Stop the clock—examining indefinite demurrage claims (MSC v Cottonex)

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Commercial analysis: Allen Marks, director at Campbell Johnston Clark, explains how the judgment in MSC Mediterranean Shipping Co v Cottonex usefully puts into perspective the point in time when the affirmation of a contract ceases to be an acceptable remedy.

Original News

MSC Mediterranean Shipping Company SA v Cottonex Anstalt [2016] EWCA Civ 789, [2016] All ER (D) 159 (Jul)

The Court of Appeal, Civil Division, held that, in circumstances where, under bills of lading, the defendant shipper was obliged to redeliver containers to the claimant carrier or suffer the imposition of demurrage, but was unable to redeliver in the foreseeable future because it did not have title, the carrier was only entitled to demurrage up to the date when it had been told of that impossibility. That was because it had then been clear that the shipper had repudiated the contract and the carrier was not in a position to wait for the contract to be performed as its performance had become impossible.

What is the significance of this decision?

The major significance is that the court on its own volition was willing to impose a date on which it considered delay had become so prolonged as to frustrate the commercial purpose of the contract and that was to be considered a repudiatory breach of the contracts.

Notwithstanding the generally understood principle of English law regarding repudiation, which provides that when one party is in repudiatory breach of contract, the other party is not necessarily bound to accept that repudiation, the courts (at first instance and on appeal) recognised that while an innocent party may have entitlement to the remedy of affirmation, in certain circumstances the court will decline to grant that remedy if the court considers damages as adequate remedy instead.

From review of the judgments at first instance and at appeal, it can be seen how the courts dealt with this. The Commercial Court said, as of September 2011 in the first instance, the date when Cottonex (the shipper) informed MSC (the carrier) that it did not have legal title to the goods, the carrier could not be considered to be bound any more, and so it was repudiatory conduct, which the carrier should have accepted.

The Court of Appeal disagreed, and said that September 2011 was too early, as it was only two and a half months after the last containers had been discharged and such a relatively short period of delay was not sufficient. Instead, it ruled that the contract became repudiated as from February 2012. **How is it especially significant to the shipping and commodities industries?**

This judgment slightly contrasts with the decision in *Isabella Shipowner SA v Shagang Shipping Co Ltd 'The Aquafaith'* [2012] EWHC 1077 (Comm), [2012] 2 All ER (Comm) 461. There Cooke J considered that, in a case of purported early redelivery by 94 days in a charterparty for 59 months, the owner did not have to accept the charterers' repudiation. Instead, the owner could refuse to accept the charterers' repudiation and affirm the contract.

However, since *Isabella v Aquafaith* many legal advisers remained nervous of giving such advice to innocent parties. Thus the Court of Appeal decision here shows that where a party considers that it has a continuing right to claim damages, eg, a demurrage clause, it actually has to look at a point from which its actions (of affirmation) could be considered unreasonable. If a party is thinking it has a demurrage clause which will keep demurrage accruing and keep it entitled to damages, the legal advice one needs to give it now has to be that at some point the clock probably has to stop, particularly if damages are an adequate remedy. This judgment puts into perspective at what point in time affirmation of a contract ceases to be an acceptable remedy.

Briefly, what was the background to this decision?

35 containers of raw cotton were shipped from various ports in the Middle East to Bangladesh pursuant to five bills of lading. Following discharge in May 2011, the consignee failed to collect the containers because following conclusion of the sale contract and shipment of the cargo, the market price of raw cotton fell.

Thereafter, the consignee sought to cancel payment of the sale contract price under the letter of credit and litigation proceedings were commenced in Bangladesh by the consignee against the shipper, resulting in an interim injunction being issued in June 2011 to restrain the issuing bank from making any payment. However, prior to the proceedings the shipper had received payment for part of the cargo. In light of the proceedings, the Bangladeshi customs authorities refused to release the containers from the yard without a court order.

In August 2011, the carrier emailed the shipper asking what actions had been taken by the shipper to release the containers and sought confirmation that demurrage would be paid. The shipper responded on 27 September 2011 that it had no title to the goods, as payment had been received and property had passed to the consignee. Accordingly, the shipper was not liable to return the containers to the carrier.

The carrier commenced proceedings in the English High Court against the shipper, claiming container demurrage. Pursuant to the bill of lading terms, the shipper had responsibilities of a 'merchant' as defined in the contract, including the obligation to pay demurrage in accordance with clause 14.8. It was agreed that the period of free time stated in clause 14.8 commenced on 13 May 2011 for the first 10 containers, on 20 May 2011 for the second lot of 12 containers and on 27 June 2011 for the last four containers.

The shipper argued that demurrage had not accrued because the carrier had not nominated a place for the return of the containers and that such an obligation constituted a condition precedent of the contract. Alternatively, it was argued that the carrier failed to mitigate losses by either purchasing replacement containers or emptying the containers and arranging their removal from the yard.

What were the key legal issues before the court?

- Under the terms of the bills of lading, was the shipper liable to pay the carrier demurrage in the first place?
- Was the judge at first instance entitled to find that the commercial purpose of the adventure had become frustrated on 27 September 2011, when the shipper informed the carrier that it did not have legal title to the goods as it had been paid for them?
- If not, the Court of Appeal asked, could it had become frustrated for a longer period of time—in other words, by 2 February 2012, at the point when the carrier offered to sell the containers to the shipper?

- If the shipper had repudiated the contracts of carriage in the bills of lading, was the carrier bound to accept the repudiation and basically entitled to a different form of damages other than demurrage?
- Is a carrier's right to recover demurrage affected by the existence of a general duty of good faith in matters of contract?
- Was the demurrage clause penal in its nature, ie, was it a penalty clause?
- Was the carrier in breach of its duty to mitigate its losses caused by the delay?

Has this judgment brought clarity? Does it leave any unresolved issues?

It has brought clarity as it suggests you cannot have damages at large running indefinitely, even if there is a demurrage clause in the contract. Moore-Bick LJ said a demurrage clause is not a penalty clause, but one can't expect it to keep running and running as a lawful claim in damages. He also commented on the good faith issue—reiterating the fact that English law does not recognise any general duty of good faith in matters of contract.

It still leaves unanswered the question of when enough is enough—where is the point where repudiation applies and the other party is effectively obliged to accept the repudiation to start to mitigate their losses?

Are there any trends developing in this area of law?

In general, it is one of a long line of cases dealing with affirmation as a remedy and repudiation, from *Isabella v Aquafaith* back to *White & Carter Councils Ltd v McGregor* [1962] AC 413, [1961] 3 All ER 1178 where Lord Reid held that, once there was no realistic prospect that the shipper would perform its remaining primary obligations, the carrier ceased to have any legitimate interest in keeping the contracts of carriage alive in the hope of future performance.

An unhappy marriage still exists between the likes of the *Isabella v Aquafaith* decision, where the court ruled that owners did not have to accept charterer's repudiation of a 59-month contract where 94 days remained. It was, Cooke J said, for charterers to look to find a fixture(s) for the vessel, not for owners to accept the repudiation and mitigate. In this case, however, the court has said that at some point, you will have to look at when the contract has become frustrated and the innocent party is obliged to accept repudiation.

The recent UK Supreme Court decision in *Cavendish Square Holdings Ltd and ParkingEye Ltd v Beavis* [2015] UKSC 67, [2015] All ER (D) 47 (Nov) dealt with liquidated damages and set the true test as to whether a liquidated damages penalty clause is a detriment imposed on the contract-breaker and is disproportionate. In light of the *MSC v Cottonex* judgment, the trend is that this isn't necessarily the case—as long as it is not audacious and ridiculous, it is acceptable to have a liquidated damages penalty clause in a contract which is negotiated on a level playing field with (quite often) the assistance of professional advisors.

Interviewed by Duncan Wood.

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