Abolishing the Exemption of Liability for Fault in Ship Management in the Nautical Fault Exemption System

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Abstract: The nautical fault exemption generally refers to the carrier's exemption from liability for the loss or damage of goods arising or resulting from the act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or management of the ship. To date, the nautical fault exemption has always been the most important exemption clause for carriers, and countries and legislation on international maritime cargo transport have paid much attention to the question of whether the nautical fault exemption system should continue to exist or be abolished. This paper analyzes the meaning of the nautical fault exemption, explores the socioeconomic roots of its emergence and development, and examines the current allocation of interests and risks between the ship owner and the cargo owner. After taking the relevant factors into account, the paper concludes that the nautical fault exemption system should undergo certain reforms.

Key Words: Nautical fault exemption; Balance of interests; Differentiation; Systemic reform

Nautical fault includes fault in navigation and fault in the management of the ship. Legal provisions on nautical fault generally define it as the fault of the master, mariner, pilot, or other servants of the carrier in the navigation or management of the ship. Navigation fault refers to the fault of the master, mariner, pilot, etc. that occurs during navigation and berthing; ship management fault refers to the fault of the master, mariner, etc. that occurs during the maintenance of the ship's performance and operational status. Here, management does not mean operational

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management or administrative management.[1]

Article 4, Paragraph 2 of the Hague Rules, which went into effect in the 1930s, states: "Neither the carrier nor the ship shall be liable for any loss or damage of goods arising or resulting from act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship." This is the well-known nautical fault exemption. To date, the nautical fault exemption has always been the most important exemption clause for the carrier, and countries and legislation on international maritime cargo transport have paid much attention to the question of whether the nautical fault exemption system should continue to exist or be abolished.

The writer believes that, under the current conditions of the shipping industry – and especially for China, a country with a large trade volume and a major shipping country on the ascendancy – the nautical fault exemption system should neither be regarded as sacrosanct nor be abandoned before its time. Rather, we should separate the nautical fault exemption into two parts: fault in navigation and fault in ship management, and retain the relatively reasonable navigation fault exemption and abolish the obsolete ship management fault exemption. The discussion in this paper will proceed in two steps. First, the paper will analyze the meaning and interpretations of the nautical fault exemption as well as the history of the exemption. Second, we will examine the various considerations for reforming the system and conclude that the navigation fault exemption should be retained and the ship management fault exemption abolished.

I. The Nautical Fault Exemption's Meaning, History, and Socioeconomic Roots

A. The Meaning of the Nautical Fault Exemption

The nautical fault exemption is generally defined as the carrier's exemption from liability for any loss or damage of goods arising or resulting from neglect or default of the mariner, pilot, or the servants and agents of the carrier in the navigation or management of the ship.[2]

This system is an obvious departure from two traditional doctrines of civil

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1 Si Yuzhuo ed., *Maritime Law*, Beijing: Law Press China, 2003, p. 113. (in Chinese)
2 Hague Rules, Art. 4(2).

liability: fault liability and respondeat superior. Under the doctrine of fault liability, the mariner assumes liability for damage to the goods arising or resulting from the mariner's fault in the navigation or management of the ship. Under the doctrine of respondeat superior, the ship owner, as the mariner's employer, assumes the liability that results from the mariner's action or inaction in the performance of the mariner's duties. But under the nautical fault exemption system, the ship owner is exempt from liability, and the cargo owner has to absorb the damage to the cargo that results from the mariner's fault. This seems to be unfair and unreasonable at first glance: the cargo owner is an innocent victim, and the ship owner evades the liability that results from his employee's actions. But before the ship has set sail, the ship owner must have performed his duty and made the ship seaworthy. The exemption of liability for navigation and management faults that arise after the ship has set sail is reasonable and realistic under certain historical conditions.[3]

In legislation, the risk-sharing system inherent in the nautical fault exemption is expressed by multiple liability standards. This type of legislation allocates liability through a mix of concepts, definitions, and structural designs.[4]

B. The Establishment and Evolution of the Nautical Fault Exemption

History is a mirror. A review of the history of the nautical fault exemption system will help us understand and analyze the system's socioeconomic significance and roots and also articulate our approach to it more clearly.

The concept of "nautical fault exemption" first emerged in the United States in the 1893 Harter Act. Prior to the Harter Act, strict liability was the norm in breach-of-contract disputes in Anglo-American common law. Before the 19th century, communication was relatively poor, and the shipper lost all contact with and control of the cargo after handing it over to the carrier. But the carrier had the ability to control, and has intimate knowledge of, the cargo's status during the transport. It was very difficult, even impossible, for the shipper to prove the carrier's or his agent's fault if the cargo was damaged during transport. Under common law, the ship owner could be exempted from liability under five conditions: an act of God, an act of a public enemy, the cargo's inherent defects and poor packaging,

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3 Yang Liangyi, *The Bill of Lading*, Dalian: Dalian Maritime University Publishing House, 1994, p. 304. (in Chinese)

4 WU Huanning ed., *Maritime Law*, Beijing: Law Press China, 1996, p. 114. (in Chinese)

general average sacrifice, and fire. At the same time, common law imposed three types of implied obligations on the ship owner: (1) the ship must be absolutely seaworthy; (2) the ship could not take unreasonable detours; and (3) the ship must navigate with due dispatch. If the ship owner failed to meet the first obligation (seaworthiness), he would be liable for the resulting loss. If the ship owner failed to meet the second or third obligation, he would also be deprived of his entitlement to the five exemptions, unless he could prove that one of the five occurrences in the exemptions would have caused the cargo owner's loss even if the ship owner had met the obligation.[5] It is evident that, under the common law of the time, the ship owner bore a risk of enormous liability. This variation of strict liability constrained the shipping industry to a certain degree.[6]

In an age when navigational technology was relatively undeveloped, maritime transportation carried huge risks. Navigation was extremely dangerous, and ships had few ways of insulating themselves against these dangers. Navigation was considered not as much a mere journey as an adventure. While the mariner faced physical dangers, the carrier also shouldered tremendous capital risks due to the huge sums of capital required in the building of ships that were capable of traversing the ocean. In addition, because communications was relatively poor at that time, the carrier had difficulty in effectively controlling and managing the mariners, and the lifestyle particular to maritime travel imposed on the mariners professional behavioral risks that were much greater than those associated with land travel and transport. Given these special risks to both person and property, basing the carrier's contractual liability on a strict liability theory had resulted in a material imbalance of interests and risks between the ship owner and the cargo owner and seriously hampered the development of the shipping industry.

In order to reverse this disadvantageous position and making use of the freedom of contract, the ship owner began to add liability exemption provisions into the carriage contract and expanded the scope of exemption from liability. As long as these provisions were clear and understandable, courts at the time generally gave effect to them. As one of the three major principles of modern civil law, the freedom of contract should have been respected by the law. However, in practice,

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5 Shi Shengke, *Theories of Liability and the Nautical Fault Exemption* (Master's Thesis), Shanghai: Shanghai Maritime Institute, December 2001, p. 7. (in Chinese)

6 Si Yuzhuo, Major Changes to the Liability Bases of Bills of Lading, in *Dalian Maritime Institute Maritime Law Department Theses*, Beijing: Beijing Academic Publications Publishing House, 1989. (in Chinese)

due to the vast difference in the negotiating power of the contracting parties, the resulting carriage contracts came to be extremely unfair. The ship owner, acting as the carrier, had great leverage. The ordinary cargo owner could not compete, and the cargo owner's freedom of contract was in fact not comparable to that enjoyed by the shipping company. According to some of these contracts, the ship owner actually had no responsibility other than the "obligation" of collecting the freight.[7] These actions on the part of the ship owner obviously did not reasonably allocate interests and risks; rather, they pushed the imbalance to the other extreme. The holder of the bill of lading often did not receive the cargo, which substantially weakened the credibility of the bill of lading in international trade. The normal flow of international trade was hindered, which in turn worked against the shipping industry's own interests.

Under these circumstances, international merchants and the shipping industry both needed a system to balance the risks and interests of the cargo owner and the ship owner so the shipping industry and international trade could grow normally. The 1893 Harter Act responded to this need in the United States. The Harter Act provided a set of minimum obligations and maximum exemption standards for the ship owner. Its main provisions were the following: (1) there was no exemption from liability for relative seaworthiness; (2) there was no exemption from liability for negligence in managing the cargo; (3) the ship owner was not liable for losses arising or resulting from fault in navigation, the management of the ship, acts of God, acts of public enemies, the cargo's inherent defects and poor packaging, lawful arrest, marine salvage, etc. The Harter Act granted broad exemptions to the ship owner, which was a departure from the ship owner's strict liability under common law. At the same time, it mandated minimum liability for the ship owner, thereby bringing to an end the era of unlimited exemptions for the ship owner when the freedom of contract was given free rein during the time of laissez-faire capitalism. It was an attempt to balance the interests of the cargo owner and the ship owner.

Because of these elements, the Harter Act had great influence on the shipping legislation of various countries and in the international community. They followed the Harter Act in granting exemptions from liability for fault in navigation and the management of ships. Examples include the 1904 Carriage of Goods by Sea Act

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7 Shi Shengke, *Theories of Liability and the Nautical Fault Exemption* (Master's Thesis), Shanghai: Shanghai Maritime Institute, December 2001, p. 7. (in Chinese)

(Australia), the 1908 Shipping and Mariner Act (New Zealand), the 1910 Canadian Carriage of Goods by Water Act (Canada). In China, Article 51 of the Maritime Law also provides for exemptions from liability for nautical fault.

In 1924, the international community adopted the International Convention for the Unification of Certain Rules of Law Relating to Bill of Lading (the Hague Rules), which established an international standard for the nautical fault exemption system. In 1968, the Protocol to Amend the International Convention for the Unification of Certain Rules of Law Relating to Bill of Lading (the Hague-Visby Rules) also went into effect. The Hague-Visby Rules added the carrier's servant and agent to the group of people who could take advantage of the nautical fault exemption. The Hague-Visby Rules also included tort as a possible rebuttal to the defense of a nautical fault exemption, thereby increasing the number of possible rebuttals.[8]

But since the nautical fault exemption system became a part of international shipping through the Hague Rules in 1924, the arguments over its continued existence or abolishment has gotten more and more intense as the practical realities of shipping and international trade have evolved. The proponents for abolishing the nautical fault exemption has become more vocal, and various countries have advanced their points of view based on their own national interests. Countries with robust shipping industries have tended to support the nautical fault exemption, while countries whose trade was relatively developed have pushed for the opposite. International organizations have also issued rules on this issue. The Hamburg Rules of 1978 abolished the nautical fault exemption, revived strict liability, and imposed the presumption of fault on the carrier.[9] The United States' Carriage of Goods by Sea Act (COGSA) of 1999 also abolished the nautical fault exemption, but provided for the opposite burden of proof, *i.e.*, there was no presumption of fault on the part of the carrier.[10] The UNCITRAL Draft Convention on the Carriage of Goods (draft from the UNCITRAL's 16th session; same below), whose drafting was begun by the Comité Maritime International (CMI) in 1999, also imposed liability on the carrier. However, fault was only presumed outside the scope of the exemption; there was no presumption of fault if the exemption applied.[11]

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8 The Visby Rules, Art. 3(1)~(2).
9 The Visby Rules, Art. 3(1)~(2).
10 United States' 1999 COGSA, Art. 9(C)~(D).
11 UNCITRAL Draft Convention on the Carriage of Goods, Art.14.

C. The Socioeconomic Background of the Emergence and Development of the Nautical Fault Exemption

The emergence and development of the nautical fault exemption system were influenced by the changing conditions of the economy and maritime trade. They reflect the theories and bases for the carrier's liability for cargo.[12]

Even though the United States had enacted the 1893 Harter Act to protect the interests of its own cargo owners, the nautical fault exemption system that it provided began to act as a fulcrum for balancing the interests of the ship owner and the cargo owner. At the technological and economic levels of the time, the exemption apportioned both parties' risks in a reasonable manner and maximized the public interest. The carrier invested the resources saved by the nautical fault exemption into the shipping business, navigation technology, the ship's capacity to weather navigational risks, and the general seaworthiness of the ship. The increased seaworthiness of ships in turn benefited the cargo owner. The nautical fault exemption was a low-cost legal tool that resulted in high returns in the form of flourishing trade and the rapid development of the international shipping industry.[13] These are the socioeconomic reasons for the nautical fault exemption system's continued vitality.

But with technological and economic progress, the wide use of modern technology in navigation, and the rapid development of the modern maritime insurance industry, the balance established by the nautical fault exemption has gradually become lopsided. This is the fundamental reason that various countries and the international community have begun to question the system and even propose its abolishment. It is necessary to update the nautical fault exemption system, search for a new fulcrum in the law, and rebalance the interests of the ship owner and the cargo owner.

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12 Zhao Yuelin and Hu Zhengliang, The Effects of Abolishing the Nautical Fault Exemption on the Carrier's Liabilities and Obligations and Other Maritime Legal Systems, *Dalian Maritime University Journal*, No. 4, 2002. (in Chinese)

13 Ni Xuewei, The Continuation and the Abolishment of the Nautical Fault Exemption, *Research on Maritime Law*, Vol. 3, Beijing: Law Press China, 2001, p. 84. (in Chinese)

II. Consider Relevant Factors as a Whole and Reform the Nautical Fault Exemption System in a Reasonable Manner

A. China's Main Reasons for Proposing the Abolishment or Retention of the Nautical Fault Exemption

1. Entities or scholars who advocate for cargo owners' interests tend to favor the abolishment of the nautical fault exemption for the following reasons:

(1) The Chinese Maritime Law grew out of customs from the early stages of the shipping industry, and these customs were closely tied to the shipping practices of the time. With the progress of technology and their extensive use in navigation, the risks associated with sea travel have decreased dramatically. Ship functionalities, navigational aids, and on-board communications equipment have substantially improved. As a result, the earlier view of sea travel as an "adventure" no longer applies, and there is likewise no longer any factual basis for granting special protection, exemptions, and privileges to the ship owner under the law.

(2) The carrier now has far greater control over the mariner. One reasons for creating an exemption for the fault of the master and the mariner during navigation was that, due to the poor state of communications at the time, the ship owner had little control over the ship and might even know nothing about the happenings on board. Hence, the doctrine of respondeat superior could not be applied to determine the carrier's liability. But now, because of technological progress, communication between ship and shore has become very easy, and the ship owner can effectively control the ship. So there is one less reason for the continual existence of the nautical fault exemption.

(3) The 1978 International Convention on Standards of Training, Certification and Watch keeping for Seafarers (STCW) (as amended in 1995) and the International Management Code for the Safe Operation of Ships and for Pollution Prevention (the ISM Code) will reduce errors and fault by the master and the mariner during navigation and in the management of ships.

(4) With the containerization and specialization in the transport of cargo (mainly oil and bulk cargo), the amount of general cargo as a percentage of all cargo in the transport chain has gradually decreased. Transport is simpler and

faster, the damage and loss of cargo are considerably rarer occurrences, and the ship owner's risks are greatly reduced. Therefore, the current way of determining the carrier's liability has resulted in an unbalanced allocation of risks and interests between the ship owner and the cargo owner.

(5) The nautical fault exemption will probably allow the carrier to avoid the liability that arises from fault in the management of cargo. Because it is usually difficult to distinguish fault arising from cargo management and that from the management of the ship, the cargo owner will find it very challenging to offer proof that distinguishes between causation from cargo management and causation from ship management.

(6) Strict liability is the rule for transport by national standard railway and highway. The abolishment of the nautical fault exemption will standardize the liability system for multi-modal transport.

(7) The Hamburg Rules of 1978, the United States Draft COGSA of 1999 and the UNCITRAL Draft Convention on the Carriage of Goods all reflect the general international trend toward doing away with the nautical fault exemption.

2. Entities and scholars who represent ship owners' interests tend to advocate for the continued existence of the nautical fault exemption for the following reasons:

(1) Although there has been steady progress in navigation technology, maritime accidents like collisions and stranding still occur from time to time. Additionally, ship tonnage and the dangers of carrying cargo are far greater than in earlier times. The modern large container ships, chemical cargo ships, and oil tankers are themselves gigantic risks. With the upsizing and specialization of ships, ship operations have become more difficult and complicated. Moreover, losses in the event of accidents are often catastrophic.

(2) Even though the carrier has much greater control and supervision over the mariners, the growth in the sizes of ships and the reduction in the number of mariners have placed mariners under greater psychological stress. This problem cannot be alleviated simply by standardizing operations. The fact that human error has remained a major cause of maritime accidents for the past decades is testament to this.

(3) With respect to risk allocation, the cargo owner and the ship owner have reached a delicate balance. Further, insurance and general average mechanisms are moving towards stability and maturity, and their progress should not be disturbed.

(4) The abolishment of the nautical fault exemption will likely deprive the

carrier of the exemption from liability for loss and damage to cargo arising from maritime risks such as inclement weather. Since nautical fault and maritime risks tend to occur together, it is extremely difficult for the carrier to prove what has been caused by nautical fault and what by maritime risks.

(5) Currently, the vast majority of countries in the world have adopted the Hague Rules or the Hague-Visby Rules, which use the partial fault liability system. Fewer countries use the Hamburg Rules, and most of them are third world countries with undeveloped shipping industries. The Hamburg Rules have not been accepted by any major shipping or trade nation.

(6) If China unilaterally abolishes the nautical fault exemption and increases the carrier's responsibility, the competitiveness of China's shipping industry will suffer enormously. The shipping industry is closely related to the national economy and national defense, and the drafting and revision of China's shipping regulations should aid the growth of the shipping industry. As a major shipping country, China should protect ship owners' interests in a practical manner and not get ahead of itself when it comes to abolishing the nautical fault exemption.

At this time, although the majority of Chinese academics recognize the disadvantages of the nautical fault exemption system, mainstream opinion still supports the maintenance of the nautical fault exemption out of consideration for the national interest.[14] But regardless of whether they advocate retaining or abolishing the nautical fault exemption or the reasons for their positions, they do not seem to have paid attention to the differences between navigation and ship management. With the current rapid pace of economic and social development, the differences between navigation and ship management have become increasingly obvious in their levels of difficulty, risks, and results when the risks materialize. It is no longer fair, reasonable, or efficient to apply the same doctrine of liability to both. Rather, the two types of activities should be distinguished and treated differently.

B. Distinguishing the Exemptions for Fault in Navigation and Fault in Ship Management

The international community has always treated navigation fault and ship

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14 Shi Shengke, *Theories of Liability and the Nautical Fault Exemption* (Master's Thesis), Shanghai: Shanghai Maritime Institute, December 2001, p. 46. (in Chinese)

management fault differently. As early as during the drafting process of the Hamburg Rules, experts were unanimous in their opinion that the exemption for fault in ship management should be abolished, but differed greatly as to fault in navigation. Many thought that the exemption for fault in navigation should be kept and the exemption for fault in ship management should be abandoned. The main differences between fault in navigation and fault in ship management are the following:[15]

1. The identities of the actors: the actors who may be at fault in navigation fault are the personnel moving the ship, *i.e.,* the personnel on duty on the bridge and in the engine department. On the other hand, the entire crew is responsible for managing the ship. The single goal of the crew on board is to maintain the ship's performance so that the ship can be navigated in a safe manner. Therefore, the group of actors involved in navigation is much smaller than that involved in managing the ship.

2. Causation of the fault: fault in navigation arises when the ship is being moved, while fault in managing the ship is related to the maintenance of the ship's effective performance. The difficulty and complexity in navigation are generally greater than those in ship management.

3. Consequences: fault arising from navigation can cause collision, stranding, the striking of a reef, or shipwreck in a storm. In other words, the losses resulting from navigation fault are usually directed to the body of the ship, and the consequences are relatively severe. On the other hand, the consequences from fault in ship management are comparatively complicated, and the damage to the body of the ship is generally minor. For this reason, mariners tend to be more cautious while navigating and less so when managing the ship.

C. Why the Exemption for Navigation Fault Should Be Retained, but the Exemption for Ship Management Fault Should Be Abolished

Based on the above comparison of navigation and ship management and taking the following factors into consideration,[16] we believe that the exemption for navigation fault should be retained, but the exemption for fault in the management

15 Xu Zhongjian, Nautical Fault and Cargo Management Fault, *Zhejiang Wanli University Journal*, No. 4, 2002. (in Chinese)

16 While a certain factor standing alone may not be very persuasive, but taken together with the discussion, they support this paper's position.

of the ship should be abolished:

1. Fairness and Reasonableness of the System, and the Balance of Interests: while the cargo owner's significant investment and high risks in maritime cargo transport should be taken into account, attention should also be paid to the carrier's basic obligations.

The interests of different parties determine a legal system's course of development and implementation, and the fundamental task of law is to regulate these interests.[17] A legal system that allocates the parties' rights and liabilities in a reasonable manner also balances their interests and risks and achieves fairness. Fairness is the basic value of a legal system and achieving it is an important task.[18] A legal system that can achieve fairness through the balance of interests is more useful than one that does not.

The basic analysis that determines the continued existence or abolishment of the nautical fault exemption is one of the interests of the ship owner and the cargo owner, which have varied in accordance with the economic conditions and the conditions of maritime trade of the time. Between the United States' Harter Act in 1893, the Hague Rules, the Hamburg Rules, the United States' 1999 COGSA, and the recent UNCITRAL Draft Convention on the Carriage of Goods, the establishment, retention, and proposed abolishment of the nautical fault exemption in legislation all reflect changes and adjustments in the balance of interests of the ship owner and the cargo owner as well as the conflicts and coordination of shipping interests among various countries.

As discussed above, the most direct reason for the emergence of the nautical fault exemption was the special risks accompanying shipping in earlier times: to balance the interests and risks of the ship owner and the cargo owner, some of the risks that were originally assumed by the carrier were transferred to the cargo owner. However, with the progress and extensive use of modern navigation technology, many of these risks have been neutralized. Thanks to the constant innovation and progress in methods of ship positioning, object identification, and communication, ship operation and management will continue to improve as a whole, with digitalization, standardization and interface standardization,

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17 Zhang Wenxian, *Jurisprudence*, Beijing: Law Press China, 1997, p. 270. (in Chinese)

18 Li Long ed., *Jurisprudence*, Beijing: People's Court Publishing House, 2003, p. 242. (in Chinese)

modularization, and the use of "smart" devices as major trends.[19] Our capabilities to avoid and protect ourselves against maritime risks have substantially increased, the number of maritime accidents has fallen dramatically, and the so-called "maritime adventure" is a thing of the past.

Of course, even with the constant progress in nautical technology, maritime accidents still occur. Moreover, with the upsizing and specialization of ships and the increase in dangerous cargo, accidents tend to cause tremendous losses, which mean that maritime transport still has enormous risks.

Nonetheless, there is no comparison between present-day maritime risks and the earlier risks. The risks have fundamental differences. In earlier times, maritime risks were huge because people had a more limited understanding of and control over these risks. People had little way of containing or reducing accidents. Because accidents occurred frequently, the lives of mariners were constantly at risk, and ship owners could not predict when they might lose a lot of property. Today's maritime risks are of a totally different nature. Our understanding of and control over maritime risks have grown qualitatively by leaps and bounds, and the safety of mariners is much better guaranteed. Maritime risks usually manifest themselves in the huge losses from a single accident, and the losses are mainly property losses. At the same time, the development of the modern maritime insurance industry has spread and moderated the risks to a large extent. Contemporary maritime risks no longer constitute a "maritime adventure" in the traditional sense. With the development and application of scientific technology, similar risks also exist in various high-tech and capital-intensive industries.

As discussed above, compared to fault in ship management, fault in navigation is more likely to give rise to disastrous accidents and cause enormous losses of the mariners' lives and the ship owners' property. Therefore, mariners tend to be very prudent in navigation. However, mariners operate huge ships in many different complicated and variable conditions. They have to deal with a pace of work that changes constantly. These and other challenges put them under great pressure and, when complicated with a lack of technical skill and experience, errors will occur. Therefore, the strict application of fault-based liability is still somewhat unfair. The situation is very different with ship management personnel. Their work often includes various daily routines that have relatively lower levels of difficulty and a

19 Jin Yongxing and Wu Xiaoyun, Navigation Technology in the New Century, *Chinese Navigation*, No. 1, 2002. (in Chinese)

slower pace. These mariners are under less stress. In addition, with improvements in communications, they can receive more assistance and instructions from the carrier. At the same time, fault in ship management has relatively complicated consequences and do not lead to disastrous accidents as a rule; rather, they more often cause the loss or delayed delivery of the cargo. For these reasons, ship management personnel typically are less meticulous and are more likely to be negligent in a subjective sense. Hence, fault-based liability should apply to return the liability arising from fault in ship management to the carrier.

Keeping in mind these changes, the goal of balancing the risks and interests of the ship owner and the cargo owner, and the doctrine of fault-based liability, the writer believes that the rights and liabilities of the ship owner and the cargo owner should be reallocated, the exemption for navigation should continue to exist, and the exemption for fault in ship management should be abolished.

2. The Costs and Benefits of Systemic Reform: the reform of any legal system has certain costs. A reform can be considered reasonable if it requires relatively low costs and yields relatively high social and economic benefits.

The operation of a legal system and the allocation of resources evolve as a process of constant reallocation of rights, adjustments to the structure of rights, and reforms to the procedure of implementation, all guided by the goal of minimizing transaction costs.[20]

Those who advocate keeping the nautical fault exemption posit that systemic reform will have enormous costs. According to this view, the cargo owner and the ship owner have reached a delicate balance in risk-sharing. Further, the institutions related to insurance, general average, and collision have improved and are moving toward stabilization, and costs will result if they are done away with too quickly.

According to new institutional economics, during institutional transformation, increasing returns and self-reinforcement will occur, *i.e.,* there will be a so-called "path dependence." Path dependence means that, once a system is chosen at a certain point in history, the choice will inevitably influence the building of other systems because the chosen system exists in a certain institutional environment and is connected with various other systems. The chosen system thereby reinforces

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20 Richard A. Posner, translated by Jiang Zhaokang and Lin Yifu, *Economic Analysis of Law*, Beijing: Chinese Encyclopedia Publishing House, 1992, Translators' Preface, p. 18. (in Chinese)

itself.[21]

The nautical fault exemption has also experienced uninterrupted self-reinforcement since its beginnings. Other systems in maritime transport related to insurance, general average, and ship collisions are constantly influenced by and must coordinate with the nautical fault exemption system. For this reason, reforming the nautical fault exemption requires changes in the relevant supporting systems as well, and these systemic changes will have costs.

Even though the reform of the nautical fault exemption system will require the reform of other related systems, these reforms are neither fundamental nor destructive and are sometimes even constructive. We can see this from the effects on maritime insurance and the general average.

(1) Maritime insurance: with the elimination of the exemption for fault in ship management, the carrier liability insurer should expand coverage and increase its ability to pay claims. For the cargo insurer, since the losses resulting from fault in ship management can be recovered from the carrier, the risks have been lowered, which can translate to lower freight rates.

(2) General average: the reform of the nautical fault exemption system will not affect the continued existence of the law of general average. Rather, the reforms only affect apportionment, mainly in revisions of the adjustment rule. In addition, removal of the exemption for ship management fault will decrease the scope of the actual general average, which better conforms to the original intent of the general average system and helps balance the relationships of the parties.[22]

It is clear that the reform of the nautical fault exemption system will not bring about enormous costs. More importantly, these reforms can produce great social and economic benefits. Holding people responsible for their own actions is both fair and efficient. If people are made liable for the actions of others, inefficiency will occur because they have little control over others and will have difficulty in preventing the occurrence of fault. But if people are liable for their own negligence, they will be motivated to take action to prevent faults from occurring, reduce losses resulting from fault, and preserve property for the good of the entire society. The traditional fault-based liability doctrine came about out of consideration for fairness

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21 Lu Xianxiang, *New Institutional Economics*, Wuhan: Wuhan University Press, 2004, p. 168. (in Chinese)

22 Zhao Yuelin and Hu Zhengliang, The Effects of Abolishing the Nautical Fault Exemption on the Carrier's Liabilities and Obligations and Other Maritime Legal Systems, *Dalian Maritime University Journal*, No. 4, 2002.

and efficiency. Reforms in the nautical fault exemption system will bring about the benefit of a reduction in the number of accidents in an efficient manner and the consequential protection of property for society. These benefits are fundamental and primary compared with the secondary costs of systemic reform. The concern for costs should not hinder economic and social progress.

Therefore, from the perspective of costs and benefits in systemic changes, the liability for fault in ship management should be reallocated to the carrier for relatively large economic and social benefits at a relatively small cost. On the other hand, the exemption for fault in navigation should be retained for the reasons elaborated above, *i.e.,* fault in navigation is usually not a result of the actor's negligence, but rather of the mariner's lack of skill and experience. If the exemption for fault in navigation is eliminated, the aforesaid economic and social benefits are unlikely to accrue. Therefore, it is not advisable to eliminate the exemption for fault in navigation at present.

3. Efficiency of the Legal System: a legal system should be relatively efficient so that both disputes and litigation expenses can be kept to a minimum.

In cases involving the operation of the nautical fault exemption system, there have always been two pairs of facts and legal issues that are difficult to distinguish: (1) the risk of maritime accidents and navigation fault; (2) ship management fault and cargo management fault. In determining the causes of an accident that resulted in cargo damage, it is difficult to tell maritime accident risk from navigation fault and tell ship management fault from cargo management fault. These difficulties have posed problems for courts and increased the number of disputes as well as dispute settlement costs.

When the ship encounters a sudden natural disaster, the navigator will most likely use reasonable skill and effort to prevent an accident. However, because of the complexity and variety of natural environments at sea, it is unlikely that the navigator can avoid all dangerous conditions in emergencies. Once an accident occurs, cargo loss will usually result. The causes of the accident are usually maritime accident risk and navigation fault. Since these two factors are intertwined during the accident, it is very difficult to determine which caused the accident or the extent of their respective contributions to the disaster. Because there is an exemption from liability for losses resulting from natural disasters, the elimination of the navigation fault exemption will give rise to difficult disputes regardless of who has the burden of proof. Disputes and lawsuits will occur more frequently.

Similarly, due to the characteristics of ship management work, it is usually difficult to distinguish between ship management fault and cargo management fault. The same act can be considered a ship management act or a cargo management act. Since the actions involved in such type of work can be categorized either way, several standards for distinguishing between the two have emerged in the judicial practice of various countries. They include the following: (1) the purpose of the act and the entity being acted upon; (2) the original nature and purpose of the act; (3) the direct cause of damage to the cargo; (4) the entity that bears the effects of the negligent act.[23] In the same case, different categorizing standards will lead to different conclusions, making it even more difficult to tell ship management fault from cargo management fault and thereby increasing disputes and lawsuits. The elimination of the exemption for fault in ship management will certainly reduce the number of this type of disputes and bring down litigation costs.

Therefore, to improve the efficiency of the law and reduce the number of disputes as well as litigation costs, the exemption for navigation fault should be retained, and the exemption for fault in ship management should be eliminated.

4. The Legal System's Protection of the Domestic Economy

Abolishing the nautical fault exemption will add to the carrier's liabilities to some extent and may exert an adverse influence on the Chinese shipping industry, which is still at a nascent stage. This is one main reason offered by those who advocate the maintenance of the nautical fault exemption.

The writer believes that, assuming that the nautical fault exemption continues to exist, even though abolishing the ship management fault exemption will add to the carrier's liability, increase liability insurance premiums, the costs of transport, and in turn the freight, the risks borne by the cargo owner will be substantially reduced at the same time and lead to a decrease in cargo carriage insurance premiums. The two sides of the balance will compensate for each other to some extent. Therefore, the abolishment of the exemption for fault in ship management in China will not lead to a significant disadvantage in price competition.

Further, in the long run, this step will not impair, but rather enhance, the competitiveness of the Chinese shipping industry. China's competitiveness among international shippers has improved as the Chinese shipping industry has evolved, especially after China's entry into the WTO, but competition has also become

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23 Xu Zhongjian, Nautical Fault and Cargo Management Fault, *Zhejiang Wanli University Journal*, No. 4, 2002. (in Chinese)

increasingly fierce. Abolishing the exemption for fault in ship management will reasonably maintain and protect cargo owners' interests and thereby secure a greater market share for the Chinese shipping industry. Meanwhile, it can also encourage improvements in ship management more efficiently to an extent that the Chinese shipping industry can bear, making the Chinese shipping industry more competitive.

5. International Consistency and Innovation: maritime law is to a large extent international law. If the legal systems in maritime law are not consistent with the shipping legislation of most countries in the world, conflicts of laws will inevitably intensify, and the development of international trade and shipping will be hindered.

From the Hamburg Rules to the United States' 1999 Draft COGSA and the recent UNCITRAL Draft Convention on the Carriage of Goods, the international inclination for eliminating the nautical fault exemption has grown to be a general trend.

It is true that the Hamburg Rules still have very limited influence in the international community, various countries have complained about the United States' 1999 Draft COGSA,[24] and the UNCITRAL Draft Convention on the Carriage of Goods still has not become an international convention, and discussions and actions on the reform and abolishment of the nautical fault exemption system has proceeded in fits and starts. However, it is clear that the rapid development of the shipping industry and international trade has made the reform and abolishment of the nautical fault exemption system a matter of time.

Nevertheless, the current conditions of international shipping legislation shows that the time is not yet ripe for eliminating the nautical fault exemption entirely. At present, with respect to carrier liability, the Hague Rules and the Hague-Visby Rules are still the most widely-applied international rules. The nautical fault exemption remains the mainstream approach. The Hamburg Rules, which abolished the nautical fault exemption, has only been adopted by small Third World countries in Africa. Developed countries that tend to stand behind cargo owners' interests, such as the United States and France (not to mention shipping powers like the United Kingdom and Northern European countries) have not signed on to

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24 Many scholars believe that, even though the United States' 1999 COGSA abolished the nautical fault exemption, the fact that it transferred the burden of proof from the carrier to the cargo owner essentially granted the nautical fault exemption to the carrier.

the Hamburg Rules. We can see that the major shipping countries and even powers that tend to protect cargo owner in the world hold a prudent attitude in this respect. Therefore, China should not be too hasty when dealing with this issue.

The establishment and reform of a system should include keep in mind both consistency with the international community and a sense of innovation. With the elimination of the nautical fault exemption being the general trend, retaining the exemption for fault in navigation and eliminating the exemption for fault in ship management will make the carrier liability system consistent with international norms as well as forward-looking. Moreover, these steps can prevent the misallocation of rights and obligations, as well as the intensification of conflicts of laws from radical systemic change.

III. Conclusion

With the continual improvements in nautical technology and mariner management, the unreasonableness, high costs, and inefficiency of the nautical fault exemption system are increasingly apparent. International legislation has also shown a trend toward eliminating the nautical fault exemption. Moreover, such a system is not an optimal way to protect China's backward shipping industry. Therefore, the writer believes that, given the current situation, the nautical fault exemption system should be reformed by retaining the exemption for fault in navigation and abolishing the exemption for fault in ship management.

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