A tough lesson on guarantee wordings: triple-check them!

The recent decision of Mr Justice Hamblen in the Commercial Court on the construction of a Letter of Undertaking ("LOU"), provided by way of general average security, will give those negotiating such securities pause for thought when considering the precise wording and liabilities agreed.

The background facts

The Owners were the demise charterers of a vessel. They time chartered the vessel under a charterparty pursuant to which the vessel operated in a liner trade, calling at ports in South East Asia, South Africa and West Africa.

With regard to General Average, the charterparty provided as follows -

> *"General average shall be adjusted at the place as indicated in Box 33 according to the York-Antwerp Rules 1994 or any amendment thereto by an adjuster appointed by Owners. In the event of general average or salvage, the Charterers shall provide an acceptable temporary security covering all goods and containers to avoid delay and secure their release so that transit/delivery may continue. The Owners agree that Charterers' temporary guarantee may be exchanged in due course for a full set of securities from the appropriate interested parties covering all goods and containers. The Charterers agree to co-operate with the Owners and the Owners' appointed average adjusters, to assist by supplying manifests and other information and, where required, to endeavour to secure the assistance of the Charterers' local agents in the collection of security, at the Owners' expense."*

In July 2007, the vessel grounded off a West African port. General Average was declared on 25 July 2007 and Owners appointed an average adjuster.

The adjuster provided a draft LOU on 27 July 2007. The initial draft was intended to be temporary security in respect of the cargo, however Charterers opted to provide permanent security. The terms of the LOU were negotiated and agreed and, on 25 September 2007, Charterers' solicitors sent a copy of the signed LOU by email to the average adjuster and to Owners' solicitors.

The LOU provided as follows -

> *"In consideration of the delivery to Cargo Interests or to their order on payment of freight due of the cargo carried on board the [VESSEL] at the time of the above mentioned casualty, we hereby undertake and agree as follows:*
>
> 1. *To pay the proper proportion of any General Average and/or Special Charges which may hereafter be ascertained to be due from the Cargo or Shippers or Owners thereof under an Adjustment prepared by the appointed Average Adjuster in accordance with the Charterparty, dated 16 August 2001, and/or the Bills of Lading issued by us ……"*

The final adjustment was published on 10 January 2012. Taking into account sums already paid, the adjustment provided that a further US$4,254,985.53 was due from cargo interests.

Charterers contested the adjustment and argued that their liability was limited to amounts that were properly and legally due – not necessarily the amount contained in the average adjustment. A draft of the adjustment had been provided to Charterers that had indicated that 79.55% of the bottom damage and 100% of the propeller damage was sacrificial damage and the amount due from cargo interests was US$6,304,663.92. The final adjustment, however, indicated that 82.17% of the bottom damage and 100% of

propeller damage was sacrificial damage and, taking into account a payment on account, the amount due from cargo interests was US$4,254,985.53. Charterers contested the correctness of these conclusions and it was their case that only a further US$3.5 million was properly and legally due.

Charterers further argued that they were not bound to accept the correctness of the average adjustment and had not given up their right to dispute the adjuster's determination.

Alternatively, they argued that Owners were estopped from challenging Charterers' construction of the LOU by accepting the LOU under cover of an email dated 25 September 2007, which stated as follows -

> *"This guarantee is provided on the basis that any liability on the part of cargo to contribute in GA arising out of this incident is agreed between Owners and Charterers or determined by the English High Court of Justice in the event GA liability is disputed."*

Alternatively, they said that the LOU should be rectified on the basis of common mistake so as to reflect the Charterers' construction.

Owners contended that, on the proper construction of the LOU, Charterers were obliged to pay the full amount stated in the adjustment, provided only that the adjustment was prepared in accordance with the York-Antwerp Rules 1994 by Owners' appointed adjuster. They argued that Charterers were bound by the findings of fact in the adjustment and the adjuster's assessment of their costs.

The Court was asked to consider as a preliminary issue the construction of the LOU and Charterers' arguments regarding estoppel and rectification.

The Commercial Court decision

The Court preferred the Owners' construction of the LOU and held that there was a clear undertaking to pay. The language of Clause 1 amounted to an unconditional and absolute obligation to pay the amount ascertained to be due in the adjustment.

Mr Justice Hamblen considered the decision of Mr Justice Sheen in *The Jute Express* [1991] 2 Lloyd's Reports 55. In that case, additional wording had been used to qualify the obligation to pay an amount *"which is payable in respect of the goods by the owners thereof*." Mr Justice Sheen found this to mean sums that were legally due and therefore the cargo interests had preserved the right to challenge the amount said to be due in the adjustment. Mr Justice Hamblen considered this to support Owners' case and that, in the absence of such wording in this case, Charterers were obliged to pay the adjusted amount. He pointed out that Charterers could have used such wording in the present case if they had wished to preserve the right to challenge the adjuster's findings.

On the proper construction of the LOU, Charterers were obliged to make payment of the amount ascertained to be due in the adjustment. The Court held that the obligation was akin to an on-demand guarantee. In doing so, it placed weight on the commercial bargain made by the parties. If this resulted in overpayment, then Charterers may have a means of recourse against Owners. If there was an underpayment, then Charterers would be free of any further liability and Owners would be left with unsecured claims against various cargo interests for the balance.

Additionally, the Court rejected Charterers' argument that Owners were estopped by representation from asserting that Charterers' construction of the LOU was incorrect as they had not responded to the covering email that had purported to add terms to the

LOU. Neither had Charterers established that the LOU should be rectified on the basis of common mistake.

Comment

This is an important case for all parties involved in the negotiation of General Average security and will be of interest to all parties involved in negotiating other types of security. In light of this decision, a guarantor's liability to pay an amount ascertained to be due under a General Average adjustment is likely to be construed as an on-demand guarantee to pay the amount ascertained to be due in the adjustment, unless express wording is included preserving the right to contest the adjustment and limiting the obligation to pay amounts that are legally due.

When negotiating the wording of General Average security, it is important that one considers carefully the precise wording of the LOU and the effect it may have on a party's obligation to make payment of general average contributions. It may be appropriate to insert additional wording to protect a party's ability to contest the determination in the average adjustment and limit the guarantor's payment obligation to making payment of amounts legally due. For other forms of security, this decision reinforces the point that all terms of the security should be included in the guarantee itself, rather than in related correspondence: the safest course of action will always be to treat the guarantee document as "stand alone" and likely to be strictly construed.

St Maximus Shipping Co Ltd v. AP Moller-Maersk AS (Maersk Neuchatel) **[2014] EWHC 1643 (Comm)**