

AN ADJUSTERS' NOTE ON SUBSTITUTED EXPENSES AND RANSOM PAYMENTS

Mitsui & Co. and others v

Beteiligungsgesellschaft LPG Tankerflotte

"THE LONGCHAMP" [2016, EWCA Civ 708]

The Court of Appeal has reversed the 2014 High Court judgement that crew wages and fuel consumed during lengthy ransom negotiations with Somali pirates could be allowed as general average under Rule F. The Court of Appeal held that Rule F cannot be applicable because there was only ever one course of action available – to pay the ransom. The position under English law therefore reverts to the position taken in 2012 by the majority on the Advisory Committee of the Association of Average Adjusters that such costs were not allowable under Rule F. The judgement also makes some interesting points on the requirement of reasonableness under Rules F and XIV of the York Antwerp Rules.

The case involved a chemical tanker that was seized on 29 January 2009 by Somali pirates. A ransom demand of US\$6 million was made by the pirates. After negotiation, a final ransom of US\$1.85m was agreed on 22 March 2009 and the vessel was released. During the period of negotiation the shipowner incurred expenditure totalling US\$181,604.25 which was claimed and allowed in an adjustment as General Average under Rule F. The majority of the disputed expenditure related to crew wages (including high risk area bonus) and maintenance, and the cost of fuel consumed during the detention period.

High Court Judgement

The High Court decision upheld an adjustment of general average, arising out of seizure by Somali pirates, in which wages and fuel during the period of negotiation of the ransom were allowed under Rule F of York Antwerp Rules 1974 as an

expense incurred in substitution for the higher cost of paying the initial ransom demand. It was also held that payment of the original ransom demand of US\$6 million without negotiation would have been reasonable.

Court of Appeal Judgement

Lord Justice Hamblen addressed the the grounds of the appeal, of which 2 issues are of particular interest:

Issue 1

Whether the Judge ought not to have concluded that the expenses were incurred in adopting a course of action undertaken as an alternative to one where the expense would have been allowable as General Average.

The Judge summarised the requirements of Rule F:

1. First, the Rule is concerned only with “expenses”;
2. Second, it is only those expenses which can be described as “extra” which qualify;
3. Third, there must have been an alternative course of action which, if it had been adopted, would have involved expenditure which could properly be charged to general average; and
4. Fourth, the extra expenses must have been incurred in place of the alternative course of action.

Lord Justice Hamblen found that Rule F was never engaged because in this case there was no alternative course of action available to owners. He concluded that there was no difference between paying the ransom immediately or in negotiating the ransom down.

"Is a short negotiation with pirates for payment of ransom leading to the release of the vessel a different course of action to a long negotiation with pirates on the same ends? In my judgement it is not; both fundamentally involve doing the same thing."

On this basis, Lord Justice Hamblen agreed with the conclusion and underlying reasoning of the majority of the Advisory Committee of the Association of Average Adjusters.

Although the express reasoning of the majority of the Advisory Committee in reaching their conclusion is different, the underlying point being made is similar. The majority are making the point that there is only one road open to owners, namely negotiation, and that road leads to wherever the negotiation ends. It is a single track road with no forks in the road and it ends in the eventual ransom payment agreement.

This reiterates that Rule F requires that the substituted expense is incurred “in place of” another expense which would have been allowable as general average. In this case the same expense (payment of ransom) was going to be incurred, the only difference being the extent of that payment.

Issue 2

Whether the judge was wrong to conclude that payment of the initial ransom demand without attempting to negotiate would have been a reasonable course of action.

Lord Justice Hamblen gave a detailed analysis, also touching on the various judgements in the “Bijela” which dealt with the question of alternative courses of action in the context of Rule XIV and temporary repairs.

In making an allowance under Rule F, you must demonstrate that it is cheaper than the alternative course of action which would be allowable in general average. Rule A requires proof that the expense of the alternative course of action would have been “reasonably” incurred. This can lead to a circular argument whereby if the alternative course of action is so much more expensive than the actual action taken, the alternative action becomes unreasonable and cannot then be relied on to justify the allowance under Rule F. A similar issue arises under Rule XIV whereby the cost of temporary repairs may be allowed to general average in substitution of the expenses allowable under Rule X which would have been incurred had temporary repairs not been effected and permanent repairs had been effected instead. However, the allowance under Rule X requires proof that the repairs were necessary for the safe prosecution of the voyage. If temporary repairs are sufficient to allow the safe prosecution of the voyage then the basis of an allowance under Rule X falls away, as does the basis for an allowance under Rule XIV.

The judgement in the “Bijela” worked around this problem by stating that Rule XIV requires you to make the assumption that temporary repairs were not an available option, and to then consider which costs would arise, thereby giving the Rule practical effect. The respondents in “Longchamp” maintained that the same reasoning should apply to Rule F, ie. you must assume that the alternative course of action was not available. However, Lord Justice Hamblen disagreed, setting out five basic principles that should guide the approach to the question.

1. Rule A requires proof that the expense of the hypothetical alternative course of action would have been “reasonably” incurred. That wording cannot be ignored.
2. The requirement of reasonableness under Rule A imports more flexibility than the test of necessity under Rule X(b). Often there may be more than one reasonable course of action available.
3. The wording of Rule XIV and Rule F is materially different. In particular, as the House of Lords held, the second paragraph of Rule XIV requires an assumption to be made.
4. The general context and applicability of Rule F is different to the specific context of Rule XIV.
5. There is no necessity to make assumptions in order to give Rule F business efficacy. The Rule is workable and in most cases works without difficulty.

This brought Lord Justice Hamblen to the question of whether an immediate payment of the ransom without negotiation would have been reasonable. He upheld the decision of the High Court in finding that it would have been reasonable to pay the ransom without first attempting to negotiate.

Points to note

1. This judgement provides a helpful clarification of the test for establishing an allowance under Rule F. With regards to the Rule, the position under English law reverts to the position taken in 2012 by the majority on the Advisory Committee of the Association of Average Adjusters.
2. The decision also makes it clear that Rule F has no application regarding detention expenses during a salvage negotiation, because whether the payment demanded by salvors is made immediately or after being negotiated downwards it is, like a ransom payment, the same course of action.
3. This clarifies the different approaches to the question of reasonableness which must be taken when applying Rule F and Rule XIV.