

# **General Average Briefing Notes**

by

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## **INTRODUCTION**

During the discussions concerning the revision of the York Antwerp Rules, which resulted in the York Antwerp Rules 1994 being agreed at the CMI Conference in Sydney in October 1994, it became apparent to a number of the average adjusters who were advising their national Maritime Law Associations that there was a great deal of misunderstanding about the object of the law of General Average. There were also suggestions that it should be "abolished". Whether and how General Average could be "abolished" were not specified, nor were the consequences of any such "abolition".

The Association of Average Adjusters, under the Chairmanship of Christopher Barstow, therefore appointed a Committee, consisting of the authors of these Notes, to report on the object of General Average, to examine some of the criticisms of it which are made and to examine the idea of "abolition" and the consequences of "abolition", with particular reference to hull and cargo insurers. These Notes are the result.

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1. What is the object of General Average?

It is a basic principle of law that any party to a contract should attempt to mitigate a loss. This principle is embodied in section 78(4), of the British Marine Insurance Act of 1906 (MIA), where it states.

*"It is the duty of the assured and his agents, in all cases, to take such measures as may be reasonable for the purpose of averting or minimising a loss."*

When measures are taken at sea which avert or minimise a loss to more than one interest, usually ship and cargo, then the general average system provides an equitable basis for allocating the cost of these measures between these interests. The principle of such an allocation is universally accepted and the York Antwerp Rules provide a universally adopted basis for calculating the allocation.

The costs of measures to avert or minimise a loss to one interest, the ship or particular items of cargo are usually recoverable from insurers as either sue and labour charges, salvage, salvage charges or particular charges (see section 64(2), 65(1) and (2) and 78 of the MIA).

The object of general average is therefore to encourage parties to avoid or minimise "the losses incident to marine adventure" (section 1 of the MIA).

2. How does it do this?

General average is a form of mutual insurance. The mutuality in the general average system is between the parties to the marine adventure, the owners of the ship and the owners of the cargo, and, behind them, their insurers. The risk of paying substantial expenses to avert or minimise a loss is thus spread more widely between these parties and their insurers.

The mechanics for calculating this spreading of the costs of averting the loss are laid down in the York Antwerp Rules. These are revised approximately every 20 years when shipowners, cargo interests and their insurers have the opportunity, through their national Maritime Law Associations, to contribute to this revision. This happened with the latest revision, the York Antwerp Rules 1994.

3. Do GA and the York Antwerp Rules work?

They provide an internationally accepted way of dealing with losses and expenses incurred by one or other party to the marine adventure to avoid or minimise total or substantial losses.

By using an average adjuster, who tries to be impartial between the parties to the adventure, only one professional adviser is involved to sort out the allocation of the losses and expenses between the parties. Thanks to Rule D of the York Antwerp Rules, the average adjuster is not concerned with fault, with why the circumstances arose that placed the property, ship and cargo, in peril. Because the average adjuster is, or should try to be, impartial it should not be necessary for the separate parties to seek legal advice. This does work in practise. Although separate parties may appoint lawyers to fight for their interests, the fight in the great majority of cases concerns rights and liabilities under the contract of carriage, questions of fault, not the correctness of the Adjustment.

In theory, in accordance with Rule E of the York Antwerp Rules,

*"The onus of proof is upon the party claiming in general average to show that the loss or expense claimed is properly allowable as general average".*

In practise average adjusters consider it part of their duty to contact parties to the adventure and, if they suspect they have incurred losses or expenses which are allowable in GA, ask them to submit the necessary documentation to allow the adjuster to make the correct allowances.

Alternative Dispute Resolution (ADR) is currently fashionable in the United States and increasingly in the United Kingdom. The General Average system as operated by reputable average adjusters is a form of ADR which has been operating satisfactorily for long before ADR was thought of, but has not yet been recognised as such.

The system does work. If it did not exist some other method of allocating the losses and expenses now allowed in GA would have to be invented.

#### 4. Has Insurance made the system unnecessary?

As pointed out in 2 above, General Average is a form of mutual insurance which spreads the cost of averting or minimising losses over owners of ship and cargo and, therefore, their insurers. The vast majority of hull and cargo policies cover General Average contributions and so General Average is a part of marine insurance. It is defined in section 66(2) of the MIA.

The UNCTAD report on General Average suggests that there could be an "insurance solution" to the perceived problems of General Average, meaning presumably that the losses and expenses which are now allowed in General Average and then paid by property insurers, could be paid by them directly without the necessity of a General Average Adjustment being prepared. This involves the partial or total "abolition" of General Average which is discussed below under paragraphs 6 and 8.

5. What are the most frequently criticised features of GA?

Various criticisms of General Average have been made since the York Antwerp Rules were first introduced. The following are the principal ones:-

- A. It is too complicated
- B. It takes too long
- C. It is too expensive
- D. The system is open to abuse by "bad" shipowners.

A. Too complicated:

The basic premise of General Average as expressed in Justinian's Code, *"What is given for all, shall be contributed to by all"*, is a concept of great simplicity and equity. The perception that it is complicated perhaps arises from the York Antwerp Rules and probably in particular the distinction between the lettered Rules, laying down basic principles, the numbered Rules, providing solutions to particular problems and the Rule of Interpretation which gives precedence to the numbered Rules. It is also probably the case that few people working in marine insurance markets, except professional average adjusters, come across general averages on a regular daily basis and virtually no one but average adjusters prepares General Average adjustments. This is because General Averages are less common than other forms of marine insurance claims, and there is perhaps no need for people other than average adjusters to have a detailed working knowledge of the York Antwerp Rules.

Other types of marine insurance claims are also complicated. A Hull policy covers the shipowner against Actual and Constructive Total Loss of his vessel, against Particular Average losses, Sue and Labour Charges, salvage and salvage charges, to say nothing of deductions new for old and the cost of sighting the ship's bottom after stranding. To those who are not involved in the insurance of ships such terms are largely incomprehensible.

B. Too Long

There are four stages in dealing with a General Average.

- i) collection of security :
- ii) collection of documents and calculation of the General Average allowances :
- iii) calculation of the contributory values and the apportionment of the total allowances :
- iv) settlement.

- i) The collection of security can be frustrating and therefore costly, especially when cargo is destined to out-of-the-way ports and/or insured with insurance companies whose staff does not know of, or understand, General Average. However, as the security has to be collected before the cargo is discharged at destination, the overall period for dealing with the General Average is not extended.
- ii) The calculation of the General Average allowances does not take any longer than the calculation of allowances for Particular Average, Sue and labour claims etc. i.e. other sorts of marine insurance claims. The delaying factors are usually the time required by claimant(s) in General Average submitting relevant documentation; in particular when a salvage goes to arbitration the completion of the adjustment may be delayed for several years. In the London and some other insurance markets, it is customary for average adjusters to handle both General and Particular Average claims and for these to be incorporated in the same Adjustment, which of course saves time, trouble and expense to the Hull Underwriters.

The 1994 amendment to Rule E should in future enable an average adjuster to deal with delayed claims by estimating them.

- iii) The actual calculation of contributory values does not take long. What can take long is obtaining the information from which to make the calculations. If for instance, a cargo Underwriter is still negotiating a settlement for a Particular Average loss with his Assured, he will be reluctant to release information which might prejudice his position. There is also the Insurance Company or Consignee who simply fails to respond to requests for information. Both these problems will now be alleviated by the average adjuster's ability to estimate contributory values in accordance with the 1994 version of Rule E.
- iv) The settlement of General Average contributions is in many cases a comparatively rapid and easy process, especially when a limited number, less than 20 say, interests are involved and the insurers of the cargo are substantial and knowledgeable companies. The time-consuming cases are those where the cargo interests are numerous and/or lethargic in replying to requests for payment. Further delays result from cargo interests' usually perfectly justifiable wish to investigate the cause of the loss which gave rise to the General Average to determine whether they have a defence to payment under the Contract of Carriage.

All four stages can now be speeded up with the use of modern communications and computers which average adjusters are increasingly using.

### C. Too Expensive

A major casualty involving ship, charterers (time and voyage), many separate cargo owners and containers with, behind them, their insurers, has the potential for disputes between all or any of these parties to the adventure as to who should ultimately pay how much to whom. Each party could involve one or more lawyers depending on whether jurisdiction is also in dispute: skilled lawyers are expensive, often costing at least £200.00 per hour. In a major casualty involving the interests referred to and their insurers, about 10 firms of lawyers would be involved: the total of their final bill, would run into hundreds of thousands of pounds even if, as is usual, no litigation actually takes place.

The advantage of the general average system is that only one professional, the Average Adjuster, is involved and it is only his account which is payable and this is spread over all the parties.

As stated above, a major casualty always gives rise to losses and expenditures to avert or minimise a greater loss, unless of course there is an actual total loss of all interests involved. These losses and expenses have to be allocated correctly by someone: at worst this is done by a judge after long and very expensive litigation: sometimes it can be dealt with by agreement between brokers and insurers: in France the Insurers' central marine claims settling organisation, CESAM, handles such questions. All these people have to be paid in some way or other. So do average adjusters. They are usually, hour for hour, cheaper than lawyers and there is usually only one average adjuster involved.

### D. The System is open to abuse.

It is well-known that there are too many old, badly maintained and badly managed ships afloat and trading, often manned by inadequate crews. There is one main reason for this! They are cheaper to hire than modern, well maintained, well managed ships, manned by competent crews. So charterers hire them and shippers of cargo load valuable goods in them: and, in soft markets, hull insurers insure them, P&I Clubs have them as members and cargo insurers underwrite the cargo carried in them. So they continue to trade and, because of their inadequacies, they continue to break down at sea and have accidents; many of these breakdowns and accidents give rise to general average situations.

Fortunately Hull and Machinery Underwriters and P&I Clubs have addressed the problem by insisting on pre-risk surveys or a refusal to cover vessels which are not in an adequate condition or only after they have been brought up to standard. Classification Societies, or at least the major ones, are now enforcing their own rules with greater vigour and Port State Control is also having an impact. All these combined with higher premiums and higher deductibles, have provided impressive results in the last two or

three years. The Salvage Association's statistics indicate a substantial decline in the number of damage surveys they have carried out in this time.

This has inevitably resulted in a decline in the number of General Averages.

Nevertheless, there will always be a number of shipowners or managers who are idle, incompetent and/or insolvent and fail to maintain their ships properly, so they break down and need to put into a port of refuge.

Because of Rules X and XI of the York Antwerp Rules, they claim in General Average the wages and maintenance of the crew, the fuel and stores consumed and the port charges incurred during the repairs which are necessary for the safe prosecution of the voyage.

The cargo owner and his insurer can and do refuse to pay their General Average contributions in such cases on the basis that the shipowner is in breach of the Contract of Carriage, in that he has failed to exercise due diligence to provide a seaworthy ship. The shipowner then, of course, claims the cargo contributions from his P&I Club.

The Hull Underwriter has greater difficulty in protecting himself from such claims except by insisting on very high deductibles or by excluding claims for General Average which arise out of wear and tear, i.e. to impose an "express stipulation" as referred to in section 66(6) of the MIA. As this Section of the Act is currently interpreted, a general average contribution is payable if the general average act is undertaken to avoid a future loss, irrespective of whether the accident giving rise to that act was or was not a peril insured against. For instance, a ship is badly maintained and the main engine finally breaks down; she is towed into a port of refuge for the common safety; the ship and cargo are saved from a total loss by perils of the sea, heavy weather, stranding etc. which would undoubtedly have threatened within a period of time. The ship's contribution is therefore payable under the policy. If Hull and Machinery Underwriters were to specify in their policies that they would only pay general average contributions where the accident giving rise to the general average act is caused by a peril insured against, they would have a better defence against payment for this sort of general average.

If this suggestion were to be adopted by Hull Insurers, there would be some consequential problems. Insurance brokers who in the London market normally provide salvage security, exercising a lien on the vessel's policy as security, might be reluctant to do so if there was any possibility that the claim for salvage and therefore general average could be resisted. The value of general average absorption clauses, which are discussed below, would be eroded, and the owner of the worn and torn ship would be more inclined to declare general average and claim at least cargo's proportion of the General Average expenditure directly or, if cargo interests have a good defence, from his P&I Club.



Hull & Machinery Underwriters also have a wider defence under section 39(5) of the Act, although the burden of proving privity of the assured is a difficult one.

## 6. Can General Average be abolished?

The law of General Average is a part of the law of the vast majority of the countries in the world. The law differs from country to country, which is why the York Antwerp Rules were invented.

So, to abolish it would involve an international convention universally ratified. If it were not universally ratified, the "abolition" could always be contractually overridden by a clause in a Contract of Carriage providing for General Average to be adjusted according to the York Antwerp Rules and the law of a country which had not ratified the abolition convention : indeed, it might be of advantage to a small country which survives on being a tax-haven to frame its laws suitably. There are no or very few universally ratified conventions.

The alternative way to abolish General Average would be by agreement, by persuading the maritime community to include clauses in Contracts of Affreightment which mutually waive the right to claim General Average contributions. So, the shipowner would waive his right to claim a contribution from cargo towards his sacrifice and expenses and the cargo would also waive its rights. This could be successful if the General Average system is so unpopular that the vast majority of those interested in maritime trade are prepared to insert such a clause in all their Contracts of Carriage.

## 7. Has General Average expanded?

There is a conception that the scope of general average has been increasing inexorably and that this perceived expansion should be stopped or even reversed. In particular, there is an idea that the Rules have moved from the concept of 'peril' to that of 'safe prosecution of the voyage'. Rules VII and VIII of the 1864 York Rules however allowed port of refuge expenses and wages and maintenance of crew respectively in general average; these are of course expenses for the safe prosecution of the voyage. From the Average Adjuster's perspective the last overall expansion of general average was in the York/Antwerp Rules 1950, and this was minor in comparison with the changes in 1924. The revision in 1974 was aimed principally at simplifying the process of adjustment and at clarification of the Rules, whilst the amendment in 1990 restricted the allowances of anti-pollution compensation to salvors in general average.

The most recent revision in 1994 was again aimed mainly at clarification and acceleration of the process of adjustment, and indeed there were two new and highly significant restrictions imposed. Firstly, the new Rule Paramount will prevent allowances in certain cases where the working of the previous Rules may have allowed a more generous interpretation than was originally intended. Secondly, the change to Rule C disbars allowances in respect of pollution liability, which has arisen as a direct consequence of a general average act. This is therefore an important restriction on the basic principal of general average, as set out in Rule A.

## 8. Can General Average claims be reduced?

The inclusion of so-called "General Average absorption clauses" in hull and machinery policies is the easiest way of eliminating the preparation of a very large number of General Average Adjustments. These clauses provide that the hull underwriters will pay General Average in full, without resort to cargo or other interests, up to a certain figure or a percentage of the insured value. The claim is still there and calculated on the basis of the York Antwerp Rules, but there is no apportionment between ship and cargo etc. This means that it is not necessary to collect General Average security, nor to calculate contributory values, nor to effect settlement with cargo for their proportion, i.e. stages i), iii) and iv) referred to in 4(B) above are eliminated. This of course results in a considerable saving in time and expense both in adjustment and delivery of the goods. These clauses are very popular with average adjusters who dislike adjusting small General Averages for two reasons : they lose money because they cannot charge adequately for the work they do : they consider the system and their expertise are being abused.

The wider use of these clauses is therefore highly desirable : it is unfortunate that the new Institute Time Clauses do not include an absorption clause.

There are however difficulties with these clauses. First of all, understandably, Hull Underwriters are reluctant to offer them to small shipowners running elderly, low value ships. It is these shipowners who need them most; first because their ships are the ones most likely to break down and give rise to small General Averages involving only a few day's detention at a port of refuge: second, as their vessels are old and small, their values will often be less than the value of the cargo they are carrying: so the shipowner is more inclined to declare General Average.

If the claim under the absorption clause is subject to the deductible and the deductible is high, the figure in the absorption clause has to be very large for it to have any value. So claims under the clause should be free of deductible. A proposal that the cargo's proportion should be free of deductible is an ingenious solution to this problem, but to a degree defeats the object of the absorption clause, because it still necessitates calculating contributory values and making an apportionment: cargo values would have to be based on estimates unless cargo receivers are to be contacted and asked to supply invoices: if that is to be done, the average adjuster might as well ask for General Average security also!

There are a vast number of absorption clauses in use and they differ widely. Any effective clause should deal with the following points:-

- a) Does the absorption figure include ship sacrifice as well as expenditure? For instance, if the figure is US\$ 100,000 and there is ship sacrifice of \$ 60,000 and expenditure of \$ 60,000, does the policy pay the sacrifice in full in accordance with section 66(4) of the Marine Insurance Act and the expenditure in full in accordance with the absorption clause i.e. \$120,000 in all? Or is the maximum claim for General Average \$100,000?
- b) Does the absorption clause cover cargo sacrifice?
- c) Is the figure payable under the clause adequate? This is a difficult figure to calculate because the larger the number of Bills of Lading, the larger the figure must be.

Another way of reducing the time and cost involved in General Average Adjustments is for the shipowner to take out a special policy to cover cargo's proportion of General Average up to a specified but substantial figure, substantial in relation to the value of his trade, higher for liner vessels, lower for bulk vessels. There are some first-class owners of container vessels who do take out such a cover, but it is not apparently widely available. If it were regularly offered to shipowners on renewal of their hull cover at a reasonable premium, it would go a long way to eliminate the preparation of a large number of the smaller General Average Adjustments which are disliked by hull and cargo underwriters, as well as their assureds and average adjusters.

A more radical and probably impossible solution to this question, would be for shipowners and their P&I Clubs to accept strict liability for all General Average contributions, falling on the cargo carried in their members' vessels. This would not eliminate the preparation of General Average Adjustments, but it would reduce the work, as there would be only two contributing parties, ship and cargo : hull underwriters would pay the ship's proportion and the P&I Club the cargo's : a system could no doubt be agreed for estimating cargo values.

If absorption clauses become increasingly common and the figures covered sufficiently large, over time General Average will become a system of spreading losses and expenses between ship and cargo only used, as it should be, in serious cases involving substantial sums of money.

#### 9. What if General Average were "abolished"?

If General Average were abolished, i.e. either by change of law or by agreement, and those losses and expenses which are at present divided between ship and cargo were not so divided, some other method of dealing with those losses or expenses would have to be devised. The end of a well-known system would inevitably lead to uncertainty, and to litigation if any new system were not seen to be fair and workable.

The most frequently suggested method would be for the losses and expenses to "lie where they fall". Therefore, shipowners would recover for their sacrifice from their insurers, and cargo owners from theirs.

This, of course, pre-supposes that a shipowner or his Master will always make the "right" sacrifice and raises the question as to what the "right" sacrifice is. To take an example : a fully loaded ship strands: to refloat, the Master can either jettison a quantity of cargo or damage the vessel's engines in forcing her off the ground : salvage assistance is not available. Now, it has been suggested that he will always "do the right thing", whichever is most efficient and involves least loss or expense : so if the "right thing" is to strain his engines, he will do it. But, the choice is not so simple. The cost of jettisoning cargo is more easily quantifiable and the ship may have been so little damaged by the stranding that she can carry the balance of cargo to destination. The amount of damage to be done to the engines is almost wholly unquantifiable and, even after refloating, the damage so done may involve resort to a port of refuge, probably under tow, for repairs. Further the Master has a duty to his employers, and they have a duty to both their shareholders and their Insurers, under the MIA (78(4)), to avert or minimise a loss. If the Master damages his engines he will lose his employers' earnings while repairing them and the Hull underwriters will have to pay for the repairs. Indeed the Underwriters could argue that they are not liable for the claim as the Master could have jettisoned the goods. The Master will probably be sacked anyway for running the vessel aground in the first place, so he might as well

jettison the cargo. In the absence of GA, the loss of cargo lies where it falls, with the cargo owner and his insurer.

When a vessel breaks down at sea, it and its cargo can be rescued by a tug employed either on a contractual basis at a daily rate or on a no-cure-no-pay salvage basis. The shipowner is the one who contracts on the daily basis and if losses lie where they fall, he and his insurers will have to pay the full amount of the hire: his insurers might not be too happy about this if the cargo is worth four or five times the value of the ship. If the ship and cargo are rescued on a salvage basis, then the salvor will obtain an award against the ship and cargo separately. Under these circumstances, it seems probable, in the absence of the General Average system, that the number of no-cure-no-pay salvages will increase : as salvage awards tend to be considerably more expensive than towage on a daily hire basis this will be to the disadvantage of both hull and cargo underwriters. The solution to that would be also to "abolish" the law of salvage.

In the absence of the General Average system, there will be problems of how to allocate expenses, especially port of refuge expenses. If the vessel is towed into a port of refuge, under a no-cure-no-pay salvage, the shipowner, basing himself on the arguments successfully put forward in the "TROILUS" and "GLAUCUS" cases, may try to argue that the vessel is not in safety until repaired and insist that all the port of refuge expenses are paid for by the salvors. The expenses, plus the salvors' mark-up, will be considered by the salvage arbitrator in his separate awards against ship and cargo, which will lie where they fall.

Even where the vessel reaches a port of refuge under her own power, there will probably be doubts about who is liable for the various expenses incurred there. Presumably the inward and outward port charges might be claimed from Hull Insurers as part of the reasonable cost of the repairs, subject to the terms and conditions of the policy. But what of the costs of discharging, storing and reloading cargo, if discharge is necessary to effect repairs? Again the shipowner, basing his argument on the "MEDINA PRINCESS", may try to claim these costs also from his Hull Underwriters as part of the reasonable cost of repairs. But what if the cargo is damaged by water used to extinguish a fire and has to be discharged, stored, sorted and reconditioned before reloading? Under the General Average system, as these are General Average expenses, the shipowner traditionally arranges and pays for these operations. But if losses lie where they fall, he may be reluctant to do so and may insist on receiving cash in advance from the relevant cargo interests before he does so or, alternatively, try to collect some kind of security to guarantee payment of these "special charges".

In many, probably nowadays the majority, of cases where a ship is likely to be detained at a port of refuge for a substantial time to effect repairs and discharge of cargo is necessary for these repairs, the shipowner arranges and pays for the cargo or part of it to be forwarded to destination by other means, confident that a substantial proportion at least, if not all, the cost will be allowable in General Average. If the loss lies where it falls, he will be reluctant to do so and the cargo interests, if they require their cargo urgently, will have to arrange and pay for this themselves ; many cargo policies do not cover such forwarding costs.

The shipowner cannot, at least under English Hull Policies, recover the wages and maintenance of his crew during repairs, as part of the reasonable cost of those repairs. He may therefore when his ship is at a port of refuge, choose to repatriate them and hire people at the port of refuge to act as watchmen, to shift the vessel to and from a repair berth etc. The cost of hiring these "riggers" is normally allowable as part of the reasonable cost of repairs.

If it is correct that the majority of the expenses at a port of refuge which are now allowed to General Average will, in the absence of General Average, fall on the shipowner and his Hull insurer, this will have further consequences. A shipowner may consider a voyage frustrated if the cost of completing it exceeds the sound market value of the ship. For example, if a ship has a value of US\$ 2,000,000 and the cost of repairing damage is US\$ 1,600,000 and the cost of the port of refuge expenses, previously General Average, now lying where they fall, on the shipowner, amount to US\$ 450,000, the total cost of completing the voyage exceeds the sound value and the voyage is frustrated: the cargo interests have to pay themselves to discharge and forward cargo to destination; under the General Average system they would only pay their contributions to the port of refuge and extra forwarding costs. Furthermore, using the same figures, the shipowner, assuming the vessel was insured for its sound value, could prove a claim for Constructive Total Loss from his Hull and Machinery Insurers, whereas, under the General Average system, he could only use ship's proportion of the expenses to prove the Constructive Total Loss and could not do so.

The "abolition" of General Average and allowing losses to lie where they fall would create many problems and it might in practise be found convenient to draw up a set of Rules to specify which party to the adventure would have to pay what expenses and under what circumstances. These might be called the New York Antwerp Rules and a profession, perhaps called Average Adjusters, might evolve to administer these new Rules. On the other hand, the disputes on the interpretation of these new Rules might be handled by lawyers, one for the ship, one for each consignment of cargo, one for the charterers and one for each of their Insurers, plus another one for the P&I Club. The cost could be quite large!

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