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P&I CLUBS: 'PAY TO BE PAID' VERSUS DIRECT ACTION – THE IMPLICATIONS OF THE EUROPEAN COURT OF JUSTICE DECISION 'ASSENS HAVN'

Globally, many jurisdictions have legislated to allow actions to be brought directly by third party claimants against an insurer without first having to sue the insured. 'Direct action suits' as they are called, can be problematic for P&I Clubs and their members as they often circumvent exclusive jurisdiction clauses in P&I Contracts, and undermine the 'pay to be paid rule'. These issues were brought to light in a recent decision of the European Court of Justice (ECJ) which has significant implications for P&I Clubs.

On 13 July 2017, the ECJ handed down its decision Assens Havn (Judicial cooperation in civil matters) [2017] ECJ C-368/16 ('Assens Havn'). The ECJ held that the direct action suit could be brought either in (i) Denmark, where the harm occured, (ii) the courts of the EU State where the insurer is domiciled, or (iii) in the EU State where the claimant is domiciled.

This decision has the potential to undermine the agreed terms of P&I Contracts (at least in Europe) as a third party bringing a direct action suit against a P&I Club is not bound by the choice of jurisdiction clause in the P&I Contract. This position has not yet been uniformly accepted throughout the world.

Key issues

- In *Assens Havn* despite an express exclusive jurisdiction clause (English law, London courts) the ECJ allowed the injured third party to bring a 'direct action suit' against a P&I Club in Denmark, where the damage occurred.
- P&I Clubs may now be sued in EU states which allow for 'direct action suit' despite express jurisdiction clauses in the P&I Contract.
- In Europe, P&I Club '*pay to be paid*' clauses can be circumvented. English courts currently hold an opposing position on this issue.

BACKGROUND TO DISPUTE IN *ASSENS HAVN*

A Swedish charterer, Skåne Entreprenad Service AB (**Skane**), entered into a charterparty for the charter of tugs, including the *Sea Endeavour I,* for which Skane procured liability insurance with Navigators Management (UK) Ltd (**Navigators**). The choice of law clause in the P&I Contract provided for English law and the parties agreed to submit exclusively to the jurisdiction of the English courts. Upon arrival in Denmark on 24 November 2007, the *Sea Endeavour I* caused damage to the quay at Assens Havn. Skane went into liquidation before proceedings were commenced, so Assens brought a direct action suit in Denmark against Navigators under the P&I Contract, seeking compensation for the damaged the quay at Assens Havn.

Assens Havn relied upon Article 95(2) of the *Danish Insurance Contracts Act 1930* (Denmark), which allows a third party to bring a direct action suit against the insurer of the wrongdoer where the wrongdoer becomes insolvent. Navigators argued that Danish law did not apply and that the Danish courts did not have jurisdiction to make any findings in relation to the P&I Contract, which was governed by English law and provided exclusively for disputes to be submitted to the UK courts. At first instance, Assens Havn's action was dismissed by the Maritime and Commerical Court in Denmark on the basis of the exclusive jurisdiction and proper law clause in the P&I Contract, where the insured and insurer agreed upon UK law and courts. Assens appealed to the Supreme Court of Denmark, who decided to stay the proceedings and refer the matter to the ECJ.

On appeal to the ECJ

The central question on appeal was whether a third party claimant (Assens Havn) seeking to bring a direct action suit against the liability insurer (Navigators) was bound by the express jurisdiction clause in the P&I Contract between the insured (Skane) and the insurer. The ECJ was only asked to decide whether the Danish courts had jurisdiction to decide the dispute. Relevantly, Article 10 of the Council Regulation No 44/2000 (**Regulations**) provides that a liability insurer may be sued in the place where the harmful event occured. In addition, Articles 13.2 and 13.5 (now Article 15.2 and 15.5) allow parties to liability insurance contracts to depart from or contract out of the express jurisdiction provided in the Regulations.

In the ECJ, Assens argued that under Article 10 (now Article 12), Navigators could be sued under the P&I Contract in the Danish courts - '*being the place where the harmful event occurred'* - irrespective of the jurisdiction and proper law clause in the P&I Contract. Navigators argued in opposition that the provisions of the P&I Contract were paramount and provided for disputes to be settled in the UK courts, with English law applying, and that accordingly Assens Havn was bound by the express jurisdiction and proper law clause in the P&I Contract.

The decision of the ECJ

The ECJ found in favour of Assens Havn: that is, it found that the Danish courts had jurisdiction to hear and determine the direct action suit against Navigators, despite the express jurisdiction clause in the P&I Contract.

Despite EU law making it expressly clear that *'the provisions of this Section* [including, Article 10] *may be departed from only by an agreement',* (which was in fact the case when Skane and Navigators agreed upon UK courts), the ECJ allowed Assens Havn's dispute under the P&I Contract to be brought in the Danish courts. Accordingly, Assens Havn was not bound by the UK exclusive jurisdiction agreement between Skane and Navigators and was free to bring its direct action suit in Denmark.

The ECJ's decision was based on two grounds: (i) that the Regulations were aimed to protect the third party and thus enabled them to sue the insurer before the courts *'where the harmful event occured'* and (ii) the injured third party should not be bound by an agreement between the insurer and insured to which it was not privy.

The implications of the ECJ's decision

The legal and commercial effects of this decision are significant in EU States where direct action suits can be brought against insurers (Denmark, Finland, Norway, Sweden, Germany, Spain and Turkey). P&I Clubs may not be able to rely on exclusive jurisdiction clauses in those EU States, and may be the subject of direct action suits in either the place: (i) where the harmful event occurred; (ii) of domicile of the insurer; or (iii) of domicile of the claimant or the policyholder.

Although not specifically addressed in the ECJ's decision, it may follow from *Assens Havn* that third party claimants may circumvent the 'pay to be paid rule' and claim directly against the P&I Club, on the basis that they are not privy to the P&I Contract. This is especially in circumstances where other EU State courts may be less susceptible to giving effect to the 'pay to be paid rule'. The 'pay to be paid rule' is a standard form clause inserted into P&I Contracts which obliges the insured to first discharge its liability to the injured third party claimant before seeking the Club's indemnity – the member must pay (the claimant) in order to be paid. Given the potentially widespread ramifications of the ECJ's decision, we compare the position in other key jurisdictions.

COMPARATIVE POSITIONS

United Kingdom

The UK is home to the majority of the members of the International P&I Club Group. The UK has traditionally been seen as a safe haven for these P&I Clubs who can operate with predictable and established marine insurance law. There are strong historic, legal, economic and policy factors which are based upon the UK position. In the UK, an injured party pursuing a direct action against a Club must use the dispute resolution clause in the P&I contract. UK law specifically protects the 'pay to be paid rule' in the context of marine insurance contracts (see *Third Parties Act* s *9(6)*). The exception is under The *Third Parties (Rights against Insurers) Act 2010* (UK) (***Third Parties Act***) s 1(2), which allows a third party suit against a liability insurer where the insured is subject to insolvency proceedings.

The UK courts adopt a different approach to the issues raised in *Assens Havn.*

This position was solidified in 2016 with the Court of Appeal decision in *Shipowners' Mutual Protection and Indemnity Association (Luxembourg) v Containerships Denizcilik Nakliyat ve Ticaret AS (**Yusef Cepnioglu**)* [2016] EWCA Civ 386 which dealt with a near identical issue to *Assens Havn* except the dispute involved a Turkish direct action suit against Shipowners' Club. The P&I Contract provided for disputes to be settled by arbitration in London. In that case, the Court of Appeal safeguarded the Club's contractual right to defend claims in the forum specified in the P&I Contract even in the context of a direct action suit.

The facts of *Yusef Cepnioglu* are that a vessel grounded in Greece and was rendered a total loss. In May 2014, the defendant charterers commenced a direct action suit in Turkey against Shipowners' Club under Article 1478 of the Turkish Commercial Code which expressly allows direct action suits. The charterers sought security of USD13.5m over the Club's assets in Turkey. The Club Rules incorporated the 'pay to be paid rule'. The Club applied for and was awarded an anti-suit injunction to prevent the charterers from bringing the proceedings in Turkey, on the basis that the P&I Contract between the insured and Club contained an exclusive jurisdiction clause providing for arbitration in London, which was not defeated by a direct action suit.

At first instance, Justice Teare of the Queens Bench maintained the anti-suit injunction and required the insurance dispute to be settled by arbitration in London. The charterers appealed the decision on the basis that the right upon which the charterers were claiming was granted by Turkish statute and therefore Turkish law and courts were applicable. The Court of Appeal dismissed the appeal, finding that the dispute must be settled by arbitration in London in accordance with the terms of the P&I Contract which mandated London arbitration [20]-[21], [37] (Longmore LJ, with Moore-Bick and McFarlane agreeing). The Court of Appeal maintained the Club's anti-suit injunction against the Turkish proceedings. The Third Parties Act s 1(2) provides that the rights of the insured under the insurance contract with the insurer *'are transferred to and vest in the injured party'*. Hence, the injured party takes the insurance contract 'as is' – including any jurisdiction clauses (see, *The Padre Island* [1984] 2 Lloyd's Rep 408).

This approach provides certainty for P&I Clubs and their members. The policy in the UK is to protect 'pay to be paid' clauses (see Third Parties Act s 9(5)-(6)). In November 2016, the charterers were granted leave to appeal to the Supreme Court of the United Kingdom. As at August 2017, the decision is still pending – we will keep you updated on those developments.

Australia

Australian courts have dealt with 'pay to be paid' clauses within the context of aviation insurance. In *Lambert Leasing Inc v QBE Insurance Ltd* (No 2) [2015] NSWSC 1196 in the Supreme Court of New South Wales considered the House of Lords decision *The Fanti* [1990] 2 AC 1 (where the House of Lords held that payment to the third party under the P&I Contract was a precondition to indemnity under the P&I cover – it upheld the 'pay to be paid' principle). Rein J at [15]-[16] stated that 'pay to be paid' clauses are *'inherently inimical to the concept of insurance'* and should be construed narrowly. His Honour stated that *'it was 'entirely inappropriate' for a pay to be paid clause to be considered to represent a condition precedent to indemnity outside a club mutual insurance arrangement'* [20]. In the *Lambert's* case the Court construed the clause as not requiring the insured to pay the injured party as a

precondition for indemnity. It found that the clause in question, on a proper construction, only required the imposition of a liability on the insured, rather than a payment in discharge of that liability. A finding of liability supported the insured's entitlement to indemnity. The practical effect of the decision was that the insurer was able to pay the injured party directly on behalf of the insured (on a finding of liability against the insured) [20]-[21].

Australian courts do not allow a third party a general right of direct action suit against an insurer save where an insured: (i) becomes deregistered (*Corporations Act 2001* (Cth) s 601AG); or (ii) has died (*Insurance Contracts Act 1984* (Cth) s 51). Additionally, under the *Bankruptcy Act 1966* (Cth) s 117 where a bankrupt is or was insured against liabilities to third parties, the right to indemnity under the insurance contract vests in the appointed Trustee in Bankruptcy. This is analogous in situations of insolvency, where the liquidator must deal with the third party's claim (*Corporations Act 2001* (Cth) s 562).

At a state level, on 1 June 2017, New South Wales enacted the Civil Liability (Third Party Claims Against Insurers) Act 2017 (NSW), which allows a claimant a direct action suit 'to recover the amount of the insured liability from the insurer in proceedings before a court' (s 4(1)). Pursuant to s 5, the third party must, however, obtain leave of the Court to proceed with a direct action suit, and 'leave must be refused if the insurer can establish that it is entitled to disclaim liability under the contract of insurance or under any Act or law' (s 5(4)). At present, NSW is the only Australian state with these provisions. Previously, NSW used a system which allowed a third party access to all insurance moneys that are or may become payable in respect of a liability that the insurer would otherwise be required to pay to the defendant, by attaching a charge over those moneys – the Northern Territory and Australian Capital Territory retain this system.

In Australia, the right of direct suit has a very narrow scope and only in the circumstances set out above.

South Korea

Under the Korean Commercial Code Article 724(2), injured third parties are allowed to commence direct action suits *'for losses caused by accidents attributable to the insured, within the limit of the insured amount'*. Where there is an international element in the legal relations, the Korean Private International Law is applicable in determining the governing law of such suits. The Korean courts have shown a tendency to respect the contractual agreement between the parties where the governing law under the contract differs from the law of the place where damage occurred. As shown in the cases cited below, the Korean courts have held that pursuant to the provisions of the Korean Private Internal Law, third parties are bound by the terms of the P&I Contract, including 'pay to be paid' clauses and the governing law therein.

In *2013.6.5 Docket No 2012gahap7046* the insured's vessel collided with a third party vessel and that party brought a direct action suit against the P&I Club in a Korean court under Korean law asserting Korea as a place of tort. The policy provided for English law. The Seoul Southern District Court held that the injured third party was bound by the P&I Contract, that the 'pay to be paid' clause was valid and that English law applied as opposed to Korean law. Similarly, in *2014.5.12 Docket No 2013na73560,* the Seoul High Court held that the law governing P&I Contracts upon which the claim arises is applicable. In both cases, the courts rejected third party claims on the basis

that the English law exception which allows a third party suit against a liability insurer where the insured is subject to insolvency proceedings did not apply.

United States

In the United States, marine insurance contracts are governed by the individual states. This has resulted in inconsistencies between the states within the context of direct action suits. By way of example, New York and Louisiana allow for direct action suits. Louisiana allows third parties to, in effect, circumvent the 'pay to be paid' rule'. In *Todd v Steamship Mutual Underwriting Association Ltd* 2011 AMC 1126 (E.D.La, Mar 28 2011) the third party bringing a direct action suit under the Louisiana Direct Action Statute was obliged to arbitrate under the P&I Club's rules, which required arbitration in London. The Louisiana Direct Action Statute specifically requires third parties to bring actions in accordance with the terms of the policy or insurance contract.

In New York, direct action suits are allowed against insurers but not under marine insurance policies, which includes P&I Club insurance (*Am SS Owners Mutual Protection and Indemnity Association v Alcoa SS Co* 2005 AMC 1498, 1511-12 (SDNY, Feb 22 2005). The Louisiana position obliges third parties to use the choice of law clause in P&I Contracts and the New York position explicitly prevents direct action suits against P&I Clubs.

Norway

In Norway, injured third parties are allowed to bring a direct action suit against insurers (*Insurance Contracts Act* s 7-6). This Act, however, allows parties to marine insurance contracts to contract out of the direct action provisions (except in cases of insolvency) (s 1-3(c)). The general position is that the provisions relating to contracts of insurance *'cannot be contracted out of to the detriment of the third party'* (s 1-3) and this appears to be in line with long-standing Norwegian case law, such as the Norwegian Supreme Court's decision in *The Skogholm Case,* ND 1954. The Swedish Court of Appeal adopted this approach in *The Degero,* ND 1996.

OBSERVATIONS

The ECJ decision in *Assens Havn* has significant implications in EU States where a third party claimant is permitted to bring a direct action suit against an insurer of *'large risks'*, (including marine, P&I Clubs and aviation insurers), will be prevented from relying on exclusive jurisdiction clauses, but instead may be sued in the place: (i) where the harmful event occurred, (ii) of domicile of the insurer or (iii) of domicile of the claimant (policyholder or third party). For P&I Clubs, this could mean that third parties may seek to circumvent the 'pay to be paid rule' in EU States. The crucial issue is that the EU Regulations are expansive and not limited to cases of insolvency, such as in the UK. Hence, where the laws of other EU States allow direct action suits in situations other than insolvency, this could mean that insurers facing such claims may find it difficult to rely on express choice of jurisdiction clauses.

The 'pay to be paid rule' has been a central feature of P&I Contracts for centuries, especially within the context of cargo claims made against carriers. A direct action suit, may in effect, allow an injured party to seek to circumvent the 'pay to be paid rule'. There is a push in Europe towards direct action legislation to better protect third party claimants. This could prove problematic for P&I Clubs. Whether EU States apply these principles is a factor to consider moving forward.

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