



Informing Progress - Shaping the Future

FOIL UPDATE

20 November 2020



Update – FOIL Roundtable: The Scrapyard Challenge

This roundtable event was held virtually on 17 November and attracted 34 attendees.

Background

This roundtable was a collaboration between FOIL’s Environmental, London FOIL Marine and D&O SFTs and was facilitated by **Karen Cornwell** of **Kennedys**. It focused on the decommissioning of ships, which, in 90% of all cases takes place in Bangladesh, India and Pakistan where ‘beaching’ (see below) is common-place. This has a potentially serious impact on the environment and the problem may increase if the current pandemic leads to a failure in cruise companies and an increase in the number of ships being disposed of. Among the issues of concern is the potential for Director and Officer (D&O) liability.

The collaboration between these SFTs arose primarily from a debate as to which forms of insurance were likely to be relevant in the event of claims arising from the decommissioning of ships.

FOIL’s Environmental SFT was set up to consider the extent to which the insurance industry is ready for environmental change but it has become increasingly interested in the issue of what happens when vessels are decommissioned. The disregard for environmental law in the countries referred to above threatens serious consequences on a world-wide basis.

IN BRIEF

This roundtable event considered:

1. How and why the decommissioning of ships poses a threat to the environment
2. What liabilities UK companies and their directors could face
3. The limitations on insurance coverage that may apply

The D&O SFT is currently concerned with issues arising from the Covid-19 pandemic but also companies' climate change policies and environmental impact.

The London FOIL Marine SFT is particularly interested in mis-declared (dangerous) cargo; the increasing size of cargo ships and the consequential problems when something goes wrong on board; breaches of emissions regulations (relating to the types of fuels used) and the decommissioning of vessels.

Vessel Breaking – an overview

The first presentation by **Toby Vallance** of **DAC Beachcroft** looked at the topic of what happens to obsolete vessels. Obsolescence may arise because the ship reaches the end of its life or because it is no longer of a type or size required. There is, however, value in the metal. The situation has been exacerbated by the pandemic.

The probability is that the number of vessels sent for scrap in the near future will rise significantly. This will probably involve 'beaching', where the vessel is run aground at full speed, supported to keep it upright and then dismantled by hand, piece-by-piece. Part of the problem is that when the outer skin (the hull) is peeled back, what lies beneath may contain often unpleasant surprises. Bangladesh, India and Pakistan are popular for this activity, as labour costs are low and labour laws, safety and environmental compliance are not as strict.

Safety is of major concern, as not only is the way in which this work is carried out inherently dangerous but it involves contact with dangerous chemicals, including some that are likely to explode if exposed to hotworks.

The environmental concerns arise primarily from the breaking-up of oil tankers, oil rigs and other oil and gas vessels of various types. There is uncertainty as to the extent to which the toxic waste present in these has been removed before they go for disposal. If there are substances still on board, how will that be properly managed?

The International Maritime Organisation introduced the Hong Kong Convention, which appears to address the issue of breaking up vessels but it has still not been ratified by a sufficient number of member states. EU Regulations have effectively brought in the convention for EU member states' flagged vessels and the Basel Convention controls the movement of hazardous waste from the EU into a less rigorous regime. There are accredited shipyards within the EU. The problem remains, however, that regulations of this nature are not applied worldwide.

The 'flag' relates to the state where the vessel is registered and that also determines the law to which it is subject. Tax is a common driver for the choice of flag state but often comes also with the less rigorous application of health and safety and environmental law.

An aggravating factor is the relatively limited number of accredited yards in relation to the number of vessels needing to be decommissioned, some of which are, in any event too large for at least some of the accredited yards. Due diligence on yards is difficult: checking how compliant they are, and cost will always be a driving factor.

Faced with all these difficulties, a ship owner may prefer instead to dispose of the vessel to a third-party, which may recycle the vessel or may send it for scrap. This does not necessarily break the chain of liability.

The big issue is how relevant this is to insurers and which type of policy may be affected? It is difficult to see how health and safety issues within the breakage yard could be visited on the original vessel owner, but that is still a possibility. Conceivably there could be D&O liability if a vessel was disposed, of whilst still containing hazardous substances, which causes environmental damage. Was the due diligence regarding the yard to which it was sold sufficiently rigorous?

Criminal liability

Chris Green of **Keoghs** took this session, looking at how criminal liability could arise. He cited a number of provisions that could be used to prosecute UK based companies:

- The Transfrontier Shipment of Waste Regulations 2007 (TFS): governing the transportation of waste for disposal only to EFTA countries which are parties to the Basel Convention.
- The potential liability of named directors and officers under regulation 55 of TSF, where there is consent and connivance or neglect.
- Hazardous Materials on Ships (Amendment etc) Regulations 2018. Regulation 9 creates effectively strict liability irrespective of where the ship may be when it is recycled. The onus is on all parties in the chain to ensure that all others are accredited and will discharge their duties legally. This makes due diligence programmes essential. The burden of proof is on the defendant to prove that it is entitled to rely on the very limited defence available. The penalties are severe and include up to two years imprisonment for individuals. Fines are not of course insurable.

Under these regulations, inspectors have wide ranging powers, again with serious penalties for non-compliance. Legal professional privilege applies, however and should be used for any discussions regarding an alleged offence and any defence.

- Proceeds of Crime Act (PCA)

Not only are there reputational issues to be concerned about and criminal liability but the prosecutor may also have recourse to the PCA. This could well be used if the company has become insolvent but it is believed that one or more officers has personal liability and has accumulated wealth generated by the illegal activity.

D&O Insurance Issues

This final session was taken by **Hannah Williams** of **Kennedys** and **James Denison** of **Weightmans**.

Hannah advised that decisions made by directors and officers, particularly regarding environmental issues, are now resurfacing many months later. Areas of risk for company officers include:

- Civil claims of various types
- Criminal prosecution
- Regulatory investigation
- Disqualification

Both under statute and at common law, directors must act in the best interests of the company. In the context of the disposal of vessels, this means that directors must be considering the possible consequences of their actions, including any adverse impact on the company's reputation. The directors will need to ensure that the company has a policy in place regarding the decommissioning of its vessels, covering risks to human health and safety, as well as the environment.

Any breaches of duty could result not only in civil or criminal proceedings but also action by shareholders. The courts may well be more receptive to applications for permission to bring such actions as environmental and climate change policies come under greater scrutiny.

Criminal liability could arise because of breaches in the jurisdiction in which the ship is broken up. Prosecutions could relate to health and safety, in this inherently dangerous activity or to damage to the environment. While the costs of a regulatory body's investigation are likely to be covered under a D&O policy, any fines will not. The ultimate risk to the directors is disqualification.

James Denison explained that any D&O policy was likely to exclude pollution and clean-up costs; fines; and deliberate acts. The definition of pollutants tends to be wide and would probably cover most material to be found in a ship run aground to be broken-up. Fines would certainly be excluded for England and Wales and defence costs would be dependent on the wording of the policy and the circumstances in which the criminal liability arose.

The deliberate act exclusion would certainly apply where the insured had carried out the act of beaching but it could also apply where there was a lack of due diligence as to what was going to happen to the vessel when disposed of to a third-party.

A separate environmental insurance policy might, however, cover some of these items.

The three SFT's involved in organising this event will be meeting again shortly, to follow-up on the issues discussed.

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