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Maritime Law News Update

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I. Introduction of Court Decisions

1. English governing law clause under cargo insurance contract

(Korean Supreme Court case 2016.6.23. Docket No. 2015da5194)

(1) Fact

A Korean cargo owner entered into a cargo insurance contract with a Korean insurer. There were two clauses included. First, all matters concerning the liability arising out of insurance policy shall be governed by and construed in accordance with the laws and customs of England. Second, if a cargo owner does not inform an insurer that an insured cargo was loaded on board, the insurance coverage of the contract shall be decreased to 'Free from Particular Average' condition which does not cover general partial loss except for jettison and washing overboard (so called 'On-Deck Clause').

On June 4, 2012 the cargo was loaded on deck of the 'MV Reis G' at the port of Shanghai. On July 7, 2012 during the voyage, one of four boiler packages fell from the vessel and was lost at sea on the coast of Oman because of the heavy weather (Beaufort scale from 8 to 9).

Upon receipt of the insurance claim by the plaintiff, the defendant (the insurer) terminated the insurance contract because of the breach of duty of disclosure by the insured. Also, the defendant claimed that he had no obligation to pay for the insurance proceed because he was not informed that the cargo was loaded on board so that the case fell within the scope of 'Free from Particular Average' condition which does not cover general partial loss except for jettison and washing overboard. The plaintiff counterclaimed that the insurer breached the duty of explanation by the insurer under the Korean Act for regulating General Terms. The Seoul High Court ruled that the terms and conditions of the contract were governed by the English governing law clause so that the Korean Act for regulating General Terms should not be applied and also ruled that there was no washing overboard accident. The plaintiff lost the case.

(2) Decision of the Korean Supreme Court

1) The governing law clause in the case stipulates that the contract is governed by the laws and customs of England regarding only the liability of an insurer rather than regarding the whole contract itself. So the Korean law which is the law most closely related to this contract shall be applied to the matters except for the matter of liability. The duty of explanation is the matter of whether the clause is included into the contract or not, not the matter of the liability of the insurer (which shall be governed by English according to contract) and thus the Korean Act for regulating General Term shall be applied. A person in charge of insurance contract from the plaintiff has been engaged in marine cargo insurance contracts for about 10 years from 2003, and has signed 30 to 50 contracts while being in charge of signing cargo insurance contracts. Since the plaintiff seemed to be fully aware of the content of the On-Deck Clause when signing the contract, the On-Deck Clause shall be included into the contract even if the defendant did not explain the content. It is wrong to judge that the Korean Act for regulating General Terms is not applied to the contract, however, the On-Deck Clause is not a subject of the duty of explanation because the plaintiff was fully aware of the content of the clause. Thus, even if the defendant did not explain the content to the plaintiff, the On-Deck Clause shall be included into the contract.

2) Under a cargo clause governed by English Law, Washing overboard simply means the accidental loss of cargo loaded on board by the direct action of the sea water. Therefore, Loss overboard, which means the loss of cargo loaded on board by the rolling and the leaning of the vessel due to bad weather, is not covered by the On-Deck Clause.

The Seoul High Court rejected the plaintiff's claim that the boiler was lost at sea because of the direct action of the sea water which entered on the deck due to 'Heavy Weather' for the following reasons; (i) If the cargo is lost by the rolling and leaning of the vessel due to bad weather, the loss does not correspond to Washing overboard, (ii) when the incident occurred, although the weather was monsoon climate accompanied by strong southwester wind, waves were not violent enough to sweep through the boiler which weighed about 54.5 tons, (iii) Clyde & Co (a law firm in UK) presented an opinion ; 'The securing of the boiler was inappropriate. The boiler was not washed overboard but slipped off the board when the vessel was rocking heavily due to bad weather. Thus, the Seoul High court concluded that the loss of the cargo in the case did not correspond to washing overboard. Accordingly, the decision of the High Court is correct and affirmed.

(3) Opinion

1) English governing law clause

The effect of English governing clause has been decided several times by the Korean Supreme Court. The Court shows firm view that it is valid and enforceable. There are also disputes on how to decide governing law under the same clause.

When a clause in a cargo insurance contract stipulates that English law is a governing law, concerning only 'liability' in the Korean Supreme Court case *1991.5.14. Docket no. 90daka25314'*, the Court did not apply Korean Commercial Code but applied for English law to the case because the breach of the duty of disclosure was included in the scope of 'liability'. Also, in the case of 'Korean Supreme Court *1998.7.14. Docket no. 96da39707'*, the Court ruled that if there was a clause saying that all matters concerning 'liability and settlement' shall be governed by and construed in accordance with English Law was included in a contract, Korean Law shall be applied concerning

the insurer's duty of explanation because it is not related to the liability and settlement issue.

The issue in the case was whether the English governing law would be applicable for the case regarding the duty of explanation of the insurer. The Korean Supreme Court ruled that the duty of explanation was about the content of the contract so it was different from 'liability', and thus there was no governing law clause to be applied about the duty of explanation. Therefore, the Court applied the Korean Act for regulating General Terms, which is the law most closely related to this contract according to Korean International Private Law, as the governing law. According to the Article 3 of the Korean Act for regulating General Terms, an insurer has a duty of explanation and if the insurer did not discharge it, the agreement (in the case agreement of On-deck clause) is not allowed to be enforced. However, an insured was supposed to know the content of the On-Deck Clause because he has been engaged in signing insurance contracts for long time. Therefore, the Court decided that the clause was not subject to the duty of explanation.

2) The difference between 'Washing overboard' and 'Loss overboard'

Loading a cargo on board is a risky job, so if an insured does not pay an additional insurance premium, an insurer will not be willing to pay the insurance proceeds. Therefore, the parties tend to include the On-Deck Clause in their contracts which covers only jettison and Washing overboard. The Supreme Court said that if a cargo was lost due to external factors such as rolling and leaning by Heavy Weather, it is called 'Loss overboard'. However, 'Washing overboard' is the loss of a cargo by the direct action of the sea water. The court concluded that the accident in this case occurred because the cargo slipped off the vessel due to the inappropriate securing not due to the waves, so it is not 'Washing overboard' accident which is covered by the insurance contract.

2. BBCHP's legal nature under Rehabilitation Proceeding

(Changwon District Court decision 2017.2.23. Docket No. 2016la308)

(1) Fact

M/V Hanjin Xiaman, a vessel which was registered in Panama, was operated by the Hanjin Shipping (Hanjin) under BBCHP(Bareboat Charter Hire Purchase) agreement and owned by a SPC. Hanjin was supplied bunker oil during its operation by an oil supplier. The supplier who had a right to claim fuel oil cost claimed that he had a maritime lien as a creditor under the Panamanian law according to Korean International Private Act Article 60. According to Panama Law No.55 of 6 August 2008 Article 244 (9)), the bunker supplier has a maritime lien under the name of creditors with debts incurred in providing for the vessels' necessaries and accessories. The creditor applied for voluntary auction to Korea Changwon District Court against the vessel and subsequently the court allowed it on Oct. 7, 2016.

According to Korean Debtor Rehabilitation and Bankruptcy Act(hereinafter Rehabilitation Act) Article 58, where a decision to commence rehabilitation procedures is made, creditor's execution based on any rehabilitation claim or rehabilitation security right, against debtor's property, shall be prohibited. Therefore, if Hanjin Xiaman is regarded as a kind of the property of Hanjin, any execution or prejudgment attachment shall be prohibited.

The Changwon District Court allowed the creditor to arrest the vessel which implied that Hanjin Xiaman was a BBCHP vessel registered in Panama, not owned by Hanjin, and thus it was not subject

to the prohibition of execution under the Rehabilitation Act Article 58. Hanjin appealed the decision to start the auction. In the Changwon District Court decision *2016.10.17. Docket No. 2016taki227*, the court decided that the vessel was not owned by Hanjin, therefore it is not subject to Debtor Rehabilitation and Bankruptcy Act Article 58. Hanjin made an appeal against the decision.

The grounds of appeal were as follows ;

(i) Hanjin established a paper company 'Panamanian SPC 1' and registered the vessel as a Flag Of Convenience (FOC) vessel in order to put it up as collateral for ship mortgage. Hanjin made a BBCHP agreement and paid the mortgage as the payment of charter hire and then borrowed 16,000,000,000 KW more from the creditor, registered the vessel as a FOC vessel at 'Panamanian SPC 2', made a BBCHP agreement and paid the mortgage as the payment of charter hire. Therefore, the one who practically owns the vessel is Hanjin, not Panamanian SPC 2. Under rehabilitation proceeding, the owner of the vessel shall be Hanjin and the creditor's maritime lien shall be regarded as a reorganization secured claim.

(ii) Even if the vessel is decided to be owned by Panamanian SPC 2, because supervision and preservation under the auction of the vessel infringed on the Hanjin's possession of the vessel, they shall be seen as execution of the property of Hanjin. Therefore, the execution shall be prohibited according to the Rehabilitation Act Article 58 because it is a kind of execution based on a rehabilitation claim or rehabilitation security right under the above Act.

(iii) The vessel was heading to Shanghai, having called at Pusan New port on her route, and got ready to sail for her final destination. Therefore, according to Korean Commercial Code Article 744, saying that neither arrest nor prejudgment attachment shall be imposed on a ship which has already completed preparations for a sailing.

(2) Court's decision

Where a decision to commence rehabilitation procedures is made, execution based on any rehabilitation claim or rehabilitation security right shall be prohibited (Debtor Rehabilitation and Bankruptcy Act Article 58). The prohibition is only imposed upon the property of a debtor. The execution of the property of third parties such as a joint debtor, a guarantor or a person who pledged one's property to secure another's obligation is not prohibited. Under BBCHP agreement, Hanjin has only the expectation right to obtain the title at the end of the charter period on the condition that it pays the charter hire completely without fail. A charterer is not able to own the ship even if the vessel is a FOC vessel. The bareboat charter agreement in this case is a BBCHP agreement and the charter period ends on 2019.3.12. While the period is not over yet, the owner of the vessel is Panamanian SPC 2.

Taking into consideration that the vessel is an international vessel, a SPC was established, the vessel was under flag of convenience, there was an bunker oil supply agreement with the respondent and the bank's relying on the ownership relation, regarding the vessel as the property of Hanjin under rehabilitation proceedings may greatly inflict the foreseeability and legal stability of the stakeholders including claimant under international transactions.

Also, even if Hanjin's possession of the vessel under the BBCHP agreement in the case was damaged as the result of execution, it is just the fallout of the execution. It is not the same as the execution of the possession itself. Hanjin's possession of the vessel is only one of contractual rights, therefore it is not allowed to argue against a third party.

Therefore, the Debtor Rehabilitation and Bankruptcy Act Article 58 is not applicable to the case

because the auction of the vessel shall not be seen as the execution of an obligor's property. The argument of the applicant is rejected.

Neither arrest nor prejudgment attachment shall be imposed on a ship which has finished preparations for a voyage (Korean Commercial Code Article 744 (1)). Finishing preparation for a voyage generally means that the ship meets the actual, legal prerequisites of law to make immediate departure possible, which also means that all crews are on board, loading cargo is finished and documents required for departure are completed. There is no evidence that the vessel has get ready for starting her voyage but rather according to the record, the vessel was going to start to load the cargo for Ningbo and Shanghai, China after October 6, 2016 when the decision to start the auction was made. Therefore, the argument of the applicant to appeal is rejected.

(3) Comment

Just like the first trial(please refer to comment in Vol. 16), Hanjin claimed that it actually owned the vessel but it established a SPC as a registered owner in a FOC country for the purpose of facilitating financial arrangement with the loan company. Under the arrangement, Hanjin put the vessel as a collateral for the loan company and it enters into BBC HP agreement with SPC. Therefore, Hanjin argued that it was the real owner and thus the vessel should be regarded as the property of Hanjin as a result the vessel should not be subject to arrest under the Rehabilitation Act.

However, Changwon District Court ruled that even if the company actually owns the vessel, it is not the legal owner of vessel because the vessel was registered in a FOC country with a SPC as owner, from the viewpoint of creditors and banks. The rationale of the judgment was enhancing legal stability and foreseeability among stakeholders.

Hanjin said that they operated 61 owned vessels. However, 55 vessels among 61 vessels were re operated under BBCHP agreements. If the Rehabilitation Act Article 58 is not applicable for the BBCHP vessels, almost all of vessels are subject to execution by creditors. If that is the case, Hanjin's rehabilitation becomes impossible because vessel is no longer engaged for the debtor's business. Therefore, there is urgent need to include BBCHP vessel as one of the property of debtor by the revision of Art. 58 of the Rehabilitation Act.

The court's interpretation on the 'preparation of a voyage' for the purpose of prohibiting vessel ready for sailing under the Korean Commercial Code Article 774 is recorded as the first decision on the issue.