UK Court of Appeal
Rules on a P&I Club Letter of Undertaking for a Limitation Fund

Introduction

Under the Convention on Limitation of Liability for Maritime Claims 1976 ("Convention"), shipowners may limit their liability in maritime claims by establishing a Limitation Fund. In a landmark decision, the UK Court of Appeal in Kairos Shipping Ltd and another v Enka & Co LLC and others [2014] EWCA Civ 217 ("Kairos Shipping") overturned a High Court decision that a Limitation Fund must be constituted by cash payment into Court, holding instead that a Letter of Undertaking ("LOU") from a P&I Club would suffice.

This decision will no doubt be welcomed by the shipowners and their insurers as a commercially sensible outcome. The use of LOUs as security for maritime claims is already a common practice in many countries. The decision of the UK Court of Appeal extended the position, confirming that a suitable guarantee from a creditworthy P&I Club is sufficient to constitute a Limitation Fund.

Brief Facts

Various claims from different parties were brought against the Appellant shipowners ("Owners") whose vessel, the "Atlantik Confidence", had sunk. The Owners applied to the UK Admiralty Court, seeking to limit their liability. Pursuant to the Convention, the Owners sought permission to constitute a Limitation Fund by provision of an LOU from their P&I Club, which was The Standard Club Europe Limited.

Issue

Article 11 of the Convention requires parties seeking to limit their liability to set up a Limitation Fund. Importantly, Article 11(2) states that:

“A fund may be constituted, either by depositing the sum, or by producing a guarantee acceptable under the legislation of the State Party where the
The UK is a signatory to the Convention. The Convention was given force of law in the UK by section 185 of the UK Merchant Shipping Act. The Court thus had to determine whether a P&I Club LOU is “a guarantee acceptable” under UK law and if such a guarantee is considered “adequate”, to validly constitute a Limitation Fund.

Holding of the High Court

The High Court Judge held that a P&I Club LOU is not an acceptable guarantee under UK law. This was based on the Judge’s analysis of the Civil Procedure Rules ("CPR"), which states at CPR Part 61.11 that “The claimant may constitute a limitation fund by making a payment into Court.”

The Judge concluded that the CPR only contemplates the constitution of a Limitation Fund by payment into Court and that, without any specific legislative provision that a guarantee is acceptable, a P&I Club LOU cannot constitute a Limitation Fund.

Holding of the Court of Appeal

The Court of Appeal overturned the decision of the High Court, finding that a guarantee such as a P&I Club LOU, is in fact an acceptable method of constituting a Limitation Fund.

On a plain reading, Article 11(2) of the Convention clearly grants the choice of whether to set up a Limitation Fund by way of a deposit into Court or by an acceptable guarantee. In light of this, a State Party would not be entitled to impose blanket exclusion on all guarantees.

The Court continued its analysis on whether a P&I Club LOU was “acceptable” under UK legislation and “considered to be adequate” by the Court, to determine if such an LOU could validly constitute a Limitation Fund.

On the first requirement of acceptability, the Court of Appeal disagreed with the High Court’s ruling, holding that there is no need for any specific legislative provision allowing for the constitution of a Limitation Fund by guarantee in order for a guarantee to be “acceptable”.

On the second requirement of adequacy, the Court of Appeal held that a guarantee would be “adequate” if the Court approving the constitution of the Limitation Fund is satisfied with the financial standing of the guarantor, the practicality of enforcement, and the terms of the guarantee instrument. The Court of Appeal noted parties’ agreement to leave the
Adequacy aspect with the Admiralty Court, it being the most familiar with and well-equipped to handle this aspect.

The Influence of the UK Court of Appeal Decision on Singapore Limitation Proceedings

Singapore is also a signatory to the Convention (albeit without acceding to the 1996 Protocol), which has been given force of law in Singapore through section 136 of the Singapore Merchant Shipping Act. Although the specific issue of whether a P&I Club LOU may be used to constitute a Limitation Fund has not been considered by a Singapore court, it is certain that Kairos Shipping will be an influential authority.

Besides legal arguments, the UK Court of Appeal in Kairos Shipping also took notice of a letter provided to the Court from the International Group of P&I Clubs. The letter highlighted the financial and practical benefits of the use of LOUs rather than a cash payment into Court. The letter also pointed out that numerous countries had already accepted P&I Club LOUs as an acceptable method of constituting Limitation Funds.

The Singapore Courts are well aware of the dominant practices relating to guarantees in the shipping industry, and are unlikely to be insensitive to sensible commercial practices. For example, as early as 1988, the Singapore High Court had exhibited its commercial wisdom in The Arcadia Spirit [1988] SGHC 8 (“The Arcadia Spirit”). It was decided in The Arcadia Spirit that a letter of guarantee from a P&I Club is sufficient security for the release of an arrested vessel, even if the P&I Club does not have any presence or assets in Singapore, and resides in a non-Commonwealth country. The Court noted that the P&I Club’s guarantees were internationally accepted by various governments, including Singapore, and that any default would be unlikely since the Club would want to maintain its international reputation.

In principle, the offer of a P&I Club guarantee to an individual plaintiff for the release of an arrested vessel bears much similarity to using a P&I Club LOU to constitute a Limitation Fund. Both are fixed amount guarantees used to secure the claims of a plaintiff, albeit a Limitation Fund guarantee would secure multiple plaintiffs instead. Given the commercially sensible view held by the Singapore High Court in The Arcadia Spirit, it would not be surprising if a Singapore Court is influenced by the commercially sensible views held in Kairos Shipping as well.

The issue of P&I LOUs is a matter of significance to the shipping industry, and unlike the UK which has CPR Part 61.11, on first blush there is nothing in Singapore’s Rules of Court that should limit the Court’s interpretation of Article 11(2) of the Convention. The decision in Kairos Shipping thus provides useful guidance should this issue arise in Singapore.
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