ITIC SPECIALIST PROFESSIONAL INDEMNITY INSURANCE

Ship management

Claims Review

The claims examples reproduced here have all featured in issues of The Claims Review and are all case studies which have either been paid by ITIC or where assistance has been provided. These examples should be invaluable in helping you to identify potential claims exposure within your business. ITIC recommends that you review your procedures continuously in order that you avoid these types of situations occurring to you and your business.

Ship manager orders repairs in the name of the wrong company

Scandinavian ship managers were appointed as technical managers of a tanker owned by a K/S limited partnership. The management agreement was originally between the ship managers and the shipowning company but was subsequently replaced by an agreement with the bareboat charterers, another K/S limited partnership.

The manager placed an order for various repairs with a German shipyard, but erroneously did so in the name of the shipowning company. The total repair cost was US$4.5 million, of which US$1.3m was paid (by the bareboat charterers) before the ship left the repair yard. When the next instalment of US$1m was not made the yard, believing it had contracted with the owners, arrested the ship and obtained security of US$1m. The bareboat charterers went into bankruptcy and the technical managers were faced with claims from the repair yard for the balance of the repair bill (US$3.2m) and from the shipowners for negligently warranting that they had authority to order repairs on their behalf.

Although German lawyers confirmed that the repair yard was entitled under German law to look to the ship managers for payment, there was no doubt that the repairs to the ship had benefited the owners. The ship manager eventually contributed US$300,000 to the settlement.

ITIC IS MANAGED BY **THOMAS MILLER**

Reports alone are not enough

Ship managers acted as managers of a vessel for a number of years until it was sold. When it was delivered in Northern Europe to the buyers, Class suspended the vessel's approvals due to the state of its ballast tanks.

The sellers faced a claim from the buyers which was settled. They then turned their attention to the managers issuing proceedings in which they alleged that they had not been kept sufficiently informed about the condition of the vessel's ballast tanks. In addition they claimed that the managers had failed to have the ballast tanks repaired during dry-docking in South Africa six months earlier.

The claim amount was the difference in repair costs between undertaking the repairs in Durban and Northern Europe six months later.

The managers defended the claim on the basis that they had reasonably relied upon figures attained during the dry docking in South Africa and the owners had received copies of the reports obtained over the years. The court appointed expert produced their report stating that survey reports showed deterioration in the ballast water tanks for a number of years and these should have been investigated. If this had been done the repairs would have been undertaken earlier at less cost. The expert concluded that it was not enough that the owners had received copies of the reports and that "the manager was under a duty to bring the future need for substantial steel renewals clearly and unequivocally to the attention of the owner".

A negotiated settlement of US$700,000 was reached.

Check the ship before taking it on!

A ship manager accepted the management of a ship, but had not inspected it. In fact due to a high staff turnover in their technical department, nobody from the managers visited the ship. The owners went on board some ten months after it had been under management and were appalled at the condition of the ship and immediately made a claim against the managers for failing to manage and maintain the ship.

The ship was old and had probably not been in the best of conditions when the managers took it over. However, they had no proof of this. The owners brought a claim of over US$400,000 against the managers. There was no starting point/initial survey on which to commence negotiations.

Documentation disclosure

A manager for a number of cruise ships was sued by the shipowners in a court in the USA in respect of alleged failure to oversee the maintenance, negligence in the provision of the manning and for negligent advice in relation to stability problems experienced by one of the ships. The plaintiffs alleged that these breaches of contract caused them to incur increased maintenance and repair costs as well as lost profits.

The rules on disclosure of documentation in US litigation are very onerous and the amount of documentation requested by the plaintiffs in this litigation was enormous. There were demands that the managers produce over 5 million documents and such was the magnitude of the request for documentation that the court ordered that a specialist company be employed to track emails specific to the management of these vessels.

The costs of the court appointed email tracking firm was US$350,000. The average monthly legal costs incurred were US$110,000 for each of the 12 months prior to trial.

At an early stage the managers and ITIC concluded that the case was without merit. However, the substantial legal costs likely to be incurred (which the winning party cannot recover in US litigation) meant that, if a sensible settlement offer was made, it would be considered. However, at no stage was such an offer made by the plaintiffs who continued to claim in excess of US$20 million.

This case went to trial. The court dismissed all the claims. The plaintiffs appealed and the managers also put in a counter claim for their fees, costs and other expenses incurred. This helped to shorten the appeal process as the plaintiffs eventually dropped their appeal and their motion for fees and costs and paid to the managers a settlement of US$375,000 to ensure that the managers dropped their counter claim.

Although the managers had comprehensively won the case the legal costs incurred of US$2.7 million were covered by ITIC.

Negligence claim against ship managers

A technical ship manager of a cruise ship was appointed for a period of 2 years and thereafter was only responsible for placing the hull and P&I insurances and handling claims.

A few months after the manager's main technical responsibilities ceased, the ship suffered a breakdown of both main engines due to contaminated lube oil. Hull insurers rejected the claim for approximately US$3 million stating that the damage was due to poor maintenance and on-board procedures. There were allegations of earlier problems with the lube oil filters.

The owner issued a summons against the insurers and the manager. The claim against the manager alleged breach of contract for failure to properly discharge his duties as technical ship manager and breach of fiduciary duty as regards the placing of the insurances of the ship.

The manager's liability was dependent, to a large extent, on the outcome of the main lawsuit between owner and insurers but as the trial date approached, the Judge convened a settlement conference which all parties attended. By this time, the claim with interest amounted to nearly US$5 million.

At the conference, the insurers and the manager were advised that the actions against both of them might well be proved but the owner was also advised that there was a possibility that their actions might fail completely.

The outcome was that the owner was persuaded to reduce his claim substantially and the agreed settlement plus defence costs were shared equally by the insurers and the manager. The total cost of the claim to the defendants was nearly US$2,000,000.

Safety Management System ("SMS") failure

An inspector of CARB - California Air Resources Board (the clean air agency of the state of California) – boarded a ship in July 2011 managed by an ITIC member at the Los Angeles Terminal.

The Chief Engineer was asked if he was aware of the revised CARB 2009 California Regulations effective from 1st July 2009 which required vessels to switch main engine, auxiliary engines and auxiliary boilers to low sulphur fuel when in Californian Regulated Waters. The Chief Engineer told the inspector that he was only aware of the requirement to switch auxiliary engines to low sulphur fuel, in accordance with the Regulation effective from 1st January 2007.

The Master checked the Safety Management System but was unable to locate the 2009 requirement. The CARB inspector then went through the records of fuel switchover for the main engine, auxiliary engines and auxiliary boilers, and ascertained that the ship had called at Californian ports 17 times between 2009 and 2011 without switching over the main engine or the auxiliary boilers. CARB imposed a penalty on the ship owners, of US$283,500, for the failure to switch fuel during 17 port calls.

The owners claimed against the managers on the basis that the managers had been negligent. In 2009 a fleet circular had been sent to all vessels by the managers setting out the change in regulations, and asking that it be displayed in a prominent position. The managers therefore initially rejected the claim as resulting from crew negligence (which was excluded in the BIMCO management agreement). The owners did not accept this rejection on the basis that the managers had failed to update the SMS.

As it was considered unlikely that the manager would successfully defend a claim resulting from his failure to update the SMS the claim was paid in full.

Oily problems

A number of governments are increasingly involving the private sector in their research and development. A ship manager contracted with the owner of an experimental hull platform to manage, operate and maintain it for a navy.

One of the manager's duties entailed the changing and analysis of the main engine lube oil. Over a period of only two years, it was necessary to change the lube oil 27 times. On each occasion, an independent testing company found a high debris content and fuel oil, from which it appeared that the lube oil was not acting adequately as a lubricant. Despite these results, the ship manager failed properly to investigate the cause of the persistent problem and eventually the ship suffered engine failure.

A report concluded that the lube oil had been providing inadequate lubrication, and that a prudent and competent superintendent should have conducted further investigations. The owner presented a claim for £800,000, which included many consequential damages and losses. As the manager was obviously at fault, the claim was contested on quantum, rather than liability, and the owner's claim was eventually settled for £590,000.

Pirates plunder cash

A ship in a fleet managed by an ITIC member was boarded by Somali pirates. The pirates opened fire on the accommodation block, entered the bridge and stopped the ship. Following the pirates instructions, the ships course was changed and she sailed to the coast of Somalia. The ship was kept by the pirates in Somalia for some months when she was released. Prior to releasing the ship, the pirates stole a large number of items. These included a cash box that was locked in a safe located in the master's cabin. The cash box included US$15,000 that had been placed on board by the Managers.

The ship manager had purchased ITIC's "cash on board" insurance. This product covers cash carried in a locked safe. The manager was reimbursed the sum of US$15,000.

ITIC provides a range of products for managers and agents which cover monies temporarily in the member's care while in transit to a ship. The cover can also be extended to include monies, including petty cash, kept in the manager's office or at his residence overnight. Money on board can be covered when kept in a locked safe.

Manager's maintenance matters

A ship manager was responsible for the technical management of a bulk carrier which called regularly at an Australian port to load iron ore.

The master had notified the manager of a problem with the winch used for the ship's mooring rope. The winch was still operational, but the pinion gear was worn and needed to be replaced. The manager had taken no action to arrange the repairs.

Over the following months, the ship called on a number of occasions at the same port. Each time, when the pilot went on board, the master explained this problem to him, and the pilot was satisfied that, given the mooring lines could be lifted by the winch, the ship was able to berth safely.

The situation continued until one pilot decided that they would not accept the master's assurances and refused to allow the ship to berth. The pilot spoke to the harbour master, who instructed the ship to go to the anchorage until the winch could be repaired. This was done, causing a 4 day delay to the ship.

The ship went off-hire in accordance with the terms of the charter-party.

The owners subsequently brought a claim for around US$150,000 against the manager for (a) the hire not paid to them by the charterers during the off-hire period, and (b) the additional costs incurred as a result of having to rectify this problem outside of scheduled maintenance. The owners asserted that, had the manager arranged for the repairs to be carried out once they were first made aware of the issue, this could have been done without the ship having gone off-hire.

Investigations confirmed that this was the case, but that the charterers had incorrectly calculated the off-hire period. ITIC also reviewed the owner's claim, and determined that some of the losses claimed would have been incurred irrespective of the manager's negligence.

Ultimately, however, it was clear that the manager had breached their obligations to the owner under the ship management agreement and a settlement of the claim was negotiated by ITIC of US$120,000.

Technical manager caught by "smoking gun"

The technical manager of a tanker which he had managed for three years, found himself on the receiving end of a claim from the owner for US$1,400,000. Multiple claims were made, mostly without any particular merit, relating to repair costs and loss of earnings. The owner's main grievance appeared to be the alleged negligence of the crew supplied by the manager. At an early stage in the arbitration proceedings the arbitrator ruled that the owner's lawyers were entitled to a full inspection of all the manager's files, which were found to include an internal memo (the "smoking gun") from the manager's superintendent criticising the performance of certain crew members and recommending their replacement. The claim was settled at the threshold of arbitration for US$300,000, mostly because of the "smoking gun" memo. The legal costs amounted to an additional US$300,000.

A failure to arrange insurance

A ship manager was appointed commercial manager of a ship by its time charterers on the basis of BIMCO Shipman 1998. One of the ship manager's duties was to arrange insurances if required. The time charterer gave a written instruction that insurance should be placed by the ship manager.

The time charterer had previously owned the ship but had entered into a sale and charter back agreement. The ship had been entered in a pool prior to the sale and this arrangement continued. The pool agreement provided that participants were to ensure that ships were insured adequately.

Some time later the ship grounded whilst entering a port in India. The owner commenced arbitration proceedings against the time charterer for allegedly directing the ship to an unsafe port/berth. At this time, it was realised that the ship manager had failed to arrange time charterers' liability insurance for the time charterer.

The ship manager was not a party to the underlying dispute between the shipowner and the time charterer. The proceedings were protracted and the dispute was ultimately settled on a drop hands basis with the shipowner and the time charterer agreeing to pay their own costs but without the time charterer having to pay any damages to the shipowner. Although the time charterer's position in the litigation had been vindicated, considerable legal costs had been incurred in reaching the settlement. These costs would have been paid under a charterers' liability policy had one been in place.

The time charterer claimed against the ship manager and there was no question that the manager had failed to place the required insurance. Therefore, ITIC indemnified the ship manager for the time charterer's claim.

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ITIC
IS MANAGED
BY **THOMAS MILLER**

For further information on any of the products, services or cover provided by ITIC contact Charlotte Kirk at:
International Transport Intermediaries Club Ltd, 90 Fenchurch Street, London EC3M 4ST.
tel + 44 (0)20 7338 0150 fax + 44 (0)20 7338 0151 e-mail ITIC@thomasmiller.com web www.itic-insure.com
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