

Can we really afford general average?

by Ben Browne, Thomas Cooper

1. The History of opposition to General Average (“GA”)

“The Rhodian law, the Digest of Justinian, the Court of Admiralty and the majority of common law judges have all accepted that general average contribution is based upon “common principles of justice”. “Natural justice” requires that all should contribute to indemnify for the loss of property which is sacrificed by one in order that the whole adventure may be saved, for one interested party should not be unjustly enriched at the expense of another.”¹ Thus it was that the system of general average evolved in a time before hull and cargo insurance. However in the 19th century (and indeed for many years long before that) hull and cargo insurance became widespread but the system of GA has continued despite considerable objection from many over the last 200 years.

In 1873 Mr Joseph Hillman, one of the representatives of Lloyd’s at the Antwerp Conference published a letter in the Times bemoaning the extension of the scope of general average in the York-Antwerp Rules and describing the system as a *“nest of fraud and abuses, a lurking place for peculation and waste. It was, in its origin, a cumbrous form of partial insurance but the necessity for its use is rendered obsolete by modern underwriting.”* He concluded by saying that the chief interest of the subject for the general public lies in the fact that the waste and unproductive outlay incidental to a system which violates the soundest principles of the economy are, in the long run, at the charge of the consumer.

In 1913 Mr H. K. Fowler, Chairman of the Association of Average Adjusters of the United States, addressed their annual meeting on the “Burden of General Average”. He too advanced a view that marine insurance provided a ready and inexpensive way by which either the ship owner or the cargo owner can be and is indemnified directly for that loss by his underwriter without reference to the liability of the other parties to the adventure to contribute. He also referred to earlier debates and compared the conditions with those existing in 1913. *“In 1877 our largest steamers did not exceed 5,000 tons. Today we have steamers of 45,000 tons and carriers of 20,000 tons of cargo. It is not an uncommon thing, especially in our coastwise trade that adjusters have to deal with 3,000 or more bills of lading in respect of a single cargo. The time, trouble, expense and delay involved are out of all proportion to the benefit achieved and a system, equitable in theory and in other times*

¹ Goff & Jones The Law of Restitution 6th edition para. 14-042(b).

valuable in practice has become out of harmony with the spirit of the age". Today the largest container vessels can carry in excess of 18,000 TEUs many of which may be groupage loads so the number of bills issued could exceed 18,000.

Mr Fowler went on to state that three parties are concerned and would be affected by change - shippers, ship owners and underwriters. *"The shippers would be utterly indifferent; they collect their losses from underwriters and there is not the slightest reason why they should bother their heads as to whether their underwriters do or do not recover from third parties. It is difficult to see any advantage to ship owners by a continuance of the present system comparable to the gain by them by its abolition"*.

On the same theme in 1915 Mr M. C. Harrison from the United States presented a very hard hitting paper entitled "The Abolishment of General Average". He suggested that *"commerce by sea has been fettered by this growing land barnacle for nearly 3,000 years. It was useful prior to the introduction of marine underwriting, but has served its time, and should not be allowed to remain as a drag upon the interests of mankind"*. In presenting his arguments and his plan he gave three reasons that demanded the abolition of the system completely:

First – the majority of the parties interested in the maritime venture at the present day do not understand the system of general average, and it is so intricate and cumbersome that, in the nature of things, it is not possible for them to gain, in the ordinary channels of commerce, even a fair understanding of its workings.

Second – the amount of work required by various interested parties is getting too great.

Third – the expense is enormous.

It is often said that general average assists a ship's master in making decisions about expenditure during the course of a marine casualty and its immediate aftermath. However over 100 years ago international cable and telegraph systems of communication placed the ship's master in almost continuous communication with his owners and now, in an age of email, satellite communication and computer technology the master simply does not need the crutch of GA because, in practice, he does not make the decisions, the owners/managers do.

2. The Cost of GA

A detailed analysis of over 1,700 GA adjustments was carried out by Matthew Marshall (Technical Director, Institute of London Underwriters) in the 1990s. Mr Marshall's report revealed that GA was:

- Too expensive: the annual cost of GA claims to insurers was approximately US\$300m. 10% (US\$30m) was made up of adjuster's fees and a further 12% was comprised of interest and commission;
- Too slow: almost two-thirds of adjustments were published in the first two years after a casualty but these accounted for only one-third of the money apportioned in GA. Even after seven years only 95% of GA adjustments had been published; and
- Too inequitable: 80% of GA cases were acknowledged to have been caused or were likely to have been caused by the fault of the ship owner or his crew. Nevertheless 60 – 65% of the total cost of GA claims was charged to innocent cargo interests.

Mr Marshall's study was carried out about 20 years ago but I suspect that the only thing that has changed is that the amount of money moved in GA has risen very dramatically as the values of ships and cargoes and the costs associated with casualties have increased². The key point however to have in mind is that GA increases the cost of dealing with casualties by something between 15 and 30%.

3. Should general average be abolished?

In their position paper dated 30th August 2013 IUMI said:

"If marine property underwriters were establishing a system of maritime insurance law from scratch today GA might very well not find a place in it. However GA is over 2,000 years old and is incorporated into the legislation of most countries and into most contracts for the carriage of goods by sea. The practical difficulty of abolishing GA would be insurmountable and would involve obtaining the agreement of all countries across the world to an

² Support for this view may be drawn from VHT's finding that in 2014 over 20% of all claims paid by German hull insurers are G.A. If this is extrapolated to the world then the amount adjusted in G.A. each year could be conservatively estimated at US\$2-2.5bn. p.a. for both hull and cargo. Of this adjusters' fees (10%) interest and commission (12%) may amount to between US\$440m and US\$550m.

International Convention which would take at least 20 years to get into law. Accordingly abolition is not a practical option.

Even if GA was abolished a substantial number of the allowances currently incorporated into the YAR would probably be allowable as a matter of general law under the equitable principles of unjust enrichment in English law and probably in a similar way in many civil law countries. The abolition of GA would therefore lead to a number of very “interesting” legal cases which, after much expensive litigation over a lengthy period of years, would establish a set of precedents something along the lines of GA as it existed prior to the YAR which might then be reduced to writing with a view to achieving uniformity of law and practice in the same way that the YAR first came into existence in 1860.

In short there is little to be gained by debating the question” of abolition.

4. Why is general average unfair?

As we have seen, one of the main justifications for general average is that it is founded on “natural justice” and fairness. But there are a number of ways in which the operation of the York-Antwerp Rules is in fact very unfair and this is hardly surprising since the Rules themselves have largely evolved under the direction of ship owners and their servants, the average adjusters. I now propose to offer a few examples of what I mean.

a. Rule D

In pretty well every country in the world it is recognised that the right to contribution in GA is lost if the peril which occasioned the sacrifice or expenditure arose from the actionable fault of the claimant. This is for two reasons: first the claimant should have no claim to contribution to a loss of which he himself had been the cause and secondly the defendant, having a cross-claim in damages, should have a defence to the claimant’s claim to contribution to avoid circuity of action. The fact that one party is thereby deprived of contribution does not, however, prevent the act from being a general average act and accordingly other parties who are not at fault are entitled to recover contribution in the ordinary way.

The rule is founded in equity as is the right to general average and there are two maxims of equity which are important here: “He who seeks equity must do equity” and “He who comes to equity must come with ‘clean hands’”. How is this to be applied in relation to general average?

As we all know under a contract of carriage the carrier will normally exclude liability for negligence in the navigation and management of the vessel or unseaworthiness which develops after the commencement of the voyage. If there is a casualty nine times out of ten the owner will deny cargo interests any evidence or access to the vessel so that they cannot satisfy themselves that there has been no breach of the contract of carriage. The ship owner then exercises a lien on the cargo and refuses to deliver it until general average security is given and requires payment of GA contributions greatly inflated by interest at 7% per annum, commission at 2% on disbursements and a number of expenses that have nothing to do with the saving of the ship and cargo from peril under the numbered YAR. What is just about that?

Seen from the point of view of a cargo interest there ought to be a rule requiring a claimant in general average to permit access to the experts of the other parties to the Common Maritime Adventure to the ship and documents and take interviews from the crew and managers a bit like an enquiry of the Antwerp Nautical Commission. This should be automatic and it should be initiated by a truly independent adjuster appointed by someone other than the ship owner. The German system in that respect has something to recommend itself. A system like this would substantially reduce the number of expensive general averages while being consistent with natural justice.

b. Temporary repairs

Rule XIV YAR 1994 provides that the cost of temporary repairs to a ship at a port of refuge relating to damage suffered for the common safety or caused by a GA sacrifice is allowed in general average. However the position in relation to the temporary repairs of *accidental damage* is treated differently. Under the 1994 YAR they are allowed “*without regard to the saving, if any, to other interests but only up to the saving and expense which would have been incurred and allowed in GA if such repairs had not been affected there*”. How this operates is best illustrated by an example: a bulk carrier laden with grain from the US Gulf to Rotterdam develops serious leaks in hold number 4 and calls at Miami as a port of refuge. Permanent repairs there would cost US\$1m. Temporary repairs costing US\$100,000 are done and the voyage continues to Rotterdam, where final repairs are made costing US\$500,000. Under the YAR 1994 the US\$100,000 is allowed in GA even though hull underwriters are saving US\$500,000 on the cost of the permanent repairs: effectively cargo contribute to the temporary repairs but get no benefit from the substantially decreased cost of permanent repairs.

Under the YAR 2004 the amount allowed as temporary repairs in this manner is capped but it is unlikely that the YAR 2016 will retain this cap due to pressure from the ICS. Can it really be right that cargo underwriters should subsidise the temporary repairs in order that hull underwriters can benefit from a massively reduced permanent repair bill?

c. Artificial general averages

Rules X and XI YAR deal with allowances at ports of refuge. IUMI have long taken the view that in an ideal system such losses do not properly fall within the spirit of GA because they are not incurred at the time of peril nor do they arise out of sacrifices made at the time of the peril in general. These allowances were called “artificial general averages” by the late Professor William Tetley of McGill University. He cites *Eagle Terminal 1981 AMC 137* where a ship was permitted to claim general average for propeller damage, discovered only in port after an uneventful voyage. He also refers to *Ellerman Lines -v- Gibbs [1986] 2 F.C. 463* where the costs of repairs to a ship’s engines were allowed even though the damage was only discovered four days after arrival in port. Underwriters often ask why should the crew’s wages and maintenance be recoverable in general average when the owner has to pay them whether or not there is an emergency; and why should fuel and stores used while the vessel is detained at a port of refuge be recoverable in GA when they are being put to the very use for which they were first provided? Few except the pure abolitionists take the view that there should be no allowances at a port of refuge but I think the majority view within IUMI is that Rules X and XI are too wide in scope.

d. Salvage

In England in the 19th century salvage was not generally readjusted in GA because it was apportioned over values at the time and place where the services ended rather than at the termination of the voyage. In the 20th century this position slowly changed through Rules of Practice in 1926 and 1942 culminating in Rule VI of the 1974 YAR. This required salvage to be reapportioned in GA in all cases. The allowance of salvage remuneration in GA in all cases has been much criticised as being an over-complication leading to significantly higher expense for marine property underwriters. Two sets of security are required to cover the same money and the whole adjustment is prolonged, sometimes for years.

Under the YAR 2004 Rule VI was amended so that salvage contributions and associated expenses would not be re-adjusted in GA unless one party paid another’s proportion. While it must be conceded that the inclusion of salvage in GA produces a fairer result in a few situations the overall effect of excluding salvage from GA would be much less frequent GAs

with far smaller sums being moved. The sort of situations where it would be fairer, but not necessarily cheaper, to include salvage and GA might be where a second casualty affects the values at the termination of the adventure and thus the apportionment (which occasionally does happen). One of underwriters' main concerns is that in many cases they are able to negotiate settlements with salvors but then cannot close their file because all the settlements have to be readjusted in general average this makes everything extremely difficult to predict and provide for, adding greatly to the burden of casualties generally.

A compromise of sorts is likely to be reached in relation to the treatment of salvage in GA in the YAR 2016 which will hopefully exclude "pure salvage GAs" but the number of grounds on which salvage can be readjusted in GA means that the new rule will not produce anything like the significant saving to underwriters the YAR 2004 would have done, if adopted.

e. The Average Adjuster's role

In England an average adjuster is appointed by one of the parties (almost always the shipowner). The average adjuster looks to the owner for payment and is his agent: in the well-known case of *Wavertree Sailing Ship Co –v- Love* [1897] A.C. 373 Lord Herschell, giving judgment for the Privy Council, said:

"The ship owner was not bound to employ a member of any particular class of persons or indeed to employ anyone at all. He might be pleased to make out his own average statement, and he may do the same at the present time if so minded. If he engages the services of an average stater, it is merely as a matter of business convenience on his part. The average stater is not engaged nor does he act on behalf of any of the other parties concerned, nor does his statement bind them".

This dictum was approved in *Castle Insurance Co –v- Hong Kong Shipping (The Potoi Chau)* [1984] A.C. 226 and Lowndes & Rudolf, General Average and York-Antwerp Rules 14th Ed. Para. 3.04 describes the decision as "undoubtedly correct".

In some countries adjusters may be appointed by the court (although this is not usually done) which of course is different but the majority of adjustments are not done in this manner worldwide. However the adjuster has to try to act in the common interest and while many achieve this they are faced with an inherent conflict of interest which makes them vulnerable to pressure from ship owners and raises suspicions about their objectivity.

In compiling adjustments and exercising their other functions adjusters have numerous opportunities to exercise discretion such as:

- Whether to collect security from and/or include low value cargo in the adjustment;
- How to calculate expenses of diverting to a port of refuge and regaining the ship's original course;
- Requiring parties to give notice of claims and, if they fail, how much to allow as their claims (Rule E YAR);
- Under the proposed York-Antwerp Rules 2016 an adjuster's discretion will extend to apportioning salvage in GA, calculating contributory values and Adjusters will now be holding cash deposits (for cargo's GA security) in bank accounts in their sole name.

Unlike lawyers, adjusters are not regulated in most countries and for this reason a proposal that guidelines should be introduced is presently under consideration. These remarks should not be seen as an attack on Adjusters, the majority of which do a good job, but it is simply not a position which is designed for comfort!

f. Interest

Under Rule XXI YAR 1974 and 1994 interest is charged on GA expenditure, sacrifices and allowances at the rate of 7% per annum. Under the YAR 2004 the interest rate is fixed each year by the assembly of the CMI and published on their website. Between January 2005 and the present day the rate has varied between 2.75% (2013 – 2015) and 6% (2009) averaging less than 4%. Under the proposed YAR 2016 it is likely that interest will be fixed on the average ICE LIBOR rate for the appropriate currency of the adjustment plus 4%. Interest is not normally recoverable under cargo and (in England at least) hull policies and nowhere is interest recoverable at as much as 7% under any policy. Interest is the single largest item which goes to increase the amount recoverable in GA and is constantly resented by underwriters as it massively increases the cost of handling casualties. To add insult to injury by virtue of Rule XXI YAR 1994 interest is not just charged up to the date of publication of the adjustment but for three months thereafter.

g. Commission

Historically it was a custom in a substantial number of countries (although not the UK) to charge commission on GA disbursements. For example, in Belgium, Lowndes & Rudolf say

the practice was to allow a commission of 2%, in Germany a customary commission of 1% was allowed on GA disbursements while in the United States the figure was 2½%. Commission long preceded interest and was described as “the cost of raising funds”. Commission was first introduced into the YAR in 1924 as a step towards standardising the practice regarding commission between countries. However at the same time Interest was introduced into Rule XXI. This has meant that, in effect, the parties to GA have been paying twice in respect of the same item for over 90 years. To tackle this criticism, adjusters began to try to justify commission as being the administrative costs to a ship owner of dealing with a GA situation but then, in addition to that, have for many years been seeking to recover the same expenses (often including bank charges) under the heading “Administration, Telexes etc” or “Agency”. As long ago as 1989 in the “KHARK 5” owners claimed US\$150,000 in “administration, telexes etc.” in relation to a major tanker GA. This was strenuously objected to but eventually paid despite the fact that the figure was not vouched even to the adjusters. From the point of view of marine property underwriters it must be questionable whether this kind of administrative expense should properly continue to go into GA whatever it is called.

5. What are marine property underwriters doing about GA?

For over 20 years now marine property underwriters, mainly through IUMI, have been campaigning to amend and reduce the scope of general average as set out in the York-Antwerp Rules. In 1994 a Rule Paramount was introduced against stiff opposition from adjusters in Sydney. The Rule Paramount provided that no allowances should be made for sacrifices or expenditure unless “*reasonably made or incurred*”. After ten more years of campaigning the York-Antwerp Rules 2004 was introduced which addressed some, but by no means all, of IUMI’s concerns. Unfortunately for marine property underwriters however almost no contracts of carriage incorporate the YAR 2004 and BIMCO refused to incorporate the 2004 YAR into any of their standard contracts so it is hardly ever used.

The process leading to the York-Antwerp Rules 2016 has involved IUMI making one concession after another in the hope of getting a set of rules which at least has a more realistic interest rate, no commission and a few less salvages readjusted in GA and a few other minor improvements over YAR 1994. The ICS has ignored the fact the vast majority of the money shifted in GA belongs to the marine property insurers and has brazenly insisted as far as it can on the reverting to the York-Antwerp Rules 1994 especially when it works to the disadvantage of cargo interests. The Shipowners are able to insist on their view because of their greater bargaining strength and underwriters’ disunity. The process makes a mockery of the claim that GA is an institution based on natural justice.

6. Conclusion

The general average system evolved out of necessity 2 or 3,000 years ago. It emerged from a world with no insurance and no communications to the shore. It remains despite the widespread use of insurance and modern communications technology. The system is expensive and time consuming: It involves collecting security often from very many interests, collecting in all expenses calculating contributory values and apportioning certain expenses between them. This often takes several years. The cost and time taken to adjust GA is substantially more than the time and cost a PA adjustment takes.

Commission at 2% and interest at 7% per annum add to the cost of all this. The complexity involved is huge. In most cases GA increases the cost of casualties by 15 – 30% depending on the length of time taken to produce the adjustment and it can be more.

The world's marine hull and cargo insurers have made few profits over the last 30 years and need to find the most economical way of handling casualty claims to keep premiums as low as practicable. Simply allowing losses to lie where they fall with cargo and hull and machinery insurers paying for what used to be readjusted in GA would be cheaper for both hull and cargo insurers because of the savings effected by having to pay no or far less interest, commission or adjusters' fees.

If it would be at all practical to abolish general average I would say do it tomorrow but unfortunately it is not so the best we can hope for is a reduction in the scope of GA and the number of adjustments.

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