Constitution of a Limitation Fund: P&I Club LOU not accepted

In Kairos Shipping Limited v Enka & Co LLC (The “ATLANTIC CONFIDENCE”) [2013], the English High Court gave a ruling on whether a Limitation Fund could be constituted by way of a Letter of Undertaking (LOU) given by the owners’ Protection and Indemnity (P&I) Club, instead of the more common practice of a cash payment into court. Kairos Shipping Limited (Owners), were represented by Clyde & Co LLP.

The Convention on Limitation of Liability for Maritime Claims 1976 (as amended by the 1996 Protocol) (LLMC 1976) enables owners to limit their liability for claims arising out of a single maritime incident. Here, Owners sought to limit their liability by setting up a Limitation Fund on the basis of a P&I Club LOU. They submitted that Article 11(2) of LLMC 1976, which provides that “the Fund may be constituted either by depositing a sum or producing a guarantee acceptable under the legislation of the State Party where the Fund is constituted,” was given force of law by Section 185 of the Merchant Shipping Act 1995 (MSA 1995).

Article 14 of LLMC 1976 states that the rules in relation to the constitution of a Limitation Fund are to be governed by the law of the State Party; in England, the relevant law is the CPR (Civil Procedure Rules). The CPR does not specifically deal with the constitution of a Limitation Fund by way of a LOU, with CPR 66.11(18) providing that “the claimant may constitute a limitation fund by making a payment into court.” However, CPR Note 2(D) – 76.1, referring to The “RENA”, explains that “Although CPR 61.11(18) states that a claimant may constitute a fund by making a payment into court the Admiralty Judge, Teare J., has recently held that a Limitation Fund could be constituted by a guarantee contained in a Letter of Undertaking to the court provided by a well known foreign based Protection and Indemnity Insurer.”

Owners also submitted that even if the CPR was inconsistent with the constitution of a Limitation Fund by way of a LOU, then the terms of Section 185 of MSA 1995, and Article 11(2) of the LLMC, are not, and the former must yield to the latter. Furthermore, constitution of a Limitation Fund by way of a LOU is not prevented by the Statute of Frauds which is the general body of English statute law affecting guarantees.

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1 See Dania Shipping Co v MSC Mediterranean Shipping Company S.A. [2012]
Although no party at the hearing argued against the Owners’ submissions, Simon J decided that none of these provided any assistance to the proposition that a Limitation Fund could be set up by way of a LOU.

The question the Judge addressed was whether a guarantee from the Owners’ club was effective to constitute a Limitation Fund for the purposes of CPR61, and the LLMC 1976 scheduled to MSA 1995. It was noted that it could seem surprising in today’s world that a suitably framed guarantee in an appropriate amount from a creditworthy provider was not effective security, and was therefore insufficient to constitute a Limitation Fund but the Court had to approach the issue as a matter of principle. It was suggested that the real question was whether any guarantee was acceptable under national legislation. Simon J stated that he was not “persuaded that the CPR enables the court to direct that the fund can be constituted other than by payment into court” and that “Practice Direction 10.10.10 to 13 are entirely directed to the constitution of the fund by payment into court.” It was Simon J’s opinion that there was nothing in MSA 1995 or the CPR to justify reversing the previous well established practice. It was concluded that in the absence of a specific statutory provision rendering a guarantee acceptable, the rule remained that a Limitation Fund could only be constituted by making a cash payment into court. It was noted that consideration should be given to effecting a change in the law, and permission to appeal was given.

This long established English practice, allowing only for payment into court, is at odds with what is happening elsewhere. Within the shipping industry, LOUs are widely accepted as valid security, and some European States, who are party to LLMC 1976, regularly accept P&I Club LOUs as the basis for constituting Limitation Funds.

The “ATLANTIC CONFIDENCE” decision is unlikely to be welcomed by shipowners generally. It deprives them of a speedy, economically viable, cost-effective means of constituting Limitation Funds. It also runs the risk of encouraging shipping interests to turn to other more LOU-friendly jurisdictions thereby prejudicing England’s predominant position in the shipping sector.

Clyde & Co will represent Owners in their appeal.