Richards Hogg Lindley

"THE LONGCHAMP"

(*Mitsui & Co. and others vs Beteiligungsgesellschaft LPG Tankerflotte*)
[2016, EWCA Civ 708]

Summary

In 2014 the High Court held that crew wages and fuel consumed during lengthy ransom negotiations with Somali pirates could be allowed as general average under Rule F as an expense incurred in substitution for the higher cost of paying the initial ransom demand. Following this judgement, some requests were made to re-open earlier adjustments where such costs had been excluded and the same principle was extended in some adjustments to similar expenses incurred while negotiating with salvors.

The Court of Appeal has now reversed this judgement on the basis that Rule F cannot be applicable because there was only ever one course of action available – to pay the ransom. 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.

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. This decision also makes it clear that Rule F has no application regarding such detention expenses during a salvage negotiation.

High Court Judgement

The High Court decision in *Mitsui & Co. and others vs Beteiligungsgesellschaft LPG Tankerflotte* [2014 EWHC 3445 (Comm)] regarding the "Longchamp" 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 as substituted expenses under Rule F of York Antwerp Rules 1974.

The case involved a chemical tanker that was seized on 29 January 2009 by Somali pirates, and a ransom demand of US$6m 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.

In his Introduction, the Judge (Stephen Hofmeyer Q.C., sitting as a Deputy High Court Judge) reviewed the history of General Average and the York- Antwerp Rules, noting the (negative) position taken by English law on substituted expenses (Wilson v Bank of Victoria, 1867) and the contrasting attractiveness of the principle to commercial interests. Where the York-Antwerp Rules apply by contract, the English law of General Average is modified by agreement (para 18 of the judgement).

The cargo interests appeared as Claimants seeking the repayment of cargo's proportion of these costs, which they denied were properly allowable as General Average on the basis of Rule F, as claimed by the Defendants. The adjustment provided the following rationale:

> *"Vessel's Owners and Managers together with the appointed Consultant negotiated successfully the initial demand of ransom in an amount of USD 6,000,000.00 down to an amount of USD 1.850,000.00 during a negotiation period of about 51 days, so that an amount of USD 4,150,000.00 was saved in the common interest of all property owners concerned, which would have been otherwise recoverable in General Average as per Rule A of the York-Antwerp Rules 1974. We are of the considered opinion that the expenses, which were incurred during the period of negotiation over the ransom amount, can be allowed in General Average as substituted expenses as per Rule F of the York-Antwerp Rules 1974, but only up to the amount of the General Average expense, which has been avoided."*

The Judge summarised the arguments as follows:

> "57 *The Defendants' case in respect of Rule F is simply stated. The expenses were incurred in order to reduce the amount of the ransom demanded by the pirates and, accordingly, were incurred in substitution for another expense (i.e. the saving between the ransom demanded and the ransom paid) which would have been "reasonably ... incurred" and thus would have been allowable pursuant to Rule A. The Defendants further say that reasonableness must be assessed on the hypothetical assumption that the alternative course (i.e. to negotiate the amount down) was not an available option.*
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> *58. The Claimants disagree. Their primary argument proceeds as follows. Rule F applies only if, on the hypothesis that the substituted expenses had not been incurred, the costs or expenses that would have been incurred (i.e. the hypothetical costs and expenses) would have been allowable as general average. Costs and expenses are only allowable as general average if, inter alia, they are "reasonably ... incurred' within the meaning of Rule A of the York-Antwerp Rules 1974. If the Defendants had made payment of the pirates' initial ransom demand of US$6 million without attempting to negotiate, the sum of US$6 million would not have been allowable as general average expenditure because the expenditure would not have been "reasonably ... incurred". In the premises, because the original demand of US$6 million would not, had it been paid, have been reasonably incurred, the costs and expenses in the sum of US$181,604.25 were not substituted expenses falling within Rule F.*
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> *59. The Claimants make three further submissions in respect of the Rule F claim. First, they contend that Rule F is not engaged because the expenditure has not been incurred in place of the expense of a ransom payment but, rather, in addition to the expense of a ransom payment. Second, they contend that the expenditure is not "extra" within the meaning of Rule F. Third, they contend that bunkers are not recoverable under Rule F as*

they are not "expenses", which are recoverable under Rule F, but losses, which are not recoverable under Rule F."

In upholding the approach adopted in the adjustment, the Judge's conclusions on these contentions were as follows:

"100. It is true that, with the benefit of hindsight, it can be said that the amount of the ransom in this case was significantly reduced by the process of negotiation. However, for the reasons which I have identified, it was not possible to state with reasonable certainty when the ransom demand was made that the amount of the ransom would inevitably be significantly reduced by the process of negotiation. Further, the contention that immediate acquiescence in the sum demanded might have led to a higher sum being demanded is no more than speculation.

101. The value of the property involved in the maritime adventure is undoubtedly a relevant factor in the assessment of whether a ransom payment was "reasonably ... incurred". If the amount of the demand clearly exceeded the reasonably understood value of the property involved in the maritime adventure, it would be unlikely that, if the payment was made, it would have been reasonably incurred. However, the same cannot be said of the situation where the amount of the demand was clearly less than the reasonably understood value of the property involved in the maritime adventure and where a saving would be made if the amount of the demand was paid.

102. For the reasons set out above I have come to the conclusion that it is not possibly reasonable to conclude that a ransom payment of US$6 million would not have been "reasonably ... incurred" within the meaning of Rule F of the York-Antwerp Rules 1974.

103. In reaching this conclusion, I derive comfort from the fact that the rule of contribution which has been invoked in the Adjustment under consideration has its foundation in the plainest equity and that the circumstances of this case were such that natural justice requires that all should contribute to the substituted expenses incurred by the Second Defendant. The reduction in the amount of the ransom was only achieved by a process of negotiation which necessarily involved the ship-owner incurring expenditure.

104. For these reasons, I am unable to accept the Claimants' contentions on this issue and it is unnecessary for me to proceed further with an analysis of the question whether the hypothetical expenditure in substitution for which the expenses were incurred "would have been allowable as general average" within the meaning of Rule F.

106. The Claimants also contend that the expenditure claimed under Rule F and allowed in the Adjustment was not "extra" within the meaning of Rule F and, accordingly, that it should be disallowed for this reason. I do not agree. In the context of Rule F, as I have held above, all that is required is that the substituted expense which has been undertaken has resulted in additional financial outlay which would not ordinarily have been incurred. That is precisely what happened in this case.

107. Finally, in this context, it is contended on behalf of the Claimants that the cost of bunker consumption is not recoverable under Rule F because the consumption of bunkers are losses and not "expenses". I have already dismissed the suggestion that the consumption of bunkers is not the incurring of an "expense" within the meaning of Rule F. Accordingly, the consumption of bunkers was properly allowed in the Adjustment as an additional" expense".

Court of Appeal Judgement

In the Court of Appeal, Lord Justice Hamblen reviewed the facts and the basis of the adjustment and referred to the two reports issued by the Advisory Committee of the Association of Average Adjusters (in 2010 on another piracy case and in 2012 regarding the "Longchamp" adjustment); he also noted the judgement in Masefield AG v Amlin Corporate Member Ltd [2010 EWHC 280 (Comm)] as setting out the typical modus operandi of Somali pirates. He then turned to the grounds of the appeal:

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.

"37. The Judge summarised the requirements of Rule F at [69] in terms which were not questioned by either side and which I am content to adopt:

(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."

38. The reference to an alternative course of action reflects the fact that substituted expenses have to be "in place of" another expense. That implies a choice being taken between two (or more) alternative courses of action.

41. The Appellants contend that in this case there was no available course of action alternative to that in fact pursed by the owners. In reality there are only two available options when faced with a hijacking of vessel and cargo by Somali pirates, namely to abandon the vessel and cargo or to engage with the pirates, negotiate and agree a ransom and pay it to effect release of ship, crew and cargo. The moment that the Somali pirates took control over the vessel, and even prior to a ransom demand being made, the owners were involved in a negotiation for the release of their vessel.

43. Some support for the Appellants' approach is to be found in the evidence. Thus, it does not appear that the owners ever considered that they faced a choice. The owners' crisis management and negotiation team were set up before any ransom demand had been made. From the outset the goal was to negotiate to obtain release of the vessel upon payment of a ransom, but in a reduced amount. There is no *evidence to suggest that they ever considered choosing between paying the ransom on demand and paying a lesser sum following negotiation.*

44. *This is also borne out by the Advisory Committee's stated experience, which is that in all Somali piracy cases the same course of action is taken, namely to negotiate and pay a reduced ransom leading to release of the vessel. Again it does not appear that there is considered to be a choice of payment on demand.*

45. *In my judgement this failure to recognise that there is a choice reflects the reality, which is that payment on demand is simply a different way of going about the same course of action and not a true alternative course of action. Whether or not the ransom is paid on demand there will still be a negotiation, there will still be delay, there will still be the incurring of vessel and crew running costs during the period of delay. In either case the same expenses will be incurred; the difference is only in their extent.*

46. *Although nobody appears to have considered it to be an option at the time, it is correct that the owners could have agreed to pay the initial ransom demand and, if the pirates had agreed to that, release of the vessel would have followed in due course, and that this could be regarded as an option that was available to owners. That does not, however, address the issue of whether it is an option to take a course of action which is a true alternative to that actually taken. 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. This is to be contrasted, for example, to a clear alternative to obtaining release of the vessel by agreeing and paying a ransom, such as by an operation to regain control of the vessel by use of force.*

51. *The Judge did support the overall conclusion he reached on the grounds that it accorded with equity and natural justice. The Respondents support this, stressing that all those interested benefited from the saving in ransom achieved and that it is fair that the cost of a general benefit should be generally shared. However, whether or not General Average is recoverable depends on the proper interpretation and application of the Rules. They reflect what is recognised as representing a fair apportionment of benefit and costs. Further, the expenses claims are ordinary operating costs incurred by reason of delay. Generally there is no recovery in General Average for ordinary expenditure (Rule A) or for loss or damage sustained through delay (Rue C). Delay will often cause loss to both ship and cargo but generally that loss lies where it falls. Whilst such owners' expenses may on occasion be recoverable under Rule F, that Rule presupposes some real choice being made, which is was not. Further, the majority of the Advisory Committee saw no unfairness in the conclusion that the expenses are irrecoverable, and that represents a respected professional view.*

52. *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.*

53. That there are no forks in the road is significant. Just as acceptance of the initial ransom demand is not a true alternative; nor is acceptance of any other ransom sum less than that initially demanded but greater than that eventually agreed. That means that the difficulty which troubled the Judge (and Mr Madge) about determining hypothetically what might be a reasonable ransom does not arise.

54. It follows that I agree both with the conclusion and the underlying reasoning of the majority of the Advisory Committee."

By allowing the appeal on Issue 1 and holding that Rule F was never engaged because there was no alternative action available, the question of whether it would have hypothetically been "reasonable" to have paid the first demand of US$6 million effectively fell away. However, Lord Justice Hamblen went on to give a detailed and interesting 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 of a grounding damage. He then set out five basic principles that should guide the approach to the question:

"71. In particular:

(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.

72. Further, it is to be noted that Hoffmann LJ in "The Bijela" considered Rule F and stated (at p422) that:

"It does not require one to suppose that the circumstances in which the owner made his choice were different from what they actually were."

73. I accordingly agree with the Judge on this issue. He expressed his conclusion as follows at [77]:

"…despite the problems canvassed by the textbook writers, there is little room for doubting the proposition that, on the true construction of Rule F of the York-Antwerp Rules 1974, the hypothetical alternative course of action must meet the requirement that is was "reasonably….. incurred" if the

> *substitute expense is to be allowed in general average. What the problems canvassed by the textbook writers show is that the requirement that the expenses, if it had been incurred, would have been "reasonably….. incurred" must be interpreted and applied with a sufficient degree of latitude to give Rule F practical effect."*

I agree with that conclusion."

The Appellants had argued that an immediate payment of the first ransom demand of US$6m would not have been "reasonable" because the established pattern of the Somali cases was for negotiation to a much lower figure to take place.

Lord Hamblen disagreed:

> *"81. In my judgement, if, as stated in the Masefield case, "the safest, most timely and effective means to secure the release" of a ship and crew was to pay a ransom, it follows that the most safe, timely and effective means of so doing is to pay as soon as possible. It may be that the general practice was to try to negotiate the ransom down, but that does not mean that it would be unreasonable to pay the ransom straight away so as to avert the very real danger to vessel, cargo and crew as quickly and effectively as possible. Nor can a course of action which procures such real and tangible benefits be regarded as an "artificial invention".*
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> *Further, in my judgement the reasons given by the Judge are all cogent and compelling reasons for concluding that payment of the initial ransom sum would have been reasonable."*

After reaching his conclusions on the two main issues, Lord Hamblen also confirmed that, if Rule F had been applicable, it was reasonable to treat bunkers as an expense (Issue 3) and that the media response costs claimed (Issue 4) could be allowed, on the evidence presented, under Rule A.

The Court of Appeal was unanimous in its decision to uphold the cargo interests' appeal. Sir Timothy Lloyd also made express reference to the fact that there was only one course of action open so that Rule F, which depended on one expense being incurred *"in place of"* another expense, could not be applicable.

Leave to appeal was denied, but it remains open to the Respondents to make an application direct to the Supreme Court.

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. This decision also makes it clear that Rule F has no application regarding such 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.

This brief review cannot do justice to the full analysis given in the judgments and there are many points that were touched on in passing that will be of interest to practitioners. Such practitioners may feel that the decision on issue 2 is inconsistent with the comments made regarding issue 1, but in absolute terms, quick payment of a first ransom demand to recover ship and crew, while minimising the period of danger to both, is impossible to argue against. Nonetheless, such a course of action in the Somali context would have been looked at very closely by the property insurers asked to pay the full amount as general average.

R.R. Cornah
14 July 2016