion in Hay Group, the inconvenience of making

> a personal appearance may cause the testifying witness to "deliver the documents and waive presence." 360 F.3d at 413 (Chertoff, concurring). Arbitrators also "have the power to compel a third-party witness to appear with documents before a single arbitrator, who can then adjourn the proceedings."

Hence, while in this circuit it is technically required that the third party witness be subpoenaed to attend at a hearing when documents are sought by an arbitration subpoena, it is acknowledged that the witness may waive this or that the arbitrators may hold a hearing to receive documents from the witness. Also, the Second Circuit has made it clear that the hearing at which a subpoena is returnable for documents from a third party may be scheduled solely for that purpose. In *Stolt-Nielsen S.A. v. Celanese AG*, 430 F.3d 567 (2d Cir. 2005) the Court of Appeals for the Second Circuit rejected the argument that a subpoena is only returnable at a hearing addressed to the "merits" of the controversy in a case.

Cases from other jurisdictions which require the presence of a witness at a hearing to subpoena documents in an arbitration setting include *Hay Group., Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004); *Empire Financial Group. Inc.*, 2010 U.S. Dist. LEXIS 18782 (N.D. Tex. March 3, 2010); and *Gloria Ware v. C.D. Peacock, Inc.,* 2010 U.S. Dist. LEXIS 44737 (N.D. Ill. May 7, 2010). The Court of Appeals for the Fourth Circuit, however, has ruled that arbitrators may issue subpoenas for documents alone, without a witness or hearing, when there is a special need for the documents. *Comsat Corp. v. Nat'l Sci. Found*., 190 F.3d 269 (4th Cir. 1999).

Former Requirement that Party Served Be Within the District or Within 100 Miles and Enforcement Limitations

The second impediment to arbitration subpoenas was geographic. Until the recent amendments, Rule 45 was interpreted to require, in the arbitration context, that a witness must be served within the district where the arbitrators sit or within 100 miles thereof. In *Dynegy Midstream Services, LP v. Trammochem*, 451 F.3d 89 (2d Cir. 2006), the Court of Appeals for the Second Circuit ruled that, because of the various references to FRCP Rule 45 in § 7 of the Arbitration Act, service under § 7 must be geographically limited as it was under Rule 45 before the recent amendments. More specifically, the court ruled that the third party must be subject to jurisdiction and served with a subpoena within the district, or within 100 miles (or within the state if allowed by a state statute or court rule). The Second Circuit in *Dynegy* therefore reversed the decision of the Southern District of New York which had enforced a subpoena served on a third party in Houston, Texas. This was followed in *In the Matter of Arbitration Between Alliance Healthcare Services, Inc. and Argonaut Private Equity*, LLC, 804 F. Supp. 2d 808 (N.D. Ill. 2011), which further held that enforcement of an out-of-state (or outside 100 mile) arbitration subpoena was, in effect, impossible because then Rule 45 required enforcement in the district where the testimony was to take place whereas Section 7 of the Arbitration Act required enforcement of an arbitration subpoena in the district where the arbitration was to take place. An interesting alternative of having an attorney issue a subpoena was discussed and approved in *Amgen Inc. v. Kidney Center of Delaware County, Ltd*., 879 F. Supp 878 (N.D. Ill. 1995).

Recent Amendments to FRCP Rule 45

FRCP 45 was amended as of December 1, 2013. Under the amended version of Rule 45(a)(2) a subpoena must now issue "from the court where the action is pending" (and not "from the court for the district where the deposition is to be taken" as was the case under former Rule 45(a)(2)(A)). Also, under amended Rule 45(b)(2), "[a] subpoena may be served at any place within the United States." Hence service of subpoenas under Rule 45 is now nationwide. However, under amended Rule 45(c)(1), a subpoena may only command a person to attend a trial, hearing, or deposition (a) within 100 miles of where that person resides, is employed or regularly transacts business in person or (b) within the state where the person resides, is employed or regularly transacts business in person (but, in the latter case, only if the person is a party or a party's officer or is commanded to attend a trial and would not incur substantial expense.) Finally, under amended Rule 45(g), there is a presumption that court enforcement of a subpoena by contempt will be in the "court for the district where compliance is required," i.e., where the hearing and/or production is to take place. That court, however, may transfer the enforcement action under Rule 45(f) "if the person subject to the subpoena consents or if the court finds exceptional circumstances." That court may then transfer the enforcement order back to the court where the motion was originally made for enforcement purposes.

Amended Rule 45 and Arbitration Subpoenas

The amendments to Rule 45 do nothing to change the court imposed limitation by cases such as *Life Receivables Trust* that arbitrators hold a hearing to obtain third party

documents by subpoena. And, under Rule 45, a witness must not have to travel further than 100 miles or out of state. Hence, it remains the case in the Second Circuit that an arbitration hearing must be held to obtain testimony or documents from a third party witness and that that hearing must be within 100 miles or within the state (subject to limitations) where the witness resides, is employed or regularly transacts business in person.

While it remains to be seen how courts will interpret amended Rule 45 and Section 7 of the Arbitration Act together, the amendments to Rule 45 would seem to now permit arbitrators to issue subpoenas for nationwide service.

Enforcement of a subpoena under amended Rule 45 will now be in the district of compliance in the first instance. The language of Section 7 of the Arbitration Act, however, requires that enforcement of an arbitration subpoena be in "the district in which such arbitrators, or a majority of them, are sitting". If the arbitration agreement, such as that proposed above or governing arbitration rules provide that the arbitrators may "sit" and hold hearings in any district, there would seem to be a reasonable basis for enforcement of the arbitration subpoena in the district where the hearing is to take place and where the witness is subject to jurisdiction. Alternatively, if this were not allowed because it were deemed that the arbitrators were not "sitting" in the location of the hearing, this enforcement gap may provide "exceptional circumstances" under amended Rule 45(f) to permit a transfer of the enforcement action back to the district where the main portion of the arbitration is to take place (and hence where the arbitrators unquestionably "sit"). That court could issue a contempt order and then "transfer the order to the court where the motion was made" under amended Rule 45 (f).

Conclusion

Amended FRCP Rule 45 now provides for nationwide service of subpoenas and this would seem to equally apply to arbitration subpoenas under Section 7 of the Arbitration Act which incorporates Rule 45. Cases like Life Receivables Trust, however, technically require a hearing in order to obtain documents by an arbitration subpoena and the hearing cannot be more than 100 miles or outside the state where the witness resides, is employed, or regularly transacts business in person. Further, enforcement of the subpoena under Rule 45, at least in the first instance, must be in the district where that hearing would take place whereas enforcement of arbitration subpoenas, under Section 7 of the Arbitration Act, must be in the district where the arbitrators or a majority of them are "sitting". Hence, unless arbitrators are free to schedule a hearing to "sit" at places other than the city designated in the arbitration clause, they are faced with a geographical limitation to their subpoena powers for enforcement purposes. While there are no known cases on point, this limitation could seemingly be overcome by an agreement, such as that suggested above or contained in governing arbitration rules, that the arbitrators can schedule a "special" hearing and "sit" at any location for the purpose of obtaining documents or testimony by subpoena. This power to "sit" in any district, would then arguably pave the way for enforcement of the subpoena in that district where the arbitrators are "sitting" for the hearing (and where jurisdiction exists over the target witness) and hence satisfy the language of Section 7 of the Arbitration Act. Alternatively, it is possible under amended Rule 45(f) that that court might transfer the enforcement action back to the district court where the arbitrators unquestionably sit for an enforcement order and that order can then be transferred back to the district where the hearing is to take place and where the target witness is subject to jurisdiction.

It would seem to be a useful tool for New York maritime arbitrators to have nationwide service of process. It is possible this may be accomplished by an amendment to an arbitration agreement or by amendment to agreed rules for the conduct of the arbitration. Rule 11 of the Commercial Rules of the American Arbitration Association contains such a rule.

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*A revised and expanded version of this article will appear in a forthcoming issue of the *American Review of International Arbitration.*

THE M/V AKILI: THE SECOND CIRCUIT RULES THAT A CLAUSE PARAMOUNT SUPERSEDES THE "PUBLIC OR PRIVATE CARRIAGE" DISTINCTION, AND EXPOSES A *"FREE-IN-AND-OUT"* TRAP FOR THE UNWARY.*

By: John R. Keough, Clyde & Co., New York

A decision in December 2012 by the United States Court of Appeals for the Second Circuit in New York reflects a change in the Court's standard of reviewing U.S. law governing charter parties and bills of lading. Though relatively unnoticed so far, the Court's decision constitutes

controlling precedent for cases in the Second Circuit and thus deserves the attention of those who charter vessels or insure the related risks.

Can a shipowner and charterer agree that the charterer will bear the risk and cost of loading and stowing the cargo, adopting "free-in-and-out" ("FIO") terms? Don't they have the commercial freedom to do so? The Second Circuit's decision in *Man Ferrostaal, Inc. v. M/V Akili,* 704 F.3d 77, 2013 A.M.C. 113 (2d Cir. 2012), demonstrates that, if they intend to do so, they must choose the words for their charter carefully. The Second Circuit's opinion (1) casts serious doubt on the future validity of the public-private carriage analysis in determining if such FIO terms could be agreed as a matter of private carriage, and (2) highlights the importance of choosing a clause paramount with care.

The M/V AKILI was a bulk cargo carrier whose head owner, Akela Navigation Co., time chartered the AKILI to Seyang Shipping. Seyang in turn subchartered the vessel to S.M. China for the voyage at issue. Finally, S.M. China entered into a part-cargo charter with a steel trader, Man Ferrostaal, Inc., for the carriage of 9,960 thin-walled steel pipes from Shanghai to New Orleans (the "Voyage Charter Party"). Upon arrival, damage was noted to part of the cargo which had been stowed beneath heavier pipes. Ferrostaal paid $286,078.32 to repair the damaged cargo. In July 2007, Ferrostaal filed suit in the District Court for the Southern District of New York, bringing *in rem* claims against the M/V AKILI and *in personam* claims against Akela Navigation Co., the vessel's manager, Almi Marine Management, and S.M. China. After a bench trial before Judge Denise Cote in January 2011, the District Court held the vessel liable *in rem* but dismissed the *in personam* claims against the head owner and the vessel manager.[2] An appeal and cross-appeal followed.

Writing for a unanimous panel of the Second Circuit, Judge Winter first addressed, and rejected, the vessel defendants' novel argument that an *in rem* proceeding against the vessel was unavailable since the vessel was not a "carrier" under COGSA. The Court reasoned that "COGSA assumes the existence of the *in rem* proceeding rather than creates it,"[3] and noted that, by setting sail with the cargo on board, the AKILI ratified the Voyage Charter Party. The Court stated: "[W]hile COGSA, if applicable, may affect or alter a carrier's obligations and thereby determine the outcome of an *in rem* proceeding against a carrier's vessel, the *in rem* remedy is a creature of maritime law, not COGSA."[4]

The Court then addressed the issue of whether a "free-in-and-out" provision in the Voyage Charter Party relieved the vessel of liability for improper stowage. The relevant provision read: "The cargo to be loaded, stowed, lashed, secured and dunnaged *free of risk* and expenses to the vessel in accordance with local regulations for steel cargoes, under deck only."[5] The vessel defendants argued that this provision absolved the vessel of liability for improper stowage of the pipes. If COGSA applied to the contract of carriage, however, it would prohibit the carrier from contracting out of the duty to stow cargo properly, thus rendering the free-in-and-out provision unenforceable. To determine whether COGSA applied by its own force to the contract of carriage, the Court looked to the so-called "Applicability Provision" shared by both COGSA and the Hague-Visby Convention:

> "[C]ontract of carriage" applies only to contracts of carriage covered by a bill of lading or any similar document of title, in so far as such document relates to the carriage of goods by sea, including any bill of lading or any similar document as aforesaid issued under or pursuant to a charter party from the moment at which such bill of lading or similar document of title regulates the relations between a carrier and a holder of the same.[6]

The Court noted that, while the Applicability Provision does not mention any distinction between public and private carriage, "most American courts … treat the Applicability Provision as calling for a determination of whether the vessel was engaged in public — roughly speaking, multiple cargos and shippers — or private — again, roughly speaking, a single cargo and shipper — carriage."[7] Many courts had generally held that, if the vessel were engaged in public carriage, COGSA applies of its own force; but if the vessel were engaged in private carriage, generally COGSA would not supplant the negotiated terms of the private agreement by force of law.

After recognizing that the public-private carriage distinction finds no textual support in COGSA, the Court observed that it has sometimes "labored" to treat bills of lading as proxies for public carriage and charter parties as proxies for private carriage. Further, the Court noted that the public-private carriage distinction is a "relic" of pre-COGSA case law applying the Harter Act, and that there is "no necessary correlation between public carriage and carriage pursuant to a bill of lading, or private carriage and voyage charter parties."[8] The Court cited its prior decision in *M/V FARLAND* as an instance where it refused to treat the compulsory application of COGSA as turning on whether there was public or private carriage, finding instead that COGSA applied because the parties agreed that a bill of lading governed relations between them.[9] The Court observed that applying the public-private distinction to the instant case would likely favor the cargo interests, as the subject voyage involved multiple cargoes and multiple

shippers — features generally associated with public carriage to which COGSA would apply.

Instead of applying the public-private distinction (as the district court had done), the Court of Appeals considered the "governing instrument" analysis utilized by the Fifth Circuit in recent cases. This approach "treats the applicability of COGSA as turning on which document — the charter party or the bill of lading — governs relations between the litigants."[10] Applying the governing instrument approach to the instant case would likely favor the vessel interests, the Court noted, as the bill of lading was a mere receipt — and the Voyage Charter Party (including its free-in-and-out provision) was the governing document. The Court acknowledged that adopting either the public-private carriage analysis or the governing instrument standard "might well … affect the outcome in this matter."[11]

In the end, however, the Court adopted neither the private-public analysis nor the governing instrument standard. Instead, the Court held that it did not have to "resolve the various issued raised *because the Voyage Charter Party's Clause Paramount incorporates the Hague-Visby Rules*."[12] Thus, "[e]ven if COGSA does not apply … *the Voyage Charter Party provides rules regarding the impermissibility of a waiver of in rem liability – Hague-Visby – identical to those of COGSA*."[13]

The Court therefore held that the Clause Paramount superseded the free-in-and-out provision, noting that it incorporated the Hague-Visby rules "notwithstanding any other provisions in this contract."[14] By incorporating the Hague-Visby rules (and their prohibition against waivers of *in rem* liability) into the Voyage Charter Party, the Clause Paramount rendered the free-in-and-out provision a nullity to the extent that it might relieve the vessel of liability for improper stowage "because it is prohibited by Hague-Visby."[15] Accordingly, the Court rejected the vessel interests' argument that the free-in-and-out provision absolved the vessel of *in rem* liability and affirmed the district court's Judgment against the AKILI.

Yet the Court offered no comment on the second sentence of the Clause Paramount, which expressly prohibited construing the FIO terms to shift to the cargo interests the responsibility or risk of loading or stowage:

> Any clauses in this contract allocating responsibility or risk with respect to loading, stowing, stevedoring, lashing, securing, dunnaging, discharging and delivery shall be deemed to apply only as price terms and shall not be interpreted to alter in any way the responsibilities of the owner and the ship as carriers as defined in the Hague Rules as respects claims for cargo and damage.

So, the "free-in-and-out" provision of the charter gave the risk to cargo interests and immunized the owner-carrier — and the Clause Paramount took away the risk and placed it back on the owner-carrier, consistent with Hague-Visby and COGSA. Against this contractual patchwork (take one risk here, take away that same risk there), some provocative questions arise: Was it necessary for the Second Circuit to analyze the Hague-Visby, COGSA and public-private carriage standards to negate the FIO terms, where the contract language chosen by the parties themselves actually did so? No conflict with Hague-Visby or COGSA actually existed; or did it? Why insert in the Clause Paramount the language negating the very FIO terms inserted? More interestingly, what would the Second Circuit rule if the Clause Paramount contained different language, say omitting the "notwithstanding any other provisions" language and affirming that the FIO terms should remain valid despite Hague-Visby and COGSA?

No published decision of any court or arbitral panel, in New York or elsewhere, has yet cited the decision in the 1½ years since it was issued. This perhaps reflects that fewer cargo cases are being litigated or arbitrated.

The full implications of the *AKILI* case thus remain to be seen. Nonetheless, the decision casts doubt on the future viability of the public-private carriage distinction. The Court of Appeals' opinion demonstrated that the court could reach the same result as the district court without resorting to the public-private carriage analysis. Moreover, the decision describes that analysis as a "relic" of case law addressing the Harter Act. The Court observes that the public-private carriage analysis finds no basis in the text of COGSA, and notes that the courts have struggled to apply this test in a reasoned manner. The Court also cited, but declined to adopt or reject expressly, the Fifth Circuit's "governing instrument" standard as an alternative to the public-private carriage test. At bottom, the Court's opinion instructs the district courts to apply the clause paramount language chosen by the parties, and cautions against mechanically applying an analysis of public-private carriage, in deciding whether COGSA applies.

The *AKILI* case may also prove a trap to the unwary shipowner or charterer, or to their respective P&I Club or insurers, who agree upon "free-in-and-out" terms in a charter, but fail to consider carefully the possible implications of the language selected in the clause paramount — which a court or arbitration panel could find effectively supersedes the otherwise agreed upon terms. It is easy to imagine circumstances where parties specifically negotiate a free-in-and-out provision in a charter, intending as part of the bargain to allocate the risk of cargo damages from improper stowage. A party unfamiliar with the *AKILI* rule

might not realize that the clause paramount, which the party may have regarded as boilerplate, could incorporate a body of law that renders the free-in-and-out (or similar) provision unenforceable. The counterintuitive consequence of *AKILI* thus sits in wait to shock the unenlightened: A boilerplate clause paramount can supersede and nullify a specifically negotiated clause for waiving the risk for improper loading or stowage. Parties to such contracts should be wary of this risk.

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* The author gratefully acknowledges the assistance of George G. Cornell, Esq., an associate in the firm's maritime practice group in New York, in the preparation of this article.

1. *Man Ferrostaal, Inc. v. M/V AKILI et al.*, 763 F.Supp.2d 599, 615, 2011 A.M.C. 786 (S.D.N.Y. 2011).

2. *Man Ferrostaal,* 704 F.3d at 83.

3. *Id.* at 84.

4. *Id.* (emphasis added).

5. *Id.* at 86 (citing 46 U.S.C. § 30701 Note § 1(b); Hague–Visby Rules, Art. I.).

6. *Id.* (citing cases from the Second and Fifth Circuits).

7. *Id.*

8. *Id.* (citing *Nichimen Co. v. M.V. Farland*, 462 F.2d 319, 326-29 (2d Cir. 1972)).

9. *Id.* (citing *Tradearbed Inc. v. Western Bulk Carriers K/S*, 374 Fed.App'x. 464, 473–74 (5th Cir. 2010); *Thyssen, Inc. v. Nobility MV*, 421 F.3d 295, 297, 307 (5th Cir. 2005)).

10. *Id.* at 87.

11. *Id.* (emphasis added).

12. *Id.* (emphasis added).

13. *Id.* at 88.

14. *Id.*

"APPELLATE" RULES FOR ARBITRATIONS?

By: LeRoy Lambert, President, Charles Taylor P&I Management (Americas), Inc., New York

The American Arbitration Association has adopted special rules permitting consensual appeal of arbitration awards on the grounds that (a) the underlying award is based on errors of law that are material and prejudicial and/or (b) determination of facts that are clearly erroneous. The AAA has designated an appellate arbitral panel to hear such appeals. These rules are available online at https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2016218&revision=latestreleased.

At the MLA Arbitration and ADR Committee Meeting on 30 April 2014, Richard Naimark, Senior Vice-President of the AAA, presented the rules. The AAA developed them primarily because a significant number of users asked for them. Jay Paré of Mclaughlin Stern spoke in favor. Don Murnane of Freehill Hogan & Mahar spoke against. A lively discussion followed. Thanks to Leo Kailas of Reitler, Kailas & Rosenblatt, Chair of the MLA Arbitration and ADR Committee, for organizing the program. Let the debate continue!

PUBLICATION OF NEW EDITION OF MARITIME ARBITRATION IN NEW YORK

By: Lucienne Carasso Bulow, SMA Past President, Member of Board of Governors, and Chair, Ad Hoc Brochure Committee

The SMA has published the sixth edition of Maritime Arbitration in New York just in time to be distributed at the BIMCO Meeting which was held in Dubai in April 2014.

This edition contains a revised foreword from Chief Judge Preska, the amended SMA Arbitration Rules, the SMA Mediation Rules, the Federal Arbitration Act as well as Marsalv, the U.S. Open Salvage Agreement that was finalized by the Salvage Committee.

In this new edition, the SMA has amended its Model Arbitration Clause to reflect the fact that SMA arbitrators hear many cases under other types of contracts than charter parties. The clause provides that the proceedings shall be conducted in accordance with the Rules of the Society of Maritime Arbitrators and that for the purpose of enforcing any award, the agreement may be made "a rule of a court of competent jurisdiction". It no longer states that the proceedings will be governed by the Federal Maritime Law of the United States because some of the contracts which provide for arbitration under SMA rules are governed by other laws. It is, therefore, advisable for parties to specify in their agreements the law which should govern their contract or charter party.

The brochure no longer contains the SMA Conciliation Rules as they have not been used for many years. Those Rules are still be available on our Website.

IN MEMORIAM: WES WHEELER

SMA member Wesley D. Wheeler passed away on Friday April 18, 2014, at the age of 80. He was also a member of the CMA and SNAME. He is survived by his wife, a son and brother and sister. Wes was a direct descendent of the family behind the Wheeler Shipbuilding Company of Brooklyn and Wheeler Yacht Company of Brooklyn and the Bronx which built pleasure and US military ships for over 50 years. Wes worked for 60 years as a naval architect and engineer, founding his own company, Wheeler Associates, and working on jobs around the world. He will be missed.

CONFESSIONS OF AN ICMA ROOKIE

By: LeRoy Lambert, President, Charles Taylor P&I Management (Americas), Inc.

Although I had been involved in the maritime legal and arbitral community since 1984, I had not been to an ICMA Conference until the Vancouver event in May 2012. Thinking back, I am not sure the reason for my indifference. Bottom line—I never made the effort to investigate what it was about, why it would help me, and never pressed for funding to attend.

In May 2012, however, events happily coincided to permit me to attend the session in Vancouver. I confess I enjoyed it greatly. The papers presented were routinely of the highest quality and provoked lively and thoughtful discussions At breaks and at the social events, one had the opportunity to meet and discuss topical issues with arbitrators from around the world and learn both how arbitrations are done elsewhere as well as the substantive issues and disputes which arbitrators, parties, and lawyers are dealing with. There was a good mix of arbitrators and lawyers, with a few academics to provide perspective and spice, and even a few end-users. Vancouver is also hard to match for visual beauty, and the local maritime community was full of warm and gracious hosts.

The next conference is in Shanghai in May 2015. Through the centuries, Shanghai has been the maritime commercial center of China and is now, more than ever, where east meets west. It is fitting that the international maritime arbitration community recognizes this fact and will hold the next ICMA Conference there. The papers will be timely and topical, the attendees will be from everywhere, and the city and excursions will be memorable. Make your plans now to attend the ICMA Conference in Shanghai May 10-15, 2015, and to submit a paper, too. Details are at http://www.icma2015shanghai.com/html/submission.

EDITORS' NOTE

It is no secret that arbitration venues around the world are competing for arbitrations. Some of New York's competitors have the advantage of being there longer and being closer to a larger number of end-users. Others are financially supported by local governments. Still other organizations earn operating/marketing funds through fees paid to administer the arbitrations under that organization's rules. President Warfield mentioned in his lead article the "Friends and Supporters" program which is now underway. The purpose is to promote New York arbitration by creating a "war chest" with the help of the SMA's friends and supporters. The tax deductible contributions will be placed into a dedicated account, the control of which will be with the president of the SMA (or any other designated member of the Board of Governors) and a member of the Friends and Supporters group. A rising tide lifts all ships!

A special thanks to those who responded to our call for papers and articles of interest. *The Arbitrator* has a long history of providing timely and relevant articles and information to the maritime arbitration community in New York and around the world. To continue to do so requires your support! If you have articles and ideas to contribute to future editions, please let us know. Also, we welcome your feedback on each and every issue. Please do not hesitate to contact us, rshaw@mystrasventures.com or leroy.lambert@ctplc.com. Thank you.

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