UK Supreme Court surprises Adjusters in the LONGCHAMP decision

The LONGCHAMP decision - The Supreme Court interprets the meaning of Rule F of the York-Antwerp Rules differently and more broadly than previous general average adjusting practice.

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The GA event and the litigation

In January 2009 the chemical carrier "LONGCHAMP" was boarded by pirates in the Gulf of Aden and diverted to Somali waters. After about seven weeks of negotiations, the vessel's owners agreed to a ransom of USD 1.85 million, down from the original ransom demand of USD 6 million.

The Owner claimed in GA the costs incurred during the period of negotiation – crew wages including risk bonus, food, supplies and bunkers. The expenses were claimed under Rule F of the York Antwerp Rules 1974 as expenses incurred in substitution for the higher cost of paying the initial ransom demand. The adjustment was disputed.

The High Court upheld the adjustment and held that the inclusion of the costs fell within Rule F. The Court of Appeal reversed this decision and Owners appealed to the Supreme Court *Mitsui & Co and others (Respondents) v. Beteilgungsgesellschaft LPG Tankerflotte MHB &Co KG and another (Appellants) [2017 UKSC 68]* setting the stage for the first opportunity for the Supreme Court to interpret Rule F under English law. In a 4-1 decision, the Supreme Court reversed the Court of Appeal's decision and held that the expenses did fall within Rule F.

To understand the Supreme Court's decision and the reaction to it within the adjusting community, it is necessary to put the case into the context of Rules, A, and F which provide:

Rule A

" *There is a general average act, when, and only when, any extraordinary sacrifice or expenditure is intentionally and reasonably made or incurred for the common safety for the purpose of preserving from peril the property involved in a common maritime adventure.* "

Rule F

" *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.* "

The shipowner argued that the expenses incurred during the negotiation were incurred in place of another general average expense namely the USD 4.15 million saved as a result of the negotiations with the pirates.

Cargo interests contended it would not have been reasonable to pay the original USD 6 million ransom demand so any such payment would not have been an expenditure "reasonably" incurred within the meaning of Rule A and therefore the original ransom demand would not qualify as an "expense which would have been allowable" under Rule F. Further, and following the Court of Appeal's reasoning, the reduction in the ransom was not an alternative course of action so the expenses during the negotiation were not "incurred in place of another expense".

Cargo interests' arguments were rejected by the Supreme Court majority.

On the first point Lord Neuberger, delivering judgement for the majority, appeared to have difficulty accepting that payment of the initial ransom demand would have been reasonable. However, he determined that it was not necessary to determine whether or not it would have been reasonable to pay the initial ransom as the reference in Rule F to an "expense which would have been allowable" is a reference to an expense "of a nature" which would have been allowable rather than the quantum of that expense.

On the second point Lord Neuberger concluded that the language of Rule F does not require that the expenses be incurred in pursuing an "alternative course" but in any event held that in this case, negotiating the ransom was a different course of action to paying the initial demand.

A final point of importance concerns the relationship between Rule C and Rule F. Rule C provides "Only such losses, damages or expenses which are the direct consequence of the general average act shall be allowed as general average. Loss or damage sustained by the ship or cargo through delay, whether on the voyage or subsequently, such as demurrage, and any indirect loss whatsoever, such as loss of market, shall not be admitted as general average."

Cargo interests argued that Rule C excludes indirect losses caused by delay and that this exclusion must therefore apply to the claim for expenses incurred during the negotiation period. The Court held that Rule C does not apply:

" Rule C applies to expenses and other sums claimed by way of general average as consequences of a general average act... It does not apply to expenses covered by Rule F... By definition, sums recoverable under Rule F are not themselves allowable in general average, but are alternatives to sums which would be allowable. "

The consequences of the decision

The Longchamp decision overturns decades of accepted average adjusting practice in applying Rule F. Prior to the decision, the generally accepted view was that a "*hypothetical alternative had to be one which would be recognized by commercial interests as 'reasonable' in terms of being practicable and not a matter of artificial invention and also 'reasonable' as regards to quantum. "* (Advisory Report of the Association of Average Adjusters, January 25, 2018)

The Association of Average Adjusters also commented that the intent of Rule F was not to open the door to any expense that might be incurred to mitigate a loss nor was Rule F intended to allow the shipowner to recover ordinary operating expenses.

Lord Sumption reminded adjusters that the courts and not general practice determine the law:

"In the absence of a comprehensive body of case law (general average rarely reaches the courts), adjusters have adopted a variety of practices or rules of thumb to supplement the Rules. This is perhaps inevitable, but such practices are not law and there is a tendency in this field for them to lose sight of the basic concepts expressed in the Rules themselves."

The difficulty of the decision in practice was outlined by Lord Mance in his

dissenting judgement,

"Rule F was not designed with the present situation in mind. The classic circumstances in which it is treated as applying are cases where there is one obvious or natural course of action open to the owners following a general average event, but there is also some different action, which might if taken lead to a more generally beneficial outcome overall... What is however clear on any view is that Rule F is not intended to cover general average situations in which owners simply do what would in the ordinary course be expected of them in the interests of the common adventure."

In the "classic circumstances" mentioned by Lord Mance, Rule F applies where an expense has been incurred in order to reduce delay, whereas in this case, Rule F has been applied in the reverse circumstances, where delay has been incurred in order to reduce expense. However, most would consider that the delay has not been "incurred" at all, as a period spent negotiating the ransom is regarded as a necessary and unavoidable result of the hijacking. For these reasons, the accepted practice of average adjusters was not to make allowances under Rule F in these circumstances

The most obvious consequence of the judgement is that vessel operating expenses incurred during the delay occasioned by ransom negotiations are now recoverable under Rule F. There are apparently a number of piracy adjustments which have been delayed while awaiting this decision and these are now likely to be issued on the basis of this judgement.

In this case, the operating expenses were limited to crew wages and maintenance and fuel and stores consumed during the period of negotiation, but following the Supreme Court's decision regarding Rule C there is nothing to stop other expenses incurred on a periodic basis being included, such as port charges and demurrage. It remains to be seen how widely this will be applied, although it seems unlikely that the principle could properly extend as far as including mortgage payments.

Whilst the principle can be extended to other situations, such as delays while negotiating salvage awards, this will rarely arise in practice given that salvors usually accept security. That said, there are exceptions, for example salvors in some jurisdictions will only accept cash by way of security. Their initial demands are typically very high, and are routinely negotiated down to more reasonable levels. Expenses incurred during these negotiations will now be allowable under Rule F.

Given that Rule F was never intended to be applied in the manner now endorsed by the Supreme Court it is possible that steps may be taken to return to the interpretation of Rule F which was previously accepted. This could be done by amending the York Antwerp Rules, by express wording in contracts of carriage or some form of market agreement. However, the York Antwerp Rules were comprehensively revised in 2016 so it is unlikely that they will be revised again any time soon. In terms of finding another method to bypass the Supreme Court decision, it may be that the scope of the decision is simply too narrow to be of much concern, especially with incidents of Somali piracy on the wane. Ultimately, while most adjusters might have disagreed with the interpretation of Rule F in this case, the principle now laid down by the Supreme Court is by no means unreasonable.