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Ν. Πενθερουδακης - 2021

***THIRD PARTY MANAGEMENT***

(AS PER A WELL KNOWN THIRD PARTY MANAGER)

Third-party ship management has witnessed significant growth since the 1980s. Today, with approximately one-third of the world’s oceangoing fleet under third-party management of some kind,1 ship managers appear in many marine transactions for a multitude of reasons. For example:

* Financial investors often appoint managers to provide comprehensive services to their acquired shipping assets which they are unable to otherwise provide in-house.
* Fully integrated ship owners may place some of their vessels under independent management as a means of benchmarking costs.2
* Publicly listed ship owners may outsource ship management to address investor concerns and to achieve better overall risk management, among other goals.3
* Marine lenders often appoint managers to assume operational and technical control of a vessel that has been retaken following mortgage foreclosure and judicial sale.

Third-party ship management services available in today's marketplace are varied, but the three most common forms are technical, crew and commercial management. Technical management typically involves the delivery of services relating to the maintenance, repair and running of the vessel, including compliance with flag state requirements and international operating standards. Crew management covers the selection, training, administration and transportation of the crew. Commercial management largely involves seeking and negotiating employment for the vessel.

Until recently, contracts for ship management services varied greatly in form. In 1988, as a consequence of the growth of the ship management industry, the Documentary Committee of The Baltic and International Maritime Council (BIMCO)4 began publishing a series of standardized ship management forms known as SHIPMAN, with the most recent iteration being SHIPMAN 2009.5 The current form—which has replaced all prior forms6—is widely used as the starting point for individual negotiations between the manager and owners.

The engagement of third-party ship managers on the SHIPMAN 2009 form raises a number of important considerations and choices for shipping investors. Among them:

**1.** **Maritime Liens**Under U.S. law, ship managers have statutory authority to order "necessaries" for a ship.7The provision of necessaries by a supplier or vendor gives rise to a maritime lien against the ship by operation of U.S. law and, unless discharged, such lien is enforceable against the ship in the U.S. through judicial proceedings in rem.8 Accordingly, it is important that investor owners be mindful of charges incurred by their manager that may give rise to maritime liens in the U.S. and elsewhere. In addition, subject to their obligation to fund the manager in accordance with the terms of the agreement, owners should seek to restrict the manager from creating, incurring or permitting maritime liens against the ship other than ones commonly allowed, such as liens for crew wages and salvage. A related question is whether the manager possesses a maritime lien enforceable *in rem* against the ship for management fees billed to the owners and advances incurred on behalf of the ship. While most U.S. courts that have considered the issue have ruled that a manager does not have a maritime lien,9 such rulings do not bind non-U.S. courts and tribunals. Accordingly, a negotiated waiver of maritime lien claims (and covenant not to sue the vessel) by the manager would be a prudent and beneficial addition to SHIPMAN 2009 from the standpoint of the investor owners.

**2.** **Term and Termination**SHIPMAN 2009 provides for a minimum contractual term during which time the agreement is non-cancellable by either party except for events of default and extraordinary events (such as the loss or requisition of the ship).10 Following the minimum term, the agreement will continue on an evergreen basis until terminated by either party for any reason or no reason upon the giving of notice.11 However, considering that a ship management contract is a personal services contract, there is nothing in SHIPMAN 2009 which effectively allows the owner to cancel the agreement during the initial term if the ship is consistently underperforming relative to the market or under some ascertainable financial formula. Such "early out" provisions—commonly seen in container management agreements—should be given consideration in circumstances where commercial management services are provided, particularly in connection with longer term engagements.

**3.** **Dispute Resolution: Choice of Law and Forum Selection**For dispute resolution purposes, SHIPMAN 2009 allows the parties to choose English law and LMAA arbitration in London or U.S. maritime law and SMA arbitration in New York or any other governing law and arbitration mechanism.12 If no selection is made, English law and LMAA arbitration will apply by default.13 While English law and London arbitration and U.S. law and New York arbitration may be acceptable alternatives in the abstract, owners should be aware of possible jurisdictional nuances in the interpretation of certain clauses14 which might make the substantive law of one jurisdiction more or less favorable to one of the parties. In addition, rights to discovery, protection of confidentiality, rules regarding assessment of attorneys' fees against the losing party, etc., also will be influenced by the parties' choice of law and forum selection, and must be considered as well.

Another key consideration is one of jurisdictional alignment. The choice of law and dispute resolution provisions contained in the ship management agreement should be aligned as much as possible with similar provisions contained in related contracts such as charter parties and related investment agreements or joint venture agreements having management features. For example, if the corresponding investment agreements, joint venture agreements or charters for the managed fleet will be subject to U.S. law and New York arbitration, it makes little sense to choose English law and London arbitration for SHIPMAN 2009, inasmuch as consolidation of arbitral proceedings becomes all but impossible in such circumstances and the potential for inconsistent results increases.

**4.** **Conflicts of Interest**Under SHIPMAN 2009, the manager undertakes to use its "best endeavors" to provide services in accordance with "sound ship management practice."15 Such duty of care is one that is "generally understood in the shipping industry"16 and one that New York maritime arbitrators are well equipped to interpret and apply. However, since large ship managers often manage the fleets of more than one owner, SHIPMAN 2009 specifically allows the manager to "allocate available supplies, manpower and services in such manner and in the prevailing circumstances" as the manager deems to be "fair and reasonable."17 The potential conflict between a manager's obligations to one owner and its obligations and allegiance to others is often not apparent. While the manager needs flexibility in this regard, the investor owner needs some comfort that its ships will be managed evenly relative to other fleets that are in the manager's portfolio, particularly fleets belonging to the manager's affiliated companies. A form of "most favored nation" provision should be considered as a practical means of addressing potential conflicts.

**5.** **Liability and Indemnification of Manager**
The degree of risk and responsibility to be assumed by the manager in connection with the services to be provided is a frequent point of contention. The stated philosophy of the draftsmen of the SHIPMAN standardized forms was to apportion "liability between owners and managers on the basis that the owners should not be in a better position than they would have been in if they managed the vessel for themselves."18 Consistent with this philosophy, SHIPMAN 2009 is decidedly pro-manager in its approach to the allocation of risk and liability. Such an approach is not necessarily in the best interests of investor owners who entrust their ships to third-party managers and rely heavily upon their judgment, skill and experience.

SHIPMAN 2009 isolates the manager from all liability to the owners for loss, damage, delays, etc., unless the owner can affirmatively prove that its loss was caused solely by the negligence, gross negligence or willful misconduct of the manager or its employees, agents or subcontractors.19 This places a substantial evidentiary burden on the owners. In cases where sole negligence can be established by the owners, the manager's liability nevertheless is limited to 10 times the annual management fee.20 Liability will exceed the limitation only where the loss results from the manager's "personal act or omission" committed recklessly or with the intent to cause same and with the knowledge that such loss would likely result.21 In addition, the owners have full indemnity obligations to the manager in connection with the latter's performance of the agreement, excluding only matters and amounts for which the manager would be otherwise liable under the agreement.

In its explanatory notes on the SHIPMAN 2009 form, BIMCO stated that these limitation and indemnity provisions have been reviewed by Queen's Counsel “and found to be in compliance with the English Unfair Contract Terms Act 1977."22 It is unclear whether BIMCO had these same provisions reviewed by U.S. maritime counsel. Possibly not. The current SHIPMAN form has been before U.S. maritime arbitrators on a number of occasions and has been discussed or referred to in at least four reported decisions.23 In two of these decisions, the manager's liability for alleged poor performance came into play under U.S. law. In the first of the two decisions, the arbitrators decided whether the owner's negligence claims against its manager were cognizable, taking into account the manager-friendly limitation of liability provisions and the heavy evidentiary burdens placed on the owner in the SHIPMAN 2009 form.24 At no point in their award did the arbitrators indicate or suggest that these provisions were contrary to U.S. law and policy. However, in the second decision, *Lin Shipping Ltd. v. V.Ships Management Ltd.*, the arbitrators (all of whom were lawyers) reviewed substantially similar limitation of liability provisions and found them to be contrary to U.S. general maritime law.25

The arbitrators in *Lin Shipping* specifically determined that any contractual exculpation of the manager based upon its own "gross negligence or willful misconduct" was contrary to "the weight of decisional law" and should be stricken from the contract. The arbitrators also struck the word "solely" from the contract on similar grounds, the result being that the manager would not be relieved from liability to the owners for its own fault. Lastly, the arbitrators avoided the contractual limitation of liability clause which capped the manager's liability at 10 times its annual fee. Among the reasons cited, the arbitrators determined that such a cap was "too low to reasonably provide any deterrent to potential misfeasance or nonfeasance of the managers."26 As a result of the award, the undoubtedly surprised manager in *Lin Shipping* was left with the potential of unlimited liability to the owner on account of its own negligence.

From the standpoint of the manager, the outcome in *Lin Shipping* was clearly not what it bargained for given the language of the contract. From the standpoint of the owners, the outcome was what it had hoped for during the negotiating process notwithstanding the language of the contract. For investor owners, the lesson of *Lin Shipping* with respect to the negotiation of liability provisions is straight from the songbook of the Rolling Stones:

*You can't always get what you want,
But if you try sometimes, well you just might find,
You get what you need!*

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1 *See*https://www.bimco.org/en/Education/Seascapes/Sea\_View/The\_modern\_ship\_manager.aspx (last accessed June 20, 2012).
2 Id.
3 R, Giorgi, *Challenges in Ship Management*, Presentation at Capital Link Forum, 2d Annual Invest in International Shipping Conference (Mar. 20, 2008).
4 Headquartered in Denmark, BIMCO is the largest of the international organizations representing ship owners controlling approximately 65% of the world’s tonnage and with members in over 120 countries. Members are stakeholders in the shipping industry having a variety of interests, including ship brokerage, management, accounting and law. BIMCO is also an accredited NGO.
5 A copy of SHIPMAN 2009 can be accessed on the BIMCO website: https://www.bimco.org/Chartering/Documents/Ship\_Management/SHIPMAN2009.aspx (last accessed June 20, 2012).
6 The immediate predecessor to SHIPMAN 2009 was the SHIPMAN 98 form.
7 46 U.S.C. § 31341(a)(3).
8 46 U.S.C. § 31342.
9 *See e.g. Community Bank of LaFourche v. M/V MARY ANN VIZIER*, 2012 U.S. Dist. LEXIS 66842 (E.D. La. May 14, 2012).
10 SHIPMAN 2009, Part I, Box 18, Part II, Clause 21(a).
11 *Id.*12 SHIPMAN 2009, Part I, Box, 21, and Part II, Section 5, Clause 23.
13 SHIPMAN 2009, Part II, Section 5, Clause 23(e).
14 *See* Paragraph 5 *infra*.
15 SHIPMAN 2009, Part II, Section 3, Clause 8(a).
16 *Associated Transport Line, LLC v. Colonial Marine Industries, Inc.*, SMA No. 3870 (Dec. 17, 2004) (N.Y. Arb., J. Berg, D. Martowski and D.J. Szostak, Arbitrators).
17 SHIPMAN 2009, Part II, Section 3, Clause 8(a).
18 *See* https://www.bimco.org/Chartering/Documents/Ship\_Management/Withdrawn\_Forms/SHIPMAN98/
Explanatory\_ Notes\_SHIPMAN98.aspx (last accessed June 20, 2012).
19 SHIPMAN 2009, Part II, Section 5, Clause 17(b)(i).
20 *Id.*21 *Id.* The description of conduct barring limitation is taken from Article IV of the Convention on Limitation of Liability for Maritime Claims, 1976.
22 BIMCO, *Comparison between SHIPMAN 2009 and SHIPMAN 98*, reprinted at https://www.bimco.org/Chartering/Documents/Ship\_Management/SHIPMAN2009/~/media/
Chartering/Document\_Samples/Sundry\_Other\_Forms/Explanatory\_Notes\_SHIPMAN\_2009.ashx (last accessed June 20, 2012).
23 *See Wallem Shipmanagement, Ltd. v. Linea Naviera de Cabotaje Linaca*, C, SMA No. 3839 (Apr. 23, 2004) (N.Y. Arb., A. Nichols, C. Tsagaris and K. Mordhorst, Arbitrators); *Associated Transport Line, LLC v. Colonial Marine Industries, Inc.*, SMA No. 3870, *supra; American Roll-On Roll-Off Carrier, LLC v. Pacific-Gulf Marine, Inc.*, SMA No. 3891 (N.Y. Arb., M. Arnold, J. Ring and D. Martowski, Arbitrators); *Lin Shipping Ltd. v. V.Ships Management Ltd.*, SMA No. 4147 (Nov. 8, 2011) (N.Y. Arb., J. Lillis, L. Sheinbaum and J. Berg, Arbitrators).
24 *Associated Transport Line, LLC v. Colonial Marine Industries, Inc.*, SMA No. 3870, *supra*.
25 *Lin Shipping Ltd. v. V.Ships Management Ltd.*, SMA No. 4147, *supra*.
26 *Id*