BENTLEYS

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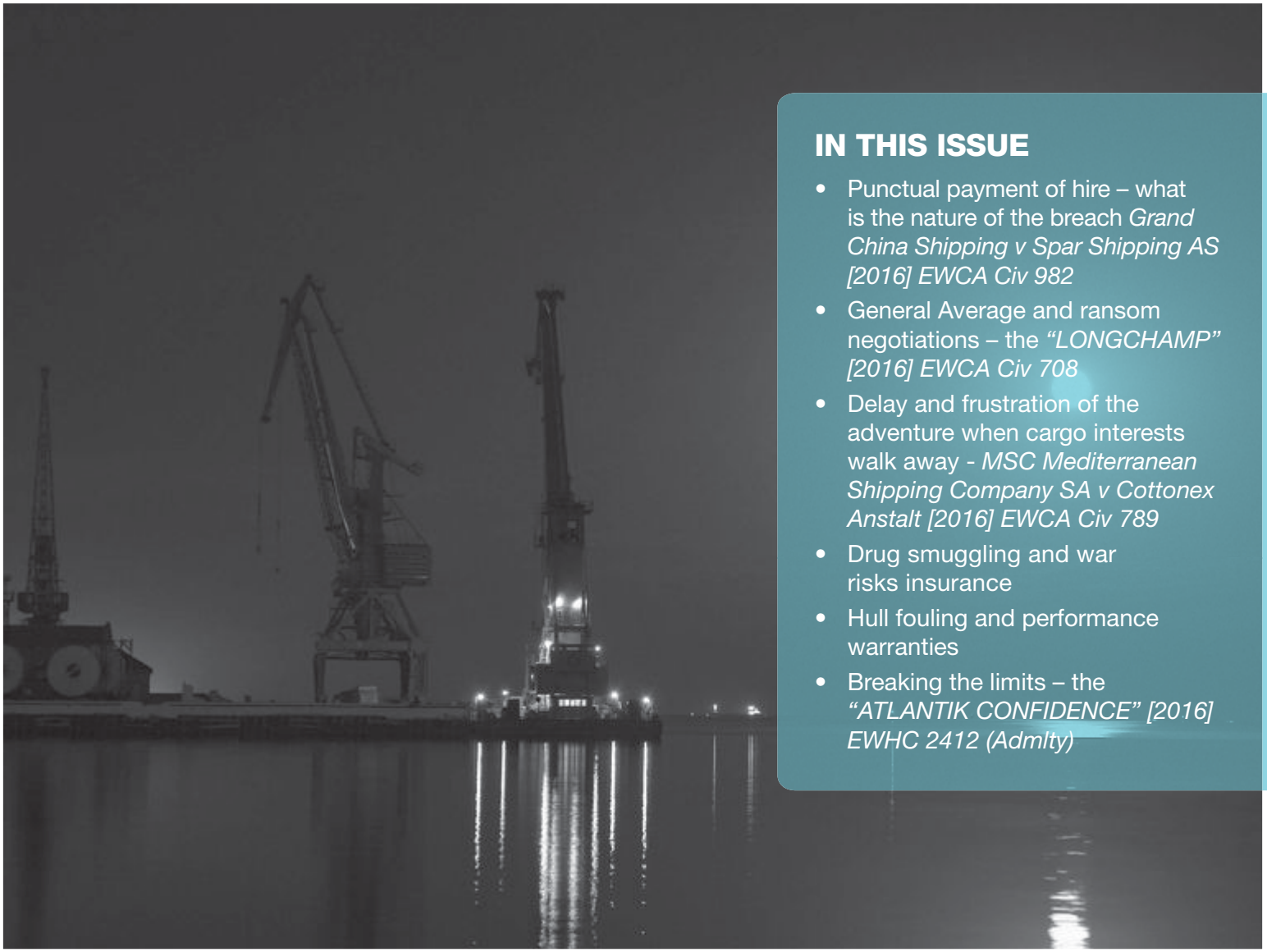

IN THIS ISSUE

PUNCTUAL PAYMENT OF HIRE – WHAT IS THE NATURE OF THE BREACH *GRAND CHINA SHIPPING v SPAR SHIPPING AS [2016] EWCA CIV 982*

In the April 2013 Bulletin we featured Flaux, J.'s High Court decision in the *"ASTRA" [2013] EWHC 865 (Comm)*. In this he expressed the view that payment of hire was a condition in the full English law meaning of that term. In other words a failure to pay even one instalment permitted an owner to treat the charterparty as at an end and to claim damages. This is important in that if a failure to pay hire is not a breach of condition but it only activates the withdrawal clause, all the owner can do is get the ship back and claim the hire due at the time of termination. The owner would not have an automatic right to claim damages for the overall loss of bargain - generally the differential between hire payable under the contract and the rates of hire available in the market.

Flaux, J.'s view has attracted some support based, in part, on a detailed consideration as to whether the prior case law was indeed authority for the contrary proposition but for the most part legal commentators *"…have expressed surprise and concern at the decision.."* (to quote the words of Gross, L.J. in this appeal).

In our April 2015 Bulletin we reported the first instance decision in this case. Popplewell, J. took the opposite position to Flaux, J. and held that a standard charterparty term in relation to payment of hire was not a condition. It was an innominate term, meaning that owners' rights against charterers would depend on the seriousness of any breach of that term. On the facts, Popplewell, J. was able to reach the conclusion that in fact the history of late and missed hire payments under the charterparties in question amounted to renunciatory conduct on the part of the charterers: i.e. an unwillingness to perform in accordance with the contract. This entitled the owners to treat the charterparties as at an end and to recover damages for loss of bargain. The charterers appealed against the finding of renunciation and the owners appealed against the finding that the payment of hire was not a condition.

As the Court of Appeal have now said *"….this appeal raises starkly for decision the question of whether Flaux, J. or Popplewell, J. was right – an issue which has, understandably, attracted much market interest and long generated conflicting observations from Judges of the highest standing…..".*

The Court of Appeal found unanimously that the payment of hire should not be treated as a condition. In detailed judgments both Gross, L.J. and Hamblen, L.J. felt that if the parties wanted a term of the contract to be treated as a full condition they should say so. Both judges reviewed the authorities and, as Hamblen, L.J. succinctly put it:

"The modern English law approach to the classification of contractual terms is that a term is innominate unless it is clear that it is intended to be a condition or a warranty…".

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The telling point in this was that the potential consequences of a very minor breach could be so dramatic. Theoretically an inadvertent mistake leading to a few minutes delay in payment of one instalment of hire could lead to a damages claim for millions.

As the Master of the Rolls (Sir Terence Etherton) said in his much shorter supporting judgement:

"…it is inherently unlikely that the contracting parties would have wished to confer on the innocent parties a right to treat the contract as at end for breach of a term which may be broken in ways and with consequences which are objectively not sufficiently serious to warrant such a draconian right…".

In this, it should be remembered that the contracting parties are perfectly free to agree such rights should they wish. In fact, Clause 11 of the recently issued NYPE 2015 form provides owners with a contractual right to damages on a withdrawal.

This is a decision which appears to have been very cognizant of the general view of the market. Given the importance of the principles in question and the sums involved one might expect to see the case go to the Supreme Court for the attention of our currently quite activist Justices. However, it is to be noted that owners were in fact ultimately successful because the Court of Appeal upheld Popplewell, J.'s finding of renunciation so this debate may go no further.

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GENERAL AVERAGE AND RANSOM NEGOTIATIONS – THE *"LONGCHAMP" [2016] EWCA CIV 708*

In the January 2015 edition of this Bulletin, we noted that the High Court at first instance had considered the general meaning of Rule F of the York-Antwerp Rules. It was held that certain expenditure incurred by owners whilst successfully negotiating a reduction in a pirates' ransom demand was recoverable.

The Court of Appeal (Kitchen, Hamblen, L.J.J., Sir Timothy Lloyd) has now overturned that decision. Rule F provides:

"any extra expense incurred in place of another expense which would have been allowable as general average shall be deemed to be general average and so allowed without regard to the saving, if any, to other interests, but only up to the amount of the general average expense avoided".

As is often the case with the confusing world of general average, the judgments make for challenging reading. The success of the appeal, however, really comes down to one simple point. Their Lordships remained unconvinced that the expense could properly be regarded as *"in place"* of any other expense. As Sir Timothy Lloyd puts it in his judgment:

"In truth, there was only one course of action open to the shipowners in the present case, namely to treat with the pirates with a view to securing the release of the ship, crew and cargo on terms which satisfied their priorities as regards speed, safety and economy, however long that might take."

As such, the shipowner was not taking any alternative course of action. They did not incur an expense in substitution for something which would have fallen into and been recoverable in GA. In other words, Rule F never came into operation in the first place.

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DELAY AND FRUSTRATION OF THE ADVENTURE WHEN CARGO INTERESTS WALK AWAY - *MSC MEDITERRANEAN SHIPPING COMPANY SA v COTTONEX ANSTALT [2016] EWCA CIV 789*

In recent years the situation where cargo interests walk away from their commercial arrangements leaving the carriers in the lurch has been a common one. In this case, the carrier sought to make very much the best of a difficult situation.

The carrier contracted with the shipper for 35 of the carrier's containers to be stuffed with raw cotton and transported to Chittagong. The shipper sold the cotton on but the price of the commodity fell in the interim.

The containers were discharged from the ship in June 2011. The cargo interests did not take delivery of them. The containers were taken into the custody of the Chittagong customs authorities and remained there. They may disappear into the black economy but to all intents and purposes they were lost to the carrier for ever.

The bills of lading contained very standard terms. After discharge the shipper had free use of the containers for a limited period. Thereafter, they had to return the containers or pay demurrage.

Although some unsuccessful commercial negotiations took place between the carrier and the shipper, the carrier's primary position remained that either the shipper should return the containers or demurrage would accrue indefinitely.

At first instance Leggatt, J. awarded the carrier demurrage from the expiry of the free time up to 27th September 2011. At that stage, the judge held the shipper had repudiated the contract of carriage. The carrier would be entitled to damages based on the value of the containers (a relatively small amount) but could not elect to keep those contracts alive and continue to claim demurrage.

The Court of Appeal (Moore-Bick, Tomlinson, L.J.J., Keehan, J.) have upheld this decision but slightly changed the timing, pushing the date of repudiation out to 2 February 2012. The Court of Appeal reiterated that the test for deciding whether the contract was frustrated or repudiated involved considering how a reasonable person in the position of the parties would answer the following question. Is the delay so great as to make performance of the obligations under the contract radically different from those which the parties had originally undertaken?

The Court of Appeal felt that the judge at first instance had pitched this point too early in the continuing saga. There might have been some uncertainty as to the future but they felt it was not until the February date that the point was reached where the contract could be said to have so changed in nature that its original purpose had been defeated.

There is a subtlety here which the Court of Appeal had to deal with. Although on their analysis the contract had been frustrated, this had still been brought about by the shipper's breach. The question had to arise, therefore, as to why the wholly innocent carrier did not have the option of affirming the contract and insisting on future performance. It is, after all, settled law that the innocent party is not automatically obliged to accept a repudiatory breach.

Lord Justice Moore-Bick, however, made the point in his judgment that for all commercial purposes the containers became lost. In layman's terms there was just nothing left in the contract for the carrier to affirm. Its purpose had disappeared. There was nothing left to insist on.

He went on to say that **if** the carrier had been in a position to affirm the contract he would not have permitted them to do this. His reasoning largely adopted that of the first instance judge in saying that the carrier would have no *"legitimate interest"* in maintaining the contract. As his Lordship put it:

"This is a classic case in which it would have been wholly unreasonable for the carrier to insist on further performance. The only reasonable course for it to take would have been to accept the shipper's failure to redeliver the containers as a repudiation of the contract"

One other point comes up. Many may be thinking, why wasn't the carrier under an obligation to mitigate their loss by going out and buying alternative containers? They could then claim their net loss by way of damages. On this the Court Appeal pointed out that the reason for container demurrage is that the delay in redelivering the containers deprives the carrier of the use of a profit-earning chattel. Those containers would not cease to be profit-earning chattels because the carrier obtained additional containers. Additional containers obtained by the carrier would not have been substitutes for the detained containers but would have increased the carrier's stock.

The case provides a wide ranging and fascinating overview of the current law relating to breach, frustration and mitigation. The suggestion by the carriers that demurrage would accrue indefinitely does look artificial and unfair. It is, therefore, encouraging to see that the argument could be rejected without having to stretch the law to achieve this.

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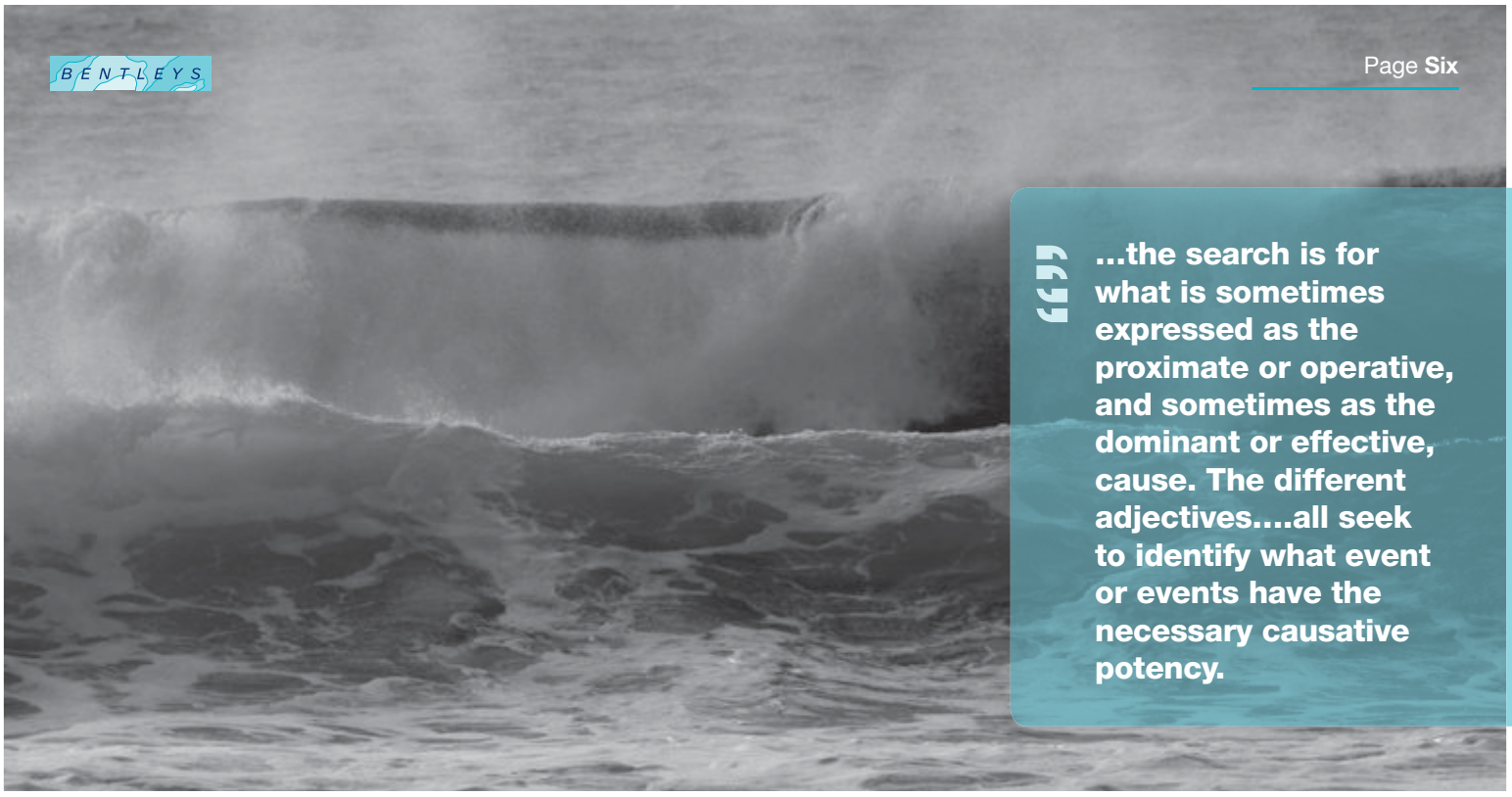

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DRUG SMUGGLING AND WAR RISKS INSURANCE

The *"B ATLANTIC" [2016] EWCA Civ 808* concerns another chattel that has effectively been lost for ever. In this case, the Venezuelan authorities discovered drugs strapped to the ship's hull. There was no suggestion that the owners were complicit in the concealment. Nevertheless, the vessel was detained, the crew were arrested and the ship eventually confiscated.

The owner claimed under the war risks policy on the grounds that the ship thus became a constructive total loss. The relevant policy was a standard war risks insurance on the Institute War and Strikes Clauses 1/10/83 with additional perils. The insured perils include *"any person acting maliciously"*. This would include the steps taken by the parties seeking to smuggle the drugs.

That was not the end of the matter. The policy also included the standard exceptions at Clause 4.1. The relevant parts excluded:

"loss damage liability or expense arising from…arrest restraint detainment confiscation or expropriation under quarantine regulations or by reason of infringement of any customs or trading regulations".

Drug smuggling is an infringement of customs regulations.

From the facts, it can be seen that there are two possible sources of the loss of the ship. Firstly, the malicious act of the third parties (a covered peril) and, secondly, the detainment because of the smuggling (an excluded peril). It becomes necessary, therefore, to identify the relevant cause. As Lord Justice Christopher Clarke eloquently puts it in his judgment:

"…the search is for what is sometimes expressed as the proximate or operative, and sometimes as the dominant or effective, cause. The different adjectives….all seek to identify what event or events have the necessary causative potency."

One thing that is immediately clear is that there can be more than one *"proximate cause"*. If so, as the Court of Appeal reconfirmed, then if one is based on an insured peril but the other falls into an exclusion, the insurer is not liable.

At first instance Flaux, J. took a convoluted path to avoid this conclusion. For him the infringement of customs regulations should be regarded only as a *"manifestation"* of the true operative cause of the loss of the ship – this was the malicious act.

The Court of Appeal adopted a much more orthodox approach to the construction of the clauses. It was pointed out that the structure of the clauses is that the risks covered are the perils **subject always** to the exclusions. The perils and exclusions together express the ambit of the cover and they have to be construed together.

In his judgment (with which the other two judges concurred) Clarke, L.J. pointed to no less than seven reasons for preferring a construction that accepted that the infringement was causative of the loss and, it follows, excluded from the policy.

In his view, the policy would need express wording (which it did not contain) to have the result contended for by Flaux, J. As he then put it:

"Unless one does so the answer is clear. If the malicious act is the concealment of drugs on the vessel and the concealment of drugs is an infringement of the customs regulations, the vessel will have been detained by reason of an infringement of the customs regulations."

The Court of Appeal's approach to construction appears to be impeccable. If a different approach is taken at some later stage then it must be going to involve a very different approach from that presently perceived as the orthodox.

HULL FOULING AND PERFORMANCE WARRANTIES

The *"CORAL SEAS" [2016] EWHC 1506 (Comm)*, deals with a very common scenario. The ship was fixed on time charter terms. In between two laden voyages the ship was required to wait in tropical waters.

Inevitably the hull and propeller became fouled by marine growth. Equally inevitably that led to a reduction in performance below that warranted. The charterer made deductions from hire and the owner claimed this back in arbitration. The arbitration tribunal found against them on this. In doing so, however, they found no particular fault on the owner's part.

Their reasoning lay in a construction of the performance warranty in the charterparty to the effect that the ship would maintain a certain speed on all sea voyages. The owner had warranted that the ship *"shall be capable of maintaining and shall maintain on all sea voyages ….under fair weather condition …. and not against adverse current"* the agreed performance. The view was taken that the owner had accepted the risk that they would not be able to comply with the performance warranty if bottom fouling took place. The owner appealed to the High Court where the matter was considered by Mr Justice Phillips. Whilst the owner's argument focussed on the proper construction of the performance warranty in the charterparty, Phillips, J. took the opportunity to look at the broader principle set out in *Time Charters 7th Ed*. (2014) where the authors indicated:

"…it is a defence for the owners to prove that the underperformance resulted from their compliance with the charterers' orders…".

This is an application of the implied indemnity principle: an owner is entitled to be indemnified for the consequence of complying with a charterer's orders as to employment. That indemnity extends to orders which a charterer is contractually entitled to give, and it is not necessary to show they have exceeded their rights under the charterparty. The limit on this is that the indemnity does not cover the normal dangers and perils associated with any voyage.

Phillips, J. felt this view was too widely stated. With all due respect to the authors of *Time Charters* he has to be correct in this. In the circumstances of the case, the owner had to be taken as having fully accepted the risk that bottom fouling could occur as part of the normal consequences of the usual perils associated with the agreed trading limits. In Phillips, J.'s view there was no reason on the facts of this case to introduce an implied indemnity to displace that allocation of risk. It is clear that in reaching this conclusion one significant factor was it would have been open to the parties to have included express wording to that effect. Such provisions are found in many contemporary fixtures given that current market conditions make it difficult to predict future trading opportunities.

The consequence of this judgment is that when we are reading this section of *Time Charters*, it is now necessary to bear in mind the following judicial statement:

"Where a vessel has underperformed, it is not a defence to a claim on a continuing performance warranty for the owners to prove that the underperformance resulted from compliance with the time charterers' orders unless the underperformance was caused by a risk which the owners had not contractually assumed and in respect of which they are entitled to be indemnified by the charterers."

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BREAKING THE LIMITS – THE *"ATLANTIK CONFIDENCE" [2016] EWHC 2412 (ADMLTY)*

It is mercifully rare for owners to scuttle their ships – particularly when they are cargo laden. It is even rarer that a finding to that effect is made by the courts. This particular casualty had featured in our Bulletin in April 2014, where the Court of Appeal had allowed owners to constitute a limitation fund with the use of a P&I Club guarantee.

In this case the cargo interests wanted to break limitation under Article 4 of the Limitation Convention. In order to do so they had to prove that the loss of the vessel and its cargo resulted from the owner's personal act or omission, *"committed with the intent to cause such loss, or recklessly with knowledge that such loss would probably result"*. In other words they had to show that the owner was complicit in deliberately scuttling the ship.

Teare, J. accepted that *"in determining whether Cargo has proved on the balance of probabilities that the vessel was scuttled in a limitation action the court should follow the same approach as it does when determining whether a hull underwriter has proved on the balance of probabilities that a vessel was scuttled."*

In particular he drew attention to helpful observations in earlier case law on the standard of proof. Cargo had to be able to exclude:

"…a substantial as opposed to fanciful or remote possibility that the loss was accidental."

The owner, however, cannot simply come up with alternative suggestions that lack plausibility or evidential support:

"…the mere existence of an opposing possibility does not prevent the balance tilting heavily and sufficiently far in favour of the insurers."

"…there must be a real or plausible explanation which is supported by the evidence, or at least not inconsistent with it."

In this case, having reviewed many factors Teare, J. concluded that the underlying cause of the casualty was a fire started in a store room which then spread. He went on to find that there was a *"real and substantial possibility"* that it was started deliberately. Other explanations for this and other factors as the saga developed were described as *"remote"* possibilities.

Teare, J. then took the next step of finding that it was the owner who had ordered the acts leading on to the ship eventually sinking, with the result that limitation was broken. A particular feature of this case is that the ship's legal owner was Kairos Shipping, but the evidence was that this company was one in a group of companies of which the sole shareholder and director was a Mr Agaoglu. The judge therefore regarded him as the *alter ego* of Kairos Shipping. The group's financing arrangements included a personal guarantee from Mr Agaoglu and in common with many shipping companies, the judge found that those finances were in bad shape. Thus Mr Agaoglu had a personal motive to improve those finances by collecting insurance proceeds for the loss of a vessel. The judge further went on to find that Mr Agaoglu had requested his senior employees to arrange the deliberate sinking of the vessel with the master and chief engineer.

This decision must have made uncomfortable reading for the hull and machinery underwriters who had paid out on a total loss and the P&I Club which had provided the LOU in respect of the limitation fund.

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