SIMPLY

SCANDINAVIAN INSTITUTE OF MARITIME LAW YEARBOOK

2006

346

SIMPLY 2006

Scandinavian Institute of Maritime Law Yearbook 2006

SIMPLY 2006

MarIus no. 346
Sjørettsfondet
Scandinavian Institute of Maritime Law
University of Oslo

ISSN 0332-7868 ©

Sjørettsfondet, 2006
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Director's preface

The year 2006 has brought a shift in the editorship of SIMPLY and the directorship of SCANDINAVIAN INSTITUTE OF MARITIME LAW. Our PhD candidate Mikaela Björkholm has taken over as editor, whereas the undersigned has taken over as director. The reason for this shift in positions is that our previous director, Erik Røsæg, withdrew as director 1st of July 2006 to take one year of research leave. The Institute would like to use this opportunity to thank Erik for his efforts as director. During his directorship he achieved several tasks:

- EU maritime law was defined as a research area. This has resulted in several doctoral thesis and research assistant thesis being written within this field.
- As an extension of this, the project "Safety, Security and Discharge Control at Sea" was born. The project was recently awarded a research grant of NOK 4 million from the Norwegian Research Council. This means that the project will start to run for full from January 2007.
- The Nordic cooperation was strengthened both on PhD level and through two professor II positions being offered with applicants from the other Nordic countries. In addition, Professor Hannu Honka from Åbo Akademi has been a guest professor at the Institute during the fall of 2006 and will continue until May 2007. This Nordic profile is further demonstrated through the participation of several Nordic professors/lecturers as authors in this edition of Simply, cf. further the editor's preface.
- The European cooperation was strengthened through the European Colloquium of Maritime Law Research (ECMLR). ECMLR held its fourth Colloquium in Nantes in September

2006, superbly hosted by our sister institution in Nantes in co-operation with the Institute. The fifth Colloquium is planned to be held in Athens in May 2008.

As in previous years, the Institute has for 2006 received 25% of its funding from the Scandinavian Council of Ministers, for which we are of course extremely grateful. Our main sponsors besides the Scandinavian Council of Ministers are:

- the Norwegian Oil Industry Association (OLF)
- the Ministry of Petroleum and Energy/ The Research Council of Norway
- the Eckbo Foundation

We are very grateful to all our sponsors.

We would also like to express our gratitude to the numerous practitioners who help us with lectures, student advice, information and exams year after year, in most cases without any fee. Their contribution is important in making the Institute what it is: a meeting place for young and established researchers, practitioners and students, all of whom bring open minds and enthusiasm for new knowledge and penetrating analysis into the Institute. In particular, we are pleased about the way practitioners and researchers from other institutions have contributed to our specialized Master Program.

More than two dozen evening seminars were held during the year, as well as several overnight seminars. I would particularly like to mention the XXII Scandinavian Lawyers' Conference in Karlskrona, Sweden, and the energy law seminar in Noordwijk aan Zee, Netherlands (in co-operation with Nederlandse Vereniging voor Energierecht and University of Groningen). The ECMLR is already mentioned above. Also worth mentioning is the Department of Petroleum Law which celebrated their 25th anniversary with a seminar in November.

A special feature this year is that several dr. juris candidates have delivered or are at the point of delivering their doctoral thesis. Henrik Inadomi has just received a positive evaluation for his thesis. Camilla Dalbak and Sondre Dyrland delivered this fall, Odd-Harald Wasenden delivers 15th of January, and Alla Pozdnakova and Anne Karin Nesdam are due to deliver during January/February. The Institute would like to congratulate all of them with carrying through their projects. Needless to say, we are very proud of this result.

Trine-Lise Wilhelmsen

Editor's Preface

We hereby present SIMPLY 2006, which will be published approximately a year after the 2005 edition. This edition is just as comprehensive as those of previous years, and I would like to thank all the authors for their contribution to the successful completion of this project.

As in earlier editions, the articles presented in this yearbook deal with a wide range of topics. What they have in common is that all the authors are in some way connected with the Scandinavian Institute of Maritime Law. A new feature this year is contributions from members of the Institute's board of directors. Needless to say, we are especially pleased to be able to include these contributions. The other authors represent all levels of research activity at the Institute. In addition to contributions from professors, lecturers, researchers, doctoral candidates and students, we have included an article by a former colleague, who was previously a professor at, and director of, the Centre for European Law and who is now a judge at the EFTA court. His article on limitation funds and bankruptcy regulation is based on a presentation held at the Institute's maritime law Post Seminar last spring. Another article that reflects the variety of topics discussed at our maritime law seminars has been contributed by our Danish board member and deals with an issue that so far has attracted little attention in the Scandinavian legal systems, the impact of product liability rules on maritime law. Demonstrating the close ties that exist between the Institute and our former colleagues, we are also delighted to include an article by a Danish associate professor, a previous participant in our doctoral programme, who has now returned to the Institute as a visiting lecturer.

Another feature that the articles published here have in common is that they mostly deal with maritime law. However, there are also two articles about insurance law, one written by a student who has stayed on at the Institute as an assistant research fellow, allowing us once again to highlight the quality of work undertaken by our young researchers. Although this year's edition does not include any articles on petroleum law, this does not reflect any slackening in our research in this area and we hope to include some major articles on this topic next year. This latter consideration apart, we trust that the articles reproduced here mirror the broad perspective that is such a strength of the Scandinavian Institute of Maritime Law.

As the articles presented are independent of each other, there is no common bibliography. Books and other materials referred to will instead be presented in footnotes. The relevant statutory law will, as far as necessary, be presented in the articles or in appendices to the articles.

Mikaela Björkholm

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Part I

Financial guarantees and the underlying contract

Professor Dr. Juris Lars Gorton,
Department of Law, Lund University

1 General background

The Norwegian case reported in Nordiske Domme i Sjofarts-anliggender (ND) 2003 p. 299 (Hålogalands lagmansrett[1]) illustrates the relationship between financial guarantees and the underlying contract.[2] The case also illustrates the way in which the courts interpret financial guarantees.

The background to the case was as follows. A Norwegian shipowner ordered a fishing vessel from a Portuguese shipyard. The contract negotiated between the parties was based on a "traditional" type of shipbuilding contract[3], containing i.a. a late delivery clause. Delivery was delayed, entitling the buyer to liquidated damages in accordance with the contractual provisions.[4]

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1 Court of Appeal of Hålogaland.

2 The case has also been discussed, but mainly from a different perspective, in *Nordisk Skibsrederforening's Medlemsblad* no. 565, March 2006, p. 6067 (H. Aadnesen, Termination of shipbuilding contracts – how to get your project costs back).

3 Shipbuilding contracts are normally based on standard forms, but these are invariably amended during the parties' negotiations over the various clauses and items particular to the relevant contract.

4 Generally shipbuilding contracts will specify that, if delivery is late, the shipbuilder will have to pay liquidated damages (instead of "ordinary" damages). The relevant provision will also normally allow the shipyard a grace period before any liquidated damages are payable. Once the grace period has elapsed, the amount agreed will be payable during a certain period, with a certain amount payable per day or per week of delay, up to a certain maximum. If this maximum period is exceeded, the buyer will usually be entitled either to terminate the contract and recover all amounts paid, including interest, or to accept late delivery, together with the maximum amount of liquidated damages. Normally the right to repayment of amounts paid in advance will be secured by a bank guarantee.

It subsequently became clear that the shipbuilder would not be able to deliver the vessel in any event due to financial difficulties and the shipyard went bankrupt.

The shipbuilder had arranged for its bank to provide advance payment guarantees in favour of the buyer to cover all amounts paid by the buyer in advance. The shipbuilding contract stated, in art. 4, item 5 i.a.:

> "If the Purchasers lawfully cancel this building contract or it becomes inoperative by virtue of clause 7 below, the Purchasers may recover the instalments they have paid with the addition of interest Act (of 17 December 1976) from the payment date to the repayment date. As security for the Purchasers´ recovery claim with the addition of interest, the Builders are obliged before the payment of the instalments to issue bank guarantees."

This provision indicated that the repayment to be made by the shipbuilder related to the buyer's pre-payments, including delay interest from the date of payment to the date of repayment. In relation to the following discussion, it is worth noting that this clause contained no specific reference to "documented costs".

Item 3, in addendum no. 1, captioned "Re section 4 of the contract – Payment", contained a sub-item 3.3: "Guarantee from the Builder for instalments paid and for completion of the ship", which

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The contract in this case was based on this principle. If, as here, there is a bankruptcy, the liquidator and the buyer will have to negotiate a settlement. Will the buyer take over the hull against the payment of a certain amount, or will the agreement be terminated and the buyer recover all money paid in advance, plus interest and possibly certain other amounts? For a general survey on shipbuilding contracts see i.a. Lund, O.: *Om erstatning for mangler og forsinkelse, utbedringsplikt og prisavslag ved skibsbygging.* Arkiv for Sjørett, Bd 11, 1971 p. 336 *et seq.* On liquidated damages, see also Gorton, L. & P. Samuelsson: *Kontraktuella viten. Festskrift till Ingemar Ståhl* 2005 p. 75 *et seq.*

indicated that repayment was secured by a bank guarantee. With respect to the repayment guarantee, this clause stated:

> "The bank guarantee mentioned in the last sentence of item 5 of section 4 of the contract shall be an irrevocable and unconditional ordinary guaranty whose issuer, wording and expiry date shall require the written acceptance of the Purchaser´s bank.
>
> The guarantee shall secure the Purchaser payment of instalments with the addition of interest and documented costs, regardless of whether or not the Builder is able to complete the ship, and shall be received by the Purchaser not later than 5 (five) Norwegian banking days before the Purchaser´s payment obligations mature."

The shipbuilding contract between the shipbuilder and the buyer thus set out the relevant terms and conditions relating to the construction of the ship, while the financial guarantee between the buyer as beneficiary and the bank as payor was a consequence of the obligations of the shipbuilder under the shipbuilding contract. In accordance with the provisions of the shipbuilding contract, the buyer paid three instalments during the first six months of the building period and the bank accordingly issued three guarantees as "refund bank guarantees". Once it became clear that delivery would not take place, the buyer demanded repayment of the money paid in advance under the financial guarantees arranged by the shipbuilder.

Under the guarantees, the bank was the issuer, the builder the principal (instructing the bank) and the buyer the beneficiary. The particular guarantees set out the cover thus:

> "Contract to which the guarantee related: a shipbuilding contract dated 6th august 1998 with belonging addendums and appendixes (hereinafter collectively referred to as the contract), between the principal and the beneficiary relating to the delivery of a purse seiner/trawler with serial no. 214.

> Aggregate maximum amount of guarantor's liability NOK 9.000.000,- (NOK nine million) with addition of interest and documented costs."[5]

The maximum amount available under the guarantees was thus NOK 9 million. The guarantee text did not define the meaning of "documented costs" and, except in addendum no. 1, the shipbuilding contract did not mention any such costs.

2 The dispute

As the shipyard failed to deliver the vessel, the buyer was entitled under the shipbuilding contract either to demand delivery and payment of the maximum amount of liquidated damages or to terminate the contract and demand repayment of all money paid in advance. Once the shipyard had gone bankrupt, the buyer had little alternative but to claim under the guarantee for the repayment of all money paid in advance plus interest. The bank paid out accordingly, but then the question of "documented costs" arose. The dispute between the buyer and the bank thus concerned the understanding of the particular words "documented costs", and the courts had to determine the meaning of the words in the context of the guarantees.

The buyer did not seek any compensation for loss of profit, but expressed the view that the words "documented costs" referred to costs relating to the inspection of the ship during the building period. According to the bank, the words "documented costs", as used in the guarantees, did not refer to such costs, but only to specific costs relating to the guarantees and the calling of the guarantees.

[5] It is worth emphasizing that the guarantee thus had a ceiling, as is customary with bank guarantees.

The courts therefore had to decide the meaning of "documented costs" in the context of the guarantees by applying the tools traditionally used for the construction and interpretation of contracts.[6] The case itself turned on the interpretation of the particular guarantee, but nevertheless gives rise to a more general discussion on the relationship between financial guarantees and the underlying contract.

Before I make any further comments on this particular case and the court's findings, the following section contains a brief review of various features of the relationship between, and particular problems relating to, financial guarantees and the underlying transaction. It is also important to bear in mind that there are certain similarities between financial guarantees and letters of credit.

3 Parties involved in the various contractual relations

As mentioned above, several parties are often directly or indirectly involved in a payment or a financial security arrangement, if one also takes into account the underlying transaction. Thus the same parties may appear in different roles in the various contractual relationships. This is the case irrespective of whether the arrangement takes the form of a letter of credit or a financial guarantee.[7] Thus the buyer and the seller in a sales agreement will,

[6] Vinje, E.H.: *Tolking av garantier i forretningsforhold*, Oslo 1999, Millqvist, G.: *Rättslig kontroll av borgensåtaganden genom avtalstolkning.* Svensk Juristtidning 1990 p. 252 *et seq.* and Gorton, L.: *Borgen – säkerhet för vad.* Svensk Juristtidning 2001 p. 27 *et seq.*

[7] Falling between these two types of arrangement are standby credits, which are in practice financial guarantees disguised as letters of credit. The

in the letter of credit, appear respectively as the principal in relation to the issuing bank and the beneficiary entitled to payment from the paying bank. In the case of a financial guarantee, the terminology used may sometimes mean that the bank ordered by the principal debtor to arrange for the issuance of a financial guarantee will be referred to as the instructing party.[8] The instructing party will instruct the (paying) bank to issue its guarantee. Although letters of credit and financial guarantees function in different ways, they share some structural similarities. Letters of credit are, however, essentially payment undertakings, whereas a financial guarantee is basically issued as a security for the payment due.

It is important to recognize the interrelationship between the contracts pertaining to the financial arrangement and the underlying contract. It is also important to note that the various transactions fall into different legal categories. It also follows that the parties involved will have varying functions and that the various contractual relationships will be governed by different rules.[9] The duty of the bank to pay is normally combined with a duty to examine and approve the documents presented to it. This is particularly so in the case of letters of credit.

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standby letter of credit has evolved out of the documentary credit to become a financial security arrangement.

8 This is the terminology employed in the URDG, see art. 2.

9 In a letter of credit transaction, the banks involved will be: the *issuing* bank, which undertakes to pay upon the presentation by the beneficiary of certain documents; the *confirming* bank, which adds its confirmation, meaning that it also gives a separate immediate primary payment undertaking beside the issuing bank; the *advising* bank, which will merely transmit the different documents without taking on any specific payment obligation; and a *paying* bank, which, on the other hand, may have promised to make payment (often following the instructions of the issuing bank).

Naturally, the different contractual relations and parties may also give rise to a number of redress scenarios where a bank, having paid out an amount, will have a claim against another bank in the chain or against the applicant. Such redress claims are common and may often be based on an express counter indemnity (guarantee), or sometimes on an implied counter undertaking.[10]

As indicated above, in the present case, such contractual relations existed between the shipbuilder (as applicant), the buyer (as beneficiary) and the bank (as payor).

4 Independence of financial guarantees

4.1 In general

Most financial transactions will involve, or have connections with, a number of different legal relationships, whether these are between different parties or different types of transaction. This is true of both domestic and international transactions, although international transactions are often of greater complexity, not only because various legal systems may be involved. International transactions that involve two or more legal systems may also give rise to various types of dispute. A payment or a financial security arrangement is normally the consequence of requirements set out in a separate contract (the underlying transaction), e.g. a contract for sale or construction, a contract for services or a loan agreement. Letters of credit are, in effect, payment arrangements whereby the bank undertakes to pay the beneficiary on the presentation of agreed

[10] Examples of such disputes include: BAYERISCHE VEREINSBANK V. BANK OF PAKISTAN /1997/ 1 Lloyd´s Rep. 61 and CREDIT AGRICOLE INDOSUEZ V. MUSLIM COMMERCIAL BANK LTD. /2000/ 1 Lloyd´s Rep. 275.

documents, whereas financial guarantees are principally relevant where the primary debtor fails to pay.

Suretyship seems to be a rather broad common law concept that has evolved out of an undertaking given by an individual as security for a payment to be made by the primary obligor if the latter fails to pay.[11] Traditional suretyship has gradually evolved into various forms of security and payment undertaking and these have further developed into unconditional and on-demand commercial undertakings. The various wordings used may have differing effects.

It may also in some cases be necessary to point out in what way and to what extent general legal rules (relating to contract or other areas of law) or more particular legal devices apply to the various relationships and transactions involved.

The underlying contract will normally contain either a payment clause or a clause relating to financial security. This will state when payment has to be made, by what means, how or when a guarantee must be provided and its required duration. Thus the division of risk between the parties to the *underlying contract* largely depends on the choices made by them in respect of payment and/or the financial security to be provided and the terms and conditions involved. A contract made on the basis of payment in advance thus represents a different type of financial risk than a contract based on open credit terms (payment in arrears). Various payment and financial security devices have evolved accordingly.

The interrelationship between the underlying contract and the payment arrangement or financial security is evidenced by obligations placed on the main debtor in the underlying contract to

[11] See i.a. Rowlatt on principal and surety (by Moss & Marks) 5th ed. London 1999 at 1.01, 1.03 and 1.09, and Goode, R: Surety and on-demand performance bonds. Journal of business law 1988 p. 87 *et seq.*

instruct a bank (or other person) either to make payment or to guarantee that it will be made.

Financial guarantees are characteristically dependent upon (accessory to) the underlying contract, meaning that the underlying transaction must be binding for the financial guarantee to be so. A financial guarantee may, however, also be closer in nature to a payment undertaking, irrespective of the validity of the underlying transaction. For the guarantee to be independent, its text must explicitly state that it is of such independent nature. This is often achieved by including an explicit statement in the guarantee that it is "independent of the underlying transaction" and that payment under the guarantee will be available on "simple demand", or on demand with reference to the relevant breach of contract or similar. As discussed below, most legal systems contain no particular rules governing so-called on-demand guarantees or independent guarantees and instead it will be up to the courts to interpret and construe the wording in any particular case. The ICC rules (458) concerning demand guarantees from 1992 (URDG) may, by reference, be made applicable to such guarantees.[12] Art. 20 in the URDG explicitly sets out the following requirements:

> "Any demand for payment under the Guarantee shall be in writing and shall (in addition to such other documents as may be specified in the Guarantee) be supported by a written statement (whether in the demand itself or in a separate document or documents accompanying the demand and referred to in it) stating:
>
> (i) that the Principal is in breach of his obligation(s) under the underlying contract(s) or, in the case of a tender guarantee, the tender conditions; and
>
> (ii) the respect in which the Principal is in breach."

[12] This was not the situation in the case that is the subject of this article. Instead, general contractual and obligatory rules were applied in the interpretation of the guarantee. The case was decided under Norwegian law.

This means that the beneficiary is entitled to demand payment under the guarantee by making a demand supported either by a written statement to the effect that there is a breach of contract or by a document required under the particular guarantee including a statement explaining the breach.

4.2 Different methods of payment and forms of financial security

National commercial law differs to various degrees, something which may hamper, or is at least thought to hamper, international commerce. Commercial law (or certain aspects of related legal rules) is also a legal field where harmonisation has been seen as particularly important. In many situations, the use of generally employed standard terms and conditions and agreed jurisdiction clauses etc. may reduce the practical consequences of the differences for the parties. It must also be emphasized that the concept of suretyship, which is known in various legal systems under different names and with some differences in effect (Bürgschaft, cautionnement, kaution, borgen, garanti), originally took the form of an undertaking by an individual and did not have any particular association with commercial transactions and/or entities.[13]

National legislation and various rules, principles, practices and contract forms may come into play depending on the particular type of arrangement. Domestic law may provide particular

[13] This is where the reader will also find that the legal structure varies in different legal systems, and it is worth mentioning that “commercial law”/”business law” in common law jurisdictions is regarded as differing from “droit commercial” in French and “Handelsrecht” in German law.

legislation and rules relating to particular types of arrangement, as well as general contractual provisions.[14]

In national law, the concept of suretyship (cautionnement, Bürgschaft etc.) originally developed as a form of personal financial security and the personal guarantee was intended as backing for a payment undertaking by a primary obligor. The idea was that the guarantor's undertaking would only become available to the creditor if the main debtor did not pay. Various types of arrangement subsequently evolved.

A modern suretyship/guarantee may be phrased in different ways and the wording may have different effects. The concepts mentioned here may not necessarily mean exactly the same thing in different legal systems, but they are reasonably similar in nature and effect. National laws differ: in some legal systems, legislation in respect of personal financial security may be rather extensive and precise, whereas in other systems, legislation may be rather crude or even non-existent. In a number of countries, particular rules have been developed where the guarantor is a private person and the "beneficiary" (creditor) is a bank (i.e. in the field of consumer law).[15] This is a development that seems gradually to be becoming more widespread in the spheres of both private and administrative law. In the sphere of administrative law, new requirements seem to have gradually evolved in relation to various financial undertakings.

As a matter of principle, the traditional surety arrangement is accessory to (dependent on and tied to) the underlying contract. In commercial situations, the term "guarantee" (financial guarantee) seems to be more commonly used.

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[14] On-demand guarantees and, in particular, letters of credit will be discussed in more detail below in sections 4.4 and 4.6.

[15] The EU is working on a new directive on consumer credit and this directive may contain rules on "consumer" suretyship.

In international commercial transactions, certain variations in drafting have developed, and one that has gradually come to play a more important role is the so-called on-demand guarantee (the unconditional or independent guarantee). These guarantees are, by way of their wording, often unconditional and independent from the underlying contract. Since national law has, in many instances, not proved very well suited to international commercial transactions, it has been necessary to establish international rules of various types. As a general point, an on-demand guarantee should not be drafted in such a way that the wording signifies that the guarantee is accessory to the underlying transaction. Instead, it should be clear that the guarantee is unconditional and independent from the underlying contract and payment under the on-demand guarantee should be available without the "right of objection" (or similar wording), and payment should be available on demand.

4.3 Rules applicable to payment and financial security

I have already mentioned that national law may provide more or less extensive rules in relation to personal security.[16]

In the sphere of private law, Swiss rules relating to personal financial security may be cited as an example of rather extensive and sophisticated legislation, whereas in English law, there is no particular legislation of a private law nature, but instead the law relating to suretyship/guarantees has largely developed at common law through a long history of court decisions. The Swedish Code of Statutes only contains a few sections dealing with these particular legal questions and case law fills in a number of gaps. However, the

[16] "Personal security" is the overriding concept used in the European civil code project.

Financial Supervisory Authority (FSA), which is entrusted with certain legislative powers in financial matters, has issued a number of rules that apply where a private person issues a suretyship in favour of the bank, covering i.a. the bank's duty of information towards the surety. This is particularly the case where a bank lends money against a personal security in favour of the bank. In such situations, some legal systems impose certain duties on the bank in relation to the surety, particularly in respect of certain types of information. In Norwegian law, Finansavtaleloven (Ot prp nr 41, 1998-99) contains rules in Chapter 10 on "kausjon", dealing in particular with the situation where a private person issues a guarantee in favour of a bank as lender.

As mentioned above, in footnote 15, there is an ongoing European civil law project dealing with, i.a., personal security (in a broad perspective).[17]

As has already been mentioned, letters of credit can be seen as forerunners to the on-demand guarantee. Only few countries have particular national legislation applying to letters of credit, but such rules are found in, for instance, the United States in its Uniform Commercial Code (UCC), Chapter 5. These rules, however, primarily target US interstate commerce.

As already mentioned, the historical background of the various financial security and payment devices varies considerably. Thus, for example, letters of credit were originally framed according to a

[17] One of the European study groups finalized a draft on personal security during 2004, which addressed most of the devices mentioned here. A useful guide to such rules can be found in the material put together by the relevant European working group. Publication of a new book based on this material is expected during 2006, Drobnig, Principles of European law. Personal security contracts. Note, however, that outside European jurisdictions, many countries have particular rules governing financial guarantees and these often also apply to on-demand guarantees.

certain legal structure in *lex mercatoria*, but a more precise legal framework has been established later. Suretyship, on the other hand, seems rather to have evolved in various national legal systems, apparently with roots in earlier Roman law and various customs.

In respect of letters of credit, the International Chamber of Commerce (ICC) as early as 1933 issued its Uniform Customs and Practice (UCP) in respect of documentary credits. These rules have been continuously amended and the most recent version, referred to as UCP 500, came into force in 1994. UCP 500 is currently being revised, and there is now a draft covering all new articles (reportedly 39 in total) due for consideration among ICC members and within the ICC during 2006 (UCP 600).

Reference is almost invariably made to UCP so that the rules will be incorporated in the contract. Even though the rules' title describes them as having "uniform custom and practice", it is doubtful whether they have the status of fully-fledged usage.[18] Since there are few other legal sources available in relation to letters of credit, a court may, even in the absence of a specific reference to UCP, apply the rules at least by way of analogy.[19]

With regard to commercial financial guarantees, the situation is somewhat different. In the case of international transactions, bonds and guarantees are increasingly now subject to certain rules also established by the ICC. Thus the ICC has adopted a number of

[18] Academic lawyers have debated whether the UCP rules should be regarded as being of customary usage or not, and some authors seem to endorse the view that they probably are, whereas others are very hesitant, see e.g. Kozolchyk, B.: Commercial letters of credit in the Americas: a comparative study of contemporary commercial transactions. Albany, N.Y. 1966 p. 75 *et seq*. In several cases, the courts have found that UCP will play an important, although not exclusive role, in the construction and understanding of letters of credit.

[19] A further point is that the ICC Banking Commission provides banks and other members with opinions in respect of particular problems relating to letters of credit. These opinions are published annually. They are not binding in the same way as court decisions, but they play an important role in the development of the use and application of different ICC instruments.

rules and standard form contracts relating to contract guarantees, on-demand guarantees, contract bonds and standby credits. The ICC Rules on Demand Guarantees 1992/93 (URDG 458) seem to be being used more often, although banks in some countries still seem reluctant to apply them. The Rules on Contract Guarantees (URCG), issued in 1974 have, however, not been very successful, but they may serve as a practical guide when drafting guarantees. Similarly, the Rules on Contract Bonds, dating from 1993/94, do not seem to be used very frequently. Standby credits, on the other hand, are arrangements that seem to be being used increasingly as a substitute for financial guarantees (mainly of the independent type) issued by banks.

The UCP rules, as well as the URDG, are explicitly applicable to standby credits, although they may not be particularly well adapted to this particular type of arrangement. In order to meet the particular requirements of standby credits, the ICC developed a special set of rules, namely the ISP (International Standby Practices), dating from 1998. These rules are better adapted to standby credits than either UCP or the URDG. They are also more detailed, which solves some problems but can also give rise to new types of dispute.

Furthermore, UNCITRAL (United Nations Conference on International Trade Law) has drafted an international convention on independent guarantees.[20] This Convention has, however, so far gained little recognition, and is generally believed unlikely to gain worldwide acceptance. The definition used in the convention in Article 2 is nevertheless worth quoting:

> "(1) For the purposes of this Convention, an undertaking is an independent commitment, known in international practice as an independent guarantee or as a stand-by letter of credit, given by a

[20] United Nations convention on independent guarantees and stand-by letters of credit, New York, 11 December 1995.

> bank or other institution or person ("guarantor/issuer") to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is inferred, that payment is due because of default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person."

One idea behind the convention was probably the creation of a better basis for protection against unfair callings under guarantees than is the case under the URDG.

4.4 Functions and design of the different types of undertaking

As mentioned above, the undertakings may be of different natures, as they may either be undertakings for immediate payment or offer secondary security for the primary undertaking. The *commercial letter of credit* is a payment undertaking, whereby the bank promises to pay the beneficiary against the presentation of documents, provided that they are in strict compliance with the terms and conditions of the letter of credit and the provisions of UCP 500. The text of the undertaking may be along these lines: "We undertake irrevocably to pay to you the amount of X USD against presentation of the following documents:…."

This is a standard phrase used in letters of credit. It signifies that the undertaking is irrevocable and that there is a duty on the beneficiary to present certain, specifically required, documents.

Financial guarantees are of a secondary nature, intended to be payable only if the principal debtor does not pay. Having said that, the actual wording used in the guarantee/credit will be decisive and, as mentioned above, it is quite common for guarantees to be made jointly and severally with the primary undertaking. Standby

credits and on-demand guarantees are normally independent of the underlying transaction and available on first demand. It is becoming more common for the demand for payment also to be made dependent on certain requirements, such as the presentation of a particular document stating that the demand for payment is being made because there is a breach or failure on the part of the principal debtor that entitles the beneficiary to receive the amount of money agreed. Such a guarantee will then be of a primary nature (although it is only intended to be used when the primary obligor does not perform). The principal questions then concern the concept of "independence", as well as the wording "without any right of objection" (or similar). Therefore payment under a guarantee will depend not only on the wording used in the guarantee, which will determine whether it is of primary or secondary nature, but also on whether it is independent from the underlying contract.

The wording used in the guarantee will have fundamental implications for the guarantor. Will he be liable primarily or secondarily, or jointly and severally with the primary debtor? The next question will be whether the guarantee is independent of the underlying contract. A reference to URDG 458 will make the guarantee unconditional and all articles of the URDG will apply to it.

There may also be a presumption that an "on-demand guarantee" will be an independent guarantee.

If, on the other hand, the guarantee text states: "We guarantee the due performance of…" (or "the due payment of…"), then this undertaking is, under Swedish law, certainly of a secondary nature, and also dependent on the underlying transaction. This means that if the underlying contract is not binding, then neither is the guarantee.

In Swedish law, for example, wording such as "I guarantee as for my own debt" implies not only that the guarantor is liable jointly and severally with the primary obligor, but also that the guarantee is not independent of the underlying contract. This in turn means that while the creditor may proceed against either the principal debtor or the guarantor, as he prefers, such a guarantee is also accessory to the underlying contract. If different wording is used, such as: "I guarantee the repayment of X's loan", this implies that the creditor must first seek payment from the primary obligor, before he is entitled to turn to the guarantor. Furthermore, this undertaking would also be of an accessory nature.

If an irrevocable letter of credit is involved, the undertaking will contain wording along the following lines: "We shall pay you upon your presentation of the following documents -----." An independent (on-demand) guarantee may also contain wording of a similar type: "Without the right of objection we will pay you on your first demand the amount of --- provided that you present to us a written statement saying that you have not received payment." This wording is also similar to that used in a promissory note[21] and in practice it may not always be easy to distinguish between an independent guarantee or a payment undertaking under a promissory note.

[21] This was the wording used in the case reported at NJA 2002 p. 244, where the "guarantees" set out the following: "Mot bakgrund av att ett köpeavtal träffats om förvärv av aktier I IBIS A/S mellan Er såsom säljare och DC Management såsom köpare, förbinder vi oss att tidigast 1988-09-22 på er första skriftliga anmodan erläffa SEK…." (Free translation: "Considering that a purchase agreement has been made regarding the acquisition of shares in IBIS A/S between you as seller and DC Management as buyers we undertake earliest on 1988-09-22 on your first written demand to pay SEK….") The text of this payment undertaking is actually closer to the wording of a promissory note (note of indebtedness).

Another type of undertaking is that made under an indemnity or "hold harmless" clause, whereby the party making the undertaking promises to indemnify a party who suffers a loss.

As already stated, letters of credit are international payment arrangements. They are basically payment undertakings, normally made by a bank, where the payment is conditional only upon the presentation by the beneficiary (often the seller) of certain agreed documents.

Letters of credit are, by their nature, separate from the underlying contract.[22] Standby letters of credit in their turn are in form letters of credit, but their function is rather like that of an on-demand guarantee. Both letters of credit and on-demand guarantees are thus drafted as devices independent of the base contract. Contractually, they normally follow what has been agreed in the underlying agreement, but their issuance will in most cases be a condition precedent to the underlying contract. At the same time, they will have the effect mentioned above and be independent of the contract for which they are a condition precedent.

Depending on the wording used, and what may be implied from the conduct of the parties, a problem may arise as to whether the arrangement involved should be regarded as of one type or the other. Such questions, which had been the subject of some earlier court decisions, came before the courts once again in the MARUBENI case.[23]

In this case, a letter of guarantee was issued by the Mongolian Central Bank on behalf of the Mongolian government. The letter was described on its face as a guarantee and was accompanied by an opinion from the Justice Minister that the guarantor had full

[22] See UCP 500 art. 3 and 4.

[23] MARUBENI HONG KONG AND SOUTH CHINA LTD V. GOVERNMENT OF MONGOLIA /2005/ EWCA Civ. 395.

power to enter into the guarantee. The obligations in respect of which the guarantee had been issued were later rescheduled twice. When the appellant (the beneficiary under the guarantee) subsequently claimed under the guarantee, the guarantor alleged that the refinancing of the obligations amounted to a material variation of the underlying obligation to which the guarantee related and that the guarantor's obligation had therefore been discharged.

The view of the beneficiary was that the guarantee was an unconditional on-demand guarantee setting out an independent promise to pay. It was a primary obligation and there was thus no discharge in English law.

The Court of Appeal found that the letter of guarantee did not describe the arrangement either on its face or in the supporting opinion as an unconditional on-demand guarantee. There was an unconditional pledge, and also an on-demand provision, but the obligation to pay under the guarantee arose only if the amounts payable under the underlying agreement were not paid when they became due. That language was appropriate only to a secondary obligation. This case illustrates both the importance of taking great care when drafting guarantees and the subtle distinctions between different types of undertakings.

5 Relationship between the underlying contract and the independent guarantee

5.1 In general

As mentioned above, the significance of independent guarantees is their independence of the underlying contract, i.e. the beneficiary may be entitled to payment under an on-demand guarantee even if there would be no right to compensation under the underlying

contract. This illustrates the separate nature of the two transactions. Another question is whether a beneficiary, having received payment under the guarantee, will then be entitled to retain the money under the underlying contract.

5.2 Co-ordination of the basic agreement and the payment/security arrangement

The payment undertaking and/or the agreed financial security in a transaction are dependent on the terms and conditions agreed in the underlying agreement, whether this is for a sale, a lease, a loan or other transaction. So in this sense there is a relationship (and a very important one) between the underlying transaction and the subsequent arrangement, the latter being consequent on the former. This means that the basic agreement will (or at least should) set out sufficiently the terms and conditions applicable to the particular type of payment/financial security. The drafting of the latter will thus depend upon the requirements set out in the underlying agreement. The subsequent financial arrangement (such as the issuance of a letter of credit or an on-demand guarantee etc.) will thus often be a condition precedent that must be met before the underlying contract becomes binding, or before the creditor becomes bound to perform.[24]

If the underlying transaction is, for example, a contract to build a ship, certain advance payments will normally have to be made to

[24] On this, see e.g. D´Arcy, L., Murray, C. & Cleave, B.: Schmitthoff's Export trade: The law and practice of international trade. 10th ed. London 2000, Chapter 11, Debattista, C.: Sale of goods carried by sea. 2. ed. London 1998 p. 101 et seq., Cranston, R.: Principles of banking law. 2nd ed. London 2002 p. 312 et seq.

the builder by the buyer.[25] The buyer will, in turn, normally require an "advance payment guarantee" to be made in its favour as security for repayment, plus interest, of such advance payments if the deal fails. Likewise, the seller will often request the buyer to provide a bank guarantee or a standby letter of credit to secure the outstanding balance. A similar situation will prevail in most large international projects. Needless to say, timing is crucial when dealing with all these arrangements and often the bank may have to issue a "letter of commitment" stating that a "guarantee" will be opened at a later stage, provided that certain terms and conditions have been met.[26]

Similar considerations will also apply in connection with other contracts, such as agreements for loans, or for the flotation or acquisition of shares in a company etc., although the details will differ. If the underlying contract is a credit transaction, there may similarly be a requirement for the borrower to arrange financial security (a pledge, mortgage, financial guarantee etc.).[27]

A loan agreement will therefore normally prescribe that, as a condition precedent to drawdown of the loan, the debtor must furnish the lender with a number of undertakings and documents.[28] Likewise, an international sales agreement may contain a clause requiring the buyer to arrange a bank to open a commercial letter

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[25] See, for instance, Gorton, L.: Ship finance agreements. *Festskrift till Kurt Grönfors*, Stockholm 1991 p. 197 *et seq.*

[26] See e.g. Wood, P.R.: International loans, bonds and securities regulation. London 1995 p. 15 *et seq.* It should also be remembered that, in some legal systems, an undertaking to negotiate and contract in the future might not be binding.

[27] An international loan agreement will normally contain a particular clause spelling out the text of the guarantee prerequisite for drawdown of the loan.

[28] Wood, P.R., *op. cit. supra* note 26, i.a. p. 16 *et seq.* and Cranston, R., *op. cit. supra* note 24, p. 312 *et seq.*

of credit before the cargo can be shipped. Failure to have such letter of credit opened in time may be regarded as a delay under the sales contract (similar to a delay in payment) and may thus amount to a breach. In this sense, there are functional similarities between the various arrangements discussed here.

If the underlying contract concerns an international sales agreement for the supply of goods, the underlying contract should contain a clause setting out the price, payment method and/or the device to secure payment and the time of payment. In international sales, various documents, and in particular transport documents, play a central role in the performance of the contract.[29] These documents will together mirror the goods involved. It is of practical importance to determine in the sales contract certain parameters in relation to the chosen method of payment/security, i.e.: the type of payment/security; the time of issuance; the duration of the undertaking; and the documents to be presented (or other measures taken) in respect of a call under a guarantee or a demand for payment under a letter of credit etc.

There is thus a relationship between the sales contract, the contract of carriage, the insurance contract and the payment/security arrangement.[30] That said, it is also necessary to recognize that letters of credit or, for that matter, on-demand guarantees, are regarded as transactions separate from the

[29] This becomes clear from UCP 500, where a substantial part of the rules (art. 20 - 38) cover different documents, of which various transport documents are particularly important (art. 23 – 32).

[30] See e.g. Gorton, L.: Seller's and shipper's fraud. In Maritime fraud, ed. by Kurt Grönfors (Gothenburg Maritime Law Association no. 64), Gothenburg 1983 p. 29 *et seq.*, Hellner, J.: Sale, carriage, insurance – integration of the contracts and harmonization of the law. In *Estudios en homenaje a Joaquin Garriguez*, 1971 p. 483 *et seq.* and Ramberg, J.: International commercial transactions, Stockholm 3rd ed. 2005.

underlying contract.[31] This may mean that, although money has been paid out under an on-demand guarantee, it can be recovered under the underlying contract, as no breach of the underlying contract has taken place.

The independent nature of the commercial letter of credit is stated explicitly in UCP 500, where art. 3 states that a letter of credit is separate from the underlying transaction and art. 4 provides that the bank deals with documents, not goods. This means that, although it is important for the applicant to make the opening bank aware of the terms and conditions of the underlying transaction when drafting the letter of credit, the bank will not, however, be bound by, or involved with, the requirements of the underlying contract with respect to its duties under the letter of credit arrangement. This "autonomy" principle or doctrine of separability, as it is also referred to, is important when it comes to determining the duty to pay the beneficiary under the letter of credit arrangement or the on-demand guarantee.[32]

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[31] The relation between the underlying contract and the on-demand guarantee is also illustrated in CARGILL INT. V. BANGLADESH SUGAR /2000/ 2 Lloyd´s Rep. p. 524. In this case, Cargill was allowed to recover money paid out by the bank to the buyer under a guarantee, since no damages were payable according to the underlying sales contract. See also TRADIGRAIN SA V. STATE TRADING CORPORATION OF INDIA /2006/ 1 Lloyd´s Rep. 216.

[32] D´Arcy, L., Murray, C. & Cleave, B. *op. cit. supra* note 24, p. 170 ff and Bertrams, R.: Bank guarantees in international trade. The law and practice of independent (first demand) guarantees and standby letters of credit in civil law and common law jurisdiction. 2nd ed. The Hagues 1996 p. 36 *et seq.* In the Swedish case reported at NJA 2002 p. 164, the Court of Appeal found that mention of the underlying transaction in an on-demand guarantee turned it into a guarantee that was not independent. The Supreme Court, however, succinctly corrected this remarkable conclusion by the lower court.

Failing a reasonably precise clause in the underlying agreement, there is always a risk that the applicant when instructing, or in its dealings with, the opening bank may try to introduce elements that narrow down the obligations of the bank or introduce requirements not contemplated by the parties when they originally agreed on the terms and conditions of the underlying contract. A dispute may then arise between the parties in respect of the drafting of the letter of credit or the guarantee. If such differences between the parties are not resolved at this point, problems may arise at a later stage, when the beneficiary realizes that it is unable to present documents in accordance with, and acceptable under, the letter of credit.

5.3 Construction and interpretation of a financial guarantee

Whether the guarantee offers personal security of the more traditional type or is a financial guarantee of an independent nature, and whether it is governed by national law or by the URDG, there is always the possibility of a dispute arising over its interpretation. The wording used may vary greatly and this, taken in conjunction with specific rules and the rules of interpretation, will be decisive for the application of the guarantee. Thus, for example, the URDG rules will mean that the beneficiary will have to meet the requirements set out in the URDG in order to be paid, unless the individual guarantee sets out specific requirements.

This also means that the courts, when determining the meaning of a guarantee, may have to apply the traditional principles of contract interpretation in order to rule on the consequences of a particular guarantee.

The Swedish Supreme Court case reported at NJA 1972 p. 1 illustrates some related questions from a particular point of view.

In this case, a Swedish bank had been instructed by certain individuals to open a financial guarantee (not an on-demand guarantee) in favour of the beneficiary as security in connection with a family dispute. The two parties were negotiating a divorce settlement and the wife was to arrange for the issuance of a financial guarantee as security for the timely return of the parties' son after the summer holidays (the husband had custody of the son). The parties never entered into a binding agreement and the bank guarantee consequently never came into force. The prospective beneficiary, however, sued the bank in the US courts for conspiracy, but lost. The Swedish guarantee bank then sued the husband in the US to recover its costs and was successful in recovering about 50%. The bank then claimed reimbursement from the instructing party of the costs incurred, referring to the underlying contract, of which one clause stated that the instructing party was to cover costs and fees. The instructing party refused to pay, alleging that such costs and fees were not contemplated in this particular case and the wording only referred to minor costs arising in connection with the guarantee. The dispute came before the Swedish courts and an opinion on custom and practice in the banking sector was presented to the Supreme Court. According to this opinion, the "costs" referred to in the relevant clause did include the costs incurred in this case, as otherwise the fees for issuing guarantees would have to be increased considerably to take account of the increased potential risk. The Supreme Court followed the opinion and found that, on the basis of "custom and practice", the clause in the contract covered the particular costs incurred.

The Supreme Court thus applied certain aspects of the general rules of interpretation (i.a. disregarding the contra proferentem rule). The Swedish Act on unreasonable contracts and contract terms had not yet come into force, but I do not believe that this legislation would have been applied in this particular case.

6 Certain central questions

6.1 In general

The above outline reflects the basic configuration of guarantee and/or letter of credit transaction. Even if the letter of credit is a

separate legal arrangement, the UCP contains a large number of provisions that illustrate the different relationships forming the background to a letter of credit transaction.[33]

Disregarding problems that may arise in connection with the underlying transaction, problems may arise between the opening bank and the beneficiary and also between the applicant (the principal) and the opening bank. Problems may, however, also arise between the various banks involved, as a result of their making different decisions when examining documents or responding to requests for payment. Consequently a number of disputes arise between the confirming (sometimes also the advising) bank and the issuing banks in relation to the examination of the documents.

Related disputes may also involve the question of whether a correspondent bank is the agent of the opening bank, or should the banks rather be seen as the agent of the applicant? Or is the concept of agency irrelevant here?

6.2 The drafting of letters of credit and guarantees

As mentioned above, it is important that those involved in the drafting of letters of credit and/or guarantees consider the wording carefully. Wording that is unclear or ambiguous may cause problems when a demand for payment is made, as the bank may decide to refuse payment. Alternatively, the bank may decide to pay, but then risks being unable to obtain reimbursement. The economic consequences may therefore be quite significant.

In this context, the principal question must be, who will ultimately be responsible for, and bear the risk of, a badly drafted

[33] The structure of URDG 458 is similar.

guarantee/letter of credit? It is obvious that banks generally have the greatest experience and competence in this area. That said, however, it is the applicant who instructs the bank and it is the applicant who is familiar with the underlying contract. Then again, the beneficiary has a say, in that it may refuse to accept the proposed wording. Often, but not always, the applicant and the bank will discuss the matter and agree on the proposed wording, which will then be accepted, or not, by the beneficiary. Failure to scrutinize the text at this stage may cause problems for the beneficiary later when calling under the credit/guarantee, as it may then find that it is unable to meet the documentary requirements.

Art. 5 in the UCP 500 states that the bank should try to avoid unclear letters of credit, but the bank's duty does not extend further than that. There seems to be no legal liability on the bank if the drafting is unclear or ambiguous. The risk of any lack of clarity seems to lie with the principal in the transaction.

If the applicant has asked the bank to assist in drafting suitable wording, it is not inconceivable that an increase in liability may result, but this question will have to be determined under the general law of contract and/or professional negligence.

Personally, I doubt that there would be more extensive liability based on, for example, a principle of good faith in this respect, particularly in English common law, but contract law principles may be used to fill out any gaps.

I will just mention an English case that illustrates one angle of some related problems, CREDIT AGRICOLE V. MUSLIM COMMERCIAL BANK.[34] In this case, the Muslim Bank opened a letter of credit on the instruction of a buyer in Pakistan in favour of the seller (referring to UCP). Clause 9 of the credit prescribed, among many

[34] CREDIT AGRICOLE V. MUSLIM COMMERCIAL BANK /2000/1 Lloyd´s Rep. 275.

other things, the following in respect of documents to be presented under the letter of credit: "Original documents along with eight copies each of invoice, packing list, weight and measurement list, Bill of Lading and certificate of origin should be sent to us by Courier at the cost of the beneficiary".

Apart from the more standardized requirements, there was also a typewritten section filling more than half of the letter of credit form and captioned "Special conditions". This was indeed an unclear provision and the court applied a general principle for instances of ambiguity and found that the confirming bank had not acted unreasonably in deciding to pay the beneficiary. The bank might have inquired into the meaning of the clause, but this would have led to considerable delay and increased costs. On balance, the confirming bank was therefore found to have acted reasonably in the circumstances.

In respect of on-demand guarantees, it is important that the parties make it clear whether the guarantee is independent or not. Sometimes guarantees express independence as well as dependence, which may cause problems. In such a situation, the court will have to interpret the undertaking, as in the MARUBENI case mentioned above.

6.3 The demand and the duty to examine the documents

Central to the law of letters of credit are the demand for payment and the checking of documents. This is where the nature of the commercial credit really becomes clear. The beneficiary has a duty to present those documents called for in the letter of credit, and the bank has a duty to examine the documents in detail.

In connection with guarantees, the situation is in practice somewhat different, since the documents do not have the same

central function. On the other hand, similar considerations may apply. The demand for payment or "calling", which is the terminology often used in connection with guarantees, may be a simple request for payment or may also involve the presentation of certain documents. This is the basic mechanism for these arrangements.

A simple oral demand for payment may lead to unfair or abusive callings, where a beneficiary, who has no "real" legal claim under the underlying contract, nevertheless demands payment under the guarantee. The guarantee may also set out certain requirements in order for payment to be made, such as the presentation of a particular document. This means that if there is a claim for payment under an unconditional on-demand guarantee, the guarantor is not entitled to refuse to pay, instead referring the beneficiary to the primary obligor.

In the case of commercial letters of credit, the documentation is central, but the documents required will vary depending on the circumstances and may comprise invoices, insurance certificates, transport documents of a various nature etc. This is also where there is a significant risk of non-compliance when it comes to meeting the requirements of the letter of credit. In the case of individual guarantees, it nowadays seems to be more common to require more of the beneficiary than a simple demand, and the URDG, in arts. 17 – 21, sets out certain requirements in relation to the demand.

Art. 19 thus prescribes:

> "A demand shall be made in accordance with the terms of the Guarantee before its expiry….."

Art. 20 is in this respect the most important provision:

> "a) Any demand for payment under the Guarantee shall be in writing and shall (in addition to such other documents as may be specified in the Guarantee) be supported by a written statement

(whether in the demand itself or in a separate document or documents accompanying the demand and referred to in it stating:

(i) that the Principal is in breach of his obligation(s) under the underlying contract(s) or, in the case of a tender guarantee, the tender conditions; and

(ii) the respect in which the Principal is in breach….."

The Convention on independent guarantees goes one step further in creating a system with respect to rights, obligations and defences in connection with independent guarantees. Thus article 16 sets out provisions in respect of the examination of demands and the accompanying documents, art. 17 spells out the rule on payment and art. 19 sets out the prerequisites for exceptions to payment.

Once the demand has been made, art. 13 of the UCP 500 imposes a duty on the bank to "examine the documents" with reasonable care. This duty of examination is of fundamental importance. The bank has to accept documents that "on their face" are in accordance with the requirements of the letter of credit and with the UCP, except possibly in the case of fraud. Conversely, the bank has a duty to refuse to accept documents that do not comply. This is the doctrine of "strict compliance". Basically, the bank has to check the documents presented "on their face".[35]

A particular duty on the bank in the case of a guarantee or a letter of credit transaction is to examine the documents on the basis of which payment will be made. Such duty lies with the guarantee bank, the issuing bank and also the confirming bank.

The documents are particularly fundamental in letter of credit transactions and this is also where the bank's duty has been developed most through court decisions. In the case of standby

[35] The concept of a document's "face" has been much discussed in connection with the ongoing revision of the UCP and it is very likely that the relevant provision will disappear or be redrafted. The "face" does not refer only to the front of a document; a general (but not detailed) survey of the reverse of the document is also required.

credits, as well as on-demand guarantees, the documents may play an equally important role, but they are often less complex.

There are thus different rules in the different ICC systems applicable to the various arrangements. The different approaches are, in my understanding, a consequence of the different types of undertaking and their different requirements. A simple demand (whenever that is acceptable, cf. the URDG, art. 20, where certain minimum requirements have been introduced) is very different from a complex letter of credit transaction, where several documents may be involved, which also have to be checked in relation to each other.

Examination of documents must establish both that all documents individually conform with the various requirements but also that the various documents required by the letter of credit are not in any way contradictory in relation to each other. This forms the basis of the so-called doctrine of strict compliance, namely that the bank must not accept documents which are "almost as good as"[36]. There is a question concerning the meaning of "on their face" and, of course, a further question may be raised as to the meaning of the words "to examine with reasonable care".[37]

In the ISP 98, rule 4 prescribes in 4.01:

> "a. Demands for honour of a standby must comply with the terms and conditions of a standby.

[36] This is the expression used in EQUITABLE TRUST CO. OF NEW YORK V. DAWSON PARTNERS LTD (1927) 27 Ll.L.R 49 at p. 52.

[37] In connection with the 1983 revision of the UCP, there were discussions as to whether a level of "super-examination" should be introduced, which would impose on the banks a duty to check e.g. whether a ship had actually called at the port of loading mentioned in the bill of lading as loading port on the date mentioned in the document. However, the costs and delays that would have resulted from such a process meant that it was not, in the end, adopted.

> b. Whether a presentation appears to comply is determined by examining the presentation on its face against the terms and conditions stated in the standby as interpreted and supplemented by these rules which are to be read in the context of standard standby practice."

Rule 4.03 adds:

> "An issuer or nominated person is required to examine documents for inconsistence with each other only to the extent provided in the standby."

In the convention on independent guarantees, art 15 deals with "demands" and states:

> "The beneficiary, when demanding payment is deemed to certify that the demand is not in bad faith and that none of the elements referred to in subparagraphs (a), (b) and (c) of article 19 are present."

Whether this serves to simplify matters is, in my view, questionable, since expressions such as "bad faith" hardly contribute to greater specificity.

6.4 Fraudulent or unfair calling

Some mention should be made of "fraud", "abusive" and "unfair calling" in this context. Whereas traditional financial guarantees are generally dependent on the underlying contract, independent guarantees that are payable on demand may give rise to a number of questions relating to so-called abuse of guarantees or fraud in connection with independent guarantees.[38] This is one of the most frequently discussed problems in connection with on-demand guarantees. The discussion will often centre on whether a beneficiary under an independent on-demand guarantee is entitled

[38] See i.a. Bertrams, R., *op. cit. supra* note 32, Swolin, H.: *Självständiga bankgarantier: Vad innebär de och när kan betalningskrav under dem vägras?* Lund 2004. See also Vinje, *op. cit. supra* note 6, p. 171.

always to obtain payment, or if there are situations where the paying bank can refuse to pay. As a basic rule, the bank has a duty to pay if the documents on their face appear to be in order and, equally, a duty not to pay if this is not the case.

Undoubtedly, there are situations where it may be difficult to say with absolute certainty whether the documents conform or not, but it is one of the primary functions of the banks to make such a judgment on the basis of their examination. One much discussed problem concerns fraud in the letter of credit, or in the transaction, as well as the unfair calling (the abuse) of an on-demand guarantee. This is also where there is a clear distinction between the on-demand guarantee and traditional suretyship. The suretyship is dependent upon the underlying contract and the surety/guarantor is thus entitled to refuse to pay if there is a relevant argument as to why payment should not be made.

Due to the independent nature of a guarantee, payment may be called, although there is no material reason for it, under the underlying contract. It is then a calling of an abusive nature. Other matters that may be of importance concern the duration of the guarantee's validity, since no call should be allowed after this has expired. It should be recognized since neither the letter of credit nor the on-demand guarantee are documents that in themselves need to be presented, from a strictly legal point of view, it should not therefore be necessary to return them to the bank. For practical reasons, however, it is always advisable to return the guarantee/letter of credit to the payor to avoid future abuses.

Both the URDG and the Convention on independent guarantees lay down a principle that there is a duty on the banks to ensure formal compliance with the demand. This stems from the letter of credit principle of strict compliance and the duty of the bank, as stated in art. 13 of the UCP 500, to examine with reasonable care all documents and "ascertain whether or not they appear, on their

face, to be in compliance with the terms and conditions of the credit…"[39] Art 13 also requires that the examination shall be made within reasonable time, "not to exceed seven banking days". The URDG, in art. 19, sets out a requirement that a demand for payment under the guarantee "shall be made in accordance with the terms of the Guarantee before its expiry." Art 20 sets out the requirements for how the demand shall be made.

The Convention on independent guarantees, in art 16, refers to the standard of conduct and the liability of the guarantor/issuer as set out in art. 14: "In discharging its obligations under the undertaking and this Convention, the guarantor /issuer shall act in good faith and exercise reasonable care having due regard to generally accepted standards of international practice….."

Now, going back to the duty of the bank to examine the documents under art. 13 in UCP 500, this duty is one of formal compliance and the bank is not required to look more than superficially at the documents. There is no duty to establish that the terms and conditions in a document that has been presented are in accordance with the underlying contract etc.

Another consideration relates to the actual meaning of "strict compliance". The term means, i.a., that the bank should not accept documents that merely seem to be "as good as"; the documents must in fact comply with the requirements in the letter of credit. There may, however, be a restriction on the bank's duty to pay in cases where the bank is aware of fraud (or similar). There have

[39] The new UCP 600 is believed to make certain changes to this principle. Cf. also the discussion in Debattista, C.: Performance bonds and letters of credit: a cracked mirror image. *Festskrift till Jan Ramberg*, Stockholm 1996 p. 101 *et seq.*

been a number of cases over the years dealing with the question of fraud/abusive calling.[40]

Problems may also arise when the issuing, confirming and negotiating banks etc. have examined the documents and come to different conclusions. There is further potential for conflict where the negotiating bank has asked for the issuing bank's approval, but the issuing bank is late in responding, or later changes its opinion, because it becomes aware of fraud.

Art. 16 of the Convention on independent guarantees states:

> "(1) If it is manifest and clear that:
> (a) any document is not genuine or has been falsified;
> (b) no payment is due on the basis asserted in the demand and the supporting documents; or
> (c) judging by the type and purpose of the undertaking, the demand has no conceivable basis,
> The guarantor/issuer acting in good faith, has a right, as against the beneficiary to withhold payment."

Apparently this text goes somewhat further than the corresponding wording of the then URDG, which in art. 20 is quite specific. There is a risk that the wording of the convention may allow for various subtle distinctions that may not be helpful when making decisions in this respect.

Related matters have been discussed in various cases and it is worth looking at a few of them here.

In the English case of OWEN (EDWARD) ENGINEERING LTD. V. BARCLAYS BANK INTERNATIONAL LIMITED,[41] an on-demand

[40] From case law it is evident that it is not easy to establish sufficient and timely proof of fraud. There is also another related problem, namely that of illegality. How should a call under an on-demand guarantee or a letter of credit be dealt with if the underlying contract is illegal? This problem has been discussed recently in Enonchong, N.: The autonomy principle of letters of credit: an illegality exception? /2006/ Lloyd´s Maritime and Commercial Law Quarterly p. 404 *et seq.*

guarantee had been issued to Libyan buyers. The buyers should have arranged for the issuance of a letter of credit, but this was never done and the buyers called the guarantee. The seller alleged that, in the circumstances, the calling of the guarantee amounted to fraud on the part of the buyers. But the court found, on balance: "The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud, and the bank has notice."

The Owen principle has been applied in a couple of subsequent cases. One was TURKYIE I.S BANKASI A.S. V. BANK OF CHINA[42], where the Turkish Bank had paid out under an on-demand guarantee to the Turkish beneficiary and demanded repayment from the Bank of China as the counter-guarantor. In the circumstances, a substantial time had passed before the Turkish bank finally decided to pay the beneficiary. The Bank of China, as well as the Chinese suppliers, alleged on reasonably good grounds that the Turkish company had acted fraudulently. They also alleged that the Turkish Bank was aware that the beneficiary was not entitled to any payment in the circumstances, since the Turkish company had not performed in accordance with its contractual obligations and knew that it had no basis for calling the guarantee. The court said, *inter alia*:

> "It is simply not for a bank to make enquiries about the allegations that are being made by one side against the other. If one side wishes to establish that a demand is fraudulent it must put the irrefutable evidence before the bank. It must not simply make allegations and expect the bank to check whether those allegations are founded or not …. It is not the role of a bank to examine the merits of allegations and counter-allegations of breach of contract. To hold

[41] OWEN (EDWARD) ENGINEERING LTD. V. BARCLAYS BANK INTERNATIONAL LTD. /1978/ Q.B. 159.

[42] TURKYIE I.S BANKASI A.S. V. BANK OF CHINA /1998/ 1 Lloyd's Rep. 250 (C.A.)

> otherwise would be to place banks in a position where they would in effect have to act as courts in deciding whether to make payment or not."

The court therefore endorsed the payment made by the Turkish bank.

The question came up again in MAHONIA LTD. V. JP MORGAN CHASE BANK AND ANOTHER[43], where the court had reason to embark on a thorough discussion of various related issues.
I do not discuss questions relating to the possibility of obtaining an injunction to prevent a bank from paying under a guarantee in situations of fraud or other serious breach.

7 Concluding remarks

The Norwegian case that forms the basis for this more general discussion on related legal problems did not so much concern the relationship between the financial guarantee and the underlying contract as illustrate the way in which a guarantee is interpreted. In my discussion here, I have considered it important to take into account the underlying contract, as it called for repayment of the amounts paid in advance plus interest.

In this case, the words "documented costs" were used only in the guarantee, not in the underlying contract. A guarantee should be judged on its own merits unless, for some particular reason, it has to be construed against the background of the underlying contract.[44] Only in particular situations will the text of an on-demand

[43] MAHONIA LTD. V. JP MORGAN CHASE BANK AND ANOTHER /2003/ 2 Lloyd´s Rep. 911.

[44] It is not entirely clear from the case report whether the guarantee was of an independent nature or not, as the report does not reproduce the full guarantee text.

guarantee be judged against the background of the underlying contract.

In this case, the courts did not have to take into immediate consideration the relationship between a financial guarantee and the underlying contract. They had, however, to discuss and evaluate the wording of the financial guarantee. During this process the courts, and in particular the Court of Appeal, applied certain traditional principles of contract interpretation (in this particular case Norwegian principles, which are, however, similar to the corresponding principles applied in other jurisdictions[45]) and concluded that there was no basis for allowing the buyer compensation for "documented costs" of the type claimed. There is no doubt that the building contract itself did not give the buyer any right to claim compensation for "documented costs" in the sense claimed by the buyer and, if the court had allowed the beneficiary/buyer payment under the guarantee, the shipbuilder (i.e. in this case the liquidator) would probably have been able to recover such money under the base contract. This also means that an independent guarantee cannot be used to increase liability under the underlying contract, although it may alter the financial risk.

The task of the court was, however, only to interpret the guarantee and its conclusion was that the wording of the guarantee did not encompass the costs claimed by the buyer.

[45] See, for instance, the particular principles set out in Unidroit Principles for Commercial Contracts, 2nd ed. Rome 2005, which contain contract interpretation principles that are basically similar to those principles that have developed in Norwegian law and in other legal system.

Part II

The obligations and liability of the shipper under the UNCITRAL project*

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* This article was originally written for "*Festskrift till Lars Gorton*"

1 Background

In 1996, the Comité Maritime International ("CMI") started discussions that eventually resulted in a "Draft Instrument for the Carriage of Goods [Wholly or Partly][by Sea]", which the CMI presented in 2001. Since then, work on the project has been continued by Working Group III of the United Nations Commission on International Trade Law ("UNCITRAL"). This working group meets twice a year, holding sessions each spring in New York and each autumn in Vienna. By the time of the 2006 Vienna session, the group's preparatory work had reached a point at which reference could be made to a Draft Convention, indicating that the text should reach the adoption stage in the foreseeable future.

The underlying reason for embarking on this project was that the present regimes had either (long since) become old-fashioned (Hague 1924 and Hague-Visby 1968) or were not achieving proper international support (Hamburg 1978, and also the MT Convention 1980). Multimodal carriage and electronic transport records are important aspects in a primarily unimodal regulation, in addition to which the realities of present variations in the use of transport documents have to be considered. Changes in the provisions in existing regimes also seem necessary. For example, the Hague and the Hague-Visby exception of nautical fault for the benefit of the carrier has been considered to be in need of review. This specific change has been debated for at least three decades and was also relevant in adopting the Hamburg Rules. Freedom of contract concerning a certain type of liner trade seems in need of expansion, but this has been a contentious issue.

A number of new features have been introduced in the Draft Convention, compared with the Hague, Hague-Visby and Hamburg Rules.

It was originally intended to introduce certain issues in the international arena in addition to what one has been accustomed to in regulating maritime transport. During the session of the Working Group in New York in 2006, however, voices were raised stating that the Draft Convention was too ambitious and created unreasonable obstacles in trying to achieve a final text within a reasonable time. Such concerns place practical matters before comprehensive harmonization. The idea of certain deletions in the Draft Convention gained momentum. When looking at deletion possibilities, however, the fact is that there is consensus on some points such as freight and right of suit, but not resulting in a considerable reduction of the extent of the Draft Convention.

Many delegations have emphasized the need to regulate matters on jurisdiction and arbitration. For others, looking at the provisions, there are several controversial issues within them. One of the major problems has arisen in the matter of exclusive or non-exclusive forum clauses. There are differing views on how largely exclusive forum clauses should be allowed and to what extent this would be governed by national law. Arbitration provisions are also in the same category of controversial issues, not only in substance as such, but also in view of maintaining coordination with the New York Convention, 1958 (Convention on the Recognition and Enforcement of Foreign Arbitral Awards). All this has led to the need to discuss the possibility to provide future Contracting States to make full or partial reservations on these particular issues, or, to some, as an even better alternative, to provide an opt-in declaration. In the latter case, should this possibility be chosen, passivity by a Contracting State would lead to the jurisdiction and arbitration chapters not being included. Reservations are not allowed in the Hamburg Rules, and the Hague and Hague-Visby Rules have no provisions on jurisdiction and arbitration.

Reservations or opt-in possibilities will decrease harmonization, but may ensure that the really important issues in the Draft Convention on substantive law will be more extensively adopted than in compelling States to include jurisdiction and arbitration provisions.[1] Similar problems could be seen when in 1978 the Hamburg Rules were adopted.[2]

2 Shipper's obligations and liability under the Hague, the Hague-Visby and the Hamburg Rules

It seems quite clear that the shipper's obligations and liability need to be regulated more extensively than under the present regimes of the Hague, the Hague-Visby and the Hamburg Rules.

The Hague, the Hague-Visby and the Hamburg Rules all include some provisions on the liability of the shipper. Only the Hamburg Rules define the "shipper".[3]

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1 For EU Member States, including jurisdiction provisions in the Convention would bring EU decision-making into the ratification process, as the EU has sole competence in matters of jurisdiction.

2 The author suggested in 1997 to amend the Hamburg Rules and provide a possibility of reservations, particularly concerning the jurisdiction and arbitration provisions which were controversial, Honka: New Carriage of Goods by Sea, Åbo 1997.

3 Article 1 paragraph 3 of the Hamburg Rules states that ""shipper" means any person by whom or in whose name or on whose behalf a contract of carriage of goods by sea has been concluded with a carrier, or any person by whom or in whose name or on whose behalf the goods are actually delivered to the carrier in relation to the contract of carriage by sea." This definition has a dual content. Firstly, the shipper is the person that is the contracting party. Secondly, the shipper is the person who actually delivers the goods to the carrier without necessarily being the contracting party. This kind of definition is confusing.

The above-mentioned regimes provide certain rights for the shipper, such as the shipper's right to a received for shipment bill of lading and a right to a shipped on board bill of lading. On the other hand, the concept of "shipper" is ambiguous under the various regimes.

There is no comprehensive approach to the shipper's obligations and liability in these regimes. The provisions can in all of them be divided into the following categories:

1) the shipper's liability for loss sustained by the carrier (or the ship), including loss of or damage to the ship,
2) the shipper's liability concerning dangerous goods, and
3) the shipper's liability related to certain information on the goods.

The wording and approaches vary somewhat between the Hague and the Hague-Visby Rules on the one hand and the Hamburg Rules on the other. As a general outline it can be concluded that the shipper's "general" liability (1) is based on fault. The shipper's breach of the requirement to inform the carrier about dangerous goods (2) results in strict liability, in addition to which there are provisions dealing with the carrier's right to destroy the goods or take other necessary measures. Certain information concerning the goods (3) is combined with the fact that the shipper is deemed to have guaranteed the accuracy of the information. Thus, the shipper is strictly liable for any inaccuracies.

Contrary to the carrier's right to limit his liability *ex lege*, the shipper has no such right of limitation under the above-mentioned regimes. The regimes are one-way mandatory in order to protect cargo interests against unilateral exception clauses initiated by the carrier. There is a right to increase the carrier's liability by contract. But, concerning the shipper's liability there seems to be no mandatory approach in the Hague and the Hague-Visby Rules, cf particularly the Hague-Visby Rules article II and article III.8, while

according to article 23.1 of the Hamburg Rules, dealing with their mandatory nature, reference is made to all provisions of those Rules. According to article 23.2, a carrier may increase his responsibilities and obligations under the Convention containing the Hamburg Rules. No such possibility of increase is explicitly mentioned concerning the shipper.

Nordic case law on the shipper's liability in respect of any of the above-mentioned categories of liability seems almost non-existent.

It is another matter that in voyage chartering the charterer's position is somewhat different in the way that delay caused by the charterer might result in liability. These rules are in the Nordic system independently regulated and separate from issues in liner trade. Further, in voyage chartering the charterer's delay may result in him having to pay demurrage which is due to the allowed laytime having been exceeded. Such arrangements are normal in voyage chartering. The charterer's liability in damages due to delay may not materialise considering the fact that demurrage will catch the loss.

3 Shipper's obligations and liability under the UNCITRAL Draft Convention

3.1 General

As far as possible, reference to particular articles in the Draft Convention has been avoided, as the numbering will be different in the final version.

Preparatory work on certain issues (scope, freedom of contract, shipper, delivery, transport documents etc.) in relation to the Draft Convention was at one stage allocated to different delegations. Issues concerning the shipper's obligations and liability were assigned to Sweden, whose delegate, Mr Johan Schelin, has carried

out extensive informal consultations and provided the Working Group with background information and alternative solutions.

It was mentioned above that the definition of the shipper in the Hamburg Rules is somewhat problematic. It would be preferable to distinguish on the cargo side between the person who concludes the contract with the carrier and the person who actually delivers the goods for carriage. The terms used in the Draft Convention are "shipper" and "consignor" respectively.[4]

The term "shipper", however, has not been sufficiently clarified to resolve all existing problems. A person can be included in the transport document as the shipper, even if the original contracting party on the cargo side is somebody else. It has been considered necessary to clarify the status of such a "documentary shipper" in the Draft Convention. The effect of the provision providing such clarification could be somewhat surprising, and care must be taken on the cargo side not to assume responsibilities unintentionally merely because of a note in the transport document or an electronic transport record.[5] Article 34 of the Draft Convention in the version WP.56, as modified afterwards, regulates the matter by stating that a person identified as the shipper in the contract particulars, although not the shipper as defined in the Draft Convention, that accepts that its name appears on the transport document or electronic transport record is subject to the responsibilities and liabilities imposed on the shipper under the Chapter dealing with the shipper's position (and article 59/WP.56). This documentary shipper is also entitled to the rights and

[4] The "shipper" is defined in article 1 (h)(WP.56) as the person "that enters into a contract of carriage with a carrier". The "consignor" is defined in article 1 (i) (WP.56) as the person "that delivers the goods to the carrier or a performing party for carriage".

[5] A transport document could, according to the definition in article 1 (n)(i) (WP.56), be a mere receipt.

immunities of the shipper. The "contracting shipper's" position nevertheless remains the same.

At one point, the status of documentary shipper was considered to apply if the person concerned merely received or became the holder of the transport document or electronic transport record. The majority view, however, was that liability could not arise only on the basis of a note in a document. Instead, some evidence of intention was necessary, reflected now through the use of the word "accepts".

The shipper's position is at present regulated in Chapter 8 of the Draft Convention (WP.56), which contains provisions concerning obligations and liability. There is a general understanding that the liability provisions will only cover the shipper's obligation in relation to the "contracting" carrier, but originally there was a reference also to performing parties.[6] This means that the shipper's liability in relation to the performing party (not being the contracting carrier) or in relation to the shipowner (not being a performing party) or to other cargo interests or to "outsiders" is not dealt with in this particular Chapter. The Draft Convention is not intended to cover issues that are clearly non-contractual. On the other hand, the relationship between the shipper and a maritime performing party[7] could be counted at least as a quasi-contractual

[6] A "carrier" is presently defined as follows, article 1 (d): "… means a person that enters into a contract of carriage with a shipper".

[7] A "maritime performing party" is presently defined as follows, article 1 (f): "… means a performing party that performs any of the carrier's responsibilities during the period between the arrival of the goods at the port of loading [or, in case of trans-shipment, at the first port of loading] of a ship and their departure from the port of discharge from a ship [or final port of discharge as the case may be]. In the event of trans-shipment, the performing parties that perform any of the carrier's responsibilities inland during the period between the departure of the goods from a port and their arrival at another port of loading are not maritime performing parties". The

relation, even if in many jurisdictions this might not be accepted. Including the relationship between the shipper and the maritime performing party in Chapter 8 (WP.56) was, in any event, considered to overcomplicate the regulation. Any claim by any of the above-mentioned parties, other than the carrier, against the shipper would have to be dealt with on a basis other than the Draft Convention.

At one point, the Draft Convention included references to the shipper's liability for personal injury. This would have been an unjustified expansion of the application of an instrument intended to deal with the carriage of goods. It is quite natural for the shipper, under certain preconditions, to be liable for death or personal injury, but such liability is based in tort and should not be dealt with under the provisions of the Draft Convention. Should the carrier be primarily liable, then he might in a recourse action be able to refer to the contract of carriage and on that basis direct a claim against the shipper. Recourse turns into a contractual issue under the Draft Convention and under the present Chapter 8 (WP.56). However, as will be seen in Chapter 3.4 below, some restrictions will probably be introduced in relation to this issue.

The shipper's position has to be seen in the light of all the liability issues covered in the Draft Convention. The fact that nautical error does not give rise to an *ex lege* exemption for the benefit of the carrier (the same approach that was adopted in the Hamburg Rules) and the fact that there is an intention to explicitly regulate the carrier's liability for delay in the delivery of the goods (once again, the same approach was adopted in the Hamburg Rules) have, when taken together with other parts of the Draft

term "performing party" is defined separately in article 1 (e) and the "non-maritime performing party" separately in article 1 (g).

Convention, clearly put pressure on the regulation of the shipper's role in the contract of carriage.

3.2 Shipper's duty to inform and deliver

In the present consolidated text (WP.56), the order of the provisions is somewhat reversed, as there first is a reference to delivery obligations and then to information obligations. Perhaps it is more appropriate the other way around.

The Draft Convention is intended to be a so-called maritime plus regulation. It contains some provisions for application in multi-modal situations. The Draft Convention in article 1.1 (WP.56) defines a contract of carriage as one where there must be a sea leg, but where another leg may also be included. The Draft Convention is thus planned to be applicable in the multimodal carriage of goods under the preconditions expressed in the Draft Convention, see article 27 (WP.56).

The maritime plus nature of the Draft Convention makes it particularly necessary to define the shipper's obligations in view of optional multimodal movements based on the decisions made by the carrier. On the one hand the shipper has to take into consideration in informing about the goods and in delivering the goods that they may be carried by different means of transport and this makes the proper preparation on the shipper's side more complicated than for a mere sea leg on a known line between two ports. On the other hand, there arises a need to discuss the carrier's role in making it possible for the shipper to inform and deliver in a proper fashion. It has been felt also in more general terms that the obligations of the contracting parties to show mutual loyalty should be expressly mentioned in the Draft Convention. The drafting on this point is not finalised. A good faith requirement in this respect is to be included. The party requesting information shall be provided

with it if the request is reasonable and if the requiring party does not have such information otherwise available.

Originally, the carrier's part of the information duty was connected with a liability rule that was placed in the Chapter on the carrier's liability, but a particular provision of this nature has been considered to unduly complicate the liability issue. The provisions on the carrier's liability for loss of or damage to the goods, and the possible rule on the carrier's delay liability would provide sufficient coverage. It is another matter what probably has to be done, if the issue on carrier's delay liability is totally excluded from the Draft Convention.

Considering the shipper's independent duty of information, this is to include everything that is reasonably necessary for the carrier properly to perform his part of the contract. It is now expressed that the shipper needs to provide to the carrier information necessary for the carrier to comply with rules and regulations of authorities in connection with the intended carriage, provided that the carrier notifies the shipper of the information, instructions and documents it requires. All information has to take place in a timely manner. When the carrier has not only an option to choose the route of the carriage, but also the mode, the reference to "the intended carriage" covers all these options. The requirement of the carrier, in turn, informing the shipper of official documentation and such like matters is in this light a proper way of regulation. The reference to "authorities" might be unclear, and it might have to be clarified. For example, does the reference cover governmental authorities and any other authorities (local etc)?

The above-mentioned information supplied by the shipper is intended for the carrier to comply with the requirements. But, the shipper would also have to provide to the carrier with information in relation to the goods so that the carrier can comply with the requirements issued by the authorities.

Another category of information that must be supplied by the shipper relates to the compilation of contract particulars and the issuance of a transport document or an electronic transport record. Further details are contained in the relevant provision.[8] This particular type of information must be kept separate from the other information supplied by the shipper, as different liability rules are applicable.

The delivery of the goods shall be arranged by the shipper in a way that the goods will withstand the intended carriage. This obligation includes the internal stowage of a container or trailer packed by the shipper. Free in and out (FIO) clauses are taken into consideration under the particular provisions of the Draft Convention, see for the time being article 14 paragraph 2 (WP.56) (and related articles in a future consolidated version) of the Draft Convention. FIO clauses have been extensively debated. The conclusion is that they may affect the liability of the carrier, as specified.

3.3 Shipper's liability except for the carrier's pure economic loss due to delay

In adding explicit obligations in further detail into the Draft Convention, there is a clear possibility that the shipper's liability will be more emphasized and exposed to claimants than has been the case so far. The number of claims against shippers may increase due to the new regulations.

The following discussion deals with the main points concerning the shipper's liability. The special case of the shipper's liability for

[8] See article 30 (c) (WP.56). This provision is probably going to be made into an independent article, see for future consolidation probably article 31bis.

the carrier's pure economic loss due to delay is dealt with separately under sub-chapter 3.4 below.

When it comes to the basis of liability in other cases than the pure delay situations, the outlines in the present regimes are in general terms repeated.

In case the shipper has caused loss to the carrier in the form of physical loss or damage, resulting also in economic loss (thus not pure economic loss), the basis of the shipper's liability is fault, except where special provisions apply. The fault provision has been decided to cover also the shipper's breach of the duty to provide information, instructions and documents to the carrier as are reasonably necessary for compliance with rules and regulations of authorities in connection with the intended carriage, provided that the carrier has timely notified the shipper of the information, instructions and documents the carrier requires. At one point this information duty by the shipper was linked with the shipper's strict liability due to breach, but the proposal was considered too onerous for the shipper, not least considering the reference to the "intended carriage". Such a reference may leave the choice of route and mode fairly open.

There are several open questions, such as burden of proof concerning the shipper's fault.

The shipper's strict liability is combined with, as before, dangerous goods and providing contract particulars on the goods for the issuance of the transport document or electronic transport record.

There has been some discussion in the Working Group on the possible definition of what is to be considered as dangerous goods. It soon turned out that this exercise was futile. There is only a general reference to how this term is to be understood.

The Draft Convention imposes strict liability on the shipper in relation to dangerous goods in two respects: firstly, the shipper

must inform the carrier of the dangerous nature of the goods, as specified above; and secondly, the shipper must mark or label dangerous goods in accordance with any rules, regulations or other requirements of authorities that apply during any stage of the intended carriage of the goods. Breach of either of these requirements by the shipper will lead to liability at least for the carrier's physical loss or damage or any economic loss sustained by the carrier that results from such physical loss or damage. Liability for pure delay is dealt with below.

The policy underlying strict liability is well known from present liability regimes and it is quite natural that there has been no need to modify what has been accepted a long time ago. As carriage of dangerous goods has become more common than before and as goods are carried mostly in consolidated form, the information supplied by the shipper is more important than ever. Carriage of dangerous goods is combined with considerable risks, and it has been thought reasonable that the shipper has strict liability not only relating to the information supplied to the carrier, but also in relation to marking and labelling the goods properly.

Finally, the shipper shall provide certain information to the carrier that is to be included in the contract particulars in the transport document or electronic transport record. There are some differences as compared with the Hague-Visby requirements. The Draft Convention, for one thing, requires the shipper to furnish information in the form of "description of the goods". But, the information for such purposes also includes identification of the party who is to be identified as the shipper, the name of the consignee, if any, and the name of the person to whose order the transport document is to be issued, if any (the same goes for an electronic transport record).

Calculation of compensation is not clarified in the Draft Convention as far as the shipper's liability is concerned. This is left

for national law. Limitation of liability, as is *ex lege* the case in the carrier's liability due to loss of or damage to the goods, is not regulated in view of the shipper, in spite of the fact that the scope of compensation might be substantial, for example, in case of the total destruction of a modern ro-ro vessel. It is another matter that other concerns prevail in cases of pure delay liability.

3.4 Shipper's liability for the carrier's pure economic loss due to delay

There has been debate on whether the carrier's liability for delay in the delivery of the goods should be included in the Draft Convention or not. This contentious issue has since been made into a package debate where it also has been discussed whether there should be a provision on the shipper's liability for the carrier's pure economic loss due to delay or not.

The debate concerning the shipper's possible delay liability is limited to, as said, to pure economic loss. In other words, when the carrier has suffered economic loss as a result of physical loss or damage, then that economic loss is covered by the provisions expressed above. This is true also when delay has caused physical loss or damage.

The question of the shipper's liability for the carrier's pure economic loss due to delay has been contentious to the extent that it has been dealt with still during the Vienna session 2006. The problem derives from the fact that in many jurisdictions, particularly that of the United States, the shipper would have no such liability on the basis of national law. It seems that there has been no difference even when the Hague Rules apply, as is the case in the United States. When in the Draft Convention it has been proposed to explicitly use the word delay in the Chapter on

shipper's obligations and liability, this approach would seemingly change the legal status in those jurisdictions.

Such a change has caused concerns that the shipper's exposure to liability would become unpredictable to an unreasonable extent. It has been suggested that the shipper should either have no liability under the Draft Convention in this respect, or the shipper's liability should be capped.

In working paper WP.74 "Shipper's liability for delay", the Government of Sweden, as head of dealing with this particular issue, has provided an exposé on the alternatives on how to deal with the above-mentioned concerns, taking simultaneously into consideration the need to look at delay as a package deal. This document includes three main options as discussed in the Working Group in different stages. They are the following:

1) There would be delay provisions in the Draft Convention neither for the carrier nor for the shipper
2) There would be delay provisions for the carrier, but no particular references in the Draft Convention to the delay liability of the shipper (for pure economic loss)
3) The Draft Convention would have delay liability provisions both for the carrier and the shipper, as further specified.

The Working Group ended up in mapping out the third alternative in further detail. The starting point as a policy issue (and a political issue) would then be that if there for delay are liability provisions for the carrier, then there must be liability provisions for the shipper. The carrier's liability for delay in the delivery of the goods was decided by the Working Group earlier, but in that connection the limitation level for the carrier was left open. This gap made it possible to look at the delay issue on the whole and as a package.

The carrier may become liable for delay not only under explicit time contracts, but also if there is delay as defined in the Draft

Convention. The carrier is planned to benefit from a limitation of liability which corresponds to, unless otherwise agreed, one times the freight payable on the goods delayed. The total amount thus payable may not exceed the limit that is established in respect of the total physical loss of the goods concerned. For comparison, the Hamburg Rules article 6.1. (b), even if limiting the carrier's delay liability to two and a half times the freight, also states that liability may not exceed the total freight payable under the contract of carriage of goods by sea. The latter addition is not included in the Draft Convention. This has to be kept in mind when comparing the limitation levels between the Hamburg Rules and the Draft Convention. Also, there is no final limit decided as yet in the Draft Convention.

The reference to "unless otherwise agreed" in the limitation provision included in the Draft Convention is at present contentious. Some delegations argue that such freedom of contract allows the carrier to avoid liability for delay altogether under the contract. It is also important to remember that volume contracts in the liner trade are, by virtue of separate provisions, subject to freedom of contract. The particular reference would therefore refer to the rest of the liner trade.

Even if the final solution as to the carrier's limitation right remains open, the above-mentioned outlines have factual influence on the decision of the shipper's delay liability.

The shipper's liability for pure delay has by some been considered problematic for two main reasons. First, the shipper has to provide proper documentation to the carrier for the intended carriage. As documentation requirements are often complicated, particularly considering public maritime security requirements (such as found in the ISPS Code), the shipper runs higher risks for causing delay to the ship than before. Second, the economic loss to the carrier might in a worst-case scenario be extremely high. Such high risk exposure

has not been considered appropriate in the view of many delegations.

In maintaining efforts to include mutual delay liability provisions in the Draft Convention, a compromise – and the only possibly compromise – has been to introduce a cap for the shipper's potential liability. Some delegations have expressed the need to have an overall cap for the shipper relating to all liability, but such a compromise has by the majority been considered to go too far in protecting shipper interests. The presently considered priority is to establish a cap for the shipper, but only in respect of pure economic loss due to delay. Otherwise the shipper's liability under the Draft Convention is uncapped.

When WP.74 established the main choices under the third alternative, limitation alternatives were also considered. They are not only a fairness and risk division question, but would have relevance in the insurability of the shipper's particular delay liability. In WP.74 consideration was given to limitation according to the value or the weight of the goods. In the Working Group debate, limitation according to freight was also introduced. None of these alternatives were in the end considered to be satisfactory, as they could not reflect a fair risk belonging to the shipper. In the end, the Dutch delegate proposed an absolute sum to protect the shipper from extensive risk exposure. In further informal consultations, a proposal was made in Vienna 2006, according to which in case of pure economic loss sustained by the carrier due to delay caused by the shipper, the liability of the shipper for breaches of its obligations under the Chapter dealing with shipper's obligations and liability would be limited to an amount equal to 500,000 SDR per incident. Such a rule is thought to maintain the shipper's liability, but simultaneously the shipper would be protected from extreme liability amounts. This fixed sum could be said to be somewhat arbitrary, but is, on the other hand, linked

with the average freight of a container, being between USD 1,500 and 3,000 per container, as explained by the Swedish delegate.

The question of what would be an acceptable cap was, during informal consultations, considered to be in need of further consideration. The debate continued on these points.

First, it was thought possibly unacceptable that the carrier would have primary liability for delay to one shipper caused by other shippers. In the package solution the carrier would have no liability at all under the Draft Convention in such a case and, therefore, recourse action would not arise. It is difficult to see how such a particular liability would arise for the carrier, him not having vicarious liability covering the shipper. If liability would arise, there would be the carrier's limitation right in view of other shippers, which, as said above, at present is set to one times the freight as specified. Any shipper liability would in a recourse situation benefit from this. In any case, many delegations seem to think that this factual position does not suffice.

Second, the shipper's cap is not applicable if the carrier's pure economic loss due to delay has been caused by the shipper's breach relating to dangerous goods. There seems to be a common understanding in the Working Group that there are no policy arguments that would defend the shipper's limitation rights in such a situation.

Third, the delay liability rules and the cap are not to affect in any way voyage chartering issues dealing with laytime, demurrage and damages for detention.

The absolute shipper's limit is considered to be helpful in the insurability of such a particular liability.

It remains to be seen what the final solution in the Working Group will be, but in Vienna 2006 there was support for the above-mentioned outlines, all delegations well understanding that a compromise was necessary.

As to the carrier's eventual possibility to agree upon the limitation level to his part, there was a balancing factor proposed according to which the shipper's cap would automatically decrease in the same proportion as the carrier would by agreement decrease his maximum liability. Thus, if the carrier would decrease his liability by, say, 25 % from one times the freight (or any other level eventually included in the Draft Convention), the shipper would also automatically benefit from a 25 % reduction in his maximum liability. This proposal was received with interest without any further commitment. One of the problems with such linkage is that there are separate risks, another that the shipper's cap is only applicable to a particular part of his liability, a liability that in practice so far seems to have arisen very rarely, if ever, in many jurisdictions.

4 Some other issues

When looking at the shipper's obligations and liability from a policy point of view, these must be evaluated in the light of the whole Draft Convention. It is full of compromises and no particular question can be looked at separately from the whole package.

In view of the shipper's position, some further comments can be made, considering, nevertheless, what has just been said.

The Draft Convention will be mandatory also for the shipper's obligations and liability in the way that decrease is not allowed. An increase in the obligations and liability would be possible. The Draft Convention may, concerning some particular provisions, state that they are non-mandatory (e.g. "unless otherwise agreed"). It is still an open matter whether a comprehensive provision on the mandatory nature of the Draft Convention concerning the shipper's obligations and liability is accepted, or, whether the nature of the provision is clarified individually. As has been said, there is a

freedom of contract basis included for volume contracts where individual voyages are performed in the liner trade. Under these circumstances the shipper's position may change, just as the carrier's position may change, due to contractual arrangements.

The Hague and the Hague-Visby Rules have no references to time bar as far as the carrier's claims against the shipper are concerned. There are only time bar rules when the claim under that Convention is directed against the carrier, as established in article III.6 subparagraph 3 (one-year time bar as specified). However, a particular provision on the basis of the Visby Protocol deals with indemnity action, see article III.6 bis of the Hague-Visby Rules. Article 20 paragraph 1 of the Hamburg Rules is clearly a two-way time bar rule (two year time bar as specified). It applies both in actions against the carrier and against the shipper provided that the claim is based on the Hamburg Rules.

In debating the time bar question – and its many specifics – the principle was established in Vienna 2006 that any provision in the Draft Convention would have to cover actions both ways. An earlier starting point was to maintain the Hague time bar in actions against the carrier, but now it seems a possibility that there would be a two-way time bar, a two year rule both ways, as specified.

Finally, it may be mentioned that, as said, the planned jurisdiction and arbitration Chapters in the Draft Convention have been under heavy debate. In any case, these particular provisions would only cover claims against the carrier and the maritime performing party, but not claims against the shipper. Even if a Contracting State would decide to apply these Chapters, national jurisdiction and arbitration rules would prevail when a claim would be directed against the shipper, unless the carrier is seeking for a declaration of non-liability.

Many issues have been omitted from the above discussion. It is nevertheless clear that there have been, and there still are, some

major obstacles to be overcome before a final solution can be found in respect of the shipper's obligations and liability. It is, however, also clear that any future discussion will be based on the considerations outlined above. The debate over the shipper's position reflects the debate in the Working Group in more general terms. Success depends on delegates' willingness to search for and accept reasonable compromises. Without such an attitude, a final Convention will never be adopted.

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Part III

Maritime product liability

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1 Introduction

Product liability within the field of maritime law has attracted little attention in the Scandinavian legal systems. If a ship suffers from a defect and causes damage, claims for property damage and personal injury are handled by means of maritime law rules. In such cases, however, it is worth considering whether the rules regulating product liability offer a relevant alternative.

In other legal systems, this line of thought is not unfamiliar. In American law, "maritime product liability" forms an independent discipline[1] and cases concerning maritime product liability are regularly brought before the courts.

Product liability rules may be of interest to the injured party because liability under these rules is unlimited. In contrast, liability under maritime law is almost always subject to limitation.

As a consequence of EU regulation, the product liability rules in Danish law basically form a dual system. Product liability is thus to some extent regulated by the Council Directive of 25 July, 1985 (85/374/EEC) on liability for defective products ("the directive"). In addition, product liability is regulated by ordinary national rules on liability, i.e. the law of negligence. The directive contains rules on liability for personal injury and damage to consumer items. Consequently, a distinction has to be made between, on the one hand, cases of personal injury and damage to consumer items, as these are covered by the rules in the directive, and, on the other, damage to business items, as this is covered by the ordinary, national law of negligence.

[1] See notably, Robert Force, Maritime Products Liability in the United States, 11 Mar. Law. 1. (1987). Under American law, the development of this area of the law into an independent discipline has had to do with procedural aspects.

This article seeks to deal with two aspects of maritime product liability. While its overall theme concerns questions of liability that arise when a ship causes damage due to a defect,[2] the focus is firstly on the liability of the manufacturer, i.e. the shipyard, under product liability rules, as compared to the liability of the shipowner under maritime law rules (Section II), and secondly on the possible liability of the shipowner under product liability rules (Section III).

2 Product liability of the manufacturer (the shipyard)

2.1 Is a ship a product?

For the product liability rules to apply, it must be possible to classify the thing causing damage as a "product", cf. art. 1 of the directive. In relation to maritime product liability, the question is whether a ship can be categorised as a "product". According to art. 2 of the directive, a "product" means "all movables". It seems clear that at least smaller transport objects, e.g. cars, fall within the concept of a "product" as defined in the directive. It is slightly less clear whether larger transport objects are also covered. Large ships and aeroplanes are subject to a separate set of registration rules that apply in relation to property law issues. These rules resemble the system applicable to immovables (as opposed to movables). This cannot, of course, be decisive in the context of the applicability of the product liability directive. It could be added that, in other contexts, large transport objects are subject to the rules regulating

[2] Maritime product liability also raises the question of the application of product liability rules when it is the goods being transported that cause damage. This aspect of maritime product liability law is not dealt with in this article.

movables. For instance, in the absence of specific contractual regulation, the ordinary rules of the sale of goods act apply when a ship is sold.[3] In addition, the preparatory work in relation to the former Norwegian product liability act supports the assumption that a ship qualifies as a "product under the directive" Thus, under the former Norwegian product liability act, transport objects were expressly exempted from the application of the act.[4] However, when Norway entered the EEA, the exemption was abolished as being inconsistent with the directive. This shows that transport objects in general were considered to be "products" by the Norwegian legislator.[5] Against this background, it seems quite obvious that a ship must be considered a "product" under the directive.

2.2 Different types of damage[6]

2.2.1 Damage to the goods being transported

A defect in a ship may result in damage to the goods being transported. For example, a leak may cause the goods to be damaged by seawater. In such circumstances, the owner of the goods has a claim against the carrier, provided the conditions in § 275 of the Danish Carriage of Goods by Sea Act (Danish COGSA) are fulfilled. According to § 274, the carrier is liable under the rule

[3] Falkanger og Bull, *Innføring i Sjørett*, 6. udgave, 2004 (Falkanger and Bull) p. 63.

[4] See NOU 1980:29, p. 99.

[5] See also Lett og Macholm, *Produktansvaret i praksis*, 2002 (Lett and Macholm), p. 38.

[6] In this article, the focus is on three types of damage, namely: damage to the goods being transported; injury to passengers; and damage to third parties. The question of the application of the product liability rules in relation to damage to the ship itself is not dealt with.

of negligence with a reversed burden of proof. Thus, in the case of a leaking ship, the carrier will be liable unless he can prove that he was unable to prevent the goods from being damaged. However, the damages payable are limited pursuant to §§ 279 and 280. If the owner of the goods is not (fully) compensated for his loss under these rules, the question arises of whether he can instead claim compensation, on the basis of the product liability rules, from the manufacturer of the ship (the shipyard).

According to the product liability rules, the manufacturer is, under certain conditions, liable for losses caused by a defective product he has put into circulation. Damage caused to consumer items comes within the scope of the directive and liability is strict. However, damage to goods during transport will normally be categorised as damage to business items. Thus, according to article 9 of the directive, damage is defined as: damage to an item of property, provided the item of property: (i) is of a type ordinarily intended for private use or consumption; and (ii) was used by the injured person mainly for his private use or consumption. Although goods being transported are often intended for private use or consumption (e.g. food), the goods are not being used for private purposes or consumption at the time they are in transit and suffer damage. On the contrary, when the goods are in transit, they are being used for commercial purposes. Consequently, damage is not normally covered by the directive and a product liability claim against the shipyard must be based on the ordinary law of negligence. This means that the shipyard is only liable if the owner of the goods can prove that the shipyard acted negligently in manufacturing the ship. In Danish law, a highly objective standard of negligence is applied, cf. U 1999.255 H. In some cases, however, damage caused to the goods may qualify as damage caused to consumer items. This would probably be the case, for instance, if the goods being carried consisted of furniture belonging to a

consumer who was moving from one place to another. In this case, the shipyard would be strictly liable under the directive.

If the manufacturer is liable under the directive, or under the law of negligence, it must be assumed that he is liable for the full loss. Thus, although the limitation rules contained in § 281, sec. 2 apply not only in relation to the carrier, but also in relation to persons of whose services the carrier makes use for the performance of the carriage, the manufacturer of the ship can hardly be seen as a person "of whose services the carrier makes use". Consequently, the shipyard cannot be seen as someone for whose acts the carrier is responsible, according to § 171, sec. 2.[7]

2.2.2 Injury to passengers

According to the Danish COGSA § 418, sec. 2, the owner/carrier is liable for personal injuries suffered by passengers if he has acted negligently. However, if the injury is due to non-conformity of the ship, the burden of proof is reversed, cf. § 421, sec. 2. If the ship suffers from a defect, it will generally also be categorised as non-conforming and thus the carrier's liability will be based on a presumption of fault. However, the amount of damages payable will be limited, see § 422, sec. 1. If the injured passenger cannot obtain (full) compensation from the carrier, the product liability rules may offer a relevant alternative. In the case of personal injury, the situation comes within the scope of the directive and liability is strict. A disclaimer in the contract between the shipyard and the owner of the ship will not have any effect in relation to the passenger, cf. also art. 12 of the directive. As in the case of damage to goods during transport, the shipyard cannot be seen as someone for whose acts the owner is responsible, according to § 427, sec. 1.

[7] If the ship has been repaired, it is possible that the repairer can be regarded as such a person, see Falkanger and Bull, pp. 153-154.

Consequently, the limitations in COGSA will not apply to a claim against the shipyard based on product liability rules. Thus, in a case of personal injury, a claim based on the product liability rules is an attractive alternative to proceedings based on the rules in COGSA.

2.2.3 Damage to third parties and the environment

The product liability rules may also offer an attractive alternative to the maritime law rules where a third party suffers damage due to a defect in the ship. According to COGSA § 151, the owner of the ship is liable for damage caused by negligent acts. There are no special rules dealing with cases of damage caused by defects.[8] In Danish law, it also seems clear that no special rules have been developed through case law. Thus in ND 1995.163 DH, concerning damage caused by a defect in the ship's steering system, liability was based on the law of negligence.[9] Where damage is caused by a collision, liability is similarly based on the law of negligence. This is also the case if the collision is caused by a defect in the ship. In Danish law, this was confirmed in U 1994.785/2 H, which also concerned a defect in the steering system. In the case of damage to third parties, the liability of the shipowner may be limited according to the rules in COGSA, chapter 9 (the global limitation rules).

As for the product liability rules, the relevant set of rules may either be that contained in the directive or the ordinary product liability rules as developed in case law. In cases of personal injury,

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[8] Cf. above in relation to § 421, sec. 2.

[9] In contrast, it does not seem quite clear to what extent Norwegian case law recognises a special type of liability in these cases. See ND 1921.401 NH (NEPTUN), ND 1952.320 NH (SOKRATES), Nd 1969 389 (LAGODALES), but cf. ND 1973.348 (UTHAUG). See, Selvig, *Erstatningsberegningen ved lasteskader*, Handelshögskolan i Göteborg, Skrifter 1962:2, 1962 (Selvig) p. 420.

the directive will apply, imposing strict and unlimited liability on the shipyard, cf. above. Liability is also strict if damage is caused to consumer items, for instance smaller boats in private use or luggage belonging to passengers on board the ship.[10] In the case of damage to other kinds of property, the relevant rules will be the ordinary rules developed in case law. Accordingly, liability will be based on negligence. In such cases, the application of the product liability rules will therefore be advantageous if it is not possible to prove negligence on the part of the shipowner or if the claim against the owner is subject to limitation.

A separate issue is whether damage caused to the environment to some extent can qualify as "property damage" under the product liability rules. As a general rule, it seems that environmental damage to surroundings that are not in private ownership (such as the sea, beaches, woods, etc.) is not classified as property damage.[11] Thus, as a starting point, the product liability rules must be considered inapplicable in cases of, for instance, oil pollution at sea caused by a defect in the ship. However, if the surroundings that are damaged are in private ownership – e.g. a private beach – it seems likely that the damage could be classified as property damage.[12] Consequently, it must be assumed that the product liability rules would apply.

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[10] In the case of damage to consumer items the liability under the directive is not entirely unlimited, cf. art 9. litra (b).

[11] Hellner, *Skadeståndsrätt*, 7th. ed., 2006 (Hellner, Skadeståndsrätt) p. 337.

[12] Hellner, *Skadeståndsrätt*, p. 337. As to the concept of ownership in relation to environmental damage, see Pagh, *Miljøansvar – en ret for hvem?*, 1998, pp. 139-140.

2.3 Recourse actions

If the shipyard is liable towards the injured party on the basis of product liability rules, the next question is whether the shipyard can bring a recourse action against the shipowner. It is necessary to distinguish between two situations. Firstly, a recourse action might present itself as an option if not only the shipyard, but also the shipowner, were liable towards the injured party (liability *in solidum*). Secondly, a recourse action might be based on the contract between the shipyard and the shipowner if the contract contains a disclaimer on the part of the shipyard. If there is liability *in solidum* between the parties, for instance because the shipyard acted negligently in manufacturing the defective ship, whereas the shipowner acted negligently because it failed to discover the defect, then the shipyard might be able to bring a recourse action against the shipowner, according to the ordinary rules relating to damage caused by more than one tortfeasor. However, the claim against the shipowner will be limited pursuant to COGSA § 176, s. 3, as the shipyard's claim will be based on subrogation (the shipyard subrogating the claim of the injured party against the shipowner). If, on the other hand, the shipowner is not liable towards the injured party, because he has not acted negligently, the question is whether a recourse action can be based on a disclaimer in the contract between the shipyard and the shipowner. The shipbuilding contract between the parties will often contain such a disclaimer. Thus, the standard shipbuilding contract 2000, in art. 10 (3rd sentence), states that: "The builder shall rectify the defect or cause the defect to be rectified at its own costs. Provided the defect is remedied within reasonable time, the builder shall have no other liability for any damage or loss caused as a consequence of the defect, except for repair or renewal of the Vessel's part/parts that have been damaged as a direct and immediate consequence of the defect without any intermediate cause, and provided such part or

parts can be considered to form part of the same equipment or same system…" Of course, this disclaimer covers actions brought by the shipowner against the shipyard.[13] What is less clear is whether the disclaimer also covers claims brought by the shipyard against the shipowner. The question of whether this kind of "reversed recourse action" can be brought has been raised previously in a different, but comparable, context. In the case ND 1961.325 NH, the shipowner had paid damages to the owner of the goods on the basis of the terms in the bill of lading. The Norwegian Supreme Court rejected a claim brought by the shipowner, in the form of a recourse action against the charterer on the basis of a disclaimer in the contract between the parties. The court's reasoning was that there was no express provision in the contract allowing for a reversed recourse action and that it would have been natural for the parties to make such provision if they had intended such an option to be available. As a starting point, the same line of thought seems to be applicable in relation to product liability. However, it might be argued that while it is foreseeable for the parties that the shipowner might be met with a claim based on the bill of lading, it is less foreseeable that third parties might make claims directly against the shipyard based on the rules regulating product liability. If it assumed that a recourse action will be allowed, the next question is whether the claim will be subject to limitation under the COGSA. According to the Danish COGSA, chapter 9, the global limitation rules apply to contractual as well as tortious claims. However, not all contractual and tortious claims are covered by the rules in chapter 9. They only apply to the types

[13] This is true to the extent the disclaimer is valid. There may be doubt as to whether this is the case if the recourse action against the shipyard is based on the fact that the shipowner has become liable for personal injury. According to art. 13 of the directive, liability for personal injury cannot be disclaimed in respect of the injured party.

of claim mentioned in COGSA § 172. According to sec. 1, no. 3 certain claims,"in respect of other loss resulting from infringement of rights other than contractual rights" are covered. When the recourse action against the shipowner is based on the disclaimer in the contract between the parties, the claim must be regarded as contractual. Consequently, this provision does not provide for limitation of the claim. Thus, since the claim is contractual, the relevant provision must be found in § 172, sec. 1, no. 1. This provision under certain conditions covers claims "in respect of loss of life or personal injury or loss of or damage to property". Judging from the wording of the provision, it seems questionable whether a recourse action that is generated by either personal injury (e.g. injury to passengers) or damage to property (e.g. damage to goods during transported) falls into this category. However, according to art. 2, para. 2 of the Convention on Limitations[14], the claims set out in para. 1 shall be subject to limitation of liability even if brought by way of recourse or for indemnity under a contract or otherwise. It has been assumed that the same rule applies in Danish law.[15] Presumably this must be taken to mean that claims brought as recourse actions by the shipyard against the shipowner will also be subject to limitation under these rules (chapter 9 of the Danish COGSA). In contrast, the claim will not be subject to limitation under §§ 279 and 280 (in the case of damage to goods) or §§ 422 and 423 (in the case of passenger injury), since these provisions only cover claims based on contracts of carriage. The contract between the shipyard and the shipowner is not a contract of carriage, but a shipbuilding contract. Consequently, a product

[14] The Convention on Limitation of Liability for Maritime Claims, 1976 as amended by the 1996 Protocol.

[15] Bredholdt, Martens & Philip, Søloven, 3rd ed., 2001 (Bredholdt & others), p. 190.

liability claim against the manufacturer can indirectly have the effect of "disturbing" the system that limits liability in maritime law.[16]

3 Product liability of the shipowner

The rules on product liability apply to the manufacturer of the product. Normally, only the shipyard will be classified as the manufacturer of the ship and the shipowner will only be subject to the rules of maritime law. However, under certain circumstances, the possibility that the shipowner may acquire the status of a "producer" under the directive cannot be ruled out. According to art. 3, para. 2, a "producer" comprises "any person who imports into the Community a product for sale, hire, leasing or any other form of distribution in the course of his business".[17] As it is not uncommon in the shipping trade for ships to be bought in non-member states and imported into the Community, it seems that the shipowner may potentially be a "producer" within the meaning of art. 3. The decisive point is whether the ship is acquired with a view to "sale, hire. leasing or any other form of distribution". This provision must be read in the light of art. 7, litra (a), which establishes that it is also a requirement for the producer to have put the product into circulation. It must be assumed that a product will be regarded as being put into circulation if it is either sold, hired out, leased or "in any other way" distributed in the course of the shipowner's business. It is obvious that the shipowner must thus be regarded as a "producer" of the ship if he has imported it into the

[16] This was the problem foreseen in the preparatory work to the former Norwegian product liability act, see NOU 1980:29, p. 99.

[17] It is doubtful whether the same concept of a "producer" applies outside the scope of the directive under negligence-based, national product liability rules.

Community and leased it out. The question is whether the shipowner should also be regarded as a "producer" if he has put the ship on charter (time charter or voyage charter). It could be argued that the shipowner has more control over a ship that is chartered out, as the shipowner still has "the nautical control" of the ship, than in the case of leasing or hire arrangements. However, taking the case law of the ECJ into consideration, it seems likely that the shipowner will also be regarded as a producer in cases of chartering, as in C-203/99, the ECJ interpreted the concept of "being put into circulation" very broadly. Against this background it must be assumed that the shipowner will, in some circumstances, be regarded as "the producer" in the sense intended by the directive.

The liability of the shipowner seems therefore to be regulated by two sets of rules simultaneously if damage or personal injury is caused by a defect in the ship. The rules of maritime law will apply to the shipowner in his capacity of shipowner, whereas the rules of product liability will apply in his capacity of "producer" under the directive. How can the clash between these two sets of rules be reconciled? The very nature of a directive must mean that the consumers to whom it applies must always have the option of relying on its rules. Thus, consumers injured by defective products must always have the option of relying on the rules of the product liability directive. At the same time, it follows from the maritime law rules that these rules must take precedence over other rules as regards *(inter alia)* questions concerning limitation. Thus, in relation to passenger injury, it follows from § 425 of the Danish COGSA, reflecting the rules in the Athens Convention, that the limitation rules apply whatever the basis of liability. Equally, § 172, sec. 1 of the Danish COGSA, reflecting art. 2, para. 1 of the Convention on Limitations, provides for the precedence of the limitation rules of maritime law over other rules. Obviously this

requirement, for the maritime law rules to take precedence over other rules, cannot be reconciled with the requirement imposed by the directive that injured parties should always have the option of claiming under it. In other words, there seems to be a clash between EU law and international law.

As a starting point the solution to this problem can be sought in the EC Treaty art. 307 (previously the Rome Treaty art. 234). According to this article, Member States are allowed to uphold rules that conflict with EU law, provided the national rules are dictated by international obligations assumed by the Member State before its entry into the EU. The Convention on Limitations was concluded in 1976 and amended by the 1996 Protocol, but Denmark became a member of the Community in 1972. As a starting point, therefore, the rules in the Danish COGSA § 172 that reflect the convention and require the precedence of the maritime law rules cannot be upheld. However, in legal literature it is assumed that art. 307 in the EC Treaty must be interpreted to mean that international obligations assumed after the entry of a Member State into the EU can also be upheld. [18] This, however, cannot be the case when the international obligation has been assumed by the member state after the entering into force of a conflicting EU directive. In this case, the member state has lacked external competence in the area of law covered by the directive. Consequently, since the directive on product liability was adopted in 1985, the maritime limitation rules reflecting the 1996 Protocol must be interpreted as not covering product liability issues. This means that the rules limiting liability in chapter 9 will not apply in a product liability case against the shipowner. As to the rules of the Athens Convention concerning passenger injury, this convention has not been ratified by Denmark. The rule in COGSA § 425 is

[18] Gulmann & Hagel Sørensen, *EU-ret*, 3rd. Ed 1995, p. 238. .

thus not dictated by international law and is therefore not "protected" by art. 307 of the EC Treaty. Consequently, it must be assumed that the injured party is free to claim against the shipowner on the basis of the product liability rules as an alternative to the rules in COGSA. Such a course of action may be attractive to the injured party, since liability under the product liability rules is strict and unlimited, as opposed to the negligence-based and limited liability imposed by maritime law rules.

4 Conclusion

In conclusion, the option of applying product liability rules in the context of maritime law seems to have been overlooked in the Scandinavian legal systems. First and foremost, when damage or personal injury is caused by a defect in the ship, the possibility of suing the shipyard as the producer of the ship is an attractive alternative to suing the shipowner under maritime law. This is because liability under the product liability rules is not subject to limitation. In particular, the product liability rules may seem attractive in personal injury cases because here the directive imposes strict liability on the producer. Claims against the shipyard based on product liability may result in a recourse action brought by the shipyard against the shipowner. Only in some cases will such a claim be subject to limitation under maritime law. Secondly, under certain circumstances, also the shipowner can be sued under the rules governing product liability. In this case the Danish maritime law rules limiting the shipowner's liability will not apply if the case concerns personal injury.

Part IV

Limitation Funds and Regulation (EC) 1346/2000 on Bankruptcy

Judge Henrik Bull,
EFTA Court[1]

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1 National Approaches to Domestic and Foreign Bankruptcies: An Unfortunate Combination

Traditionally, states tend to take an approach to the international effects of bankruptcy proceedings that at first sight may seem unprincipled: while their own bankruptcy proceedings are deemed to apply to the worldwide assets of the debtor, foreign bankruptcy proceedings are not recognised as having any effect with regard to assets located on the territory of the state. States may practise some exceptions to both principles, but universal effect for their own bankruptcy proceedings and non-recognition of foreign ones remain the general rule.

The universal aspirations of the state's own bankruptcy proceedings are easily explained by the need of the estate to disinvest the debtor of as many of his assets as possible in order to satisfy the creditors to the best possible extent. As a corollary to this, the claims of foreign creditors are usually accepted on an equal footing with the claims of domestic creditors. However, some claims, such as foreign tax claims, may not be recognised, and foreign creditors may in any case be at a disadvantage from a practical point of view, with regard to information about the bankruptcy proceedings, the need for translation etc. Some states also allow bankruptcy proceedings that are purely domestic with regard to assets claimed by the estate, but then only domestic creditors may be allowed to participate, or at least may enjoy preferential rights. In any case, such proceedings are not the norm when bankruptcy is declared against a debtor at his principle place of business. The principle of universalism seems to be the norm in this case.

On the other hand, it is natural to consider the opening of bankruptcy proceedings against a person as an exercise of public authority by the state. The debtor is disinvested of his assets regardless of his own will. The bankruptcy may also have negative consequences for some of his creditors. Although insolvency, which is the usual precondition for bankruptcy, implies that the debtor will not in any case be able to satisfy all his creditors in full, some creditors may still have been better off if no bankruptcy had been declared. For legal or practical reasons, they may have had an advantage over the other creditors and the bankruptcy may put an end, wholly or in part, to those advantages. Although mortgages are usually respected in bankruptcy, the mortgage creditor's rights may be curtailed to a certain degree. The right to set-off of a creditor who also owes money to the debtor may not be recognised by the estate. These are just a couple of examples of the legal consequences of bankruptcy, which may vary from state to state. The debtor's wish to preserve certain business relationships for the future, by paying at least some of his business partners in full, may also count for little with a liquidator who is winding up the debtor's business activities. From this perspective, it is natural for states to apply the same principle to foreign bankruptcy proceedings as they apply to the exercise of public authority by other states in general: for reasons of sovereignty, and also in order to protect their own undertakings and citizens against possible unfair treatment, such proceedings are not recognised as having legal effect on the territory.[2]

[2] However, courts or administrative authorities may sometimes accept, when settling a preliminary question before making their own decision, that a party involved in the case is under certain legal obligations, or has certain rights, of a public law nature according to foreign judicial or administrative decisions. This preliminary recognition may have certain consequences for the outcome of the case. This is not the same thing as recognising foreign

Thus, when the approaches taken by the state to its own bankruptcy proceedings and foreign bankruptcy proceedings are considered in isolation from one another, both approaches are perfectly understandable.

However, it is also easy to see that the combination of the two approaches is not a good solution in all respects: the principle of universalism is frustrated for all states through their own non-recognition of foreign bankruptcies. The more closely integrated economies become, the bigger the problem. The recognition of foreign bankruptcies may be an acceptable price to pay for achieving universality for one's own bankruptcies – provided, however, that the legal effects of the foreign bankruptcy proceedings are acceptable with regard to their substantive content. Since most states take their own law as a yardstick for deciding what is fair and equitable, this means in practice that the effects should not be too dissimilar to the effects of domestic bankruptcies.

2 The EC Solution

No wonder then that the EC started work on a system of mutual recognition of bankruptcy proceedings within the Community as early as the 1960s. In addition to instituting complicated rules on the mutual recognition of bankruptcy proceedings, the system also contained rules on harmonisation of such matters as set-off and avoidance. However, the draft treaty, which was ready in 1971, came to nothing. The general assumption seems to be that this was because the treaty was simply too ambitious in its aims; the Member States were simply not ready for this kind of harmonisation.

decisions as such as having their intended effect, under foreign law, on the territory of the state.

It was only in 2000, through Regulation 1346/2000, that the EC managed to institute a system of mutual recognition of bankruptcies, with the result that a bankruptcy will have universal effect throughout the Community.[3] This was achieved without any attempt at harmonisation of bankruptcy law.

It is the Member State in which the debtor has his centre of main interests that will be competent to open bankruptcy proceedings with such universal effect.[4] According to Article 4, several of the central issues in a bankruptcy will also be governed by the law of that state, the *lex concursus*. These include matters such as determining those assets which form part of the estate, avoidance and the conditions under which set-off may be invoked.

Without any attempt at harmonisation, this is a bold approach. However, Member States' mutual recognition of each other's bankruptcy law is not absolute: according to Articles 5 to 15, several important issues shall either be governed by the law of other states (such as the rights to acquire or use immovable property, which are, not surprisingly, to be governed by the law of the Member State in which the property is situated)[5], or may be invoked by a party if they would give him a more favourable solution than the *lex concursus* (for instance with regard to set-off if the law applicable to the insolvent debtor's claim provides the other party with a more favourable right than under the *lex concursus* to set off his own claim against the debtor's)[6]. Some rights are simply not to be affected by the opening of bankruptcy

[3] Denmark is not bound by the Regulation due to its "Maastricht reservations". The Regulation does not form part of the EEA Agreement, which binds Norway, Iceland and Liechtenstein to the rules governing the internal market of the EU.

[4] See Article 3 and Articles 16–18.

[5] Article 8.

[6] Article 6.

proceedings. This is the case with rights *in rem*.[7] As most states will apply the *lex rei sitae* to such rights on the one hand, and the debtor will be disinvested in relation to those assets according to the main rule of *lex concursus* on the other, the solution in practice is that the estate will have to respect the rights *in rem* at the place where the assets are, but can otherwise administer and dispose of the assets. Reservation of title is also not affected by the opening of insolvency proceedings against the purchaser of the goods where, at the time of the opening of proceedings, the asset is situated within the territory of a Member State, other than the State in which the proceedings were opened.[8]

There are also other exceptions to the main rule of *lex concursus* that relate to such matters as employment contracts and transactions through payment systems and in financial markets. However, such exceptions fall outside the scope of this article.

In addition to choice-of-law rules that point to another applicable law than the *lex concursus*, there is also one other means by which a creditor (or other person) may avoid the application of *lex concursus* to a particular asset in which he has an interest. This is the opening of secondary insolvency proceedings pursuant to Articles 27–38 of the Regulation. Such proceedings will only have effect in respect of assets that are situated in the state where the secondary proceedings are opened,[9] but with regard to those assets, the issues regulated, according to the Regulation, by the *lex concursus* will now be regulated by the law of the state where the assets are situated, rather than the law of the state in which the primary proceedings take place.[10] One reason why a

[7] Article 5.

[8] Article 7.

[9] Articles 3(2) and 27.

[10] Article 28.

creditor may want to request the opening of secondary insolvency proceedings may be to retain a privileged position that he enjoys under the law in that jurisdiction, but which he does not enjoy under the law of the state in which the main proceedings are taking place, and which is also not protected by the specific exceptions to the *lex concursus* rule contained in Articles 5–15 . The creditor's privileged position will then only apply in relation to the assets located in the state where he has opened secondary proceedings, but under the circumstances that may be quite sufficient, precisely because of the creditor's privileged position.

However, the problem for the creditor may be that secondary insolvency proceedings may only be opened in states where the insolvent debtor has an establishment.[11] With regard to assets situated in other states within the Community, a creditor will have to accept the consequences under the law of the main proceedings, unless an exception can be found in Articles 5–15.

As follows from the description above, those exceptions generally mean that it is the applicable law in the Member State in which an asset is located that will regulate the rights of the estate in relation to creditors with a special interest in the asset. The reason for this, of course, is that even though the exceptions may be common to all, or many, of the Member States when they are considered as broad categories – rights *in rem*, for instance – the exact scope of the exception may vary. Typically, the system of security rights and their status in bankruptcy may differ significantly from Member State to Member State. There is no Community policy of harmonisation in this field.

[11] Article 3(2).

3 Limitation Funds: The Problem

This leads us to a particular feature of maritime law. Under international conventions on limitation of liability, limitation funds are set up to cover claims for damage and should only be available for payment of claims subject to the limitation of the shipowner'sliability. This means that, if a shipowner who has established a fund is declared bankrupt, the fund may not be amalgamated into the bankruptcy estate for distribution among all creditors on equal terms. This is so even if, under a "pay-to-be-paid" clause in the insurance contract, the fund formally only exists to reimburse the shipowner in respect of his payments to the injured parties, without the injured parties having any direct claim against the insurer.

There is no choice-of-law rule in Regulation 1346/2000 dealing with limitation funds. It would seem that none of the exceptions to the main rule of *lex concursus* would apply: the principle of exclusive use of the limitation fund can hardly be characterised as a right *in rem* (Article 5 of the Regulation); nor as a reservation of title under Article 7, which in any case does not protect against avoidance actions. This leads us back to the main rule of *lex concursus*. However, the situation here is much the same as it is with regard to those situations for which the Regulation does have choice-of-law rules derogating from the main principle of *lex concursus*: for the time being, there is no common policy in the Community on limitation funds. Nor are the Member States, of their own initiative, party to the same conventions on limitation of liability, and some may not be party to any of the conventions.

In order to simplify the following discussion, it is restricted to the 1976 Convention on Limitation of Liability for Maritime Claims (the "1976 Convention" or the "Limitation Convention") and the 1996 Protocol thereto. However, the problem would be the same

with regard to all limitation funds that formally only serve to reimburse the shipowner for his payments to the injured parties. (If the fund is set up by the insurer and the injured parties have a direct claim against him, it is likely that the fund would not be considered to belong to the bankrupt debtor's assets at all and consequently not be subject to the disinvestment caused by the bankruptcy. Still, according to Regulation 1346/2000, this is a matter to be governed by the *lex concursus*.)

Let us assume that a ship has caused damage that falls within the scope of the 1976 Convention in EU Member State A. The shipowner, who is liable for the damage, has established a limitation fund in that state in order to have the ship released from an arrest initiated by the injured parties.[12] Under Article 11(1) of the 1976 Convention, and consequently also under the law of Member State A, the fund shall only be available for the payment of claims in respect of which limitation of liability may be invoked. It also follows from Article 14 that the rules relating to the constitution and distribution of the fund shall be governed by the law of the State Party in which the fund is constituted.

According to normal practice, the shipowner's insurer issues a guarantee covering the liability in respect of which limitation is claimed, and as each claim against the shipowner in respect of the incident is decided, it is the insurer who actually pays out the money awarded to the injured parties on behalf of the shipowner. However, this is a purely practical arrangement. Under the "pay-to-be-paid" clause of the insurance contract, which is recognised as valid in Member State A, the injured parties have no direct claim against the insurer. Formally, the payments made by the insurer to the injured parties may be seen as an assignment by the shipowner,

[12] Cf. Article 13(2) of the 1976 Convention.

who is acting as assignor of his claim against the insurer, with the injured parties as assignees.

Then, shortly after the insurer has paid out according to the guarantee, the shipowner is declared bankrupt in EU Member State B. The shipowner has his centre of main interests in EU Member State B, and does not even have an establishment in Member State A. This prevents secondary bankruptcy proceedings from being opened against the shipowner in Member State A. Had that been the case, the secondary bankruptcy proceedings would have included the limitation fund and would have been governed by the law of Member State A as *lex concursus*, see Section 2 above.

The liquidator of the estate sets his eye on the sums paid out to the injured parties. According to Article 4(2)(m) of Regulation 1346/2000, avoidance is to be governed by the *lex concursus*. Under the rules on avoidance in Member State B, assignments such as this may be voidable transactions. Certain prerequisites have to be fulfilled, e.g., the transaction must take place within a certain time before bankruptcy is declared, or the parties benefiting from the transaction must know at the time that the debtor was in a state of insolvency. However, let us assume that these prerequisites are fulfilled in the case at hand. This would mean that, under the law of Member State B, the liquidator might now take action against the injured parties to compel them to pay their proceeds from the limitation fund into the bankruptcy estate, in return for a simple claim for a dividend from the bankruptcy estate in due course.

The situation would, of course, be the same if the shipowner, rather than relying on a guarantee, had set aside his own money for the fund and then paid out to the injured parties in a situation where he could no longer afford to pay his other creditors.

Admittedly, such an avoidance action may be easier said than done if the injured parties reside outside the EU, as other states may not recognise the right to pursue avoidance claims under a

foreign bankruptcy in their courts, or recognise court decisions on avoidance handed down by the courts of Member State B. However, under Article 18 of Regulation 1346/2000, the liquidator "may exercise all the powers conferred on him by the law of the State of the opening of proceedings in another Member State", provided the bankruptcy has been declared at the centre of the debtor's main interests. This must include the right to pursue avoidance claims in any Member State. Likewise, under Article 25, all other Member States must recognise and enforce judgments by the courts of the Member State in which the bankruptcy proceedings take place, insofar as the judgments derive directly from the insolvency proceedings and are closely linked with them. This must include judgments in cases concerning avoidance.[13]

Provided that Member State B is also bound by the 1976 Convention, there is no problem from the point of view of maritime law, as Member State B is then also bound by the rule that the limitation fund is only to be used for the payment of claims in respect of which limitation of liability may be invoked. Assuming that this rule has been correctly implemented in the law of Member State B, the *lex concursus* will then protect the injured parties against avoidance actions on the grounds mentioned above. Article 44(1) of the Regulation states that the Regulation "replaces, in respect of the matters referred to therein, in the relations between Member States, the Conventions concluded between two or more Member States". However, the Regulation simply does not regulate the substantive content of bankruptcy rules pertaining to which assets form part of a bankruptcy estate, or with regard to avoidance. Consequently, there is no contradiction between the

[13] Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters does not apply to actions for avoidance in bankruptcy, cf. Article 1(b).

Regulation and Member State B's honouring of its obligations under a limitation convention as part of its bankruptcy law, when bankruptcy proceedings are opened in Member State B.

However, it may very well be that Member State B is not party to the 1976 Convention. The fact that Member State B is not party to either the 1976 Convention or the 1996 Protocol would in most cases not prevent the shipowner from establishing a limitation fund in Member State A.[14]

In that situation, it would seem that the choice-of-law rules of Regulation 1346/2000 compel Member States bound by treaty provisions on the exclusive use of limitation funds to accept actions and judgments on avoidance emanating from Member State B, which is not party to the limitation convention, with decisions in the matter being based on the law of Member State B as *lex concursus*. It would seem unlikely that Member State B would have an internal rule which, independently of any treaty obligation, would state that a limitation fund, established in another state, could only be used for the payment of claims in respect of which limitation of liability could be invoked according to the law of that other state.

A slightly different, but equally troublesome, situation would arise if the shipowner were to go bankrupt in Member State B (not party to the 1976 Convention/1996 Protocol) after the limitation fund had been set up in Member State A (party to the Convention/Protocol), but before the injured parties had been paid. If the limitation fund had been established out of the shipowner's own funds, it would seem self-evident that, under the Regulation's rules on applicable law, the money in the fund would now, under *lex*

[14] Article 15(1) of the Convention allows the Contracting Parties to exclude persons who do not have their principle place of business in a state that is party to the Convention from the right to seek limitation of liability. However, few Contracting Parties seem to have used this option.

concursus, belong to the estate. The injured parties would only receive the same dividend as any other non-privileged creditor. If the limitation fund has been established under a guarantee issued by the insurer, the guarantee might have to be interpreted, on the basis of the "pay-to-be-paid clause" in the insurance contract, as only obliging the insurer to pay out from the fund the actual sums that the shipowner would pay out to the injured parties. It may well be that the bankruptcy estate in Member State B will have to accept this, even if Member State B is not party to the limitation convention, as this is really a case where the bankruptcy estate is bound by the same conditions under contract law as would apply to the debtor outside of bankruptcy if he were not to pay the claims in full. In this case, the insurer will not end up contributing to the payment of claims not related to the limitation fund. He will only reimburse the estate for sums actually paid out as dividends to the injured parties. The only way the fund will benefit the injured parties will be through the slight increase in the dividend paid to all creditors, deriving from the payments made by the fund to the estate, compared to the situation if no fund had been established.

Of the 27 EU Member States,[15] Austria, the Czech Republic, Hungary, Italy, Portugal, Romania, Slovakia and Slovenia are not parties to either the 1976 Convention or the 1996 Protocol.[16] Belgium, Estonia, France, Greece, Latvia, Lithuania, the Netherlands and Poland are parties to the 1976 Convention, but not the 1996 Protocol. The latter States are therefore not bound to respect the rule that the fund may only be used for the payment of claims in respect of which limitation of liability may be invoked with regard to liability outside the scope of the original 1976

[15] As of 1 January 2007.

[16] Situation as of September 2006.

Convention[17] or in excess of the liability limitations laid down in the original 1976 Convention.[18] In addition to this, Malta is a party to the 1996 Protocol only, which means that it is bound by both the Convention and the Protocol in relation to those states which are parties either to only the Protocol or to both the Convention and the Protocol, but not vis-à-vis states which are parties only to the 1976 Convention, not the 1996 Protocol.[19]

Thus the situation is of more than just academic interest.

4 Community Law and International Law

The question is, however, whether this would really be the result. Would Regulation 1346/2000 force Member States that are parties to the limitation convention to violate their obligations under international law?

Two situations should be distinguished.

The first would involve injured parties who were nationals of Third States that were also parties to the limitation convention. Were Member State A, or any other Member State party to the limitation convention, to allow an action for avoidance instituted by the liquidator from Member State B to succeed, those Member States would violate their obligations under the limitation convention vis-à-vis the Third State.

According to Article 307, first paragraph, of the EC Treaty, rights and obligations arising from agreements concluded between one or more Member States on the one hand, and Third States on the other, before the Member State(s) acceded to the Community, are

[17] Cf. Article 2 of the 1996 Protocol amending Article 3(1) of the 1976 Convention.

[18] Cf. Articles 3 and 4 of the 1996 Protocol amending Articles 6 and 7 of the 1976 Convention.

[19] Article 9(2) of the Protocol.

not affected by the provisions of the EC Treaty. The same must, of course, apply to conflicts between such treaties and EC secondary legislation. Under general international law, this rule of priority is self-evident.

In relation to Regulation 1346/2000, this would mean that the Regulation should be read with the proviso that it does not compel Member States to violate their obligations vis-à-vis Third States. In other words, Member States must have the right to give priority to their obligations under limitation conventions entered into before their accession to the EU.

Although the EC Treaty is silent on the point, one must assume that the same must apply to treaties concluded between Member States and Third States after membership in the EU became effective for the Member State concerned, provided that the Member State acted within an area in which it still had the right under Community law to conclude treaties. Any other solution would lead to an obvious violation of international law.[20]

[20] See Ernst-Ulrich Petersmann: Commentary to (then) Article 234 in Groeben/THiesing/Ehlermann (Hrsg.): Kommentar zum EU-/EG-Vertrag, 5th edition Baden-Baden 2000, pp. 5/568–5/569. Paragraphs 84–86 of the judgment in Joined cases C-241/91 P and 242/91 P, RADIO TELEFIS EIREANN (RTE) AND INDEPENDENT TELEVISION PUBLICATIONS LTD (ITP) V COMMISSION OF THE EUROPEAN COMMUNITIES [1995] ECR 743, could perhaps be said to point in another direction. At paragraph 85 of that judgment, the ECJ simply noted that the relevant provision of the Paris Act, amending the Berne Convention on copyright, which of course also involves Third States, was ratified by the United Kingdom only after its accession to the EC. It would seem that this statement was meant to distinguish this situation from treaties entered into before the accession of the United Kingdom to the EC, which the Court dealt with at paragraph 84. However, in both cases the main argument of the Court was that Article 307 (then still Article 234) could not be relied on in intra-Community relations. The case did not really concern the question of whether or not the United Kingdom could honour its obligations under the Paris Act vis-à-

However, it follows from Article 307 EC, second paragraph, that Member States have an obligation to "take all appropriate steps to eliminate the incompatibilities between Community law" and treaty obligations towards Third States. It follows from case law from the European Court of Justice ("ECJ") that this obligation goes so far as to impose an obligation to denounce treaties with Third States if attempts fail to adjust them only as far as necessary.[21] Needless to say, if the principle of Article 307, first paragraph, applies also to treaty obligations vis-à-vis Third States entered into after accession, then the principle laid down in Article 307, second paragraph, must also apply to that situation. This principle could be characterised as nothing more than the general principle of Community loyalty (Article 10 EC), as applied to the specific question of treaty obligations towards Third States.

The second situation would concern injured parties who were nationals of either Member State A or other EU Member States that were also parties to the limitation convention.

As mentioned above, Article 44(1) of the Regulation states that the Regulation "replaces, in respect of the matters referred to therein, in the relations between Member States, the Conventions concluded between two or more Member States". As some of the conventions listed as examples in Article 44(1) are conventions that also include Third States among their Contracting Parties, it is obvious that Article 44(1) also applies to such conventions.

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vis Third States. Consequently, one should not conclude from this judgment that the ECJ in such a case would come to the conclusion that Member States would be under an obligation towards the Community to violate treaty obligations vis-à-vis Third States which the Member State at the time was free to enter into under Community law.

[21] Case C-62/98 COMMISSION OF THE EUROPEAN COMMUNITIES V THE PORTUGUESE REPUBLIC [2000] ECR 5171, at paragraphs 49–50.

This would seem to lead to the conclusion that, in this case, the *lex concursus* principle of the Regulation would take precedence over any obligation to reserve a limitation fund for the injured parties.

In this context, the general principles of international law would probably not be an obstacle. The Vienna Convention on the Law of Treaties contains a provision on the right of two or more parties to a multilateral treaty to conclude an agreement to modify the treaty as between themselves. Article 41 stipulates that, in cases where the multilateral treaty itself is silent on the subject, which the 1976 Convention/1996 Protocol are, such modifications are permissible if they do "not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole". This is so even if the modification "does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations".

The EC is not a Contracting Party to the Vienna Convention. However, the Convention is usually regarded, for the most part, as a codification of customary international law. The extent to which this is the case is somewhat nebulous, not least because the rules of customary international law are seldom clear-cut themselves, but it would seem strange to assume that it is a principle of customary international law that two or more parties to a multilateral convention may modify their obligations under the convention among themselves even if that modification is "incompatible with the effective execution of the object and purpose of the treaty as a whole".

The ECJ, in RTE AND ITP V COMMISSION, mentioned above, did not however make such a reservation when it stated, in paragraph 84, that "[i]t is, however, settled case-law that the provisions of an agreement concluded prior to entry into force of the Treaty or prior to a Member State's accession cannot be relied on in intra-Community relations if, as in the present case, the rights

of non-member countries are not involved". The Court then referred to its judgment in Case 286/86 MINISTÈRE PUBLIC V GÉRARD DESERBAIS 1988 [ECR] 4907, where the Court basically said exactly the same thing, without commenting on the question of whether there were limits to this approach under international law that would also apply to what is now Article 307. However, in both cases it was pretty clear that the non-application of the provisions of the multilateral treaties in question did not really touch upon "the object and purpose of … [the relevant multilateral treaties] as a whole", so the Court had no reason to go into this. One should therefore not conclude from this that the ECJ would not recognise the limitation laid down in Article 41 of the Vienna Convention on the Law of Treaties. (RTE AND ITP V COMMISSION concerned the relationship between copyright law (exclusive right to reproduction) and competition law (abuse of dominant position) or, more concretely, the extent to which the copyright holder's refusal to license his product on the basis of his exclusive right of reproduction would constitute an abuse of dominant position. Before concluding that, in this case, there was an infringement of the prohibition of abuse of a dominant position, the Court noted that "the exclusive right of reproduction forms part of the author's rights, so that refusal to grant a licence, even if it is the act of an undertaking holding a dominant position, cannot in itself constitute abuse of a dominant position" (paragraph 49). MINISTÈRE PUBLIC V GÉRARD DESERBAIS, concerned the import into France of Edam cheese from Germany with a fat content of 34.3%, whereas, under French legislation, Edam cheese had to have a minimum fat content of 40% percent. The Netherlands Government, in its observations before the Court, had stated that each Member State could make the right to use the name "Edam" subject to compliance with the requirements laid down by the Stresa Convention and the Codex Alimentarius, drawn up jointly by the FAO and the WHO, and that both instruments lay down a minimum fat content of 40% for that type of cheese. Before making the comment, cited above, about what is now Article 307, the Court observed that "the rules of the Codex Alimentarius on the composition of certain foodstuffs are in fact intended to provide guidance for defining the characteristics of those foodstuffs. However, the mere fact that a product does not wholly conform with the standard laid down does not mean that the marketing of it can be prohibited" (at paragraph 15). Thus, it would seem that the Court did not find that it would have been in any way a violation of the Stresa Convention or the Codex Alimentarius to establish an obligation under Community law for France to accept the import of German low-fat Edam.)

The question is then whether the inviolability of the limitation fund laid down in Article 11(1) of the 1976 Convention is a "provision, derogation from

which is incompatible with the effective execution of the object and purpose of the treaty as a whole".

A derogation from the principle that shipowners may limit their liability would obviously be incompatible with the effective execution of the object and purpose of the treaty as a whole. However, the 1976 Convention/1996 Protocol make it optional for the Contracting Parties to make limitation of liability dependent on the establishment of a limitation fund.23 Indeed, the wording indicates that limitation without the need to establish a limitation fund should be the general rule. Against that background, and also given the tendency of the ECJ to favour solutions which it perceives to further the full effect of Community law in the Member States, it is likely that the Court would indeed find that it would not be a violation of international law to give the lex concursus rule of Regulation 1346/2000 priority over Article 11(1) of the 1976 Convention on the exclusive use of limitation funds.

Even if the Court should rule otherwise, this would not bring permanent relief to those who would like the rule of the 1976 Convention to apply fully also within the EU. Article 307(2) would, in this case also, mean that the Member States would be under an obligation to remedy the situation, if necessary by denouncing the limitation convention.

5 The Need for a Community Solution

Regulation 1346/2000 was a bold move to cut the Gordian knot created by the combination of most states' unwillingness to recognise foreign bankruptcies and their insistence that their own bankruptcies had effect abroad. It was based on the realisation that, on the one hand, harmonisation of the substantive law relating to bankruptcies would simply be too cumbersome and, on the other, that it was not really necessary.

However, as bankruptcy is one of the most complicated legal situations in existence, the Regulation was probably not based on a

[23] Cf. Article 10.

firm belief that all possible problems had now been thought through and that exactly the right balance, between the main principle of *lex concursus* and the application of the law of other States, had been found once and for all. On the contrary, it seems that the drafting committee, a group that probably consisted mainly of bankruptcy experts, only thought through those situations with which bankruptcy experts would typically be familiar: rights *in rem*, reservation of title, employment contracts etc. This suggests that the Community legislature should keep an open mind about including further exceptions to the main rule of *lex concursus* in cases where this would be in the interest of the Community as a whole.

This would seem to be the case in relation to limitation funds under maritime law. Although they may not, perhaps, be the most central issue in conventions on limitation of liability, such funds certainly contribute to the smooth functioning of international maritime transport, typically by providing a tool for obtaining the release of a ship from arrest. As insurers are not likely to take lightly a bankruptcy estate's appropriation of a limitation fund through avoidance actions, this means that the Regulation, as it now stands, will make it more difficult to persuade insurers to issue guarantees in the way described above. This will add to the costs of international shipping, and consequently add to the costs of both intra-Community trade and the Community's external trade.

There are two ways of dealing with the problem. As part of its maritime policy, the Community could decide that all Member States should accept the inviolability of limitation funds as part of their own internal law. As discussed in Section 3 above, this would make the problem disappear.

The other solution would be to solve the problem on the basis of Regulation 1346/2000. It is difficult to see that a provision in that Regulation, to the effect that the status of a limitation fund should be decided according to the law of the Member State in which the

fund has been established, would seriously undermine the effective operation of the system set up under the Regulation. The Regulation already contains several exceptions to the main rule of *lex concursus*, and a special rule for limitation funds, based on the wording of Article 14 of the 1976 Convention[24] would not be contrary to the system established under the Regulation. Rather, it would be in line with the exceptions that already exist.

[24] "…the rules relating to the constitution and distribution of a limitation fund, and all rules of procedure in connexion therewith, shall be governed by the law of the State Party in which the fund is constituted."

Part V

The charterer's ("befrakter's") right to limit his liability in respect of a claim from the shipowner for damage to the vessel – Scandinavian and English law*

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* This article was originally written for "*Festskrift till Lars Gorton*"

1 Introduction

This article examines the extent to which a charterer is entitled, under Scandinavian and English law, to limit his liability in respect of a claim from the shipowner for damage to the vessel. The term "charterer" refers to a person or entity buying transport services or transport capacity as defined in a contract of affreightment with the owner of a ship.[1] The charterer may cause damage to the ship either through his management or operation of the ship, or as shipper and/or owner of the cargo being transported on the ship.

The right to limitation of liability arises under the Convention on the Limitation of Liability for Maritime Claims of 1976 (LLMC 1976). As this Convention has been ratified both by the Scandinavian countries and the UK, a comparative approach seems appropriate, especially as the question of the charterer's right to limit liability in respect of damage to the ship has been addressed in two relatively recent English court decisions, the AEGEAN SEA and the CMA DJAKARTA.[2] An analysis of these decisions and a comparison with the position under Scandinavian law is therefore of interest, as is an evaluation of the relevance of the English decisions should the situation under Scandinavian law differ.

I will start by outlining the relevant rules determining limitation in subchapter 2. Subchapter 3 addresses the English approach to this issue, while the legislative situation in Scandinavia is discussed

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1 Falkanger/Bull: Scandinavian Maritime Law, the Norwegian perspective, 2nd ed. Oslo 2004, p. 241.

2 TRADERS CORPORATION V. REPSOL PETROLEO S.A. AND ANOTHER (The Aegean Sea), QBD (Comm Ct), Aegean Sea, [1998] 2 Lloyd's Rep. 39, CMA CGM S.A V CLASSICA SHIPPING CO LTD (The CMA Djakarta) Court of Appeal (Civil Division) 12 February 2004, [2004] 1 Lloyd's Rep. 460.

in subchapter 4. A summary and some reflections appear in subchapter 6.

2 An outline of the limitation rules

The LLMC 1976[3] provides a right of limitation to those persons defined in art. 1 in respect of claims as defined in art. 2, cf. further below. The limitation amount relates to any claim arising on any distinct occasion,[4] with one limitation amount for passenger claims,[5] one amount applying in respect of claims for loss of life or personal injury that is not passenger claims,[6] and one amount applying in respect of any other claim.[7] Except for the amount in relation to passengers the amount is calculated in relation to the tonnage of the ship. If separate claims are raised against several persons having a right of limitation, there are rules on aggregation of the claims.[8] Further, all liability may be channelled to a limitation fund, if such a fund is constituted in accordance with the convention.[9]

Article 1 defines those persons entitled to limit liability. The relevant provisions in our case are art. 1, nos. 1 and 2:

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3 The LLMC 1976 is discussed in Falkanger/Bull: chapter 9, Wetterstein; *Globalbegreänsning av sjörättslig skadestandsansvar* (Åbo 1980), Blom: *Sjölagens bestämmelser om redaransvar* (Stockholm 1985) p. 50 et seq., Griggs and Williams: Limitation of liability for maritime claims, 3rd ed., 1998, Griggs, Williams and Farr: Limitation of liability for maritime claims, 4th ed., 2005.

4 *LLMC 1976 art. 6. 1, first sentence.*

5 LLMC 1976 art. 7.

6 LLMC 1976 art. 6, letter (a).

7 LLMC 1976 art 6, letter (b).

8 LLMC art. 9.

9 LLMC chapter III, in particular art. 11.

> "1. Shipowners and salvors, as hereinafter defined, may limit their liability in accordance with the rules of this Convention for claims set out in Article 2. 2.
>
> 2. The term "shipowner" shall mean the owner, charterer, manager and operator of a sea-going ship."

Those claims subject to limitation are defined in art. 2, where the relevant provision is no. 1 (a):

> "claims in respect of … loss of or damage to property … occurring onboard or in direct connexion with the operation of the ship or with salvage operations …".

In English law, the LLMC 1976 convention was first contained in the Merchant Shipping Act (MSA) 1979, Schedule 17, part 1. Today, section 185 of the MSA 1995 provides that the LLMC 1976, as set out in a schedule to the Act, should have the force of law in the UK. The rules of the convention are therefore directly incorporated into English law.[10]

In Scandinavia, on the other hand, the 1976 LLMC rules were translated and included as part of the 1994 Scandinavian Maritime Code (MC),[11] i.e. the convention was "transformed" into Norwegian law.[12] The English translation of the relevant provisions reads as follows:

> Persons entitled to limitation of liability
>
> "The reder, shipowner, charterer or manager can limit his or her liability according to provisions of this Chapter". [13]

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[10] Eckhoff: Rettskildelære, 5th ed. by Jan Helgesen, Oslo 2000, p. 288.

[11] The Norwegian Maritime Code 24 June 1994 no. 39 (NMC), The Danish Maritime Code 16 March 1994 (DMC), the Swedish Maritime Code 9 June 1994 (SMC) and the Finnish Maritime Code 15 July 1994 (FMC).

[12] Eckhoff op. cit, Ot prp nr. 32 (1982-83) Om lov om endringer I lov 20 juli 1893 nr. 1 om sjøfarten med mer, p. 21.

[13] NMC and DMC § 171, first subparagraph, first sentence, SMC and FMC § 9:1, first subparagraph, first sentence.

> Claims subject to Limitation
>
> "The right to limitation of liability applies, regardless of the basis of the liability, to the claims in respect of
>
> 1. loss of life or injury to persons (personal injury) or loss of or damage to property (property damage), if the injury or damage arose on board or in direct connection with the operation of the ship or with salvage".[14]

The 1994 Scandinavian MC resulted from a co-operative effort between Denmark, Norway, Sweden and Finland. The rules in the various codes are substantially the same but not identical.[15] However, the rules addressed here are all based on the LLMC 1976 Convention and are thus identical.

3 English law; the AEGEAN SEA and the CMA DJAKARTA

3.1 The concept of "charterer" in relation to the right of limitation

The first question addressed in both the AEGEAN SEA and the CMA DJAKARTA concerns the interpretation of the concept of "charterer" in relation to the LLMC 1976, art. 1, no. 2. The Commercial Court[16] chose in both cases to interpret the concept of "charterer" narrowly: only including the charterer to the extent that he was

[14] NMC and DMC § 172, first subparagraph, no. 1, SMC and FMC § 9:2, first subparagraph, no. 1.

[15] Falkanger/Bull p. 26.

[16] TRADERS CORPORATION V.REPSOL PETROLEO S.A. AND ANOTHER (The Aegean Sea), QBD (Comm Ct), Aegean Sea, [1998] 2 Lloyd's Rep. 39, CMA CGM S.A V CLASSICA SHIPPING CO LTD (the CMA Djakarta) [2003] EWHC 641 (Comm), [2003] 2 All E.R (Comm) 21.

acting as owner. As it was agreed that the charterer did not act as owner in either of the cases, the right of limitation was denied:

The Aegean Sea was chartered by Repsol Oil International Ltd (ROIL) on a voyage charter party for a cargo of crude oil. On the way to discharge the cargo in La Coruna, the vessel grounded on the Torre de Hercules rocks, broke in two and exploded, resulting i.a. in the loss of the vessel and most of the cargo. The owner of the vessel sought to recover i.a. the value of the vessel from i.a. ROIL, and claimed that the nomination of La Coruna was a breach of the charter party and the loss was sustained in consequence of complying with the charterer's orders. ROIL denied liability. However, in the event they were held liable, they contended that they would be entitled as charterers to limit their liability under the 1976 Convention, art. 1, no. 2.

This was not accepted by the court. The court referred to the distinction between the "owner" and "salvor" as persons being entitled to limitation, and stated that this presumed that all the persons included in the concept of owner were so included only insofar as they acted as owner. This was supported by the phrase in art. 6 (2) of the previous 1957 Convention "in the same way as they apply to an owner himself". Even if this phrase was not re-employed in the 1976 Convention, the same result was obtained by keeping the charterer within the category of shipowner (p. 47-48). The court further referred to art. 9, providing for a single fund for all those identified as being within the class of shipowner, and stated that "it cannot have been intended that either the limitation amount or the fund be reduced by direct claims by the owners against charterers for the loss of the ship…; it was intended for the claims by cargo interests and other third parties external to the operation of the ship against those responsible for the operation of the ship. To permit claims of the type advanced by the owners against the charterers for the direct losses they suffer to come within the scope of the limitation amount or the fund would diminish what was available to others (p. 50).

The CMA Djakarta was chartered on a time charter party to be traded in the charterer's liner network. The vessel suffered damage by way of explosion and fire due to transport of containers with bleaching powder. The shipment was a breach of the express terms of the charter party relating to dangerous cargo. The owner claimed against the charterer for i.a. damage to the ship, whereupon the charterer claimed that he had a right to limit his liability. The court rejected this claim, referring mainly to the reasoning of the judge in the AEGEAN SEA. However, the court also added that, as it was clear that the

shipper did not have a right of limitation, it would not make commercial sense to give such right in general to the charterer. [17]

This decision was, however, overruled by the Court of Appeal:[18]

The Court of Appeal held that the ordinary meaning of the word "charterer" in art. 1(2) of the 1976 Convention connoted a charterer acting in his capacity as such, not a charterer acting in some other capacity (paragraph 13). To claim that a charterer had to be acting *qua* owner, or as if he were owner, would impose a gloss upon the wording of the Convention and accord it a meaning other than its ordinary meaning. Further, this interpretation would also impose a requirement, the ambit of which would often be difficult to ascertain (paragraphs 15 and 18). On the other hand, the argumentation was concerned with the charterer of the whole ship. The court touched upon the right of limitation for a slot charter or a part charter, but was "content to leave to another day" whether these were included in the concept of "charterer" in this respect (paragraph 18).

Thus, the position today is that time and voyage charterers have a general right of limitation under the LLMC 1976, art. 1, no. 2, but the question has not been resolved in relation to part charters or slot charters.[19] Further, the Commercial Court assumes in the CMA DJAKARTA that the shipper does not have a right of limitation according to English law. This was not commented on by the Court of Appeal.

3.2 Does the right of limitation cover damage to the ship?

As the court in the AEGEAN SEA ruled that the charterer only had a right of limitation when he acted as owner, it was not necessary to

[17] Paragraphs 32, 39 and 40.

[18] [2004] 1 Lloyd's Rep. 460.

[19] Griggs,Williams and Farr: Limitation of liability for maritime claims, 4th ed. 2005, p. 11, argues that slot charterers should be included.

discuss the extent to which the claim in respect of damage to the ship was covered by the LLMC 1976, art. 2. Even so, the judge stated that, in his view, the loss of the ship was not the loss of "property … occurring in direct connection with the operation of the ship" as set out in art. 2(1)(a); because it was the operation of the very ship that must cause the loss of property, the ship itself could not be the object of the wrong.[20] This was followed by the court in the CMA DJAKARTA:[21]

The Court of Appeal held that the wording is not "apt to cater for a case where the very ship, by reference to the tonnage of which limitation is to be calculated, is lost or damaged because the loss envisaged is loss to something other than that ship herself" (paragraph 23), and that "the claims in respect of which an owner or a charterer can limit do not include claims for loss or damage to the ship relied on to calculate the limit" (paragraph 25). The court also repeated the phrase from the AEGEAN SEA that "it is the operation of the ship that must cause the loss of property; the ship cannot be the object of the wrong" (paragraph 26).

The Court of Appeal's decision was appealed to the House of Lords,[22] but the case has apparently now been settled.

[20] [1998] 2 Lloyd's Rep. 39 at p. 51.

[21] [2004] 1 Lloyd's Rep. 460. The decision in this case was followed by the Admirality Court in [2004] 2 Lloyd's Rep. 469, The Darfur, where the court held that losses incurred as a consequence of damage to the ship held responsible in a collision settlement could not be limited. In this case however, it was the charterer who brought the claim against the owner of the ship.

[22] Griggs,Williams and Farr: Limitation of liability for maritime claims, 4th ed. 2005, p. 10.

4 Scandinavian law

4.1 The concept of "charterer"/"befrakter"

The 1994 MC, section 171, first subparagraph, first sentence, provides a right of limitation to the "charterer" ("befrakter"). As the expression "charterer" is not qualified in relation to the type of charter (voyage/time charter or bare-boat charter), it seems natural to understand the expression as including all kinds of charterer, regardless of the type of charter contract. Nor does the expression itself make it necessary to distinguish between a charter of the whole ship and a part charter. This position is also supported by the definition of "charter" in the 1994 MC:

> "*carrier*, the person who, through a contract, charters out a ship to another (*the charterer*);[23]

Further, as there is no condition relating to the type of function the charterer must perform in relation to the damage that triggers a right to limitation, the charterer must enjoy this right regardless of the function he is performing, i.e. not only when he is acting as owner.

On the other hand, the concept of "charterer" departs from the concept of "shipper" ("sender") in the MC.[24] Therefore, according to the wording of the 1994 MC, the shipper is not entitled to limitation.

The preparatory documents, on the other hand, support an even broader interpretation of the expression "charterer".[25] The

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[23] NMC and DMC § 321 second subparagraph, SMC and FMC § 14:1

[24] NMC and DMC § 251, SMC and FMC § 13:1.

[25] The regulation is not commented upon in the Preparatory documents to the 1994 MC. However, the LLMC 1976 was originally incorporated into the previous Scandinavian MC, cf. NMC 1893 sections 234 and 235, included by an act of 27 May 1983 nr. 30, DMC 1892 sections 234 and

Scandinavian legislators discuss the Scandinavian concept of "befrakter" as compared to the English expression "charterer". Their attitude is that the Scandinavian concept of "befrakter" includes voyage and time charterers, charterers of the whole ship and part charterers,[26] and even "stykkgodsbefrakter", which was the term used in the previous MC, corresponding to the English "shipper".[27] It is admitted that this interpretation is uncertain in relation to the LLMC 1976, as the preparatory documents to the previous 1957 Convention, that use the same term, state that it should be interpreted narrowly.[28] However, as the question is not discussed in the preparatory documents to the LLMC 1976, and there is no reason to treat the shipper differently, the Danish and Norwegian attitude was that this interpretation was not contrary to

235, included by an act of 1 April 1985, and SMC 1891 sections 234 and 235, included by law 1983:699. Further, the issue is commented upon in the preparatory documents to the inclusion of the previous 1957 Convention, when the "charterer" was included in the group entitled to limitation. The relevant preparatory documents are therefore the documents relating to these provisions.

[26] NOU 1980:55 *Begrensning av rederansvaret*. Passasjerbefordring (NOU 1980:55), p. 14, *I Betænkning afgivet af Sølovsutvalget angående i.a. III Begrænsning av rederansvaret*, p. 29, SOU 1961:33, *Redareansvarets begränsning*. Betänkande avgivet av sjölagskomitten, p. 51-52, Kungl. Maj:ts proposition nr. 35 år 1964 p. 103.

[27] Ot prp nr. 32 p. 23, *I Betænkning afgivet af Sølovsutvalget angående i.a. III Begrænsning av rederansvart*, p. 29, Regeringens proposition 1982/83:159, *Ändring i sjölagen m.m*., p. 98-99. The Norwegian legal committee argued that a right of limitation for the shipper/stykkgodsbefrakter was contrary to the LLMC 1976 art. 2 and therefore made it necessary to exclude the shipper from the general aggregation rules, cf. (NOU 1980:55), p. 14 and the draft § 238 no. 4. This was, however, overruled by the legal department, who followed the opinion of the other Scandinavian countries.

[28] *I Betænkning afgivet af Sølovsutvalget angående i.a. III Begrænsning av rederansvaret*, p. 29, Prp. 1982/83:159 p. 98.

the LLMC 1976.[29] In particular, there was reference to the unfair situation that would exist if the shipper and the owner were jointly liable for damage arising if the operation of the ship resulted in the ship colliding with a third party. The third party would be able to claim full recovery from the shipper, whereas the shipper's claim against the owner would be subject to limitation, even if the part charterer were given the same protection as the owner.[30] It was also emphasized that, even if the concept of "charterer" in the LLMC 1976, art. 2 did not include the "shipper", individual state parties were free to include him.[31]

In the Scandinavian MC 1994, the expression "stykkgodsbefrakter" ("shipper") is amended to "sender".[32] However, there is no indication in the preparatory documents that this alteration was intended to have any consequences with regard to the right to limitation. Apparently, therefore, the position is unaltered.[33]

Under Scandinavian law, the conclusion is therefore that the expression "charterer" ("befrakter") includes total and part charterers, and also the shipper. There is however some disagreement as to the extent to which the latter interpretation is in accordance with the LLMC 1976, art. 2.

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29 *I Betænkning afgivet af Sølovsutvalget angående i.a. III Begrænsning av rederansvart*, p. 29, Ot prp nr. 32 s. 23.

30 *I Betænkning afgivet af Sølovsutvalget angående i.a. III Begrænsning av rederansvaret*, p. 29.

31 Prop. 1982/83:159 p. 99, NOU 1980:55 p. 14, but then with a separate aggregation rule, cf. above.

32 NMC and DMC § 251, SMC and FMC § 13:1.

33 Cf. further Wilhelmsen: *Rett i havn*, Oslo 2006, subchapter 7.5.1.

4.2 The right to limitation against the owner for damage to the ship

4.2.1 The wording

The right to limitation includes "loss of or damage to property (property damage) … if the … damage arose on board or in direct connection with the operation of the ship or with salvage". The expression "damage to property" or "(property damage)" is not qualified in any way. As a starting point, damage to a ship must therefore also be included. On the other hand, damage to a ship is not damage "on board the ship". Thus the question is whether or not such damage arises "in direct connection with the operation of the ship".

It is clear that in the case of collision damage to another ship, the owner/charterer will have a right to limit liability in respect of a claim from the owner of the other ship. Thus, property damage under the second alternative encompasses a "ship" as damaged property. Further, the discussion here concerns damage to the ship caused either by the charterer's management or operation of the ship, or by the cargo shipped by the charterer. All these functions are part of the operation of the ship. As a starting point, it therefore seems natural to say that damage to a ship caused by management or operation of the same ship or by cargo transported by that same ship is damage to a ship (property) arising "in direct connection with the operation of the ship".

The question that then arises is whether this text should be interpreted more narrowly, so that damage is only covered when it is to a ship *other* than the ship whose operation caused the damage.

4.2.2 The preparatory documents

In their extended discussion of the concept of "befrakter", as a party entitled to limitation (see subchapter 4.1 above), the preparatory documents also describe the situation where there is a common need for any "befrakter", the shipper included, to be able to limit his liability, namely when due to insufficient packaging the goods causes fire or explosion onboard.[34] Similarly, it is emphasized that any "befrakter" may be liable for damage to the ship and to cargo owned by other charterers and shippers; of particular importance is liability for damage caused by dangerous cargo.[35] There is therefore a clear presumption that the right of limitation applies to damage to the chartered ship.

This solution is further supported by the preparatory documents to the incorporation of the previous 1957 Convention into the previous Scandinavian MC, where the protected group was limited to the "main charterer".[36] The Norwegian preparatory documents agree that the convention is presumed to mean that it also applies to claims as between owner, reder, charterer and manager.[37] The text does not in particular mention damage to the ship, but the wording is wide enough to include such damage. This interpretation is more clearly supported by the Swedish preparatory documents:

The remarks concern the extension of the parties being entitled to limitation in section 261 to include i.a. liability in respect of anyone for whom the owner or

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[34] Cf. Prop. 1982/83:159 p. 99.

[35] NOU 1980:55 p. 14. It is clearly presumed that this situation is covered by the draft section 235 first subparagraph no. 1, which conforms to the 1994 MC § 172 first subparagraph no. 1, which is again based on the LLMC 1976 art. 2 no. 1.

[36] Norwegian MC 1893 § 261, Swedish MC 1891 § 261, Danish MC 1892 § 261.

[37] Cf. *Innstilling I fra Sjølovkomiteen* p. 18, Ot prp nr. 13 (1963-1964) p. 14.

other person is responsible, in this case the master and crew. The purpose of the rule was to prevent the right of limitation being nullified by the claim not being invoked against the owner or the charterer, but against people whom the owner or charterer would feel morally obliged to, or otherwise have to, indemnify.[38] It was claimed that this reasoning was not appropriate in the situation where the master etc. were liable for damage to the actual ship, and also that a limitation of liability on the basis of the ship's tonnage in this situation seemed irrational. Even so, the conclusion was that the wording of the Convention did not make it possible to exclude damage to the owner's own vessel from the limitation rules.[39]

The discussion concerned the right of limitation in relation to the master and crew. However, it is clear from the discussion that, according to the provision, the owner's "own vessel" (i.e. the ship on whose tonnage the limitation amount was based) was included in the types of property that, if damaged, would trigger a right to limit liability. This must also be true in relation to the charterer.

The provision incorporating the rule in the previous 1957 Convention concerning the kind of property damage to which the right of limitation applied was found in the Swedish MC 1891, section 254 and the Norwegian MC 1893, section 254, as amended in 1964. The right of limitation concerned i.a. liability for property damage caused by anyone onboard, cf. section 254, first subparagraph, no. 2, and liability for property damage having arisen in connection with the navigation or operation of the ship, cf. section 254, first subparagraph, no. 3. In particular, the latter alternative, which would cover acts or omissions by both the charterer and the master and crew, is quite similar to the part of the provision in the MC 1994, section 172, first subparagraph, no. 1 being discussed here. The slight amendments in the text on this point seems irrelevant in relation to the question of whether or not property damage to "the owner's own vessel" is included.

The preparatory documents therefore imply that the 1994 MC, section 172, first subparagraph, no. 1 is intended to include damage

[38] Cf. Kungl. Maj:ts proposition nr. 35 år 1964 p. 103.

[39] Cf. Kungl. Maj:ts proposition nr. 35 år 1964 p. 105 to 106.

to the "owner's own vessel" or the ship on which the limitation amount is based, and further that the legal basis for this result is the similar rules of the LLMC 1976.

4.2.3 Other legal sources

To my knowledge there are no Scandinavian court cases dealing with this issue.

The purpose of the limitation rules has first and foremost to do with insurance issues concerning limitation for damage that may be caused by the operation of the ship. The focus was the limit of insurance capacity available to cover the owners total liability in case of an accident.[40] If these issues concerned solely the owner's liability, it would be obvious that damage to the "owner's own vessel" would not come within the rules. However, as the charterer is also entitled to limitation, damage to the ship is part of the total risk involved in the operation of the ship. Seen in this perspective, the main purpose of the limitation rules itself argues in favour of the rules encompassing damage to the ship caused by the charterer. Even so, the insurance argument is weaker in this respect, as the value of the ship, unlike most other issues relating to liability, is known. However, liability for damage to the ship may be added to liability for damage to cargo, thereby giving rise to greater and unknown amounts.[41] The rule is therefore not contrary to the purpose of the Convention.

Scandinavian legal academics have touched on the matter in several textbooks. The general view seems to be that damage to the ship is included:

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[40] Cf. IMCO Limitation of liability, London 1976, LEG/CONF.5/C.1/SR.1, p. 2, 4, 6-9, Wetterstein l.c. p. 55 and p. 58 ff., [1998] 2 Lloyd's Rep. 39, CMA DJAKARTA, paragraph 69.

[41] Cf. the NOU 1980:55 p. 14, Prop. 1982/83:159 p. 99.

Selvig states, with reference to the Preparatory Documents, that the provision in the 1893 MC, section 241, which conformed to the section 261 discussed above, implies that claims between, for instance, the charterer and the owner are regulated by the limitation rules. This is also true if the charterer damages the ship.[42]

The same view is stated by Falkanger/Bull in relation to the 1994 NMC, section 171, referring to the same legal sources.[43] Falkanger/Bull add that the solution differs from English law with reference to the CMA DJAKARTA case, but no conclusions are drawn from this. In Finnish literature, Wetterstein claims that the rules include the charter's liability in respect of the owner, but there is no mention of damage to the ship in particular.[44]

4.2.4 Conclusion

It follows from the above discussion that the wording of the 1994 MC, section 171, first subparagraph, first sentence, cf. section 172, first subparagraph, no. 1, implies that the charterer is entitled to limit his liability in respect of the owner of the ship for damage to that same vessel. The terms "charterer" or "befrakter" encompass, according to the preparatory documents, charterers of the whole ship (demise charterers, time and voyage charterers), part or slot charterers, and presumably also the shipper ("stykkgodsbefrakter"). However, there seems to be some uncertainty as to whether the latter rule conforms to art. 2 of the LLMC 1976, or whether it results from the freedom of individual states to enact limitation rules.

On the other hand, it is clear that the Norwegian and Swedish legislators intended damage to the owner's own vessel to fall within

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[42] Cf. Rederansvaret, MarJus no. 35 § 4.6 p. 4. He refers to Innstilling I fra Sjølovkomiteen p. 18, Ot.prp. nr. 13 (1963-64) p. 14 and Kungl. Maj:ts Proposition 1964:35 p. 197 (the reference should be to p. 107).

[43] Falkanger/Bull: l.c., p. 181. Surprisingly enough, they do not refer to the NOU 1980:55 p. 14, which relates directly to the provisions applicable today. The result is the same however.

[44] Wetterstein; Globalbegränsning av sjörättsligt skadeståndsansvar, p. 80.

the limitation rules, and that this was presumed to be in accordance with both the LLMC 1976 and the previous, 1957 Convention.

5 Summary and some reflections

The above discussion demonstrates that there are some differences between English and Scandinavian law in the interpretation of the limitation rules. Even if the Court of Appeal, in the CMA DJAKARTA, allowed the charterer a right of limitation when acting as charterer and not as owner, the position in relation to slot charters and part charters is unresolved and it seems clear that the shipper does not come within the rules. This is contrary to the position in Scandinavia. It may be argued that the Scandinavian rules are contrary to the LLMC 1976 in relation to the position of the shipper, but even so, this was clearly intended by the legislators. Further, in both the AEGEAN SEA and the CMA DJAKARTA, the English courts rejected any right to limitation where the damage was to the owner's own vessel, whereas Scandinavian legal systems seem to accept this right.

As both the English and Scandinavian rules are based on the same international convention, it may be argued that such a difference is unfortunate.[45] The question therefore arises of whether Scandinavia should follow the relatively recent English decisions. From a *de lege lata* perspective, however, it may be unlikely that the Scandinavian courts will follow the English decisions. The Scandinavian approach seems to have well been considered by the legislator, and, apart from the inclusion of the shipper, is also closer to the ordinary meaning of the wording in the convention. From a Scandinavian perspective, the reasoning in the English cases for excluding damage to the owner's own vessel seems somewhat

[45] Eckhoff l.c. p. 289.

artificial, and the fact that the CMA DJAKARTA was settled before a conclusion was reached by the House of Lords indicate that the position is unclear under English law. A change in the Scandinavian approach would therefore seem to require a change in the relevant legislation.

However, several arguments may be put forward to support such a change. Firstly, it may be argued that since there is a contractual relationship between the owner of the ship and the charterer, it is more natural to regulate the division of risk for damage to the ship in the charter party, rather than in an international convention.[46] Also, it may seem illogical that a breach of a charter party that results in damage to the vessel will be treated differently from a breach that does not lead to such damage. Further, the need for limitation may be questioned in general. One issue here is whether maximum insurance capacity is a sufficient argument for limitation.[47] Other transport sectors manage without this kind of limitation rule. It can therefore be argued that the limitation rules result more from tradition than necessity, if a thorough evaluation of the need for such rules is carried out.[48] Such rules may easily counter economic efficiency, as they create disincentives for the taking of preventive measures.[49] This argument is, however, less strong in the case of a contractual relationship between the tortfeasor and the injured party if the injured party had full information in advance about the risk of damage. In this case, he would have been able to add the risk of damage to the cost of chartering the ship and take this into consideration when he

[46] The AEGEAN SEA p. 47, Charterers and the right to limit, S. &T.L.I.2003, 4(3), 4-5.

[47] Wetterstein p. 245 et seq, Ot prp nr. 32 (1982-83) p. 7.

[48] Falkanger/Bull p. 179, Wetterstein p. 239 -240.

[49] Wilhelmsen; *Rett i havn*, subchapter 12.4.2.1, and note 800 with further references.

calculated the price he was willing to pay.[50] However, if such information is not available, limitation of liability also militates against economic efficiency in the contractual setting. To induce economic efficiency in the transport sector, limitation of liability ought to be kept to a minimum. This argument therefore supports the narrower English approach.

[50] Wilhelmsen; *Rett i havn*, subchapter 12.4.2.4, and note 824.

Part VI

Too many claimants, too little insurance[1]

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[1] This article is a translation from my article in "*Festskrift till Lars Gorton*"

1 The problem

Most insurance policies are limited to a specific amount.[2] When there is only one claimant against the insurer, that does not cause any other problem but the shortage of money itself. When the insurer has paid out the money, there will possible a conflict regarding the further distribution of the insurance monies: Should they be included in the general estate of the claimant or should they be for the benefit of specific creditors, such as the patients of a doctor who is guilty of malpractice which again has triggered payments under his liability insurance.

If several persons can claim directly on the insurer, the limit of he insurance causes another type of problem: How should the insurance monies be distributed of they are or may be insufficient to cover all claims? The article deals with the substantive aspects of this issue - should all claimants be paid in proportion to their claims - as well as the procedural - how should the insurers and courts go about to handle a case like this?

Limited insurance amounts are found in all kinds of insurance. In marine insurance, with which I am more familiar, there is an overall limit of the P&I clubs' liability of USD 4-5 billion and special limits for bio-chemical risks and oil pollution risks. Hull insurance is usually limited to a specific amount, and war insurance (for hull and P&I combined) regularly consists of several layers that are all limited.

[2] Exceptions are, *ia*, the P&I system before the present overall limits were introduced, the Scandinavian car accident insurance schemes as far as personal injuries are concerned and - in most kinds of insurance - insurance for auxiliary risks such as legal costs to defend against the insured main claim.

This problem of distributing a limited insurance amount arises in different situations. If third parties have a direct action against the insurer, the problem of distributing the insurance sum among them may arise. Similarly, the issues may arise if there are several insured or beneficiaries under the insurance, and the policy does not address the problem. Finally, the problem may arise if an insurer has put an overall ceiling for payments under a group of policies; *eg*, a limit for terrorist related payments during a year. Such problems can be found in primary insurance as well as reinsurance.

If there are not only several claimants, but also several insurers, the problems increase in complexity. The insurer then would not only have to take into consideration what other claims there may be, but also possible payments - or non-payments - from other insurers, and he would have to consider recourse actions against other insurers. These issues are however not different in principle from the issues arising in other situations when there are multiple insurers. I will therefore, for the sake of simplicity, assume that there is only one insurer.

The claimants may agree on a procedure and a distribution of claims, they may join actions or they may pursue their claim in a group action. These eventualities will not be considered here.[3]

2 Is equity equality?

If there is not enough for everyone, the more common rule in the law is to pay each claimant in proportion to his claim (the *pro rata*

[3] The pro rata rule is strong in such cases, see COX V. BANKSIDE MEMBERS AGENCY LTD. [1995] 2 Lloyd's Rep. 437 at p. 463-4 per Gibson, LJ, COX V DEENY [1996] LRLR 288 QB and V. H. Cooper: Basis and manner of distribution among multiple claimants of proceeds of liability insurance policy inadequate to pay all claims in full 70 A.L.R.2d 416 (Westlaw, updated 2006) §§ 2(a) and 3.

rule). This is the rule in, *eg*, bankruptcy and global limitation of shipowners' liabilities, and relies of the old doctrine that equity is equality. However, apparently the views are divided in this particular situation. Quite a few courts have held that the principle should be first past the post - so that the insurer can pay claimants in full until the insurance limit is exhausted, and then rightfully can reject all claims.

In England, the preference for the first past the post rule was established in COX V BANKSIDE.[4] Here, several claimants sued the insurer under the Third Parties (Rights Against Insurers) Act, 1930 under an errors and omissions policy, confusingly enough in respect of errors and omissions committed by an insurance agent in arranging other insurance covers. Bingham, MR, put it this way:

> "The first basis rested on the familiar equitable principle that equality is equity. ... It was not however suggested that the maxim had ever been applied in any situation remotely like the present and I do not think crude application of this principle can displace the ordinary rule of chronological priority" (at p. 457).

Apparently, the English court felt that a specific basis would be needed to apply the equality rule in this case. It was not suggested that the claimants in fact were treated equally in that they had an equal chance to come first passed the post. But considerable efforts were made to demonstrate how difficult equal treat treatment of claimants would be in practice, not having a more or less well established procedure; unlike in bankruptcy and global limitation.

Despite some criticism of the principle,[5] the rule is apparently accepted in England.[6] The Law Commission did raise the issue in

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4 *Ibid*.

5 Clarke: The Law of insurance Contracts (4th ed, London: LLP 2002) para 5-8F1, Mance: Insolvency at sea [1995] LMCLQ 34, 53-55 and perhaps COX V DEENY, *supra*.

one of its consultation papers.[7] This could have been the chance to add the necessary legal basis and procedural rules for the *pro rata* rule. But neither the Commission nor the Government apparently can see a need for a change here.[8]

In Scandinavia[9], on the other hand, the pro rata rule has never been seriously challenged.[10] Apparently, there is a broad agreement on the rule. Sweden has even incorporated the rule in the new act on insurance contracts,[11] and it is also fund in the legislation on car accident insurance.[12]

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6 Birds and Owen: MacGillivray on Insurance Law (London: Sweet and Maxwell 2003) para 8-20 *et seq.*, Lowry and Williams: Insurance Law: Doctrines and Principles (2nd ed, Oxford: Hart 2005) p. 351-2, Merkin: Colonvaux's Law of Insurance (7th ed, London: Sweet and Maxwell 1997) para 19-20, Smith and Howe: Errors and Omissions Insurance and the Lloyd's Litigation: The Decision in Cox v Bankside, Int. I.L.R. 1995, 3(6), 208-210.

7 Third Parties (Rights Against Insurers) Act 1930. Law Commission Consultation Paper No 152/ Scottish Law Commission Discussion Paper No 104 (1997) part 7.

8 *Ibid.,* Lowry and Williams, *l.c.* p. 352, Department for Constitutional Affairs: Analysis of Responses to the Consultation Paper Third Parties - Rights Against Insurers: A Consultation Paper on the implementation of the Joint Law Commission and Scottish Law Commission Report, 'Third Parties - Rights Against Insurers' by way of a Regulatory Reform Order (London February 2004; http://www.dca.gov.uk/consult/rro/tprairesp.htm (accessed 28 Nov 2006)).

9 There is extensive cooperation on insurance legislation among the Scandinavian States.

10 Bull: *Innføring i forsikringsrett* (Oslo: Copied 2003) ch. IV.3.6.

11 SFS 2005:104 *Försäkringsavtalslag* 9Ch9§.

12 Norwegian Act relating to compensation for injury caused by a motor vehicle [Automobile Liability Act] 3 Feb 1961 § 9. Only liability for damage to property is limited, and therefore the rule only applies to such damage.

One reason for this position may be the strong ideological emphasis on equality in Scandinavia. Another may be the very wide powers of the courts to imply terms - including a term of *pro rata* distribution of implied insurance funds - in contracts.

In the US, insurance law is State law. The decisions are disparate, to some extent also within states.[13] A commentator who states that the majority of cases favor the first past the post rule does not seem to have taken all cases now published into account.[14]

The more frequent situation where the issues discussed here arise in the US is under different schemes for compensation for damage caused by uninsured motorists. The total amount of compensation under such schemes is often very low, but motorists that are careless with their insurance may seem to be likely to be careless in their driving, too. One state, New York, has enacted the *pro rata* rule for the purposes of a scheme of this type,[15] and this is also recommended in the literature.[16]

Internationally, the Legal Committee of the IMO has recommended the *pro rata* rule in connection with a SDR 340 million per incident terrorism cover for passengers.[17] Although this is insurance in respect of claims subject to global limitation, the insurance limit may be below the applicable global limit of the vessel, if any, so that

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[13] Keeton and Widiss: Insurance Law (St. Paul: West 1988 p. 790 *et seq* (a strong argument in favor of the *pro rata* rule), Hinshaw *et al.* 7A Am. Jur. 2d Automobile Insurance (Westlaw, updated 2006) § 431. An excellent policy discussion is Keeton: Preferential Settlement of Liability-Insurance Claims 70 Harv. L. Rev. 27.

[14] Cooper *l.c.* § 2[a].

[15] Keeton and Widiss l.c. p. 793, Cooper *l.c.* § 4[c].

[16] Keeton and Widiss l.c. p. 794, Cooper *l.c.* § 2[b].

[17] IMO Reservation and Guidelines for Implementation of the Athens Convention (Circular letter No. 2758, 20 Nov 2006) para 2.2.2. (I was involved in the drafting of the guidelines, which may explain my lack of critical distance.)

the pro rata rule of the applicable global limitation scheme would not apply.

The international maritime conventions on compulsory insurance for a fixed amount per incident do not require the insurer to prorate payments, although they allow him to do so.[18] But clearly, the intention is that all claimants should be treated on an equal footing, and that has also, as far as I know, been the practice of the insurers and the International Oil Pollution Fund.

A similar issue may arise if two or more insurers that covered the same liabilities under the Athens convention,[19] where there is a *per capita* limitation and, consequently, no arrangements for *pro rata* distribution. If one of the insurers then becomes insolvent, could then the other pay out the limitation amount in full on a first come, first served basis and leave the others to their destiny? Again, I would not think this would be the intention, given that the idea is to provide a minimum protection for passengers. But the drafters have obviously not taken the draconian effects of the first past the post rule into consideration.

In contract practice, insurers do not seem to have been very focused on the choice between the *pro rata* and the first past the post rule. Indeed, I have not been able to find any standard insurance clauses addressing the issue.

Altogether, it is not immediately obvious which should be the preferred rule of *pro rata* rule and the first past the post rule.

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[18] International Convention on Civil Liability for Oil Pollution Damage, 1992, art VII(8), which refers to art IV(4).

[19] IMO Reservation and Guidelines *l.c.* envisage two insurers, but they will cover different liabilities (war and non-war, respectively). However, the convention to which these Guidelines relate gives an indication that the insurance certificate may be backed by two or more insurers see Athens Convention Relating to the Carriage of Passengers and their Luggage by Sea, 2002, Explanatory Note 2 to the Annex.

From the point of the insurer, it is the easiest to pay to the first claimant if it is clear that he has to pay anyway - that saves administrative costs and dispose of all litigation with other claimants. Insurers would obviously favor the first part the post rule.

For the claimants, the first past the post rule is obviously the best for the first of them. But none of them can be sure to be first past the post. Therefore, claimants generally are better served by a *pro rata* rule than a first past the post rule - in that way, they will at least get something.

Unlike Bingham, MR in COX V BANKSIDE,[20] I would tend not to construe this as a matter of whether to limit the rights of the first claimant. That would in my view be a very formalistic analysis, which only focuses on whether there is a legal basis to subject the pursuit of his claim to a distribution procedure. A more realistic analysis is that this is a matter of whether one claimant should have preference before the others. And if the answer to that is no, I think the formal problems of subjecting the first claimant to a distribution procedure can be overcome in most legal systems.

Procedurally, the first past the post rule may seem easier to handle for the courts. They do not have to set up a distribution procedure. But the technical difficulties are, as discussed below, limited and manageable. They will inevitably cause delay, but it would be disproportionate to set aside the claims of later claimants only to avoid delay for the claimant first in line.

Also the first past the post rule does however entail procedural problems. Because the outcome of the insurance claims are dependent on the progress of each claimant in the court system, the courts must be extremely careful to treat all claimants equally - whatever that is when the issues differ. The problems in this respect

[20] *L.c.* at p. 457.

are insurmountable if the claims are subject to litigation in different jurisdictions.

In COX V BANKSIDE, Bingham MR suggests that the courts sometimes should make arrangements so that two completing claimants are getting their verdicts on the same day,[21] so that none of them passes the post before the other, and they consequently will obtain coverage *pro rata*. But it is not clear in which situations the courts should intervene in this way and in which cases it should not, and it may seem unsatisfactory that the outcome for the parties should depend on the administrative discretion of the court. And it would be unfortunate under such arrangements that neither of claimants can appeal the decision of the court (as they would thereby lose their priority), so that errors that court may have made cannot be corrected.

From a policy point of view, the first past the port rule is awkward, because provides an almost serendipitous advantage for the first claimant, which he, when contracting, cannot rely on obtaining. Occasionally, the position of the first claimant may not be totally serendipitous due to his special efforts to get ahead of the other claimants. But such efforts should hardly be encouraged by the legal system.

In my mind, the analysis demonstrates that the *pro rata* rule should be the preferred rule.

3 The dilemma of the insurer

If it is clear that the full amount under the insurance must be paid, the interest of the insurer is normally to pay out with as little litigation as possible. But the dilemma is: Could the insurer possibly incur liability in connection with such payments? If so, he may have to pay more than the insurance amount, and he would perhaps choose an over-cautious approach that is not in the interest of claimants.

[21] *L.c.* at p. 459.

Both under the *pro rata* rule of the first past the post rule, the problem is therefore whether the insurer can incur liability for having settled with one claimant to the detriment of all the others. Under the *pro rata* rule, liability may also incur because a new claimant turns up that has not been taken into account in the *pro rata* distribution of the limited insurance amount.

In the US, it is well settled law that an insurer does not incur liability for settlements in good faith in the situations discussed here.[22] I do not hesitate to recommend a similar rule for other jurisdictions, and believe that it is likely to be adopted in order to speed up settlements. The question is only what constituents a settlement in good faith:

Obviously, advance payments, *eg*, under the Montreal Convention[23] would be settlements in good faith. In these cases, the insurer is under a legally obligation to pay before a final judgement.

Even under the first past the post rule, where settlement or not may determine the fate of the other claims, the insurer cannot be obliged to contest all claims in court. He should be left a wide discretion in determining whether or not to accept a claim,[24] but should perhaps take the situation of the potential claimants - *eg*, the seriousness of their injuries under liability insurance - into consideration.[25] However, when there is much as stake for the

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[22] Ashley: Special Problems In Third-Party Cases Bad Faith Actions Liability & Damages (Westlaw, updated 2006) § 4:19, Cooper *l.c.* § 5, Russ: Distribution Among Multiple Claimants, 12 Couch on Ins. (Westlaw, updated 2006) § 170:29, Hinshaw *et al. l.c.* § 431.

[23] Convention for the Unification of Certain Rules for International Carriage by Air, 1999, art 28.

[24] In this direction, see Schermer and Schermer: Insurer's obligation to prioritize claims for settlement--The "first come, first served" rule, 1 Auto. Liability Ins. 4th § 11:1 (Wstlaw, updated 2006).

[25] Cooper and Huddleston: Annual Survey of Texas Law. Part II. Insurance Law, 46 SMU L. Rev. 1541 at p 1556-7.

claimants, but nothing at stake for the insurer (he has to pay his limitation amount anyway), courts should watch out for nepotism or indeed paybacks in the settlements. In such cases, the settlements should not be accepted as settlements in good faith.

Under the *pro rata* rule, the insurer cannot be expected to wait to the end of the limitation period before claims can be distributed. If the interest of speedy justice requires early payments, why should the insurer have to do so at his own peril? This is well in line with the common practice in global limitation and bankruptcy.[26]

In the Guidelines for the implementation of the Athens Convention, the Legal Committee of the IMO recommends (and allows) the following insurance clause in connection with a SDR 340 million ceiling for terrorism related passenger claims at sea:

> ".the distribution of this amount may be made in one or more portions to claimants known at the time of the distribution"[27]

This clause will make settlement easier for the insurer. First of all, he is allowed to distribute to the claimants known to him, and does not have to take into consideration that there may be other claimants that he does not know about. Second, he can distribute the amount in portions, so that he does not have to retain more than necessary for claims under litigation. Together, this means that a claimant that comes forward at a late stage may get less than a claimant that comes forward at an early stage, because there is not much left for the late claimant. However, the clause is in my view a fair balance between equality and speedy settlement.

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[26] See, *eg*, the wide powers for early distribution of a bankrupt's estate in Norwegian Act relating to Bankruptcy No. 58/1984 s. 127, translated at http://www.ub.uio.no/ujur/ulovdata/lov-19840608-058-eng.pdf (accessed 28 November 2006).

[27] IMO Reservation and Guidelines *l.c.* para 2.2.2.

An insurer that acts in this way will most likely be considered to act in good faith even without an express clause. Generally, it is likely that a careful insurer will not be put in much of a dilemma when settlements in good faith are recognized.

4 Procedural issues - both rules

Regardless of whether the first part the post rule or the pro rate rule should prevail in the relevant jurisdiction, there will be problems of procedure.[28] These problems relate to the fact that individual judgements would have to be coordinated. Under the *pro rata* rule, there will have to be a procedure for the distribution of the insurance amount. And under the first past the post rule, one needs to ensure that not all claimants obtain judgements and enforce them in full.

These problems could be difficult enough to handle within one jurisdiction, in particular if several courts or judges are involved. However, international aspects may add to the complexity.

At the enforcement stage, the situation may be that several claimants have a judgement against the insurer. They may attempt to enforce them in different jurisdictions if the insurer has assets in many jurisdictions and the judgements obtained are recognized in these jurisdictions. How can one then make sure that the

[28] In the discussions leading up to the Athens Guidelines, the P&I Clubs pointed out the procedural problems, which to them seemed insurmountable, see in particular their letter to the Correspondence Group 26 Mar 2006
http://folk.uio.no/erikro/WWW/corrgr/insurance/P&I28Mar06.pdf
(accessed 28 Nov 2006). Apparently, they used this as an argument against any insurance at all of the kind in discussion. The IMO Legal Committee neither found the problems insurmountable. But the analysis has certainly been helpful when writing this article.

enforcement is carried out on the basis of either a variation[29] of the pro rata rule or a version of the first past the post rule, and also coordinate the way the courts apply that rule?

It is not the recognition as such that is the problem. To the extent the individual judgements deal with the distribution of the limited insurance amount, they could hardly be binding on the other claimants who have not taken part in the action, and must therefore be subject to further distribution procedures. The recognition rules only make it impossible to choose the strategy to ignore foreign judgements.

Also when claimants seek judgements for their claims, there are problems. At the time when the first judgements are passed, the court and the parties may not be aware that there may be a problem with the limit to the insurance undertaking. And even if they are aware of it, different courts may make their decisions on the basis of different assumptions as to how the limited insurance amount should be distributed.

These problems could not be resolved by an ordinary jurisdiction clause in the insurance contract, let alone an arbitration clause. The problems discussed here typically arise when other than parties to the insurance contract can sue under it. And they are not necessarily bound by jurisdiction clauses,[30] and hardly ever by arbitration clause.

A particular problem is created by possible counterclaims between claimants and insurers. In many jurisdictions, a claimant

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[29] In this context it may, *eg*, be crucial whether the jurisdictions involved have the same view on *when* the post is passed under the first passed the post rule. Is it when a judgment is awarded, when it is *res judicata* or when it is enforceable in that jurisdiction?

[30] See, *ia*, Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters art 11.

may set off his debt to the insurer against his claim under the insurance by no other formalities than a simple declaration. This is so even in insolvency, when the claimant would otherwise only be entitled to a dividend of his claim. Can the claimant against an insurer who has limited his liability avoid the adverse affects of he *pro rata* rule or the first past the post rule by declaring a set off? And how would that effect the proceedings concerning other, competing claims?

The solution seems to be to centralize the distribution of the limited insurance amount to one jurisdiction, so that the specific rules of that jurisdiction would be decisive for all in respect of set off and the general strategy for the distribution of the insurance amount (*ie*, some variation of the pro rata or first past the post rule). When such proceedings are opened, they would trigger the *lis pendens* and recognition and enforcement rules of the Brussels regulation, which also apply in respect of judgments *erga omnes*.[31]

This is the strategy chosen in the Athens Guidelines, by allowing the insurer under the compulsory scheme to include a specific jurisdiction clause relevant to the distribution of the limited insurance amount.[32] It is likely that these guidelines will become an integral part of EU law, so that the issue of their relation to the earlier and more general Brussels regulation does not arise. However, more generally the relationship to the Brussels regulation must be clarified. Will a jurisdiction clause for the distribution of a limited insurance amount be acceptable?

The starting point is that jurisdiction clauses are enforceable. The problem relates to the third party claimants (if third part claims are allowed), who have not accepted the jurisdiction clause. As stated

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[31] ECJ case C-39/02 MÆRSK OLIE & GAS A/S V FIRMA M. DE HAAN EN W. DE BOER (ECR 2004 p. I-9657).

[32] The IMO Reservation and Guidelines *l.c.* para 2.2.2.

above, the Brussels Regulation provides a right for them to sue the insurer where the damage occurred, regardless of the jurisdiction clauses of the insurance agreement. However, it is submitted that this only applies to actions to establish the claim, and that the claim still might be subject to general distribution procedures, such as the insolvency procedure of the insurer, global limitation procedures, general average procedures and - procedures for the distribution of a limited insurance amount. There is simply no indication that the Brussels Regulation is intended to overrule such procedures. That would also have been quite meaningless.

Clauses in the insurance contract that render the right of direct action illusory may be set aside, either under the law of the insurance contract or the overriding law of the *lex fori* where direct action is sought. An example is the paid to be paid rule in P&I insurance. However, the jurisdiction clauses recommended here are of another nature. It s submitted that the direct action claimant must accept them as an integral part of the insurance arrangements he seeks to benefit from.

Altogether, there is a need for a coordinated procedure for the distribution of the limited insurance amount, regardless of whether the preferred rule for the distribution would be the *pro rata* rule or the first past the post rule. Such a coordinated procedure can be achieved by an appropriate jurisdiction clause for the distribution procedure.

5 Procedural issues - the *pro rata* rule

Under the *pro rata* rule, additional procedural issues arise.

If one recognizes that the insurer shall have liberty to settle claims under the *pro rata* rule in a sensible manner (*supra* 3), a court of law should, of course have he same liberty when the limitation amount is paid into the court or a similar procedure is applied. Often, however, a court will feel a need for rules that are

more stringent in the sense that they do not leave much room for discretion.

In some cases, there will be a distribution of funds for other reasons. In maritime law, there may be a global limitation procedure or a general average adjustment. The insurer may also be subject to insolvency proceedings. In such cases, the distribution of the limited insurance amount could easily follow the same procedure as the distribution of the proceeds in general.

When a system for prorating is in place in this way, it would indeed require some dogmatic guts to insist on the first past the post rule, even if that would be applicable in the outset. But theoretically, it would be possible to insist that the latest claimants have no claims at all - not even a claim for dividend - also in such cases.

If the basis for the insurer's limitation only is based on the global limitation rules, obviously the *pro rata* procedure of these rules must be adhered to. But the insurer may have limited his exposure to the global limitation amount also in the insurance contract. In that case, the first past the post rule could be applied, *eg* if there is direct action against the insurer. These situations are similar to the situation in which the insurer has limited his liability to a limit that is lower than the global limitation amount.

In the majority of cases, where there are no such procedures for the distribution of funds pending, it is submitted that courts should look to the practice in such cases when faced with a claim for a *pro rata* distribution of a limited insurance amount. Without going into details of the inherent powers of the courts under different legal systems, it is likely that the limitation rules can be used by analogy. If the rules for global limitation procedure are fragmentary - this is not uncommon - then the court still would have to handle limitation cases, and it is submitted that handling the distribution of a limited insurance amount *pro rata* is no greater challenge.

Admittedly, there would however be some procedural hitches here. First, the court must somehow make sure that the insurer pays for the costs of the distribution of the case. The insurer is

usually liable to pay costs in addition to the insurance amount, and must also undertake to distribute of the amount, and there is no reason why he should come out better by leaving this to the court. Furthermore, the insurer will hardly be interested in defending any claim, as he will only pay the insured amount anyway. Therefore, the other claimants - to whom illegitimate claims are threats - should somehow be allowed to challenge a claim. In most cases, the court hopefully has an inherent jurisdiction to find good procedural solutions.

There are, however, procedural issues that arise in this context that hardly can be resolved without the intervention of the legislator, at least in the traditions with which I am familiar. First, if a claimant takes over the role of the insurer to challenge unfounded claims, the better rule would be that the costs in such litigation, at least if successful, should be levied on the insurer or the amount to be distributed, and not on the individual claimant who challenged the competing claim. Second, there should be a possibility to distribute the insurance amount where a global limitation fund has been constituted - even if constituted outside the jurisdiction where actions against the insurer usually can be brought - in order to take advantage of the similarities in the procedures.[33] Ideally, these matters should be addressed by the relevant legislators or appropriate insurance clauses. However, even if these matters remain unresolved, the courts would be able to deal with the *pro rata* rule to the extent necessary to effectuate the terms of the insurance agreement.

[33] The IMO Reservation and Guidelines *l.c.* para 2.2.2 allows the claims to be brought "in any State Party in which legal proceedings are instituted in respect of claims allegedly covered by the insurance," which is identical to the jurisdiction prescribed for constituting a limitation fund in the Convention on Limitation of Liability for Maritime Claims, 1976, art 11.

6 Conclusion

The use of limits to the exposure of the insurer may prove problematic when there is more than one claimant. The problems are far from ignorable, but they are possible to handle, regardless of whether the principle for distribution is *pro rata* or first past the post.

Insurers, insureds and potential claimants who are aware of the problems caused by limited insurance amounts are likely to attempt to find alternative solutions, and avoid the clauses to the extent possible. Adding appropriate clauses to the insurance contract may help the situation. The most important would be a clause for the distribution of the limited insurance amount in one specific jurisdiction. Also some rules on the distribution procedure may be helpful, to the extent these are accepted by the court of distribution. The same goes for a clarification of whether the principle of first past the post of *pro rata* should be applied. In the latter issue, the *pro rata* rule is clearly preferable.

Part VII

EC agency law and intermediaries in shipping

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1 Introduction – recent developments in EC agency law

The aim of this article is to present the recent developments in EC agency law concerning the applicability of the directive on the coordination of the laws of the Member States relating to Commercial Agents[1] ("the directive").

The directive is of interest for several reasons. It represents one of the few areas of contract law in the EU, outside the field of consumer law, where there is harmonised hard, rather than soft, law.[2] The substance of the directive is also interesting, as it harmonises rules in an area where there has been, and still is, a wide gap between the common law and continental perspectives.[3] The whole concept of agency law differs in the two legal traditions. In the common law system, questions concerning agency have centred on the intermediary's capacity to bind the principal. Because of the fiduciary nature of the relationship, the reasoning behind the common law position was that it was the principal who was the party in need of protection. The agent's capacity to affect the principal's legal position therefore had to be limited.[4] The directive is not concerned with such issues, but instead regulates

[1] Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to commercial agents.

[2] The European Principles of Contract Law (PECL) lack legislative recognition, and it is likely that the Common Frame of Reference, prepared by various working groups in Europe, will be of a soft law nature as well.

[3] Prior to the directive, the "Commercial Agent" did not exist as a legal concept in English common law and there was no understanding of the concept of commercial agency. See Severine Saintier: Commercial agency law. A comparative analysis. Aldershot 2002, p. 208.

[4] Op. cit., p. 48.

the relationship between the principal and the intermediary, the so called "inner" relationship.

It was nevertheless difficult, even in respect of this inner relationship, to find a common European platform on which to base the rules of the directive. The greatest difficulties were encountered in reaching agreement on the rules regulating termination of the agency contract. At the time the wording of the relevant provisions had to be agreed, art. 100 of the EC treaty required the European Council to reach a unanimous decision. It was clear that this was impossible and, as a result, a compromise was adopted whereby Member States could choose between alternative provisions that offered either a French system of damages or a German system of indemnity on contract termination. As most Member States have adopted the "German" system, this system has also received the most attention in the case law handed down by the European Court of Justice ("the ECJ"). It is the *applicability* of the provisions dealing with this indemnity system, established under articles 17(2) and 18 of the directive, that is the subject of this article.

Because of the political and procedural difficulties of reaching agreement on the directive, its *scope* and *content* both became more and more limited until a compromise was finally reached in 1986. It was only in the final version of the directive that the alternative systems, providing for either damages or an indemnity on contract termination, were first presented. At the same time, the scope of the directive was limited to commercial agents negotiating the *sale or purchase of goods.* Commercial agents negotiating contracts for services were excluded. No formal explanation was given for this, even though comments from various institutions and committees within the EU on the previous proposals had given a

green light to the inclusion of such agents within the scope of the directive.[5]

Against this background, it is remarkable to read two recent preliminary rulings from the ECJ on the scope of application of the provisions concerning the agent's right to an indemnity. Following these rulings, the scope of the directive has been comprehensively extended. The first ruling was in the well-known case of Ingmar GB Ltd v Eaton Leonard Technologies Inc[6] (INGMAR V. EATON), where the ECJ decided that the mandatory rules of the directive must apply despite the inclusion of a choice of law clause in the agency contract that might have led to a different result. In other words, the provisions regulating the commercial agent's right to an indemnity on contract termination ("the indemnity provisions") are internationally mandatory.[7]

This decision has been criticised for going too far in limiting the basic tenet of private international law concerning the freedom of the parties to choose the system of law by which they wish their contractual relations to be governed.[8]

The second case is the more recent one of Poseidon Chartering BV v. Marianne Zeeschip VOF and others (POSEIDON V. MARIANNE ZEESCHIP).[9]

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5 For the English perspective, see The Law Commission, Law Com. No. 84 Law of Contract Report on the proposed E.E.C. Directive on the Law relating to Commercial Agents. October 1977. As a critical comment to this, see Ole Lando: The EEC Draft Directive relating to Self-Employed Commercial Agents. The English Law-Commission versus the EC Commission, RabelZ 1980, p. 1-16.

6 Case 381/98 INGMAR v. EATON [2000] ECR I-9305.

7 See 5.1 below.

8 See Maarit Jänterä-Jareborg: *När är harmoniserade gemenskapsregler internationellt tvingande?* (When are harmonized EU rules internationally mandatory?) Europarättslig Tidsskrift 2004 p. 403-413 at p. 411.

9 Case C-3/04 POSEIDON V. MARIANNE ZEESCHIP, not yet published.

The basic question in this case concerned the definition of a commercial agent in art. 1 (2) of the directive. The court ruled that the fact that the intermediary had only *negotiated one contract* was not decisive; it was not prerequisite that he should have negotiated several contracts. The essential question was rather whether the intermediary had a *continuing authority* to contract on behalf of the principal.[10]

The intermediary in this case had arranged the *charter of a ship*. Such an intermediary would not normally be caught by the directive, as the contract in question would be for the supply of *services*, not *goods*. The wording of the directive provides that it applies solely to self-employed intermediaries with authority to negotiate contracts for the supply of goods, *not* intermediaries with authority to negotiate contracts for services.[11] In this particular case, however, the national legislator (the Netherlands) had extended the scope of the term commercial agent to include intermediaries negotiating contracts for services.

As the court decision was to take the form of a preliminary ruling on the interpretation of EC law, the ECJ had to discuss thoroughly the demarcation between national and EC law to decide if it had *jurisdiction* in the case. The arguments used to confirm the court's jurisdiction are interesting on a general level and also specifically with regard to the shipping industry, where different types of intermediary are commonly used.

The result of the court's deliberation was that, provided certain pre-conditions were fulfilled, agents negotiating contracts for the supply of services were also covered by the provisions of the

[10] Op.cit. Oppart.

[11] See POSEIDON V MARIANNE ZEESCHIP at 11 and the Court order of 6 March 2003 in Case C-449/01 ABBEY LIFE ASSURANCE, not published.

directive, including the indemnity provisions contained in article 17 (2).

This article summarises the rulings in the two cases mentioned above and also discusses their possible consequences. It may be possible to argue that the indemnity provisions now apply to all commercial agents operating in the EU, provided the relevant Member State has widened the scope of the term commercial agent to include agents negotiating contracts for *services*. As we will see, quite a few member states have done this. If a shipping agent can be classified as a commercial agent, the EC rules on remuneration on termination of the relevant agency contract, as implemented in the respective Member State, will apply.

Before we turn to the question of applicability, the following section contains a summary of the relevant provisions, together with some recent case law that gives some guidance on the complicated issue of their interpretation.

2 The EC Rules on Indemnity on Termination of Commercial Agency Contracts

2.1 The preconditions outlined in the Directive

The provisions regulating the commercial agent's entitlement to an indemnity are contained in articles 17-19 of the directive. These rules ensure the commercial agent a certain level of economic compensation when the agency contract is terminated. The basic reasoning behind this system, which is harmonised throughout the EU, is the elimination of restrictions on the carrying-on of the activities of commercial agents, the achievement of uniformity in

conditions of competition within the community and increased security for commercial transactions.[12]

More important for understanding the interpretation of the provisions is, however, an appreciation of the underlying purpose of the directive and, in particular, of the provisions on indemnity and damages. This underlying purpose is *the protection of the commercial agent after termination* of the agency contract. The directive presupposes that every agent is in need of protection. This need of protection need not be proved; also an agent without any need of protection might claim indemnity according to the directive.

This principle of protection of the agent was explicitly spelt out in the decision in INGMAR V EATON, where the court stated: "The purpose of Articles 17 to 19 of the Directive, in particular, is to protect the commercial agent after termination of the contract".[13]

Article 17 sets out the basic rule, under which Member States are required to take measures necessary to ensure that the commercial agent is, after termination of the agency contract, entitled to remuneration. The Member States can choose whether remuneration should take the form of an *indemnity,* pursuant to art. 17 (2), or *damages,* pursuant to art. 17 (3).

The Nordic countries, like most EU Member States, opted for the remuneration to take the form of an indemnity, pursuant to art. 17 (2). The summary provided here is therefore limited to this situation. Questions concerning applicability will, of course, be the same regardless of the system of remuneration chosen by an individual Member State.

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[12] Case C-215/97 BARBARA BELLONE V. YOKOHOMA SPA [1998] ECR I - 2191 at 10 and 17, see also INGMAR V. EATON at 23.

[13] INGMAR V. EATON at 21.

Article 17 (2), provides:

> (a) The commercial agent shall be entitled to indemnity if and to the extent that:
>
> – he has brought the principal new customers or has significantly increased the volume of business with existing customers and the principal continues to derive substantial benefits from the business with such customers, and
>
> – the payment of this indemnity is equitable having regard to all the circumstances and, in particular, the commission lost by the commercial agent on the business transacted with such customers. Member States may provide for such circumstances also to include the application or otherwise of a restraint of trade clause, within the meaning of Article 20;
>
> (b) The amount of the indemnity may not exceed a figure equivalent to an indemnity for one year calculated from the commercial agent's average annual remuneration over the preceding five years and if the contract goes back less then five years the indemnity shall be calculated on the average for the period in question,
>
> (c) The grant of such an indemnity shall not prevent the commercial agent from seeking damages.

In short, this means that the commercial agent, as a basic starting point, is entitled on termination of contract to payment of an indemnity that is not to exceed one year's remuneration. The indemnity is not in lieu of damages and, accordingly, the rules also apply where the contract is terminated "legally", following a period of notice, as regulated by art. 15 of the directive.

The agent will lose entitlement to the indemnity if *either:* he fails to notify the principal, within the time limit of one year following termination of the contract, that he intends to pursue his entitlement, art. 17 (5); *or* the contract was terminated on the grounds of fault attributable to the commercial agent that would justify immediate termination of the contract under national law, art. 18 (a); *or* if the contract was terminated without due cause by the commercial agent himself, art. 18 (b). In addition, an agent who

assigns his rights and duties under the agency contract to another agent will lose the right to remuneration at termination, as this right follows the contract, art. 18 (c).

With the exception of the above situations, as set out in articles 15, 17 and 18 of the directive, the commercial agent is entitled to an indemnity as provided in art. 17 (2). The parties may not derogate from the articles mentioned above before expiry of the contract. This mandatory element is spelt out in art. 19 and was made internationally mandatory by the ECJ in INGMAR V. EATON. This case is discussed further below under 5.1.

2.2 Recent guidelines on the interpretation of the rules on indemnity

The interpretation of the provisions on indemnity is complex and any attempt to summarise it lies far beyond the scope of this article.[14] There are, however, a few questions relating to the use of *legal sources* and the *discretion of national courts* on the calculation of the indemnity on which I would like to comment.

According to art. 17 (6) of the directive, the Commission was to submit to the Council a report on the implementation of art. 17, and, if necessary, submit proposals for amendments.

The Report, "Council Report on the application of Article 17 of the Council Directive on the coordination of the laws of the Member States relating to self-employed commercial agents", was submitted in 1996.[15] Basically, the Report made reference to the

[14] As the workings of the German legal system seem to be crucial to understanding the provisions on indemnity in the directive (see discussion below), it may be useful to refer to the basic book on this topic: Wolfram Küstner and Kurt Manteuffel: *Handbuch des gesamten Aussendienstrechts*, Band 2, *Der Ausgleichsanspruch des Handelsvertreters*, Heidelberg 1995.

[15] COM (1996) 364 final.

German system for calculating the agent's *Ausgleichanspruch*, according to the German HGB § 87 b), and attempted to outline the principles of this system. The report failed, however, to give a "correct" picture of the German system and was criticised for containing direct misunderstandings of it.[16]

The legal status of this document has consequently been debated, along with the influence of the German domestic rules on indemnity *(Ausgleich)* on the termination of agency contracts.[17]

From a specifically Norwegian point of view, it may be worth mentioning that the Norwegian preparatory work on the implementation of the directive in Norwegian law (Norway is obliged to implement the directive under the EEA agreement) expressly provides that if it is unclear how to interpret a provision under the Norwegian rules concerning payment of an indemnity[18], German law may be of assistance.[19] It is quite uncommon to refer to foreign domestic law in this way as a legal source for solving domestic legal problems, but it illustrates the difficulties associated with these provisions.

A recent decision by the ECJ has somewhat clarified the legal status of the Council Report. The decision was a preliminary ruling under art. 234 in Honyvem Informazioni Commerciali Srl v. Mariella De Zotti (HONYVEM V. MARIELLA).[20] In this case, the ECJ dealt with

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16 See Ute Sellhorst and Alison Dennis: Payments on Termination of Commercial Agents´ Contracts: The German System for Compensation Payments and the Commission Report, International Company and Commercial Law Review 1997 p. 323-366.

17 See Ellen Eftestøl-Wilhelmsson: *Fra etterprovisjon til avgangsvederlag. Handelsagentens sluttoppgjør i et historisk og komparativt perspektiv*. (The Right of the Commercial Agent to Termination Payment in a Comparative and Historical Perspective), Oslo 2005 p. 51 *et seq.*

18 *Lov om handelsagenter og handelsreisende* (The Commercial Agents Act) 56/1992 § 28.

19 Ot. prp. nr. 49 (1991-92) *om lov om handelsagenter og handelsreisende* (Norwegian preparatory bill on The Commercial Agents Act) p. 69.

20 Case C-465/04 HONYVEM V. MARIELLA, not yet published.

three questions concerning a particular Italian system of calculating the indemnity in conjunction with the provisions of a collective agreement. The ECJ ruled that it was a violation of the mandatory nature of the indemnity rule to agree an indemnity that was smaller than that to which the individual agent would be entitled under the directive.

The court admitted, however, that even though the system established by art. 17 is mandatory and outlines a *framework*, it does not "give any detailed indications as regards the method of calculation of the Indemnity before termination of contract".[21] In its use of the word "framework", the court referred to the judgment in INGMAR V. EATON paragraph 21. In that case, the word framework referred to articles 17 and 18 of the directive.

In HONYVEM V. MARIELLA, the court expanded the scope of the framework to include the Council Report, thereby giving it legal status as a relevant legal source in the interpretation of the indemnity provisions of the directive. This is the consequence of paragraph 35, where the Court commences its argument by stating that the Member States may exercise their discretion as to the choice of method for calculating the indemnity.[22] The court then mentions the Council Report, submitted by the Commission, and states: "That report provides detailed information as regards the actual calculation of the indemnity and is intended to facilitate a more uniform interpretation of Article 17. Therefore …within the framework prescribed by Article 17(2) of the Directive, the Member States enjoy a margin of discretion which they may exercise, in particular, in relation to the criterion of equity."[23]

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[21] HONYVEM V. MARIELLA at 34.

[22] This already follows from INGMAR V. EATON at 21, as pointed out by the ECJ in HONYVEM V. MARIELLA at 35.

[23] L.c.

We might conclude that the ECJ has elevated the criticised Report of the Commission to the status of a relevant legal source for dealing with questions concerning the calculation of an indemnity pursuant to art. 17 (2) of the directive, thus simplifying the process. As already mentioned, the following discussion concerns the types of intermediaries to which this indemnity rule applies. Before we turn to the content of the relevant judgments, the following section examines the legal definition of a commercial agent, as set out in the directive.

3 To whom does the indemnity protection apply?

3.1 Commercial agents as defined in the directive

Articles 1 and 2 of the directive set out its scope and contain the definition of a *commercial agent*. According to art. 1 (2), for the purpose of the directive, a commercial agent is:

> "…a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the "principal", or to negotiate and conclude such transactions on behalf of and in the name of that principal."[24]

[24] According to art. 1 (3) of the directive, this does not include:

- a person who, in his capacity as an officer, is empowered to enter into commitments binding on a company or association,
- a parter who is lawfully authorized to enter into commitments binding on his partners,
- a receiver, a receiver and manager, a liquidator or a trustee in bankruptcy.

According to art. 2, the directive shall not apply to:

- commercial agents whose activities are unpaid,

Accordingly, there are three main prerequisites that must be fulfilled in order for an intermediary to be classified as a commercial agent under the directive.

Firstly, the intermediary has to be *self-employed,* as opposed to a regular employee. This requires a certain degree of independence. The German *Handelsgesetzbuch* (Commercial Code) § 84, first paragraph, second sentence puts it as follows: "*Selbstendig ist, wer im wesentlichen frei seine Tätigkeit gestalten und seine Arbeitzeit bestimmen kann*". The intermediary must be able to decide how and when to perform his obligations under the intermediary contract. The concept is one of a business-to-business arrangement, where the intermediary assists the principal in obtaining and concluding contracts. A commercial agent is thus normally responsible for his own expenses in relation to the contract. His pay will frequently vary according to the number or value of business transactions concluded, although this is not a pre-condition for being classified as a commercial agent.

Secondly, the intermediary must have *continuing authority to negotiate* on behalf of another person or to negotiate and conclude transactions on behalf of and in the name of the principal. In other words, the commercial agent is not a party to the contract, but he may be entitled to conclude contracts on behalf of his principal. As a commercial agent, according to the directive, must have *continuing authority* to negotiate, the contractual relationship ought to be *long-term*. Consequently, the commercial agent has a duty to look after his principal's interests and act loyally and in

– commercial agents when they operate on commodity exchanges or in the commodity market, or
– the body known as the Crown Agents for Overseas Governments and Administrations, as set up under the Crown Agents Act 1979 in the United Kingdom, or its subsidiaries.

good faith. This duty also follows from art. 3 of the directive. The total number of contracts negotiated is, as will be outlined in section 4 below, not relevant.

A third pre-condition is that the commercial agent must act in relation to the *sale or purchase of goods*, not services.[25] However, if the individual member state has made the EC rules also applicable to agents for services, such agents will also be caught by the directive. This is one of the key issues discussed in section 4 below.

3.2 What about the various types of intermediary involved in shipping?

There are many types of intermediary involved in the shipping sector and it is not always easy to classify the different actors, as the same party may wear different legal "hats" in different situations.

In practice, a shipping business may be involved in all sorts of activities, both in relation to shipowning and/or chartering and in various intermediary roles. From a legal point of view, it is important to distinguish between these different roles. If an agency contract can be characterised as long-term and the intermediary is self-employed, but has continuing authority to negotiate contracts for or on behalf of the principal, there is a risk that the mandatory EC rules will apply if the contract is terminated. The fact that the intermediary is involved in the shipping business will not necessarily exclude him from the general provisions of the directive.

[25] It may sometimes be difficult to draw a distinction between goods and services. This is especially true when the goods also contain an element of service, see Mads Bryde Andersen: *Handelsagentlovens anvendelse ved distribusjon av edb-programmer* (The applicability of the Commercial Agency Code in the distribution of software programs), Ugeskrift for Retsvæsen 1995 B p. 169-176.

For the directive to apply, however, it must be possible to classify the shipping intermediary in question as a commercial agent as defined in the directive. It is not easy to make a general statement on the classification of all the various intermediaries involved in shipping, as a "label" applied in everyday life may not always reflect the legal status of the intermediary in question.

Nevertheless, it is possible to provide some guidelines. In general, there are three main categories of intermediaries involved in shipping: *ship's agents*, *forwarding agents* and *shipbrokers*.[26]

There are basically two types of *ship's agents*: port agents and liner agents. A *port agent* is generally appointed by the shipowner to attend to all the business of the vessel while in port and will be authorised to deal with all normal matters arising, including: ordering, at the request of the master, necessary supplies on behalf of the vessel and her owner; payment of port and other dues; arranging pilotage; and making cash advances to the master.[27]

As far as the obligations of the ship's agent involve the negotiation of contracts for the sale or purchase of *goods* (e.g. necessary supplies) on behalf of the shipowner or the charterer, the ship's agent may well fulfil the directive's definition of a commercial agent. It is quite clear that ship's agents are not employees, but act independently. As far as the ship's agent is involved in negotiating the sale or purchase of goods, he comes directly within the scope of the directive. If the purpose of the intermediary contract is the negotiation of *contracts for services*, the intermediary will be regulated by the directive if the relevant member state has included agents negotiating such contracts within

[26] See Lars Gorton: Intermediaries in Shipping, in Intermediaries in Shipping, Sjörättsföreningen i Göteborg, 1991 p. 27 *et seq*.

[27] Op. cit. p. 33.

the scope of the directive.[28] In both cases, the key question is whether or not the authority of the intermediary is "*continuing*", in other words, whether the contractual relationship is *long-term*.[29]

The *liner agent* is normally tied to a liner carrier, who in this context is the principal. The liner agent functions as a kind of general agent of the shipping line. In the booking of cargo, the liner agent represents the principal. In this capacity, the agent identifies potential shippers, either by making direct contact or through freight forwarders. Once the booking has been accepted, it is made by the liner agent on behalf of the carrier. When deciding whether a liner agent can be classified as a commercial agent within the framework of the directive, it is necessary to establish whether the relevant member state has extended the scope of the directive to include agents for services and whether there is a long-term contractual relationship between the liner agent and the carrier.

The second category of intermediary consists of the *freight forwarders*. A freight forwarder's tasks include assisting the cargo owner with the carriage of goods, the storage of goods and other services connected with the transport and storage of goods.[30] Freight forwarders may perform these services either as intermediaries or on their own account, either as contracting carriers assuming liability without performing the carriage themselves or as performing carriers. The EC rules on commercial agency may apply, but only where the freight forwarders are not themselves *party to the contract.*

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[28] See below 4.2.3.

[29] See below 4.1.3.

[30] See e.g. *Nordiskt speditørforbunds alminnelige bestemmelser* (The Nordic Association of Freight Forwarders' General Conditions) 2000 § 2.

According to Ramberg, it is not unusual for *freight forwarders* to act as agents for a liner shipping company.[31] In this case, the agency will usually be exclusive, so the freight forwarders will book all cargo with the shipping line they represent, unless specific instructions to the contrary are received from the shipper.[32] When an agent has such an exclusive right to represent a liner shipping company, one could argue that the relationship must be seen as long-term, with the freight forwarders having a continuing authority to negotiate the cargo contracts, as is outlined in section 4 below.

The third category of intermediaries consists of the *shipbrokers*. Contrary to freight forwarders, shipbrokers can be characterised as true "middlemen", as they facilitate contractual negotiations between the parties, but are not themselves party to the contract.[33] Shipbrokers negotiate all kinds of contracts for both the supply of services and the sale and purchase of goods. Examples would include contracts of affreightment and charter parties, as well as other shipping contracts such as those for ship sale and purchase. Normally a shipbroker does not have long-term relations with the party on whose behalf he is acting and therefore does not have any

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31 Jan Ramberg: The Law of Freight Forwarding (Intermediaries in Shipping, Sjörättsföreningen i Göteborg, 1991 p. 135). The easy-going use of the term liner agent employed by Ramberg may seem puzzling, especially in the light of Falkanger/Bull/Brautaset's statement: "The liner agent must not be confused with the freight forwarder" (see Thor Falkanger, Hans Jacob Bull, Lasse Brautaset Scandinavian maritime law, The Norwegian perspective, 2nd ed., Oslo 2004 p. 158). I believe there is no divergence between the authors in relation to the main practical functions of the two groups. Nevertheless, I do think Ramberg is right in the sense that a freight forwarder may also wear different legal hats and, when performing on a long-term basis on behalf of one principal, must legally be considered a liner agent.

32 L.c.

33 Thor Falkanger, Hans Jacob Bull, Lasse Brautaset, op. cit., p. 157.

"continuing authority" to negotiate on behalf of one single principal.

There are, however, different types of shipbroker and, from a legal point of view, a general distinction can be drawn between those who represent *one of the interests only* and those that have a *more independent role*. As a starting point, only the former may be characterised as commercial agents according to the directive. This group of shipbrokers can be further sub-divided into: *owner's brokers,* who act on behalf of the shipowner to find cargoes (or charterers) for the ship; and *charterer's brokers,* who act on behalf of the charterer to find ships to meet his needs, e.g. to ship cargo. If a shipbroker handles all the business of a particular principal, he may be referred to as a *confidential broker*.[34]

Previously, the motivation for entering into such an arrangement was frequently the shipowner's need for cash. The idea was that the broker would finance parts of the shipowner's business and, in return, be appointed as a permanent (or confidential) broker. The Norwegian Professor Emeritus Sjur Brækhus described this situation in an article published in 1955.[35] Because of the similarities between an agent and a confidential broker, Brækhus decided not to deal with these agreements in his book: "The legal position of the shipbroker".[36]

As mentioned above, the starting point is that only shipbrokers with a duty of loyalty towards the principal come within the scope of the directive. In such cases, the traditional sub-condition requiring "long-term" relations is normally fulfilled. However, according to recent case law from the ECJ, shipbrokers without any

[34] See Nicholas Gaskell: Shipbrokers (Intermediaries in Shipping, Sjörättsföreningen i Göteborg, 1991 p. 43 – 113 on p. 53).

[35] *Avtaler om "fast meglerforbindelse"* (Agreements on a "permanent broker" relationship), Arkiv for Sjørett bind 2 (1955) p. 474-492.

[36] See Sjur Brækhus: *Meglerens rettslige stilling* (The legal position of the broker), Oslo 1946, p. 411.

explicit duty of loyalty towards the principal may also be defined as commercial agents according to the directive. This was the case in POSEIDON V. MARIANNE ZEESCHIP. Following this case, it might be argued that an independent intermediary in shipping, who has operated on behalf of the same principal for several years in succession, comes within the scope of the directive. If the contract(s) negotiated by the intermediary relate to the sale or purchase of goods, the EC rules apply directly. Following POSEIDON V. MARIANNE ZEESCHIP, agents negotiating contracts for *services* may also come within the rules, provided that the relevant member state has enacted legislation accordingly. The following section discusses the consequences of POSEIDON V. MARIANNE ZEESCHIP.

4 The questions put to the European Court in POSEIDON V. MARIANNE ZEESCHIP

4.1 Is an intermediary who has negotiated a single contract a commercial agent?

4.1.1 Background to the decision

As we have seen, the indemnity provisions contained in the directive apply to an intermediary that can be legally classified as a commercial agent according to articles 1 and 2. This means that, in many situations, intermediaries operating in the shipping business will be caught by the directive. This has now been confirmed by the ECJ in POSEIDON V. MARIANNE ZEESCHIP. In this case, the ECJ limited the question to be answered to concern an intermediary *exclusively in the shipping business* "with authority to conclude a single charter for a ship".[37]

[37] POSEIDON V. MARIANNE ZEESCHIP at 20.

More precisely, the question was whether an intermediary, who had negotiated *only one contract* that related to a *service* (the transportation of cargo), could be classified as a commercial agent. The first part of the question refers directly to the applicability of the directive, while the second concerns the extent of the European Court's jurisdiction.

It was clear from the order reference that Poseidon had acted as intermediary in a ship charter concluded between Marianne Zeeschip and a company called Maritramp. The charter was extended annually from 1994 to 2000. During that time, Poseidon recorded, inter alia, the outcome of the annual negotiations to extend the charter in an addendum thereto. Between 1994 and 2000, Poseidon received commission in the sum of 2.5% of the charter price. After contractual relations between Marianne Zeeschip and Poseidon were terminated, Poseidon brought an action against Marianne Zeeschip claiming damages for breach of the contractual notice period, unpaid commission and an indemnity for loss of custom.[38]

Marianne Zeeschip refused to pay, arguing that Poseidon was not a commercial agent because it had negotiated only one contract and that a commercial agency contract was characterised by the agent being involved in more than one contract.

The national court[39] addressed three questions to the ECJ:[40]

> 1) Is a self-employed intermediary, who has arranged (not several but) one contract (a charter for a ship) which is renewed every year and pursuant to which, in respect of the renewal of the charter, the annual freight negotiations (except, during the period from 1994 to 2000, in 1999) are conducted between the owner of the ship and a third party and the outcome of those negotiations is recorded by the

[38] POSEIDON V. MARIANNE ZEESCHIP at 7 and 8.

[39] Rechtbank Utrecht – Utrecht District Court.

[40] POSEIDON V. MARIANNE ZEESCHIP at 10.

> intermediary in an addendum, to be regarded as a commercial agent within the meaning of Directive 86/653...?
>
> (2) If it has to be determined whether an agency contract exists, does it make any difference to the answer to Question 1 that remuneration (commission) of 2.5% of the charter has been paid over many years and/or that Article 7(1) of the Directive refers to transactions concluded and to the existence of an entitlement to (the) commission where the transaction is concluded with a third party whom [the intermediary] has previously acquired as a customer for transactions of the same kind?
>
> (3) Does it make any difference to the answer to Question 1 that Article 17 of the Directive refers to customers instead of customer?

The ECJ only answers those questions that it finds essential for the interpretation of the relevant EC law. Here the three questions were boiled down to one question on whether a self-employed intermediary with authority to conclude a single charter for a ship, subsequently extended over several years, is a commercial agent for the purposes of the directive.[41]

4.1.2 The reasoning of the court: a contextual reading of "commercial agent"

The ECJ started its reasoning by putting the term "commercial agent" into its legal context. An earlier version of the directive[42] had defined a commercial agent as an intermediary with authority to negotiate an unlimited number of commercial transactions.[43] Intermediaries appointed to negotiate "…a specified transaction or a number of specified transactions, only" were, however, not included. According to this version of the directive, the charterparty agent, Poseidon, would not have counted as a commercial agent.

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41 POSEIDON V. MARIANNE ZEESCHIP at 20.

42 OJ 1977 C 13, p. 2.

43 Op. cit. article 2.

The fact that the wording of the directive had been changed, however, implied that the proposed restriction had been deliberately rejected by the Community legislature, who wanted the directive's scope to be wider.

In accordance with the above reasoning, the ECJ stated that it was "clear" that commercial agents "in particular" were characterised by the fact that they were invested by their principals with continuing authority to negotiate.[44]

The importance of the existence of a *long-term relationship* was also clear from other provisions in the directive. The court mentioned articles 3 and 4 (obligation of the parties to act loyally and in good faith towards each other), art. 6 (agent's remuneration during the duration of the contract), and, finally, art. 17 (agent's rights after termination of the contract). [45]

One counter-argument to this contextual reading of art. 1(2) can be based on the fact that art. 17(2) (a), which contains the pre-conditions for entitlement to indemnity, refers to *customers* in the plural: "The commercial agent shall be entitled to an indemnity if and to the extent that ... he has brought the principal new customers or has significantly increased the volume of business with existing customers".

4.1.3 Conclusion: a single contract is sufficient if the agent has continuing authority to negotiate

The ECJ found this argument relevant, but not determinative. Following the opinion of the Advocate General, the court established that "…the number of transactions is not the sole determining factor in assessing whether the principal conferred

[44] POSEIDON V. MARIANNE ZEESCHIP at 24.

[45] L.c.

continuing authority on the intermediary"[46], although it would normally be an indicator of continuing authority. In other words, the main question is whether or not the agent has *continuing authority* to negotiate contracts for or on behalf of the principal. The issue here is whether relations between the parties can be characterised as *long-term*. If this is the case, the intermediary may be a commercial agent as defined in the directive.

This also seems an appropriate place to mention that, regarding the interpretation of the pre-conditions for entitlement to an *indemnity,* the number of customers brought by the agent is irrelevant, according to the Council Report. The Report states that an indemnity can be granted even if the new business obtained by the agent only consisted of one new customer. Provided this is the case, the pre-condition has been fulfilled.[47] In accordance with the "new" legal status of the Report, as set out in HONYVEM V. MARIELLA[48], it would be correct to apply this understanding of the term "customers" in the interests of achieving a harmonised understanding of the norm, even though the national courts have discretion in their interpretation of the indemnity provisions. In other words, an intermediary may well be classified as a commercial agent and come within the scope of the directive, despite the fact that he has only negotiated one contract. The essential question is whether the agent had authority to negotiate on a continuing basis.

In POSEIDON V. MARIANNE ZEESCHIP, no written contract referring to a continuing relationship was produced, but there was no need for such a document. The court stated: "In the present case, given the renewal of the contract over several years, there can

[46] POSEIDON V MARIANNE ZEESCHIP at 25.

[47] COM (1996) 364 final, p. 2.

[48] See 2.2 above.

be no doubt that the intermediary had continuing authority."[49] Despite the fact that the underlying purpose of the directive is the protection of the weaker party, there is no requirement to prove any dependence on, or particular attachment to, the principal. It is not even necessary to show any express requirement of loyalty. The balance of proof is rather the other way around: if it is clear that the contractual relationship was of a long-term nature and that the independent intermediary had continuing authority to negotiate on behalf of the principal, the intermediary will be classified as a commercial agent and the directive's provisions concerning loyalty will apply.

The line of demarcation between commercial agents governed by the directive and other intermediaries, who will normally operate on short-term contracts and therefore fall outside the scope of the directive, has thus been moved. This is partly because there is now a relatively low threshold for characterising an agreement with an intermediary as long-term and partly because the protective provisions of the directive will, in certain circumstances, also apply to commercial agents negotiating *service contracts,* as discussed below.

4.2 Does the directive apply to agents for the supply of services?

4.2.1 Agents for the supply of services are not governed by the directive

The problem of whether the directive applied to an agent who had negotiated a *single contract* was not the only issue before the ECJ in POSEIDON V. MARIANNE ZEESCHIP. The court also had to consider the fact that the relevant contract concerned the supply of

[49] POSEIDON V. MARIANNE ZEESCHIP, at 21, second sentence.

a *service* – the charter of a ship – and the wording of the directive made it clear that its provisions did not apply in this situation.

Before the ECJ could reach its conclusion, as discussed above, concerning the definition of a commercial agent, the court therefore needed to determine whether it had jurisdiction at all, since the intermediary concerned was not acting in "…the sale or the purchase of goods"[50], but was negotiating a contract for the supply of *services*.

The starting point was clear: the directive applies "…solely to self-employed intermediaries with authority to negotiate contracts for goods and not self-employed intermediaries with authority to negotiate services …"[51] This means that agents negotiating contracts for services fall outside the scope of the directive and EC law in this area.

4.2.2 The problem of jurisdiction

Individual Member States, however, may apply the rules of the directive to a broader range of intermediaries, as was the case in the Netherlands. The question was, however, whether the ECJ had jurisdiction to interpret a national provision that did not implement an EC provision.

According to the co-operation, established by art. 234 EC, between the ECJ and national courts and tribunals, it is for the national courts to decide both *the need* for a preliminary ruling and *the relevance* of the questions submitted to the Court.

The Court Registry of the ECJ therefore asked the referring court, the Rechtbank Utrecht (Utrecht District Court), whether it wished to maintain its

[50] Art. 1(2) of the directive.

[51] POSEIDON V MARIANNE ZEESCHIP at 11 with reference to an order of 6 March 2003 in Case C-449/01 ABBEY LIFE ASSURANCE, not published in the ECR.

reference for a preliminary ruling.[52] The referring court confirmed that it would maintain its reference, as it considered that the concept of "commercial agent" needed to be interpreted uniformly, both in the narrow and the broad sense. The referring court therefore preferred not to wait for a case to be brought before it dealing with the narrower definition of a commercial agent/agency contract.[53]

As has been established in previous cases, the ECJ can only refuse a request for a preliminary ruling if it is: "…quite obvious that the ruling sought by that court on the interpretation of Community law bears no relation to the actual facts of the main action or its purpose or where the problem is general or hypothetical."[54] This was not the case here.

Accordingly, neither the wording of art. 234 EC, nor the purpose of the procedures established by that article, exclude the ECJ from giving a preliminary ruling to determine the rules applicable to a situation that is purely internal to the referring state. [55]

In order to prevent future differences in interpretation, provisions or concepts taken from Community law need to be interpreted uniformly, irrespective of the context in which they appear. The ECJ has therefore decided that, when domestic legislation adopts the same solutions as those adopted in Community law, the Court

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[52] POSEIDON V. MARIANNE ZEESCHIP at 11 in fine.

[53] Op. cit. at 12.

[54] POSEIDON V. MARIANNE ZEESCHIP at 14.

[55] POSEIDON V. MARIANNE ZEESCHIP at 16 with reference to Case C-28/95 LEUR-BLOEM [1997] ECR I-4161 at 32; Case C-130/95 GILOY [1997] ECR I-4291 at 28 and Case C-1/99 KOFSIA ITALIA [2001] ECR I-207 at 32. According to Martijn W. Hesselink, this seems to imply that the national courts can submit preliminary questions to the ECJ with regard to most subjects covered by the reform of the law of obligations, the Common Frame of Reference. See: The Ideal of Codification and the Dynamics of Europeanisation: The Dutch Experience. European Law Journal 2006 pp. 279-305 on p. 303.

has jurisdiction and should make a preliminary ruling on how that legislation should be interpreted. The intention of this is to avert discrimination against foreign nationals and possible distortion of competition.[56]

4.2.3 Legal effects of the conclusion

On the basis of this judgment, we can conclude that an independent commercial agent negotiating the supply of *services* may also come within the jurisdiction of the ECJ and be subject to the directive, provided that two pre-conditions are fulfilled:

– the national authorities must have made the directive applicable to agents negotiating contracts for services; and
– such applicability must be mandatory: the national courts must not be empowered to derogate from the actual provisions on which the ECJ will give a preliminary ruling.[57]

Through these pre-conditions, the ECJ recognises the sovereignty of the Member States. It is up to each individual Member State to decide the scope of the EC law when applying it within its own borders. By making the directive applicable to agents for the supply of services, a Member State widens the scope of the directive and thereby the jurisdiction of the ECJ.

If, on the other hand, the parties are able to derogate from the provision in question, the basic reasoning for granting the ECJ jurisdiction, which is increased harmonisation of the content of Community law, will not apply, and there will be no need for a preliminary ruling in order to maintain any harmonisation.

In our context, the question relates to the legal definition of a commercial agent and the nature of the relevant provisions means that it is not possible to derogate. This means that when a Member

[56] POSEIDON V. MARIANNE ZEESCHIP at 16.

[57] Op.cit. at 18.

State has made the directive applicable also to agents in the service sector, the starting point is that these agents shall be protected by the directive in the same way as the agents that are directly protected by the directive.

4.2.4 The current situation

As already mentioned, the *Netherlands* has made the directive applicable to agents negotiating contracts for the supply of services.[58] The same is true in *Germany,*[59] *Italy,*[60] *Austria,*[61] *Portugal,*[62] *Spain*[63]*and France.*[64] These countries all have a broad definition of what constitutes a commercial agent, not limiting it to an agent negotiating contracts for the supply of goods.[65]

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58 *Burgerlijk Wetbok* (The Civil Code) Article 7:428(1).

59 *Handelsgesetzbuch* HGB (the Commercial Code) § 84.

60 *Codice Civile* (The Civil Code) article 1742. It should here be mentioned that the term commercial agent according to the Italian system presupposes that the agent is entrusted with a specific geographical area. See Roberto Baldi: *Handelsvertreterrecht in Italien* in Graf von Westphalen (ed.): *Handbuch des Handelsvertreterrechts in EU-Staaten und der Schweiz*, Köln 1995 p. 721.

61 *Handelsvertretergesetz* (The Commercial Agency Code) 1993 § 1. BGBl. No. 88/93. All though the Austrian code has a broad definition of agency, the code explicitly excludes intermediaries working with *unbewegliche Sachen*; that is intermediaries dealing with property.

62 *Decreto-Lei* (Law Decree) No 178/86 § 1.

63 *Ley de contrato de agencia* (The law on Commercial Agency Contracts) 27.5.1992 article 1.

64 The directive was implemented by a Statute of 25.6.1991, later implemented in the new Commercial Code article L-134 to article L134-17.

65 It should be noted, however, that certain categories of agents already protected by other statutes, might be excluded from the general statutory on commercial agents. In France these include travel agents, insurance agents, exchange and stock market agents, *administrateurs judiciaries* and

On the other hand, many countries have not extended the scope of the directive and have made their national laws on commercial agency applicable only to agents negotiating the sale or purchase of *goods*. This is true of *Belgium*,[66] *Greece,*[67] *Luxembourg,*[68] *Great Britain (England, Scotland and Wales),*[69] *Northern Ireland*,[70] and *Ireland.*[71] Similarly, the *Nordic countries* have implemented the directive as it is worded, making it directly applicable only to agents negotiating the sale, or purchase, of goods.[72]

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estate agents, see Severine Saintier, op. cit., p. 172. Also in Austria exchange and stock market agents are excluded from the general statutory together with agents providing loans. See the preparatory work; *Regierungsvorlage* 16.7.1992 *Erläuterungen,* p. 2.

66 In Belgium, the directive is implemented in an act on implementation of the commercial agency directive of 3.4.1995. The wording of art. 1, which defines the meaning of the term commercial agent, is wide and refers to agents that are authorised to negotiate *Geschäften*. According to Christoph Kocks, this still limits the definition of a commercial agent to an agent negotiating contracts for the sale or purchase of *goods.* See Christoph Kocks: *Handelsvertreter in Belgien*, in Graf von Westphalen (ed.): *Handbuch des Handelsvertreterrechts in EU-Staaten und der Schweiz*, Köln 1995 p. 12.

67 Presidential decree 219/1991 Article 1 paragraph 2

68 Law on commercial agency 3.6.1994 article 1.

69 The Commercial Agents Regulation 1993 [S.I. No. 3035 1003] article 1 paragraph 2.

70 Commercial Agents Regulation (Northern Ireland) 1993/483 article 1 paragraph 2 as modified by SI 1997/31.

71 Statutory Instrument SI no. 33 of February 21st 1994 article 1.

72 All the Nordic Countries have implemented the directive by means of separate Acts on Commercial Agency. The definitions of commercial agency comply with the wording of the directive. In *Denmark,* the relevant statute is *lov om handelsagenter og handelsrejsende* 272/1990 § 2. In *Sweden, Lag om handelsagentur* 1991/351, 1 §. This provision has been commented on by Herbert Söderlund: *Agenträtt – Kommentar till lagen om handelsagentur m.m* (Agency law – A commentary to the act on

According to the preparatory work for the Norwegian act, the provisions concerning payment of an indemnity may be applied, by analogy, to other intermediary contracts, in so far as it is natural to do so.[73] In my opinion, it is possible to argue that such an analogy could naturally be drawn in the case of agents negotiating contracts for the supply of services. This is because the underlying reason for the indemnity is the system of remuneration during the duration of the contract and this is the same for agents negotiating both types of contracts.[74]

So far, we can conclude that if the Member State has made the directive applicable to *agents for services*, contracts with such agents must be seen in a wider legal context than only the national. The agents' legal position will be governed by the EC directive in the same way as that of commercial agents directly regulated by the directive.

The effect of this conclusion is, however, controversial, as the ECJ has also widened its jurisdiction in the legal area of commercial

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Commercial Agency), Stockholm 1994 p. 18 *et seq.* In *Finland, Lag om handelsrepresentanter och försäljare* 1992/417, 1 §. And, finally, in *Norway* the directive has been implemented through *Lov om Handelsagenter og handelsreisende* 56/1992 § 1. The provision has been commented on by Ellen J. Eftestøl: *Agenturloven med kommentarer* (The Statute on Commercial Agents with comments), Oslo 1998 p. 9 *et seq.*

[73] Ot. prp. nr. 49 (1991-92) op. cit., p. 40.

[74] A very thorough analysis of problems relating to the making of such an analogy, with an emphasis on the situation of the franshisee, is given by Lars Norheim in his doctoral thesis: *Franchising, avgangsvederlag og agentur* (Franchising, indemnity and agency) Oslo, 2003. Norheim advocates the possibility of making an analogy in this situation, see in particular p. 350-351. I have been more skeptical about applying the system by analogy, except in the case of agents for services, see Ellen Eftestøl-Wilhelmsson: *Eneforhandlerens, franchisetagerens og tjenesteagentens rett til et økonomisk sluttoppgjør* (The dealers´, the franchisees´ and the service agents´ right to indemnity at termination of contract). Tidsskrift for rettsvitenskap, 2005 p. 608-628.

agency in the geographical sense. This was the result of the earlier decision INGMAR V. EATON, mentioned above, in which the court stated that the parties could not derogate from the indemnity provisions in art. 17(2) by including a *choice of law clause* in the agency contract, as the provisions were to be considered *internationally mandatory.*

The decision in INGMAR V. EATON dealt with a "traditional" commercial agent assisting his principal in the sale of goods. It is interesting, however, to consider the impact of this decision in our context: does it mean that an *agent for services* is also protected against choice of law clauses aimed at avoiding the protective rules of the directive?

On the one hand, one could argue that this is straying too far from the original purpose of the directive, which only aimed to protect agents dealing with the sale and purchase of goods. On the other hand, the same arguments that were outlined in POSEIDON V. MARIANNE ZEESCHIP, on harmonising the content of EC law relating to all agents in the European Union, might lead to a different result. It is important to remember that EC law on commercial agency consists both of the provisions outlined in the directive as well as the rest of the *acquis communautaire,* including court decisions.

Once the ECJ had decided that it has jurisdiction in relation to commercial agents negotiating service contracts, it could be argued that the whole *acquis communautaire* should apply, including the result in the INGMAR V. EATON. This judgment will be discussed in the following section.

5 The extent of applicability of the directive

5.1 INGMAR V. EATON; the indemnity rules are internationally mandatory

Ingmar and Eaton had concluded a contract under which Ingmar was appointed as Eaton's commercial agent in the United Kingdom. Eaton was based in California. A clause of the contract stipulated that the contract was governed by the law of the State of California.[75] When the contract was terminated, Ingmar claimed compensation for damages pursuant to article17, as implemented in the UK. The English High Court, Queen's Bench Division, held that the article did not apply, since the contract was governed by the law of the State of California. Ingmar appealed. The Court of Appeal decided to stay the proceedings and request a preliminary ruling on whether articles 17 and 18 of the directive must be applied where the commercial agent carries on his activity in a Member State, even though the principal is established in a non-member country and a clause of the contract stipulates that the contract is to be governed by the law of that country.[76]

The case touches upon the limits to the territorial scope of the directive and Community law on the one hand and a basic tenet of international private law on the other.[77] Removing the freedom that contracting parties enjoy to decide which system of law should govern their contractual relations is a serious interference in the parties' rights under private international law. Such interference

[75] INGMAR V. EATON at 10.

[76] INGMAR V. EATON at 14.

[77] The case is analyzed from the perspective of private law by Haris P. Meidanis: Public policy and *ordre public* in the private international law of the EC/EU: Traditional positions of the Member States and modern trends, European Law Review 2005 p. 95-110.

can only be permitted in the case of rules that are classified as mandatory for the purposes of private international law. Eaton argued that this would only be the case in extremely limited circumstances.[78]

The ECJ based its decision on the rationale behind articles 17 and 18. The directive is basically designed to *protect* the commercial agent and articles 17 and 18 provide protection in the case of contract termination. For this purpose the articles are, according to the ECJ, "mandatory in nature".[79] This is confirmed by the fact that, under article 19, the parties may not derogate from articles 17 and 18 to the disadvantage of the agent before the contract expires. In contrast to what one might have thought, that article 19 provided the legal basis for the mandatory nature of the compensation/indemnity system set out in the directive, the ECJ stated that articles 17 and 18 were mandatory *in nature*; article 19 only provided additional legal reinforcement.

The court based its decision entirely on the directive and did not discuss the rules of private international law. The result was in line with the motivation behind the directive, which was the harmonisation of rules relating to commercial agents throughout the EU.[80] Such harmonisation will not only protect the agents, but also impose uniformity on competition conditions within the EU and thereby increase the security of commercial transactions.[81]

The result of INGMAR V. EATON is, in brief, that articles 17 and 18 of the directive must be applied if the commercial agent carries on

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78 INGMAR V. EATON at 17.

79 Op. cit. at 21.

80 As pointed out by Ulla Liukkunen: The Role of Mandatory Rules in International Labour Law, Helsinki 2004, p 145, the question of whether or not a provision of a directive is international mandatory has to be determined by taking into account the nature and purpose of the provision.

81 INGMAR V. EATON at 23.

his activity in a Member State, even though the principal is established in a non-member state and a clause of the contract stipulates that the contract is to be governed by the law of that country.[82]

5.2 Does this include service agents? INGMAR v. EATON plus POSEIDON v. MARIANNE ZEESCHIP

As pointed out above, the ECJ has, through its decisions first in INGMAR v. EATON and then in POSEIDON v. MARIANNE ZEESCHIP, radically widened the scope of the directive in comparison to its actual wording. In INGMAR v. EATON, the indemnity rules of the directive were made internationally mandatory, while in POSEIDON v. MARIANNE ZEESCHIP, agents for services were brought within the scope of EC agency law and the jurisdiction of the ECJ.

One might ask if the two cases combined widen the scope of EC agency law even further. In other words, are the indemnity rules designed to protect the agent on termination of contract also internationally mandatory if the commercial agent in question negotiates contracts for services and the directive is made applicable on service agents by the national authorities?

Provided that the national authorities have not decided otherwise, a positive answer would be consistent with the arguments used to give the ECJ jurisdiction in cases involving such contracts. In POSEIDON v. MARIANNE ZEESCHIP, stress was laid on the importance of the uniform understanding of Community law. This was especially important to avoid discrimination against foreign nationals or any distortion of competition.[83] The same arguments appear in the court's reasoning in INGMAR v. EATON.

[82] INGMAR v. EATON Oppart.

[83] POSEIDON v. MARIANNE ZEESCHIP at 16.

Here the court stresses that the intention of the harmonising measures contained in the directive is: the elimination of restrictions on the carrying-on of the activities of commercial agents; the achievement of uniform conditions of competition within the EU; and the increased security of commercial transactions.[84] In addition, the directive is designed to protect freedom of establishment for all commercial agents and the operation of undistorted competition in the internal market.[85] In other words, the same conditions should be applied to all commercial agency contracts within the EU in order to achieve undistorted competition. This would lead to the conclusion that the rule in the directive article 17 (2) on indemnity is international mandatory also when applied on service agents.

On the other hand, the harmonisation argument could be turned. Not all service agents in the EU are protected by the directive. The level of protection will therefore vary in different Member States. For the service agents there is no undistorted competition in the internal market: A service agent established in the Netherlands may claim indemnity according to article 17 (2) of the directive. It is quite uncertain whether a service agent in for example Sweden might do the same. Most likely the Swedish service agent is not entitled to such indemnity.[86] If a principal located in Sweden includes a choice of law clause applying Swedish law to the contractual relationship with a service agent in the Netherlands, the Swedish and the Dutch service agent would be governed by the same legal framework and neither of the agents would be protected by the directive. If, on the other hand, the principles laid down in

[84] INGMAR V. EATON at 23.

[85] INGMAR V. EATON 24.

[86] Such a right would have to be based on analogy from the Swedish act on Commercial Agency, see above 4.2.4.

INGMAR V. EATON apply, the choice of law clause in the contract with the Dutch commercial agent would be void and the Dutch agent would be protected by the directive, were as the Swedish agent would not.

Despite this problem, I would advocate that the INGMAR V. EATON principle should be adopted on service agents when the Member State where the agent is operating has made the directive applicable to service agents. The difference between the service agent operating under the Swedish legal framework and the Dutch service agent is that the legal framework governing the latter is linked by governmental decision to the EC agency law; the rules of the directive. The legal concepts in the directive have to be interpreted uniformly. If the ECJ has decided that "mandatory" in the context of the indemnity rules of the directive means "international mandatory", as in INGMAR V. EATON, then this has to be applied in all circumstances where the concept appear, for example when a Member State has decided to treat an intermediary with authority to negotiate services in the same way as an intermediary with authority to negotiate contracts for the sale or purchase of goods.

6 Conclusion

It is clear that the ECJ, in the two rulings discussed in this article (POSEIDON V. MARIANNE ZEESCHIP and INGMAR V. EATON) has comprehensively widened the scope of the directive. This has been achieved partly by arriving at a broad interpretation of the directive's definition of a commercial agent and partly by classifying the provisions relating to termination of contract – the indemnity rule – as internationally mandatory.

There are two aspects of the definition of a commercial agent where the ECJ has adopted a broad approach to interpretation.

Firstly, the agent must have *continuing authority* to negotiate on behalf of the principal. Normally such a pre-condition would suggest that the agent would have to negotiate *several contracts*. Although the ECJ stated that this would be the typical situation, it found that it was not a legal pre-condition that had to be fulfilled for a party to qualify as a commercial agent.

In POSEIDON V. MARIANNE ZEESCHIP, Poseidon had, during its relationship with Marianne Zeeschip, negotiated *one charter* of a ship on behalf of Marianne Zeeschip. The charterparty was renewed annually from 1994 to 2000. In the renewal process, the agent did nothing except to record the outcome of the negotiations between his principal and Maritramp. This was, however, sufficient, as there was no pre-condition concerning the number of contracts that had to be concluded. In the present case, there was no doubt that the intermediary had had continuing authority to negotiate on behalf of the principal, given the renewal of the contract over several years.

Following this case, the boundary between those intermediaries we would normally think of as brokers and commercial agents has been moved. The scope of the definition of a commercial agent is now broader than has traditionally been the case.

Secondly, the ECJ has widened the scope of the directive by claiming jurisdiction to interpret national provisions concerning *agents for the supply of services*. A prerequisite for the court's jurisdiction is that the national authorities must have determined that such agents should be governed by the same rules as commercial agents negotiating contracts for the sale and purchase of goods. As outlined above, quite a few Member States, such as France, Germany, Italy and Spain, have adopted such rules.

The effect of these rulings may be of major significance for the *shipping industry,* especially in relation to the negotiation of contracts of affreightment or charterparties. Intermediaries

involved in the negotiation of this kind of contracts have, until recently, fallen outside the scope of the directive, partly because of its nature and partly because the intermediary has generally been seen as a *broker,* not having any kind of long-term business relationship with the principal. This is true of both the traditional *shipbroker* and the *freight forwarder*. The decision in POSEIDON V. MARIANNE ZEESCHIP shows that demarcation between traditional brokers and the modern concept of the commercial agent is increasingly unclear. Each situation has to be analysed on its own merits to establish whether relations between the parties could be characterised as long-term. Following the ECJ's ruling, the directive will apply to a wider range of situations, including those where the relationship between the parties is neither deep nor formalised.

A traditional *liner agent* that has operated on a long-term basis for a single principal would probably be entitled to claim an indemnity on termination of contract pursuant to art. 17(2) of the directive, provided that the Member State in which the agent operated had made the directive applicable to agents negotiating contracts for services. The situation would, of course, have to be reviewed in the light of the actual contractual relationship.

Prior to the case of INGMAR V. EATON, the parties could opt out of the mandatory provisions of the directive by a single *choice of law clause*. This is no longer possible, as the rules have been made internationally mandatory for the benefit of all commercial agents operating in the EU. It could be argued that this protective rule is also applicable to agents negotiating contracts for services, provided that the relevant Member State has widened the scope of the directive to include such intermediaries. The conclusion in this matter is however still open.

Part VIII

Multi-party arbitration in international trade – Problems and solutions

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1 Introduction

1.1 Arbitration and international trade law disputes

Arbitration has traditionally been the preferred means of dispute resolution in international trade. The reasons normally given for this include: the opportunity to select expert judges; the need for a neutral forum, independent of both parties' national courts; the doctrine of confidentiality (which exists to varying degrees in different jurisdictions); the possibility of obtaining a judgment according to trade practices or equity (in some systems, see e.g. López-Rodriguez (2006)); and last, but not least, the existence of the New York Convention of 1958 on the recognition and enforcement of arbitral awards, which provides for both the recognition of arbitral agreements and the recognition and enforcement of arbitral awards on a worldwide scale – at present this is not the case for judgments given by the ordinary courts. In addition, arbitration has, traditionally, generally been held to be quicker and cheaper than court proceedings. This no longer tends to hold true.

Presently, arbitration is losing ground to other types of *alternative dispute resolution,* e.g. conciliation or mediation. Still, in many cases, conciliation or mediation are used as a first resort, but if what is, in effect, a formalised attempt to reach an amicable solution fails, arbitration proceedings will generally ensue. Thus, at present, arbitration as a means of dispute resolution is not under any real pressure. On the contrary, the existence of a multi-million dollar arbitration industry is encouraging legislators in many states veritably to overbid each other to provide the most "arbitration friendly" solutions.

1.2 Multi-party disputes and arbitration

Given that arbitration is the only real option for international commercial dispute resolution at present, the question arises of whether or not it is an appropriate method for resolving the problems presented by international trade. It is clear that, in most ways, arbitration proceedings satisfy the needs of the parties. It is indeed likely that the tribunal will be equipped with both the legal and technical or commercial expertise necessary to understand and resolve the problem and, generally, problems are resolved very professionally. This is not the challenge faced by arbitration as the preferred means of dispute resolution. Instead, the Achilles heel of arbitration lies in its core feature: the fact that *arbitration as a means of dispute resolution presupposes consensus between the parties*. This gives rise to problems in cases where a number of parties are stakeholders in what is, in effect, a single legal dispute. This feature of arbitration is generally held to be one of its main disadvantages.

There are good reasons for dealing with a single dispute in a single forum. A quick overview of these reasons may be found in the Brussels Regulation on jurisdiction and enforcement of judgments in civil and commercial matters, Art. 28(1) and (3). This provision deals with related actions and states: "Where related actions are pending in the courts of different Member States, any court other than the court first seized *may* stay its proceedings. … For the purpose of this Article, actions are deemed to be related where they are so closely connected that it is expedient to hear and determine them together to *avoid the risk of irreconcilable judgments* resulting from separate proceedings." (The author's italics.) The question of related actions is a watered-down version of *lis pendens*. Note that, according to Art. 27 of the Brussels Regulation, where the same dispute between the same parties is brought before different courts in the Member States, any court

other than the court first seized *shall* stay its proceedings. These provisions are mirrored in many countries' own Codes of Civil Procedure in recognition of the need for expediency and to avoid the handing down of contradictory judgments. The rationale behind these rules also applies to arbitral proceedings, but as the legal framework is different, the possible solutions cannot be quite as clear-cut.

The following discussion examines the central legal features of arbitration in order to evaluate the extent to which it is equipped to deal with multi-party issues. As well as discussing various sets of arbitration rules and different countries' legislation, factors that should be considered by both arbitration tribunals and the courts when determining whether or not multi-party proceedings should be allowed to go ahead in any given case are identified. Finally, it is discussed whether, in years to come, the courts will be likely to provide a better forum for multi-party disputes.

2 Multi-party situations in international trade

Before focusing on the legal framework for multi-party arbitration, it will be useful to consider the situations in which multi-party contracts or contractual structures are likely to arise. The first situation that comes to mind is contract work, where contractors, sub-(sub-)contractors and suppliers work together to fulfil what is, in fact, a single obligation, namely that of the main contractor. The second involves situations where the same asset is resold many times before it ends up with the final receiver, be that dry commodities or crude oil, sold under a string of letters of credit, or cargo space on a ship, sold under a chain charterparty. The third situation discussed here, of which reinsurance is the main example, involves the spreading of a single financial risk between several

undertakings. In all these situations, the parties will often contract on back-to-back terms, but this is not always the case and, even if it is, it is not self-evident that the existence of back-to-back contracts will establish consent to multi-party arbitration. Another set of difficult multi-party situations exists in relation to, e.g., the laws of succession or the rules of company law. Assuming that piercing of the corporate veil is allowed under the law applicable to the parties' dispute on the merits, may an arbitration agreement between the claimant and a subsidiary be invoked against the parent company? Similarly, take the situation where a company forms part of an international merger and is subsequently split to form a whole new company structure. What happens to arbitration agreements that were entered into before, or during, the restructuring of the company? This is not an easy question to answer and requires a thorough analysis of (at least) the rules applicable to the merger and the rules applicable to the arbitration agreement.

3 Obstacles to the use of arbitration in multi-party disputes

3.1 Arbitration as a consensual process

When entering into an arbitration agreement, the parties renounce one of the central rights featured in any society built on the rule of law: the right to take disputes of a legal nature before the courts. For this reason, legislators in different states require *proof* that this was, in fact, the intention of the parties, often by requiring certain formal criteria to be fulfilled. Different ways exist of securing this proof. In Denmark, Norway and Sweden, the normal rules of contract formation apply. However, even if there are no formal requirements, e.g., for the contract to be in writing, the courts will tend to require it to be clear that: i) there is an agreement between

the parties; *and* ii) this agreement contains an agreement to arbitrate. An example of a more formalised type of proof is found under English law, which provides in s. 5 of the Arbitration Act 1996 that an agreement should *exist* in writing or in another *recorded* form (even if oral arbitration agreements may be binding in equity). The New York Convention of 1958 goes further (at least in the author's interpretation, but for a different view see the Court of Appeals 5th Circuit in SPHERE DRAKE V. MARINE TOWING, (1995))[2], and requires the agreement to arbitrate to have arisen through an *exchange* of written communications between the parties. This approach is mirrored in the UNCITRAL Model Law, Art. 16. Even more rigid requirements have existed, although there has been a tendency to abandon these in recent years, in keeping with the desire of many states to provide more "arbitration friendly" regimes (cf. the former Norwegian Code of Procedure, Sec. 452, which required that arbitration agreements be *signed*).

So, for an arbitration agreement to be formed, not only must the general requirements of contract law be satisfied, but the additional preconditions described above must also be fulfilled. If we take arbitration as a process that derives its legitimacy from the consent of the parties and the principle of *pacta sunt servanda* (setting aside mandatory arbitration procedures imposed by legislation), this means that, on the one hand, a person or entity who is not party to *any* arbitration agreement may neither demand to join in existing arbitral proceedings nor be summoned to appear before the arbitral tribunal by the parties to such proceedings. On the other, it means that parties who have clearly agreed to arbitrate should, as a starting point, not be relieved from the obligations flowing from that agreement. However, between these two extremes, a whole expanse of difficult middle ground exists.

[2] SPHERE DRAKE V. MARINE TOWING, (1995) XX ICCA Yearbook 937

3.2 Arbitration as a two-party set-up

Arbitration tends to be seen as a two-party set up, where A and B decide to arbitrate existing or future disputes between *themselves*. This becomes very obvious if one examines different provisions regarding the appointment of arbitrators. According to, for example, the UNCITRAL Model Law Art. 10(2) and 11(3), the number of arbitrators shall be three: one arbitrator to be appointed by each of the parties and these arbitrators to appoint the third "umpire". Thus the rules of the Model Law do not even contemplate the existence of more than two parties. This is also the case with the new Danish Arbitration Act 2005 § 11(2). The existence of more than two parties has, however, been foreseen in other sets of rules. Thus, the ICC rules, in Art. 10(1), provide that "... where there are multiple parties, whether as Claimant or as Respondent … the multiple Claimants, jointly, and the multiple Respondents, jointly, shall nominate an arbitrator…". This seems to be the standard solution adopted in arbitration rules that do in fact address this issue, see e.g. the Danish Arbitration Rules, 2004 § 18, 1st sentence, the German Arbitration Rules 1998, sec. 13 and the Swiss Rules, Art. 4. Such provisions resolve some of the problems caused by the assumption that there is a two-party set-up, but still operate under the assumption that, basically, only two opposing views will be arbitrated, which may not at all be the case. A simplistic example would be where contractor A and subcontractor B have each provided half of a piece of machinery to buyer C. If C wishes to bring a claim for damages for non-conformity against A and B, they will, as a starting point, seem to have a common interest in arguing that the piece of machinery is indeed in conformity with the parties' contract. However, if C manages to demonstrate that the machinery probably fails to conform to the contract, A and B will become adversaries, as it will be in each of their best interests to argue that any negligence or error committed

was the fault of the other party. The rules mentioned above have chosen not to address this problem directly, but nonetheless provide for a solution. This is that if – for whatever reason – arbitrators are not appointed in accordance with the rules, the relevant arbitration institution may instead appoint all (alternatively, under the Danish rules, some) of the arbitrators. (If this also fails, the UNCITRAL Model Law, in Art. 11(4)(b), provides that if the parties cannot reach an agreement to appoint, the courts will, upon application, appoint an arbitrator in their stead.)

Other options exist. If consolidation of arbitral procedures has been ordered by the court under the Dutch Code of Civil Procedure, Art. 1046, (see below), the only requirement as to the number of arbitrators in the multi-party proceedings is that it should be uneven. The Dutch Code of Civil Procedure thereby caters for the situation where there are more than two opposing interests. It could be argued that there is no need for each of the parties to be able to appoint their "own" arbitrator, as the arbitrators are independent of the parties and must be unbiased. However, the psychological effect of each party being able to appoint an arbitrator in whom they trust should not be overlooked and It is suggested, that the arbitration institutions should consider this option the next time they revise their rules. Any fear of unduly "inflating" the arbitral procedure may be checked by making it an option, which is only granted after application to the tribunal.

3.3 Arbitration as a confidential process

Under French law, confidentiality of arbitral proceedings is a matter of public policy, see Art. 1469 of the French New Code of Civil Procedure and De Saint Marc (2003). Other jurisdictions may

not take it quite that seriously, see Kouris (2005), but it is a central feature of arbitration that the parties assume the process to be their business only. The need not to have commercial secrets, prices and co-operation agreements made available to the whole world is a real one. Therefore, persons or entities who are, in effect, third parties, in relation not only to the parties' actual contract but also to the parties' whole legal relationship, should, as a rule, not be allowed to participate in the proceedings. However, such persons or entities are very unlikely to have a real legal interest in the case, and their participation should be refused for that reason alone. Indeed, parties likely to have a real interest in the consolidating or joining in of existing disputes are those to whom the contractual relationship between the original parties is probably already known, at least in part. Thus, a supplier who has supplied machinery according to specifications given by the contractor, in conformity with the obligations under a contract between the contractor and the owner, is likely already to be familiar with the relevant parts of that contract. Indeed, a prudent contractor would have ensured that the contracts were back-to-back, so that he would be able to direct any claim from the owner regarding the machinery against the supplier. In such a situation, too much emphasis should not be given to the confidentiality of the proceedings. The parties' main interest, that their dispute, contract and/or industrial secrets are not disclosed to those whom they do not concern, is still protected.

3.4 Multi-party proceedings and the enforceability of the arbitral award

The reason for carrying out arbitral proceedings is the obtaining of an arbitral award. Furthermore, it is of vital importance for the award to be enforceable – otherwise the losing party may refuse to

comply with the award without suffering any legal consequences and the time, money and effort devoted to the whole procedure will have been wasted. Under the New York Convention 1958, Art. II, each Contracting State shall recognise written arbitration agreements entered into by the *parties*. Keeping that in mind, tribunals may be reluctant to join proceedings between parties who are not *strictly speaking* parties to the *same* contract. Further, an *ad hoc* tribunal that has no rules on multi-party proceedings to fall back on might fear that a losing party would challenge an award given by the tribunal under the New York Convention, either under Art. V(1)(c), on the grounds that the award deals with a dispute falling outside the scope of the arbitration agreement, or under Art. V(1)(d), by claiming that the arbitral tribunal was not composed in accordance with the parties' agreement. Whether such a fear is justified depends on the "arbitration friendliness" of the state where enforcement takes place. It will not always be possible to identify this state in advance, so concerns on the part of tribunal in this respect may have a rational basis. Still, courts in many states will only subject the tribunal's decisions to gentle scrutiny in this respect and, overall, issues relating to the enforceability of the arbitral award should not be overstated.

3.5 Practical problems relating to multi-party arbitration proceedings

The importance of the expediency of arbitration proceedings must not be overlooked. The English Arbitration Act 1996, s. 1(a), provides: "the object of arbitration is to obtain the fair resolution of disputes by an impartial tribunal *without unnecessary delay or expense*." (The author's italics.)

It may seem mundane, but economies of scale will tend to work against arbitral procedures involving too many parties. Simply

getting the parties and their lawyers together in one room for a sufficient length of time may prove cumbersome. Also, the greater the number of parties involved, the greater the risk of stalling techniques being employed by parties who fear that the award may go against them (or by overworked lawyers). Arbitral tribunals have means of "punishing" parties who do not stick to a time schedule by making a ruling in default or making the ruling on the evidence etc. before them, see the UNCITRAL Model Law art. 25 or, e.g., the Danish Arbitration Act 2005 § 25, sec. 3, but many tribunals shy away from using such means because of fears that, e.g., disallowing a new submission will lead to the award being challenged at a later stage. Considerations of expediency will also tend to work against the adding of new claims, or indeed new parties, to proceedings that have already been initiated, see e.g. the ICC Rules Art. 19 and 4(6), which provide, as a starting point, that neither new claims nor related actions between the same parties will be allowed after the terms of reference have been signed, that is to say, after the arbitral procedure has been formally initiated.

Thus, if the court or tribunal fears that, by allowing multi-party proceedings, it risks the arbitration procedures grinding to a halt, multi-party proceedings should not be allowed.

4 The legal basis for multi-party arbitration procedures

4.1 The decision to allow multi-party arbitration

The major obstacles to arbitration in multi-party disputes have been discussed above. Even so, where a sufficient legal basis can be shown to exist, multi-party arbitration should, as a starting point, take place. The legal basis for a multi-party arbitration procedure may be found in the contract between the parties in the broad

sense, in the rules of the various arbitration institutions, or in law or statute. Each of these possibilities is considered in turn below. Once a legal basis has been established, the relevant body will then have to decide whether to allow the multi-party procedure. The relevant *pros* (the need to avoid conflicting rulings and to obtain the correct outcome to the dispute) and *cons* (mostly listed above under point 3) should be taken into consideration and a decision will have to be made. If the legal basis is sufficiently clear, the court or tribunal will not have much choice as to whether to allow the proceedings or not. However, if the result of allowing the multi-party proceedings to go ahead would be a process that would be much more expensive and prolonged, multi-party proceedings could be refused irrespective of, e.g., the existence of a multi-party arbitration clause. In cases where the legal basis is less clear, the *pros* and *cons* outlined above will be central to the decision-making process.

The arbitral tribunal will generally have first say on whether it is competent to engage in multi-party proceedings in any given case. If it is competent, then the multi-party proceedings should be allowed. This follows from the doctrine of *Kompetenz-Kompetenz*, which in recent years has become generally accepted, consider, e.g., the UNCITRAL Model Law, Art 16(1), and the principle that the Tribunal determines its own procedure. Even so, the courts will have the last word. Further, a party may choose to initiate court proceedings, instead of arbitral proceedings, despite the existence of an (alleged) agreement to arbitrate. In that case, the courts may have the first say as well. The courts will also have first say in cases where statutory rules provide that the court may *order* consolidation of, or joinder in, arbitral proceedings, see point 4.4 below.

4.2 Multi-party arbitration proceedings in accordance with the parties' contract

On the assumption that arbitration is a consensual process, the first place to seek a legal basis for multi-party proceedings is in the contract between the parties in general and in the applicable arbitration clause or submission agreement in particular. The first thing to look for is whether the parties have included an actual *multi-party arbitration clause* in their contract. A good example of such a clause can be found in the General Conditions for the Building and Construction Trades 1992 (AB 92, standard conditions used for contract work in Scandinavia). The conditions provide in § 47, sec. 1, that all disputes between the parties should be settled by the arbitral tribunal for the building and construction trades. However, § 47, sec. 8 continues: "When these conditions apply between the Owner and several parties (contractors, suppliers) the provisions in sec. 1-7 also apply to the internal relationship between the said parties." (The author's translation). Thus, the parties will be bound to arbitrate even if their dispute is not with their direct contractual counterpart. This clause should also provide sufficient contractual basis for actual multi-party proceedings, as the parties have not only adopted the same arbitration clause, they are, in effect, parties to the same arbitration agreement. It is thus perfectly feasible to have an arbitration agreement that is effective within a chain of back-to-back contracts. However, the wording of arbitration agreements or clauses in back-to-back situations is not always – or even, indeed, not often – in this format. Instead the wording tends reflect the normal "two-party set-up" and only ends up governing a multi-party situation due to, e.g., incorporation by reference, a standard example of this being the incorporation of the provisions of a charterparty into a bill of lading. This may give rise to problems of general contract law nature, as one must then evaluate whether the (standard form of)

contract containing the arbitration clause has indeed been incorporated into the parties' contract. Thus, in the ruling of the Danish Supreme Court in U 1963.488, a reference in a contract to Conditions A, which in turn referred to Conditions B, was not sufficient to incorporate the arbitration clause in Conditions B into the contract. Similarly, in TRYGG HANSA V. EQUITAS (1998),[3] general words of incorporation were not effective to incorporate an arbitration agreement in the primary insurance contract into, firstly, the excess of loss insurance and subsequently the reinsurance of the excess of loss cover.[4]

If there is no actual multi-party arbitration clause, the court or tribunal seized with the case must evaluate whether the whole contractual structure is such that multi-party proceedings should be allowed. This was the situation in the (in)famous case of DOW CHEMICALS V. ISOVER SAINT GOBAIN (1982).[5] In this case, various subsidiaries of the Dow Chemicals Company had undertaken to deliver thermal isolation equipment to Isover Saint Gobain. However, not all members of the Dow Chemicals group had entered into a direct arbitration agreement with Isover Saint Gobain, including, in particular, the parent company, Dow Chemicals (USA). There were problems with one of the products ("Roofmate"), and Isover Saint Gobain attempted to sue several companies in the Dow Chemical group, including the parent company, Dow Chemicals (USA). The "Roofmate" was in fact delivered by Dow Chemicals (France), with whom Isover Saint Gobain had no direct agreement either, let alone an agreement to arbitrate. The French Court of Appeal rejected jurisdiction on 5

[3] TRYGG HANSA V. EQUITAS, [1998] 2 Lloyd's Law Reports 439 QBD.

[4] Further on this point see, e.g., Siig (2003) pp. 77-201 and Di Pietro (2004).

[5] DOW CHEMICALS V. ISOVER SAINT GOBAIN, ICC Interim Award No. 4131 of 23 September 1982

February 1982, referring Isover Saint Gobain to arbitration. The arbitral tribunal in turn stated firstly that, on its proper construction, both Dow Chemicals (USA) and Dow Chemicals (France) were parties to the original contract and secondly, referring to *lex mercatoria* and the needs of international commerce, the tribunal found that, in economic reality, the Dow Chemicals group formed a single economic entity and the agreement to arbitrate was thus applicable to all the claims put forward.

Isover Saint Gobain subsequently challenged the award in the French courts, but the Court of Appeal in Paris found, in a ruling of 21 October 1983, that the arbitrators had been justified in assuming competence in the case and the plea that they had made their award in the absence of an arbitration agreement was unfounded.

Construing a legal basis for multi-party proceedings in this way is therefore an option if the relevant applicable law so allows. Even if the court seized with any claim for setting aside the award would not, according to its own law, have accepted, e.g., the doctrine of "economic reality", (for instance English law rejects the principle, see Woolhouse (2004)), the tribunal's jurisdiction should be accepted by the court seized with any claim for recognition and enforcement if the tribunal's decision is in keeping with the law chosen by the parties, see the New York Convention Art. V(1)(a). As long as the construction of a multi-party arbitration clause based on a specific contractual structure or company set-up is in accordance with both the law which applies to the arbitration agreement *and* the law applicable to the substance of the parties' dispute, the New York Convention will tend to ensure the enforcement of any subsequent award.

4.3 Multi-party arbitration proceedings according to the rules of international arbitration institutions

One way in which parties may give consent to multi-party proceedings is by agreeing to arbitrate under the rules of an arbitration institution that allows multi-party arbitration, e.g., through the consolidation of procedures or by allowing parties to join in existing procedures. Arbitration institutions seem to be somewhat reluctant to adopt such rules, but they do exist. The first example mentioned here is found in the ICC Rules, Art 4(6), regarding the request for arbitration: "When a party submits a Request in connection with a legal relationship in respect of which arbitration proceedings between the same parties are already pending under these Rules, the Court may, at the request of a party, decide to include the claims contained in the Request in the pending proceedings provided that the Terms of Reference have not been signed or approved by the Court…".

The provision is very narrow and only allows for the consolidation of two related disputes between the same parties, insofar as the Terms of Reference have not been approved, i.e. insofar as actual arbitral proceedings have not yet been initiated. True multi-party situations are thus not dealt with by this provision.

We now come to the Vienna Rules 2001. In Art. 10, these provide:

> "A claim against two or more Defendants shall be admissible only if the Centre has jurisdiction for all of the Defendants, and in case of proceedings with three arbitrators, if all claimants have nominated the same arbitrator, and:
>
> a) If the applicable law positively provides that the claim is to be directed against several persons, or
>
> b) If all parties are bound by the same arbitration agreement, or

c) If the admissibility of multiparty proceedings has been agreed upon, or

d) If all the defendants submit to multiparty proceedings, and … all Defendants nominate the same arbitrator. …"

To be relevant, the provision presupposes that the Vienna arbitration centre has jurisdiction over all defendants. If this is the case, multi-party proceedings may be allowed provided the parties consent (*litra* (c) and (d)), or if there are several defendants according to municipal law (e.g. where two parties are jointly and severally liable for certain damage) according to *litra* (a). Regarding multi-party situations, which are likely to occur in the context of international trade, *litra* (b) would apply to situations where e.g. the corporal veil has been pierced and also, apparently, where the parties have contracted back-to-back.

The inclusion of such provisions in institutional rules should be encouraged, as it rules out the possibility that the consolidation of proceedings may be invoked at a later state as a basis for challenging the arbitral award. Even if the relevant institution has not made such rules, or in cases where there is an *ad hoc* tribunal, Art. 19(2) of the UNCITRAL Model Law, and therefore national arbitration acts incorporating it, provide that, if the parties fail to agree on the procedural rules to be applied, the tribunal will decide its own procedure. A tribunal is therefore competent to order consolidation etc. if it sees fit. This way of regulating the issue (in effect by not regulating it) may have advantages over the method adopted in the ICC Rules, as the presence of narrow provisions that allow consolidation in very well defined and restricted circumstances is likely to be interpreted *a contrario*, disallowing consolidation in any other cases. Still, provisions such as Art. 10 of the Vienna rules seem to offer a good way forward, as they are wide enough to cater for most situations where multi-party arbitration may realistically be an issue.

Unfortunately, the multi-party problem cannot be solved by the inclusion of such provisions in the various institutional rules, as the institutions have no legitimacy or authority as regards claimants or defendants that have not submitted to their jurisdiction in the first place. Institutional rules do not provide the authority either to consolidate proceedings before the relevant arbitration institution with other arbitration proceedings or to force third parties, against whom one of the parties may have a recourse claim, to appear before the tribunal. Such powers may only be vested in the courts.

4.4 Statutory regulation of multi-party arbitration proceedings

Under the English Arbitration Act 1996, s. 35(1), the parties are free to agree either that arbitral proceedings shall be consolidated with other proceedings or that hearings shall be held concurrently. However, s. 35(2) provides that, unless the parties agree to confer such powers on the tribunal, it cannot order consolidation of proceedings. Thus, under English law, the rule that the tribunal can establish its own procedure does not extend to multi-party situations.

Fortunately, this is not the approach adopted in all jurisdictions. Under the Dutch Code of Civil Procedure, Art. 1045, the arbitral tribunal may allow a third party to intervene in existing arbitral proceedings, provided he has an "interest" in the case. In addition, a party who, if he loses the case, will have a recourse claim against a third party may summon such third party. The provision is, however, not so far-reaching as it may at first appear, as an intervention or joinder will only be allowed if the third parties and the existing parties make a written agreement to that effect. Art. 1046(1) of the Dutch Code of Civil Procedure is rather more far-reaching: "If arbitral proceedings have been commenced before an

arbitral tribunal in the Netherlands concerning a subject matter which is connected with the subject matter of arbitral proceedings commenced before another arbitral tribunal in the Netherlands, any of the parties may, unless the parties have agreed otherwise, request the President of the District Court in Amsterdam to order a consolidation of the proceedings." The decision whether or not to order consolidation is made solely by the District Court after having heard the parties. The provision does not restrict the judge in making his/her evaluation or give any hints as to when a consolidation should, or should not, be ordered, unlike the Californian Code of Civil Procedure, sec. 1281, sub-sec. 3:

> "A party to an arbitration agreement may petition the court to consolidate separate arbitration proceedings, and the court may order consolidation of separate arbitration procedures when:
>
> 1) Separate arbitration agreement or proceedings exist between the same parties; or one party is a party to a separate arbitration agreement or proceedings with a third party; and
> 2) The disputes arise from the same transactions or series of related transactions; and
> 3) There is common issue or issues of law or fact creating the possibility of conflicting rulings by more than one arbitrator or panel of arbitrators."

The similarity of this wording to Art. 28 of the Brussels Regulation on jurisdiction and enforcement of judgments in civil and commercial matters (quoted above under point 1.2.) immediately comes to mind. The Alaskan Code of Civil Procedure, chapter 43, sect. 370, contains the same provision almost verbatim, but adds a fourth requirement that obliges the court to be cautious in its evaluation, namely: "… prejudice resulting from a failure to consolidate is not outweighed by the risk of undue delay or prejudice to the rights of or hardship to parties opposing consolidation."

To a Scandinavian lawyer, the idea of the courts having the power to consolidate arbitral proceedings is rather exotic. To take one example, the Danish Arbitration Act 2005 contains no such provision, nor has the inclusion of one been suggested during the revision that has taken place in recent years. As the courts derive their powers from positive law, there are no means by which the Danish courts may facilitate arbitration in this way. However, a provision such as that contained in the Alaskan Code of Civil Procedure, chapter 43, section 370, provides transparency and predictability on a national level and should be viewed by legislators as the way forward. Even so, the Alaskan clause does not resolve every problem. Under the rules of international law, a court's jurisdiction only extends to the borders of state where it is situated. A court is therefore unable to order consolidation of arbitral procedures taking place in foreign states. Further, under the present wording of the New York Convention, parties wishing to obstruct the consolidation of arbitral proceedings may simply initiate double proceedings pursuant to the wording of (some of) the parties' arbitration agreement or refuse to recognise the legitimacy of the consolidated proceedings and challenge the award – in default – on that ground at a later stage. As things stand at present, such uncertainties in relation to consolidated arbitral procedures cannot be ruled out.

5 The way forward?

Given the way in which international arbitration is currently regulated, if parties anticipate that disputes that may arise from their legal relationship are likely to involve multiple parties, their safest option is the insertion of an effective multi-party arbitration clause into their contract. They should therefore not only adopt the same two-party arbitration clause within their contractual set-up,

but they should also adopt a clause that will be effective with regard to any two parties linked in the chain of contracts and with regard to claims based on a direct right of action and claims against parties considered jointly responsible in respect of any claim. In addition, the parties should preferably agree on an arbitration institution whose rules positively provide for consolidation of proceedings or, alternatively, specify a seat of arbitration where consolidation may be ordered by the courts. If this is incompatible with the parties' desired forum, the arbitration clause should positively provide that: i) the tribunal may consolidate any concurrent actions taking place pursuant to the clause; and ii) any other parties to the clause may join, or be joined, at the tribunal's discretion. In all these situations, the parties should establish specific appointment procedures in case they wish to depart from the normal three-arbitrator set-up. The autonomy of the parties and their right to determine the arbitration tribunal's procedure is so heavily protected by the New York Convention, Art. II and V, that an arbitral award arrived at under such a clause should be immune to challenge.

If multiple proceedings seem less likely, the choice of a set of institutional rules that allows for consolidation of proceedings, or of a seat of arbitration where consolidation may be ordered by the courts, may seem sufficient. However, especially as regards the latter option, awards made in proceedings consolidated by the courts in the absence of express consent in the arbitration clause, may be challenged. As has already been mentioned, despite these shortcomings, arbitral institutions and the courts should consider the adoption of regulations governing multi-party situations when their rules or codes of procedure are next up for revision.

Having considered the options available within the arbitration system, the question remains of whether the ordinary courts may be better suited to dealing with international multi-party disputes.

Specialist courts at a national level may provide the technical or commercial expertise required by the parties, one example being the Danish Maritime and Commercial Court in Copenhagen, whose panels consist of one judge and two lay experts. However, the parties may be deterred by problems concerning international recognition and enforcement of the judgment, as well as the lack of confidentiality. However, if confidentiality is not the parties' biggest concern, parties to multi-party contracts within the EU and EFTA member states could opt for the system established under the Brussels Regulation and the Lugano Convention, as this double convention provides a complete set of rules governing direct jurisdiction, consolidation and *lis pendens*, as well as a guarantee that judgments made within the rules will be recognised and enforced.

Outside the geographical scope of the EU and EFTA jurisdictions, the new Convention on Choice of Court Agreements of 30 June 2005 could provide a solution. Unfortunately, in its final form, the convention has ended up as basically a version of the New York Convention as applied to court jurisdiction. The opportunity to realise a double convention, complete with direct jurisdiction, consolidation, *lis pendens*, recognition and enforcement rules has therefore been lost. Had the situation been otherwise, parties in multi-party contractual relationships would have been well advised to opt for court jurisdiction, instead of agreeing to arbitrate (assuming that confidentiality was not indispensable). Under the new convention, the parties may enter into a multi-party jurisdiction agreement and request that any ruling of their chosen court be recognised and enforced by the potential States party. By entering into a jurisdiction agreement under the rules of the convention, the parties also submit to the general jurisdiction of the selected court, and the rules on joinder and consolidation under the applicable national law will apply, allowing the dispute to be

resolved in a single venue. However, in cases where the jurisdiction of the court is not based directly on a jurisdiction agreement, recognition and enforcement is not guaranteed under the convention. This may cause problems in cases where the parties' main assets available for execution are located in other states. Finally, it is still uncertain how successful the convention will be, so it does not represent a real option for international parties at present.

To conclude, for the time being, the only real option for parties that may become involved in multi-party disputes in international trade is a well-drafted multi-party arbitration clause – and some good luck.

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Part IX

The EU's Exercise of Port and Coastal State Jurisdiction*

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* This article also appears in Annuaire de Droit Maritime et Océanique (January 2007), published following the Fourth European Colloquium on Maritime Law Research: "Perspectives on maritime law – safety, security and protection", at which this paper was presented.

1 Introduction

It is sometimes claimed that the EU's maritime safety policy, and in particular the policy pursued since the turn of the millennium, following the *Erika* and *Prestige* accidents, defies internationally agreed standards and thereby violates international law. A review of the growing bulk of EU legislation in this field reveals certain trends that support such claims. In particular, it emerges that the more recent legislative acts are clearly more independent of their international counterparts than were the early EU regulatory measures of the mid-1990s. This does not, however, in itself prove that the EU's maritime safety measures violate international law. In fact, it might just as well prove the opposite: that the EU in pursuing its policy has made creative use of a variety of opportunities offered by international law.

This article does not analyse the legality of the relevant EU legislation and thus will not prove the veracity of either claim. Its more limited ambition is to illustrate some general trends in the development of EU maritime safety legislation by identifying certain tendencies in its relationship with the international maritime safety rules and by highlighting certain issues which may be of particular interest from the point of view of international law. Such a limited review can only provide a general characterisation of the relationship between the EU's maritime safety policy and international law. At best, it may give an indication as to whether or not the claims of illegality are justified.[1]

[1] A more comprehensive review of the same subject matter is undertaken by the present author in chapters 5 and 6 of his study 'The EU Maritime Safety Policy and International Law', due to be published in late 2007. Those chapters, unlike this article, include a more detailed assessment of the legality of the individual legislative measures discussed here.

The gradual development towards more autonomous EU rules in this field is particularly noticeable when the relevant EU legislation is separated into measures adopted from the perspectives of the flag, port and coastal States.[2] The EU has generally held back from adopting measures from the flag State perspective to avoid disadvantaging its Member States' fleets. Because of this, and since requirements which are limited to ships flying the flag of the regulating State do not generally give rise to difficulties under international law, the focus of this article lies on the development of rules applicable to all ships, i.e. those adopted from the port and coastal State perspectives.

Since maritime safety is a highly regulated field at international level, any regional legislation in this area almost inevitably relates to a corresponding set of international rules, usually in the form of provisions in a convention adopted within the framework of the International Maritime Organization, the IMO. The situation has evolved, however, even during the brief 15-year history of the EU's maritime safety policy. While the early EU measures primarily served to implement the international rules at regional level, later rules have increasingly sought to complement, develop or even strengthen their international counterparts. From a legal point of view, the significance of these developments lies in an increased potential for discrepancies in substance between the two categories of rules and, more importantly, in the fact that the law of the sea

[2] In the following, where reference is made to measures adopted from the perspective of the flag State, this refers either to EU legislation which only covers ships flying the flag of EU Member States or to standards for EU flag State administration. A port State perspective signifies that the target of regulation is ships of all flags, to the extent they call at ports of EU Member States, while coastal State measures cover ships of all flags transiting the coastal waters of Member States, without calling at their ports.

makes a close link between the jurisdiction of States or regions to prescribe and enforce rules for international shipping in the first place and the international applicability and acceptance of those rules. The latter consideration explains why the substantive relationship between the EU rules and their international counterparts is taken as the point of reference in this article.

2 On the jurisdiction of States under the law of the sea

In brief, the international law of the sea, as codified in the 1982 United Nations Convention of the Law of the Sea (UNCLOS), offers limited prescriptive and enforcement jurisdiction to (coastal) States over foreign ships that merely transit their maritime zones. The jurisdictional balance between the coastal and maritime interests differs in respect of each maritime zone. In general, both types of jurisdiction increase in proportion to the geographical proximity of the maritime zone in question to the coastal State.

On the high seas, the flag State has exclusive jurisdiction over ships flying its flag "save in exceptional cases expressly provided for in [UNCLOS]".[3] Two such exceptions are relevant for present purposes. Firstly, Article 218 provides port States, under certain conditions, with authority to take enforcement measures in relation to violations of international discharge rules, irrespective of where the discharge took place and whether the port State itself was affected by it. Secondly, Article 221 offers a coastal State, in the case of major casualties involving major environmental damage, the possibility to take proportionate action to protect its coastline and related interests.

[3] UNCLOS Article 92(1).

Exclusive flag State jurisdiction does not imply, however, that the setting of safety standards is completely left to the flag State. Under UNCLOS, all flag States are to ensure that their ships comply with the "generally accepted international rules and standards" ('GAIRS'), wherever the ship is located and irrespective of whether the flag State has formally ratified those standards.[4]

The jurisdiction of coastal States to prescribe rules for international shipping in their exclusive economic zone ('EEZ') is normally limited to 'generally accepted international rules and standards established through the competent international organization',[5] while a corresponding limitation in the territorial sea only applies to rules which relate to the construction, design, equipment and manning ('CDEM') of foreign ships.[6] Otherwise, the regulatory sovereignty of the coastal State extends to its territorial sea.

States' powers to enforce these rules similarly depend on the nature and location of the violation. Detailed enforcement provisions only exist in respect of the violation of environmental requirements. In the EEZ, enforcement is only admissible with respect to (significant) pollution discharges fulfilling various criteria as to severity and evidence. The enforcement powers in the territorial sea are more comprehensive, but remain subject to the doctrine of foreign ships' right of 'innocent passage' through the territorial seas of other States.[7] Ships may, however, lose their right

[4] UNCLOS Articles 94(5) and 211(2). On the meaning of this concept, see in particular the Final Report of the International Law Association's Committee on Coastal State Jurisdiction relating to Marine Pollution over Vessel-Source Pollution, 2000.

[5] UNCLOS Article 211(5). See also Article 211(6) on coastal State jurisdiction within 'special areas' of the EEZ.

[6] UNCLOS Article 21(2).

[7] UNCLOS Article 220(2), (3), (5) and (6).

of innocent passage, and hence be subjected to the complete jurisdiction of the coastal State, but in the light of the stringency of the applicable criteria, this is not likely to be relevant in most cases.[8]

Port States, by contrast, enjoy significant regulatory and enforcement authority over foreign ships. Internal waters are, for jurisdictional purposes, assimilated to the land territory of the State and through their voluntary presence in the port or internal waters of a State, ships have subjected themselves to the territorial jurisdiction of the relevant port State. Moreover, it is widely recognised that ships enjoy no general right of access to ports in international law. This implies, *a fortiori*, a right for the port State to make access to its ports conditional on compliance with specific requirements.[9]

Limitations to this *a priori* unlimited jurisdiction of port States include the restraints which follow from treaty commitments, whether imposed by bilateral or multilateral, maritime, commercial or other treaties, and from principles of general international law, such as the prohibition of discrimination or of abuse of right. Proportionality requirements may also place limitations on the enforcement measures which may reasonably be taken against ships which fail to comply with the port State's requirements. Yet such limitations are obviously less specific and more dependent on

[8] See in particular UNCLOS Article 19(2) which lists twelve *activities* which render passage non-innocent, including "any act of wilful and serious pollution contrary to this Convention" and "any other activity not having a direct bearing on passage". The condition of a ship, or a violation of the coastal State's national laws, does not therefore in itself give rise to a loss of the right of innocent passage. See also the Final Report of the ILA Committee, *op cit.* note 4, Conclusion No. 7.

[9] See UNCLOS Articles 25(2) and 211(3).

the circumstances of the individual case than the relatively clear-cut, maximum limits imposed on coastal State regulation.

The legal regime described above, which is admittedly simplified as it overlooks certain maritime zones altogether,[10] may be schematically summarised as follows:

	Flag State	**Coastal / port State**
High seas	Minimum: 'Generally accepted international rules and standards' (GAIRS) (i.e. SOLAS, Marpol, STCW etc.)	No, but limited environmental enforcement jurisdiction
EEZ		Maximum: GAIRS
Territorial sea		National rules, but for CDEM rules, max: GAIRS
Internal waters, Ports		Internal rules (implicitly) Maximum: ?

Inserting the existing EU maritime safety measures into such a table causes certain difficulties as few measures are exclusively based on a coastal, port or flag State perspective. In most cases, the same measure incorporates several perspectives. Most port State measures, for example, also apply to ships flying the flags of the Member States, while different provisions of the same instrument, or amendments thereof, may address topics from different

[10] Notably, the contiguous zone, straits used for international navigation and 'special areas' of the EEZ. EU legislation does not generally address these maritime zones, however, the only exception being Directive 2005/35, which in Article 3(1)(c) explicitly includes straits used for international navigation, subject to the regime of transit passage, within the regulatory reach of the directive.

perspectives. Notwithstanding such imperfections, the following table seeks to indicate the main emphasis of the 25 substantive EU maritime safety measures which have been adopted so far.[11]

	Flag State	Coastal / port State
High seas	5	1
EEZ		2
Territorial sea		
Internal waters, ports		17

3 The EU acting as a port State

3.1 Prescription

In terms of substantive coverage, the 25 or so relevant directives and regulations now cover virtually every aspect of safety at sea, ranging from classification societies, port State control and seafarers' training to technical and operational requirements for specific classes of ships (notably passenger ships and oil tankers), rules on standards for pollution and waste management and, to some extent, even to issues of maritime civil liability and compensation. In the light of the brief review above of States'

[11] In the table below, as is the case more generally in this article, the EU measures are categorised on the basis of their most far-reaching element. Measures which apply both to ships flying the flag of a Member State and to ships of any flag when entering EU ports are hence considered to represent 'port State measures', while measures which include provisions for both port-bound ships and ships which merely transit the waters of Member States are considered 'coastal State measures'.

jurisdiction over foreign ships under international law, it should come as no surprise that the EU has predominantly sought to regulate these matters by means of rules which apply to all ships entering the ports of Member States. By opting for port State regulation, many jurisdictional restraints may be circumvented and there are no easily identifiable or rigid maximum limitations on this type of requirements. As opposed to national rules imposed by individual States, moreover, regional rules for port-bound ships will in reality cover a large portion of coastal traffic as well, given that a significant portion of the ships which transit the coastal waters of one Member State will be heading for the port of another. Roughly two out of three legislative measures fall into this category.

Far from all port State measures are legally controversial. To begin with, measures which exclusively seek to implement international rules on ships while in EU ports should raise few concerns in this respect. The prime example is the 'port State control Directive'.[12] Despite numerous amendments and refinements over the years, this directive, which still represents one of the cornerstones of the EU's maritime safety policy, has largely remained 'clean' of regional standards. The control and enforcement of international standards approved by the IMO and the ILO was the original, and still remains the principal, objective of the directive.

In other cases, the requirement for an international foundation for the rules which apply in EU ports has been somewhat relaxed. An example is the enforcement of ILO Convention No. 180 on

[12] Council Directive 95/21/EC of 19 June 1995 concerning the enforcement, in respect of shipping using Community ports and sailing in the waters under the jurisdiction of the Member States, of international standards for ship safety, pollution prevention and shipboard living and working conditions (port State control), as amended.

working time.[13] In this case, the basis for the EU-wide application of the rule lies in the international entry into force of that convention. However, the convention has been brought into force through the ratification of only five States, casting doubt on its truly international nature.

Other examples that show how the international applicability criterion has been relaxed over time include EU measures which seek to achieve an early implementation of international rules at regional level (after their adoption, but before their international entry into force),[14] even where there is uncertainty over whether the international rules in question will ever enter into force,[15] or the mandatory application of international standards which are laid down in non-mandatory terms, such as, most notably, IMO Codes or Resolutions.[16]

Another EU strategy has been to introduce measures which seek to 'improve' the international rules by filling perceived gaps therein. An uncontroversial variant is to extend the scope of application of the IMO rules to ships to which they would otherwise not apply, such as, notably, ships only engaged in domestic traffic in a

[13] Directive 1999/95/EC of the European Parliament and of the Council of 13 December 1999 concerning the enforcement of provisions in respect of seafarers' hours of work on board ships calling at Community ports.

[14] See e.g. Council Regulation (EC) No 3051/95 of 8 December 1995 on the safety management of ro-ro passenger vessels.

[15] Council Directive 97/79/EC of 11 December 1997 setting up a harmonised safety regime for fishing vessels of 24 metres in length and over. This directive implements, and to some extent exceeds, the 1993 Torremolinos Protocol on the Safety of Fishing Vessels, which has not entered into force.

[16] E.g. Directive 2001/96/EC of the European Parliament and of the Council of 4 December 2001 establishing harmonised requirements and procedures for the safe loading and unloading of bulk carriers.

Member State.[17] In other cases, the EU has sought to address matters closely related to those regulated in the international conventions, but which, for some reason, have not been included in the final convention text. A relatively innocent example is the 2000 port waste reception facilities directive, which builds upon the obligations of the Marpol Convention, but goes several steps further by strengthening the obligations of ships to deliver their waste in ports and by imposing rules on how port States are to handle and charge for the waste they receive.[18]

More controversially, certain EU port State rules regulate matters which have been discussed but in the end left out of the international conventions, due to lack of sufficiently widespread support. The requirement to carry a voyage data recorder ('VDR') on board is a case in point. The phased-in requirements of Directive 2002/59 encompassed a broader range of ships than SOLAS Regulation V/20 and had the effect of requiring existing cargo ships, which had specifically been excluded from the coverage of the international obligation, nevertheless to be equipped with a VDR when calling at EU ports.[19] Another example concerns stability requirements for ro-ro passenger ships. Standards

[17] E.g. Council Directive 98/18/EC of 17 March 1998 on safety rules and standards for passenger ships.

[18] Directive 2000/59/EC of the European Parliament and of the Council of 27 November 2000 on port reception facilities for ship-generated waste and cargo residues.

[19] Directive 2002/59/EC of the European Parliament and of the Council of 27 June 2002 establishing a Community vessel traffic monitoring and information system and repealing Council Directive 93/75/EEC, Article 10 and Annex II(II). See also Article 9(3) and Annex XII of Directive 95/21 (referred to in note 12 above), as amended by Directive 2001/106/EC. With effect from 1 July 2006, SOLAS Regulation V/20 has been amended so as to reduce the differences to the EU VDR requirements. See IMO Resolution MSC.170(79).

which were not accepted by the IMO, but which were nevertheless implemented by certain Northern European States, were eventually, in 2003, made applicable throughout the EU.[20]

By far the most controversial EU rules, from a legal and political point of view, are those that regulate matters already covered by international rules, but where different standards are introduced for ships entering EU ports. CDEM requirements are particularly controversial in this respect, as they represent a *de facto* modification of the international rules for ships wishing to enter EU ports. There are not many examples of this type of rule and the principal example, which relates to the construction of oil tankers, is well-known. Following the *Erika* accident in December 1999, the Community agreed to phase out single-hulled oil tankers more rapidly than the international schedule established in Marpol. The EU phasing-out scheme introduced a timetable that corresponded more closely to that applying in the USA under the 1990 Oil Pollution Act, but, unlike the latter, the EU scheme maintained the international technical rules and definitions on the construction of oil tankers as laid down in Marpol. However, these rules never gave rise to a conflict with the international rules, since Marpol was amended in parallel to incorporate the EU requirements, subject to some minor compromises which were eventually accepted by the EU. Once EU Regulation 417/2002 entered into force, it therefore corresponded to the amended international rules.[21]

Not long after the entry into force of that Regulation, however, the next major oil tanker incident involving an ageing single-hull tanker occurred in EU coastal waters. The sinking of the *Prestige*

[20] Directive 2003/25 of the European Parliament and of the Council of 14 March 2003 on specific stability requirements for ro-ro ships.

[21] Regulation 417/2002 of the European Parliament and of the Council on the accelerated phasing-in of double hull or equivalent design requirements for single hull oil tankers and repealing Council Regulation No 2978/94.

prompted the Community to revisit its phasing-out scheme in order to match it more closely with that originally proposed by the Commission. The revised EU Regulation included a tighter phasing-out schedule than its predecessor and also introduced construction requirements for ships carrying heavy grades of oil.[22] This time, the adoption of the EU Regulation was not linked to a corresponding amendment of Marpol. It entered into force while international negotiations to re-amend Marpol were still on-going and the two phasing-out schemes remained at odds until the Marpol amendments entered into force on 5 April 2005, some 18 months after the entry into force of EU Regulation 1726/2003.

3.2 Enforcement

A similar trend towards a gradual increase in the stringency of the rules may also be observed in the field of enforcement of the rules applicable to foreign ships entering EU ports. The now classic method of ensuring compliance by foreign ships is port State control (PSC). Since the adoption of the PSC Directive in 1995, port State control has remained one of the key pillars of the EU's maritime safety policy and the principal remedy with respect to ships that fail to meet applicable international standards.

The EU PSC regime has gradually moved beyond the traditional two-step approach of inspection and, where necessary, detention of ships. The first version of the directive introduced a new remedy in banning from all EU ports ships which had been ordered to proceed to the nearest appropriate repair yard, but had failed to do so.[23] The use of this remedy has been broadened in subsequent

[22] Regulation 1726/2003 of the European Parliament and of the Council amending Regulation (EC) No. 417/2002 on the accelerated phasing-in of double hull or equivalent design requirements for single hull oil tankers.

[23] Directive 95/21, *op. cit.*, note 12, Article 11(4).

amendments to the regime and it is now used almost routinely on ships which have multiple detentions in EU ports over a certain period.[24] Other developments in the enforcement regime include the increased use of mandatory inspections of certain categories of ships, 'automatic' detention in the case of certain deficiencies and the public 'black-listing' of non-complying ships and their operators.

Port State control is, however, primarily a means of ensuring compliance with international rules. This applies to the EU regime as well and EU lawmakers have generally been careful not to 'pollute' the PSC Directive with the control and enforcement of standards of a purely regional character.[25] For standards which are purely regional in scope, other solutions have been envisaged for promoting and ensuring compliance in ports. An early and cautious variant was the linking of non-compliance with the regional rules to an increased probability of inspection, or a more detailed inspection, by PSC.[26] Later measures have sometimes introduced separate regional enforcement methods which are similar to detentions, but have a different name and function and do not technically fall under PSC. Examples include the prohibition on

[24] For the latest proposal to extend the regime of 'banning' further, see COM(2005)588 final. See also the list of ships currently banned from EU ports at www.emsa.eu.int.

[25] The principal exception being the use of PSC to enforce EU requirements regarding the carriage of VDRs, which recently has been proposed to be removed from the PSC Directive (COM(2005) 588 final).

[26] The original PSC Directive (*op. cit.* note 12) foresaw these types of enforcement solution with respect to non-compliance with Council Directive 93/75/EEC concerning minimum requirements for vessels bound for or leaving Community ports and carrying dangerous or polluting goods (Annex I) or non-compliance with Article 8 of Council Directive 94/58/EC on the minimum level of training of seafarers (Annex III).

leaving port before delivering waste under Directive 2000/59 and the mandatory rest periods under Directive 1999/95.

Since the turn of the millennium, more powerful remedies have been introduced, the most notable example being the refusal of access to EU ports *a priori*, that is, for whole categories of ships on the basis of criteria which may be verified ahead of arrival, without a physical inspection of the ship. This remedy is notably applied with respect to oil tankers which do not meet the double-hull requirements of Regulation 1726/2003.

Another step in developing the range of enforcement measures available to port States was taken in 2005 through the adoption of the 'pollution sanctions Directive', which, together with the associated Framework Decision 667/2005/JHA, for the first time introduced an obligation to impose criminal sanctions on persons who violated the international discharge standards. These two measures have the combined effect that violations of the Marpol discharge standards for oil and noxious liquid substances shall be 'infringements' and subject to criminal penalties to the extent such violations have been committed "with intent, recklessly or through serious negligence". Ship-source pollution was thus among the first fields of Community law to make use of the gradual increase of Community competence in the field of criminal law that has taken place over the past decade.[27]

[27] See also Case C-176/03, COMMISSION V COUNCIL, ECR [2005] I-7879. Following this case, which declared invalid Council Framework Decision 2003/80/JHA on the protection of the environment through criminal law on the grounds that it infringed on the Community's competence in the field of environmental protection, and should therefore have been adopted in the form of a Community measure, the Commission has sought to annul Framework Decision 2005/667/JHA (Case C-440/05). These proceedings, however, relate to the division of competence between the Community and Member States in matters of criminal law and are unlikely to affect the material substance of the sanctions regime.

3.3 Conclusion

The above brief, and very cursory, review of EU port State legislation reveals a trend towards further-reaching measures over the course of time in the fields of both prescription and enforcement. Port State measures represent the core of EU maritime safety legislation, and the increase in the quantity of such measures in the past decade has been coupled with a gradual movement towards independence from the international rules. From originally having merely implemented the international rules, the EU maritime safety measures increasingly impose additional, sometimes even competing, requirements on ships bound for EU ports, irrespective of their flag. In terms of substance, such rules not only relate to operational requirements, which may be complied with if the ship's crew so decides, but also to CDEM matters which are beyond the control of those in charge of the ship's operations.

In parallel, the measures taken to enforce those requirements have grown more robust over time. Port State control has been complemented by ever more stringent sanctions on non-complying ships. The criteria for use of the ultimate sanction, the refusal of access to any EU port, have not only been continuously broadened but the sanction has also been applied with respect to requirements of a purely regional origin and scope.

While this development may be interesting from a policy point of view, it does not necessarily follow that it is illegal under international law. As indicated in section 2 above, the limits of States' jurisdiction over foreign ships that are voluntarily in their ports are far from clear. The same applies to the relevant IMO conventions, which are usually adopted from a purely flag State perspective and which do not generally restrict port States from

exceeding their standards.[28] The EU has exploited such uncertainties to justify its port State rules. Gradually, through a series of small steps, and somewhat bigger steps following accidents, precedents have built up to establish a legal regime which seemed unthinkable only a decade ago.

Yet it is difficult to find immediate inconsistencies between the EU rules and international law. In several cases, questions may legitimately be raised about the legal foundation of the regional rules, but it would appear that direct violations of any clear rule of international law are difficult to find, at least following the IMO's (re-) amendment of the double-hull Regulations 20 and 21 in Marpol Annex I in 2003. The presumed lawfulness of the EU's port State measures is also supported by the notable absence of legal criticism of their development. While industry organisations, other States and the IMO itself have frequently raised significant policy concerns in relation to the EU's port State measures, those concerns have rarely been formulated in legal terms. Arguably, the EU's legislative practice in the field of port State jurisdiction has even served to clarify and change international law on that jurisdiction's extent.

[28] By contrast, certain more recent IMO conventions specifically confirm the jurisdiction of port States to introduce more stringent legislation. See e.g. Article 1(3) of the 2003 International Convention on the Control of Harmful Anti-fouling Systems on Ships; Article 2(3) of the 2004 International Convention for the Control and Management of Ships' Ballast Water and Sediments; and Marpol Regulation I/21(8)(2).

4 The EU acting as a coastal State

4.1 Prescription

The regulation of ships that merely pass through the coastal waters of Member States, without calling at their ports, has the advantage from the regulator's point of view that all ships that pose potential safety or environmental risks may be covered by such legislation. On the other hand, the regulatory restraints on this type of regulation are considerably more severe. It was noted in section 2 above that, apart from non-CDEM rules in the territorial sea, coastal State regulation is essentially limited to rules and standards which are "generally accepted" at international level.

Such limitations notwithstanding, EU maritime safety legislation has taken certain steps in the field of coastal State regulation in the past few years, by regulating ships that are merely transiting the coastal waters of Member States. The first truly 'coastal' measure was the 'traffic monitoring directive', which was drafted in the aftermath of the *Erika* accident in 1999 and approved in 2002.[29] This directive covers variety of issues, some of which are of a purely coastal nature. The directive regulates, *inter alia,* the procedures and criteria to be followed by Member States when adopting ship reporting systems, vessel traffic services or ships' routeing measures in their coastal waters.[30] These rules are generally closely linked to the international rules and standards as laid down in SOLAS Chapter V and related guidelines, and their applicability to ships flying the flag of third States requires acceptance of the traffic measures by the IMO.[31] The EU rules on traffic measures primarily

[29] Directive 2002/59, *op. cit.* note 19.

[30] *Ibid.*, Articles 5, 7 and 8.

[31] A curious exception is Article 8(b), which exceeds the jurisdictional limitations imposed by the IMO rules by providing that foreign ships are to

serve to establish EU-wide criteria for proposing and implementing systems that are to be approved internationally and do not, therefore, generally give rise to inconsistencies in relation to IMO conventions or the law of the sea.

Similarly, the directive includes certain provisions that make use of the jurisdiction available to coastal States under international law following marine incidents. Notably, its Article 19 transforms a Member State's right under international law to take appropriate measures following a maritime incident, irrespective of its location, into an obligation. While the appropriateness and usefulness of transforming a right which originates in the doctrine of necessity into a general obligation under EU law may be questioned, it is difficult to argue against the lawfulness of the EU making collective use of the well-established, but unspecific, right of intervention that is acknowledged and codified in several international conventions.[32]

More recently still, the EU has adopted two directives that regulate discharges and emissions from ships. Both Directive 2005/33, regulating the sulphur content in ships' fuels, and Directive 2005/35, providing for sanctions for violations of the Marpol discharge standards, extend their requirements to ships passing through the coastal zones of Member States. While the bulk of the provisions in both directives corresponds to the international standards as laid down in the relevant Marpol annexes, both instruments to some extent go beyond those standards, increasing their interest from an international law point of view.

comply with vessel traffic services established beyond the territorial sea of Member States, insofar as those ships are bound for a Member State.

[32] Most notably in the 1969 International Convention relating to Intervention on the High Seas in Cases of Oil Pollution Casualties and in UNCLOS Article 221. See also Article 9 of the 1989 International Convention on Salvage and various regional marine environment protection conventions.

The directive on sulphur content in fuel departs from Marpol in two principal ways. First it slightly exceeded the international standards in a temporal sense, by implementing more stringent requirements for the North Sea 'Sulphur Emission Control Area', before the corresponding international rules entered into force.[33] Secondly, it introduces special fuel requirements for passenger ships in regular traffic between EU ports. There are no equivalent requirements in Marpol. Interestingly, these requirements apply not only in the coastal waters of the EU Member States, but anywhere during the ship's passage, including, it seems, on the high seas.

The pollution sanctions directive is more solidly based on the international rules, at least as far as the material standards are concerned. As was noted above in section 2, UNCLOS gives strong jurisdictional support for a geographically widespread implementation of the Marpol discharge standards, irrespective of where the violation has occurred. The directive makes use of this jurisdiction to extend its reach beyond violations that have occurred in the coastal zones of the Member States. It introduces sanctions for any violation of the Marpol discharge standards that have been committed intentionally, recklessly or through serious negligence. Yet two aspects of the directive depart from its otherwise strict adherence to the international rules. Firstly, Article 5(2) removes the exception granted in Marpol Regulations I/11(b) and II/5(b) for owners and masters, insofar as they have not caused the discharge intentionally or "recklessly and with knowledge that damage would probably result", in favour of the directive's general scheme based on intent, recklessness or serious negligence, when the violation has occurred in the territorial sea of a Member State. Secondly, the

[33] The more stringent standards for the North Sea under the directive will apply as from 11 August 2007, while the corresponding amendment of Marpol Annex VI becomes applicable on 22 November 2007.

directive extends the sanctions regime to any person who has been found to cause the damage, rather than only to specified persons, such as the owner or master of the ship.

These features of the directive have recently been challenged in the European Court of Justice by a group of industry associations seeking to have the directive invalidated because it violates international law.[34] This is unlikely to succeed, however, as the legal foundation for the claim is weak and seems to be based on a series of misunderstandings of the law of the sea and of Community law. As noted above in section 2, UNCLOS, which takes precedence over Marpol in jurisdictional matters,[35] specifically accepts national rules in the territorial sea as long as they do not relate to CDEM standards. Its enforcement provisions do not impose any limitation as to the persons that may be prosecuted for pollution offences. Nor does Marpol contain any limitation as to the persons who may be subject to sanctions for violating its provisions. Marpol is, in any event, not acceded to by the Community and does therefore not represent a ground for declaring a directive invalid under Community law.

4.2 Enforcement

The gradual increase in prescription over foreign ships in the coastal zones has not, so far at least, been matched by any corresponding development with respect to enforcement at sea. Out of the three directives discussed in the previous section, the first does not include specific enforcement provisions at all, while

[34] See the referral by the High Court of Justice of England and Wales, Queen's Bench Division, in INTERTANKO ET AL V SECRETARY OF STATE FOR TRANSPORT of 4 July 2006. The ruling by the European Court of Justice (Case C-308/06) is expected in late 2007.

[35] Marpol Article 9(2).

the enforcement of the latter two directives is predominantly to be undertaken in ports. An ambition for some degree of at-sea enforcement of the requirements relating to sulphur content in fuel is to be found in a vague reference that enforcement of the regional standards for passenger ships is to be ensured by Member States "*at least* in respect of … vessels of all flags while in their ports"[36], while Member States, in respect of the standards in Sulphur Emission Control Areas, "may *also* take additional enforcement action in respect of other vessels in accordance with international maritime law."[37] The pollution sanctions directive is clearer in this respect, specifically establishing that a Member State may take enforcement measures against ships committing a violation in the EEZ, while, for some reason, failing to make use of the considerably more robust jurisdiction under UNCLOS Article 220(2) for violations which have occurred in the territorial sea.

4.3 Conclusion

Significantly less rules have been adopted from the coastal State than the port State perspective. In view of the stringent limitations imposed by the law of the sea on this type of regulation, it is nevertheless notable that three measures, which are at least in large part of a coastal nature, have been adopted and implemented since the turn of the millennium. From a policy point of view, it is particularly notable that two out of the three coastal measures exceed the international discharge rules and standards in certain respects. This suggests that the EU has become reluctant to 'merely' implement international rules without supplementing them with some kind of regional regulatory 'added value'.

[36] Article 4a(4), emphasis added.

[37] Article 4a(3), emphasis added.

In the light of the way port State jurisdiction has developed, the three coastal State measures might be taken as representing a starting point on which further amendments and additional measures will be based, to be implemented on the basis of precedent, through a 'policy of small steps', as seen in the field of port State prescription. On the other hand, through these three measures, the EU has largely exhausted the opportunities provided by international law to complement the international pollution rules with respect to transiting ships. Regional coastal State standards relating to, for example, the design or equipment of ships will almost automatically create significant tensions with the law of the sea, and the development of such standards is therefore likely to remain limited as long as the EU confines its ambitions within the limits of the law of the sea.[38]

An alternative, but probably more realistic, scenario is that, as long as the international legal restraints on regional measures remain as strict as they are today, the EU is unlikely to prioritise the adoption of purely coastal measures. For practical as well as legal reasons, it seems more probable that *if* the EU in the future seeks to impose its own requirements on ships merely transiting the coastal waters of its Member States, those requirements will mainly be enforced in ports, making use of the more flexible enforcement jurisdiction of port States. Available regulatory techniques include the postponement of enforcement until the violating ship subsequently enters an EU port, or the use of collective port State jurisdiction, by which violations in the coastal zone of one Member

[38] It may be noted that the Commission, following the *Prestige* accident, proposed an initiative to amend the jurisdictional regime laid down in UNCLOS so as to provide coastal States with greater jurisdictional powers over foreign ships. See notably COM(2002) 681 final, pp. 13, 14. However, there seems to have been no follow-up to these policy statements to date.

State are enforced in the port (Member) State of destination. Both techniques represent largely uncharted legal territory.

5 Conclusion

The hypothesis that the EU, in pursuing its maritime safety policy, consciously flouts international law finds very little support in the brief survey of the relevant legislation undertaken above. Indeed, the opposite contention seems more likely to be true, i.e. that international law considerations underlie all EU maritime safety measures and that both the substance of the rules and the methods chosen for their enforcement are normally based on careful considerations of what can and cannot be done within the jurisdictional limits of international law. Whether the EU has always landed on the right side of the dividing line between legality and illegality is open to argument and question marks might well be raised with respect to certain elements of individual measures. Nevertheless, it is submitted that no piece of EU maritime safety legislation represents a direct violation of international law of a kind to justify the suspicion that disregard of international law forms part of the EU's maritime safety policy.

While it is true that the developments described above tend towards increased independence from international rules and hence towards greater friction with the principles of the law of the sea, a distinction should be made between port State and coastal State measures. With respect to the former, the EU has clearly exploited the notable flexibility of international law when implementing its standards for foreign ships. In exercising coastal State jurisdiction, by contrast, it has been cautious in challenging the more precise and static borders of international law. The fact that all regulatory measures that involve an element of coastal State jurisdiction have been adopted in the past five years may be

interpreted as a sign of increased ambition in this field. Yet, in terms of substance, the measures concerned have either sought to implement generally accepted international rules or have related to issues where a degree of national or regional jurisdiction is provided for in the relevant international regulations.

The absence so far of direct confrontation with international law may be taken as an indication that if and when the EU's maritime safety policy is developed further, continued emphasis will be placed on the port State perspective, possibly coupled with a 'combined' approach, under which the regulatory reach of the requirement will extend to transiting ships, but it will only be enforced once the ship voluntarily places itself under the jurisdiction of the same, or another, Member State. Such 'combined' jurisdiction is largely untested in practice and there are no clear limits on how far this type of jurisdiction may extend in substantive, geographical or temporal terms. In this sense, it represents another potential avenue for developing port State jurisdiction that may well be picked up by the EU in the future.

Part X

Safeguarding EC Fundamental Freedoms: Are Ship Blockades Exempt from the Freedom of Movement Rules?*

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* This article also appears in Annuaire de Droit Maritime et Océanique (January 2007), published following the Fourth European Colloquium on Maritime Law Research: "Perspectives on maritime law – safety, security and protection", at which this paper was presented.

1 Introduction

This paper has been inspired by the VIKING LINE case,[1] now pending in the European Court of Justice. The case raises the delicate question of the balance between economic freedoms and social rights. The immediate issue is whether a seafarers' union, aiming to reach a collective agreement, can be deprived of the weapon of collective action – i.e. blockade of a ship – when such action restricts the shipowner's fundamental freedoms pursuant to the EC Treaty. The paper discusses whether a ship blockade is caught by the free movement provisions, or if such an action, by analogy with the Court's ruling in the ALBANY case,[2] falls outside the provisions' scope. In other words, is there a "social policy exception" from EC law that exempts trade unions from the free movement provisions when they defend seafarers' interests?

1.1 The VIKING LINE case

Together with the LAVAL case,[3] the VIKING LINE case is groundbreaking as it will be the first time that the European Court of Justice will be directly confronted with a conflict between economic freedoms and trade union rights. From a shipping perspective, the VIKING LINE case is of greater interest, as it specifically concerns a conflict between the rights of a shipowner

[1] C-438/05 THE INTERNATIONAL TRANSPORT WORKERS' FEDERATION AND THE FINNISH SEAMEN'S UNION (pending case), received at the Court Registry on 6 December 2005.

[2] C-67/96 ALBANY [1999] ECR I-5751.

[3] C-341/05 LAVAL UN PARTNERI (pending case), received at the Court Registry on 19 September 2005. This case is also referred to as the VAXHOLM case.

and those of a seafarers' union. The shipowner's intention was to improve its position in the increasingly competitive market for ferry services in the Baltic by re-flagging one of its ships. This brought the shipowner into conflict with the seafarers' union, whose interests lay in safeguarding the jobs of its members.

The case is, however, somewhat unusual. Firstly, it concerns a shipowner's right to establish business in another Member State. Secondly, the interests involved are mainly of the same nationality. The shipowner is the Finnish Viking Line Abp, the ship concerned – the Rosella – is Finnish-flagged and the Finnish Seamen's Union (acting, however, in close co-operation with the International Transport Workers' Federation, the ITF) is behind the actions that make re-flagging pointless for the shipowner. The case does, however, have some transnational elements. The Rosella trades between two EU Member State capitals, Helsinki in Finland and Tallinn in Estonia, and the shipowner's intention was to register her in Estonia.[4]

1.2 The ITF European Ferries Policy

A clash between the interests of shipowner and those of a seafarers' union more commonly occurs when a foreign ship is blockaded when loading or discharging in a port of the trade union's country of operation. In fact, this is just the situation that Viking Line would probably have faced once it had established itself in Estonia

[4] For details of the case see the High Court of Justice (UK), Queen's Bench Division, Commercial Court, Case No: 2004 Folio 684, 16th June 2005, VIKING LINE V. THE INTERNATIONAL TRANSPORT WORKERS' FEDERATION AND THE FINNISH SEAMEN'S UNION and the subsequent appeal, Supreme Court of Judicature, Court of Appeal (Civil Division), Case No: A3/2005/1393(A) and 1393 and A3/2005/1394(A) and 1394, THE INTERNATIONAL TRANSPORT WORKERS' FEDERATION AND THE FINNISH SEAMEN'S UNION V. VIKING LINE ABP AND OU VIKING LINE EESTI.

and re-flagged the Rosella. FOC ships[5] are not the only targets of such actions. In accordance with the ITF *European Ferries Policy*, also referred to as *the Athens Policy*, bona fide national flag vessels are also targeted. With the main objective of eliminating competition from cheaper national flags, ITF affiliates strive to establish common terms of employment – in fact, requirements for "regional cabotage rights" – for all ferries[6] trading within a given region, particularly the Baltic.[7]

Recently, the Finnish, Swedish, German and Estonian Seamen's Unions demanded in a joint statement that the Estonian shipowner Tallink start negotiations on the contracts for the crews on four of its Estonian-flagged vessels operating in the Baltic. The aim was to introduce employment conditions that could be approved by the unions in all countries concerned. Hence, the requirement was that existing Estonian collective agreements should be replaced by collective agreements corresponding to the employment standards in the port State(s) affected by the trade.[8] As Tallink did not enter into negotiations with the unions, the FSU and its Finnish stevedore colleagues started a blockade against the ships in late May 2006. The blockade was lifted three days later, after a collective agreement was concluded between Tallink

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5 FOC – Flag of Convenience – ships is an ITF concept. In the VIKING LINE case, the Rosella was, by the ITF's definition, a FOC ship, as the beneficial ownership was to remain in Finland and the main reason for re-flagging was to reduce labour costs by employing foreign seafarers.

6 According to the Athens Policy, the campaign is limited to ferries, defined as any vessel/s that can be considered as constituting a cargo ferry, cargo passenger ferry, ro-ro/passenger cargo ferry, passenger ferry or a ro-ro cargo ferry.

7 International Transport Workers' Federation: A comprehensive review of the ITF FOC Campaign, *Oslo to Delhi*, paras. 54 – 55 and 114 – 117. http://www.itfglobal.org/files/seealsodocs/ENG/492/oslo%5Fto%5Fdelhi.pdf.

8 Press release from the Finnish Seamen's Union's representative assembly 27.4.2006, http://www.smury.fi/?module=news&id=20 and Helsingin Sanomat 16.5.2006, also published in English: "Tallink replaces Finnish crew with low-paid Estonians" at www.helsinginsanomat.fi/english.

and the FSU, which will gradually raise the Estonian wages to the Finnish level by 1 July 2008.[9]

As the Athens policy imposes requirements that "impede or render less attractive the activities of a provider of services established in another Member State where he lawfully provides similar services",[10] it will primarily trigger Article 49 of the EC Treaty concerning freedom to provide services and Regulation 4055/86 EEC applying the principle of freedom to provide services to maritime transport.

1.3 Balancing the shipowner's right to provide maritime transport services and a seafarers' union's right to blockade a ship

The conflict between a shipowner's right to provide maritime transport services and a trade union's right to blockade a ship will be the main focus of our discussion when looking further into the question of balancing economic freedoms and trade union rights. This will be discussed in the light of the first of not less than ten questions referred to the European Court of Justice for a preliminary ruling in the VIKING LINE case.[11] The question is whether there is a social policy exemption from the free movement rules that would exempt collective action, by analogy with the Court's ruling in the ALBANY case, from the ban on restrictions to free movement:

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9 http://www.smury.fi/?module=news&id=28 (the website of the Finnish Seamen's Union) 5.6.2006.

10 C-76/90 SÄGER [1991] ECR I-4221 para. 12, joined cases C-369&376/96 ARBLADE [1999] ECR I-8453 para. 33 and C-165/98 MAZZOLENI [2001] ECR I-2189 para. 22.

11 O.J. 11.3.2006, C 60 pp. 16 – 18.

> Where a trade union or association of trade unions takes collective action against a private undertaking to enter into a collective bargaining agreement with a trade union in a particular Member State which has the effect of making it pointless for that undertaking to re-flag a vessel in another Member State, does that action fall outside the scope of Article 43 of the EC Treaty and/or Regulation 4055/86 by virtue of the EC's social policy including, inter alia, Title XI of the EC Treaty and, in particular, by analogy with the Court's ruling in Case C-67/96 *Albany* [1996] ECR I-5751, paras 52-64?

In other words, does a right to blockade prevail over the shipowner's right to provide maritime transport services, in that the blockade should be granted immunity from the free movement provisions, just as the collective agreement was granted immunity from the competition rules in the ALBANY judgment.

2 The ALBANY judgment

2.1 The facts of the case

The Dutch case ALBANY[12] concerned the relationship between a collective agreement and the EC Treaty competition rules. The facts in ALBANY were similar to those in the simultaneous cases BRENTJENS[13] and DRIJVENDE BOKKEN[14].[15] All three cases involved collective agreements, which by a Ministerial decree had been declared binding *erga omnes* for all employers within a given sector. According to the agreements, all workers employed within the sector were to be affiliated to an agreed sectoral pension fund

[12] C-67/96 ALBANY [1999] ECR I-5751.

[13] C-115--117/97 BRENTJENS [1999] ECR I-6025.

[14] C-219/97 DRIJVENDE BOKKEN [1999] ECR I-6121.

[15] The opinion of AG Jacobs, delivered on 28 January 1999, therefore covers all three cases. The ECJ, however, gave a separate judgment in each case.

set up by the parties to the collective agreement. Albany, Brentjens and Drijvende Bokken, who were not parties to the collective agreement, each wanted to make pensions arrangements on better terms outside the agreed funds. However, exemption from affiliation to the sectoral funds was not granted. Consequently, the companies challenged the compulsory affiliation as being incompatible with the EC Treaty's competition rules.

2.2 The application of competition rules to collective agreements

According to Article 81(1) EC, "agreements between undertakings" are caught by the competition rules. This wording might lead one at first glance to assume that collective agreements fall outside the scope of the rules, as one party to the agreement – the trade union – cannot qualify as an "undertaking", at least not as long as it is acting within the social field.[16] The ALBANY judgment, however, shows that certain collective agreements are nevertheless caught by the competition rules.[17] This has been explained by focusing on the other party to the agreement – the employer – which is usually an undertaking and thus comes within the competition rules. To the extent a collective agreement is preceded by an agreement between

[16] A functional approach to the concept of an undertaking could, however, lead to a trade union being caught by the competition rules when engaged in economic activities outside the scope of the core activities of trade unions. See Edwardsson, Eva: *Konkurrenslagen, kollektiva hemförsäkringar och stuverimonopolet*. Juridisk Tidskrift 1997-98, pp. 952 – 983, at p. 961.

[17] In a commentary on ALBANY, Gyselen points out that "the only safe (and interesting) conclusion that can be drawn of the judgment is that the Court does not rule out that Article 81(1) might apply to certain types of collective agreements". Gyselen, Luc: Case Law. Common Market Law Review 37, 2000, pp. 425 – 448 at p. 441.

employers to enter into it, the collective agreement will imply an agreement between undertakings or a decision by an association of undertakings (the employers' association) and thus meet the criterion to come within the rules.[18] This explanation is, however, not entirely convincing and furthermore rules out the application of the competition rules to single employer collective agreements.[19] Nevertheless, collective agreements have a severe impact on competition, as they fix the purchase price of a central component in production, i.e. labour. As price-fixing agreements are explicitly forbidden by virtue of Article 81(1) a) EC, collective agreements may, in principle, be prohibited under the competition rules.

2.3 The immunity of collective agreements from competition rules

Although several questions were at issue in ALBANY,[20] this paper focuses on the decision taken by the social partners in the context of the collective agreement; i.e. the decision to set up the sectoral

[18] Boni, Stefano and Pietro Manzini: National Social Legislation and EC Antitrust Law. World Competition 24(2), 2001, pp. 239 – 255, at pp. 246 – 247; Ichino, Pietro: Collective Bargaining and Antitrust Laws: an Open Issue. The International Journal of Comparative Labour Law and Industrial Relations 17, 2001, pp. 185 – 197, at p. 190 and Sørum, Tom: Collective agreements and competition law. Scandinavian Institute of Maritime Law Yearbook SIMPLY 2003, pp. 251 – 270, at pp. 253 – 255. See also the opinion of AG Jacobs in C-67/96 ALBANY, C-115--117/97 BRENTJENS and C-219/97 DRIJVENDE BOKKEN, para. 244.

[19] Evju, Stein: Collective Agreements and Competition Law. The Albany Puzzle, and van der Woude. The International Journal of Comparative Labour Law and Industrial Relations 17, 2001, pp. 165 – 184, at p. 183 and Gyselen *op. cit. supra* note 17 at p. 441 – 442.

[20] This paper hereafter refers only to the judgment in ALBANY. The Court handed down corresponding rulings in BRENTJENS and DRIJVENDE BOKKEN.

pension fund and to request the public authorities to make affiliation to that fund compulsory for all workers in that sector. When considering whether this decision violated the competition rules, the Court first noted that Article 81 EC[21] prohibits all agreements between undertakings which may affect trade between Member States and distort competition within the common market and that any agreements or decisions prohibited pursuant to that article are automatically void.

Secondly, the Court found that two Community objectives of equal importance were at stake: competition policy on the one hand and social protection on the other.[22]

This was based on the reading of the Treaty provisions in conjunction: according to Article 3 of the Treaty, the activities of the Community are to include not only "a system ensuring that competition in the internal market is not distorted"[23] but also "a policy in the social sphere"[24]; furthermore, Article 2 provides that a particular task of the Community is "to promote throughout the Community a harmonious and balanced development of economic activities" as well as "a high level of employment and of social protection".[25]

The Court further pointed out that the social objectives, to be pursued by the Community and the Member States together, included improved living and working conditions, proper social protection, dialogue between management and labour, the development of human resources with a view to lasting high employment and the combating of exclusion. The Court noted that

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21 At that time, Article 85 of the Treaty.

22 C-67/96 ALBANY, para. 54.

23 Article 3(g) of the Treaty, now Article 3(1)(g) EC.

24 Article 3(i) of the Treaty, now Article 3(1)(j) EC.

25 The amended Article 2 EC provides correspondingly that the Community's task is "to promote throughout the Community a harmonious, balanced and sustainable development of economic activities" and "a high level of employment and of social protection".

the collective agreement is a means of pursuing these objectives, and also that various rules of Community law expressly encourage and promote collective bargaining.[26]

On the basis of these considerations, the Court held that even if "it is beyond question that certain restrictions of competition are inherent in collective agreements between organisations representing employers and workers … the social policy objectives pursued by such agreements would be seriously undermined if management and labour were subject to [Article 81(1) EC] when seeking jointly to adopt measures to improve conditions of work and employment". Hence, "an interpretation of the provisions of the Treaty as a whole which is both effective and consistent" implies that "agreements concluded in the context of collective negotiations between management and labour in pursuit of such objectives must, by virtue of their nature and purpose, be regarded as falling outside the scope of [Article 81(1) EC]".[27]

2.4 The immunity test – the nature and the purpose of the agreement

The immunity established in the ALBANY judgment is, however, conditional. To fall outside the ban on unfair competition, the collective agreement has to meet the immunity test defined by the Court. Immunity prevails as long as the conditions are met; accordingly, if the conditions are not met, the collective agreement will be subject to the competition rules.

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[26] In this, the Court referred to Articles 118 and 118b (Articles 117 to 120 of the EC Treaty have been replaced by Articles 136 EC to 143 EC) and the Agreement on social policy (O.J. 1992 C 191, p. 91). C-67/96 ALBANY, paras. 55 – 58.

[27] C-67/96 ALBANY, paras. 59 – 60.

The test as to whether a collective agreement falls within the scope of Article 81(1) EC or not is two-tiered and focuses on both *the nature* and *the purpose* of the agreement. On the one hand, the agreement must derive from a dialogue between management and labour – the "social dialogue" – and be concluded in the form of a collective agreement as the outcome of collective negotiations between organisations representing employers and workers. On the other, the collective agreement must be made in pursuance of social objectives.[28] The Court held that the agreement at issue in ALBANY met both criteria.[29] [30]

The scope of immunity has been discussed with regard to the *purpose* element of the test.[31] In paragraph 60 of the ALBANY judgment, the Court relates immunity to the pursuit of "such social objectives", with the word "such" referring to the previous paragraph. Whether this means that immunity will apply not only to "measures to improve conditions of work and employment" but also to collective agreements pursuing, more generally, "social policy objectives" remains unclear (both are mentioned in

[28] *Ibid.* paras. 59 – 60.

[29] *Ibid.* paras. 61 – 64.

[30] In (joined) cases C-180--184/98 PAVLOV [2000] ECR I-6451, however, a scheme similar to that in ALBANY did not escape the competition rules, as the decision on the pension fund was concluded by an association of undertakings (self-employed members of a profession) and not in the context of collective bargaining between employers and employees (para. 68 of the judgment).

[31] Bruun, Niklas and Jari Hellsten (eds.): Collective Agreements and Competition Law in the EU. The Report of the COLCOM-project. Iustus Förlag, Uppsala 2001, at pp. 45 – 46 and 55 – 57; Vousden, Stephen: Albany, Market Law and Social Exclusion. Industrial Law Journal, (29) 2000, pp. 181 – 191, at p. 189 and Sørum, *op. cit. supra* note 18, at pp. 266 – 270.

paragraph 59). Both interpretations are possible.[32] That immunity is limited to collective agreements aiming to improve working conditions – rather than having social objectives in general – may, however, be deduced from the Court's ruling in VAN DER WOUDE, where the immunity test was referred to once again and related to improvement of employment and working conditions:[33]

> …agreements entered into in the framework of collective bargaining between employers and employees and intended to improve employment and working conditions must, by virtue of their nature and purpose, be regarded as not falling within the scope of [Article 81(1) EC].

VAN DER WOUDE nevertheless augments the ALBANY concept to a certain extent. The collective agreement in question established a healthcare insurance scheme that, although it affected the employees' working conditions, was less closely related to pay than the pensions system at issue in ALBANY.[34] Hence, collective agreements improving working conditions not directly linked to remuneration also fall within the scope of immunity, but to what extent? Defining more generally the types of agreement to which immunity will apply is still a problem following VAN DER WOUDE.[35]

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[32] Bruun and Hellsten, *op. cit.*, at p. 45.

[33] C-222/98 VAN DER WOUDE [2000] ECR I-7111 para. 22. See also joined cases C-180--184/98 PAVLOV [2000] ECR I-6451 para. 67.

[34] The opinion of AG Fennelly in C-222/98 VAN DER WOUDE, delivered on 11 May 2000, para. 25. Cf. the judgment in C-67/96 ALBANY, para. 63, in which the Court noted that the collective agreement at issue in ALBANY contributed directly to remuneration.

[35] Bruun and Hellsten, *op. cit. supra* note 31, at pp. 55 – 57 and Evju, *op. cit. supra* note 19, at p. 182.

3 The ALBANY approach and the free movement provisions

3.1 Some introductory remarks

It is not self-evident that an analogy can be drawn between the competition rules and the free movement rules, as is suggested in the VIKING LINE case. Even if both the competition rules and the free movement provisions are intended to facilitate the internal market, they still constitute two different sets of rules. Neither their addressees nor the derogations available from them are the same. While the prohibition of competition distortion contained in Article 81 EC is addressed to private enterprises,[36] and has a direct effect on agreements concluded between them, the free movement provisions are addressed to Member States. Hence the ban on restrictions to free movement does not primarily apply to the conduct of private persons or organisations.

With regard to derogations, exemption from the competition rules may be granted for economic reasons,[37] while exemptions to the free movement provisions are essentially of a non-economic nature. In addition, the derogations recognized under the free movement rules refer to public interest, which in turn cannot be invoked in relation to the competition rules. Furthermore, the "rule of reason" exception, created by the Court to balance the right of

[36] See, however, ECJ case C-2/91 MENG [1993] ECR-I751. According to the judgment, Article 81 EC, read in conjunction with Article 10 EC, requires the Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings.

[37] Article 81(3) EC.

free movement with the public interest of a Member State,[38] has not so far been applied in relation to the competition rules.[39]

The possibility of applying the rule of reason, which is firmly embedded in the Court's case law and appropriate for justifying infringements that further social interests, may suggest that the application of an ALBANY approach is not possible within the field of free movement. The Court does not, however, always follow its own system and the rule has been set aside from time to time.[40] Furthermore, it may be necessary to adopt a new approach to the making of exceptions, as private addressees are in practice caught to some extent by the free movement provisions.[41] Although the Court has held that there is nothing to preclude individuals from relying on the public interest justifications,[42] the rule of reason may be inappropriate for application to the private sector, as public interest considerations are relevant to Member States, rather than to private enterprise.[43]

3.2 Convergence between the competition rules and the free movement provisions

As there are no obvious analogies between the competition rules and the free movement provisions, an ALBANY approach to

[38] It is important, however, to remember that the rule of reason is applicable only with regard to restrictions that are not directly discriminatory on grounds of nationality.

[39] Mortelmans, Kamiel: Towards Convergence in the Application of the Rules on Free Movement and on Competition. Common Market Law Review 38, 2001, pp. 613 – 649, at pp. 635 ff.

[40] *Ibid.* at p. 636.

[41] See Section 4.1 below.

[42] C-415/93 BOSMAN [1995] ECR I-4353 para. 86.

[43] Mortelmans *op. cit. supra* note 39 at p. 642.

exempting collective action from the free movement provisions seems to presuppose some convergence between the competition and free movement rules. Mortelmans has, through an analysis of the Court's case law, demonstrated some degree of convergence between the two sets of rules, although they are different in approach. Certain restrictions escape the prohibitions under both the competition rules and the free movement provisions.[44] This was the case in ALBANY, but also in the free movement case DELIÈGE.[45]

The DELIÈGE case concerned the Belgian judo federation's selection rules and their impact on an athlete's opportunities to provide her services to organisers of sporting tournaments. The Court held that "although selection rules … inevitably have the effect of limiting the number of participants in a tournament, such a limitation is inherent in the conduct of an international high-level sports event, which necessarily involves certain selection rules or criteria being adopted. Such rules may not therefore in themselves be regarded as constituting a restriction on the freedom to provide services …" [46]

The ruling in DELIÈGE is comparable to that in ALBANY, although comparison can only be made to a certain degree.[47] Yet the DELIÈGE judgment shows that the Court is prepared to recognize "immunity" from the free movement provisions by adopting a similar approach to that taken in granting immunity for collective agreements in ALBANY.[48] Although sporting rules are, in principle, caught by the Treaty provisions, they fall, under certain conditions, outside the scope of the prohibitions (non-applicability of the prohibition). Hence the Court respected the need to regulate sporting tournaments, even if the rules inherently restrict the right to free movement.

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44 *Ibid.* at p. 647.

45 Joined cases C-51/96 & C-191/97 DELIÈGE [2000] ECR I-2549.

46 C-51/96 and C-191/97 DELIÈGE para. 64.

47 Mortelmans *op. cit. supra* note 39, at p. 630.

48 *Ibid.* at pp. 628 – 630.

Unlike ALBANY, the Court did not set up an immunity test in DELIÈGE, but neither did it acknowledge exemption of the whole of a sporting activity from the scope of the Treaty. A distinction has to be made between two separate types of rules adopted in the field of sport: those concerning the economic aspects of a sporting activity as against those that are of sporting interest only. While the former are caught by the free movement provisions, purely sporting rules do not constitute a restriction on free movement, provided they are of a non-economic nature and necessary for the conduct of the sport in question.[49] Consequently, an apparent "immunity test", comparable with that applied in ALBANY, deals with both the nature (sporting rules) and the purpose of the sporting rules (pure sporting interest: facilitating the functioning of a sport).

Although similar in approach, there is one important difference between the two cases, as the DELIÈGE approach, unlike ALBANY, includes a proportionality test. Hence, a sporting rule must be proportionate to its proper objective if it is to escape the free movement provisions.[50] The reasoning in DELIÈGE therefore seems

[49] C-415/93 BOSMAN [1995] ECR I-4353 paras. 76, 104 and 127; C-51/96 & C-191/97 DELIÈGE para. 43 and C-176/96 LEHTONEN [2000] ECR I-2681 paras. 34 and 56. See also AG Cosmas' opinion in C-51/96 & C-191/97 DELIÈGE, delivered on 18 March 1999, paras. 68 – 69. The interpretation of the Court's case law regarding the impact of purely sporting rules on free movement has also been discussed by the Court of First Instance in MECA-MEDINA, concerning anti-doping rules adopted by the International Olympic Committee. The Court did not however touch upon this question when the judgment of the Court of First Instance was appealed. See the Court of First Instance Case T-313/02 MECA-MEDINA [2004] ECR II-3291, paras. 40 – 41 and ECJ case C-519/04 P MECA-MEDINA, judgment of 18 July 2006 (not yet reported in ECR). See also the opinion of AG Léger in the appeal case C-519/04 P, delivered on 23 March 2006, paras. 15 – 21.

[50] C-415/93 BOSMAN para. 104; C-51/96 & C-191/97 DELIÈGE para. 43; C-176/96 LEHTONEN para. 56 and C-519/04 P MECA-MEDINA para. 26. As to

close to a rule of reason approach, where the rule of reason is simplified to the extent that sporting rules aimed at facilitating sport and purely sporting objectives, i.e. the proper functioning of competitions, are presumed to impose objectively justifiable restrictions on free movement, but must be assessed as to their proportionality. This observation seems to imply that the ALBANY approach is also not far from a free movement rule of reason derogation, as it recognises the collective agreement as a both appropriate and proportionate means of obtaining an objective of general interest, i.e. the improvement of working conditions.

Hence, both with regard to the case law concerning the free movement provisions and the immunity test's close resemblance to the rule of reason, an analogy with the Court's ruling in ALBANY cannot be completely ruled out in the field of free movement.

4 "Simulation" – applying the ALBANY approach to the blockade

4.1 The applicability of the free movement rules to the blockade

The immunity of collective agreements, as recognised in the ALBANY judgment, was based upon the consideration that such agreements are caught by the competition rules at the outset, although many will fall outside the application of the prohibitions provided the immunity test is met. Accordingly, the question of whether the ALBANY approach is applicable to the blockade is relevant only if the blockade is caught by the free movement rules. On the other hand, an ALBANY approach is not by itself sufficient

the ALBANY approach, neither was any proportionality test required in C-222/98 VAN DER WOUDE.

to exclude the application of the free movement provisions to the blockade.

While the free movement provisions form part of the EC Treaty, the Community enjoys no general competence in the field of social policy and labour law and hence jurisdiction is primarily the domain of the individual Member States. By virtue of Article 137, the competence of the Community is limited to supporting and complementing the activities of the Member States in achieving the social objectives defined in Article 136 EC. This does not, however, include Community measures regarding *inter alia* "the right to strike or the right to impose lock-outs" (Article 137(5) EC). Here I am assuming that the "right to strike" covers the right to blockade a ship, even though the expression "strike" is used, rather than "collective action".

Even if the right to regulate collective action is in the domain of Member States, this does not necessarily mean that collective action is protected from Community interference. There has nevertheless been discussion as to the extent of possible Community competence.[51] The bottom line is that where there is a conflict between the right to collective action and market freedoms, the Court's competence cannot be completely ruled out. The forthcoming judgments in LAVAL and VIKING LINE are likely to shed further light on the situation.

It is the duty of a Member State to respect Community law when acting within its domain of competence and the EC Treaty thus

[51] Hellsten, Jari: On the Social Dimension in Posting of Workers. Reasoning on Posted Workers Directive, Minimum Wages and Right to Industrial Action. Publications of the Finnish Labour Administration 301, Helsinki 2006, http://www.mol.fi/mol/fi/99_pdf/fi/06_tyoministerio/06_julkaisut/06_tutkimus/tpt301.pdf, at pp. 80 – 83 and the discussion referred to and summarised in note 202.

imposes boundaries on Member State activity.[52] The free movement provisions require Member States not only themselves to refrain from adopting measures or engaging in conduct liable to impede free movement but also, in conjunction with the loyalty principle contained in Article 10 EC, to ensure that the fundamental freedoms are respected in their territories. Hence, a Member State is not only responsible for its own actions. The actions of private parties are also the responsibility of the relevant Member State and a Member State that fails to adopt all necessary and proportionate measures to prevent the obstruction of free movement through the actions of private parties will fail in its obligations under the free movement provisions.[53]

The extent to which the free movement provisions have *horizontal direct effect* and must also be respected by private individuals and organisations is, however, as yet unresolved.[54] In ANGONESE,[55] the Court held that Article 39 EC (free movement of workers) has direct horizontal effect and the rulings in WALRAVE[56] and WOUTERS[57] suggest that this is also the case with regard to free movement of services and establishment, at least when private bodies regulate employment in a collective manner. Case law does not, however, necessarily imply that a trade union has an obligation to respect a shipowner's right to free movement. In the VIKING LINE case, the English High Court nevertheless held that Article 43 on the freedom of establishment also had horizontal direct effect.

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52 C-246/89 COMMISSION V. UK [1991] ECR I-04585, para. 12.

53 As in "the Spanish Strawberries case", C-265/95 COMMISSION V. FRANCE [1997] ECR I-6959 para. 66.

54 This is the second question raised in the VIKING LINE case.

55 C-281/98 ANGONESE [2000] ECR I-4139 paras. 32 – 36.

56 C-36/74 WALRAVE AND KOCH [1974] ECR 1405 para. 17.

57 C-309/99 WOUTERS [2002] ECR I-1577 para. 120.

This finding was based partly on an assumption that the Finnish Seamen's Union preformed "a quasi-public function" that was caught by the free movement rules as in, for example, WOUTERS. In addition, the English court assumed that the European Court of Justice would apply the same case law consistently to workers, establishment and services, and accordingly the previously recognised horizontal direct effect of Article 39 EC would equally apply to free movement of services and establishment.[58] However, the case law concerned deals with restrictions imposed by an employer[59] or organisation[60] on an individual's options to make a living, either as an employee or by self-employment. In such situations, a uniform application of the various rules on free movement is well founded. However, the provisions on free movement of services and establishment might not have horizontal direct effect where trade unions impose conditions on the economic activity of an enterprise service provider. A Member State is nevertheless obliged not to allow trade union action that is inconsistent with the Treaty. Accordingly, the question of the applicability of an ALBANY approach to collective action is still relevant, even if the Court should find that a trade union is not itself obliged to respect the free movement rules.

4.2 The blockade – an inherent restriction on free movement

As a starting point, the effect of the blockade action on the shipowner's right to provide maritime transport, and vice versa, can

[58] High Court of Justice (UK): VIKING LINE v. ITF & FSU, *op. cit. supra* note 4, paras. 112 – 115.

[59] C-281/98 ANGONESE.

[60] A sporting association (WALRAVE AND KOCH) and a Bar Council (WOUTERS).

be compared to the relationship between collective agreements and fair competition that the Court recognised in ALBANY. Just as a collective agreement inherently restricts competition, so a blockade inherently restricts free movement of transport services when it is directed towards ships in intra-Community trade. Conversely, the objectives of the blockade would undoubtedly be undermined if the blockade were subject to the free movement provisions.

4.3 Balancing Community objectives

When assessing a conflict between trade union interests and a shipowner's economic freedoms, it is not unfeasible that the Court will repeat its arguments from ALBANY and find two competing Community objectives that have to be balanced: free movement on the one hand and social protection on the other:[61]

> Under Article 3(1)(c) and (j) of the EC Treaty, the activities of the Community are to include not only "an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital" but also "a policy in the social sphere". Article 2 of the EC Treaty provides that a particular task of the Community is to "promote throughout the Community a harmonious, balanced and sustainable development of economic activities" and "a high level of employment and of social protection"[62]

Given that the blockade action is in pursuit of such objectives, neither the blockade nor the right to provide maritime transport services may be given precedence without damaging one or other of these objectives. Hence, the ultimate question in deciding whether the ALBANY approach can be applied to balance trade union interests against the right to free movement focuses on the immunity test.

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[61] Hellsten, *op. cit. supra* note 51 at p. 112.

[62] Compare the ALBANY approach in para. 54 of the judgment.

4.4 The immunity test

To decide whether a general immunity test can be established in relation to the blockade, it is necessary to discuss both the blockade's social objectives and the blockade itself, i.e. the means of achieving those objectives.

4.4.1 Social objectives …

In ALBANY, it was clearly protection of the social objectives, rather than the social dialogue or the collective agreement itself, that was the rationale behind the immunity granted to collective agreements. It was the social objectives that would be "seriously undermined" if the social partners and their agreements were to be made subject to competition rules, not *vice versa*.[63] However, as mentioned above, the scope of the social objectives that will give rise to immunity is still not defined.[64] It is thus uncertain whether the immunity gives the social partners the right to pursue any social objective of their own choosing. On the other hand, the ALBANY judgment was based on the need to balance two Community objectives, of which one (the social objective) is primarily the responsibility of the Member States. Therefore the scope of any potential immunity seems to be limited to cases where social objectives are pursued that may be achieved by individual Member States (or the Community) in accordance with Community law. Accordingly, ALBANY reflects a

[63] Hellsten, Jari: On Social and Economic Factors in the Developing European Labour Law. Reasoning on Collective Redundancies, Transfer of Undertakings and Converse Pyramids. Swedish National Institute for Working Life (Arbetslivsinstitutet): Work Life in Transition 2005:11, http://ebib.arbetslivsinstitutet.se/aio/2005/aio2005_11.pdf, at p. 69.

[64] See Section 2.4 above.

Member State's powers to set its social agenda and the Court's willingness to respect the means used to achieve the set objectives.[65]

The unmistakable aim of the collective agreement that is the objective of the blockade is the improvement of working conditions. However, a blockade of a ship is a somewhat particular affair, involving elements of both solidarity and protectionism. Better pay is obviously in the foreign seafarers' interests, but also at stake (and perhaps overriding the latter) are the interests of the trade union members: elimination of unfair competition from cheaper foreign crews and the saving of members' jobs. The former objective, as it involves remuneration, seems to fall within the ALBANY formula, while the status of the latter is uncertain in the light of case law refining the immunity approach from ALBANY. In addition to the ambiguity that exists following ALBANY, the Court has not recognised the combating of unfair competition from low-cost labour as a sole ground for justifying exemption from the free movement provisions. On the other hand, the same case law does not exclude such an objective from providing justification if the action in question, objectively considered, is also in pursuance of protection of foreign workers.[66]

Put in the perspective of Member States' rights and obligations to define their social objectives, the cross-border effect of the blockade seems problematic. The securing of employment opportunities may be in the interests of the home state of the trade unions, but at the same time, the demand for improved working conditions for the foreign seafarers may constitute a questionable interference with the social and political objectives of another Member State.

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[65] Boni and Manzini, *op. cit. supra* note 18 at pp. 254 – 255.

[66] C-49, 50, 52-54 & 68-71/98 FINALARTE AND OTHERS [2001] ECR I-7831 paras. 39 – 42; C-164/99 PORTUGAIA CONSTRUÇÕES [2002] ECR I-787 paras. 25 – 30 and C-60/03 WOLFF & MÜLLER [2004] ECR I-9553, paras. 34 and 40 – 43.

A legal basis for requiring a provider of maritime transport services to meet the employment requirements of a Member State, other than the flag State, seems to be lacking. As a general rule, responsibility for regulating manning conditions lies with the flag State. This is clear with regard to ships providing services within another Member State's territory (maritime cabotage)[67] and consequently, the flag State principle seems to be self-evident when the trade has less impact on the interests of one port State only. Furthermore, although Community social policy aims at preventing a "race to the bottom" between Member States,[68] Community measures for regulating manning conditions in intra-Community trade have not been successful.[69] Nor does the Posting of Workers Directive (PWD), aiming at fair competition and the protection of workers in transnational provision of services,[70] apply to "merchant navy undertakings as regards seagoing personnel".[71] One might, however, argue that the shipping sector, although excluded from

[67] Article 3 of Regulation 3577/92 EEC applying the principle of freedom to provide services to maritime transports within Member States (maritime cabotage).

[68] Davies, A.C.L: The Right to Strike Versus Freedom of Establishment in EC Law: The Battle Commences. Industrial Law Journal 35, 2006, pp. 75 – 86, at p. 85.

[69] Proposals for a Directive on manning conditions for regular passenger and ferry services operating between Member States (COM(1998) 251 final and COM(2000) 437 final) and for a Regulation amending Regulation 3577/92 EEC applying the principle of freedom to provide services to maritime transports within Member States (maritime cabotage) (COM(1998) 251 final) have both been withdrawn. (See COM(2002) 203 final at p. 7, O.J. 9.1.2004, C 5 at p. 18 and COM(2004) 542 final/3: Withdrawal of Commission Proposals which are no longer of topical interest at p. 15).

[70] Fifth recital of the preamble to Directive 96/71/EC concerning the posting of workers in the framework of the provision of services.

[71] Article 1(2) of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services.

the scope of the directive, does not escape the pre-PWD case law of the Court regarding the protection of posted workers under the EC Treaty.[72] This case law seems, however, to be limited to the protection of workers performing their labour *within the territory* of a host Member State,[73] and hence work on board ships under the jurisdiction of the flag Member State seems to lie outside the scope of this case law. A posted-worker approach to shipping would also be very impractical, as it would imply that the working conditions of the crew should change each time the ship on its voyage enters the jurisdiction of another Member State.

4.4.2 … and means for achieving the social objectives

It is beyond question that the social partners have an important role in improving social and working conditions and that, in many Member States, agreements concluded within the social dialogue are a central means of implementing social improvements. In ALBANY, the social partners acted in accordance with the Member State's social agenda, as emphasized in the authorities' decision to make the collective agreement *erga omnes* binding.[74] If collective agreements were to become subject to the scrutiny of the competition authorities, a great many would be declared void, due to their inherent impact on competition, thus depriving the Member States of their freedom to choose how to regulate employment relationships.

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[72] Hellsten, *op. cit. supra* note 51, at p. 133.

[73] C-62&63/81 SECO [1982] ECR 223 para. 14; C-113/89 RUSH PORTUGUESA [1990] ECR I-1417 para. 18; C-43/93 VANDER ELST [1994] ECR I-3803 para. 23; joined cases C-369&376/96 ARBLADE [1999] ECR I-8453 paras. 41 – 42 and C-165/98 MAZZOLENI [2001] ECR I-2189 para. 28.

[74] As no such decision was at hand in C-222/98 VAN DER WOUDE, the immunity is nevertheless not restricted to situations where an explicit normative decision has been given by the State.

The respect for the collective agreement acknowledged in ALBANY may indicate that other methods adopted by Member States in pursuit of social objectives should also be respected, e.g. collective action. It is, however, notable that the Court referred to the social partners' *joint measures* to improve working conditions.[75] This may imply that immunity does not extend to unilateral measures, such as blockades. Furthermore, as the Court did not discuss whether the collective agreement was a proportionate means of achieving the social objectives, it is possible that for immunity to be granted, the measure employed (e.g. a blockade) requires some degree of Community law protection to escape a proportionality assessment. It is possible to deduce from Community law provisions on the social dialogue that collective agreements may enjoy such protection.[76] However, collective action has not been recognised as comprising a part of the social dialogue acknowledged in Community law. Accordingly, collective bargaining on the Community level has been compared to *collective begging*.[77]

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[75] C-67/96 ALBANY, para. 59.

[76] C-67/96 ALBANY, paras. 55 – 58. AG Jacobs in his opinion, paras. 135 and 160 – 161, noted that the EC Treaty itself, although encouraging collective bargaining, does not explicitly grant a right to bargain collectively. Neither could he find sufficient convergence of national legal orders and international legal instruments on the recognition of such fundamental right. On the other hand, the Advocate General asserted that the collective bargaining process, like any other negotiation between economic actors, is sufficiently protected by the general principle of freedom of contract and therefore does not require a more specific fundamental right to protection.

[77] Britz, Gabriele and Marlene Schmidt: The Institutionalised Participation of Management and Labour in the Legislative Activities of the European Community: A Challenge to the Principle of Democracy under Community Law. European Law Journal 6, 2000, pp. 45 – 71, at p. 70.

Although it is mentioned in the Community Social Charter,[78] and later on in the EU Charter of Fundamental Rights,[79] no right to take collective action is explicitly protected by Community hard law. The only place where this right is spelled out in the Treaty is Article 137(5), which limits the Community's competence in the field of collective action.[80] So far, there is also no basis in case law for protection under Community law for the right of collective action.[81]

The right of collective action may, however, be recognised by the Court as a fundamental human right. According to settled case law, fundamental rights form an integral part of the general principles of law whose observation the Court ensures. For that purpose, the Court draws inspiration from "the constitutional traditions common to the Member States" and from "the guidelines supplied by international treaties for the protection of human rights on which the Member States have collaborated or to which they are signatories". In this context, the European Convention on Human Rights from 1950 (ECHR) has special significance.[82] The Court also

[78] Article 13 of the Community Charter of Fundamental Social Rights of Workers, 1989 (not published in the Official Journal) mentions the right to strike.

[79] Article 28 of the Charter of Fundamental Rights of the European Union. O.J. 18.12.2000, C 364 p. 1 – 22.

[80] See Section 4.1 above.

[81] In ALBANY, AG Jacobs' was in favour of a right of "collective action in order to protect occupational interests in so far as it is indispensable for the enjoyment of freedom of association" protected by Community law. Opinion in C-67/96 ALBANY etc., para. 159. He seems to base his conclusion on the Court's previous case law (cases C-175/73 UNION SYNDICALE, MASSA AND KORTNER [1974] ECR 917, C-415/93 BOSMAN [1995] ECR I-4353 and C-194/87 MAURISSEN [1990] ECR I-95), but the "right of action" to which the Court referred in these cases does not seem to include a right to strike. See Franssen, Edith: Legal Aspects of the European Social Dialogue. Social Europe Series 4, 2002, at p. 25.

[82] C-112/00 SCHMIDBERGER [2003] ECR I-5659, para. 71.

respects the binding case law of the European Court of Human Rights (ECtHR).[83]

It follows from ECHR Article 11(1) that trade unions have a right to protect the occupational interests of their members. The right to strike is not expressly mentioned, nor has the article so far been interpreted by the ECtHR as granting an absolute right to strike or take other collective action. The article protects the right of a trade union to fulfil its function to protect the occupational interests of its members, but it does not grant any special treatment to the unions or their members. The ability to strike nevertheless represents one of the most important means by which a trade union can fulfil its function, although there are others.[84] Accordingly, if collective action is the only means available, the denial of this weapon might be a violation of the ECHR.[85] Nevertheless, it is important to note that the ECHR only covers a union's right to protect the occupational interests of its own members, not those of other workers. Hence, solidarity action is not covered in any event. Furthermore, restrictions may be placed on the exercise of a trade union's rights in accordance with ECHR Article 11(2) if this is

[83] C-499/04 WERHOF [2006] ECR I-2397, para. 33 is an example of this.

[84] See the judgments of the ECtHR in SCHMIDT AND DAHLSTRÖM V. SWEDEN no. 5589/72, of 6 February 1976 §§ 34 – 36 and WILSON, NATIONAL UNION OF JOURNALISTS AND OTHERS V. THE UNITED KINGDOM nos. 30668/96, 30671/96 and 30678/96, of 2 July 2002 §§ 40 - 44. See also the ECtHR decisions in UNISON V. THE UNITED KINGDOM no. 53574/99, of 10 January 2002 and FEDERATION OF OFFSHORE WORKERS' TRADE UNIONS AND OTHERS V. NORWAY no. 38190/97, of 27 June 2002.

[85] ECtHR decision in UNISON V. THE UNITED KINGDOM, *op. cit.*, where a prohibition on collective action – which the union held was the only means available to it to protect its members under the circumstances – was found to be in breach of Article 11(1) and had to be justified under Article 11(2).

"necessary in a democratic society ... for the protection of the rights and freedoms of others ..."[86]

Even if the ECHR so far seems to be the primary source of the fundamental rights respected by the European Court of Justice, there might be others. The international instruments that seem to be of most relevance are the European Social Charter (ESC)[87] and ILO Conventions 87 and 98 on freedom of association.[88] The ESC is mentioned in the EC Treaty as a source for the fundamental social rights that the Community and its Member States *have in mind* when defining their objectives in the social area,[89] and is also referred to in the EU Charter of Fundamental Rights.[90] The ILO Conventions 87 and 98 have, on their part, been ratified by all the Member States.

While the right of collective action is expressly protected by the ESC,[91] the ILO Conventions do not spell out any such right. The

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[86] Article 11(2) ECHR says: "No restrictions shall be placed on the exercise of these rights other than such as are prescribed by law and are necessary in a democratic society in the interests of national security or public safety, for the prevention of disorder or crime, for the protection of health or morals or for the protection of the rights and freedoms of others ...". For examples on the justification of restrictions to a trade union's right to defend the interests of its members see the decisions of ECtHR in UNISON V. THE UNITED KINGDOM and FEDERATION OF OFFSHORE WORKERS' TRADE UNIONS AND OTHERS V. NORWAY, *op. cit. supra* note 84.

[87] The European Social Charter was adopted in 1961 and revised in 1996.

[88] Freedom of Association and Protection of the Right to Organise Convention, 1948 (ILO-87) and Right to Organise and Collective Bargaining Convention, 1949 (ILO-98).

[89] Article 136 EC.

[90] Fifth recital of the preamble to the Charter.

[91] Article 6(4) of the ESC according to which the Contracting Parties undertake to recognise "the right of workers and employers to collective action in cases of conflicts of interest, including the right to strike, subject to

right to collective action has, however, been acknowledged for decades by the ILO supervisory bodies,[92] as derived from the freedom of association protected by Convention 87 and the principles embodied in the ILO Constitution.[93] Nonetheless, under neither the ESC nor the ILO regime is the right of collective action absolute and unlimited or precise and detailed. Furthermore, the ILO Committee on Freedom of Association has not taken a clear position regarding the protection of blockades and recognises that there are situations in which a blockade may be prohibited:

> The boycott is a very special form of action which, in some cases, may involve a trade union whose members continue their work and are not directly involved in the dispute with the employer against whom the boycott is imposed. In these circumstances, the prohibition of boycotts by law does not necessarily appear to involve an interference with trade union rights.[94]

According to the ESC, the right of collective action may be restricted if "necessary in a democratic society for the protection of the rights and freedoms of others…",[95] whereas the supervisory

obligations that might arise out of collective agreements previously entered into."

92 The Committee on Freedom of Association (CFA) and the Committee of Experts on the Application of Conventions and Recommendations (CEACR).

93 Gernigon, Bernard, Alberto Odero and Horacio Guido: ILO principles concerning the right to strike. International Labour Law Review 137, 1998, pp. 441 – 481, at p. 442.

94 ILO CFA: Digest of Decisions 1996 para. 471.

95 Article 31(1) of the 1961 Charter and Article G of the 1996 revised Charter say that "The rights and principles set forth in Part I when effectively realised, and their effective exercise as provided for in Part II, shall not be subject to any restrictions or limitations not specified in those parts, except such as are prescribed by law and are necessary in a democratic society for the protection of the rights and freedoms of others or for the protection of public interest, national security, public health, or morals."

body, the European Committee of Social Rights (ECSR), assesses the conformity of national law and practice with the ESC. Through ECSR decisions and conclusions, the extent of the ESC protection of the right to collective action emerges step by step. In contrast, the scope and details of the right to collective action embodied in the ILO Conventions materialize from the decisions and observations of the ILO supervisory bodies and substantial "case law" has developed since these bodies were set up. It is, however, notable that neither the ECSR nor the ILO "case law" is binding on the contracting parties. Furthermore, there are examples where contracting states have not complied with the rectifications advised by the supervisory bodies.[96]

Although the ESC, unlike the ILO instruments, clearly protects a right to take collective action, the ILO rights seem more far-reaching when it comes to the principles emerging from "case law". While, e.g., a right to take solidarity and sympathy action is to a degree protected by the ILO regime,[97] the ECSR has not so far

[96] The ILO CEACR has repeatedly held that the negotiating powers of the Danish seafarers' unions in respect of foreign seafarers employed on board ships registered in the Danish International Shipping Register (DIS) are inconsistent with the ILO Conventions. The Danish government, however, continues to avoid amending the DIS Act. See most recently CEACR: Individual Observation concerning Convention No. 98 published 2005. For a case of secondary action in the UK see Germanotta, Paul and Tonia Novitz: Globalisation and the Right to Strike: The Case for European-Level Protection of Secondary Action. The International Journal of Comparative Labour Law and Industrial Relations 18, 2002, pp. 67 – 82, at p. 70.

[97] The ILO Committee of Experts "considers that a general prohibition on sympathy strikes could lead to abuse and that workers should be able to take such action, provided the initial strike they are supporting is itself lawful" (CEACR: General Survey 1994: Freedom of association and collective bargaining: The right to strike, para. 168). Also ILO CFA: Digest of Decisions 1996 para. 486.

expressed any clear opinion on this aspect of collective action. However, the scope of the right to take sympathy action still has to be defined under the ILO approach.[98]

Hellsten has recommended that the ILO right to strike should be adopted as a coherent EC standard, based on the fact that the ILO Conventions are binding for all Member States and in most cases qualify as "earlier international treaties", which according to Article 307(1) are not affected by the EC Treaty.[99] His arguments seem well founded. However, as the right to strike and the scope of this right – including a possible right to take international blockade action – relies on interpretations made by the ILO supervisory bodies, the crucial question is whether the European Court of Justice will respect this non-binding "case law". I cannot fully concur with Hellsten's positive view.[100] If a right to take collective action is given precedence over the economic freedoms – which is an obvious outcome if such right is recognised in Community law – the recognition of the "case law" of the supervisory bodies will imply that the Treaty freedoms are limited each time the supervisory bodies extend the right to collective action. Hence, recognition of the emerging "case law" will affect the autonomy of the Community's legal order. In addition, according to Article 307(2) of the EC Treaty, Member States have an obligation to take all appropriate steps to eliminate the incompatibilities between "an earlier international treaty" and the EC Treaty. There is even a theoretical possibility that a Member State would be required to denounce an incompatible international agreement.[101]

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98 ILO CEACR: General Survey 1994 *op. cit.* para. 168.

99 Hellsten, *op. cit. supra* note 51, at pp. 97 – 102.

100 *Ibid.* at pp. 102 – 106.

101 C-62/98 COMMISSION V. PORTUGAL [2000] ECR I-5171, para 49 and C-203/03 COMMISSION V. AUSTRIA [2005] ECR I-935, para. 61. The latter case concerned the incompatibility between the EC Treaty provisions on

5 Concluding remarks

This paper has discussed two aspects of applying the ALBANY approach to a ship blockade: firstly whether a concept created under the competition rules may be applied within the field of free movement; and secondly the applicability of the concept itself to the blockade.

The question of whether an ALBANY approach can be adopted under the free movement rules was answered in the affirmative (Chapter 3). Although there is hardly any convergence between the competition rules and the free movement provisions, an ALBANY-like approach is also recognised under the latter, exempting private actions that inherently restrict free movement from the scope of the provisions. Furthermore, the immunity test set by the Court in ALBANY reassembles the rule of reason justification recognised under the free movement provisions: the two-tiered test by which a collective agreement may escape the ban on unfair competition is comparable to pre-recognising the collective agreement as both an appropriate and proportionate means for obtaining an objective of general interest, i.e. the improvement of working conditions.

The application of an ALBANY approach to the blockade (Chapter 4 "Simulation") is, however, only relevant if the blockade at the outset is caught by the free movement rules. Hence, an ALBANY approach is not in itself sufficient to exclude the application of the free movement provisions to the blockade.

equal treatment for men and women and ILO Convention No 45 prohibiting the employment of women in underground work. In practice it is, however, hardly likely that a Member State would be required to denounce ILO Conventions 87 and 98, especially as the Community requires developing counties to comply with these instruments in order to qualify for the special incentive arrangements for sustainable development and good governance. (See Article 9 of Regulation 980/2005 EC applying a scheme of generalised tariff preferences.)

Whether the blockade is in principle caught by the free movement rules has, however, yet to be resolved. The forthcoming judgments in LAVAL and VIKING LINE may provide the answer.

When assessing a possible conflict between trade union interests and a shipowner's economic freedoms, it is likely that the Court will, in line with ALBANY, refer to the objectives and tasks of the Community and find two competing objectives that have to be balanced: free movement on the one hand and social protection on the other. Given that the blockade is in pursuit of such objectives, neither the right to blockade nor the right to provide maritime transport services may be given precedence without damaging one of those objectives. Hence, the first test to determine whether the blockade can be granted exemption, by analogy with the ALBANY judgment, is whether its objectives are protected. In this regard, the cross-border nature of the blockade is problematic. A Member State's right (and obligation) to improve social protection within its territory would, without doubt, be recognised by the Court as an appropriate objective, but it is doubtful whether interference in another Member State's social agenda can be accepted. Furthermore, the combating of social dumping to protect the national labour market is not a convincing objective when it involves measures directed at ships from other Member States.

If the Court nevertheless accepts such objectives, the second test for applying an ALBANY approach to the blockade is whether the means of achieving the objectives, i.e. the blockade itself, will escape having to pass a proportionality assessment and consequently qualify for immunity. This will require that such action is protected by Community law. As the protection of collective action cannot be deduced from binding sources of Community law, the question will turn on whether the Court recognises a right of collective action, e.g. with reference to the European Social Charter and/or ILO Conventions 87 and 98. On

the basis of these international instruments, the Court might recognise a general principle concerning the right to take collective action, but such a principle would have to be supplemented by a principle that the right of collective action is limited. The scope of protection would hence remain ambiguous, and the Court will hardly be eager to wipe out part of the uncertainty by recognising the non-binding "case law" developed under the international instruments. However, no clear and absolute right to blockade foreign ships seems to have materialized even under this "case law" and such action must therefore be assessed on a case-by-case basis with regard to its objectives.

The final conclusion is that it seems unlikely that an ALBANY approach would exempt a blockade from the application of the free movement provisions. Any possible justification of the blockade must therefore be assessed with reference to the free movement exceptions or the rule of reason test. In this assessment, the extent of trade union fundamental rights is likely to be a central consideration. Whether this conclusion is correct may become clear following the VIKING LINE case. But it is also possible that the Court will first address the second question put to it by the referring court: i.e. whether the free movement provisions have horizontal direct effect. If the answer to this question is negative, the remaining questions in the VIKING LINE case will become irrelevant and the question of whether an ALBANY approach can be adopted in the field of free movement will perhaps remain unanswered.

Part XI

Reinsurance contracts

Application of the law, the reinsured's duty of disclosure and the reinsurer's obligation to indemnify the reinsured[1]

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[1] This article is based on the author's thesis "*Reassuransekontrakter*", written while the author was working as a research assistant at the Scandinavian Institute of Maritime Law during 2004-2005, under the supervision of Professor Dr. juris Hans Jacob Bull. The thesis was published in MarIus no. 338.

1 Introduction

Reinsurance is a type of insurance that involves the transfer of risk from one insurance company to another. Reinsurance contracts are entered into in an international market and their purpose may simply be described as "the insuring of insurers".[2] This article deals with various problems relating to English-language reinsurance contracts that are governed by Norwegian law. Its title, "*Application of the law, the reinsured's duty of disclosure and the reinsurer's obligation to indemnify the reinsured*", merely signposts the main topics dealt with. Its aim is to identify, and try to resolve, some questions that often cause disagreement between the parties and also to shed light on the interpretation of commonly used terms under Norwegian law.

Reinsurance contracts are often written in English. The main reasons for this are: the international character of the market; the predominance of the language in international business; and the importance and influence of the British reinsurance market. Choice of law will depend either on the wording of the contract's choice of law clause or on the rules of international private law. Norwegian law is a natural choice if both parties are Norwegian, but is also not an unusual choice if one party has its head office in Norway. If the contract is governed by Norwegian law, it will be interpreted in accordance with the Norwegian tradition of contractual interpretation and the mandatory rules of Norwegian law will apply. Non-mandatory rules will be ascribed the status of background rules of law.

[2] Cf. Robert Kiln and Stephen Kiln, Reinsurance in practice, 4th ed., London 2001, p.1.

2 Reinsurance – a brief guide

2.1 The concept

There is no legal definition of reinsurance, which is the transfer of part of an insured risk from one insurance company (*the cedent/the reinsured*) to another (*the reinsurer*). The reinsured transfers a part of his premium and, in return, the reinsurer participates in potential damages up to the amount agreed in the reinsurance contract. The reinsured retains full responsibility towards the ultimate insured, who cannot claim directly against the reinsurer.[3] The transfer of risk is known as a *cession*. When a reinsurer cedes part of his potential exposure to another reinsurer, this is known as a *retrocession.* Insurers obtain reinsurance from other direct-writing insurance companies or, alternatively, from *professional reinsurance companies* that only offer reinsurance.

Reinsurance as a concept implies a diversification of risk. This serves several purposes: *firstly*, reinsurance may increase the insurer's capacity to accept risks, thus enabling him to insure a volume, type or size of risk that he would not otherwise be able to cover. It also increases the capacity of the insurance market in general;[4] *secondly*, reinsurance promotes financial stability by ameliorating the adverse consequences of either an unexpected accumulation of losses or a single catastrophic loss. By absorbing a proportion of such losses, reinsurance protects the reinsured's balance sheets; *thirdly*, reinsurance may strengthen the solvency of an insurer. This

[3] This principle is internationally recognised; cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 35.

[4] Sjur Brækhus and Alex Rein, *Håndbok i kaskoforsikring,* Oslo 1993, p. 314.

may be important from a regulatory perspective, as regulations may impose a minimum "solvency margin".

2.2 Types of reinsurance[5]

2.2.1 Proportional reinsurance

Reinsurance contracts may be categorised as either proportional or non-proportional. Both types of contact may offer either facultative reinsurance or treaty (obligatory) reinsurance. *Proportional* contracts divide the risks between the reinsured and the reinsurer in a specific ratio. The reinsurer receives a proportion of the direct insurer's received premium and, in return, covers an equivalent part of the liability.

Proportional facultative reinsurance involves an agreement under which, as a general rule, a single risk is reinsured. It is entered into by offer and acceptance, whereby the reinsurer retains the "faculty" to accept or reject the offered risk(s). Non-proportional facultative reinsurance is seldom encountered in practice.

Treaty reinsurance involves the ceding of many risks. The main sub-divisions are quota share and surplus reinsurance. Under a *quota share treaty,* the ceding company is required to cede, and the reinsurer is required to accept, a fixed proportion of each and every risk accepted by the ceding company on a *pro rata* basis. Participation in each risk is fixed and certain. The treaty may limit the

[5] Cf. Colin *Edelman QC, Andrew Burns, David Craig and Akash Nawbatt, The Law of Reinsurance, Oxford 2005, p. 9, P T O'Neill and J W - Woloniecki, The Law of Reinsurance in England and Bermuda, 2nd ed., London 2004, p. 13, Jon Gleditsch, Reassuranse: en kort innføring,* Oslo 1991, p. 8 and Thomas Wilhelmsson, *Om reassurandörs ersättnings-skyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 17.

maximum amount payable per risk. Under a *surplus treaty,* the ceding company cedes, and the reinsurer is required to accept, the surplus liability over the maximum amount of risk set by the ceding company (the retention). The retention is expressed as a fixed maximum sum. *Extra Cover/Open Cover* reinsurance involves elements of both facultative and treaty contracts. The ceding company has an option to cede, but is not bound to do so, whereas the reinsurer is bound to accept an agreed share of any risk in fact ceded within the scope of the treaty.

2.2.2 Non-proportional reinsurance

Under a *non-proportional contract,* the reinsurer receives a slice/-layer of the risk written by the reinsured and his premium depends on the proportion of risk assumed. A reinsurer of the "first" loss may take a higher percentage of the premium than one who only reinsures losses that exceed a certain (high) sum.

The most common reinsurance contracts are *excess of loss treaties*. Under these, recovery is available when a given loss exceeds the ceding company's defined retention. The reinsurer agrees to cover all losses that exceed a certain specified limit in respect of any one risk, or any one event, up to a specified maximum. The reinsured retains 100 per cent of the risk up to a specified maximum and recovers an agreed percentage of any loss that exceeds that sum. Generally, the bands of risk covered widen and the premiums increase as you move up through the layers. The highest layers are known as "catastrophe cover".

Under *stop loss reinsurance*, the reinsurer accepts full liability once aggregated losses, in respect of a given class or book of business, exceed a specified amount, usually expressed as a percentage loss ratio, and sometimes also up to a limit of liability. An *aggregate excess of loss* treaty is similar to stop loss, but the

limit of the reinsurer's liability is defined by reference to actual losses that are expressed as sums of money. These policies protect the reinsured against an accumulation of losses arising from the same occurrence, event or circumstances.

3 Contractual materials and sources of law

3.1 Reinsurance clauses

Apart from the general rules of contract law, no mandatory rules of law govern the contractual relationship between the parties. Hence, the parties' legal positions basically depend on the interpretation of the contract. Directions and rules for interpretation can be found in the Norwegian legal tradition and more specific standards may be derived from market practice. Background rules of law are only relevant if interpretation of the contract does not resolve the problem.

Various standard terms are available, including, *inter alia,* a "placement slip" for the London market, drafted by the International Underwriting Association of London (IUA) and Lloyd's, and marine reinsurance terms, drafted by The Joint Excess of Loss Committee (JELC), a group formed by Lloyd's and the Institute of London Underwriters Marine market.[6] There are also organisations that promote clarity in relation to contractual practice, such as the Brokers and Reinsurance Markets Association (BRMA). The expression "standard terms" does not have a statutory definition in Norwegian law. Erlend Haaskjold has defined them as contract terms that are drawn up in advance and that are intended for future use in an undetermined number of contractual relationships of a

[6] IUA's Reference Book of Marine Insurance Clauses 74th ed., pp. 253-258.

certain type.[7] Market practice demonstrates that many of the customary clauses contain similar expressions. This suggests that they are standard terms.

According to Norwegian contract law, the interpretation of contractual clauses should be based on the parties' *mutual understanding* at the time they entered into the contract. If it is not possible to establish such mutual understanding, it is necessary to apply *the principle of objective interpretation*. According to this principle, the starting point is the linguistic comprehension of the wording, based on how it would be read by a person with knowledge of the market. This principle is given great weight in relation to commercial contracts.[8] Alternative interpretations may be eliminated through interpretation of the contract wording in context. Other relevant arguments may be based on the contractual situation, by reference to e.g. preparatory works and the parties' expectations, and on the applicable law and other sources of law.[9]

English-language contracts may contain clauses originating from the English reinsurance market. It is likely that when such clauses were drafted, there was an assumption that they would be governed by English law. The meaning ascribed to such clauses under English law is therefore relevant and may influence their interpretation.[10] According to Norwegian legal tradition, the clauses' meaning under English law may be relevant in various ways. It may, for example, offer insight into the parties' mutual

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7 Cf. Erlend Haaskjold, *Kontraktsforpliktelser*, Oslo 2002, p. 166 and Ola Ø. Nisja, *Standardvilkår – en oversikt*, TfF 2003, pp. 1-3.

8 Cf. i.e. Rt. 2000 p. 806, Rt. 2002 p. 1155 and Rt. 2003 p. 1132.

9 The rules of interpretation are described in Geir Woxholt, *Avtalerett,* Oslo 2003, p. 458 et seq.

10 See Viggo Hagstrøm, *Obligasjonsrett,* Oslo 2002, p. 43 and Thor Falkanger, The incorporation of charterparty terms into the bill of lading, Sjörättsföreningen i Göteborg Skrifter, 1967:3, p. 55 et seq.

understanding, market practices, the clauses' origins and policy considerations.

3.2 Sources of law

There are no statutes regulating the parties' contractual relationship in relation to reinsurance. The Act relating to Insurance Contracts, no. 69 of 16 June 1989, ("the ICA 1989") excludes its application to reinsurance contracts by virtue of ss. 1-1(4) and 10-1(4). The preparatory works state that the act is not suitable for application to reinsurance contracts and also point out that the ICA 1930 contained the same exclusion. According to the preparatory works for the latter, reinsurance was considered *essentially different* from other forms of insurance.

The ICA 1989 nonetheless supplies a relevant source of law: it is the only act regulating insurance contracts; its provisions apply to business-related insurance; and many of its provisions incorporate general principles into statute. Whether its provisions may be used as a starting point for establishing the applicable law in cases involving reinsurance, or may be applied by analogy, will depend on the result of an evaluation of the particular circumstances.

The ICA 1989's exclusion of reinsurance contracts from its scope argues against the application of the act, as its provisions are clearly not adapted to the risks covered in reinsurance. On the other hand, the preparatory works for the ICA 1930 assumed that its provisions could be applied by analogy.[11] However, significant material changes were made when the ICA 1989 was drafted that made the legislation more consumer-friendly, with a greater focus on appraisement of the actual circumstances, rather than on predict-

[11] Cf. Nicolai L Bugge, *Lov om forsikringsavtaler av 6. juni 1930,* Oslo 1939, p. 31-32 and Reidar Brekke, *Forholdet mellom cedent og reassurandör,* NFT 1937, p. 167.

ability. These amendments make analogical application of the act less likely, as the application of consumer-friendly provisions to a reinsurance contract may affect the original contractual balance. Further, the ICA 1989 is non-mandatory in relation to various types of business-related insurance, cf. s. 1-3(2). An argument against the application of the ICA 1989 is that rules developed in practice in relation to such types of insurance, especially rules applying to insurance of an international nature, such as marine insurance, will often bear a greater similarity to, and be better suited to, re-insurance. The ICA 1930 is also a relevant legal authority and has the advantage that it does not focus on the interests of consumers. However, it has not been updated since the 1980s, and the provisions may therefore imply solutions that differ from modern international insurance practice.

There is not much Norwegian *case law* dealing with reinsurance contracts. Disagreements are normally resolved either through negotiation or out-of-court settlements and disputes are referred to arbitration. Rt. 1881 p. 81 is the only Supreme Court judgment concerning interpretation of a reinsurance contract. The Supreme Court has also made some interesting remarks in cases concerning direct insurance, e.g. in Rt. 1956 p. 249, where the court commented on the ceding party's duty of loyalty towards the reinsurer.[12] *Arbitration practice* is a significant source of law. Generally, case law suggests that arbitration awards tend to have a moderate impact, but this may be different in the case of re-insurance, as there are few relevant sources of law. Arbitrators, however, normally consider these awards as equivalent to case

[12] An interesting judgment was also handed down by the Court of Appeal, *(Borgarting lagmannsrett)*, on 8 December 2006 (05-136447ASI-BORG/03). The judgment, which deals with the interpretation of reinsurance contracts, was not final and enforceable when this article went to press.

law.[13] Both published and unpublished awards are relevant. Until 1968, Scandinavian awards were published in Assurandør-Societetet's law report (ASD) and since 1994, they have been published in Forsikrings- og Erstatningsretlig Domssamling (FED). In an unpublished award dating from 1995, concerning the background rules of Norwegian law on the duty of disclosure, Professor Dr. juris Hans Jacob Bull took the principles in the Norwegian Marine Insurance Plan as his starting point.

Custom is a word used to refer to certain long-established commercial practices. In the context of this article, it refers to practices in the insurance business, where many unwritten rules influence the drafting and interpretation of contracts. Practices relating to all types of insurance are relevant. A practice may only be characterised as a custom if it has a certain solidity, spread and durability and implies a reasonable rule. International customs can be applied directly, whereas local customs may be national or market-related. National customs derive from legal traditions, insurance systems and background rules of law. The Scandinavian courts have generally taken a Continental, as opposed to an Anglo-American, approach, as a natural consequence of the fact that Scandinavian insurance law is, to a large extent based on Continental law.[14] The application of local, market-related customs presupposes that both parties have a connection to the specific market. *Other (non-customary) market practices* are also relevant: everything from the practice of an individual company to practices that can nearly be classified as customs.[15]

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[13] See Sjur Brækhus, *Sjørett, voldgift og lovvalg,* Oslo 1998, pp. 185-203.

[14] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, pp. 32-33.

[15] Cf. i.a. Rt. 1987 s. 1358 and Rt. 1993 s. 1482, Hans Jacob Bull, *Innføring i forsikringsrett,* Oslo 2003, pp. 41-43.

The Norwegian Marine Insurance Plan, dating from 1996 ("the NMIP"/"the Plan"), regulates shipowners' insurances. The Plan consists of standard terms drafted jointly by the representatives of the respective parties. As a starting point, standard terms may only be applied if they are incorporated into the contract and their application was clearly intended by the parties. According to case law, however, various circumstances may lead to their application in other situations.[16]

Generally, the Plan may be applied either as *non-mandatory legislation* or as a type of private *practice*. If the former, the whole Plan must be applied. Alternatively, its individual terms can be regarded as a type of private practice. Their relevance and impact will then depend on the evaluation of various arguments, concerning e.g. the extent to which they reflect a relevant custom, their appropriateness to the particular circumstances and other legal authorities.[17]

The extent to which the NMIP must be considered to constitute background rules of law in relation to *reinsurance* (its particular *relevance and weight*) is not clear. It is generally less controversial to consider the individual provisions as examples of private practices and, as such, they often appear to offer reasonable starting points and/or arguments.[18] There are several arguments in support of the application of the NMIP's provisions. One of these is the

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[16] Cf. Rt. 1973 p. 967, and Hans Jacob Bull, *Innføring i forsikringsrett,* Oslo 1997, p. 101 et seq.

[17] Cf. Torstein Eckhoff, *Rettskildelære,* 5. utgave ved Jan Helgesen, Oslo 2000, p. 254, Hans Jacob Bull, *Avtalte standardvilkår som privat lovgivning,* Festskrift til Sjur Brækhus, 1: Lov, dom og bok, Oslo 1988, p. 105, and Harald G Venger, *Kaskoforsikring av petroleumsinstallasjoner under bygging,* MarIus no. 233, Oslo 1997, pp. 39-40.

[18] See Hans Jacob Bull, *Avtalte standardvilkår som privat lovgivning,* Festskrift til Sjur Brækhus, 1: Lov, dom og bok, Oslo 1988, p. 105.

Plan's *historical development.* Until the audit in 1930 of the NMIP of 1906, reinsurance was explicitly referred to as an insurable interest. Furthermore, the Plan has not been amended in line with the consumer-friendly changes that characterise the ICA 1989. Another argument is the *resemblance* between marine insurance and reinsurance contracts, as both are very commercial and international in nature. Furthermore, *foreign law* supports application of the Plan. Many countries apply their marine insurance legislation and standard plans directly or analogically to the reinsurance of marine risks.[19] An advantage of applying the Plan's provisions is that one can rely on a detailed, well-functioning and familiar set of rules.[20]

Foreign sources of law are relevant, even if foreign law is not considered an independent legal authority.[21] Such sources are important in reinsurance because of the international character of the business and the limited national legal authorities. This is illustrated in Rt. 1880 p. 81, which *inter alia* refers to Swedish, German and English sources of law. Harmonisation between different countries' applicable law is important because of the international market, suggesting that these sources should be ascribed great weight. In this article, frequent reference is made to the applicable *English sources of law and the applicable English law.* This is partly because of the English-language nature of the contracts and the market in which the clauses originated, but also because English law is highly respected in the international market,

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19 Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 28.

20 Cf. Hans Jacob Bull, *Tredjemannsdekninger i forsikringsforhold,* Oslo 1988, p. 445.

21 Cf. Torstein Eckhoff, *Rettskildelære,* 5th edition by Jan Helgesen, Oslo 2000, p. 283. E.g. Rt. 1953 p. 1217 and Rt. 1957 p. 778.

suggesting that it may offer suitable principles for the Norwegian courts to follow. English reinsurance law consists of common law, primarily developed through case law, and the Marine Insurance Act of 1906 ("MIA 1906"), which regulates the reinsurance of marine risks, cf. s. 9(1). The relevant provisions of the MIA 1906 incorporate general principles of insurance law into statute and, for this reason, its provisions are also often referred to in cases concerning non-marine insurance.

There is not much *legal literature* dealing with Scandinavian reinsurance law and none of the existing articles are exhaustive. Continental and English reinsurance law on the other hand, are well covered.

The choice of legal authority to take as a starting point may be influenced by whether or not the particular legal question is specific to reinsurance. If it is, e.g. a question concerning interpretation of the reinsurance cover, a suitable starting point will often be found in market customs and practices. If the question is not specific to reinsurance, e.g. a question regarding the duty of disclosure, sources such as the ICA 1989 and the NMIP may be natural starting points, as these contain (presumably) well-functioning regulations that may be apposite.

4 Arbitration clauses

4.1 Introduction

The parties may agree that the arbitrators are not to be bound by the strict rules of law, but will act as *amiable compositeurs*. This implies that they may place greater emphasis than normal on the specific interests of the parties and considerations of reasonableness, justice and business practice, and make awards *ex aequo*

et bono.[22] Such clauses are generally speaking rare, but they are often found in reinsurance contracts,[23] where they are used because the parties want the arbitrators to take a commercial, rather than a strictly juridical, approach. The emphasis is on obtaining a reasonable award. Generally, application of the strict rules of law ensures predictability for the contracting parties, but this need is partially fulfilled by giving more weight to market practice.

My aim here is to determine the impact of these clauses in practice. I contend that their actual significance is less than their wording would tend to suggest.

The Arbitration Act (AA 2004) regulates both the arbitration agreement and the arbitrators' application of the law. The validity of the agreement depends on the rules of law according to the contract's choice of law. The principal rule regarding the appli¬cation of the law is that the arbitrators are obliged to base their decision on the applicable law, cf s. 31 of the AA 2004. The panel may only deviate from the applicable law where they have an "explicit" authorisation from the parties to solve the dispute on a different basis. Although s. 31 only mentions reasonableness, and does not specify any alternative criteria, a linguistic interpretation of the section, the preparatory works and policy considerations imply that the regulation is not exhaustive. When the legislator has permitted the dispute to be resolved on the basis of reasonableness, it is reasonable that the parties may also agree on more specific criteria, e.g. market practice.

4.2 Types of clause

Arbitration agreements must be interpreted in accordance with the general principles of contract law. The different types of clause are described in the following paragraphs. When seeking to establish

[22] Cf. Giuditta Cordero Moss, Can an arbitral tribunal disregard the choice of law made by the parties?, a non-published article based on her speech at Industrijuristseminaret March 13, 2004, p. 16.

[23] Cf. Stewart Boyd, "Arbitrator cannot be bound by the Law" Clauses, Arbitration International 1990, vol. 2, pp. 122-123.

objectively the natural linguistic meaning of the wording, it is helpful to distinguish between clauses that merely state that the arbitrators are not bound by the law and those that establish supplementary criteria.

Clauses without supplementary criteria often merely establish that the arbitrators are not to be bound by, or may refrain from following, "the law" or "any strict rules of law". Normally, "the law" must be interpreted in accordance with the choice of law. A synonymous expression is that the arbitrators shall interpret the contract as "an honourable engagement". Once not bound by the (strict) rules of law, the arbitrators may emphasise specific facts, the interests of the parties, reasonableness, considerations of justice and market practice. The result may be an award that deviates from the background rules of law. The aim of such clauses, namely, the obtaining of a reasonable result, is achieved through the application of a standard of reasonableness that is based on customs and market practice, rather than on rules constructed for "normal" situations.

The other main group is the type of clause that *lays down supplementary criteria.* Practice and equity are the most commonly specified. *Practice* may be referred to more specifically, e.g. "business practice" or "custom and usage". If not, the word must be interpreted in context. Generally, “practice” covers case law, arbitration awards, customs and other private practices. Various questions arise in relation to customs and other market practices, i.a. the origin of the relevant practice. Some clauses will address such issues explicitly, stating, e.g., "reinsurance practice" or "insurance and reinsurance business". If there is no basis for taking the opposite view, both reinsurance and insurance practices are probably relevant. Many clauses lay down that "*equity*" shall be the decisive criteria, e.g. "an equitable rather than strictly legal interpretation", "equity and good conscience" or "*ex aequo et bono*", i.e.,

considerations of justice and reasonableness are to be decisive. The aim is to secure a commercial, rather than a purely juridical, approach.[26] Because the nature of the relevant considerations will depend on the particular business sector, market practice will ultimately be the crucial factor in the obtaining of a reasonable and just result in any specific case. To conclude, market practice is thus the most important factor under either criterion.

4.3 The general meaning of the clauses and their basis in common law

The conclusion to section 4.2 above indicates that the clauses may have a general meaning independent of the way in which they are formulated. English case law demonstrates that English judges have confined themselves to describing the essence of the clauses, namely, that the tribunal is not bound by the strict rules of law.[27] According to Norwegian law, commercial contracts must be subjected to an objective interpretation if the parties' mutual understanding cannot be established. The parties' wide contractual freedom will be reduced by a general meaning, and this is problematic when the choice of formulation depends on individual negotiations. Still, the fact that the different formulations do not make any obvious difference in practice, justifies the establishment of a general principle. Contractual practice and theory indicate that the purpose of the clauses is to free the arbitrators from the strict rules

[26] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, pp. 29-30.

[27] Cf. Stewart Boyd, "Arbitrator cannot be bound by the Law" *Clauses,* Arbitration International 1990, vol. 2, p. 122 et seq.

of law and instruct them to seek to achieve a reasonable solution based on commercial considerations and market practice.[28]

Whether this principle can be classified as a *custom* depends on how long it has been established, how consistently it has been practised and to what extent it has been viewed as a rule of law. The principle must also be recognised internationally if it is to be accorded customary status.[29] Scandinavian legal literature indicates that the first condition is fulfilled, but leaves the remaining questions unanswered. The AA 2004, s. 31(3), argues against considering the principle as constituting a custom, because it establishes that the arbitrators may only deviate from the law if they have *explicit authorisation* to do so. Wilhelmsson argues that a commercial adaptation is a custom, without considering or commenting on the basis for this assertion, except for a reference to unfounded statements by Brekke and Østergaard.[30] My conclusion is that there is no legal basis for claiming that the principle is an internationally recognised custom.

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[28] Cf. Reidar Brekke, *Forholdet mellom cedent og reassurandör*, NFT 1937, p. 175 and Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 29.

[29] See 7.5 and William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 66.

[30] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 30 and Reidar Brekke, *Forholdet mellom cedent og reassurandör*, NFT 1937, p. 175.

4.4 The importance of the clauses

My assertion is that, under Norwegian law, the clauses' importance in practice is less than their wording would tend to suggest. This assertion is made in the light of the traditional Norwegian approach to contract law and the applicable reinsurance law (see section 3 above regarding the relevant sources), which both imply that the arbitrators' actual application of the law will be similar, regardless of whether or not they are bound by its strict rules. To identify the actual consequences, it would be necessary to compare cases where the arbitrators were able to disregard the strict rules of law with cases where they were not.

The concept of reasonable interpretation is an important feature of the Norwegian contract law tradition. Market practices and commercial considerations are very important, and there are few (if any) "strict rules of law", except for internationally accepted customs. This suggests that the special arbitration clauses, that free the arbitrators from the strict rules of law, generally, will not make much difference to the result, compared with cases where the arbitrators are bound by the strict rules of law, because of the traditional Norwegian approach to contract law and the applicable law.

The situation under English law demonstrates that the clauses may have a greater impact in other jurisdictions. Unlike Norwegian law, English contract law prioritises the parties' need for predictability, rather than the achievement of a reasonable result in the particular circumstances. Greater emphasis is attached to the wording, and the parole evidence rule means that information that has passed between the parties during the preparation of the contract cannot be taken into consideration.[31] The arbitration clau-

[31] Cf. William Reynell, Anson's law of contract, 28th ed., Oxford 2002, p. 127 et seq.

ses disregard this rule of evidence. Furthermore, English reinsurance law is well developed, and if the arbitrators are not bound by its rules, this will have significant consequences for the application of the law. The extent of English reinsurance law makes it more likely that the arbitrators will reach results at variance with the background rules of law.

Another question is whether or not these clauses will have any impact if a dispute comes before *a court of justice*. The parties do not have competence to regulate a court of law's application of the law. Wilhelmsson argues that the courts of law will nevertheless respect the wording agreed by the parties, by placing greater emphasis on market practice than other sources of law, such as case law.[32] The Norwegian courts have never been faced with such clauses. Because the parties cannot overrule the court of law's application of the law, it is not likely that the judges would be willing to grant the clauses effect, although this does not mean that their wording might not have some influence.

5 The duty of disclosure

5.1 Introduction and relevant sources of law

The parties to an insurance contract have a pre-contractual duty of disclosure that obliges them to exchange information about matters of significance before they enter into the contract. The duty is an aspect of the fiduciary relationship between the parties and arises because one party (the reinsured) is in a much stronger position to know or discover the material facts than the other (the reinsurer).

[32] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 31.

When establishing the applicable rules of reinsurance law, the best starting point will be the most appropriate rules from related fields of law. The *ICA 1989* regulates the duty, but the consumer-friendliness of many of the relevant sections argues against applying them. The rules in the *ICA 1930* are better adapted to commercial relations as such, but have not been updated. The rules concerning the duty in the *Act relating to conclusion of agreements, etc*. (No. 4 of 31 May, 1918) and the *general principles of contract law* are both relevant. The courts normally derive the duty from the principle of loyalty when the contract is commercial. The rules in the Act relating to conclusion of agreements, etc. and the general principles of contract law are widely formulated and require a comprehensive use of discretion. Because the regulation of the duty in the ICA 1989 (and the ICA 1930), the NMIP and general contract law is derived from the same general principles, the choice of rules is not likely to be decisive.

Norwegian courts of law have never considered the duty of disclosure in relation to reinsurance, but some rules of law were established by Professor Dr. juris Hans Jacob Bull, in an unpublished arbitration award dating from 1995. Professor Bull applied the principles behind the rules in the NMIP by analogy. This approach is supported by the Plan's historical development and the fact that its provisions are detailed, well developed and regarded as appropriate by parties' representatives in a similar contractual relationships. The same approach is adopted below in sections 5.2-5.3.

5.2 The content and extent of the duty

Section 3-1(1) of the NMIP may serve as a starting point when determining those matters of which the reinsured must inform the reinsurer:

> The person effecting the insurance shall, before the contract is concluded, make full and correct disclosure of all circumstances that are material to the insurer when deciding whether and on what conditions he is prepared to accept the insurance.

The person effecting the insurance must consider what circumstances are "*material*" *to the insurer*. The extent of his duty depends on *objective* criteria; namely, of what circumstances does a prudent insurer normally want and demand knowledge.[33] According to s. 3-5 of the NMIP (and s. 4-4 of the ICA 1989), the insurer may not invoke a breach of duty if the circumstances "have ceased to be material to him". Applied to *reinsurance*, it will be decisive to establish which matters are normally considered material by a prudent reinsurer.

In English law, the pre-contractual duty of disclosure derives from the principle of utmost good faith. The legal basis for this principle lies in common law and the Marine Insurance Act 1906 ("MIA 1906") ss. 17-20, which incorporates the common law principles. In *PAN ATLANTIC V. PINE TOP (1995)*[34], the court established the modern formulation of the rules that apply in relation to reinsurance, cf. *ASSICURAZIONI GENERALI V. ARAB INSURANCE GROUP (2003)*[35].

Under these rules, the reinsurer may only invoke a breach if the undisclosed or misrepresented facts: (1) are material to the risk; (2) have induced him to enter into the contract; (3) were within the knowledge of the reinsured; and (4) not within the reinsurer's knowledge. S. 18(2) of the MIA gives an instructive starting point for determining whether the facts are *material*: "Every circumstance is

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[33] Cf. the preparatory works to the NMIP (1996), pp. 65-66.

[34] PAN ATLANTIC INSURANCE CO V. PINE TOP INSURANCE [1995] 1 A.C. 501 HL

[35] ASSICURAZIONI GENERALI SPA V. ARAB INSURANCE GROUP [2003] Lloyd's Rep. IR 131 AC

material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk". The English rules are similar to s. 3-1 of the NMIP, and may therefore be of interest in interpreting the Norwegian provision. *Inter alia,* English case law establishes that the fact does not need to be decisive for the reinsurer, nor be a fact that the reinsurer would have regarded as increasing the risk. Most relevant facts revolve around circumstances that may affect the subject of the cover, e.g. the ceding party's previous claims history.

The disclosure must be "*full*" *and* "*correct*", cf. s. 3-1(1). The latter requirement seldom creates difficulties, but the concept of "full" disclosure raises some questions. The insurer may not invoke a breach of the duty if he "knew or ought to have known of the matter" when he entered into the contract, cf. s. 3-5. The insurer must act prudently, and the rule is interpreted as imposing on him a *duty to make inquiries* when the way the risk is presented appears confused, suspicious or unusual.[36] The insurer is always assumed to have knowledge of customs, market practice and matters of common public knowledge.

Applied to *reinsurance,* the principles require the reinsured to give a fair presentation of the risk, disclosing all the material facts in sufficient detail to enable a prudent reinsurer to decide whether or not he needs additional information. A full and detailed presentation is not always required. The reinsurer must require additional information if a prudent and reasonable reinsurer would suspect the existence of further relevant information. English law corresponds with this approach and thus supports the application of the NMIP principles to reinsurance.[37]

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[36] Cf. the preparatory works for the NMIP (1996) p. 70. See the similar rules in s. 4-4(1)1, cf. 4-1 in the ICA 1989 and general contract law

[37] Cf. e.g. CONTAINER TRANSPORT INTERNATIONAL V. OCEANUS MUTUAL UNDERWRITING [1984] 1 Lloyd's Rep. 476.

In his unpublished arbitration award from 1995, Professor Bull considers the duty of disclosure. The broker who placed the reinsurance had drawn up "placing information", according to which the reinsured had never insured ships that were more than 15 years old, apart from particular exceptions. When a 19-year-old ship was wrecked in 1993, an investigation revealed that approximately one quarter of the insured fleet was over 15 years old. Professor Bull concluded, basically on the basis of the NMIP principles, that the reinsured was not in breach, despite the fact that he gave inaccurate and/or incorrect information regarding the ages of the ships. Professor Bull emphasised that the reinsurer had not made his expectations clear and that a prudent reinsurer would have doubted the facts presented, on the basis of the formulation of the "placing information", and required additional information if the age of the ships was of great importance.

5.3 Degree of blame and sanctions

The sanctions according to the NMIP are: invalidity; exemption from liability; and/or termination. The regulation distinguishes between different degrees of fault: fraud; other types of breach; and innocent breach. All the provisions assume that there has, viewed objectively, not been full and correct disclosure, cf. 3-1. *Fraud* is dealt with under s. 3-2. If the person taking out the insurance has fraudulently failed to fulfil his duty of disclosure, "the contract is not binding" on the insurer, who may also give 14 days' notice to "terminate other insurance contracts" with the same insured.

Neither the NMIP nor its preparatory works define the meaning of "fraud", but the latter makes it clear that the distinction in the NMIP between fraud and other breaches of the duty of disclosure, is based on the definition in the ICA 1989. According to this act's preparatory works, fraud presupposes that the insured was

positively aware that he was giving out incorrect/incomplete information and that his intention was to obtain an insurance contract or a contract on better terms than would have been the case if he had made full and correct disclosure.[38] It is not relevant whether the information would have influenced the insurer's decision to take on the risk and consequently the principle of causation does not apply.

Applying this principle to reinsurance, the contract will not be binding on the reinsurer, if the reinsured fraudulently fails to fulfil his duty of disclosure. An example would be where the reinsured does not inform the reinsurer of matters of importance to the reinsurer's evaluation of the risk, despite the reinsurer's inquiries, with the intention of obtaining improved terms. Application of this principle is supported by the similar provisions of ss. 4-2(1) and 4-3 of the ICA 1989, s. 5 in the ICA 1930 and general contract law.[39]

In English law, the reinsurer is left with two choices if the reinsured has failed to fulfil his duty of disclosure: explicit avoidance or affirmation of the contract.[40] The undisclosed or misrepresented facts must have *induced* the reinsurer to enter into the contract (cf. 5.2 above). According to *Assicurazioni Generali v. Arab Insurance Group*, the incorrect/incomplete information must have been an "effective cause" (not necessarily the sole cause) of the particular (re)insurer entering into the contract. This condition is not fulfilled, "if the insurer would have entered into the contract on the same terms in any event". According to legal theory, any type of inducement is sufficient.[41] The major difference between the

[38] Cf. Ot.prp. no. 49 (1988-89), pp. 63-64.

[39] Cf. the preparatory works of the NMIP (1996), p. 67.

[40] Cf. s. 17 of the MIA and Colin Edelman QC, Andrew Burns, David Craig and Akash Nawbatt, The Law of Reinsurance, Oxford 2005, p. 130.

[41] Cf. Colin Edelman QC, Andrew Burns, David Craig and Akash Nawbatt, The Law of Reinsurance, Oxford 2005, pp. 122-123.

NMIP's concept of "fraud" and the English requirement that there must have been inducement is that the NMIP does not require a causal link between the reinsured's actions and the reinsurer's entry into the contract. Such causal connection is only required in the case of "other breaches", cf. s. 3-3. Although the desirability of harmonisation would support implying a similar condition into s. 3-2 of the NMIP, the rule as it stands today is supported by the ICA 1989, the ICA 1930 and general contract law, all of which derive from the traditional Norwegian legal approach, which is that fraudulent actions will always be penalised, regardless of their consequences in practice.

S. 3-3 in the NMIP regulates "*other breaches*", which covers all cases where the insured is at fault, except fraud. There must be a *causal link* between the negligent behaviour and either the insurer's entering into the contract or the conditions of the contract itself. If it has to be assumed that the insurer "would not have accepted the insurance" if the insured had fulfilled his duty, "the contract is not binding on the insurer", cf. s. 3-3(1). If it can be assumed "that the insurer would have accepted the insurance, but on other conditions", the insurer is liable to the extent the insured can prove "that the loss is not attributable to such circumstances as the person effecting the reinsurance should have disclosed", cf. 3-3(2). The insurer may also terminate the insurance by giving fourteen days' notice, cf. s. 3-3(3).

The position under the ICA 1989 is similar, and mainly supports the application of the principles in the NMIP to reinsurance. It nevertheless establishes a different rule for determining the insurer's liability. S. 4-2(2) states that the insurer's liability "may be reduced or cease to exist", which means that the reduction may vary from 0 to 100 per cent, and s. 4-2(3) contains directions on how the reduction is to be estimated (the court "must" take account of the impact of errors on the evaluation of the risk, the degree of

blame, the course of events and the general circumstances). This rule was not considered as suitable for inclusion in the Plan, mainly because it might increase the number of disputes, as priority was given to clarity and predictability. Although achieving a reasonable result is of great importance in reinsurance, the approach taken by the Plan is likely to be best suited to commercial agreements such as reinsurance contracts.

Innocent breaches of the duty of disclosure, "without any blame attaching", are regulated under s. 3-4 of the NMIP. In such cases, "the insurer is liable as if correct information had been given, but he may terminate the insurance by giving fourteen days' notice". The similar provision in the ICA s. 4-2 (cf. s. 4-3(1) of the ICA 1930), the principles of contract law and the approach taken under English law all support the application of this principle to reinsurance.

In the case of reinsurance, one might ask of what circumstances the reinsured would be deemed to have knowledge, as if so, there is no innocent breach. Under English law, s. 18(1) in the MIA 1906 lays down that the assured is "deemed to know every circumstance which, in the ordinary course of business, ought to be known by him." The reinsured thus has a duty to disclose matters which are within his constructive knowledge, but to which he has turned a blind eye. This means it is not in an innocent breach if the reinsured, being suspicious of a material circumstance that ought to be disclosed, turns a blind eye and refrains from inquiry. If so, the reinsured will be deemed to know whatever such an inquiry would have revealed.[42]

A different question is whether good faith on the part of the reinsured might discharge him from liability for the breach. The

[42] Cf. Colin Edelman QC, Andrew Burns, David Craig and Akash Nawbatt, The Law of Reinsurance, Oxford 2005, pp. 123-124.

situation where incorrect or incomplete information is given in good faith is covered by English law and regulated under s. 20 of the MIA 1906. As a starting point, s. 20(1) lays down that every material representation made before the contract is concluded must be true. Further, s. 20(3) distinguishes between representation as to a matter of fact and representation as to a matter of expectation or belief. A representation as to a matter of fact is true if it is substantially correct, cf. s. 20(4), while a representation as to a matter of expectation or belief is true if it is made in good faith. The principles contained in the NMIP form the basis of a corresponding rule in Norwegian reinsurance law. For example, if the reinsured, before the contract is concluded, in good faith shares his thoughts about the future development of the market with the reinsurer, he can not be blamed if his expectations turn out to be wrong and the reinsurer loses money on the contract.

6 The reinsurance contract's scope of cover

6.1 Contractual regulation

According to the general principle of indemnity, the reinsurer is only obliged to indemnify the reinsured where a loss falls: i) within the cover of the reinsured policy; and ii) within the cover created by the reinsurance. This chapter examines how the scope of cover is regulated in reinsurance contracts. Disputes concerning the consequences of events that occur after the signing of the contract are not discussed. The extent to which the reinsured must prove his liability according to the underlying policy is discussed in chapter 7.

Normally it is necessary to compare various clauses in the reinsurance contract to establish its scope of cover. General clauses describing the liability of the reinsurer are often entitled “Object and Scope” or “Interest”. Limitations on liability and exceptions

may appear in other clauses. *Proportional contracts* normally contain general and special conditions. While the general conditions usually describe the scope of the reinsurer's liability in broad terms, the special conditions will often describe it more specifically, e.g. through a list of the business actually covered.[43] Proportional contracts may contain various exemptions and exceptions. It is not unusual for the reinsurer only to accept the risk of certain perils, e.g. natural catastrophes, or to explicitly exclude certain risks, e.g. "War on land and isolated War risks". He may also only accept the risk of losses that occur in a specified geographic area. In *non-proportional contracts*, the scope of cover is generally regulated in more detail. Per Event Excess of Loss contracts contain a definition of "loss" that normally includes all loss, damage, liability or expenses or series thereof arising from one event. This simplifies the task of evaluating whether, for example, an expense comes within the contract's scope of cover.

Some proportional contracts *incorporate the terms of the underlying policy*. This implies that the terms in the underlying policy are incorporated into the reinsurance contract. Common formulations include "Wording as original" and "being a reinsurance of and warranted the same gross rate, terms and conditions as […]" (Lloyd's J1 formula). Such wording is normally intended to secure *back-to-back* cover. This means that the reinsurance contract and the underlying policy have identical scopes of cover and duration, and that any warranties in the underlying policy will also apply as

[43] These standard terms, from a Norwegian cedent, may serve as an example: "**Share and Scope:** The [Reinsured] agrees to cede and the Reinsurer agrees to accept by way of reinsurance or retrocession the share of the [Reinsured's] insurances and/or reinsurances stipulated in Part Two." "**Business:** Direct insurances and/or facultative reinsurances written by [the Reinsured] in respect of oil and/or gas and/or other oil related activities, but excluding risks completely led in the Non-Marine market."

between the reinsured and the reinsurer.[44] When establishing the scope of cover, it is necessary to compare the contracts. The incorporation of the underlying insurance policy into the reinsurance contract may give rise to inconsistencies, e.g. different deadlines may apply to similar duties to give notification in cases where the (re)insurer has knowledge of any circumstances that may give rise to a claim under the contract. In the case of such inconsistency, the general rule under Norwegian law is that the reinsurance contract will prevail, unless there are grounds to conclude otherwise. Disputes may also arise as to whether the incorporated terms merely bind the reinsurer to indemnify the reinsured's payments under the underlying policy or whether the terms operate independently in the context of the reinsurance (often referred to as "full" incorporation). Such disputes will have to be resolved through interpretation of the relevant contract(s).

In the English case HIH Casualty and GENERAL Insurance Ltd. v. New Hampshire Insurance Co (2001)[45], the question was whether the incor¬p¬o¬rated waiver of defences clause served mere¬ly to emphasise the "follow the settlements" clause or was independent, in which case the reinsurer was held to have waived defences as between itself and its reinsured. If fully incorporated, the reinsurer could not plead non¬-¬disclosure or mis¬re¬p¬resentation, but if the effect was to bind the reinsurer to the pay¬ments made by the reinsured, it could refuse to pay the reinsured where there was a separate ground for avoi¬dance. The Court of Appeal found that the clause was not independent, but merely served as a "follow the settlements" clause (see chapter 7 below)[46]

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[44] Cf. Rhidian D Thomas, The Modern Law of Marine Insurance, vol. 1, LLP 2002, p. 68.

[45] HIH CASUALTY AND GENERAL INSURANCE LTD. V. NEW HAMPSHIRE INSURANCE CO. [2001] 1 Lloyd's Rep. 378 QBD and [2001] 2 Lloyd's Rep. 161 CA

[46] Cf. Colin Edelman QC, Andrew Burns, David Craig and Akash Nawbatt, The Law of Reinsurance, Oxford 2005, p. 59.

6.2 Presumption of back-to-back cover?

When the contract does not clearly regulate the scope of cover, this raises the question of whether there is a presumption of back-to-back cover, i.e., a presumption that the parties intended that whatever was covered under the original insurance should also be covered under the reinsurance. One may suppose that this will often be the intention of parties to *proportional contracts*, as the ceding party will usually want to reinsure the major part of his risk. The presumption might therefore seem reasonable in the absence of any arguments to the contrary. This view is supported by s. 25 of the NMIP of 1871 and Ragnar Brekke's draft standard terms, which both established such a presumption. Thomas Wilhelmsson claims that such a presumption must apply, unless the reinsurance contract regulates the situation otherwise.[49] This approach is also supported by English law, which stresses that the presumption is "cautious" and that different wording in the contracts is likely to be understood as being intentional.[50]

One might ask whether the application of the presumption in practice might mean that the principle of objective interpretation is to be put aside. Another question concerns whether or not it is reasonable for the reinsurer alone to take the burden of vague wording. Nevertheless, most sources suggest that one should apply a *cautious* presumption of back-to-back coverage in the case of proportional contracts.[51] In the case of *non-proportional* contracts,

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[49] Cf. Reidar Brekke, *Internationale Reassuranceregler,* NFT 1924, p. 4 and Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication nr 21, Stockholm 1976, pp. 44-46.

[50] Cf. P T O'Neill and J W Woloniecki, The Law of Reinsurance in England and Bermuda, London 2004, p. 160.

[51] See Rhidian D Thomas, The Modern Law of Marine Insurance, volume one, LLP 2002, pp. 68-70, regarding the effect of incorporation clauses.

such as Excess of Loss and Stop Loss contracts, the reinsurer is only liable for losses that exceed a fixed limit. The ceding party does not seek to reinsure his total risk and the parties' intention is unlikely to be the establishment of back-to-back cover. English law supports this position, and establishes that there is no presumption of back-to-back cover in the case of non-proportional contracts.[52]

7 The reinsurer's duty to follow the settlements

7.1 "Follow the settlements" clauses

Assuming that the loss falls within the cover of the insured policy, according to the principle of indemnity, the question then arises as to whether the loss falls within the cover of the reinsured policy, cf. 6.1 above. In the absence of any distinct provision to the contrary, the burden of proof lies on the reinsured. In the reinsurance contact, the parties will often regulate the extent to which the reinsured must prove his liability in relation to "follow the settlements" and/or "claims co-operation" clauses.

"Follow the settlements" clauses impose a duty on the reinsurer to indemnify the reinsured without the reinsured having to prove liability under the underlying policy. In this article, I only deal with clauses that do *not* thoroughly regulate the reinsurer's duty of indemnity, in other words, clauses that do not clearly establish that duty's limitations. Such clauses often merely contain general expressions such as: "pay as may be paid thereon"; "follow the fortunes"; "follow the settlements"; and "all settlements shall be binding". Modern proportional contracts often use the wording

[52] Cf. AXA REINSURANCE V. FIELD 2 Lloyd's Rep. 233, [1996] HL, O'Neill/-Woloniecki (2004), pp. 160-163.

"follow the settlements", while non-proportional contracts normally state "all settlements shall be binding".

Continental legal theorists have claimed that "follow the settlements" and "all settlements shall be binding" clauses that do not regulate the limitations on the duty, must be interpreted as a reference to a general reinsurance principle. According to these Continental theorists, these clauses therefore have the same effect independent of their wording: the reinsurer has a duty to indemnify the reinsured without the reinsured having to prove liability under the underlying policy. No Norwegian case law or arbitration awards address this question, and there is no uniform market practice. It is the limitations placed on the duty of indemnity that cause problems in practice and these clauses do not solve this problem. Therefore one might argue that unless the wording adopted has a specific meaning according to market practice, there is no reason to distinguish between the different formulations. This is supported by Thomas Wilhelmsson, who suggests that the Continental doctrine should be applied under Scandinavian law.[53] On the other hand, one might argue that the clauses' different origins should prevent the application of a general interpretation. This argument has been decisive in English law.[54] Unless there is a concrete basis for interpreting the relevant clause differently, the Norwegian courts are likely to apply the Continental doctrine in accordance with their traditional practice.

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[53] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 52. See also Hjuler (1929), p. 37.

[54] See Colin Edelman QC, Andrew Burns, David Craig and Akash Nawbatt, The Law of Reinsurance, Oxford 2005, pp. 71-84 and William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 52.

The following comments focus on "follow the settlements" clauses. The wording used in these clauses is similar to that used in non-proportional contracts, i.e. "all loss settlements shall be binding", and the same comments may therefore also apply to these clauses. The main question is where a Norwegian court should draw the line limiting the extent of the duty to indemnify in these cases. Here I only comment on the legal grounds for objection that may be raised by the reinsurer. I would argue that the reinsurer is entitled to refuse liability where the reinsured has acted dishonestly and where a prudent non-reinsured insurer would not have honoured a similar claim under the underlying policy.[55]

7.2 Limitations on the duty

It is necessary is to establish a suitable norm by which to determine the limitations on the duty of the reinsurer. Predictability in this context is important for the reinsured, as otherwise he can only be certain of cover if he has the reinsurer's approval.

The wording of a "follow the settlements" clause does not impose any requirements as to the reinsured's conduct. It states that the clause only regulates the reinsured's "settlements" (i.e. "settlements of claims") in the light of other expressions that normally appear in

[55] English law distinguishes between the reinsurer's factual and legal objections. The principle rule, cf. INSURANCE COMPANY OF AFRICA V. SCOR (UK) REINSURANCE CO. LTD. 1 Lloyd's Rep. 312 [1985] CA, is that the reinsurer cannot refuse liability on the basis of a claim that the loss, as a matter of fact, was not covered by the underlying insurance policy. There are a few exceptions to this rule, which mainly correspond with the reinsurer's legal objections. English law and policy considerations indicate that a similar rule must apply under Norwegian law.

reinsurance contracts, such as "damage", "loss" and "cover".[56] Another important factor concerns the parties' legitimate expectations when they enter into the contract. The reinsured must expect to look after the reinsurer's interests as if they were his own, and the reinsurer may legitimately expect the reinsured to act loyally and only pay such claims as would be honoured by a prudent, non-reinsured insurer.[57] A mutual fiduciary duty is imposed on the parties (see chapter 5, above). This is especially important in reinsurance because these contracts are based on *a relationship of trust*. The importance of these factors of loyalty and trust was underlined by the Supreme Court in Rt. 1956 p. 249. Because "follow the settlements" clauses are a result of the relationship of trust, it is natural to require the reinsured to behave in a loyal manner. This makes it necessary to determine, however, the kind of behaviour that is incompatible with the duty of loyalty.[58]

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[56] Cf. Axel Hjuler, *Reassurandørens Forpligtelse til at deltage i Skadesutbetalinger,* NFT 1929, p. 39, and the case HILL V. MERCANTILE & GENERAL REINSURANCE CO. LTD. [1996] L.R.L.R. 841 HL.

[57] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication nr 21, Stockholm 1976, p. 60 and Axel Hjuler, *Reassurandørens Forpligtelse til at deltage i Skadesutbetalinger,* NFT 1929, p. 38.

[58] William C Hoffman claims that the courts in most countries would enforce the clauses unless certain objective, circumstantial evidence shows that the reinsured has not acted in good faith; i.e.: (1) the loss does not falls within the cover created by the reinsurance; (2) the payment is dishonest or; (3) based on defective investigations or evaluations. This constitutes Hoffman's "loss settlement rule", which is based on a comparative analysis of continental, English and American law, cf. William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994).

Of the grounds for objection that may be raised by the reinsurer, the first category is based on *dishonesty,* including fraud and other arrangements made in bad faith. Such grounds for objection are universally recognised.[59] Although such a situation has not been considered by the Norwegian courts, it is likely that they would accept such grounds for objection. Considerations of reasonableness imply that the reinsurer is entitled to expect the reinsured not to engage him by means of dishonest arrangements and this is supported by the importance of the principle of loyalty in insurance and by the general contract law rule that holds that a contract based on disloyalty may be considered null and void. The rule also has support in Scandinavian reinsurance theory.[60]

The modern interpretation of "follow the settlements" clauses under *English law* is based on two judgments: *INSURANCE COMPANY OF AFRICA V. SCOR (UK) REINSURANCE CO. LTD.* (1985) [61] and *HILL V. MERCANTILE & GENERAL REINSURANCE CO. LTD. (1996)*[62]. In *SCOR*, Robert Goff L.J. stated (p. 330) that the reinsurer agreed to indemnify the reinsured "provided that the claim so recognised by them falls within the risks covered by the policy of reinsurance as a matter of law, and provided that in settling the claim the insurers have acted honestly and have taken all proper and businesslike

[59] Cf. William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 78.

[60] Cf. Reidar Brekke, *Internationale Reassuranceregler,* NFT 1924, p. 21 and Axel Hjuler, *Reassurandørens Forpligtelse til at deltage i Skadesutbetalinger,* NFT 1929, pp. 30-31.

[61] INSURANCE COMPANY OF AFRICA V. SCOR (UK) REINSURANCE CO. LTD. [1985] 1 Lloyd's Rep. 312 CA)

[62] HILL V. MERCANTILE & GENERAL REINSURANCE CO. LTD. [1996] L.R.L.R. 841 HL

steps in making the settlement." Dishonesty includes "fraud, bad faith and collusion".

From the reinsurer's point of view, this type of objection is important, because these clauses may tempt the reinsured into making dishonest settlements. For example, the reinsured, knowing that the reinsurer will cover most of his loss, may be tempted to make payments to generate goodwill in the market or "to be nice" to an important customer. The less risk the reinsured has retained, the more tempting this will be. In this context, the type of reinsurance is highly relevant. The probability of dishonest payments is higher under a proportional facultative contract for large risks or under a non-proportional contract, because one payment in these cases might activate the reinsured's reinsurance cover.

Other grounds for objection concern cases where *the reinsured's loss settlement is not based on a proper and commercial investigation and/or estimation*. This type of objection is also universally recognised according to Hoffman.[63] The basis for this objection can be found in the parties legitimate pre-contractual expectations: the reinsurer must expect to cover the reinsured's loss, while the reinsured can expect to be covered, provided the reinsured's loss settlements have been in accordance with market practice. The applicable norm can be formulated as follows: the reinsurer may deny liability if *the reinsured has not acted as a prudent, non-reinsured insurer.*[64] But what type of behaviour on the part of the

[63] Cf. William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 81.

[64] Cf. Reidar Brekke, *Internationale Reassuranceregler,* NFT 1924, p. 21, Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, pp. 59-60 and William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial

reinsured does this norm refer to? The standard is objective, and the decisive argument is whether an experienced, non-reinsured insurer would consider the settlement to be legitimate, taking the circumstances surrounding it into consideration. This view is supported by English law, where Goff L.J stated in *SCOR* that the reinsured has to take "all proper and businesslike steps in making the settlement" and that the clause "presupposes that reinsurers are entitled to rely not merely on the honesty, but also on the professionalism of insurers".

The standard establishes that the reinsurer may deny liability if the reinsured's settlement contravenes the professional standards applicable to insurers according to market practice. It does not however, establish the extent to which the reinsured's conduct has to fall below the required standard. Is any variance sufficient, or must there be a qualified degree of negligence? Hjuler claims that, under Norwegian law, the reinsurer can only deny liability if the reinsured is guilty of gross negligence. This view accords with the Continental doctrine. Simple negligence, as opposed to gross negligence, is defined as unfortunate circumstances that may occur in well-managed companies.[65] On this point, English and Continental law appear to differ, because, according to English law, simple negligence is sufficient.[66] However, these rules do not make any

Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 82. This formulation of the norm is also supported by the Supreme Court's statements in Rt. 1956 p. 249 on p. 251.

65 Cf. Axel Hjuler, *Reassurandørens Forpligtelse til at deltage i Skadesutbetalinger,* NFT 1929, p. 40 and Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, p. 55.

66 Cf. *SCOR* [1985] CA and William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the

difference to the result in practice, as a settlement at variance with market practice will normally be considered to be a grossly negligent act according to the Continental doctrine, leading to the conclusion that market practice is decisive in any case.

Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), pp. 80-81.

7.3 The effect of "claims co-operation" clauses

As a general rule, the reinsurer does not have control over the reinsured's settlements under to the underlying policy. Nevertheless, the reinsured will often want to involve the reinsurer in order to prevent disputes, and the parties may also have agreed on a clause seeking to give the reinsurer a right to influence the settlement, a so-called "claims co-operation" clause. Such a clause has partly the same purpose as a "follow the settlements" clause, as both clauses regulate the extent to which the reinsured needs to prove that the loss falls within the cover of the reinsured policy. The clauses may be formulated in different ways, e.g.: "The reinsurer shall be given the opportunity of co-operating in the settlement" and "No settlement or compromise shall be made and no liability admitted without the prior approval of the Reinsurers". It is necessary to distinguish between clauses that establish that the reinsured may not admit liability or make any payments without the reinsurer's approval and those that do not.

If a contract contains a "follow the settlements" clause and a "claims co-operations" clause, the latter may reduce the effect of the former. The two clauses will conflict if the "claims co-operations" clause requires the reinsurer's approval. Under English law, this problem arose in *Scor*. It was resolved through interpretation, with the court making the assumption that the parties' intention must have been that the "claims co-operation" clause was supposed to reduce the effect of the "follow the settlements" clause in such a way that it only had any effect if the reinsured had obtained the reinsurer's approval. In effect, the court gave precedence to the "claims co-operations" clause. This would also probably have been the result under Norwegian law.

If the reinsurer does not approve the settlement, or if the reinsured does not ask for his approval, the effect of this will depend on how the clause is interpreted. If the consequences are not clearly regulated, the reinsurer's liability probably depends on whether or not the reinsured can prove that the loss falls within the cover of the reinsured policy and within the cover created by the reinsurance. Under English law, *GAN INSURANCE v. TAI PING INSURANCE (2001)*[67], establishes that the reinsurer is not liable if interpretation of the contract suggests that liability depends on his approval. In my opinion, the result should be the same under Norwegian law. The Oslo District Court *(Oslo tingrett)* came to a different conclusion in an (appealed) judgment dated 3 June, 2005 (No. 04-058134), based on the lack of a causal link between the fact that the reinsured did not notify the reinsurers and the fact that the reinsurers were liable according to the reinsurance contract.

"Claims co-operation" clauses that merely establish a right to co-operate do not affect "follow the settlements" clauses. It is natural for a reinsurer to want to influence the reinsured's settlements, but when a reinsurer is given this opportunity, policy considerations suggest that he must comply with the reinsured's settlements, regardless of whether or not he has exercised his right.

7.4 Is the duty to "follow the settlements" a custom?

A general question is whether or not the reinsurer's duty to "follow the settlements" of the reinsured can be categorised as a custom. Such clauses are often included in reinsurance contracts, and their modern formulations have been in use since the start of the twentieth century.

[67] GAN INSURANCE V. TAI PING INSURANCE [2001] 1 Lloyd's Rep. I.R. 667 AC

Wilhelmsson claims that a "normal" duty to "follow the settlements" has a basis in custom under Finnish law. He refers to several policy considerations that form the foundations of such a custom, i.a. the reinsured's situation (if the reinsurer is not bound by the reinsured's settlements, the reinsured will need the reinsurer's approval before making any settlements, unless he is willing to risk carrying the loss himself). Wilhelmsson also claims that the market understands the duty as a natural part of the contractual relationship because of the relationship's basis on trust. He also claims that this is supported by Scandinavian legal theory. Furthermore, he asserts that several Continental legal theorists have argued that the duty should be considered a custom.[68] Hoffman also considers Continental legal theory. He does not conclude, but merely mentions, that some German authorities maintain that, in the absence of a clause providing to the contrary, "an internationally recognised reinsurance custom or trade usage may give rise to a duty to follow the actions".[69]

English case law establishes that the duty does not have a basis in custom under English law.[70] In conclusion, there is no internation-

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[68] Cf. Thomas Wilhelmsson, *Om reassurandörs ersättningsskyldighet vid skadeåterförsäkring,* Försäkringsjuridiska Förenings publication no. 21, Stockholm 1976, pp. 52-53, Kuno Alfthan, *Om reassurandörers betalningsskyldighet vid sjöförsäkring,* Defensor Legis 1924, p. 106 and Axel Hjuler, *Reassurandørens Forpligtelse til at deltage i Skadesutbetalinger,* NFT 1929, p. 39.

[69] Cf. William C Hoffman, A Common law of reinsurance loss settlement clauses: A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 66.

[70] BODEN V. HUSSEY [1988] 1 Lloy's Rep. 423 CA and William C Hoffman, *A Common law of reinsurance loss settlement clauses:* A Comparative Analysis of the Judicial Rule Enforcing the Reinsurer's Contractual Obligation to indemnify the Reinsured for Settlements, Lloyd's Maritime and Commercial Law Quarterly (1994), p. 66.

ally recognised duty on the reinsurer to follow the reinsured's settlements. In any event, the legal basis for such a duty, as put forward by Wilhelmsson, does not seem sufficient under Norwegian law

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