STEPHENSON HARWOOD

August 2024

Commodities in Focus Weekly – issue 90

Construction of a *"pay as may be paid"* clause in charterers' liability insurance – *MS Amlin Marine NV on behalf of MS Amlin Syndicate AML/2001 v (1) King Trader Limited (2) Bintan Mining Corporation (3) The Korea Shipowners' Mutual Protection & Indemnity Association* [2024] EWHC 1813 (Comm)

In recent Commercial Court proceedings in *MS Amlin v King Trader Limited* the Court was asked to consider whether a "pay as may be paid" clause in a policy of charterers' liability insurance had the effect that no indemnity was payable by the insurer where the assured had not discharged the legal liability for which indemnity was sought. The Court concluded that in this specific scenario, no indemnity was payable because the assured had not discharged the legal liability for which the indemnity was sought.

Facts

King Trading Ltd (the "**Owner**") time chartered the vessel SOLOMON TRADER (the "**Vessel**") to Bintan Mining Corporation ("**BMC**") on 29 May 2017. BMC took out a policy of charterers' liability insurance (the "**Policy**") from Amlin on 28 March 2018, with cover incepting for 12 months from 1 April 2018.

The Policy took the form of an insurance certificate (the "**Certificate**") and an attached Amlin wording entitled "Charterers' Liability: Marine Liability Policy 1 – 2017" (the "**Booklet**").

The Certificate described the insurance as "Charterers' Liability including Liabilities for damage to Hull Class 1", and among identifying the security, the vessels covered, period of insurance and the maximum amount insured (USD 50m) and other similar terms, in section headed "Conditions" stated "as per Marine Liability Policy for Charterers 1-2017 as attached", with specifying some specific conditions, one of which was that war risk cover was as per "Part 4 of Marine Liability Policy for Charterers 1-2017". The Certificate also set out the payment terms, in a provision which provided that breach of the payment terms might lead to rejection of all claims whether arising before or after the breach.

The Booklet was made up of five parts but the effect of the Certificate was that only Parts 1 (Part 1 Charterers Liability – Class 1) and 4 (Part 4 War Risk Protection Cover) formed part of the Policy.

The opening of Part 1 provided that *"The Company shall indemnify the Assured against the Legal Liabilities, costs and expenses under this Class of Insurance which are incurred in respect of the operation of the Vessel, arising from Events occurring during the Period of Insurance as set out in sections 1 to 17 below"* and in the definitions section, *"Legal Liability"* was defined as *"Liability arising out of a final unappealable judgment or award from a competent Court, arbitral tribunal or other judicial body".*

Part 1 did not specifically refer to the general terms and conditions, however section 25 of Part 5 provided that any contracts of insurance for Class 1, 2 or 3 incorporate the general terms and conditions and also provided that the terms and conditions in each class of insurance would prevail over the general terms and conditions in the event of conflict, with the terms of the Certificate taking precedence over everything else.

Part 5, inter alia, contained the following provision, the provision in issue:

"It is a condition precedent to the Assured's right of recovery under this policy with regard to any claim

by the Assured in respect of any loss, expense or liability, that the Assured shall first have discharged any loss, expense or liability."

On 4-5 February 2019, the Vessel grounded in the Solomon Islands.

On 25 March 2021, BMC went into insolvent liquidation in the British Virgin Islands.

Amlin commenced proceedings on 5 October 2022 seeking a determination that no indemnity was payable by it because BMC had not discharged its liability for which indemnity was sought.

On 14 March 2023, an LMAA arbitral tribunal sitting in two references in Hong Kong found BMC liable in damages, and interest, to the Owner and Korea Shipowners' Mutual P&I Association ("**KP&I**") (Owner and KP&I together as "**Third Parties**") in respect of the grounding and further costs awards were made by the LMAA tribunals, again in favour of the Third Parties on 20 January 2024, with the total amount awarded to Owner and KP&I exceeding USD 47million.

BMC was wound up on 24 April 2024.

The Third Parties (Rights against Insurers) Act 2010

Section 1 of the Third Parties (Rights against Insurers) Act 2010 (the "**Act**"), provided certain conditions are met, transfers and vests insured's rights under a policy in respect of insured liabilities where the insured incurs a liability against which it is insured and becomes insolvent in third parties, who are then entitled to bring a direct claim against the insurer to enforce those rights.

Here this meant that BMC's rights under the Policy in respect of the insured liability were transferred and vested in the Third Parties who were entitled to bring a direct claim against Amlin to enforce those rights. BMC's liability to the Third Parties had been established for the purposes of the Act.

Of relevance was also section 9 of the Act, which deals with situations where the transferred rights are subject to a condition that the insured has to fulfil. Section 9(5) of the Act provides that transferred rights are not subject to a condition requiring prior discharge by the insured of the insured's liability, but that is qualified for marine insurance, which the Policy was, by section 9(6), which provides that the statutory overriding of any condition requiring prior discharge applies only to the extent that the liability of the insured is a liability in respect of death or personal injury, which was not the case here.

Commercial Court Decision

In these proceedings Amlin sought a determination that no indemnity was payable by it to the Third Parties because BMC had not discharged its liability.

This was contested by the Third Parties who argued that either the "pay first" clause did not form part of the Policy, or as a matter of construction it should be interpreted as not applying where a third party seeks to enforce the Policy, or the insured is unable to discharge the liability or is insolvent, or that a term should be implied into the Policy to this effect. It was argued that the only condition for liability was a final judgment not the judgment *and* the discharge of that liability by payment by the assured.

The Third Parties put forward several arguments, alleging that the "pay first" clause was repugnant to the terms of the Certificate, that it was repugnant to the main purpose of the Policy and that it was inconsistent with the other provisions in Part 5 of the Policy.

The Judge considered the relevant lines of authority and helpfully summarised the legal principles which would need to be considered when construing the Policy and noted that in circumstances such as this the Court would not apply a set of binary rules, but rather the answer will reflect the interplay of a number of factors. The relevant principles of construction were as follows:

(i) Where the alleged inconsistency is between a clause specifically agreed for the contract in issue, and a provision in an incorporated set of pre-existing printed terms, it will be open to the Court to find that the clause in the printed terms is not incorporated at all, or, if it is, the Court will be more ready to read it down.

(ii) Where the alleged inconsistency is between two clauses which appear in a single document, the argument that one of the clauses is not incorporated is very difficult and the court will be more likely to conclude that the clauses were intended to co-exist and construe them accordingly.

(iii) In determining whether and to what extent two clauses can co-exist, it is relevant to consider whether giving effect to the supposedly repugnant clause will still leave the more substantive clause with a real and sensible content and if the subsidiary clause is to be read down, whether it will be left with a meaningful and sensible content.

(iv) There will be greater readiness to read down, or read out if necessary, a subsidiary clause which is inconsistent with a provision which forms part of the main purpose of the contract, or which is inapposite to the main contract into which it is to be incorporated.

The Judge was not convinced by the arguments advanced by the Third Parties that the "pay to be paid" clause should be read out of the Policy on the grounds of repugnancy or inconsistency with the terms of the Certificate or Part 1, the main purpose of the Policy, or other provisions of Part 5, or "ruthlessly" read down.

Whilst the Judge accepted that a clause such as this which has the effect of imposing a restriction on the right to enforce the indemnity arising under the Policy, the "pay to be paid" clause had to be expressed in clear language, which it was.

Nor was the Judge convinced of the Third Parties' arguments on construction, in which they suggested that the "pay to be paid" clause is applicable only where the insured has the means to pay or that it does not apply at all in the event of insolvency, or implication, because there was no necessity or business efficacy to require the implication of words limiting the operation to those scenarios.

The Court therefore found for Amlin, with the effect that because BMC had not discharged its liability, no indemnity would be payable by Amlin to the Third Parties.

Comment

The short judgment contains an interesting background to the Act and the treatment of "pay first clauses", which limit a right to indemnity for liability risks to circumstances in which the relevant liability needs to be discharged by the insured, and are also found in P&I Clubs' Rules, and a very thorough analysis of the principles applicable to the construction of contracts. It makes an interesting read to anyone taking out charterers' liability insurance, and dealing with contract negotiation in general.

The Judgment also includes an interesting post-script by the Judge noting that "pay first" clauses reduce the efficacy of the protection these types of liability policies offer where the entities involved take out insurances to be made whole for liabilities, but then find themselves in a position where they would be unable to claim on the insurance, as they would not be able to pay, or even find themselves rendered insolvent.

As "pay first" clauses have been left largely outside the statutory control, other than in the case of personal injury and death the effect of these are left to the common law rules on incorporation, interpretation and implication and the position can vary from one case to another, depending on the underlying facts.

Please click here for a copy of the full judgment.

Author

Monika Humphreys-Davies

Managing associate, Dubai

T: +971 4 407 3928
E: monika.humphreys-davies@shlegal.com

Contact us

We hope that you find this update both useful and interesting. If you have any comments or would like to learn more about this topic, please get in touch with either your usual SH contact or any member of our commodities team by clicking here.

STEPHENSON HARWOOD