LIMITATION OF LIABILITY AS A RISK ALLOCATION MECHANISM IN MARITIME LAW

F S Dethridge Memorial Address to the Maritime Law Association of Australia and New Zealand

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The theme which I have chosen for this address is "limitation of liability as a risk allocation mechanism in maritime law". It is currently a topical subject, in New Zealand at least, which I hope will make it of some interest.[1] But that topicality carries with it some dangers for an address such as this. There will be many among you in this audience who are directly involved in limitation issues, on all sides. It would be hazardous for a sitting judge to venture into the reefs and shoals of the specifics. I hope to navigate clearer waters by directing my remarks at a more general level. I will discuss the development of the concept of limitation by examining its history, and the policy considerations which underlie it. I will then describe the limitation of liability regimes in place on a global basis. Finally, I will venture some thoughts on the current relevance of the concept in this modern age.

The basic concept of limitation of liability is simple. Those involved in the ownership of a ship are entitled to limit their liability in respect of claims arising out of their operations, to a total sum which is fixed by the law. The limit is not, as is more usual, set by the practical reality of the financial capacity of the party concerned, or the extent of his insurance cover.

Limitation in this way is not the norm for the law in allocating risk between those responsible for causing damage and those suffering that damage. In most situations, the law serves the function of prescribing the circumstances in which the person causing damage will, or will not, be liable to compensate persons harmed. The application of the law on a claim by claim basis will determine the extent of that liability in financial terms. The law does not, in fields other than maritime law, apply an overarching limit on the total amount to which the

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1 See for example *Daina Shipping Company v Te Runanga O Ngati Awa* [2013] NZHC 500, 2 NZLR 799.

wrongdoer may be subjected, when the wrongdoing from a single event or circumstance leads to a multitude of claims.

That is not to say, of course, that the victims of accidents which cause widespread damage to many claimants, in the non-maritime arena, will always, in the end result, be fully compensated for the amount which the law determines as just recompense for the loss. As I have noted, the capacity of the wrongdoer to pay damages, either directly from its own resources or from insurance, sets a de facto limit to the amount which individual claimants will receive. In allocating the total resources available among all such claimants, the law generally operates on a "first up best dressed" basis. The plaintiff who is quickest off the mark in enforcing his claim will be paid ahead of his more tardy fellow sufferers.[2]

When the law does intervene to alter that case by case determination of liability, and the satisfaction of it, it generally does so in a way quite the reverse of limitation of liability. The usual mechanism for addressing the issues involved is to provide not that the liability of the wrongdoer be limited, but rather that the wrongdoer must maintain a specified level of resources, by insurance or some others means, to meet the expected liability.

In contrast, in the maritime environment, the extent of liability is fixed by law, and the law prescribes the way the amount available is allocated among claimants. Why then has maritime law developed a concept of limiting the total liability of the wrongdoer for the consequences of a maritime disaster? Lord Denning MR addressed that question in *The Bramley Moore*.[3]

He said:

> The principle underlying limitation of liability is that the wrongdoer should be liable according to the value of his ship and no more. A small tug has comparatively small value and it should have a correspondingly low measure of liability, even though it is towing a great liner and does great damage. I agree that there is not much room for justice in this rule; but limitation of

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[2] For an example of the operation of that principle, see *Cox v Bankside Members Agency Ltd* [1995] 2 Lloyd's Rep 437 (CA).

[3] *The Bramley Moore* [1964] P 200 at 220, [1964] 2 WLR 259 (CA).

> liability is not a matter of justice. It is a rule of public policy which has its origin in history and its justification in convenience.

Let me examine its origin in history, and its justification in convenience.

The origin of limitation of liability is obscure. The modern formulation of liability, that the liability of a shipowner is limited to an amount calculated by reference to the tonnage of his ship, is entirely a creature of statute.[4] The modern statutes implement international agreements. There was no such rule, either at common law or in admiralty, in our two countries or in the United Kingdom, from where our common law was initially derived. That great admiralty judge, Dr Lushington, described the historical position as being: "By the ancient maritime law, the owners of a vessel doing damage were bound to make good the loss to the owners of the other vessel, although it might exceed the value of their own vessel and the freight."[5]

The view has been expressed that the concept of limitation originated in the notion of *Commande*.[6] That term describes the type of joint adventure of shipowners or merchants which was common in the Mediterranean in the Middle Ages, in the days before formal legal structures for joint ventures, in the form of joint stock companies and the like, were developed. The liability of the joint adventurers was limited in ways which did not expose each of them to unlimited personal liability for the venture. But the concept of limitation was not incorporated directly into the medieval maritime codes such as the Rolls of Oléron.

The concept seems to have first been established in continental Europe. Three different systems developed among maritime nations.[7]

Under the first system, the liability of a shipowner was effectively limited to the value of the vessel. This method of limiting liability was first enacted in the Swedish Maritime Code of 1667, and spread to a number of other countries. The method of limiting liability to the

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4 Limitation of Liability for Maritime Claims Act 1989 (Cth); Maritime Transport Act 1994, pt 7.

5 *The "Volant"* (1842) 1 W Rob 383 at 387, 166 ER 616 at 618 (Admir).

6 Kenneth C McGuffie *Marsden*: *The Law of Collisions at Sea* (11th ed, London, Stevens & Sons, 1961) at 129–134.

7 For a fuller description of the history, see Nigel Meeson and John A Kimbell *Admiralty Jurisdiction and Practice* (4th ed, Informa Law, London, 2011) at ch 8.

actual value of the vessel was quite simple: the shipowner gave notice of abandonment of the vessel and in effect wiped his hands of the disaster. The claimants were left to get what they could, by subjecting the abandoned vessel to judicial sale, and hopefully satisfying their claims from the proceeds.

A second system emerged in Germany, from about the mid-nineteenth century. It was based on the notion that the object which caused the damage, that is to say, the ship, was directly liable to the person harmed. Instead of serving a notice of abandonment, the liability of the shipowner was limited to the value of the ship and freight.

The third system developed in English law, by a series of statutes from the mid-eighteenth to the late nineteenth centuries. Those statutes created a limitation based on a sum calculated by reference to the tonnage of the ship. The dominance of Britain and its empire and the diplomatic influence which it exercised, meant that this mode of limitation has prevailed, and is now incorporated in the international conventions on limitation.

The earliest English statute was the Responsibility of Shipowners' Act 1733. The immediate trigger for that Act was the decision in *Boucher v Lawson*.[8] In that case, a shipowner was held liable in full for a cargo of gold bullion stolen by the Master. That decision was greeted with alarm and outrage by the shipowning community. A petition to Parliament by shipowning interests contrasted the unfavourable position of English owners with those on the Continent. That comparative disadvantage was probably at least as important as the perceived injustice to the shipowners. In reviewing the history, Lord Stowell noted that a prompt for the legislation was the limitation regime in Holland, then a major competitor of Britain for maritime dominance.[9]

Parliament acted very quickly to change the law. The preamble to the 1733 Act sets out very clearly, in the language of the day, the policy considerations which underpinned the Act. It bears quoting. It said:

> Whereas it is of the greatest consequence and importance to this kingdom to promote the increase of the number of ships and vessels, and to prevent any

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8 *Boucher v Lawson* (1733) Cas T Hard 194, 95 ER 125.

9 *The "Dundee"* (1823) 1 Hagg 109, 166 ER 39 (Admir).

> discouragement to merchants and others from being interested in and concerned therein: and whereas it has been held, that in many cases owners of ships or vessels are answerable for goods and merchandise shipped or put aboard the same, although the said goods and merchandise, after the same have been so put on board, should be made away with by the masters or mariners of the said ships or vessels, without knowledge or privity of the owner or owners; by means whereof merchants and others are greatly discouraged from adventuring their fortunes, as owners of ships or vessels, which will necessarily tend to the prejudice of the trade and navigation of this kingdom.

The 1733 Act limited the liability of the shipowner to the value of the ship and freight, for claims arising out of the theft of cargo by Master or crew. That introduced the principle of limitation. Subsequent acts extended the application of the principle to other types of claim, where the claim arose in circumstances where there was no "fault or privity" on the part of the owner. They also provided for greater certainty in the amount of the limit, by moving from the actual value of the ship to a notional value. The legislation set an amount per ton of the tonnage of the vessel. The various limitation statutes were consolidated in the Merchant Shipping Act 1894, in two very well known provisions, ss 503 and 504. In 1900, the right to limit was extended to all cases where, without fault or privity of the person seeking to limit, loss or damage had been caused to property or right of any kind whether on land or water or whether fixed or movable.[10] Both of our countries operated, for a long part of our history, under the 1894 Imperial Act.[11]

So, by these developments, English law moved in about 170 years from a position where a shipowner had no limit on liability, to a narrow limitation of liability for theft by master or crew based on the actual value of the ship, to a comprehensive limitation for all types of claim except those to which the owner was privy, based on a notional per ton figure.

[10] Merchant Shipping (Liability of Shipowners and Others) Act 1900 (UK) 63 & 64 Vict c 32.

[11] In New Zealand, the 1894 Act provisions remained in force until repealed and replaced by the Shipping and Seamen Act 1952.

These developments were all statute law, not judge-made law. As an aside, I mention that drafting of the statutes has not received universal acclaim from the judiciary which had to apply the statutes. In a judicial *cri de couer* Edmund Davies LJ said:[12]

> Were bewilderment the legitimate aim of statutes, the Merchant Shipping (Liability of Shipowners and Others) Act, 1958, would clearly be entitled to a high award. Indeed, the deep gloom which its tortuousities induced in me has been lifted only by the happy discovery that my attempts to construe them have led me to the same conclusion as my brethren.

So much, then, for the history and policy rationale behind the domestic legislation. By their nature, ships travel the high seas. To be effective, any regime for the limitation of a shipowner's liability must be adopted internationally, on a broadly uniform basis. From the early years of the 20th century, there were international efforts to rationalise three different systems of limitation which were then in operation, as I have described. A leading proponent in those efforts is Comité Maritime Internationale, or CMI, in which both Australia and New Zealand participate, through your association. CMI identified limitation as a subject suitable for regulation by international convention.

CMI's first attempt at achieving uniformity resulted in the 1924 Limitation Convention. That established the English system as the basic model, and was in effect an international adoption of s 503 of the Merchant Shipping Act 1894. That convention received little international acceptance and CMI revisited the subject in the 1950s, leading to the 1957 Limitation Convention. The 1957 Convention also adopted the British system, and increased the limits of liability for property and personal injury claims. The 1957 Convention was more widely adopted than the 1924 convention, but the topic of limitation remained a live one, for both CMI and the International Maritime Organisation (IMO). A further convention was promulgated in 1976.[13] The 1976 Limitation Convention introduced further changes. Importantly, the onus of proof of "fault or privity" on the part of the owner was reversed. It was now incumbent on the claimant to establish fault, not on the owner to show absence of fault. Also, the calculation of the limitation fund, originally intended to produce a figure roughly equivalent to the commercial value of the vessel, was now influenced by

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12 *The "Putbus"* [1969] P 136, [1969] 2 All ER 676 at 680.

13 Convention on Limitation of Liability for Maritime Claims; adopted 19 November 1976.

considerations of the availability of insurance.[14] The limits in the 1976 convention were increased by a protocol in 1996.

The outcome of these international developments is that in place of the three quite different modes of prescribing the limit on the liability of the shipowner, there is now one basic model. That is limitation to a fixed sum based on the tonnage of the vessel, for claims occurring without fault or privity on the part of the owner. There are four significant variations on that theme, in the 1924 convention, the 1957 convention, the 1976 convention and the 1976 convention as amended by the 1996 protocol. Each has some measure of international acceptance.

Modern technology, and the increasing extent to which the seas are exploited by means other than the passage of ships, have led to extension of the concept of limitation to maritime operations beyond the traditional role of the shipowner. A range of conventions, such as the International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea 1996, (the HNS Convention) a number of conventions concerning nuclear incidents, and concerning oil pollution, address liability for damage in those fields, including the establishment of limitation funds.

As well as the global limitation, the principle of limitation as a risk allocation mechanism in maritime law has been applied to specific types of claim. Again, CMI has played a critical role in these developments. Examples are the rules for limitation of liability for passenger claims contained in the Athens Convention 1974, and the regimes for limiting the liability of shipowners and others for damage to cargo, in the Hague rules, the Hague-Visby rules, and the Hamburg Rules. Those conventions are a separate topic in themselves and I do not venture into that today. I simply note that the policy considerations underlying those specific limitation regimes are very different from those underlying the global limitation of a shipowner's liability. Those conventions were in large part a response to contractual terms which relieved the shipowner from financial responsibility.[15] An important part of the

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14 Patrick Griggs "Limitation of Liability for Maritime Claims: the Search for International Uniformity" [1997] LMCLQ 369.

15 For a brief description of the history, see Sir Bernard Eder (ed) *Scrutton on Charterparties and Bills of Lading* (22nd ed, Sweet & Maxwell, London, 2011) at ch 20.

impetus behind the passenger and cargo liability regimes was not to limit the liability of the shipowner, but to limit the ability of the shipowner to exclude liability by contract.

I come then to discuss the policy rationale which underlies the limitation of the liability of shipowners and other involved in maritime adventures, in the modern era. Lord Mustill, a previous very distinguished presenter of this address, has on another occasion described six policy justifications which can be advanced as the motives which impelled the development of limitation of shipowner's liability.[16] I describe those briefly, and consider their present relevance. I also discuss other modern policy considerations which are now relevant to the concept of shipowner's limitation.

Lord Mustill's first motive was the concept that the shipowner and the cargo owner were participants in a common adventure for the benefit of both at the cost of both and at the risk of both. The limitation of the shipowner's liability assisted the apportionment of those risks between the joint venturers. That motive harks back to the notion of *Commande*, that I mentioned earlier.

The second and related consideration is that high cargo values meant that the value of the cargo might substantially exceed the value of the ship. In the event of the total loss of ship and cargo, the total loss, would, without a limitation of the liability of the shipowner for damage to the cargo, rest disproportionately with the shipowner rather than the other venturer, the owner of the cargo.

The third feature noted by Lord Mustill was that the introduction of the concept of limitation of liability of shipowners was broadly contemporaneous with the development of limited liability through the joint stock company, in other areas of economic activity.

Fourth, the nature of seagoing operations exposed the shipowner to a significant risk of ruin without fault. That created a perceived injustice in the conditions then prevailing. In those earlier times, the shipowner had little practical control over his venture. He could do little more than farewell his vessel from the dockside, entrust his fortune to the integrity and skill of his master and crew and, like Antonio, the Merchant of Venice, seek news on the Rialto

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[16] Lord Mustill "Ships are Different – or are they?" [1993] LMCLQ 490.

and wait for his bottoms to come in. There was a general sentiment that it was unacceptable for the shipowner to be ruined by claims arising from an event for which he was not personally to blame, and about which he could have no knowledge until after, perhaps long after, it had happened.

The fifth motive is the attraction of venture capital. Limitation of liability helped to remove an obstacle to the investment of venture capital, at a time when commercial ventures were mainly conducted by individuals, with unlimited personal liability. Limitation would thus encourage the development of a national merchant marine. In those days of Empire, that was a very important policy consideration. It is worthy of note that the broadly contemporaneous development of joint stock companies served a similar economic purpose in other areas of commerce.

The sixth consideration, which Lord Mustill described as a more recently publicised justification, is a general benefit to users. Limitation laws protect not only the carrier, but those using and benefiting from his service. They do so by enabling the shipowner to continue in business, and to prevent an additional impost which would be passed on to cargo owners and ultimately consumers in general by means of freight increases.

Very few of those justifications would be seen as having significant relevance, if the principle of limitation of a shipowner's liability was re-examined, from a policy perspective, today. Lord Mustill was of that view. He said:[17]

> The economic considerations which are said to justify the continued existence of a limitation of shipowners' liability no longer bear any resemblance to those which originally led to its creation, all of which have dropped away, leaving only the comparatively modern proposition that it is in the general interests of society at large that shipowners should be permitted and indeed encouraged to remain in their traditional business; performing it in the traditional way. This proposition might be right, but there are increasing numbers who are thinking about it, who do not regard it as self evident, and who are ready to say so.

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17 Lord Mustill, above n 16, at 499.

Several of the motives to which I have referred arose from the less sophisticated business structures and commercial arrangements of those earlier times. Those motives have become largely irrelevant in the modern age. There are now legal methods of structuring commercial enterprises available to overcome the obstacles. The use of one-ship companies can enable a shipowner to limit his exposure to the capital employed in the operation of each vessel. That may produce an outcome not essentially different from the statutory scheme. As I noted at the outset, the limitation of liability of shipowners is at odds with way the law fixes liability in other areas. It is however important not to over-emphasise the importance of that. The parallel and broadly contemporaneous development of limited liability corporations may well enable venturers in other activities to achieve a limitation on their exposure from those activities. This means that in the modern age, limitation of the liability of shipowners as it now exists may be less necessary as a means of achieving a balance in the risks involved in that form of economic activity than it once was. But it may for that reason be less out of line with the way risk is allocated in other forms of economic activity than it was when it originated.

The notion that it was unfair to expose a shipowner to unlimited liability for events over which he had no control also needs re-examination today, in the light of modern shipping operations. The shipowner has direct communication with, and the ability to exercise control over, his vessel at every hour of the day and night, anywhere in the world. In that respect he is little different from the operator of any other large commercial enterprise, who does not have the benefit of limitation of liability.

Modern attitudes would also influence views on what is desirable to encourage investment in shipping. Encouragement would not necessarily be seen as justifying a different liability regime for shipowners. The development of a national merchant marine is less important from a policy perspective than it once was. Societal attitudes would not necessarily regard the attraction of venture capital as an unqualified benefit, to be encouraged by limiting the liability of the venture capitalist. Modern attitudes to activities which carry a risk, particularly to the environment, are different from those in the past. Society generally, and certain interest groups in society in particular, increasingly advocate for the total costs of activities which carry risks, such as environmental risk, to be allocated to the party whose activities create the risk. Limitation of liability runs counter to that. I do not comment

further on this, because it leads me close to the hazardous waters which I eschewed at the beginning of this address. It is however an important consideration, and one not to be underestimated.

Another important difference from the time when limitation was developed is the much larger scale and complexity of maritime operations. The changes have implications for the concept of limitation by reference to the size of the ship. The size of the ship is a convenient, but rather rough and ready, measure for assessing the liability which the shipowner should bear. There is no necessary proportionality between the size of a ship and the potential damage it may cause. It is true that larger ships mean larger limitation funds. But it is also true that the potential damage from a marine disaster has increased significantly. It may be doubted whether there ever was a close relationship between the quantum of the limitation fund calculated by reference to the size of the vessel and the quantum of the potential damage which a vessel of that size could cause. But any proportionality must now be questionable. Modern ships are specialised and purpose built. Their potential to cause harm can differ greatly according to their function, in a way which bears little relationship to their size.

A further significant difference now from then is that there is a much wider range of potential claimants against a shipowner in a maritime casualty. In earlier days, the risk involved in a maritime adventure, the voyage of a ship, was largely confined to the parties directly involved. The parties were the shipowner on one hand, and the owners of the cargo which he carried, or his passengers, on the other. Risk distribution was largely between those participants. The risks are no longer confined to those parties. The increasing complexity of modern commerce means that there will now be a larger number of parties indirectly connected to the venture who will be affected by its success or failure. For example, the cargo carried on a vessel may have been on-sold, possibly several times over, to parties who will have ordered their affairs in the expectation of the safe arrival of that cargo. Also developments in the law, such as the 20th century extension of liability in negligence for example, mean that the indirect victims of a casualty may now have claims that would not have been seen as significant when the concept of limitation was developed.

Further, and more importantly, there are persons who are not involved in the venture, either directly or indirectly, who have the capacity to suffer significant damage from a maritime

casualty. Modern technology, and the increased size and sophistication of ships, creates a potential for damage to these uninvolved parties in a way which was simply not possible and did not require consideration, when the concept of limitation was developed. The most obvious example is the potential for maritime casualty to cause pollution. The fisherman or the tourist operator who depends directly or indirectly on the sea for his income can be affected by a catastrophe which arises from a venture in which he has no interest, direct or indirect.

Risk allocation among those wider classes of potential claimants raises a set of issues not relevant in the simpler days of old.

A very important consideration today is the potential of ships to cause pollution. Maritime law addresses in a number of ways the environmental risks arising from pollution. I have already mentioned the pollution conventions. A further recognition of the need for the law to address potential harm from pollution are the developments in the law of salvage. The traditional "no cure, no pay" basis for compensating those who undertake salvage when a ship has been damaged at sea has given way to a recognition that it is not only the property of the shipowner and cargo owner which is at stake in a salvage operation. Salvors must also be concerned with the potential environmental effects, and must be compensated for the measures which they take to address those effects, whether or not they are ultimately successful in saving any property of the shipowner or the cargo owners. A limitation of liability regime which requires those who suffer damage from adverse environmental effects to stand in line with other claimants might now be seen as running contrary to the modern trend. But, again, I am sailing near dangerous waters, and I say no more on this topic.

When I reflect on the matters I have mentioned, it seems to me that it is unlikely that, if we were starting with a clean slate, we would now adopt a risk allocation mechanism in the maritime field like that which we have. However, I think that there are two main considerations which make fundamental change unlikely.

The first is the power of incumbency. The present liability regime has been in place for many years. The industry worldwide has organised its affairs, and its insurance arrangements, in

ways which would make fundamental change difficult, and likely to occur only if the present arrangements were seen to be entirely inappropriate.

I think that the present regime is not likely to be seen as entirely inappropriate, largely because of the second consideration. That second consideration is the need for international congruity in maritime matters. An internationally uniform risk allocation mechanism has distinct advantages over the different regimes which would be likely to arise if liability was left, as in other areas of economic activity, to the domestic law.

I mention those as some of the considerations which may well influence the future of limitation of liability as a risk allocation mechanism in maritime law. They are complex, and they do all not point in a clear direction as to how they should influence the policy of the law. I do not have a crystal ball, and I do not intend to venture any view about how the law may develop, either domestically or internationally, in this regard. I have attempted only to point out issues, not to provide answers. You in this audience, with your involvement in these issues as participants or as advisers, will help to determine the future shape of our law in this important area.

Alan MacKenzie
Judge of the High Court of New Zealand