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# Insurance related problems in bareboat charter agreements



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## Abstract

In 2017, the majority of the United Kingdom Supreme Court held in its judgment in the *Gard Marine and Energy v China National Chartering (The Ocean Victory)* case that, in bareboat charters under the 'BARECON 89' form, if both the owner and the charterer are jointly insured under a hull policy, the damages caused to the vessel by the charterer cannot be claimed by the insurer by way of subrogation after indemnifying the owner. The interpretation of the charter party leads to the conclusion that the liability between the parties is excluded. Faced with the Supreme Court's decision, the Baltic and International Maritime Council (BIMCO) adopted a new standard bareboat charter agreement only a few months later, the 'BARECON 2017' form, which amends, among other clauses, the one related to insurance. The present paper analyses (i) the new wording of the clause mentioned above and (ii) its incidence on the relationship between the parties of both the charter agreement and the insurance contract and its consequences for possible third parties. Despite BIMCO's attempt to change the solution adopted by the Supreme Court and his willingness to allow the insurer to claim in subrogation against the person who causes the loss, the consequences, as it will be seen, do not differ much in practice when the wrongdoer is the co-insured charterer. On the contrary, when the loss is caused by a time charter or a sub-charter, in principle, there will be no impediment for the insurer to sue him.

**Keywords:** Bareboat charter, BARECON, Marine insurance, Joint and composite insurance, Subrogation of the insurer

## Introduction

Under a bareboat charter agreement, the owner of a vessel grants its possession to the charterer in return for payment, defined as hire. Such agreements are more often than not based on internationally accepted standard forms, e.g. those drafted by the Baltic and International Maritime Council (from now on, BIMCO), and arguably include one or more clauses dedicated to hull and indemnity insurance. However, insurance clauses have given rise to numerous controversies over the years, especially concerning the insurer's subrogation in the owner's rights when the person responsible for the casualty is the demise charterer himself. Some of these cases are *The Yasin* ([1979] 2 Lloyd's Rep. 45 QBD), *Petrofina (UK.) Magnaload Ltd* ([1983] 2 Lloyd's Rep. 91), *Stone Vickers Ltd v Appledore Ferguson*



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*Shipbuilders Ltd* ([1991] Lloyd's Rep 288), *National Oilwell v Davy Offshore* ([1993] 2 Lloyd's Rep 582), *Hopewell Project Management Ltd v Ewbank Preece Ltd* ([1998] 1 Lloyd's Rep. 448), *Co-operative Retail Services v Taylor Young Partnership* ([2002] UKHL 17), *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars Ltd* ([2002] ULHL 17), and *Rathbone Brothers plc v Novae Corporate Underwriting* ([2014] EWCA Civ 1464).

Concerning the problem of subrogation of the insurer in bareboat charter parties, the most recent of the court decisions in this regard is the judgment of the United Kingdom (UK) Supreme Court in *Gard Marine and Energy v China National Chartering* ([2017] UKSC 35). With the need to adapt the forms to new trends, the ruling mentioned above led BIMCO to adopt a new bareboat charter party: the 'BARECON 2017' Standard Agreement. Among other amendments, the insurance provisions in Clause 17 have had some significant changes.

The paper is structured in six sections. The current Section puts the research into context. Section 2 concerns methodology. Section 3 is dedicated to the bareboat charter agreement regarding its concept, nature and legal regulation, classes, differences with corresponding figures, and the incidence of forms, especially the BARECON form. Insurance clauses included therein will be analysed in Section 4, which concerns the obligation to contract and maintain insurance, its breach, and the problem of subrogation of the insurer in the insured's rights and remedies. Section 5 addresses the Supreme Court's judgment in *The Ocean Victory* case and its implications on the new 'BARECON 2017' Standard Agreement. Finally, Section 6 concludes.

## Methodology

The present paper seeks to analyse a very topical issue in the field of contracts for ships' use: the insurance of the owner and the charterer, respectively, in a bareboat charter agreement. Both the charter agreement itself and the maritime insurance contract have been the subject of detailed analysis in the literature's body. There is also a considerable number of court decisions that deal with both issues. The approach regarding the relationship between insurance and charter contracts taken by the UK Supreme Court in its 2017 *Ocean Victory* ruling has forced a review of some of the traditional foundations in the matter. As a result, BIMCO has deemed it necessary to modify its BARECON standard agreement to precisely incorporate solutions to the problems raised in the Supreme Court's decision.

In this sense, the paper purports to review not only the vast literature and case-law before the judgment, both in England and in other European countries (mainly Spain and Italy), but also the not very numerous later sources, to determine the exact scope of the novelties introduced in the 'BARECON 2017' form. This paper also pursues a comparative view of the bareboat charterers' regulation in the Spanish, Italian, French and English national legal systems. Furthermore, given that the BARECON form is almost always subject to English Law, to address the main question, i.e., the insurance clause and the insurer's subrogation rights, the paper also analyses the solutions provided by the Marine Insurance Act 1906.

## The bareboat or demise charter agreement

### Concept, legal nature, and regulation

A ship hiring or leasing is defined as a contract by which one person – the owner – transfers to another – the bareboat or demise charterer – the possession of a vessel for a certain period and in exchange for a price, – *the hire* – (Arroyo Martínez, 2015; Bennett, 2017; Petit Lavall M<sup>a</sup>.V., 2015). The parties' legal relationship is a lease of movable assets – *locatio rei* – (Petit Lavall M<sup>a</sup>.V., 2015; Carlón, 1969). This contract's main characteristic is the conveyance of possession to the charterer, who acquires the vessel's use and enjoyment (García-Pita, 2005). Although the demise charterer does not acquire the ownership of the vessel, it is considered that during the term of the contract, he is the de facto (or beneficial) owner of the ship in its relations to third parties (Hofmeyr, 2017).

In English law, as opposed to bills of lading, there is not a statutory regulation for the general terms of the bareboat charter. Instead, there is a regulatory control of certain terms of the contract, such as seaworthiness or limitation of liability. In the absence of such general regulation, case law and literature have established the bareboat charterer definition and characteristics. In this regard, it has been said that the “*charter by demise operates as a lease of the ship pursuant to which possession and control passes from the owners to the charterers*” (Davis, 2005). Likewise, Hofmeyr (2017) states that “*a demise charter party (also known as a 'bareboat' charter party) is, as the term 'demise' indicates, a contract of lease under which exclusive possession of the vessel passes from the owner to the charterer for the duration of the period of hire*” .

Under Spanish law, this type of contract (known as “*arrendamiento de buque*”), has been regulated for the first time by Act No 14/2014, 24 July, on Maritime Navigation (from now on, Maritime Navigation Act or MNA). In any case, the provisions of the MNA are mostly non-mandatory. For that reason, the parties often use (as they did before) especially international forms. The MNA defines the ship leasing contract in Article 188. It establishes that “*under a bareboat charter agreement, the owner undertakes, in exchange for a fixed price, to deliver a specific vessel to the charterer so that the latter may use it temporarily per the provisions agreed or, failing these, according to its nature and characteristics*”.

In other countries, bareboat charter agreements have been addressed much earlier by the legislator. For example, in the Italian case, bareboat charter agreements are regulated in Article 376 of the Codice della Navigazione. Article 376 establishes that “*(s) i ha locazione di nave quando una delle parti si obbliga a far godere all' altra per un dato tempo la nave verso un determinato corrispettivo* (in English: “[l] easing of a ship occurs when one of the parties undertakes to let the other enjoy the ship for a period of time towards a specific hire”). Likewise, pursuant to Article L5423–1 of the French Code des Transports, “*(p) ar le contrat d'affrètement coque nue, le fréteur s'engage, contre paiement d'un loyer, à mettre à la disposition d'un affruteur un navire déterminé, sans armement ni équipement ou avec un équipement et un armement incomplets pour un temps défini* (in English: “[b] y the bareboat charter contract, the charterer undertakes, against payment of rent, to place a specific vessel at the disposal of a charterer, without armament or equipment or with incomplete equipment and armament for a definite time”).

Although under English law there is no difference between bareboat and demise charters, under both Spanish and Italian law, it is well established that there are two

kinds of ship leasing: charter by demise (or gross charter) and bareboat charter (SAP IB 679/2006; Petit Lavall M<sup>a</sup>.V., 2015; Tullio, 2016). In both cases, the ship shall be delivered in a seaworthy condition and shall be armed and equipped. However, the fundamental difference between both figures revolves around the crew (Arroyo Martínez, 2015). Thus under Spanish or Italian laws, if the charterer receives the ship unmanned, we will be under a bareboat charter. In contrast, a charter by demise applies if, besides the transfer of the ship's possession, the charterer is subrogated in the crew's employment contracts entered by the shipowner. The latter is not very often used in practice, except in yachting, so that the agreement most frequently employed in the maritime industry is the bareboat charter (Petit Lavall M<sup>a</sup>.V., 2015). In this work, we will study the bareboat charter, that is, the hiring of a ship for a time when the shipowner provides only the ship. In contrast, the charterer provides the crew together with all stores and bunkers and pays all operating costs (See Brodie, 2013).

#### **Differences with other figures**

As seen, the bareboat charter agreement is defined as a lease of movable assets. It is precisely its legal nature that makes it possible to distinguish this type of contract from other similar ones, such as time and voyage charters (Bennett, 2017; Carlón, 1969). Therefore, under a bareboat charter party, besides the transfer of the ship's possession, both the master and the crew are hired by the charterer or become dependent on him (Bennett, 2017; Ruiz Soroa et al., 1989). By contrast, under a time charter agreement, there is no conveyance of the ship's possession. The captain and the crew remain under the shipowner's direction, at least as far as the ship's nautical management is concerned (Gabaldón García and Ruiz Soroa, 2006; Hofmeyr, 2017). To correctly delimit both figures, it is indeed necessary to establish which of the parties assumes the nautical and the commercial management of the ship, respectively. Under a bareboat charter party, the demise charterer assumes both the nautical and the commercial management.

Nevertheless, under a time charter agreement, the charterer will be responsible for the commercial management, while the owner retains the nautical management (*Scandinavia Trading Tanker Co AB v William Dickinson & Co Ltd (The Alresford)* [1942] 2 K.B. 65 at 69; Bennett, 2017; Pulido Begines, 2015). For its part, under a voyage charter agreement, there will be no conveyance of the ship's possession to the charterer, either, and the latter only acquires the right to use all or part of the ship to transport goods from one port to another. Besides, the charterer will not be responsible for either nautical or commercial management, which will both remain in the hands of the owner (*Whistler International Ltd v Kawasaki Kisen Kaisha Ltd (The Hill Harmony)* [2001] 1 A.C. 638 at 652; Arroyo Martínez, 2015; Bennett, 2017).

#### **The use of forms in bareboat charter parties: the BARECON standard agreement**

Despite the importance of this contract for the maritime industry, there is no bareboat charter agreement uniform international regulation. With the usually non-mandatory nature of the provisions in those jurisdictions with specific regulation of the demise charter, this has traditionally led the parties to take recourse to internationally accepted forms. The most well-known is the 'BARECON' Standard Agreement (Petit Lavall

M<sup>a</sup>.V., 2015; Arroyo Martínez, 2015), as adopted by BIMCO in 1974 and amended in 1989, 2001 and, finally, in 2017.

#### ***Historical development of the BARECON standard form***

The origins of these forms go back, as has been said, to the year 1974, when BIMCO, through its Documentation Committee, approved, in Cannes, two models of bareboat charter-parties known as *Bimco Standard Bareboat Charter Party*: 'BARECON A' and 'BARECON B' (Petit Lavall M<sup>a</sup>.V., 2015; García-Pita, 2005). The main difference between them was that the first one was intended for ships' hirings in use, while the second was created for leasing of ships under construction, financed through a ship mortgage (Petit Lavall M<sup>a</sup>.V., 2015; Gabaldón García and Ruiz Soroa, 2006). These forms were made up of three parts: The first one contained a series of boxes to be completed by the parties, which included the contract's particularities, and in the presence of any inconsistency with Part II, the parties agreed on the validity of this part's provisions. It is in the second part that the contract conditions are detailed. Finally, an optional purchase clause was established in Part III at the end of the contract (Gorina Ysern, 1986; González-Lebrero, 1998).

The changes occurring in the shipping market, especially those concerning flagging-out, led BIMCO to approve in Hamburg, in 1989, a new form: The Baltic and International Maritime Conference (BIMCO) Standard Bareboat Charter, known as 'BARECON 89' (González-Lebrero, 2015; Davis, 2005). In this form, the differentiation between ships in use and ships under construction financed by a ship mortgage disappeared, leaving all the bareboat charters included under the same form (Petit Lavall M<sup>a</sup>.V., 2015; Arroyo Martínez, 2015). This new form consisted of five parts. Similarly to the previous document, Parts I and II included a brief description of the contract's content and the general contract clauses, respectfully. Part III regulated the assumption of the leasing of ships under construction. Part IV established a sale option. Finally, Part V contained a series of provisions that applied for vessels registered in a bareboat charter registry (González-Lebrero, 1998; Hofmeyr, 2017).

In 2001, BIMCO carried out a new update and approved the 'BARECON 2001'. This became the most complete and appropriate form for the needs of this type of contract. Consequently, it has been the most used form in practice since its approval (Petit Lavall M<sup>a</sup>.V., 2015; Davis, 2005). 'BARECON 2001' was an update of 'BARECON 89' and maintained the same structure. The main novelties were the 'Indemnity', 'Termination', 'Repossession' and 'Dispute Resolution' clauses.

#### ***The most recent BARECON standard form***

In 2017, sixteen years after its last modification, BIMCO drafted a new form, the 'BARECON 2017', to reflect an updated commercial practice image, and include advances in legal matters. The drafting of this new form, which was published in December 2017, was mainly motivated by the decision of the United Kingdom Supreme Court in *The Ocean Victory* case. The decision issued a few months before, in May 2017, dealt, inter alia, with the insurance clause of the 'BARECON 89' form. The new form maintains the structure of its predecessors. However, in addition to the novelties introduced in the insurance clause, which are the most relevant, the 'BARECON 2017' also includes another series of

novelties: charter period, latent defects, delivery conditions, familiarisation, inspections and maintenance.

Firstly, regarding the charter period, 'BARECON 2017' clause 2 adds a new section (b) that allows the charterer to extend the charter period. In any case, this decision must be communicated to the owner in writing, with due notice, and both parties must agree.

Secondly, if within 12 months after the agreement (or within the term agreed between the parties), a latent defect arises, the shipowner will have to bear the repair costs caused by such defects (cl. 3) (See Hofmeyr, 2017). However, until this latter form, BARECON did not define what is meant by a latent defect. Contrarily, the BARECON 2017 introduces as a novelty such definition. According to Clause 1, a "*latent defect means a defect which could not be discovered on such an examination as a reasonably careful skilled person would make*". Therefore, it seems that the new form follows the definition offered by Porter J in *Charles Brown & Co Ltd v Nitrate Producers' Steamship Co Ltd* (1937) 58 Ll.L.Rep. 188.

Thirdly, the novelty introduced regarding the obligation to deliver the ship in a seaworthy condition stands out in terms of delivery conditions. In 'BARECON 89' and 'BARECON 2001' forms, the obligation mentioned above was configured as an obligation measured against reasonable diligence (García-Pita, 2005). In other words, there was no breach of the obligation to deliver the ship in a seaworthy condition if the owner could demonstrate that he acted diligently. The clause established that "*[t] he Owners shall before and at the time of delivery exercise due diligence to make the Vessel seaworthy and in every respect ready in hull, machinery and equipment for service under this Charter*". However, after the approval of 'BARECON 2017', the above changes in Clause 3 (a) now states in its first section that "*[t] he Owners shall deliver the Vessel in a seaworthy condition and in every respect ready for service under this Charter Party and in accordance with the particulars stated in Boxes 4 to 6*".

Fourthly, the new form introduces a 'familiarisation' clause, under which "*[t] he Charterers shall have the right to place a maximum of two (2) representatives on board the Vessel at their sole risk and expense for a reasonable period prior to the delivery of the Vessel*". Likewise, "*[t] he Owners shall have the right to place a maximum of two (2) representatives on board the Vessel at their sole risk and expense for a reasonable period prior to the redelivery of the Vessel*".

Fifthly, in bareboat charter agreements, it is planned to carry out inspections in the vessel. They are known as 'on hire survey' if it occurs when the vessel is delivered or 'off-hire survey' if it is performed when the vessel is redelivered. Through these inspections, the charterer or the owner verifies the condition of the vessel. These inspections are included in BARECON forms. However, the new form introduces a relevant novelty. The 'BARECON 2017' allows underwater inspections to be carried out to verify the good condition of the rudder, propeller, bottom and other underwater parts of the vessel [cl. 7 (b)].

Finally, regarding the maintenance obligation, the new standard form contractually provides that the charterer is responsible for maintaining and repairing the ship during the contract term. However, the charterer will not be responsible for paying for ship repairs if these are due to latent defects, normal tear and wear or structural damages. Regarding the latter, in the previous standard forms, the costs derived from structural changes and new equipment necessary for the ship's operation, due to class

requirements or mandatory regulations, had to be borne by both the owner and the charterer through a reasonable distribution. However, the 'BARECON 2017' replaces the previous provision and establishes two alternatives. In one of them, Clause 13 (b) (i), which is configured as the general rule, the costs would be assumed by the charterer. In the other alternative, Clause 13 (b) (ii), the parties establish an amount in the contract; if the costs are less than that amount, the charterer should bear them, while if the costs are greater, a formula is established to distribute them between the owner and the charterer.

### **Insurance clauses in bareboat charter parties**

The provisions on insurance are contained mainly in 'BARECON 2017' Clause 17, which envisages two types of insurance of interest to the parties. On the one hand, the hull and machinery (H&M) insurance, and on the other hand, the protection and indemnity (P&I) insurance. Hull and machinery policy protect the assured against the damages or losses caused to the ship, including its equipment, machinery, boilers, fixtures and fittings. On the other hand, P&I insurance is liability insurance covering the liability, both in contract and tort, of the shipowner or the charterer in case of damages caused to third parties. P&I insurance is characterised by the fact that, in many cases, the insurers are the owners and charterers themselves, who are grouped in a mutual society called P&I Club.

### **The obligation to take out insurance**

Marine insurance is the oldest of the insurance contracts, dates from the fourteenth century, and was born in Italy. However, the first regulation of marine insurance appears in the Ordinances of Barcelona's Magistrates of 1484, a compilation of customary uses (Ruiz Soroa et al., 1993). Furthermore, marine insurance is of great importance in the maritime industry, in general, and in charter parties in particular. For this reason, concerning bareboat charter agreements, the forms have traditionally established a clause regarding the obligation to take out and maintain insurances. In this sense, in its first version, model A of 'BARECON 1974' already established that the party obliged to procure insurance for the ship against both marine/war and indemnity risks was the bareboat charterer (Gorina Ysern, 1986; García-Pita, 2005). However, there was an alternative clause that, if included, imposed the obligation to take out H&M insurance on the shipowner, but the demise charterer was always responsible for contracting P&I insurance (Gorina Ysern, 1986). This same option was applied by the subsequent drafters of the BIMCO form in 1989, 2001 and 2017.

In this regard, Clause 17 (b) of 'BARECON 2017' establishes that: "*(i) During the Charter Period the Vessel shall be kept insured by the Charterers at their expense against hull and machinery, war and protection and indemnity risks (and any risks against which it is compulsory to insure for the operation of the Vessel, including maintaining financial security in accordance with subclause 13(c) (Financial Security))*". An alternative option is established in Clause 17 (c), according to which "*(d) uring the Charter Period the Vessel shall be kept insured by the Owners at their expense against hull and machinery and war risks. The Charterers shall progress claims for recovery against any third parties for the benefit of the Owners' and the Charterers' respective*

interests”, but that it “shall be kept insured by the Charterers at their expense against Protection and Indemnity risks (and any risks against which it is compulsory to insure for the operation of the Vessel, including maintaining financial security in accordance with subclause 13(c) (Financial Security))”. When the parties take none of these options (i.e., unless otherwise agreed), it shall be the charterer who shall take out all the insurances mentioned in the clause.

Indeed, the parties are free to select any one of the possibilities mentioned above. However, the literature has documented commercial and legal circumstances where insurance options under BARECON form may be more suitable. In this sense, there are at least three criteria on which the parties may rely upon when determining who has to procure insurance for the ship. They are 1) the criterion linked to the obligation of maintenance, 2) the criterion linked to the insurable interest, and 3) the criterion linked to the contract’s duration.

#### ***The criterion linked to the obligation of maintenance***

According to the first criterion, the clauses’ design is linked to the duty to maintain the ship. As seen, both the nautical and the commercial management of the vessel fall within the charterer’s responsibility. The logical consequence of the fact that the bareboat charterer is, during the term of the contract, the “de facto” owner is that he also assumes the maintenance and repair costs (Petit Lavall M<sup>a</sup>.V., 2015), and this is also the solution adopted in ‘BARECON 2017’ Clause 13(a). However, this obligation is limited in principle to damages produced because of the ship’s operation, and special rules are established for structural repairs and those due to the ship’s defect. Its natural wear and tear are also excluded (Pulido Begines, 2015; Girvin, 2017). To ensure adequate compliance with the maintenance obligation, the owner is allowed to carry out inspections on the ship during the term of the contract, as long as they do not affect the ship’s normal operation. The owner must bear the expenses incurred due to the survey (Clause 14) (Petit Lavall M<sup>a</sup>.V., 2015).

Furthermore, the bareboat charterer is bound to return the vessel in the same condition in which she was received. When the agreement is terminated, and the parties have not extended it, the charterer must therefore return the ship in the same condition and with the same qualities with which she was received, except, as seen, for normal wear and tear (Clause 10). Consequently, where the parties opt for the criterion linked to the obligation of maintenance, it is reasonable to place the obligation of insuring the vessel on the bareboat charterer (Gabaldón García and Ruiz Soroa, 2006).

#### ***The criterion linked to the insurable interest***

The second criterion links the obligation to insurance, not to maintenance, but with the insurable interest. Moreover, although the charterer is responsible for maintaining and repairing the ship, the owner must still guarantee that the charterer is entitled to the vessel’s peaceful enjoyment (Petit Lavall M<sup>a</sup>.V., 2015). In this sense, by virtue of the indemnity clause (Clause 22), the charterer must neither be disturbed by the exercise of maritime liens against the vessel nor by seizures derived from events before the bareboat charter agreement. If these were the case, the shipowner would have to adopt all reasonable measures to hold the charterer harmless, who will have the right to be

compensated for breach of a warranty (Pulido Begines, 2015). Furthermore, the demise charterer has a lien on the ship for those amounts paid in advance to the owner that the latter is not entitled to collect (Clause 20).

Arguably, both parties to the charter agreement have insurable interests related to the ship: They have obligations that, although they are different, are similar in their material scope. Indeed, according to MIA Section 5(1), it has an insurable interest “every person [...] who is interested in a marine adventure”. In particular, Section 5(2) establishes that “a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof”. Thus, given that the shipowner and the charterer can both be affected in their assets by claims, which are potentially burdensome for each of them, it can be said that both parties are holders of insurable interest (García-Pita, 2005; Gilman et al., 2018).

The question then is who has the main interest in each case, since it should arguably be him who has to insure the vessel against the risks that affect this particular interest. Indeed, the insurable interest of the shipowner is proprietary: he is the owner of the ship. On the contrary, that of the demise charterer is probably his desire not to be liable to the owner in case of damage to or the vessel’s loss (Aikens, 2017; Blackburn and Dinsmore, 2018). Although it seems logical to cover such interest with recourse to liability insurance, it can also be insured under a hull policy (See *Feasey v Sun Life Ass Corp of Canada* [2003] EWCA Civ 885). Indeed, considering the literal wording of ‘BARECON 2017’ Clause 17, the intention of the parties arguably is that the liability of the charterer *vis-à-vis* the owner is covered by the hull policy, while the P&I insurance would cover the liability of the former (and the owner) to third parties.

Besides, during the contract term, the charterer may be held liable to third parties for damages caused by himself and his agents and servants, both in contract and tort (Petit Lavall M<sup>a</sup>.V., 2015). Such risks are included in the scope of coverage of P&I insurance (Hazelwood and Semark, 2013), which is why it is arguably the charterer who, as the party who faces them, should contract and maintain this insurance. However, there are occasions on which, even though it is the charterer who possesses the vessel, liability for the damage caused is attributed *ex lege* to the shipowner (García-Pita, 2005). This is the case, for example, concerning damages caused by oil pollution from tankers, which are also included among the risks insurable under P&I policies. However, even where the owner is *prima facie* liable for the damage caused to third parties, he will have an action against whoever is responsible for the loss, which, in the present case, will usually be the charterer, as he is in charge of the nautical management of the ship. Consequently, if the parties chose this criterion, it would seem logical that the owner should be responsible for contracting and maintaining H&M insurance, while the charterer would be under a duty to provide P&I insurance (García-Pita, 2005; Rodríguez, 1984).

#### ***The criterion linked to the duration of the contract***

Finally, the last criterion that may assist the parties when determining who is responsible for contracting insurances is linked to the contract’s duration. In this sense,

according to BIMCO the owner should be responsible for insuring the vessel against the hull, machinery and war risks in those cases in which the ship is chartered for short periods, between four and six months (e.g. cruise ships and ferries). In all other cases, it would be the charterer who would be obliged to contract insurances. (Petit Lavall M<sup>a</sup>.V., 2015; Davis, 2005). In the author's opinion, this criterion seems logical because it is normal for the shipowner to have already assured the ship before the demise charter is agreed. For this reason, it seems more reasonable for the interests of the parties, both from an economic and practical point of view, that, in short-term contracts, the ship stays insured by the owner, without prejudice that the latter passes on the insurance cost to the charterer through an increase in the hire. Indeed, since there is previous hull insurance arranged by the shipowner, it would make no sense that the charterer would have to arrange an identical hull policy. Neither would it be practical for the owner to terminate or interrupt his insurance policy for a four to six months period. Indeed, after finishing the charter agreement, he would have to arrange another policy again. Therefore, under short-term contracts, the most reasonable option is that the owner is the party who shall contract the hull insurance, without prejudice to who will have to pay for the premiums.

#### **The breach of the duty to take out and maintain the insurances**

Be that as it may, whoever is the party responsible for taking out and maintaining the insurance, the breach of such obligation will give the innocent party the right to repudiate the charter party (cl. 31(a)(ii)(2)) and sue for damages (Gorina Ysern, 1986). English literature and case law has established that the injured party is entitled to terminate the contract if the contract expressly envisages this consequence or, failing that when it derives from the content of the contract (*Grand China Logistics Holding (Group) v Spar Shipping AS* [2016] EWCA Civ 982,). Otherwise, it should be considered an innominate or intermediate-term (*Bunge Corp v Tradax Export SA* [1981] 1 W.L.R.), so that the intention of the parties when they concluded the contract has to be taken into account (Sarll, 2017). However, as seen, the 'BARECON 2017' Standard Agreement expressly provides that the obligation to take out and maintain the insurance is a condition, so any breach in this regard will give the other party the right to terminate the bareboat charter.

The situation is different when, without fault of the parties to the charter agreement, the insurer does not pay the compensation due, even though the risk is covered by the policy; for example, in the event of insolvency of the underwriters. In this regard, it appears to be necessary to distinguish between two cases, depending on when the insolvency occurs: before or after the casualty. In the first case, the insolvency of the insurer before the casualty arguably entails a breach of the 'insurance' clause, since it requires not only to take out insurance, but also to maintain it during the term of the contract (Blackburn and Dinsmore, 2018; Gürses, 2017).

On the other hand, if bankruptcy occurs after the casualty, the obligation to maintain the insurance should not be considered to have been breached, given that – at least after the total loss of the ship – the bareboat charter agreement is deemed to be terminated (cl. 31 (c)). The termination of the contract also implies the termination of the obligation to take out and maintain the insurance (*Gard Marine and Energy Ltd & Anor v China National Chartering Company Ltd & Anor* [2017] UKSC 35) (which,

furthermore, could no longer be made effective, as the risk intended to be covered had previously materialised). Accordingly, if the insolvency occurs after the loss, liability lies with the party who causes such loss (*The Ocean Victory* [2017] UKSC 35).

A different situation would arise in case of partial loss, i.e. the ship is simply damaged, and the cost of repairing such damages is less than the sum insured. On the one hand, the charterer would have to compensate for the damages caused (without insurance, given the underwriters' insolvency). This is so because, under 'BARECON 2017' clause 13(a), the charterer is responsible for the vessel's maintenance and repairs during the contract term. On the other hand, since the contract is still in force, it may also be considered to have been breached by the party responsible for contracting and maintaining the insurance, by virtue of clause 17, from the moment at which the insolvency is known to the party obliged to take out the insurance (*The Ocean Victory* [2017] UKSC 35).

### **Subrogation of the insurer**

Another issue that arises concerning the insurance clause is that of the subrogation of the insurer. Subrogation is an institution whereby the underwriters acquire the rights and remedies the insured may have against the persons responsible for the damage or loss, once compensation has been paid, up to the limit of that compensation.

Accordingly, for the subrogation of the insurer to occur, two conditions are necessary: (i) that the underwriters compensate the insured for the damage suffered in the subject-matter insured (Tato, 2002), and (ii) that there is a third party who is responsible for causing the damage compensated by the insurer (Martín Osante, 2012). Concerning road transport insurance, the Spanish literature occasionally adds a third condition: the underwriters' willingness to subrogate to the insured's rights and remedies. However, concerning marine insurance, it is considered unanimously accepted that subrogation operates *ipso iure* (Arroyo Martínez and Rueda Martínez, 2017; Romero Matute, 2018). In any case, it does not seem to be very relevant as to the fact that subrogation is not an obligation but an insurers' right.

A particular problem that may arise about the insurer's subrogation in the bareboat charter agreements is the one that occurs when both owner and charterer are insured jointly under composite insurance. In the event of a casualty, the charterer is responsible for loss of or damages to the ship. This has been a controversial issue over the years because the parties' insurable interests under a bareboat charter agreement are different, at least in what the hull insurance is concerned. While the shipowner's insurable interest is the ship's property, that of the charterer lies in the desire not to be held liable vis-à-vis the owner in the event of the ship's damage or loss. Consequently, the situation is not that of joint insurance but that of composite insurance.

We are under a joint policy when the insurable interests of the parties in the subject matter insured are the same. It would be the case of co-ownership, where all insured parties would have the same insurable interest (i.e. a proprietary interest) In those cases all co-insureds are exposed to the same risks and they suffer a joint loss when a casualty due to an insured peril occurs (Gürses, 2016). Consequently, it is considered that the co-insureds' rights and obligations are indivisible (Merkin and Stuart-Smith, 2004; Dewar, 2011), and any damage or loss affects them all. Likewise, any of the co-insureds' negligence or fraud will affect all of them, regardless of who caused the damage (Clarke,

2014). Conversely, where the insurable interests are different (as it happens, for example, in a bareboat charter, where the insurable interests of both the shipowner and the bareboat charterer are different), the situation is that of composite insurance. In these cases, despite the fact that the parties are insured under the same policy, it is held that there are as many insurance contracts as insurable interests. Therefore, each party retains its rights and obligations (*Eide UK Ltd & Anor v Lowndes Lambert Group Ltd & Anor* [1997] EWCA Civ 3005.). For that reason, it is considered that the breach or fraud of one of the parties does not affect the other co-insured(s) (Harris, 2011).

Regarding this issue, English literature and jurisprudence have developed three doctrines to solve it: the theory of circuity of action, the theory of the implicit term in the insurance contract, and the doctrine of the construction of the main contract.

#### ***The theory of circuity of action***

According to the *theory of circuity of action*, under a joint or a composite policy, the insurer cannot recover the co-insured' compensation from who caused the damage. This is so because the amount that the insurer could claim by way of subrogation would be the same as that the co-insured charterer could request from the insurer under the hull insurance policy (which, as shown above, also arguably covers his interest in not being held liable vis-à vis the owner) (*The Yasin* [1979] 2 Lloyd's Rep. 45; *Petrofina (UK) Ltd v Magnaload Ltd* [1983] 2 Lloyd's Rep. 91). For this theory to apply, two conditions must be met: (i) identity between the parties that are claiming; and (ii) that the amounts which are reciprocally claimed are the same (Rose, 2013; Jing, 2016).

However, given that the insurable interest of the charterer (in avoiding liability to the owner) can be insured both under a P&I and a hull policy, if the latter only covered the owner's proprietary interest but not the charterer's liability causing the damage, his interest would not be insured under the H&M insurance. If the bareboat charterer is responsible for the casualty, the insurer could proceed against him once the compensation has been paid to the owner. Therefore, in those insurance contracts in which the only insured interest is the ship's ownership (proprietary interest), the theory of 'circuity of action' would not prevent the insurer's subrogation (Gürses, 2016). Likewise, in cases where the sum insured is less than the damage caused, the circuity of action would not prevent the insurer from claiming the amount of those damages not covered by the policy.

#### ***The theory of the implicit term in the insurance contract***

Due to the limitations of the 'circuity of action' doctrine, a second theory arose by which, in the event of composite insurance, the insurer cannot take the position of the owner and claim against the co-insured charterer because the insurance contract itself prevents him from doing so (Mead, 1998; Thomas, 2016). In this sense, in *Stone Vickers Ltd v Appledore Ferguson Shipbuilders Ltd* [1992] 2 Lloyd's Rep. 578, the High Court held that in cases where the party in breach appears in the insurance policy as co-insured and has an interest in the vessel, the insurer cannot exercise the right of subrogation against the co-insured who caused the damage or loss. The Court understood that there is an implicit term in the insurance contract under which the insurer waives

the right to exercise such remedy. A couple of years later, the same judge upheld the 'implicit term' theory in *National Oilwell v Davy Offshore* [1993] 2 Lloyd's Rep. 582.

#### ***The theory of the construction of the main contract***

Subsequently, in *Co-operative Retail Services v Taylor Young Partnership* [2002] UKHL 17, the then House of Lords confirmed, albeit in obiter dictum, the opinion expressed in *Hopewell Project Management*. Nevertheless, the Court held that the explanation for the underwriters' lack of standing was rather to be found in the underlying contract. In other words, the House of Lords held that there was an implicit term in the main contract, by virtue of which the co-insured parties waived the right to claim from each other the damages covered by the insurance policy (Gürses, 2016). Thus, a third theory was born, that of the 'construction of the main contract'. According to this theory, to decide whether or not the insurer can be subrogated into the owner's rights, it is necessary to analyse the parties' provisions in the main or underlying contract, in this case, the bareboat charter agreement. If the liability between the parties is excluded, either explicitly or implicitly (Merkin and Stuart-Smith, 2004; Lowry et al., 2011), such exclusion affects the insurer, who will then lack standing to sue. Conversely, if the liability between the parties is not excluded, there will be no impediment, in principle, for the insurer to bring a subrogated claim against the co-insured who caused the loss (Gürses, 2016; Ter Haar, et al., 2016).

### **THE OCEAN VICTORY CASE and its implications in the new BARECON 2017 standard agreement**

#### **Case background**

The above problem, i.e., the possibility of the shipowners' insurer to claim against the co-insured charterer, seemed to be solved by the UK Supreme Court in the *Gard Marine and Energy Ltd & Anor v China National Chartering Company Ltd & Anor* case. In this case, the registered owner, Ocean Victory Maritime Inc. (hereinafter, 'OVM'), entered, on June 8, 2005, into a bareboat charter agreement with a related company, Ocean Line Holdings Ltd. (hereinafter, 'OLH'), for the ship Ocean Victory. This contract was based on the Barecon 89 model. OLH, in its turn, entered into a time charter agreement with China National Chartering Co Ltd. ('Sinochart') on August 2, 2006, who, subsequently, entered into another charter contract with Daiichi Chuo Kisen Kaisha (hereinafter, 'Daiichi'), on September 13, 2006. All the charter contracts mentioned above contained an undertaking that the vessel could only enter 'safe ports'.

The controversy arose because, in 2006, when trying to leave the port of Kashima (Japan) during a storm, the Ocean Victory ran aground and split in half. After this incident, on October 15, 2008, the insurer of both the owner and the bareboat charter, Gard Marine & Energy Ltd. (hereinafter 'Gard'), after paying OLH and OVM the corresponding compensation, claimed against Sinochart – who, in turn, initiated proceedings against Daiichi as the last charterer in the chain – for the damages caused by the breach of the 'safe port' clause' included in the charter-parties.

In the first instance, the judge held that the incident was caused by a breach of the 'safe port' clause and, consequently, ordered the charterers to compensate Gard for 103.2 million dollars. However, the Court of Appeal subsequently departed from the

trial judge's opinion. The Court of Appeal considered that Kashima was a 'safe port', meaning that the charterers had not incurred a contract breach. Furthermore, the Court established that OVM and OLH, and, consequently, Gard as their insurer, had no right to claim the ship's insurer's amount covered.

Gard once again appealed the judgment to the Supreme Court, questioning, in this regard, whether clause 12 of the Barecon 89 form, under which both the owner and the charterer appear as co-insured, implies a waiver of the right of subrogation by the insurer in the action against the charterer for breach of the 'safe port' clause. The waiver of rights between the parties of a contract has traditionally been a controversial issue due to the ambiguity of the word 'waiver' and its different meanings. In this sense, the notion of this concept has been addressed previously by the House of Lords in *Motor Oil Hellas (Corinth) Refineries S.A. v Shipping Corporation of India (The Kanchenjunga)* ([1990] 1 Lloyd's Rep 391). In this sense, the question raised in *The Ocean Victory* case is whether or not the fact that the shipowner and the charterer appear as co-insureds under the same policy meets the conditions to be considered a waiver of rights between them.

#### **The judgment of the united Kingdom supreme court**

To answer this question, the Supreme Court, which analysed the problem in *obiter dictum*, given that there was not a breach of the 'safe port' clause, eventually opted for the theory of the 'construction of the main contract', which makes it necessary to analyse the provision made by the parties in the underlying or main contract, in this case, in the bareboat charter agreement. Thus, if liability between the parties were excluded, either explicitly or implicitly, such exclusion would affect the insurer, who will then lack standing to sue. Conversely, if the underlying contract did not exclude liability between the parties, there would be no legal impediment, at least initially, for the insurer to claim in subrogation against the co-insured who caused the loss.

When applying the construction of the main contract theory to this case, the majority held that the insurer was not entitled to subrogate in the owner's position and claim against the charterer. The reason for this decision had to be sought in clause 12 of the 'BARECON 89' form. This clause set up an exhaustive code of rights and obligations of the parties, in which the owner and the charterer appear as co-insured. Moreover, following an interpretation of the contract as a whole, the co-insureds' liability among themselves is excluded. Indeed, the contract interpretation led the majority to conclude that the parties intended to try to obtain, in the event of an insured loss, compensation for damages exclusively from the insurer, thus excluding any liability that may exist between owner and charterer for breach of the charter party.

However, the decision was not unanimous among the judges of the Court. On the one hand, Lord Clarke, following the Court of Appeal's decision in *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars Ltd*, understood that excluding the liability of the charterer must be expressly established in the contract. The absence of such express provision would imply that the parties intended that the charterer could be held liable to the owner for the breach of the 'safe port' clause (Aikens, 2017). On the other hand, Lord Sumption held that the express inclusion of a 'safe port' clause implied that the liability between the parties in case of a breach would also have to be expressly excluded. Consequently, in the absence of the previous waiver, the lack of

standing of the insurer was not due to the exclusion of liability between the parties but rather to the fact that, since both parties were jointly insured, the payment of compensation by the insurer satisfied the charterer's liability (Blackburn and Dinsmore, 2018).

Although for the bareboat charterer himself, the consequences of one or the other approaches are not very relevant unless the compensation paid by the insurer is lower than the amount of the damage caused (under-insurance). In the absence of charterer's contractual liability, which is the solution advocated for by the majority of the Court, entails, in its turn, the irresponsibility of the time charterers and sub-charterers. On the contrary, if the opinion expressed in the dissenting votes were to be followed, there would be an action for liability against the charterer, which, once satisfied by the insurer, would allow the latter to bring a subrogated claim against the subsequent (time) charterers and sub-charterers who were not insured under the hull policy.

#### **Subrogation of the insurer in the BARECON 2017 standard agreement**

When drawing up the new 'BARECON 2017' Standard Agreement, BIMCO appears to have considered the Supreme Court's decision, as well as the arguments put forward by Lord Sumption. Indeed, the current 'BARECON 2017' clause 17(a) establishes a series of general provisions that apply regardless of whom is responsible for taking out the insurance.

As a novelty, the clause clearly establishes that the mere fact that the parties appear as co-insureds in the hull policy does not imply an exclusion of their liability in the contract. Thus, the insurer's compensation to the owner for the damage caused to the ship shall only imply satisfaction, but not exclusion or discharge of the charterer's liability towards the owner. Furthermore, to prevent any interpretative doubt, the 'BARECON 2017' expressly establishes that the insurer's payment does not prevent the owner from bringing a claim against the charterer, nor the insurer itself from bringing such claim by way of subrogation.

The new clause also appears to answer the question regarding the insurer's standing to bring a subrogated claim against the subsequent charterers and sub-charterers, which would now be feasible. Thus, in those bareboat charters in which the parties are subject to the 'BARECON 2017' provisions, if a casualty occurs, both owners and charterers, and their insurers suing in subrogation, may bring a claim against those who are third parties concerning the demise charter agreement.

However, it does not seem to solve, at least completely, the problem of subrogation in the contractual rights that stem from the demise charter itself. Although the liability of the charterer who causes the damage is not excluded in the underlying contract, the insurer would arguably still be deprived of the right to subrogate under the other two theories mentioned, i.e., the theory of circuity of action and the theory of the implicit term in the insurance contract. On the one hand, the insurer would, in principle, be entitled to claim in subrogation against the charterer who caused the loss. However, the latter would still be insured by the person who tries to claim from him. As a consequence, a "circuity of action" would probably arise and, therefore, the insurer would be deprived of the right to claim against the wrongdoer charterer.

On the other hand, the insurer's subrogation into the owner's claims against the co-insured charterer would arguably be considered waived, under the theory mentioned

above of the implied term in the insurance contract. However, in the opinion of the author, this interpretation is not incompatible with the terms of 'BARECON 2017', which in clause 17(a)(ii) establishes that payment by the insurer shall be no bar to a claim for indemnity against the charterer by way of subrogation. Indeed, the clause does not prevent, but neither does it recognise, at least expressly, a claim against the co-insured wrongdoer by way of subrogation. Since the demise charter is for the insurer *res inter alios acta*, nothing therein should prevent the latter from explicitly or implicitly waiving the right to subrogate.

Regarding the subjects who contract with the charterer, for example, a time charterer, the solution is necessarily different. Once the damages to the owner have been paid on behalf of the bareboat charterer, there should be no obstacle for the insurer to subrogate into the position of the co-insured charterer and claim against the sub-charterer in breach, who doubtlessly is a 'third party' concerning the H&M insurance. However, it appears reasonable that if the co-insured demise charterer decided to claim loss of profit, which is not covered by the hull policy (Merkin et al., 2010), or if the insurance did not cover all the damages, his claim for supplementary damages from the time charterer or other third party would arguably have preference over the insurer's subrogated claim (Romero Matute, 2018).

Finally, regarding the practical implications of this new clause, it does not seem that, concerning the bareboat charter parties, beyond clarifying the question of the charterer's liability against the owner, it does not seem that it will have significant consequences. Although the liability between both the owner and the charterer is not excluded, the insurer continues to have no standing to sue by way of subrogation *vis-à-vis* the charterer. However, this change will entail an obvious advantage for the insurer. Indeed, since the liability between the parties is not excluded but is simply satisfied, the insurer will claim against charterers and sub-charterers who are not insured under the composite insurance. Consequently, 'BARECON 2017' Clause 17 seems to clarify (i) the problem regarding the insurer's subrogation in cases of composite insurance and (ii) the insurer's standing to bring a subrogated claim against charterers and sub-charterers. For these reasons, this new form is expected to be very frequently used from now on.

## Conclusions

Regarding the obligation to take out and maintain insurances, the new BARECON form does not introduce significant changes. Still, it enables the parties to choose between the following alternatives: that the charterer shall be responsible for taking out and paying for both hull, machinery, and P&I insurance; or that he is only under an obligation to contract the latter, while the owner is obliged to contract the H&M policy. Although the parties are free to choose the option that suits them best, three basic criteria may influence their decision: the criterion linked to the maintenance obligation; the criterion linked to the insurable interest; and the criterion linked to the demise's duration charter. In any case, unless otherwise agreed, it will be the charterer who is obliged to take out and maintain both insurance policies.

However, the BARECON insurance clause has been modified because of the UK Supreme Court's judgment in *The Ocean Victory* case. It now establishes that when the parties appear as co-insureds in the H&M insurance policy, that does not exclude their liability for breach of the charter party. Consequently, it does not prevent, in principle,

the subrogation of the insurer into the rights of the owner. However, the hull insurer will arguably have no claim against the charterer through subrogation since there would be a 'circuitry of action'. Likewise, since the insurance clause does not expressly recognise the insurer's right of subrogation but simply does not exclude it, the insurer will arguably still be deprived of the right to subrogate under the theory of the implicit term in the insurance contract.

Conversely, as provided in 'BARECON 2017' Clause 17, once the owner (and the charterer) has (have) been compensated for all the damages caused, the insurer is subrogated into his rights and can claim against the sub-charterer(s) who caused the damage or loss. However, if the demise charterer has suffered damages that are not covered by the policy, he will arguably have priority over the insurer when claiming compensation from the (sub-)charterer who is responsible for the casualty.

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