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Independent Inspectors in Commodity Sales Transactions: Commercial Expectations and the Duty of Care

Commodity sales contracts commonly refer quality and quantity certification to an independent surveyor or inspection company.

The English High Court's recent decision in *AIC Limited v ITS Testing Services (UK) Limited* [2005] EWHC 2122 (Cresswell J) considers the scope of duties of such inspection companies. This decision is significant for the reason that the same contractual mechanism is in widespread use in different commodities and trades around the world.

The Court has found the jointly-appointed "independent inspector" to be a classic illustration of the principle that where a person with a particular expertise provides a report which he knows will be passed on to another who can be expected to rely on it, that person assumes responsibility for what is in the report.

Facts

ITS Testing Services (UK) Limited (ITS) was appointed by AIC Limited (AIC) and Mobil Sales and Supply Corporation (Mobil) to carry out an inspection on a mixed cargo of regular and premium unleaded gasoline which AIC bought from Mobil FOB Mobil's Coryton Refinery.

AIC suffered losses as a result of the cargo not in fact meeting the specifications of its contract with Mobil (when ITS had certified that it did).

Outcome

ITS was found liable not only in negligence and for deceit, but also by implied terms of ITS's contract with Mobil and AIC. Other defences raised by ITS including time bar under the *Limitation Act 1980* (UK) were unsuccessful and ITS was held liable in full for damages sufficient to put AIC back in the position it would have been in but for the wrongful acts of ITS.

By the time the decision was made against ITS, nine years had passed since the certification of the cargo in question. AIC had in the meantime unsuccessfully defended litigation from its sub buyer in two other jurisdictions (relying on the faulty certification), had resold the cargo at a loss and had then pursued its claim through the English High Court. The damages payable by ITS included compensation for all the losses AIC claimed including AIC's legal costs wasted in other countries.

Nexus with cargo owner

An inspection company's mandate is often from both seller and buyer and the charges of the inspection company may be paid by one or both parties. The reasons for judgment look beyond those immediate clients of the inspection company to the commercial purpose of the inspection certificate. An inspection company such as ITS will be aware that its certificate is likely to be required for presentation to the buyer, any sub-buyers and their banks and

furthermore that such a certificate is part of the documentation against which payment will be made for the commodity in question.

Consequences for cargo inspectors

The ramifications of this decision for independent cargo inspectorates are potentially severe. The difficulties that inspection companies may have under English law in excluding their liability by contract terms have recently been highlighted. Furthermore, Cresswell J did not decide whether the inspection company's duties extend to sub-buyers and others with interests in cargoes they certify (such as banks). These remain open issues and will be of immediate and continuing concern to cargo inspectors and their insurers. (C Swart, Holman Fenwick & Willan, Lloyds List, 19 October 2005.)

ITS's tangled web

In this case, the inspection company compounded an initial negligent inspection by subsequently secretly re-testing a broached sample, and then concealing the re-test result. It told its client AIC that ITS "stood by" its initial (incorrect) certification.

If the full facts had been known to AIC when the cargo quality problem manifested itself at discharge, or soon after, a commercial settlement could have been reached.

Alternatively perhaps the problem could have been mitigated by blending with other fuel, at a cost a fraction of the damages that were ultimately awarded against ITS.

In a number of areas, ITS had departed from its own procedures manual. If ITS had adhered to its own quality assurance standards, the outcome could have been very different.

An interesting comparison

Is there a difference between the reports of cargo inspection companies and the reports of other professionals?

It is interesting to compare the approach of the English Court to the reports of classification societies in *Marc Rich & Co AG v Bishop Rock Marine Co Ltd (the "Nicholas H")* [1994] 1 LLR 492 (Court of Appeal). In the *Nicholas H* a Nippon Kaiji Kyokai (NKK) classification society surveyor had issued reports on the condition of a ship found with cracks in its hull. Following an NKK report and recommendations retaining the ship in class until completion of the voyage, the ship continued on its voyage and sank en route. Hirst J at first instance found that NKK owed the owners of a cargo that was lost with the ship a duty of care capable of giving rise to a liability in damages. The Court of Appeal reversed that finding on the basis that there was insufficiently close relationship between the cargo owner and NKK and that it would not be fair, just or reasonable to impose such a duty of care. The House of Lords upheld the result reached in the Court of Appeal.

Discussion

In the *AIC* decision, it was said that the inspection company would be aware that its certificate would be relied on by commercial parties outside the inspection contract. This was material to the nexus between plaintiff and defendant. In the *Nicholas H*, Hirst J thought that a classification society would be aware that its recommendation could in practice determine whether the voyage proceeded, and of possible dire effects on insurances, mortgages and other common commercial arrangements of a negative recommendation. In the final outcome there was, however, held to be no nexus between plaintiff and defendant.

The difference in approach is partly explained by the existence of the Hague and Hague-Visby regimes which impose a non-delegable duty on the shipowner to exercise due diligence to make its ship seaworthy. This was seen as a potent reason (in both the Court of Appeal and the House of Lords) for deciding against imposing a duty of care on the classification society in that instance.

Over time it seems likely that the reasoning of the higher Courts in *Nicholas H* will be tested again in different contexts, possibly by reference to some of the "common commercial arrangements" mentioned by Hirst J.

Classification societies and the US view

The US Court of Appeals (Fifth Circuit) has ruled that a classification society may be liable to a third party for negligent misrepresentation of a ship's condition in the context of a ship sale and purchase (*Otto Candies LLC v NKK* 2003 US App 346 F.3d 530).

Conclusions

Inspection companies will need to review the integrity of their quality assurance procedures, and their insurance and contractual arrangements in light of this decision.

The English (as well as Australian) courts will continue to grapple with the boundaries of the tortious duty of care in relation to professional reports that are relied on in commerce.

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