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OUTSIDE COUNSEL Expert Analysis

U.N.'s New Compensation Treaty: Should United States Ratify It?

On Dec. 11, 2008, the U.N. General Assembly adopted the newest version of its "Draft Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea," culminating a six-years drafting effort.[1]

The convention, if adopted by the United States and its trading partners, will, among other changes, set the parameters for the compensation available to shippers of goods, which are lost or damaged in international ocean transit. Since the last time the United States adopted such a law was in 1936 with the passage of the U.S. Carriage of Goods by Sea Act, which, though clearly outdated, remains in effect, shipping interests have watched these once-a-century developments with keen anticipation.

Domestically, the Maritime Law Association of the United States (MLA) and its members are considering whether or not the United States should ratify the Draft Convention. An international signing ceremony is scheduled in Rotterdam on Sept. 21-23, 2009. It will then be up to each U.N. member country (including the United States) to decide whether or not to ratify these rules.

The convention seeks "harmonization and modernization of the legal regime...which in many countries date back to the 1920s or earlier..." and the convention will be called the Rotterdam Rules.[2]

History

The convention is the result of 13 working sessions of the UNCITRAL spanning a six-year period from April 2002 to July 2008. The call for a new convention dates even further back to 1996, when the UNCITRAL invited the Comité Maritime International (CMI) to begin work on a draft instrument that would "adjust[] and moderniz[e] the rules of international cargo transport, which should become the basis for international uniformity in this area for the 21st century."[3] Thus this treaty marks the culmination of years of work towards creating a new international shipping compensation convention seeking to account for technological advancements in shipping and to establish a sensible increase in a carrier's liability limitation.[4]

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The Scope

The scope of transport covered by the treaty includes any international carriage with an international sea leg. The convention provides U.S. shippers with a significant increase in carrier liability limits for cargo loss or damage. Based on this it is widely hoped, that the passage of the convention will at a minimum act as a wake up call and stimulate the U.S. Congress to update its own shipping compensation statute, the Carriage of Goods by Sea Act (COGSA), which, at over 70-years-old, has been widely criticized for its inability to account for modern developments and still applies the outdated $500 per-package limitation.

For, many years there has been a consensus in the United States that a change to the United States' shipping compensation scheme is long overdue. This revelation is not new, the statute's shortcomings have been well-documented by courts and commentators alike. In fact in response, in the late 1990s, the U.S. Maritime Law Association (MLA) attempted to update U.S. COGSA.

It was that effort that prompted, at least in part, the present U.N. undertaking. Among the more notorious complaints is COGSA's inability to account for containerization and multi-modalism, its outdated package limitation, lack of a per-weight limitation and its stubborn liability regime.[5]

Moreover, COGSA has been criticized because it does not expressly prohibit a carrier to limit its liability under any circumstances and courts have upheld liability limits even in the face of egregious facts, like a carrier stealing cargo.[6]

In addition, inflation has diminished COGSA's package limitation to a negligible amount.[7] While a $500-per-package limitation was a triumph for shippers in 1936, inflation has essentially nullified it as a form of reasonable compensation today. A rudimentary survey of staple prices then and now is startling. Consider that in 1936 the average home cost $3,925, a gallon of gasoline was $0.10, and a loaf of bread cost just $.08.[8] Today, those same items average $206,000, $3.50 and $1.28, respectively. The rate of inflation from 1936 to 2008 is a whopping 1,429 percent, meaning that $500 in 1936 equals roughly $7,145 today.

Previously, virtually every other nation has effectively dealt with low limit problems by adopting more contemporary international treaties.[9] The present difference is illustrated by the review of actual damage to a large consignment of machinery weighing 49,870[10] kilograms shipped overseas. In China, Japan and the United Kingdom (2 SDRs/kg) the recovery would be $146,617 as opposed to the U.S. recovery of $500 per package.

As the example demonstrates, foreign shippers suing under their own laws currently recover roughly 3,675 times what a U.S. shipper would recover suing in the United States for the identical loss under identical circumstances. The open question is whether the convention resolves this deficiency and, if so, at what cost.

Key Provisions

The convention is a wholesale update from previous conventions, attempting to account for contemporary issues such as containerization, multi-modal shipments, the proliferation of electronic records and, of course, outdated liability limitation amounts. A few key features of the draft are:

• **Modified Door-to-Door Coverage. Art. 26.** Otherwise known as "maritime plus," the convention would apply for carriage under a contract of carriage where "The contract shall provide for carriage by the sea and may provide for carriage by other modes of transport in addition to the sea carriage," thus covering maritime carriers, even for inland losses (unless "it can be proven that the damage occurred during land transport that, absent this convention, would have been subject to a mandatory applicable international convention").

Currently, COGSA only covers sea carriage. But the convention does not cover subcontractors engaged in transport outside of a sea terminal, such as truckers or railroads.

• **Applicability to "Maritime Performing Parties." Art. 1¶6(a) & Art. 19 ¶(b)(iii).** The convention defines "maritime performing parties" as a performing party undertaking any of the carrier's obligations during the period between "the arrival of the goods at the port of loading and their departure from the port of discharge of a ship." The Draft Convention applies therefore to maritime service providers associated with a particular carriage, and entitles them to the carrier's defenses and limits of liability when the loss occurred while the maritime performing party was performing any activity "contemplated by the contract of carriage." Currently, COGSA generally only covers parties who issue a bill of lading. Thus, the new convention would cover, for example, stevedores, marine terminals and ship managers.

• **Enhanced Limitations of Liability. Art. 59 ¶1&3.** The convention limits liability "for breaches of its obligations under this convention" to "875 units of account per package or other shipping units, or three units of account per kilogram of the gross weight of the goods...whichever amount is higher, except when the value of the goods has been declared by the shipper and included in the contract particulars...." "Units of account" referred to is the Special Drawing Rights as defined by the International Monetary Fund.[11] As of today, this would equal a package limitation of approximately $1,260, and a per-kilogram limitation of about $4.44. Currently, COGSA limits, are much lower.

• **Retention of the "Container Clause." Art. 59 ¶2.** The convention expressly provides that "[w]hen goods are carried in or on a container, pallet, or similar article of transport used to consolidate goods, the packages or shipping units enumerated in the contract particulars as packed in or on such article of transport are deemed packages or shipping units. If not so enumerated, the goods in or on such article of transport are deemed one shipping unit. Currently, many U.S. courts interpret COGSA consistent with the "Container Clause."

• **Burden of Proof and Liability Changes. Art. 17 ¶3&6 & Art. 20.** Previously, under U.S. law, if one or more causes contributed to cargo loss, one attributable to the carrier and one not attributable to carrier, the court was required to attribute the entire loss to the ocean carrier.[12] Now, the court will be required to apportion the loss between the parties. Defenses arising out of errors in navigation are now eliminated and defense for fire are limit to fires onboard a ship.

• **Special Rules for Volume Contracts. Art. 80 ¶1.** The convention provides that notwithstanding the otherwise applicable liability provisions and limit to liability a carrier and a shipper may enter into a "volume contract" which "may provide for greater or lesser rights, obligations and liabilities than those imposed by this convention." Currently, COGSA has no such exception. The volume contract exception, as discussed infra, may be the most controversial section of the proposed new convention.[13]

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• **Jurisdictional Changes. Art. 66.** The convention also sets forth new jurisdictional criteria. It is reported that this provision was added at the urging of the United States to correct the U.S. jurisdictional problems of *Vimar Seguorosy Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 199 (1995). Under *Sky Reefer* forum selection clauses are enforceable no matter how inconvenient the foreign jurisdiction may be. Under the convention, even if a bill of lading contains a choice-of-forum clause, cargo interest may file suit in either: the place of origin; the first port of loading; the carrier's principle place of business; the last port of discharge; or the place of destination. However, once again the convention allows for parties to a "volume contract" to include a choice of forum clause. Art. 67 & 72. Apparently therefore, carriers will continue to be permitted to designate undesirable forums for shippers in volume contracts. (Member states can, if they wish, opt out of the convention's jurisdictional provisions). Moreover, volume contracts can include an arbitration clause that may be binding on "a person that is not a party to the volume contract...." Art. 75 ¶(4).

• **A New Recklessness Standard. Art. 61.** The convention sets forth a standard for the loss of the benefit of limits of liability worded as follows: "a personal act or omission of the person claiming a right to limit done with the intent to cause such loss or recklessly and with knowledge that such loss would probably result." This language suggests a new wilful misconduct standard.[14]

The Volume Contract

As noted, the new convention departs dramatically from the framework of existing treaties—largely in effect worldwide since roughly 1924—because for the first time it permits carriers to opt out of the convention liability scheme and in theory to be subject to very limited liability by virtue of entering into "volume contracts" with particular shippers.[15] The argument in favor of freely negotiated contracts is often raised. However, there are several reasons, beyond the recent unhappy outcomes associated with financial deregulation, why some argue that deregulated liability limits for the first time since the 1930s may not be beneficial. Some would argue that regulation is necessary because there is here a classic "asymmetry of information" problem: not even an experienced maritime lawyer can easily comprehend and effectively evaluate the risks arising out of the tortuous lexicon of a current multi-country transportation contract.[16] In addition, it has been recognized that while not always the case, in the liner trade "a certain inequality of bargaining power between the shipper and the carrier is assumed to exist."[17]

Finally, it is well-known that under the present limits of liability prudent shippers often purchase their own cargo insurance. This is prudent behavior and to insure one's belongings is encouraged. However when part of the motivation of purchasing the insurance is to avoid de minimus low liability limits public policy is further frustrated. Such low liability limits could have the unfortunate consequence of stripping much of the incentive for carriers to perform diligently.[18] While it is the cargo insurers who in the first instance foot the bill for COGSA's shortcomings, it is the consumers of goods who ultimately feel it with increased costs. As the world's largest nation of importers, this in the long run could impact American business more acutely than any other nation's.

Will New Convention Satisfy?

The true long-felt need in the United States for higher package limits, will surely cause many to advocate strongly for the swift passage of the convention. However, the larger question now is whether the convention will indeed de facto provide the modernization sought, or whether COGSA's limits of liability should simply be revised upwards. The sought-after remedy of more equitable shipper compensation may unravel if in fact there is a proliferation of the "volume contracts" under which the convention's limits and liabilities can simply be contracted down to limits below those of U.S. COGSA. The exception for volume contracts thus seems poised to swallow the balance of the proposed rules set forth in the convention, potentially defeating the entire purpose of the "reform" effort.

Liability and its limits are over-arching themes in the convention and the fear is that without these two pillars in place the whole liability and damage scheme may fall apart. The quid pro received and provided by all interested parties, may lose there import if by a simple edit to a master agreement a carrier can slip in a "derogation" clause that will bind the shipper for all transport for the duration of the contract.

No economic studies appear to have been performed to gauge the potential effect of the new convention. Thus, it has been met with both support and criticism. For example, the European Shipper's Counsel has come out forcefully against the convention asserting the improvements for shipper "are at best uncertain as they are usually qualified in such a way that they prove illusory";[19] however, others view the convention as a fair compromise between the competing interests. For example, a spokesman for the National Industrial Transportation League, representing large U.S. shippers, has called the new treaty "a major improvement over the status quo."[20]

One temporary alternative if the convention (especially the new volume contract provisions) is viewed as potentially flawed would be to retain the current COGSA's structure but to adopt the Rotterdam Rules limits of liability. Another option would be to partially adopt the convention as domestic U.S. law, excluding any objectionable provisions.

How the U.S. Congress ultimately deals with the new convention will be closely watched by all interested in shipping and related liability.

1. See Press Release, dated Dec. 11, 2008 Administration of Justice, Criminal Accountability of U.N. Officials on Mission Among Issues, as General Assembly Adapts 18 Texts Recommended by Legal Committee, available at http://www.un.org/News/Press/doc./2008/gall0798.doc.htm; see also; Press Release dated Oct. 20, 2008, Links Between Commercial Law Reform and 'Culture of Rule of Law', available at http://www.un.org/News/Press/docs//2008/gal3346.doc.htm. The draft convention has been posted by the Maritime Law Association (MLA) of the United States by the Carriage of Goods Committee under the header Rotterdam Rules posted at www.mlaus.org. (herein after the "convention").

2. Press Release, "United Nations Commission on International Trade Law Working Group Adopts New Draft Convention on the Contract for the International Carriage of Goods Wholly or Partly by Sea," UNIS/L/117 (July 7, 2008), available at http://www.unis.unvienna.org/unis/pressrels/2008/unisl117.html. See also note 1, Dec. 11, 2008, Press Release.

3. 1 Thomas J. Schoenbaum, ADMIRALTY AND MARITIME LAW, §10-15 at 649 (4th ed. 2004); Mary Helen Carlson, "U.S. Participation in the International Unification of Private Law: The Making of the UNCITRAL Draft Carriage of Goods by Sea Convention," 31 Tul. Mar.L.J. 615, 625 (Summer 2007).

4. See Michael F. Sturley, "Setting the Limitation Amounts for the UNCITRAL Transport Law Convention: The Fall 2007 Session of Working Group III," 5 Benedict's Mar. Bull. 149, 149 (3d/4th Qtr. 2007).

5. See Carlson, supra note 3 at 625. For a thorough discussion of the so-called "package problem," see 1 Thomas J. Schoenbaum, ADMIRALTY AND MARITIME LAW, §10-13 at 718 & n.17. See, e.g., *Hayes-Leger Assoc. Inc. v. M/V Oriental Knight*, 765 F.2d 1076, 1079 (11th Cir. 1985) ("[T]he term 'package'...has no legislatively supplied definition. Rather, the task of defining and applying the term has fallen to the courts."); *Binladen BSB Landscaping v. M.V. "Nedlloyd Rotterdam,"* 759 F.2d 1006, 1011 (2d Cir. 1985) ("[T]he principal difficulty has lain in defining the meaning and scope of the word 'package,' a term left undefined by Congress.").

6. Almost every other nation prohibits limitation in such circumstances. See, e.g., Protocol to Amend the Hague Rules ("Hague-Visby"), Feb. 23, 1968, 1977 Gr. Brit. T.S. No. 83 (Cmnd. 6944), art. IV, par. 5(e); Convention on the Carriage of Goods by Sea ("Hamburg Rules"), March 31, 1978, 17 I.L.M. 608, art. 8, par. 1. See also 1 William Tetley MARINE CARGO CLAIMS, Chapter 5 pp. 247-250.

7. Rod Sullivan, COGSA $500 Package Limitation Is Really an Exoneration From Liability, FLORIDA MARITIME ACCIDENT LAWYER (July 12, 2006), available at http://floridamaritimelawyer.clarislaw.com/general/cogsa-500-package-limitation-is-really-an-exoneration-from-liability.html. The authors of this article have not re-calculated these figures.

8. The People History, 1936, available at http://www.thepeoplehistory.com/1936.html; This figure reflects the national median home price as of the last quarter of 2009, as reported on Feb. 14, 2008, by CNN Money, available at http://money.cnn.com/2008/02/14/; Energy Information Administration, U.S. Department of Energy, March 11, 2008 Report, available at, http://www.eia.doe.gov/emeu/steo/pub/mar08.pdf; Robert Gavin, Surging Costs of Groceries Hit Home, The Boston Globe (March 9, 2008), available at, http://www.boston.com/business/personalfinance/articles/2008/03/09/surging_costs_of_groceries_hit_home/; These calculations are based on the Consumer Price Index, available at, http://inflationdata.com/Inflation/Inflation.

9. For instance, the 1968 Hague-Visby Rules and a subsequent protocol in 1979—operative in roughly 70 percent of countries that trade with the United States—increased the per-package limitation to 666.67 Special Drawing Rights (SDR), added an alternative per-kilogram limitation of 2 SDRs, whichever is higher, and included a "container clause," which expressly defines the number of packages for limitation of liability purposes. The Hague-Visby limitations equal roughly $1,080 per package and $3.24 per kilogram. There are also the Hamburg Rules. Rolled out in 1978 as an updated alternative to the Hague-Visby Rules, this convention boasts a reputable presumption of carrier liability and sets the liability limitation at 835 SDRs per package or 2.5 SDRs per kilogram, whichever is greater. This package limit equals about $1,353 and $4.05 per kilogram. Only the United States lags behind in setting appropriate shipper compensation, affording one of the lowest statutory per-package limitations of liability on earth and offering no per-weight limitation.

10. Package and Kilo Limitations of 148 Countries (Updated Weekly), available at, http://www.mcgill.ca/maritimelaw/glossaries/package-kilo/. The limitation amounts are based on the value of the dollar compared to the SDR as of Dec. 22, 2008, according to the International Monetary Fund's Web site at www.imf.org.

11. The International Monetary Fund offers daily valuations of the SDR in U.S. Dollars at http://www.imf.org.

12. Carlson note 3 at p. 632, see also *Schell v. The Vallescura*, 293 U.S. 296, 307 (1934).

13. See also Carlson note 3 at 636; see also Convention defines "volume contract" as "a contract of carriage that provides for the carriage of a specified quantity of goods in a series of shipments during an agreed period of time" art. 1 ¶2.

14. This language is a departure from the fundamental breach concepts used in the Hague/Visby Rules or applicable under COGSA and is not consistent with past maritime jurisprudence relating to forfeiture of liability limits based on the acts of a defaulting carrier. See 1 William Tetley, MARINE CARGO CLAIMS, Chapter 5 at 227 (4th ed. 2008); see also (The Visby Rules), Protocol to the Brussels Convention on Bill of lading 1924 signed at Brussels, Feb. 23, 1968 at art. 4(5)(h).

15. Draft Convention, art. 80¶4 (Prohibiting "volume contracts" from opting out of liability in very limited circumstance).

16. E.g., *The Delaware*, 161 U.S. 459, 473 (1896) ("That bills of lading have thus become so lengthened, complex, and involved that in the ordinary course of business it is almost impossible for shippers of goods to read or check their various conditions...."); *Royal Ins. Co. v. Orient Overseas Container Line Ltd.*, 514 F.3d 621, 637 (6th Cir. 2008) (describing a multi-modal bill of lading as a "byzantine labyrinth of clauses meant to govern liability").

17. Carlson note 3 at p. 630.

18. This situation is known as "underdeterrence." As explained by Judge Richard Posner in his classic text Economic Analysis of Law (Little Browne, 3rd ed. 1986) at pp. 186 & 187:

> To permit the defendant to set up my insurance policy as a bar to the action would result in underdeterrence. The economic cost of the accident, however defrayed, is $10,000, and if the judgment against him is zero, his incentive to spend up to $10,000 (discounted by the probability of occurrence) to prevent a similar accident in the future will be reduced.
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> If compensation is the only purpose of the negligence system, it is a poor system, being both costly and incomplete. Its economic function, however, is not compensation but the deterrence of inefficient accidents.

19. http://www.europeanshippers.com/Position Paper April 2007. See also Carlson note 3 at 625; see also generally Sturley note 4.

20. Rotterdam Rules: U.N. Group American Shipper Completes draft of Cargo Liability Convention, by Chris Dunn. September 2008, American Shippers Magazine.