

Court of Appeal Clarifies Innocent Charterer's Duty to Mitigate

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Introduction

The Court of Appeal's recent decision in *The Asia Star* is significant to the shipping industry, as the courts have now made clear that it is important for a charterer to consult a defaulting owner on the measures that the former intends to take in order to mitigate damage caused by the latter's contractual breach.

It is now vital for an innocent charterer to inform defaulting owners of its intended steps to mitigate losses where mitigation will incur substantial costs. Furthermore, the courts will be more willing to scrutinize the reasonableness of an innocent party's failure to take action - for example, where it rejects a reasonable opportunity to mitigate its loss caused by the defaulting party's breach.

Facts

The appellant was the owner of the *Asia Star*, which was chartered to the respondent, a trader in edible oils. It was chartered to load palm oil bought from three Indonesian suppliers that would later be sold to a Turkish company under series of contracts.

The appellant was required to deliver the vessel at the respondent's nominated ports in Indonesia and Malaysia for loading. However, due to bad weather in South Korea and a change in discharge schedule, the *Asia Star* was unable to reach the nominated loading ports within its stipulated loading period. The respondent agreed to an extension of time. However, when the *Asia Star* reached the loading port in Indonesia, its cargo tanks were found to be unfit for carrying palm oil. No substitute vessel was found and the *Asia Star* departed without the cargo.

The respondent attempted to secure a substitute vessel. The respondent's shipbroker found a suitable substitute, the *Puma*, but negotiations broke down because the respondent refused to pay

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the higher freight rate for the Puma. The respondent was unwilling to pay more than US\$25.50 a tonne, whereas freight on the Puma was US\$27.50 a tonne - US\$2 more, but less than the Asia Star's freight rate of US\$32.00. Consequently, the respondent suffered losses arising out of the cancellation of various supply contracts entered into before the charterparty of the Asia Star. The respondent commenced an action *in rem* against the appellant. The appellant was found liable for failing to deliver the vessel, with damages to be assessed.

The assistant registrar at the assessment of damages hearing held that the respondent had failed properly to mitigate its losses by failing to procure the Puma as a substitute vessel. The assistant registrar considered that the respondents should have chartered the Puma, given the respondent's dire situation, instead of insisting on a lower freight rate. The respondent appealed to the High Court, which found for the respondent. The High Court disagreed with the assistant registrar's finding that the respondent had acted unreasonably in its mitigation of damage. It found that the respondent had acted reasonably, despite its failure to procure the Puma; therefore, its claim for damages was not limited to the difference between the freight costs that it would have paid had it chartered the Puma and the freight costs payable for the Asia Star. The court's assessment increased the claimable damages almost fivefold.

The Asia Star's owners appealed to the Court of Appeal.

Court of Appeal decision

The Court of Appeal allowed the appeal and reinstated the assistant registrar's decision (with arithmetical corrections to the quantum of damages payable).

In reaching its decision, the court took the opportunity to restate the law on mitigation of damages, which can be summarized as follows:

- The innocent party must take all reasonable steps to mitigate the loss caused by the breach, and cannot recover damages for any loss which could have been avoided, but which it failed to avoid due to its own unreasonable action or inaction;
- An innocent party that goes beyond what the law requires of it and avoids incurring loss is not entitled to recover damages;
- The innocent party may recover expenses incurred in the course of taking reasonable steps to mitigate its losses;
- The innocent party's conduct will be evaluated from the date of the breach by the defaulting party; and
- The burden of proof in showing that the innocent party failed to mitigate its losses falls on the defaulting party - ordinarily, this burden is not easily discharged.

On the facts, the court held that the charterer should have notified the defaulting party of the measures that the charterer intended to take in order to mitigate the damage caused. In the context of the Asia Star, where the charterer intended to incur substantial additional expenditure in chartering a replacement vessel in mitigation of its loss, the charterer should ordinarily have

notified the defaulting owner of (i) the alternative vessel or vessels available for charter, and (ii) the particular course of action that the respondent proposed to take.

The defaulting owners needed to be notified for two reasons.

First, a notification by the innocent party to the defaulting party would have prevented the latter from subsequently arguing that the innocent party had not taken steps to mitigate the damage or that the measures were unreasonable (particularly where the defaulting party does not suggest a better alternative at the time of notification).

Second, the court was concerned about the economic wastage that would be caused by unreasonable steps taken unilaterally by the innocent party. The court opined that such a rule, which encourages communication between parties regarding available mitigation measures, accords with the notion of fairness and minimizes avoidable economic wastage.

For practical purposes, this means that an innocent party should communicate to the defaulting party the measures that the former intends to take in response to the latter's contractual breach. Failure to do so may adversely affect the court's view of the reasonableness of the innocent party's conduct in its mitigation of damages. However, if the defaulting party fails to offer other options or respond to such communication by the innocent party, it seems that the court will not fault the innocent party for taking measures that may be excessive or unreasonable.

This case is also significant because the court implicitly considered that an innocent charterer can mitigate by chartering an alternative vessel of larger capacity if no alternative vessel of equivalent capacity is available. However, the court also considered that a charterer may reasonably decline to charter an alternative larger vessel if assuming the risk of dead freight would have a great and adverse financial effect on the charterer.

As a practical point, this means that an innocent charterer should also consult the defaulting shipowner if the charterer is unable to find an alternative vessel of equivalent capacity. More importantly, this avenue of consultation will give the charterer a way of putting the shipowner on notice of dead freight that is payable as the result of chartering a larger vessel.

Comment

This decision is instructive for charterers in dealing with defaulting owners that fail to deliver vessels.

It is always better to take positive action to mitigate one's losses instead of remaining inactive, but it is also important not to take measures that go beyond what the law requires.

It is important for an innocent party to notify the defaulting party of the mitigation measures or options that are available to it and to inform the defaulting party of the course of action that it wishes to take. A defaulting party should consider the course of action proposed by the innocent party and inform it of any objections or better options.

Ordinarily, parties to a contract of carriage of goods by sea should always endeavour to find substitute vessels if the contracted vessel is unable to fulfil its contractual obligations.

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