

VOYAGE CHARTERPARTIES
DAMAGES – AN ALTERNATIVE VIEW

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What follows is an expanded version of the lecture given at the LMAA Spring Seminar 2nd May 2012. Notwithstanding the title, it relates to both single voyage charters and time charter trips. The figures used in the examples are not intended to represent actual situations or to take into account other factors such as loss of time while securing alternative employment or movements in market rate levels, but to illustrate the underlying concepts that apply to setting rates and thus should be applied in determining damages.

You have just heard from my colleagues concerning what is at the moment the glamour aspect of damages for repudiation, early termination of a period charter. I deal with the more mundane topic of determining loss and damages for repudiation of a single voyage charter or a time charter trip. I am going to argue that the present way of assessing damages, by directly comparing the notional income from a repudiated charter with that from the substitute voyage is likely to lead to the wrong conclusion. The examples relate to the dry bulk market, but are applicable to others.

The rate for any charter is based on the expected follow-on employment and in my view we should not compare the intended and mitigating voyages in isolation. They must each be *calculated in conjunction with the charter that would have been expected to immediately follow* and the result of each of these then compared.

Why do I say this?

Whenever I consult the section in the book Voyage Charters pertaining to the rules for assessing damages my eye is caught by the following rule:

“At the end of the substitute voyage the ship may be better - or worse – placed for future employment than she would have been at the end of the chartered voyage. If such is the case, it should be reflected by the giving of an allowance against the damages if the ship is better placed, or by an award of an extra sum if she is worse placed.”

Voyage Charters, 3rd Edition 21.90 (4)

Why does that rule catch my eye? Because it is **wrong**.

There is no need for a tribunal or court to make this type of adjustment. That was already done when the rate for the substitute employment was negotiated.

What determines a time charter rate or time charter equivalent?

A ship's daily income from a particular charter is a function of two factors. The first is her physical characteristics, the most obvious being her consumption. The second factor is the place from where she will commence the charter. We leave characteristics for another day and focus here on the place from where the vessel starts the charter.

Where a ship starts a charter is determined by where she finishes her previous employment. Thus the place where the ship finishes one charter has financial consequences for the next charter. These are twofold:

1. The level of rates generally in the market where the charter will finish. These are usually measured by reference to the rates for what are referred to as round voyages.

2. The distance to the next loading port or delivery point. This determines the fuel cost to reach one of those points and the overall time needed to perform the charter. The further the distance, the higher the fuel cost to be deducted from the net income. That lower income spread over a greater number of days means that the daily income from the charter will be lower.

*Despite pertaining to the employment that will follow, these consequences are always reflected in the freight rate or charter hire, and thus the daily return, **for the present employment.***

The differing perspectives of charterer and ship owner

A ship owner and a charterer apply different criteria in evaluating a potential fixture:

- An owner is concerned with the vessel's *income per day* over the duration of the charter. A time charter rate is no problem to evaluate but he must convert a *per-tonne voyage freight rate* to a daily *time charter equivalent*.
- A charterer's yardstick is his expected freight cost, usually expressed as the *freight rate per tonne of cargo*. For a charterer, an offer on a rate per tonne basis is readily comparable, but a time charter rate must be converted to a rate per tonne.

The respective calculations are:

The ship owner's calculation:

The freight rate per tonne of cargo
multiplied by
the number of tonnes to be loaded
minus
the direct voyage expenses
divided by
the expected number of days on the voyage
gives
the **time charter equivalent**

The time charterer's calculation:

The **daily charter hire**
multiplied by
the expected number of days on the voyage
plus
the direct voyage expenses
divided by
the number of tonnes to be loaded
gives
the (notional) **freight rate per tonne of cargo**

The two calculations are the mirror image of each other. The two types of charter are simply alternative apportionments of the financial responsibilities to be undertaken in performing the voyage. Whatever bargain is eventually struck, whether voyage or time charter, the daily result for the owner would be effectively the same if performed in the other format.

Thus, the time charter equivalent *for a particular ship* for a voyage charter will be the same as the charter hire rate if the voyage is performed on a trip basis. That also means that when I use the term “rate” I am referring to both charter hire and the corresponding time charter equivalent. It doesn’t matter, therefore, whether we are discussing a voyage charter or time charter trip.

Market indifference

A charterer (and thus the market) is indifferent to an owner’s circumstances. A charterer is prepared to pay the present market voyage freight rate, either actual or notional, for his cargo, but will not pay a premium to an owner facing a long approach voyage in ballast. If an owner chose to fix his ship to a relatively distant port on the previous voyage, that is his affair; he is expected to have secured compensation for the subsequent shortfall through the daily return from the previous voyage.

Thus, the underlying principle is:

*The time charter equivalent or the time charter hire for the **present voyage** must take into account the economic circumstances that the vessel is **expected to face on her next employment**.*

How the present voyage affects the next

What is the effect of the two aspects of where the vessel finishes, rate levels in the market where the ship will finish the charter and distance to the next load port or delivery point?

As already mentioned, general rate levels are usually determined by reference to the rate for time charter round voyages in the geographical market concerned. The Baltic Exchange Panamax Index for an Atlantic round voyage, for example,

is based on delivery between Skaw in Demark and Cape Passero on the southern tip of Sicily, via North or South America with redelivery between Skaw and Cape Passero. A Pacific round voyage is defined as delivery Japan-Korea range via the west coast of North America or Australia with, again, redelivery within the same range as the delivery.

Generally, the rate for a voyage presently under consideration would be determined by calculating it in combination with the expected rate for the ship as a follow-on voyage in the relevant market. In theory, and usually in practice, a ship owner should be indifferent to which charter he fixes. This is because the overall result of one charter combined with the anticipated result of the expected follow-on charter should be the same as for other such possible combinations.

In simple numerical terms a brief example of the choice which an owner of a ship open in the Mediterranean might face could be:

An Atlantic round voyage of some 48 days at \$18,000 per day followed by a second Atlantic round voyage of similar duration at the same rate.

A 58-day trip from Atlantic to Pacific (Japan-Korea range) at \$21,000 per day followed by a 47-day Pacific round voyage at \$14,000 per day. As can be seen, the current Pacific round voyage rate is some \$4,000 less than the comparable voyage in the Atlantic. This accounts for the \$21,000 rate to take the ship to the Pacific, where her subsequent trading prospects will be diminished – an owner will expect a premium in such circumstances.

The \$18,000 per day for the 96 days spent on the two possible Atlantic round voyages will be compared with the \$17,866 average daily income over the 105 days for the trip to the Pacific followed by a Pacific round voyage. The latter will give an average daily return of some \$134 per day less but over a slightly longer period. In practice, the two combinations would be seen as sufficiently

comparable when considering the ship's next employment. As the round voyage serves as the representative indicator of rates levels in a geographical market, it might, in today's parlance, be called the "default" voyage. In more peripheral geographical markets, that might be another type of voyage, but we are concerned here with the principle involved and the round voyage will serve our purposes.

What is the effect of the second aspect of where the ship will finish, the distance to the next loading port or place of delivery?

Just as an owner will expect a premium to send the ship to the Pacific, where levels are lower, he must concede a discount to send the ship from the Pacific to Atlantic. Based on the previous examples, we can assume a trip from Pacific to Atlantic would be \$12,000 per day to be followed by an Atlantic round voyage at \$18,000. The \$12,000 daily will take the ship to the Skaw/Passero range and there will be no break between redelivering from one charter and delivering into the second.

But what is the situation if the ship is fixed from the Pacific with redelivery in the Black Sea? A 55-day trip with delivery Japan via Australia, redelivery Black Sea at U.S. \$12,000 per day gives a total income of \$660,000. The Owner, however, must ensure that the rate agreed is sufficient to notionally maintain the \$12,000 daily rate on the Black Sea/Cape Passero leg, otherwise the effect of that leg will be felt on the next charter. As the following calculation shows, the fuel cost of the ballast leg and the Bosphorus passage will reduce the overall income from the follow-on round voyage, which will be divided by the greater number of days on the charter, as the 4 days of the ballast leg must be included, thus further reducing the daily result:

Round voyage delivery Cape Passero via USA redelivery Rotterdam:

48 days x \$18,000	\$864,000
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Ballast Black Sea to Cape Passero:

Fuel: 4 days = 120 tonnes @ \$425 / tonne	(51,000)
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Bosphorus transit	<u>(10,000)</u>
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	\$803,000
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\$803,000 / 52 days = \$15,442

How, then, does the owner bridge this financial as well as geographical gap? Will his next, round voyage, charterer think to himself, "he's a nice fellow, we'll add something to the rate to compensate"? Certainly not; the decision to fix his ship to the Black Sea was the owner's and the charterer is indifferent to his situation.

To maintain the notional \$12,000 daily from Japan to Cape Passero, the owner requires a charter hire rate equivalent to 59 days at \$12,000 per day plus the fuel and Bosphorus transit expenses:

59 days x \$12,000	\$708,000
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Fuel and Bosphorus	
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charges	<u>61,000</u>
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	\$769,000
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Thus, the required daily charter hire for redelivery in the Black Sea would be:

\$769,000 / 55 days = \$13,982

Although the shortfall in income will affect the result of the following voyage, it must be anticipated and allowed for in the present charter. The market recognizes and accepts this. If a ship could be fixed to Cape Passero at \$12,000, why would its owner fix the same rate to the Black Sea? The Japan/Black Sea

charterer will understand that he must pay the appropriate incremental rate to attract tonnage for his business.

How does this affect the assessment of damages?

The present approach to assessing loss for repudiation does not allow us to look beyond the notional result of the repudiated charter compared with that of the substitute, “otherwise one would be involved in calculations to the end of the ship’s working life” (per Staughton LJ, the “*Noel Bay*” [1989] 1 Lloyd’s Rep. 361).

I agree that it would be ridiculous to consider calculating to the end of a ship’s life. I do think, however, that we should be able to look at the immediate follow-on employment for each of the charters in question. But no further than that, in the same way that a ship owner will not normally look further than the expected follow-on employment when negotiating a ship’s next charter.

The anomaly of the present approach is illustrated by considering the trip to the Black Sea at \$13,982 (in practice, probably \$14,000) as having been repudiated. If the ship were to have fixed Japan to Skaw/Cape Passero in mitigation at the market rate of \$12,000 per day, the Owner could legitimately claim a loss of almost \$2,000 per day for the period of overlap when, as will be seen, there was in fact no loss.

What to do?

It is always easier to identify a problem than to find a solution. We saw earlier that an owner’s choices for next employment should be the equivalent when each is viewed in conjunction with the expected follow-on employment. We also saw that the yardstick for determining rates in a particular market is generally the relevant round voyage. I suggest that a more accurate assessment of loss can be obtained by calculating the cancelled and substitute charters in conjunction

with the respective default that would have been expected to follow each, comparing the daily overall result of the two calculations for the period of overlap of the repudiated and mitigating voyages. The default voyage calculations would, of course, have to be based on the rates applicable when they would have been performed to allow for changes in market conditions, and other factual circumstances would be taken into consideration.

Consider the result of such a calculation for the trip Japan/Black Sea at \$13,982 per day assumed to be repudiated and the Japan/Cape Passero trip at \$12,000 assumed to be performed in substitution. A straightforward comparison of the respective rates for the period of overlap would indicate a loss to the Owner of 55 x \$1,982, or \$109,010. Calculating the two against the default follow-on employment however, would show the true position:

59-day trip delivery Japan redelivery Black Sea at U.S. \$12,000 per day followed by the default 48-day round voyage delivery Cape Passero via USA redelivery Rotterdam at \$18,000:

59 days x \$12,000	708,000
48 days x \$18,000	<u>864,000</u>
	\$1,554,000

$$\$1,554,000/106 \text{ days} = \$14,660 \text{ per day}$$

55-day trip delivery Japan redelivery Black Sea at U.S. \$13,982 per day followed by the default 47-day round voyage delivery Cape Passero via USA redelivery Rotterdam at \$18,000:

55 days x \$13,982	769,010
Fuel and Bosphorus charges	(61,000)
47 days x \$18,000	<u>846,000</u>
	\$1,554,010

Although the days on-hire only total 102, the 4 days spent ballasting from the Black Sea must be taken into account, so that the overall result of \$1,554,010 will be divided by 106. Thus:

$$\$1,554,010 / 106 \text{ days} = \$14,660 \text{ per day}$$

The more dissimilar the repudiated and substitute employment, the more necessary it is to make this type of adjustment so as to avoid the distortion inherent in the present approach.

I accept that there is an artificial element in this, but that is not unusual in calculating damages. Laytime is worked out in full; an option on the part of the party in breach is assumed to be exercised in his favour. In other fields, trade statistics are weighted to give a proper result. Why not here? I also accept that it will not be perfect, but I do believe that it would give a more accurate assessment than is possible at the moment.

This may be looked upon as some Heath Robinson solution. It is not. This is how rates are actually formulated in the real world and I think that adopting this technique would give a far better picture of whether or not a loss has been incurred and, if so, what it actually is.