60 EAST 42ND STREET, SUITE 1638
NEW YORK, NY 10165
(212) 354-0025
FAX: (212) 869-0067

TL@TISDALE-LAW.COM

TISDALE
LAW OFFICES, LLC

New York, NY · Southport, CT

10 SPRUCE STREET
SOUTHPORT, CT 06890
(203) 254-8474
FAX: (203) 254-1641

WWW.TISDALE-LAW.COM

Classification Society Liability after PRESTIGE

Introduction

Classification Societies have been described as the historical offspring of the union of marine insurers and vessel owners, attended by the merchant. In the 17th and 18th centuries, owners needed technical assistance to improve the seaworthiness of their vessels and insurers needed the comfort of knowing that the vessels they were insuring were indeed seaworthy. Merchants also were interested in the reliability of the vessels in which their goods might be carried. Over the course of the 18th and 19th centuries, Classification Societies were founded to provide reliable information and to supervise and improve construction and maintenance of vessels for owners and insurers. By the end of the 19th century, Classification Societies were relied upon by owners to provide the certification that was more and more becoming necessary to comply with international conventions and national laws of the flag states, to provide the necessary assurance to marine underwriters and to permit them to take advantage of entry into P&I Clubs. Charterers, cargo interests, and banks all came to rely upon the assurances given by a Classification Society as to the integrity of the vessel in which they may be interested for their own varied purposes.

In order to establish the vessel's integrity, Classification Societies established rules for the design, construction and periodic survey of numerous types of vessels. The Society performs classification surveys to determine whether the ship's structure and conditions satisfy their rules. If the ship meets the requirements, the Society issues a Classification Certificate for the ship. These classification surveys are conducted in regular five year cycles subsequent to the issuance of the initial Classification Certificate to determine whether the ship remains in satisfactory condition. In addition, Classification Societies conduct statutory surveys for the benefit of the flag states that are parties to various international treaties that oblige them to regulate ships sailing under their flags. These Statutory Certificates certify that the vessels comply with the specific international treaties. These are generally referred to as the SOLAS, Load Line, MARPOL etc., certificates.

In an early case on the issue, *Great American Insurance Company v. Bureau of Veritas*, the court recognized two duties arising from classification surveys of vessels:

> The first duty, as already discussed, is to survey and classify vessels in accordance with rules and standards established and promulgated by the Society for the purpose. The second duty of the Classification Society is that of due care in the detection of defects in the ships it surveys and corollary of notification thereof to the owner and charterer.

338 F. Supp. 999, 1011-12 (S.D.N.Y. 1972), *aff'd*, 478 F.2d 235, (2d Cir. 1973).

Some authors have questioned the inclusion of the term "and charterer" in the obligation of notification by a Classification Society.

A number of cases against Classification Societies for alleged breaches of their duties in the issuance of classification and statutory surveys have arisen. A pattern, albeit somewhat unclear, has arisen from these decisions.

Liability of Classification Societies to Shipowners

Generally speaking, courts have not looked favorably upon a vessel's owner's right to recovery against Classification Societies for their failure to detect defects or deficiencies. As previously mentioned, the *Great American* court established the two duties owed by Classification Societies. However, when it comes to a suit for breach of these duties by vessel owners, the court has declined to extend liability against the Classification Society for breach of these duties. Courts have traditionally found that extending this rule to a shipowner would undermine the traditional doctrine of imposing upon the shipowner a non-delegable duty to exercise due diligence to maintain its vessel in a seaworthy condition. If courts were to recognize such a cause of action "the accountability of owners for the unseaworthiness of the vessel for all practical purposes would evaporate." *Id.* at 1012. The Second Circuit twenty years later in *Sundance Cruises Corporation v. American Bureau of Shipping*, 7 F.3d 1077, 1084 (2d Cir. 1993) went on to reaffirm this position, stating "ABS cannot be said to have taken over Sundance's obligations in this regard by agreeing to inspect and issue a classification certificate to Sundance." *Id.*

Insofar as the reliance on Statutory Certificates is concerned, vessel owners are generally unsuccessful in their pursuit of the Classification Society. Because agreements for the classification of ships involve maritime contracts, these contracts are governed by maritime law and are therefore subject to federal maritime choice of law rules. Federal maritime choice of law principles are derived largely from the Supreme Court's decision in *Lauritzen v. Larsen,* 345 U.S. 571 (1953) and its progeny. As discussed later, this choice of law analysis involves seven, sometimes eight factors (which are non-exclusive and which are not to be mechanically applied), to assist the court in determining what substantive law should be applied.

Generally speaking, however, when a shipowner is a party to the litigation and the flag is found not to be a "sham" country (so-called "flags of convenience"), in establishing the liability for issuance of statutory certificates courts generally apply the law of the flag as "the most compelling because of the flag state's clear and powerful interest in the actions that are at the heart of this case." *Sundance Cruises Corp. v. American Bureau of Shipping*, 799 F. Supp. 363, 387 (S.D.N.Y. 1992). In the capacity as the party responsible for the issuance of Statutory Certificates, Classification Societies are found generally to be "persons" entitled to immunity as nominees of the flag state which generally has incorporated some provision allowing it sovereign immunity for negligence in the exercise and performance of any of its duties.

Classification Society Liability to Third Parties

As previously advised, in determining the liability of the Classification Society, U.S. courts initially will perform a conflict of law analysis utilizing the *Lauritzen* test. The factors generally relied upon in such a test include the following:

1. The place of the wrongful act;
2. The law of the ship's flag;
3. The domicile of the injured party;
4. The domicile of the shipowner;
5. The place of the contract;
6. The inaccessibility of the foreign forum;
7. The law of the forum; and
8. The shipowner's base of operations.

When there is privity of contract, "the tendency of the law is to apply in contract matters the law which the parties intended to apply." *Lauritzen,* 345 U.S. at 589. Where no privity of contract exists, the law incorporated in the contract is of little significance.

Although the court in *Lauritzen* emphasized the importance of the law of the flag which "overbears most other connecting events in determining applicable law," its application is limited. The *Lauritzen* court noted that the strong considerations in favor of applying the law of the flag "must prevail unless some heavy counterweight appears." 345 U.S. at 586. The law of the flag is only one of several factors and is much less significant when the shipowner is not a party to the suit.

> Whatever significance law of the flag may have in cases where the ship or its owner is a party and where other factors fail to point clearly to another jurisdiction's law, we see no reason to apply the law of the flag here in preference to that of another jurisdiction whose ties are more pertinent to the dispute, especially given the fact that neither the ship nor the owner is a party.

Carbotrade S.p.A. v. Bureau Veritas, 99 F.3d 86, 92-93 (2d Cir. 1996).

In *Carbotrade S.p.A.,* the Second Circuit applied the law of Greece as the place where the tortuous act was committed. The court was further compelled to using the law of Greece because of the presence of the Classification Society office there, and that Greece was the vessel operating company's base of operations, giving "Greece considerably more substantial contacts than back at the law of the flag" with this dispute. *Id.* at 92.

Thus, it is not unusual for a U.S. court to apply foreign substantive law in determining the rights and liabilities of the Classification Society in a particular case. *Carbotrade* was tried under Greek law as was *Sealord Marine Co. v. American Bureau of Shipping*, 220 F. Supp. 2d 260 (S.D.N.Y. 2002).

United States courts applying U.S. law in actions against Classification Societies have held, with respect to an injured third party who relied on the Classification or Safety Certificates, a cause of action may exist. Generally, the cause of action is viewed as one of negligent misrepresentation by the Classification Society. To prevail on a cause of action for negligent misrepresentation under Section 552 of the Restatement (Second) of Torts, the claimant must establish the following:

1. The Classification Society, in the course of its profession, supplied false information for the claimant's guidance in a business transaction;
2. The Classification Society failed to exercise reasonable care in gathering the information;
3. The claimant justifiably relied on the false information in a transaction that the Classification Society intended to influence; and
4. The claimant thereby suffered pecuniary loss.

Otto Candies, LLC v. Nippon Kaiji Kyokai Corporation, 346 F.3d 530, 535 (5th Cir. 2003).

By far, the most heavily litigated element is the claimant's need to establish a close relationship to the Classification Society. In particular, a plaintiff claiming negligent misrepresentation must be a "person or a member of a 'limited group' of persons, for whose benefit and guidance the defendant either intends to supply the information or knows that the recipient intends to supply it." *Otto Candies,* 346 F.3d at 535. The idea that it is merely possible or foreseeable that a non-client of the information supplier would rely on the information is insufficient. Cases in the Second Circuit have described the relationship necessary as approaching privity between the Classification Society and the party claiming reliance on class, relying on a long line of New York state cases including *Glanzer v. Shepard*, 233 N.Y. 236 (1922) (Cardozo, C.J.); *Credit Alliance Corp v. Arthur Anderson & Co.*, 65 N.Y. 2d 536 (1985), and others.

Reino de España v. The American Bureau of Shipping

With its long and exhaustive history, *Spain v. ABS* addresses some new issues and defers other issues for a later day. On November 19, 2002, the M/T PRESTIGE, an oil tanker, sank off the coast of Spain discharging millions of gallons of oil along 140 miles of the Spanish coast causing significant environmental and economic effects. The PRESTIGE was classed by ABS from the time of its construction in 1976 and was surveyed and classed by ABS throughout its operational life. The vessel had been flagged by the Commonwealth of the Bahamas since 1994 and sailed under the flag of the Bahamas from that time until its sinking. ABS is a Recognized Organization pursuant to its contract with the government of the Bahamas and is authorized to carry out statutory surveys of Bahamian flag ships. None of the surveys in question were performed in Spain and there was no evidence that Spain communicated, in any way, with ABS or reviewed any of the certificates prior to the casualty. Spain is a signatory to the International Convention on Civil Liability for Oil Pollution Damage, adopted November 29, 1969, 973 U.N.Y.S. 3 (1975, as amended by the 1992 protocol, 1997 U.N.T.S. 255 ("CLC").

Shortly after suit was filed in 2003, ABS made a Motion to Dismiss the Complaint for lack of subject matter jurisdiction. ABS argued that it was entitled to the benefit of the exemption of liability found in the "channeling provisions" of the CLC. Further, ABS argued that, because Spain was a signatory to the CLC, Spain was obligated to pursue any claims it may have for oil pollution liability in other signatory states of the Convention. The United States is not a signatory to the CLC. Nearly four years after the motion was filed, the district court ruled upon ABS' motion and dismissed the Complaint for lack of subject matter jurisdiction. In so doing, the district court determined that the channeling provisions of the CLC limit the liability of "other persons who ... perform services for the ship ... unless the damage resulted from their personal act or omission, committed with the intent to cause such damage, or recklessly and with knowledge that such damage would probably result." (CLC Article III (4)). One year later, the Second Circuit Court of Appeals determined that the CLC does not divest the federal court of subject matter jurisdiction because the United States has not ratified that treaty. The court reserved decision on whether principles of *forum non conveniens* or international comity supported a discretionary decision not to exercise jurisdiction over the case. Upon remand, the district court maintained jurisdiction, but addressed a renewed Motion for Summary Judgment by ABS.

At the conclusion of discovery, ABS again filed a Motion for Summary Judgment. In regard to choice of law, Spain argued that the law of the United States should apply to its claims because ABS is a U.S. corporation and its alleged wrongful conduct, the issuance of the Classification Certificate, occurred in the United States. Alternatively, Spain argued that Spanish law should apply because the injured party is the sovereign state of Spain. On the other hand, ABS argued that the law of the flag should apply to all surveys, including the classification

surveys. Alternatively, ABS argued that the law of the United Arab Emirates and China should apply because the two surveys principally at issue were conducted in those countries. During oral argument, certain concessions were made by Spain's counsel and the court agreed that maritime law of the United States governed ABS' Motion for Summary Judgment.

One of the concessions made by Spain during oral argument was its abandonment of its claims premised on mere negligence. Presumably because of decisions addressing the policy considerations surrounding Classification Society liability (minor charges measured against potentially huge liabilities, the Classification Society's not-for-profit status, etc.), and the requirements to show a relationship approaching privity, Spain rested its claim entirely on "reckless conduct taken within the United States." *Reino de España v. American Bureau of Shipping*, 729 F. Supp. 2d 635, 643, n.3 (S.D.N.Y. 2010).

Relying upon another New York state court decision, *Eaves Brook Costume v. Y.B.H. Realty Corp.*, 76 N.Y. 2d 220 (1990), the court concluded that ABS had no cognizable duty owing to the plaintiff. *Reino de Espana*, 729 F. Supp. 2d at 644. In *Eaves*, however, the plaintiffs merely alleged negligence as opposed to recklessness. Other New York decisions such as *Strauss v. Belle Realty Co.*, 65 N.Y. 2d 399 (N.Y. 1985) have found that the duty to avoid grossly negligent conduct was no different from the duty to avoid negligence. Recognizing that gross negligence entailed a lesser degree of misconduct than reckless conduct, the court concluded that the duty owed is the same in recklessness as it is in negligence. The complaint was dismissed and an appeal was taken to the United States Court of Appeals for the Second Circuit.

On August 29, 2012, the U.S. Court of Appeals handed down its decision. The court noted the concessions made by Spain and its agreement that "policy interests" described in *Sundance Cruises* justify an exemption of Classification Societies from the general rule of negligence liability. Spain, however, maintained that such interests "do not .... extend to reckless conduct." *Reino de España v. American Bureau of Shipping,* 691 F.3d 461, 463 (2d Cir. 2012). The court also identified that the district court's decision was to the effect that Spain was outside the "quite limited" set of parties to whom a Classification Society might normally be liable in tort for conduct relating to its surveys. *Id.* The court also noted that the district court held that reckless conduct such as that alleged here would still not give rise to tort liability to a third party such as Spain, absent a pre-existing specific relationship between Spain and the society of a sort not present here. *Id.*

Instead of addressing the question head on, the Second Circuit of Appeals punted! The court stated the following:

> We conclude that we need not resolve the question whether a Classification Society may be held liable in tort to a third party such as Spain for reckless conduct in connection with the classification of vessels. Rather we assume *arguendo* for purposes of this appeal that defendants did owe the duty to Spain. In our view, Spain has nevertheless failed to adduce sufficient evidence to create a genuine dispute of material fact as to whether defendants recklessly breached that duty such that their actions constituted a proximate cause of the wreck of the PRESTIGE.

Id. at 463.

In a footnote, the court noted that "because Spain does not argue that Classification Societies may be held liable to third parties for negligence, we do not address that question either." (Citations omitted). *Reino de España*, 691 F.3d at 463 n.1. The Court of Appeals then reviewed each of Spain's allegations of ABS' recklessness and concluded that they either did not reach the level of recklessness or they did not proximately cause the sinking of the PRESTIGE. As there were no genuine issues of material fact, the Second Circuit Court of Appeals affirmed the district court's dismissal of Spain's Complaint, albeit on other grounds.

Seven years of discovery, two Motions for Summary Judgment and two appeals to the Second Circuit Court of Appeals later, we are no further along than when the PRESTIGE sank. Insofar as the test for a Classification Society's liability to third parties for negligence is concerned, U.S. law requires the establishment of a relationship approaching privity between the plaintiff and the Classification Society. In those specific, limited circumstances, liability has been established. *See, e.g., Otto Candies.* Whether or not that same level of relationship is required in cases of gross negligence or recklessness remains undecided at the Court of Appeal's level. Those issues have been left for another day.

Thomas L. Tisdale