SUN MOBILITY
Insurance and Claims Services Limited

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To: Transport Industry Operators

B/L's fraudulent representation

The English Commercial Court issued a Judgment on 7/11/2012 holding a carrier liable for US$458,655.69 owing to its issuing 13 clean Bills of Lading for a consignment of steel pipes which had some pre-shipment damage. [2012 EWHC 3124 (Comm)]

This claim arose from the carriage of a consignment of steel pipes on the M/V Saga Explorer from Ulsan in Korea to ports on the West Coast of North America (Los Angeles, San Francisco and Vancouver) between September and October 2008; and which were found damaged on arrival. The relevant contracts of carriage were 13 Bills of Lading signed by Orion Shipping as agent; naming the Shipper as Nexteel and the Consignee and Notify Party as KOP.

The Bills of Lading were dated 25/9/2008 and contained a description of the goods:

> E.R.W Steel Pipes
> Spec: ASTM A53B/ASME SA53B
> ...
> Details are as per attached rider

The Bills of Lading included the following words on the front of the printed form:

> SHIPPED in apparent good order and condition, weight, measures, marks, numbers, quality, contents, and value unknown, for carriage to the Port of Discharge ... to be delivered in the like good order and condition at the aforesaid Port unto Consignees or their Assigns ... In accepting this Bill of Lading, the Merchant expressly accepts and agrees to all its stipulations on both pages, whether written, printed, stamped or otherwise incorporated as fully as if they were all signed by the Merchant. One original Bill of Lading must be surrendered in exchange for the Goods or delivery order.

In addition the Bills of Lading included a RETLA Clause.

> RETLA CLAUSE: If the Goods as described by the Merchant are iron, steel, metal or timber products, the phrase 'apparent good order and condition' set out in the preceding paragraph does not mean the Goods were received in the case of iron, steel or metal products, free of visible rust or moisture or in the case of timber products free from warpage, breakage, chipping, moisture, split or broken ends, stains, decay or discoloration. Nor does the Carrier warrant the accuracy of any piece count provided by the Merchant or the adequacy of any banding or securing. If the Merchant so requests, a substitute Bill of Lading will be issued omitting this definition and setting forth any notations which may appear on the mate's or tally clerk's receipt.

The attached rider contained details (including the length and weight of the bundles of steel pipes) and the reverse of the Bills of Lading contained Terms and Conditions which included an English Jurisdiction clause and an applicable US General Paramount Clause incorporating the US Carriage of Goods by Sea Act 1936 (COGSA).

The 1st Defendants were the Registered Owners, the 2nd Defendants were the Demise Charterers and the 3rd Defendants were the Time Charterers of the vessel. It was agreed between the parties that any claim for damage to the cargo lay only against the 3rd Defendants and it was convenient to refer to them as the Owners.

The main issue in the case related to the nature of the representation as to the condition of the pipes on shipment, whether it was relied on and what damage flowed from any breach.

KOP was indemnified against their loss by their German Insurers, who at all times acted through and by B&H. B&H claimed against the Owners on the basis that it satisfied the conditions of a 'Procedural Agency' under German law, being authorised to bring a claim in its own name on behalf of the Insurers.

A load port survey was carried out by Korea Surveyors and Adjusters ('KOSAC'), whose report was dated 25/9/2008. This report noted that the cargo was,

> in apparent good order & condition with the following damage/exception.

There then followed 16 pages of what was described as 'Damage/Exception Prior to Loading'. This consisted of descriptions of the steel as 'partly rust stained', and variations of this description, 'wetted before shipment by rain and partly rust stained and slightly scratched on surface', 'wetted before shipment by rain and partly rust stained in white oxidation on surface.' The survey also noted:

> All of the above damages/exceptions were acknowledged by the vessel's master and duly noted/appended to the relevant Mate's Receipt.

Attachment No.1 of the Survey Report (also dated 25 September) was a Recommendation Letter to the Master signed by the KOSAC Surveyor and the Chief Officer as follows,

> As a result of the survey, we found that all the shipments loaded on board the vessel to be in apparent good order & condition except the shipments mentioned on the 'Cargo Damage/Exception List' attached hereto.
> With regard to the noted damages/exceptions to the shipments, we recommend that they shall be claused in or appended to the relevant Mate's Receipt and Bills of Lading.

The Mate's Receipts issued in respect of the cargo and signed by the Chief Officer contained a short form of Retla Clause (omitting reference to timber products) which was printed prominently:

> The term 'apparent good order and condition' when used in this Bill of Lading with reference to iron, steel or metal products does not mean that the goods when received, were free of visible rust or moisture. If the shipper so requests, a substitute Bill of Lading will be issued omitting the above definition and setting forth any notations which may appear on the mates' or tally clerks' receipts.

and noted the receipt on board

> Condition of Cargo as per Survey Report.

The Survey Report was identified as the KOSAC report.

Although the Mate's Receipt contained the reservation that the cargo was received in the condition as noted in the KOSAC report, the Bills of Lading contained no such reservation. The reason why they were not claused was explained by Mr Kim of Orion Shipping.

> The shippers in this case, Nexteel, did not demand or request any bill of lading showing 'notations'. Instead Nexteel (having seen the KOSAC Report) requested that the Bills be issued unclaused against LOIs. I read the Mate's Receipts and the KOSAC Report (including the section headed 'Damage/Exception found Prior to Lading'), which I compared with what was stated in the RETLA clause and (on that basis) I considered there was no need to clause the Bills. Accordingly I agreed to Nexteel's request and proceeded to sign the Bills. It was certainly not my intention to mislead anybody.

The Letters of Indemnity referred to by Mr Kim, dated 25 September and headed 'Letter of Indemnity for Issuance of Clean Bills of Lading', were addressed to the Owners. After noting the 'exceptions to the cargo's apparent condition observed prior to shipment' as noted on the Mate's Receipt 'per surveyor's cargo exception', the details of which were set out, the letters continued,

> but we hereby request you to issue 'clean' bills of lading without making any remarks on the bill as to the cargo damaged condition whatsoever and to deliver the said cargo accordingly against production of a least one original bill of lading
> In consideration of your complying with our above request, we hereby agree as follows:
> 1. To indemnify you, your servants and agents and to hold all of you harmless in respect of any liability, loss, damage or expense of whatsoever nature which you may sustain by reason of complying with our request.
> 2. In the event of any proceedings being commenced against you or any of your servants or agents, in connection with our request aforesaid, to provide you or them on demand with sufficient funds to defend the same.

The indemnity was stated to be governed and construed according to English Law, and was reinforced by undertakings to put up bail if the vessel were arrested at the suit of cargo interest, and to submit to the Jurisdiction of the High Court in London.

The very much more likely explanation was that Nexteel realised that if the Bills of Lading were claused they would not be paid and persuaded Mr Kim that Owners should issue clean bills of lading in exchange for the Letter of Indemnity.

The vessel arrived at the three discharge ports during the course of October 2008. There, and in subsequent surveys, the cargo was found to be rusted to a greater or lesser extent.

KOP gave evidence about KOP's contracts with Nexteel for the supply of steel pipes. KOP made cash deposits available to Nexteel in order to relieve its cash-flow problems; and cash was released by KOP on receipt of clean on board Bills of Lading and invoices.

Under s.3(3)(c) of US COGSA, after shipment of the cargo on board the vessel the Master (or his agent) is bound on demand to issue to the shipper a bill of lading showing 'the apparent order and condition of the goods'. Before he can do that the Master (or his agent) must form an honest and reasonable, non-expert view of the cargo as he sees it and, in particular, as to its apparent order and condition. The Master may ask for expert advice from a surveyor but ultimately it will be a matter of his own judgment on the appearance of the cargo being loaded.

The Bills of Lading in the case in question contained a statement on their face that the cargo was shipped 'in apparent good order and condition'. If there had been no RETLA clause, this would amount to a representation of fact which could be relied on as reflecting the reasonable judgment of a reasonably competent and observant master.

In the case of *Tokio Marine & Fire Insurance Company Ltd v Retla Steamship Company* [1970] 2 Lloyd's Rep 91 (US 9th Circuit CA), the Court was concerned with construing provisions as to the apparent good order and condition of the cargo and a Rust clause in the following terms:

> The term 'apparent good order and condition' when used in this Bill of Lading with reference to iron, steel or metal products does not mean that the goods when received, were free of visible rust or moisture. If the shipper so requests, a substitute Bill of Lading will be issued omitting the above definition and setting forth any notations which may appear on the mates' or tally clerks' receipts.

These were the words used under the heading 'Retla Clause' in the Mate's Receipts in the case in question, although the wording of the RETLA clause in the case in question was slightly different. In the *Tokio Marine* case there was rust and wetness which was described in the Mate's receipts as 'heavy rusty', 'white rusty', 'rusty', 'heavy flaky rust' and 'wet before loading.' The US 9th Circuit, having referred to the Privy Council case of *Canada and Dominion Sugar Company Ltd v. Canadian National Steamships Ltd* [1947] AC 46, held (p.95-96) held that,

> ... the bills of lading here, 'read fairly as a whole', show that the term 'good order and condition' was qualified by the clause defining the term with respect to iron, steel or metal products.

This part of the reasoning is uncontroversial. The conclusion of the Court is more debateable. Having referred to the fact that the Rust clause appeared boldly and capitalised on the bill of lading and to the shippers' express right to request substitute bills setting out any notations in the Mate's receipts; the Court found that there was no affirmative representation by the owners that the pipe was free of rust or moisture when it was received by the carrier. In summary, all surface rust of whatever degree was excluded from the representation of apparent good order and condition.

The Owners submitted that English law should follow the *Tokio Marine* case in holding that the RETLA clause was not limited to rust which was in some sense, 'minor' or 'superficial.' The Owners drew attention to the inherent ambiguity and uncertainty of such terms; and referred to *Scrutton on Charterparties* where the Owners submitted the case was cited with approval.

In the 21st edition, the editors noted (at Artcle.63):

> The practice is now developing of including in the bill of lading a definition of 'good order and condition' which makes it clear that the representation does not imply that the cargo is free from the type of defect which commonly affects the cargo in question, e.g. rust (metal goods) or moisture (timber). There appears to be no reason why these clauses should not be valid: and they do not appear to offend the Hague-Visby Rules.

In the 22nd edition, the editors reframed their view of the law in Article 77 at 8-031,

> ... wording may clarify (and restrict) the representation being made. Thus, a bill of lading may attest to the apparent good order and condition while including a definition of 'good order and condition' which makes it clear that the representation does not import that the cargo is free from certain defects, often a type of defect that commonly affects the cargo in question, e.g. rust (metal goods) or moisture (timber).

In each of the two editions there is a foot-note reference to the *Tokio Marine* case.

The cargo insurer submitted that the RETLA clause did not render the words 'apparent good order and condition' meaningless. The provisions should be read together and each provision given proper effect. To the extent that the RETLA clause was designed to except from liability it should be read restrictively. The

cargo insurer argued that the RETLA clause only excluded (surface) rust which was likely to be found in any normal cargo and which would not detract from its overall quality and affect its merchantability.

There would seem to be a number of problems with this formulation, for example: what was the degree of 'surface rust' which fell outside the representation, what was a 'normal' cargo of steel and why was merchantability relevant to the representation by the Master of the carrying vessel?

The Judge came to the following conclusions as to the proper construction of the two provisions in the Bills of Lading.

(1) The RETLA clause could and should be construed as a legitimate clarification of what was to be understood by the representation as to the appearance of the steel cargo upon shipment. It should not be construed as a contradiction of the representation as to the cargo's good order and condition, but as a qualification that there was an appearance of rust and moisture of a type which might be expected to appear on any cargo of steel: superficial oxidation caused by atmospheric conditions. The exclusion of 'visible rust or moisture' from the representation as to the good order and condition was thus directed to superficial appearance of a cargo which was difficult, if not impossible, to avoid. It was likely to form the basis of a determination as to whether there had been a further deterioration due to inherent quality of the goods on shipment under s.4(2)(m) of US COGSA, or Article 4(2)(m) of the Hague-Visby Rules.

(2) It followed that the Judge rejected the Owner's argument, based on the facts of the decision in the *Tokio Marine* case, that the RETLA clause applied to all rust of whatever severity.

First, because such a construction would rob the representation as to the good order and condition of the steel cargo on shipment of all effect.

Secondly, because of what appeared to be a misapprehension as to the nature of the trade. One of the grounds for the decision in the *Tokio Marine* case was that the Rust clause provided that it was always open to the shipper to call for a substitute bill of lading showing the true condition of the cargo as set out in the Mate's Receipt, (see p.961 of the report). However, the objection to this part of the reasoning is that it is highly unlikely that a shipper of cargo would ask for a claused bill of lading reflecting the terms of a Mate's Receipt: rather the contrary, as the case in question reveals. The matter has been put in clear and emphatic terms by Professor Michael F Sturley in an article in the *'Journal of Maritime Law and Commerce'* (April 2000) pages 245-248.

> Some courts, led by the Ninth Circuit in *Tokio Marine & Fire Insurance Co. V Retla Steamship Co.,* have nevertheless permitted carriers to include standard clauses in their bills of lading that essentially disclaim all responsibility for the required statement. Although COGS A ß 3(8) explicitly prohibits any clause lessening a carrier's liability 'otherwise than as provided in this Act', 'rust clauses' have been justified on the ground that that the shipper had the option of demanding a different bill of lading that did not contain the offending clause. In practice, such a demand would be unlikely, for the typical effect of a rust clause is to permit a seller to ship rusty steel to its customer while still obtaining the 'clean' bill of lading that enable it to be paid under a letter of credit.
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> ...
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> Permitting the carrier to escape liability for the statement of apparent order and condition undermines the Hague Rules' goal of protecting the bill of lading as a commercial document on which third parties can rely. Indeed, one of the principal abuses that the Hague Rules were intended to correct was the carriers' use of 'reservation clauses' to exonerate themselves from responsibility for the description of the goods. Thus the rules required the bill of lading (if one were issued) to include the specified information without reservation unless the exception (found in the proviso to COGSA ß 3(3)) applied. A carrier's use of a reservation clause when the exception did not apply would be 'null and void' under COGSA ß 3(8).
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> ...
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> The phrase 'on demand of the shipper,' upon which the *Retla* court relied so heavily, does not alter the carrier's obligation to include the information required by COGSA ß 3(3) wherever it does issue a bill of lading.

(3) The *Tokio Marine* case has not been consistently followed; and this position is reinforced by a bulletin issued by the UK P&I Club (221-11/01). After referring to the reason why US Courts have upheld the Retla Clause, the bulletin continues.

> However, there remains a risk to Members using such clauses as, whilst some courts in the United States may have upheld the clause, other U.S. courts and courts in other jurisdictions have not. The only safe means of avoiding claims arising from pre-shipment damage is to ensure that the bill of lading is claused to reflect the apparent order and condition of the goods at the time of loading. Failure to properly describe the condition of the cargo leaves the carrier open to allegations of being a party to a misrepresentation,

particularly from third-party purchasers of the cargo who have only contracted to do so based on a bill of lading and who have not been shown any pre-shipment survey by the sellers.

The final sentence is both accurate and pertinent.

It was clear that all parties considered that the Bills of Lading should have been claused in the form of the Mate's Receipts up to the point when Mr Kim decided that clean Bills of Lading should be signed and a Letter of Indemnity issued 'in consideration' of Owners complying with Nexteel's request. The KOSAC report and the Mate's Receipts described the appearance and condition of the cargo; and this was not reasonably and honestly represented by the Bills of Lading as signed. The Judge did not accept the evidence of the Owners that this cargo was shipped in a normal and unexceptional condition for this type of cargo, or otherwise fell within the RETLA Clause. Those who saw the cargo being loaded plainly did not regard the condition as normal and unexceptional. The Judge accepted the cargo insurer's view that this cargo should have been (at a minimum) described as 'rust spotted' or 'partly heavily rusted'. In addition it was common ground that that there was no significant deterioration of cargo during the sea passage from South Korea to the US Pacific ports. It was therefore material that none of the numerous surveyors who attended on discharge or soon after (including those appointed on behalf of Owners) considered that the damage to the cargo carried under the Bills of Lading was 'normal' or 'to be expected'. On the contrary, they noted extensive oxidation, described as 'moderate to severe' and 'severely oxidised.' Cullen Maritime, who attended on behalf of the Owners during discharge in October 2008 found 'heavily rusted condition' and 'rust to 'varied degrees', including 'in heavily rusted condition in stow prior to discharge.' These observations were made in relation to cargos which had been notified to have been shipped in apparent good order and condition.

The decision to issue and sign clean Bills of Lading involved false representations by the Owners which were known to be untrue and intended to be relied on. What occurred was not an 'honest and reasonable non-expert view of the cargo as it appeared,' but a deceitful calculation made on behalf of the Owners by their authorised agent at the request of the Shippers and to the prejudice of those who would rely on the contents of the Bills of Lading. In view of the Judge's conclusion that the representation in the Bills of Lading was fraudulent, a presumption arose that the innocent party (in the case in question the holder of the Bills of Lading, KOP) was influenced by it. It is open to the fraudulent party to rebut this presumption; but despite the points made by the Owners, the Judge had concluded that the Owners had failed to do so. The Judge accepted KOP's evidence that it relied on the representations in the Bills of Ladings to its detriment by taking up the bills and sending them to its discharge port agents and taking delivery of the cargo pursuant to their terms. It was inherently unlikely that it would have done so if they had been claused. The Judge accepted KOP's evidence that it would not have credited monies against the relevant Nexteel invoices and would have rejected the cargo and the Bills of Lading if it had been aware that the Bills of Lading materially misrepresented the apparent order and condition of the cargo. This was not, in its view, cargo which was either sound or acceptable, nor was it cargo which was simply suffering from minor damage. At the very least KOP would have insisted on another survey of the cargo before accepting it.

The Judge accepted the evidence of the cargo insurer in relation to KOP's loss. On this basis the calculation of loss was agreed at US$430,996.19, with an overall loss when surveyor's fees were included of US$458,655.69. It followed that the cargo insurer was entitled to Judgment in the principal sum of US$458,655.69.

Please feel free to contact us if you have any questions or you would like to have a copy of the Judgment.

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