Charterparties, frustration and market value - Bunge S.A. v Kyla Shipping Company Limited (the "KYLA") [2012] EWHC 3522 (Comm)

By Damien Magee and Mark Bamford

In the recent Commercial Court decision of Mr Justice Flaux in *Bunge S.A. v Kyla Shipping Company Limited* (the "KYLA"), the Court found that where the costs of repairing a vessel exceeded her market value this did not amount to frustration (as the owners alleged), but rather that in circumstances where an express continuing warranty to maintain the vessel's insurances had been given, the owners had assumed the risk of repair.

The facts

Pursuant to a time charter (on an amended NYPE 1946 form) dated 6 February 2009, Bunge S.A. (the "**Charterers**") agreed to charter the "KYLA" (the "**Vessel**") from Kyla Shipping Company Limited (the "**Owners**") for a 12-15 month period (at charterers' option). The Vessel was due to undergo her fifth special survey in May 2010 at the end of the charterparty and clause 41 of the charterparty, in relation to insurances, stated "***O****wners warrant that throughout the currency of this Charterparty the vessel shall be fully covered by leading insurance companies/International P&I Clubs acceptable to the Charterers against Hull and Machinery, War and Protection and Indemnity Risk. Cost of such cover to be at the sole expense of the Owners…… Hull and machinery: USD16,000,000 London, Norway and USA Markets*."

The Vessel was accepted by the Charterers on 25 February 2009, and on 4 May 2009, through no fault of the Owners, was damaged in a collision whilst alongside another vessel at a terminal in Brazil (which resulted in the Vessel striking the quay and another vessel). Initial inspections by the classification society resulted in the Vessel being dry-docked and in the period up to September 2009, various repair quotations were obtained by both the Owners and their hull and machinery underwriters. The Owners declared the Vessel a constructive total loss and served notice of abandonment on their hull and machinery insurers, which was rejected by the insurers with the resulting claim by the Owners being settled for US$14,275,263 (the Vessel having been sold for scrap). On the same day that the Owners served the notice of abandonment, the Owners notified the Charterers that the costs of repairs were uneconomic and a few days thereafter, by follow up letter, that the charterparty was frustrated. The Charterers thereafter commenced arbitration against the Owners, rejecting the frustration argument.

At the arbitration it was common ground that at the time of the incident the sound market value of the Vessel was US$5,750,000 and that the repairs exceed this sum (the estimated cost of repairs being in the region of US$9,000,000). Ultimately the arbitrator found for the Owners (who argued the Vessel was, in their words, a "*commercial total loss*", as the cost of repairs was greatly in excess of the sound market value of the Vessel). The Charterers appealed this point and queried if there was a general principle, peculiar to charterparties, that a charterparty will usually be discharged where the vessel chartered is damaged such that the cost of repair exceeds the value of the vessel (or to put it another way, if the "*commercial total loss*" principle was valid and if this could result in frustration).

The decision

The Court, in finding for the Charterers, examined the modern law on frustration, considering the principles found in *J Lauritzen A.S. v Wijsmuller B.V.* ("THE SUPER SERVANT TWO") [1990] 1 Lloyd's Rep 1 and *Edwinton Commercial Corporation & Anor v Tsavliris Russ (Worldwide Salvage & Towage) Ltd* ("THE SEA ANGEL") [2007] EWCA Civ 547. It must be remembered that, as noted by Flaux J, the "*effect of frustration is to kill the contract and discharge the parties from further liability under it, the doctrine is not to be lightly invoked, must be kept within very narrow limits and ought not to be extended*" and that a "*frustrating event must take place without blame or fault on the side of the party seeking to rely on it*."

The Court was not willing, in circumstances where the charterparty contained an express continuing warranty in relation to the hull and machinery insurance cover, to accept the Owners' argument that there existed "*some general rule or principle peculiar to charterparties that a charterparty will usually be discharged where the vessel is damaged to such an extent that the cost of repair exceeds the value of the vessel.*" Examining "THE SEA ANGEL" the Court held that "*the correct approach in each case is to ask whether on its true construction, the contract under consideration provides for the event or contingency which has occurred or allocates the risk of that event or contingency to one or other of the parties.*" Flaux J also noted that the "*presence of the insurance warranty in clause 41 in the charterparty makes it impossible for the owners to say that what has occurred (which is a casualty the cost of repairing which is several million dollars less than the insured value of the vessel) amounts to something radically different from what was contemplated or to a "ruinous expense" or that there is a break in identity between the contract as provided for and contemplated and its performance in these circumstances.*"

In such circumstances the Owners were found to have assumed the repair costs up to the value of US $16,000,000 (the insured value). Applying the "*reality check*" advocated by Rix LJ in "THE SEA ANGEL" that there was "*nothing unjust*" in holding the Owners to the bargain that they had contractually agreed to perform pursuant to charterparty. Repair of the Vessel, where the costs of repair were less than the insured value was thus not radically different from that which had been promised by the Owners under the charterparty.

Interestingly, in the ruling the Court held that the principle that the Court should disregard the fact that insurances had been obtained when making any determination (or importantly in allocating risk) did not apply in the circumstances. The Court held that the "*fact that the charterparty contains this express continuing warranty as to the hull insurance and its amount makes it impossible for the owners to contend that the principle that insurance is normally res inter alios acta should apply.*"

In light of this ruling it is advised that owners and lenders (who often receive the benefit of a charterparty through assignment) examine charterparty clauses in great detail in the wake of this ruling, in particular in relation to the allocation of risk and insurance obligations for the cost of repairs. This becomes all the more pertinent where vessels are approaching the end of their estimated life cycle where the costs of repairs following a casualty may exceed the value of the vessel. Given that the Court placed such weight in the express continuing warranty in relation to the hull and machinery insurance cover, it has yet to be determined if the Court would reach a similar conclusion where the repair costs are in excess of the sound market value.

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