ABC CONTAINERLINES
SOME ISSUES FOR INSURERS CONCERNING THE INSTITUTE CLAUSES FOR INSOLVENCY AND FINANCIAL DEFAULT

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ABC Containerline collapse: a NZ insurer's viewpoint

INTRODUCTION

News of the collapse of the ABC Containerline broke in New Zealand in April 1996. The 'Cornelis Verolme' was arrested in New Zealand on the 4th April. The vessel had been chased and boarded by the Auckland Police fast launch 'Deodar'. In command was NZ's very own derring-do McElroys, who - it was later reported by the Registrar of the High Court in Auckland - then swarmed on to the vessel's deck with the writ between their teeth.

The 'Cornelis Verolme' had cargo transferred on to her from the 'Martha II', arrested in Melbourne on February 15th, by a Norwegian bank, Den Norske Bank, for overdue mortgage payments. The NZ Shipping Gazette, on March 2nd, reported that there were over 200 containers of import cargo on board the 'Martha II' bound ultimately for NZ. In retrospect, the arrest of the 'Martha II' may have been the decisive moment for ABC, even although the vessel was not directly owned by ABC Containerline. She was owned by an associate company called Combo Carriers Luxembourg, owned by Mr. Rosenfeld.

On board the 'Cornelis Verolme', on arrival in NZ, were cargoes of sausage skins, Easter eggs, lawnmowers, fishing nets, industrial grade tyres, rope and onion bags, as well as other cargo. With the exception perhaps of the Easter eggs, which both missed their market and probably deteriorated in ambient temperatures, the cargoes in the main was not perishable, as befits a country that is effectively an exporter of primary products and an importer of the wherewithal to do so. However, the 'Brussels', which was arrested in Halifax, Nova Scotia, had NZ export meat and onions bound for Europe. New Zealand insurers were therefore presented with an inwards vessel at the final port of destination, and outgoing export cargo, comprised largely of perishables.

The collapse of ABC had been a singular event, although possibly only in the singularly short-term memories of insurance underwriters. It was certainly on a scale that affected the whole market, and it made most companies go scurrying for their Witherby's, the annually published collection of the Institute of London Underwriters Clauses.

Most cargo written in New Zealand, probably like Australia, is written through open covers, annually - adjustable policies, or from insurance facilities granted to freight forwarders and the like. Most of the insurance conditions are based on the Institute of London Underwriters clauses, issued in London. There was some initial considerable confusion as to the cover response.

This paper attempts to outline some of the issues raised in NZ, and their background. There was a marked lack of discussion amongst NZ insurers to find a common position. Perhaps this was because we were dealing with such a basic building block of our products that we felt a little foolish revealing any doubts in public. Perhaps I'm being too cynical. I personally remember feeling that sinking feeling at the outset when I realised that matching cover to expectations was not going to be easy.

Given that there was a lack of insurer co-operation or collusion, the general comments below about the NZ market and NZ insurers should be taken with an implicit warning that the atmosphere was each man for himself.

Basis of cover: the ILU clauses

The ILU clauses were rewritten in the 1980's when the London market bowed to both UNCTAD and judicial criticism of the SG policy format and the archaic wordings in use. These were more in tune with the days of sail and poor international communications, but

had the benefit of being judicially contested in many circumstances, so there was some semblance of certainty. However, since its introduction, the Institute Cargo Clauses (A) 1.1.82 has been largely successful in being clear and uncontested in its plain English format. But in some respects these clauses seemed to have aged, and some of that age was shown in the ABC Containerline collapse. (This 'aging' should not be over-emphasised; in fact an argument could be put forward that they have simply matured).

Since the 1980's, when the ILU revised their clauses, the world of international transportation has changed considerably. One example of the march of time has been the change to using reefer containers. The Institute Frozen Foods Clause (A) 1.1.86 covers temperature variation 'attributable to breakdown of refrigerating machinery resulting in its stoppage for a period of not less than 24 consecutive hours', which one assumes was drafted with only ships' refrigerated holds in mind.

The ICC(A) begins with a Risks Covered section, comprising of clauses 1, 2 and 3. Risks Clause 1 covers 'all risks of loss or damage to the subject-matter insured except as provided in 'exclusion clauses '4, 5, 6, and 7 below'. Clause 2 gives cover for General Average and Salvage charges (GA&S Clause 2); and clause 3 gives cover for the little used Both to Blame collision provision.

Unfortunately Risks Clause 1 of the ICC(A) does not identify clearly that it is <u>physical</u> loss or damage covered, although this is perhaps implied (but not absolutely clearly) by the words 'of' and 'to' in 'This insurance covers all risks of loss of or damage to the subject-matter insured...'

It was therefore argued that some consequential losses - such as expenses - are not excluded and therefore could conceivably see the light of day in the face of such hardship. In the early 1980's, consequential loss insurance in cargo underwriting was not as prevalent as it is today. Thus in the current underwriting environment today it is easier to see that logic. Above all, a court today, particularly in NZ, is more likely to see that logic if a claimant faces considerable losses. The previous All Risks Clauses, which originally stated 'All risks of loss or damage to' were quietly amended (I think in 1968) to include the 'of' as in "All risks of loss <u>of</u> or damage to' to stem any suggestion that the intention was to include any consequential losses.

The word 'loss' is used in GA&S clause 2 of the Risks Covered section is unqualified by an 'of' to denote a physical loss:

> 'This contract covers general average and salvage charges ... incurred to avoid or in connection with the avoidance of loss from any cause except those excluded by Clauses 4, 5, 6, and 7 or elsewhere in this insurance'

There is no attempt to exclude a non-physical proximate cause here, which would give rise to a valid claim for GA&S charges – but that is because the clause is giving cover for a specific indemnity.

The two basic Insolvency and Financial Default exclusion clauses in the ILU clauses

Exclusion clause 4.6 of the Institute Cargo Clauses (A) excludes insolvency and financial default of the vessel. The exclusion clause is very wide in its scope:

> In no case shall this insurance cover ...
> 4.6 loss damage or expense arising from insolvency or financial default of the owners managers charterers or operators of the vessel

Insolvency is a fairly straightforward circumstance to recognise, but financial default as a proximate cause could encompass a wide set of circumstances. Conceivably a cargo owner might be denied cover by this clause when a perfectly financially healthy shipping company

which has a dispute with a port authority over port dues at a scheduled transshipment port, resulting in the port withholding power to the vessel's refrigerated containers on shore.

This (unlikely) example assumes a Through Bill of Lading. The incident would presumably be within the terms the Hague-Visby tackle-to-tackle rule, as per *Mayhew Foods v OCL 1984 1 Lloyd's Reports 317*. In that case, a container of frozen poultry was shipped from a UK port, then discharged and stored for almost a week at Le Havre before being loaded on board another ship for Saudi Arabia. A single Through Bill of Lading covered the entire transit. On arrival in Jeddah, permission to discharge the container was refused because the contents had decayed. "Offensive juices were reported to be dripping from it". The temperature control on the container, instead of being set at -18°C was set at +2 to +4°C. The poultry was eventually sold as animal food. The miss-setting had occurred at the time of off-loading the container at Le Havre, and by the time the container was loaded on the vessel bound for Jeddah, the damage would have been done. It was held that land storage was in relation to and in connection with the carriage of the goods under the Through Bill of Lading, and the carrier was liable as per the Rules.

My example is not within the drafters' intention, but the point is that there are a wide set of circumstances under the umbrella of the carrier's financial default to which the cargo owner is exposed.

I note in *Hudson & Allen's "The Institute Clauses Handbook" 1st edition, 1986*, they state that:

> '[a] person is said to be insolvent when he unable to pay his debts in full. If that be the applicable definition in the context of this clause, "insolvency" would appear to be wider even than "financial default" and include the situation in which many shipowners or operators still manage to continue trading. It appears that the intention of the draftsmen was to exclude all types of claim for a recovery and forwarding of the goods arising from the abandonment of a voyage by shipowners and operators who had run out of funds while the voyage was still in being'.

The book goes on to state that the insolvency and financial default exclusion clause was new in 1982, and caused some resentment in some quarters when it was introduced:

> 'This clause was felt to bear particularly heavily upon the assured under an "all risks" policy, since it had been held that the unlawful detention of goods amounts to "conversion", thus founding a claim upon a policy against 'all risks"' - *London & Provincial leather Processes v. Hudson (1939) 64 Ll.L.Rep. 352.*

It appears that the drafters by this exclusion clause attempted to draw a firm bold line firmly between insuring cargo, a physical object somewhere in the transportation chain, and insuring a financial risk, that of the carrier. The latter risk was in the early 1980's definitely within the realm of commercial risks that the exporter and importer have to bear in international trade. Perhaps in those days that delineation was clearer; or perhaps the change in trade practice, brought about by the 1970's oil shock and the consequent quest for the cheapest freight rates through a myriad of inventive freight forwarders and NVOCCs, was not fully realised by underwriters and brokers alike. It is clearly the intention of the clause to encourage the use of reputable i.e. financially sound carriers, and exclude the consequences of choosing a cheaper alternative - perhaps even a large 'conference buster' such as ABC Containerline.

Another example of the harshness of the ICC(A) insolvency exclusion clause is the exposure to insolvent NVOCCs, which I understand has affected individual NZ insurers from time to time.

The type of cargo to be insured is within the ambit of a cargo underwriter's skill and knowledge during the annual negotiation; who carries that cargo from one country to another generally is not. The closest I personally I have seen is an underwriter inform his clients that there would be an increase in premium rates as a penalty for using a particular shipping

company, but that was because they were abysmal for recoveries, having a particularly gruesome arbitration clause and a hard-nosed attitude.

Are expenses incurred by the cargo interest because of the ocean carrier's insolvency covered?

The major issue that arose in NZ from discussions on the ABC Containerline episode concerned this exclusion clause 4.6 of the ICC(A) - it does exclude 'loss damage or expense', which implies that expense is otherwise covered under an All Risks policy. After all, the Risks Covered Clause does not specifically exclude consequential losses. But, cried NZ insurers, 'expense' in the exclusion clause relates to the cover given for general average and salvage 'charges' in GA&S Clause 2.

So much for plain English - 'expense' as a word does not appear in the Risks Covered clauses, except in an unrelated concept of the cost of defending a cargo owner's liability under the 'Both to Blame Collision' clause. It therefore fails to be considered as a loss or damage within '[t]his insurance covers all risks of loss of or damage to...'

No doubt a London practitioner of the black art of underwriting will state that that Risks Covered Clause only encompasses direct and immediate physical losses (or otherwise costs arising from GAs or salvage) as it has always been said to mean that in the London market. We use and tinker with these London clauses at our own peril in the Antipodes, where a court might be less inclined towards tradition and more towards *contra preferentum*. Certainly that London practitioner would say that the ILU clauses are for London and the rest of the world should note that the last clause of ICC(A), Clause 19, states 'This insurance is subject to English law and practice'.

The exclusion clause for delay, clause 4.5, states that 'loss damage or expense' - that expense word again - 'proximately caused by delay' does not apply to expenses under the Risks Covered clause 2, which grants cover for general average and salvage <u>charges</u>. The technical term 'charges' are then 'expenses'. Is a charge a sub-type of expense, or just a synonym? It is not immediately clear that this oblique reference in one exclusion clause defines that the only expenses covered under the entire ICC(A) are GA & S charges.

The conventional underwriting wisdom is that GA & S charges are synonymous with 'expenses', and that's all that's covered. That line of argument follows the UK's 1906 Marine Insurance Act's turn-of-the-century's phraseology which equates expenses to charges in the definitions of particular charges, salvage charges and so on. This statute was imported almost verbatim into NZ. Further, it should be noted that the ICC(A) Forwarding Charges Clause 12 seems to use the word 'charges' as a synonym for expense(s):

> Where as a result of the operation of a risk covered by this insurance, the insured transit is terminated at a port or place other than that to which the subject-matter is covered under this insurance, the Underwriters will reimburse the Assured for any extra charges properly and reasonably incurred in unloading storing and forwarding the subject-matter insured to the destination to which it is insured hereunder.
> This clause 12, which does not apply to general average or salvage charges, shall be subject to the exclusions contained in clauses 4, 5,6 and 7 above, and shall not include charges arising from the fault negligence insolvency or financial default of the Assured and their servants.

Because of the width of the carrier insolvency / financial exclusion clause 4.6 in ICC(A) for a loss - whether direct, physical or otherwise - proximately caused by the insolvency of the carrier, it was initially clear in insurers' minds that there was no cover for the hapless cargo owner if their cargo was insured under these ICC(A) clauses.

However, the word 'expense' that appears in most the Clause 4 exclusion clauses seems to have a wider meaning than merely GA & S charges in clause 2, if only that wider meaning is

apparent to a wider public. In the present highly competitive insurance environment in NZ, where individual insurers were using such 'generic' clauses and exclusions, pussyfooting around with whether one word means exactly the same as another, and whether the addition of 'to' as in 'loss to' absolutely excludes consequential losses was a dangerous pastime.

Insolvency / Financial Default Exclusion clause in Institute Commodity Trades Clauses (A) 5/9/83

However, some open policies in NZ have substituted the Commodity Clauses insolvency / financial default exclusion (the Institute Commodity Trades Clauses (A) 5/9/83 clause 4.6) instead of the simpler and more draconian version in the ICC(A). This has some important provisions that reduce the ambit of the exclusion clause considerably:

> In no case shall this insurance cover ...
> loss damage or expense caused by insolvency or financial default of the owners managers charterers or operators of the vessel where, at the time of loading of the subject-matter insured on board the vessel, the Assured are aware, or in the ordinary course of business should be aware, that such insolvency or financial default could prevent the normal prosecution of the voyage.
>
> This exclusion shall not apply where this insurance has been assigned to the party claiming hereunder who has bought or agreed to buy the subject-matter insured in good faith under a binding contract.

The two provisions are [1] that the Assured was or should have been aware (in the ordinary course of business) at the time of loading that something was seriously amiss; and [2], as in common in commodity trading when the cargo is bought and sold many times whilst on the high seas, that the exclusion would not apply to subsequent buyers who had no influence over the choice of carrier. That raised an issue of fairness in the minds of some NZ insurers - whether NZ importers, in the main the smaller of the two commercial parties, and had no influence or say in the choice of carrier, should likewise be able to escape the net.

For an insurer to gauge the awareness of his client of affairs maritime is a difficult matter. It appears that whichever of the commercial parties is arranging the transportation, they must be aware of the financial situation of the carrier when their goods cross the ship's rail at the port of loading. The exclusion clause certainly makes it clear that the financial default or insolvency must be common knowledge. 'In the ordinary course of business' implies that the commercial party need not specifically seek that information unless it is their business specifically to do so – that information must be in the public commercial domain. The exclusion also makes it clear that the financial default or insolvency must have already occurred at the time of loading, or that it was screaming headlines and almost certain to occur - to the point that the Assured was being reckless by allowing their cargo to be physically placed on that vessel.

Most NZ importers and exporters, I expect, would have taken the chance even if they had an inkling about the true state of ABC Containerline. When freight is paid in advance, it is a strong-minded shipping manager, in a world dominated by cost accountants, that forfeits that freight money and pays again to another carrier.

From a particularly NZ perspective, this is for two reasons, if one discounts the 'she'll be right' optimism of many Kiwis.

First, there are not that many international ocean carriers serving NZ, because of our isolated position in the South Pacific. There simply isn't too much choice. Second, the much more important and central issue was that ABC were seen as the shipping company that was always close to the edge - it almost had to be, to undercut conference rates.

That ABC had been in financial difficulties was not an unusual situation. It was in fact the normal situation. Their parlous state had been a weary tale told for years. Certain sheep with

certain agendas had called 'wolf' before. Mr. Rosenfeld had in the past always provided rescue at the eleventh hour. The arrest of the 'Martha II' for overdue mortgage payments was not at the time an obvious 'abandon ye all who sail with ABC ships' message. If it had been, no doubt some prudent marine insurers might have been advising marine brokers of the extent of their client's cover. This was not was not done in NZ to my knowledge, even although it arguably falls with the currently hot topic of 'risk management'.

It should be remembered that the arrest of the 'Martha II' was by a bank for the non-payment of not ABC but an associate company; and the 'Cornelis Verolme' was arrested for the purpose of pursuing a cargo recovery by a NZ insurer. It did not seem like the major creditors swooping down in a concerted and organised operation. It seemed in NZ to be a disparate chain of events that had just together proved too much. It seemed to have happened more by bad timing than inevitability.

How practically does an insurer deduce that a certain category of NZ importer should have known that the ABC Containerline was in dire straits? A small importer in NZ, who is told by his multinational supplier overseas merely that his cargo will be delivered by the NZ agent of their freight forwarder by such-and-such a date, is almost certain never to have heard of ABC Containerline - let alone a more known name as (the then) Nedlloyd. 'ABC' itself is a forgettable name. The only trade press our importing clients would read might be a 'Ball Bearings Times' or a 'Tractor and Excavator Manufacturers' Digest'.

One might expect the shipping department of a large NZ company to know of the rumours constantly surrounding ABC Containerline. This presents an insurer with many claims pending from the collapse of ABC with a difficult dilemma. At what horizontal strata of NZ business does the insurer draw a line between the 'Big Boys in the Know' and the 'Blissfully Ignorant Minnows', lower down the scale?

For importers with goods on the 'Martha II', bound for NZ, some NZ insurers considered whether this clause required those importers to re-assess the situation when their cargo was transferred from the arrested vessel to the 'Cornelis Verolme'. It was widely publicised at the time to NZ importers, but more as a *fait accompli* than a choice. Importers were told that their cargo would be transferred to the 'Cornelis Verolme' to complete the voyage to NZ.

The correct answer to this specific question is not immediately clear. The exclusion clause merely states that the time to consider the question is when the cargo is being loaded on board the vessel. That vessel is not confined by the clause to the original vessel; and the transportation chain had been interrupted to such an extent it is arguable that the ordinary course of transit had ceased. That hallowed underwriter's phrase 'ordinary course of transit' means that the cargo's whereabouts is known only by reference to the vessel's location or a timetable, and the commercial parties have little if no influence on its disposition. Once the commercial parties have control of their cargo, the ordinary course of transit ceases. (The usual situation in which this crops up is when an importer elects to leave their cargo at the wharf as there is no room in their own warehouse or godown to store the cargo). However, at the time of the transfer of cargo in Sydney, it was not blindingly obvious that the carrier was insolvent or seriously in financial default. In such circumstances, it was difficult to apply the exclusion clause.

It is not the intention of this paper to go through the exact circumstances of each arrest and each stranded cargo at the ports of Haifa, Halifax, and Auckland. The point is that in most, if not all, circumstances, it was difficult both practically and legally to apply the Commodity Clauses' Insolvency and Financial Default exclusion clause. Part of that difficulty lay in insurers first understanding and identifying with the breadth and the harshness of the conventional interpretation of the ICC(A) exclusion clause.

Expenses of extra freight and unloading

Most clients did not have damaged cargo at the end of the day. They were bruised financially by the extra costs of unloading and extra freight. For those with lower value bulk cargoes,

such as onions in Halifax, Nova Scotia, bound for Europe, it made the whole venture financially unsound, and salvage markets at the port of arrest were sought.

Most looked for solace from their insurance policies. Most NZ insurers initially stated that these costs were not covered. Delay and Inherent Vice were mentioned as exclusions, denying cover. This was not quite correct, in my opinion, as the proximate cause was patently the insolvency of the carrier and not either delay or inherent vice, which in this case were the results of the insolvency, and not the root cause of any losses. The delay exclusion, it should be noted, does have a big bite: it excludes 'loss damage or expense proximately caused by delay, even although the delay be caused by a risk insured against...' This phraseology is taken directly from the Marine Insurance Act 1906, s55. However, insurers' involvement in the ABC collapse was not through the proximate cause of delay, for example, for subsequent loss of shelf-life whilst the containers were unobtainable. Delay itself is the proximate cause trigger for this particular exclusion clause to operate. In the main, the chain of events had not, in my opinion, been sufficiently disrupted and the active and efficient cause remained the insolvency / financial default. It was only when the cargoes were released back into the Assureds' hands that perhaps these other exclusions could come into play if there was excessive delays in forwarding, or mitigation or salvage.

In any event, most of us insurers in NZ said, there was only a delay due to arrest, expenses that were consequential losses and no physical damage to, let's say, lawnmowers or fishing nets. The insolvency / financial default exclusion applied to those covers that had the ICC(A) exclusion. Sympathies were extended to those importers who, for example, had the latest models of European domestic gas heaters stranded in Haifa, destined to heat chilled NZ homes during the approaching NZ winter, when they presented their large extra freight and handling costs as an insurance claim.

There was, though, a nascent feeling of disquiet in some quarters about the exclusion clause's mention of expenses: 'In no case shall this insurance cover ...loss damage or expense caused by insolvency or financial default ...' Why exclude expenses if that cover is supposedly not given in the Risks Covered clauses? It is not the function of an exclusion clause to give cover, unless that intention is very clear. In other words, if the exclusion clause excludes expenses, but the Commodity Clauses insolvency / financial default exclusion clause does not apply, is cover for insolvency or financial default expenses given for these circumstances?

It was a very tenuous argument to state that this clause by itself is giving that cover - but it did raise an issue that expenses are bundled into the phrase 'all risks of loss of or damage to' in the Risks Covered clause 1. After all, expenses are clearly a loss, albeit a financial one.

Also, insurers realised that, as the exclusion clause in the ICC(A) makes no reference to the situation where Through Bills of Lading are in force, where it is the contracting ocean carrier that selects any subsequent carrier, the exclusion clause was potentially very harsh indeed. These circumstances were not present in the ABC case; and that inequity was not raised by insurance brokers. However, that realisation should raise a few underwriting eyebrows before it raises the hackles of a judge.

Conclusion

How NZ insurers tackled the many claims for extra freight and handling expenses was an individual company decision. There was no agreed market consensus. My company, for example, paid additional freight and handling costs where the cargo was stranded short of the final destination port, and where there was genuine hardship. We treated it as a marketing exercise.

Like many insurers, we felt that the exclusion was unfair when claimants had effectively little or no control over the choice of carrier; and – even when there was no physical damage – there was a genuine expectation that such 'fortuities' were covered.

It would have been a purist insurer that followed the conventional interpretations in a marketplace that was both softening because of insurer over-capacity and turmoil in the broker market. Arguments about 'expenses' being covered by ICC(A) were entertained by some NZ insurers in this light, but it was commercial pressure that ruled. That commercial pressure was enhanced by a desire by NZ insurers to settle the claims either ex gratia or 'without prejudice', perhaps to hide any confusion, and perhaps preserve the status quo for more minor incidents in the future.

Hopefully the purpose of this paper highlights some of the difficulties we had in New Zealand. By conventional underwriting wisdom, the results of using a financially unstable carrier fall to commercial risk, borne by the commercial parties alongside as the ever-present financial risks of participating in international trade, and not to insurable physical accidents to cargo.

However, matching the circumstances of the ABC collapse to insurance covers was not an easy task. In many cases, it was galling to NZ insurers that the very basic building blocks of cover behind almost all policies had to be examined afresh. The size and scale of ABC Containerline made its collapse seem like a fortuity.

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