B J Macfarlane & Co

United Kingdom: Transfield Shipping Inc. Of Panama v Mercator Shipping Inc., The Achilleas [2008] Ukhl 48: House Of Lords Decision On Remoteness Of Damages

10 July 2008

Article by Reema Shour

This is a shipping case that was originally taken to arbitration. In brief, the facts are as follows: there was a time charterparty regarding the vessel "Achilleas", under which charterers gave notice of redelivery between 30 April and 20 May 2004. Consequently, owners proceeded to fix the vessel for a subsequent period of up to six months with new charterers. The new charter rate was much higher than the old charter rate due to market increases. The new charter also provided for a laycan period (i.e. the delivery period for the vessel) which, if not met by the latest 8th May 2004, entitled the new charterer to cancel the fixture.

The vessel was not delivered in time to meet the cancellation date under the new charter so the cancellation date was extended by agreement between the parties to the second charter. However, this agreement was subject to the original hire rate being reduced to reflect adjustments to the market rate at the prevailing time. Owners sought to recover this difference in the hire rate as damages from the original charterers.

The arbitrators (by a majority, rather than unanimously) decided in favour of owners on the basis that the loss of fixture damages was not too remote. The charterers appealed to the Commercial Court which agreed with the arbitrators. The charterers appealed again, asking the Court of Appeal to determine the following issue: whether the damages a charterer was liable to pay to an owner in relation to late redelivery of a vessel were limited by the principles of remoteness of damage to the difference between the charter rate and the market rate at the time of redelivery over the length of the period encompassing the time between the agreed redelivery date and the actual redelivery. Alternatively, whether the owners could claim damages based on the loss of their next fixture.

The charterers argued that without special knowledge of a subsequent fixture, a charterer should not be held liable for that additional loss but should only have to pay the loss in respect of the applicable market rate during the overrun period. They further submitted that to depart from this straightforward formula for the calculation of damages would create uncertainty in the chartering market.

The Court of Appeal dismissed the appeal, stating that there was no binding rule or authority that damages for the late delivery of a time-chartered vessel was limited in the way charterers argued. Rather, damages for loss of fixture might be available on the proper facts. Insisting that the charterers should have been given special information of the follow-on fixture by the owners was uncommercial and undesirable. Furthermore, the charterers could reasonably have been expected to anticipate that the owners would agree a new fixture in expectation of the vessel being redelivered to them. This was not an unusual or unexpected occurrence. In addition, the owners had acted entirely reasonably in seeking to mitigate their losses by renegotiating the new fixture for a lower hire rate. Owners were therefore entitled to claim their actual loss rather than the conventional market loss.

The charterers would not give up and appealed to the House of Lords, on the basis that there is no reported case in which late redelivery caused the loss of a profitable following fixture, notwithstanding that freight rates in the market have often been volatile.

The House of Lords has now rendered its decision and, unlike the lower courts, allowed the charterers' appeal. Lord Hoffman referred to the comments of the dissenting arbitrator in the initial arbitration, who stated that "a reasonable man in the position of the charterers would not have understood that he was assuming liability for the risk of the type of loss in question", not least because such a risk would be completely unquantifiable. Whilst the parties to a charter would regard it as likely that the owners would enter into a forward fixture at some time during the currency of the charter, they would have no idea when that would be done or what its length or terms would be. On the other hand, if owners could see that the last voyage was bound to overrun and put the following fixture at risk, they had the option of refusing to undertake it. If owners accepted orders for the last voyage and this overran, they would be entitled to be paid for the overrun at the market rate only.

Lord Hoffman also commented that the general understanding in the shipping market was that liability was restricted to the difference between the market rate and the charter rate for the overrun period and any departure from this rule was likely to give rise to a real risk of serious commercial uncertainty which the industry as a whole would regard as undesirable. He contrasted the present case to the case of "Czarnikow Ltd v Koufos (The Heron II)" [1969] 1AC 350, where Lord Reid commented that damage could be held to arise "naturally" i.e. according to the usual course of things, from breach of a contract where it was of a kind which the charterter, when he made the contract, ought to have realized was not unlikely to result from a breach of contract by delay in redelivery.

Lord Hoffman went on to add that it was logical to found liability for damages on the objective intention of the parties because all contractual liability is voluntarily undertaken and it must in principle be wrong to hold someone liable for risks for which the people entering into such a contract in their particular market, would not reasonably be considered to have undertaken.

Whilst this case involved a highly specialized area of commercial law, the principle by which the issue had to be resolved is one which applies in the law of contract generally, specifically to the rules governing the remoteness of damage, as originally established in "Hadley v Baxendale" (1854) 9 Exch 341. As Lord Reid stated in "The Heron II", where a party entering a contract wishes to protect itself against a risk which to the other party would appear unusual, "he can direct the other party's attention to it before the contract is made".

A sigh of relief in the charter market, therefore. In order to protect themselves, however, ship-owners should continue to bring to charterers' attention any future fixtures they have arranged if they anticipate that the current charter might impact in any way on those future contracts, particularly in an environment of significantly fluctuating market rates.

However, beyond shipping law and with reference to commercial contracts in general, contracting parties should keep in mind that the English courts remain wary of "opening the floodgates" by relaxing the established rules on remoteness and foreseeability of damage. They should, therefore, ensure that insofar as possible specific and unusual risks and losses are provided for in the contract and that the contract is as tightly drafted as possible.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Specific Questions relating to this article should be addressed directly to the author.

 Do you have a question for the author?

View Popular Related Articles on from UK

The Bunkers Convention (Barlow Lyde & Gilbert LLP)
Following its ratification by Sierra Leone in November 2007, The International Convention on Civil Liability for Bunker Oil Pollution Damage (2001) ("Bunkers Convention") will enter into force on 21 November 2008.

AG’s Opinion: EU Law Precludes Anti-Suit Injunctions In Aid Of Arbitrations (Barlow Lyde & Gilbert LLP)
On 4 September 2008, Attorney General Kokott of the European Court of Justice issued her much awaited opinion on the “Allianz SpA (formerly Riunione Adriatica Di Sicurta SpA) and Others v West Tankers Inc. “ case.

Credit Crunch: Monoline Insurers (CMS Cameron McKenna LLP)
Monoline insurers have in recent times provided essential insurance for structured finance products like collateralised debt obligations and credit default swaps.

Auditors and third party liability – judicial reassurance (CMS Cameron McKenna LLP)
The issue of auditors’ liability to third parties has been brought sharply into focus recently with The Company Law Reform Bill which embodies some significant changes in relation to auditors’ liability, namely the ability to negotiate "Liability Limitation Agreements".

Liability Of Sub-Brokers Who Place Inadequate Insurance Cover (B J Macfarlane & Co)
The recent case of “Dunlop Hawyards (DHL) Ltd v Erinaceous Insurance Services Ltd v Lockton” [2008] EWHC 520 Comm has shed further light on the potential pitfalls that may arise where more than one broker is involved in placing insurance on behalf of an assured.

The Sub-Prime Crisis: An Update And Issues To Consider (Barlow Lyde & Gilbert LLP)
Reports of new write-downs and revelations of banks’ increasing exposure to sub-prime debt have been an ongoing feature of 2008.

Parties Should Proceed Warily Over War Clauses (Holman Fenwick Willan)
Recent tensions in the Caucasus have dominated shippingheadlines.

Arbitration Round-Up (Barlow Lyde & Gilbert LLP)
Arbitration has historically been a popular method of resolving insurance and reinsurance disputes.

Other Information about B J Macfarlane & Co

 View summary of all information contributed by B J Macfarlane & Co

 View Firm's Website