Indemnity Clauses and Limitation of Liability

Patrick Griggs CBE (Past President, CMI) and Norman A. Martínez Gutiérrez (Lecturer at the IMO International Maritime Law Institute, Malta) *examine the recent Hong Kong case of* Sun Wai Wah Transportation Ltd. v. Cheung Kee Marine Services Co. Ltd *on limitation of liability.*

INTRODUCTION

Most contracts for the carriage of goods by sea under bills of lading are regulated by the Hague or Hague-Visby Rules. In contrast, parties to contracts for the hire of vessels enjoy freedom of contract. As a result, parties to hire agreements (such as charterparties) often incorporate clauses into the contract by which they agree to indemnify each other for certain types of loss. This was the case in *The Wang Fat No. 3* where the parties entered into such an indemnity agreement: see *Sun Wai Wah Transportation Ltd. v. Cheung Kee Marine Services Co. Ltd. and the Owners and/or Other Persons Entitled to Sue in Connection with the Cargoes Lately Laden on Board the Barge "Wang Fat No. 3"* (High Court of the Hong Kong Special Administrative Region, Court of First Instance, Admiralty Action No. 134 of 2009).

The main issue in this case was whether claims presented by the hirers under an indemnity agreement were subject to owners' right of limitation of liability under the 1976 Convention on Limitation of Liability for Maritime Claims ("LLMC '76").

FACTS

By a Hire Agreement dated 18 April 2009 Sun Wai ("the shipowners") chartered their barge *Wang Fat No. 3* to Cheung Kee ("the hirers").

On 26 April 2009 the barge developed a list of about 45° for about 2 minutes while under tow. During this time, some containers fell from the barge into the sea. Other containers which remained onboard sustained loss and damage.

Following this incident, the shipowners applied to the Hong Kong Court of First Instance for a limitation decree under the LLMC '76, which was given the force of law in Hong Kong by Section 12 of the Merchant Shipping (Limitation of Shipowners' Liability) Ordinance (Cap. 434).

THE DISPUTE

Hirers were facing claims from third parties whose cargo was lost or damaged as a result of this incident and they objected to the shipowners being granted a limitation decree. No one, apart from the hirers, objected to the shipowners' application. The hirers' objection was that on the same day the parties concluded the Hire Agreement they also entered into an Indemnity Agreement.

Under the Indemnity Agreement, the shipowners undertook to indemnify the hirers against "all action, liability, loss suits, claims, demands, proceedings, costs, charges, or expenses whatsoever" and "[t]o pay [the hirers] on demand the full amount of any loss or damage whatsoever which [the hirers] may incur as a result of, in connection with or in any way related to the performance of the services". Based on this Agreement the hirers argued that the shipowners were not entitled to limit their liability as they had undertaken to indemnify the hirers against the full amount of claims for which the latter could be held liable to third party cargo interests.

The hirers contended that, by entering into the Indemnity Agreement, the shipowners had waived any benefit granted to them by the LLMC '76. On this point they emphasised that Article 1 of the Convention only provides that the shipowner "may" limit his liability, and that nothing prevents a shipowner from accepting a fuller liability than that provided for in the Convention.

They based their arguments on *The Satanita* [1897] AC 59 (HL) (also known as *Clarke v. The Earl of Dunraven and Mount-Earl* [1897] AC 59). In that case, yacht-owners entering in a regatta had agreed to be liable for "all damages" arising from the infringement of the rules of the Yacht Club Association. During the regatta, the *Satanita* collided with and sank the *Valkyrie* as a result of improper navigation not due to the actual fault or privity of the owner of the *Satanita*. After considering the facts of that case the House of Lords held that, as a matter

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of construction of the relevant agreements, the obligation to compensate for "all damages" meant that the owner of the *Satanita* was not entitled to limitation under the Merchant Shipping Amendment Act 1862. Indeed, Lord Macnaghten had stated (at p.67) that: "[T]he expression 'all damages arising therefrom' means what it says, and ... the generality of this expression is not to be cut down or restricted by anything outside the rules". Thus, the hirers in the present case argued that, absent express words to such effect, there was no scope for construing the Indemnity Agreement as somehow "subject to the 1976 Convention".

On the other hand, the shipowners explained that the law on limitation of liability had changed since *The Satanita* ruling. For example, at the time when *The Satanita* was decided only claims for damages were subject to limitation. Consequently, any claim for indemnity under a contract to indemnify would not be subject to limitation. The shipowners noted, however, that now the position is different. Indeed, in accordance with Article 2(2) of the Convention, except for certain specific types of claims identified in Articles 2(1)(d)-(f), claims "set out in paragraph 1 shall be subject to limitation of liability even if brought by way of recourse or for indemnity under a contract or otherwise."

REYES J'S JUDGMENT

The matter came before Reyes J who delivered his judgment in Chambers on 25 November 2009. He expressed himself to be not persuaded by the hirers' arguments. Instead, he

preferred to construe the Indemnity Agreement in the context of Article 2(2) of the LLMC '76. He explained that "*[t]he existence of the Convention is part of the factual matrix*" and that there was no evidence that the shipowners or the hirers "*(both experienced in the business of carrying goods by sea) would have been unaware of the provisions of the Convention*".

In Reyes J's opinion, "*[w]hen the parties entered into the Indemnity Agreement, they must be taken to have done so in the context of a shipowner (such as Sun Wai) being able to apply for limitation under the Convention even in respect of a liability to indemnify*".

He, therefore, held that in the absence of clear words to the contrary, he could not "*read the references to full indemnification in the Indemnity Agreement as meaning other than a full indemnity within the terms of what the Convention permits.*"

An important consideration in Reyes J's mind in reaching this decision was that the hirers themselves were entitled to apply for a limitation decree. Accordingly, their liability to third parties (if any) could also be limited in accordance with the Convention. It followed that the potential liability of the hirers would not exceed that of the shipowners under a limitation decree. As a result, it was impossible for the quantum of the hirers' liability towards third parties to exceed the amount of the shipowner's limited liability.

A further point considered was that any claim by the hirers against the shipowners for indemnification under the Indemnity Agreement would be subject to an obligation on the hirers' part to take reasonable steps to mitigate their loss. In Reyes J's opinion this would compel the hirers to limit their potential losses by seeking a limitation decree themselves. Otherwise, their claims against the shipowners could be deemed to be unreasonably greater than they should otherwise have been.

For these reasons, Reyes J held that the shipowners were entitled to a limitation decree.

COMMENT

The issue was clear; should the shipowners' contractual undertaking to indemnify the hirers "the full amount of any loss or damage whatsoever" nullify the shipowners' right to limit under the LLMC '76? In the judge's view, the parties (both experienced in the business of carrying goods by sea) should have been aware of the provisions of the LLMC '76 and it followed that the Indemnity Agreement could only be interpreted as being subject to the right of limitation recognised by the LLMC '76. The right to limit arises as a matter of law and does not need contractual recognition. A shipowner only needs to establish that the claim falls under Article 2 of the Convention in order for the right to limit to apply. As recognised by Lord Phillips of Worth Matravers, M.R. in *The Leerort* [2001] 2 Lloyd's Rep. 291 at 295 once he establishes that, "it is virtually axiomatic that the defendant shipowner will be entitled to limit his liability".

But how can this statement be reconciled with an Indemnity Agreement in the terms used in this case? It is suggested that even if the indemnity was considered to mean "the full amount of any loss...", this should not be interpreted as "full quantum of claims faced by the hirers" but the "full extent of the hirers' liability" and, as Reyes J explained, the hirers themselves could be entitled to limit their liability. Consequently, the hirers' "full extent of liability" as expressed in the Indemnity Agreement should be deemed to be the limit of liability prescribed by Article 6 of the Convention.

Similarly, considering the hirers' obligation to mitigate their loss, it is suggested that they should, themselves, invoke their right to limit liability. If not, the hirers would be prevented from claiming any excess liability from the owners. In the light of the foregoing, it is suggested that the undertaking by the shipowners

to indemnify the hirers to the full extent of their liability should be construed, as was done by Reyes J, as subject to the provisions of the Convention. Therefore, to avoid suffering any additional liability, it would be up to the charterers to apply for a limitation decree themselves.

As explained by Longmore LJ in *CMA CGM S.A. v. Classica Shipping Co. Ltd.* [2004] 1 Lloyd's Rep. 460 at 469, cargo claims are claims in respect of loss of or damage to property occurring on board the vessel which fall within Article 2(1)(a) of the LLMC '76. Hence, in the present case the shipowners would be able to limit their liability for such claims even though the claims were brought against them by way of indemnity and the hirers' claim would fail to the extent that liability was discharged by them in a sum exceeding the appropriate limit. Moreover, as explained by Teare J in *Metvale Ltd. and Another v. Monsanto International Sarl and Others* [2009] 1 Lloyd's Rep. 246 at 250, pursuant to Article 11(3) of the Convention "a fund constituted by one of the persons mentioned in Article 9 or his insurer shall be deemed constituted by all persons mentioned in Article 9". Therefore, any fund that could have been constituted by the hirers would be deemed constituted also by the owners.

It must be noted that Reyes J's decision that the right of limitation prevailed over the indemnity clause, in which he considered that both parties should have been aware of the provisions of the Convention, is consistent with modern principles of contractual construction with their emphasis on the importance of the overall background to the relevant commercial transaction. Therefore, in future, in order to preserve the right to a full indemnity, it will be necessary to employ clear language. The hirers of the *Wang Fat No. 3* may have achieved their evident intent if they had added to the Indemnity Clause suitable wording along the lines of "notwithstanding the provisions of any Convention on Limitation of Liability for Maritime claims which may apply."