Liability of Classification Societies: An Evolving Dilemma

By

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Classification Societies have enjoyed as much popularity and acclaim in key areas of the shipping world as the Australian Prime Minister recently achieved with the "popular press" on his recent visit to London.

In years gone by, those societies belonging to the International Association of Classification Societies were widely regarded as prestigious and authoritative bodies. Non-IACS societies were seen as more questionable, but the IACS members were well reputed. Now, even the reputable IACS Societies have been criticized by insurers, and even government!

In the "Ships of Shame" report issued by the Parliament of the Commonwealth of Australia in December 1992,[1] the 12 Classification Societies authorised by the Government of Panama to act on its behalf in administration of load line matters were described as Societies with "a limited expertise". The Government noted that:

> "The one sure thing about the standard of many non IACS classification societies participating in the international shipping industry is that it is not good." (p. 54).

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1. Inquiry into Ship Safety. Report from the House of Representatives Standing Committee and Transport Communications and Infrastructure, Australian Government Publishing Service, Canberra December 1992.

Criticism was not limited, however, to non-IACS Societies.

The Parliamentary Committee responsible for the report noted "... it is apparent that many of those Classification Societies outside IACS and even some members of IACS are not carrying out their functions adequately." The Committee said (at page 53):

> "Put bluntly, ample evidence was put to the Committee that the quality of inspections has gone down as the intensity of competition for clients has gone up. The requirement for Classification Societies to accommodate both regulatory responsibility and the desire to respond to market pressures explains the decline in Classification survey standards."

This paper will consider the role of Classification Societies, the duties they perform, and under what circumstances they can or should be found liable for a breach of duty. Policy implications of changes in the legal rights and responsibilities of Classification Societies will also be considered.

Role

Most of the audience will be aware of the long and grand history of Classification Societies, commencing with

Lloyd's Register of Shipping which began operations in 1760.

Lloyd's Register evolved a set of rules which established minimum safety standards for the construction of ships, and a set of procedures to ensure that a ship is maintained appropriately. The standards applied by each Classification Society are known as its Rules and these form a basis of a vessel entering a particular class and maintaining class over time.

That a vessel is in class, and its class history, is material, from the viewpoint of hull underwriters. Class Certificates can also affect obligations under a charter party. For example, the description of a vessel's class on the Register of Ships constitutes a contractual condition that, at the time the charter party was made, the ship is classed as indicated **(Routh v. MacMillan, 159 E.R. 310)**.

Classification is also relied on by Government in the regulation of maritime safety. For example, Section 187BA of the **Navigation Act 1912** (Commonwealth) provides that the National Maritime Safety Authority may "approve, in writing, a standard Classification Certificate issued by a survey authority."

In Australia, 6 members of IACS are authorised to perform statutory surveys and issue Certificates under Section

187BA. According to the "Ships of Shame" report, they are:

American Bureau of Shipping

Bureau Veritas

Det Norske Veritas

Germanischer Lloyd

Lloyd's Register of Shipping

Nippon Kaiji Kyokai

Even though third parties may rely on Classification Society surveys, the "client" of the Classification Society is the ship owner who employs the Classification Society to approve a ship's construction plans, and various aspects of construction, and thereafter, to provide periodic surveys to certify that the ship remains in a satisfactory condition (i.e. maintains class).

The role of the Classification Society, summarised in the "Ships of Shame" report is "to verify, on behalf of the ship owner, the construction and ongoing standard of the vessel."

Duties

The duties of a Classification Society have been defined by the Courts. In **Great American Insurance v. Bureau Veritas (1973) 1 Lloyd's Law Reports 273,** Judge Tyler of the Southern District Court of New York held, in a subrogated claim by cargo owners against a Classification Society as follows:

> "What duties are owed by a Classification Society to its clientele? Although there is scant law on the subject, it can be reasoned that by undertaking to survey and classify a vessel, a Classification Society obligates itself to perform 2 duties with due care. The first duty ... is to survey and classify vessels in accordances with the rules and standards established and promulgated by the Society for that purpose. The second duty of a Classification Society is that of due care and detection of defects in the ships it surveys and the corollary of notification thereof to the owner and charterer."

The nature of the relationship between the vessel's owner and the Classification Society is intrinsically contractual. The duties owed by the Society to its client are specified in the agreement between them.

Typically, Classification Societies contract with owners on terms which exempt the Society from liability in the event of error on the part of its surveyor. For example, NKK issues reports which contain the following caveat:

> "This report is issued subject to the condition ... that neither the Society nor any of its Committees is under any circumstances whatever to be held responsible for any inaccuracy in

any report or Certificate issued by the Society for any error of judgment, default or negligence of its officers, surveyors or agents."

Under Australian law, any direct client of a Classification Society would be unable to obtain redress if the Society operating under such an exemption clause breached its duty under the contract, because the exemption clause would be construed under Australian law "according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears ..." **(Darlington Futures Limited. v. Delco Australia Pty Ltd) (1986) 161 CLR 500.**

The law determining the contractual duty of a Classification Society to its client ship owner is relatively straightforward, depending as it does on the terms of the agreement.

The more interesting issue, from a legal viewpoint, is the duty of a Classification Society to third parties. It is in this area that the modern case law on Classification Societies has evolved.

Recent Cases

(a) English decisions

The foundation for actions against Classification

Societies by third parties lies in the evolving law of negligent mis-statement, commencing with **Hedley Byrne v. Heller (1964) A.C. 465** and the Australian corollary **M.L.C. v. Evatt (1968) 122 C.L.R. 556.** Both decisions held that an adviser could be liable in certain circumstances for negligent advice given to a person who reasonably relied on that advice.

In **Mariola Marine Corporation v. Lloyd's Register of Shipping (The "Morning Watch") (1990) 1 Lloyd's Law Reports 547,** Mr Justice Phillips considered whether the defendant Classification Society owed a duty of care to persons other than owners and whether the Society was liable for losses sustained by a third party.

The "Morning Watch" was built in 1962 in compliance with the rules of Lloyd's Register of Shipping. Regular surveys were subsequently carried out in accordance with the Class rules; however, in October 1984, owners requested an early survey in anticipation of selling the vessel.

The Classification Society surveyor, who was already familiar with the vessel, prepared an interim certificate after a 3 day inspection. He listed certain repairs which would be required before the vessel could pass a special survey. The repairs dealt mainly with areas of corrosion.

Owners of "Morning Watch" offered the vessel for sale on terms including the following:

> "Always maintained to 100 A1 at Lloyd's .... Has passed current special survey (November 1984) with no difficulty so purchaser is spared expense of a survey."

The purchasers were given details of the survey position before making an offer to purchase the vessel "as is, where is"; however, the interim certificate issued by Lloyd's was not shown to the prospective purchaser, nor did the buyer ask for it.

The buyer made known its intention to refit the vessel and, following a meeting between the prospective purchaser and the surveyor, Lloyd's agreed to issue a new certificate provided that the new owners signed a letter confirming that 3 outstanding repairs would be dealt with during the proposed refit.

The surveyor then issued an interim certificate recommending the deferment of remaining repairs pending modifications. The purchase was completed and the vessel was slipped for repairs. When the deck planking was removed to permit the proposed modifications an area of corrosion was exposed. After further investigation, other areas of corrosion were also found.

The buyers sued Lloyd's Register, alleging that the vessel had been unseaworthy and that the corrosion should have been recorded on by the Lloyd's surveyor.

Mr Justice Phillips held as follows:

(i) When a Classification Society issues a class certificate, the Society can, by issuing the certificate, expressively or impliedly represent the condition of the vessel.

(ii) A duty of care may arise between the Society and the third party if it is reasonably foreseeable to the surveyor that a person will rely on the survey.

(iii) Lloyd's Register deliberately maintained a system of classification whereby parties other than the owners of vessels were expected to rely on the fact that the vessel was maintained in class, thereby providing an assurance that the vessel was maintained in good condition.

Notwithstanding the general principles enunciated by Mr Justice Phillips, he found Lloyd's Register was not liable because, on the facts of the case, there was not the necessary connection between the plaintiff and defendant to give rise to a duty of care. He said there was insufficient proximity between the purchaser and Lloyd's Register of Shipping to substantiate a claim.

There were 2 fundamental problems, from the perspective of the purchasers; first, they could not prove reliance on the surveyor's certificate when, as a matter of fact, they had not seen it before entering into the contract of sale. Secondly, they had suffered "pure economic loss" for which the English Courts would not allow recovery.

The second recent decision of the English Court is consistent with the reasoning in **"The Morning Watch"**. In **Marc Rich & Co AG v. Shiprock Marine Co Ltd & Ors (The "Nicholas H") (1992)** 2 Lloyd's Law Reports 481, Mr Justice Hirst considered the liability of NKK to owners of cargo which had been lost when "Nicholas H" sank with all its cargo.

Proceedings were issued by cargo interests against owners of the vessel and against NKK. The claim against owners was settled by reference to the limitation fund, and cargo interests claimed the balance of the loss from the Classification Society.

Mr Justice Hirst was asked to consider as a preliminary issue, whether NKK owed a duty of care to cargo interests which duty was capable of giving rise to liability and damages.

The background to the claim was as follows.

The "Nicholas H" was found to have cracks in her hull en route from South America to Italy fully laden. The NKK surveyor recommended that repairs be carried out at the nearest port prior to the vessel sailing to Italy. Owners resisted the surveyor's recommendation that immediate permanent repairs be carried out. They put the vessel into a nearby harbour and arranged temporary repairs which were then inspected by the same NKK surveyor.

> Following inspection the surveyor issued a report which included the recommendation that the vessel "..... proceed on the intended voyage to discharge port ... repairs now done to be further examined and dealt with as necessary ... at earliest opportunity after discharging present cargo ... further recommend vessel be retained as classed subject to above condition ...".

The vessel immediately sailed and on the following day the temporary repairs cracked. Further repairs attempted at sea failed and the vessel sank.

Mr Justice Hirst held that the criterion for determining the existence of a duty of care was the proximity test. He said:-

> "the proximity criterion is essential in the present case particularly since ... there is such a wide variety of circumstances where a party not in a contractual relationship with the NKK might seek to establish liability and where proximity provides a very valuable test for separating the sheep from the goats." (p.499).

Adopting the proximity test, he found a very close degree of proximity between the surveyor and cargo interests. He noted that the surveyor knew that the vessel was fully

loaded and therefore knew that if it was dangerous for the vessel to go to sea, the goods were just as likely to be damaged or lost as the vessel itself.

The Judge found that the surveyor must have appreciated that since the ship owner would almost inevitably accept the recommendation that he should sail, he was directly affecting the interests of cargo. Although he agreed that the surveyor had no actual direct physical control over the vessel in the sense that he could bar her from sailing, "the decisive influence upon the ship owners which .... the second recommendation must have had, and would reasonably be foreseen to have, is very closely akin to control." (p.500).

Having concluded that the requisite degree of proximity was made out, Mr Justice Hirst then considered whether there were public policy considerations which ought to preclude the finding of a duty of care to cargo interests. He rejected the argument that, if he found the possibility of liability on the part of the Classification Society, it would "open the floodgates".

In finding that NKK did owe cargo interests a duty of care capable of giving rise to a liability in damages, Mr Justice Hirst noted that this was a "one off" decision and he was confident that the proximity test would act as an adequate safeguard against extravagant consequences. He emphasized the uniqueness of the fact situation as the basis for his decision:

> "The fact that there is apparently no previous decision upholding a duty on the part of a Classification Society to a cargo owner may well be because there is no precedent for a situation such as exists under the present assumed facts." (p.500).

(b) U.S. cases

The American Courts have been active in considering the liability of Classification Societies in recent times. Proceedings were brought against the American Bureau of Shipping by passengers injured when the cruiseliner "Sundancer" ran aground and sank. The Federal Court in New York at first instance upheld the previous authority in **Great American Insurance v. Bureau Veritas,** and noted that a Classification Society Certificate was not an assurance to the ship owner that it had satisfied its non-delegable duty to provide a seaworthy vessel.

In finding for ABS, Judge Whitman Knapp accepted that the Society had immunity from prosecution under Bahamian law, which was applicable. He also found, as a matter of fact, that the failure by ABS to detect defects in a water of piping system which lacked non-return valves, and to find holes in a "watertight" bulkhead, was not negligent, as several organisations had surveyed the vessel at various times and none had spotted the defects.

The "Sundancer" decision is on Appeal, as is a more recent decision in which a US Court dismissed an action brought by survivors and dependents of victims of the fire on "Scandinavian Star" in the waters between Norway and Denmark in 1990. The plaintiffs had brought an action against Lloyd's Register, which had kept the vessel in class.

Again, under Bahamian law, which was held applicable, Lloyd's Register was entitled to immunity from prosecution. The Court also ruled that Florida, where the proceedings had been brought, was an inappropriate forum because most of the witnesses and evidence were in Scandinavia.

In summary, the U.S. courts have relied on an overiding principle of imposing a non-delegable duty of care on owners, taken together with a consideration of immunity clauses in contracts between owners and Societies to find in favour of Societies. Unfortunately as both recent cases are on appeal there is little benefit to be gained from speculating about the trend in U.S. law in this area, save to say that it appears to be surprisingly more conservative than the law emanating from the English Courts.

(c) Australian Law

There is no directly relevant case on point; however the Australian courts have been evolving Australian law on

negligent mis-statement for some time. This should be relevant in determining the likely approach to be taken by the Australian courts to the liability of Classification Societies.

The interesting feature of the judgment **The "Nicholas H"** is that Mr Justice Hirst considered, but rejected as inapplicable, the lynch pin Australian authority on negligent mis-statement in **Council of the Shire of Sutherland v. Heyman (1985) 157 C.L.R. 424.** Mr Justice Hirst noted that as **Shire of Sutherland** dealt with the claim for pure economic loss, its authority was not relevant to the facts before him, the loss suffered by cargo owners having been actual physical damage.

The Australian Courts have been more flexible than the English Courts in their approach to recovery of damages, including damages for pure economic loss, arising from negligent mis-statement.

In **Shaddock v. The Council of the City of Parramatta (1981-1982) 150 C.L.R. 225** the High Court held that damages for pure economic loss were recoverable from a municipal council which breached its duty to provide correct information in a certificate relating to road widening proposals affecting land. Developers who bought land in reliance on the certificate issued by the authority were awarded damages which put them in the same position as they would have been in had they not made the

purchase in reliance on the incorrect statement. The Court refrained from the resolving the difference of opinion between the majority and minority in **M.L.C. v. Evatt**, holding (per Gibbs, C J) that "in this branch of the law it seems desirable to .... avoid attempting to lay down comprehensive rules but rather to proceed cautiously, step by step."

Subsequently, the High Court, in a line of authorities, re-emphasized the twin tests of reasonable foreseeability and proximity in determining negligence claims. By relying on these twin tests, the Court was aware of the possibility of expanding the categories on negligence too quickly.

In **Shire of Sutherland v. Heyman**, Brennan, J held that, apart from the tests of reasonable foreseeability and proximity, a further brake should be applied. He indicated that the Courts should develop novel categories of negligence incrementally and by analogy with established categories, rather than by extending a **prima facie** duty of care restrained only by indefinable considerations designed to negative or reduce the scope of duty or the class to whom it is owed.

In addition to the common law on negligent mis-statement, there is a further Australian remedy available where a corporation engages in conduct that is misleading or deceptive or is likely to mislead or deceive (Section 52,

Trade Practices Act 1974 (Commonwealth). Further, Section 53 of the Trade Practices Act outlaws a corporation from "falsely representing goods which are of a particular standard, quality, value, grade, composition, style or model or have had a particular history or previous use". By Section 4(1) of the Act "goods" include ships.

In the writer's view, it is strongly arguable that an action would lie against a Classification Society under Section 52 and/or Section 53 of the **Trade Practices Act** in the event that the Society made a false and/or misleading representation in Australia about the class of a ship.

Trends in the Law: Dilemmas to be Resolved

In **Great American Insurance v. Bureau Veritas**, Mr Justice Tyler explained the U.S. Courts' reluctance to impose liability on Classification Societies as a reinforcement of the onerous duty imposed by the law on ship owners. He said:

> "The unstated policy underlying the decisions

> not to allow surveys and classifications to operate as defences to the duty of providing a seaworthy ship is clearly to preserve the ancient, absolute responsibility of an owner for the condition of his ship. This is evidenced by the fact that, were such surveys and classifications allowed to constitute a due diligence defence, the accountability of owners for the seaworthiness of their vessel for all practical purposes would evaporate."

This issue has been taken up recently in an excellent article by Russell Harling of Thomas Millers.[2] In discussing **The "Nicholas H"** he suggested that a second undesirable consequence of attributing liability to Classification Societies would be their assumption of the role of insurers of cargo.

The English Courts have sought to deal with the risks of expanding liability of Classification Societies by rigorously applying the proximity test and by assuming that it will save the Courts from expanding liability too widely and/or quickly; however, the Courts have not expressly grappled with the policy issues underlying claims against Classification Societies. In particular, they have not addressed the possible unintended consequences of shifting responsibility from owners to Classification Societies.

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2. The Liability of Classification Societies to Cargo Owners (1993) LMCLQ 1.

It is also arguable that the English Courts have not readily grappled with the issue of causation of loss in the two cases discussed. In **The "Morning Watch"** one might question why the Classification Society Certificate **could** have affected the purchasers' position when the vessel had been purchased on the usual shipment sale terms - "as is, where is."

Similarly, in **The "Nicholas H"** one can readily find a causal connection between the owners' decision to put to sea, and the loss of cargo; however, the chain of causation between the surveyor's decision to keep the vessel in class, and the loss of the cargo is more difficult to discern. Could it not be said that the owners' decision to continue the voyage constituted a **novus actus interveniens,** a supervening act of negligence, which broke any chain of causation between the surveyor's decision about the class of the vessel, and the ultimate loss of the cargo?

The first dilemma, if the legal liability of Classification Societies is expanded, is that it may have a consequential effect of diluting the heavy burden which the Courts rightly place on owners to maintain seaworthiness, and to act responsibly.

From a policy viewpoint, it is intrinsically undesirable to promote a shift of responsibility away from owners, given that they hold all of the relevant cards in their

hands when deciding on the use of their vessels. Whilst it is true to say that the hapless surveyor in the "**Nicholas H**" knew the risks associated with the vessel going to sea if unsafe, it is equally true to say that owners knew or should have known of the risks, and should not have put the vessel to sea in a questionable state.

From the viewpoint of Australian law, the path to imposing stricter liability on professional advisers has already been laid down by the Courts. Any Judge called upon to determine the liability of a Classification Society to a third party will be irresistably drawn down that path notwithstanding the policy desirability of reinforcing owners' responsibilities.

In medical negligence cases, the Courts have rejected the notion that the standard of care should be determined by the subjective standards of a particular profession. Instead, the Courts have held that they will impose their own rigorous, objective standards of care on the medical profession. For example, in **F v. R (1983) 33 S.A.S.R. 189,** the Full Court of the Supreme Court of South Australia said:

> "In many cases an approved professional practice ... will be decisive. But professions may adopt unreasonable practises. Practises may develop in professions ... not because they serve the interests of the clients, but because they protect the interests or convenience of

members of the profession. The Court has an obligation to scrutinize professional practises to ensure that they accord with the standard of reasonableness imposed by the law. ... the ultimate question ... is not whether the defendant's conduct accords with the practises of his profession ... but whether it conforms to a standard of reasonable care demanded by the law. (p.194)."

F v. R. recently received High Court endorsement in a well publicised decision on the duty of the doctor as advice giver **(Rogers v. Whitaker (1992) 175 C.L.R. 479).**

It is predictable that, as the law develops, there will be increasing tension between the widening scope of liability of professional advice givers such as Classification Societies, and the desirability of the law reinforcing the responsibility of parties for their own actions.

The second dilemma for the evolving law on the liability of Classification Societies lies in the conflict between the trend of the common law to expand the liability of professionals and the countervailing trend of statute law to impose tort reform. Statutory caps on damages have been imposed not only in a number of States in the US, but throughout Australia in relation to industrial and

motor vehicle accidents. (3)

The medical profession and auditors, in particular, have clamoured in the public domain for wider statutory limitation on liability. Auditors have argued that it is both unfair and unreasonable that they should, as the only "deep pocket" defendant in sight, shoulder the responsibility for major corporate losses. Similarly, obstetricians facing large damages payouts to brain damaged babies, have argued that the practise of obstetrics will, if it has not done so already, reach a crisis in which doctors will simply refuse to deliver babies if they are required to face expensive civil litigation.

Just as tort reform in the motor vehicle area has been hastened by the role of Government as the monopoly third party insurer, it is foreseeable that to the extent that Governments rely on Classification Societies for enforcement of maritime safety, Governments will be vulnerable to demands by Classification Societies for protection from large awards of damages. As it seems likely that Governments will become increasingly dependent on information supplied by Classification Societies because of the trend, worldwide, towards privatisation, the prospect for statutory intervention is clearly raised.

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3. For example, in the Transport Accident Act 1986 (Vic) victims of transport accidents are precluded from bringing claims for general damages assessable at around $30,000.00 and there is cap on general damages for pain and suffering and loss of enjoyment of life of around $300,000.

If Governments are to rely increasingly on Classification Societies for enforcement of maritime safety, the policy objective of Governments will be to promote the interests of Classification Societies as private standard enforcement agencies.

To the extent that Government is likely to be dependent on flourishing competent Classification Societies, the Government may well become politically vulnerable to a demand by Classification Societies for protection from large and onerous awards of damages.

In the next few years, the shipping community, in general, will rely to a greater degree than ever before, on Classification Societies, as the aging world fleet lurches towards finality. Notwithstanding the move by the London market to impose a structural condition warranty enforced through the Salvage Association in 1992, Hull Underwriters will continue to rely heavily on Class, as will P & I Clubs.

In this context, Classification Societies may be well placed to deflect the liability pendulum away from its current swing towards them.

currently about 30 classification societies, with 11 as members of IACS, with another 2 awaiting membership.

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The American New York Cos - all New York Cos - all 3 US Cos were in New York - Clarke says in other US jurisdictions Classification Societies would be found liable.

← Michael Challis says Class Societies ~45 have run only those cases they thought they could win – they have settled a no. of other cases.