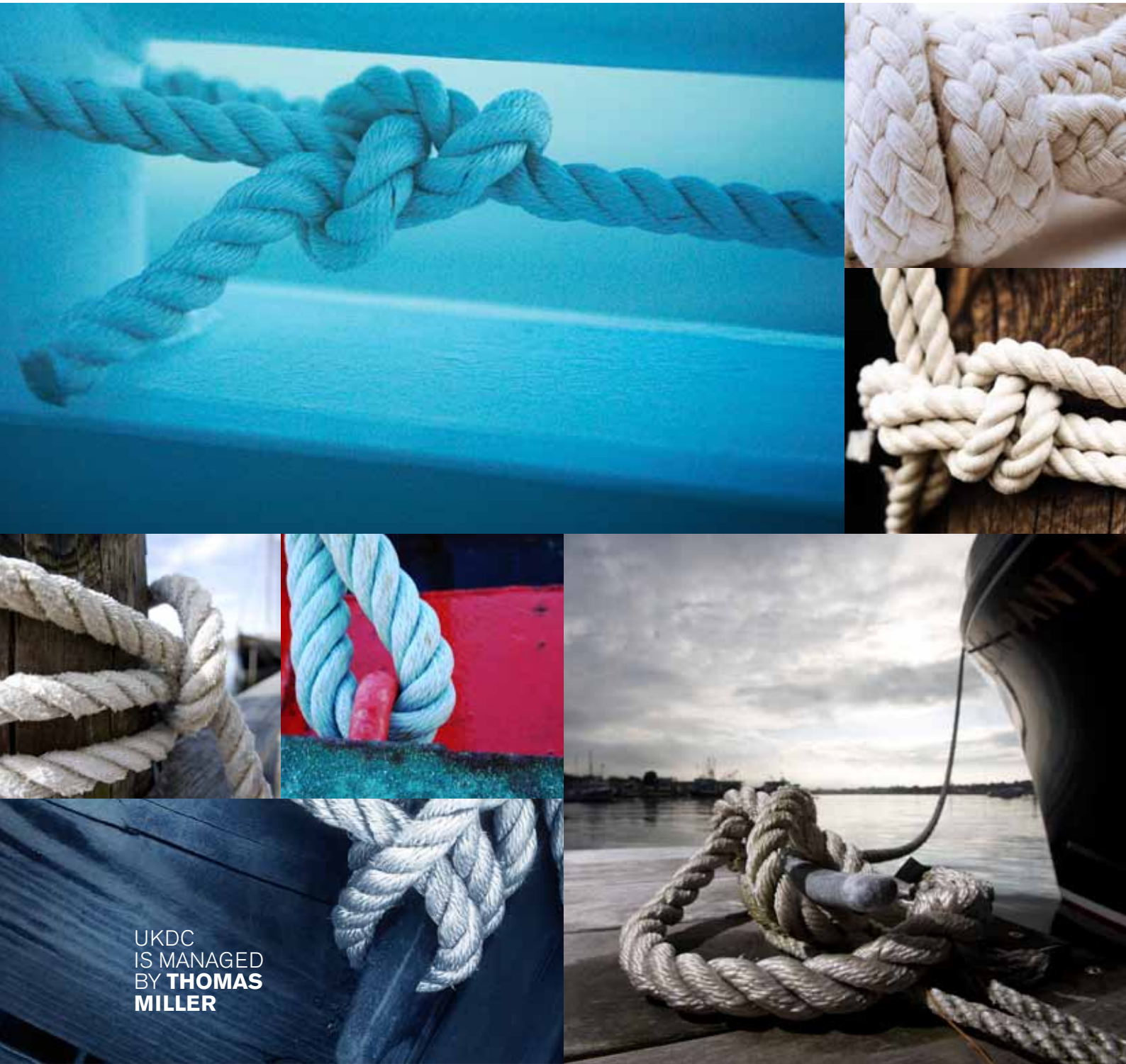
UK DEFENCE CLUB

Minimising Counterparty Risk



UKDC
IS MANAGED
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Contents

“These tough operating conditions and high-profile defaults have shown that there are no certainties anymore.”

Introduction

Recent years have seen tough operating conditions for those involved in the transport of goods round the world. With the volume of trade declining rapidly and a surplus of tonnage after the good years, earnings have plummeted and a number of companies have found themselves in financial difficulties, with high profile companies seeking financial protection from their creditors. This may involve a period of re-organisation from which the company may emerge to trade again, or the company may cease operating altogether. In either case the creditors may find themselves having to receive significantly less than the amount that they are owed by the defaulting company, or maybe nothing at all.

These tough operating conditions and high-profile defaults have shown that there are no certainties any more. Added to this, the complications caused by the international nature of shipping, with different jurisdictions and legal systems, and sophisticated corporate structures, may make it appear that there is little that can be done if another party defaults.

Whilst it is true that there are no guarantees in shipping, there are steps that can be taken before fixing, during the course of a charter and after it terminates to ensure that the best possible protection is obtained. Risk cannot be eliminated altogether, but this publication aims to explore some of the ways that the risk of a contractual counterparty defaulting, and its consequences, can be reduced.

Pre-Fixing Issues

Before a contract is even signed there are simple steps that can be taken. The Association has often been asked to assist a Member with what at first sight appears to be a good claim, only to have to advise reluctantly that the claim is worthless because the contract is not binding, because the Member has not in fact contracted with the party with whom it believed that it was contracting, or the company simply has no assets, or no assets against which any arbitral award or judgment can be enforced.

Pre-Fixture Enquiries

The Association's Rules have for a number of years included a Practice Recommendation relating to pre-fixture enquiries. This is one factor that the Association will take into account when considering whether to support a Member in respect of a dispute. However, a Member can help itself by checking:

- whether the party with whom it is considering contracting is the party that it believes it is contracting with;
- whether the other party has a reputation for being slow to pay or not paying at all, or maybe has a number of outstanding judgments or arbitral awards against it that it has failed to honour; or
- simply what its financial standing is.

These enquiries can be made through brokers, other operators with whom the other party has contracted or one of the corporate investigation companies. This is all to have the best possible information as to financial risk that the other party may pose.

The key is knowing ones client and ensuring that the contracting party is who he says it is and that the party signing the contract has the necessary authority.

Signing Charterparties and Agency

It is a feature of English law that a contract can be agreed in an informal way. There is no need for it to be in writing and it can be agreed orally. It is common practice these days for the parties to do away with a signed, written charterparty and for this to be evidenced by a fixture recap with charterparty administration clause, perhaps with reference to a previous charterparty and additional clauses. Whether the charterparty is to be drawn up and signed or to be evidenced in a fixture recap, or exchanges between the parties, it is important to be sure that the person who signs the charterparty, or with whom one has been negotiating, has authority to enter a binding contract. Otherwise a Member may find that there is no binding contract with the other party. There may be a right to claim against the person negotiating the fixture, such as a broker, for breach of the warranty of authority, but that may not always be an adequate remedy.

The question of authority of one person to bind another and agency is a broad and complex subject. Authority can be actual or apparent.

Actual Authority

Actual authority is where the person with whom a party is negotiating a contract has the permission or consent of its principal to do so, which may be express or implied. Implied authority may exist if the person with whom a party is negotiating is an employee of the other party, for example the chartering manager, where that person is said to have "usual" authority to conclude charterparties that would be usual for a particular business or trade. Implied authority is more difficult to establish, and will depend upon the facts, where the person with whom a party is negotiating works for a company within the same group as the company who is to be the principal to the contract.

It is common to use a shipbroker when fixing a ship on charter. The shipbroker cannot necessarily be assumed to have actual authority, but he can act in one of two ways.

"It should not be assumed that, simply by being appointed as shipbroker by one of the parties, the shipbroker has actual, or even apparent authority. "

Pre-Fixing Issues (continued)

The first is simply to act as a "post box" passing on messages between the parties, where the shipbroker will not have authority to bind a party without reference back to it. The second is where the shipbroker acts as an agent for one of the parties and has authority to conclude a contract. It should not be assumed that, simply by being appointed as shipbroker by one of the parties, the shipbroker has actual, or even apparent (see below), authority. As is often the case, much will depend upon the facts of the particular case. However, a shipbroker is likely to have apparent authority to pass on the agreement of his principal, even if he does not have apparent authority himself to conclude a contract. This can be a fine distinction that is considered further below.

Apparent or Ostensible Authority

If the person acting on behalf of a principal does not have actual authority (whether express or implied) he may have what is known as apparent or ostensible authority. This may exist where the principal represents to another party that the agent has authority. This may be by what the principal says or does. It usually involves a holding out to the outside world that the agent has general authority to conclude business that would normally be expected. However, in the Ocean Frost [1986] 2 Lloyds Rep. 109 the House of Lords held that a vice-president and chartering manager of a company, who did not have actual authority to do so, did not have apparent authority to conclude a 3-year charter, as that type of onerous business was not something that he would have authority on his own to do.

A more complex situation arises where the agent does not have actual or apparent authority in his own right to contract on behalf of his principal, but may have apparent authority to inform the other party that his principal has agreed to conclude a particular transaction (as is often the case with shipbrokers – please see above). In First Energy v Hungarian Bank [1993] 2 Lloyds Rep. 194 the senior manager of a regional branch of a merchant bank based in London was negotiating with another party. The senior manager had confirmed that he had no actual or apparent authority himself to conclude a particular transaction. Later he wrote to the claimant informing it that he obtained the agreement of his head office to conclude the transaction. The Court of Appeal held that although he did not have actual or apparent authority to conclude the transaction he did have apparent authority to communicate that authority to do so had been obtained from head office. This may be a fine distinction but, as was commented, this makes sense otherwise every party would have to check with the other party's senior management (or even the board) whether actual authority had been given.

Care also needs to be taken that the correct party is identified as the party to the contract. In the "Elikon"

[2003] 2 Lloyds Rep. 430 the Court of Appeal held that, where the owner was named as company A c/o company B, and company B signed the box where the owner was to sign but without qualifying its signature "as agents" or otherwise, it was company B that was the owner under the charterparty. There are other principles that can be applied where the identity of one of the parties is unclear, or the wrong party has been named. This involves an analysis of the factual background to the conclusion of the charterparty. However, it is better to identify this clearly in the contract.

In fact there is a series of cases in English law where the court has looked at the negotiations leading up to the conclusion of the contract, the terms of the contract (not just who is named as a party but what other clauses may say about the rights and obligations of other persons) and the form of signature to find that the agent is in fact the principal to the contract, that the agent is liable along with another person as principal under a contract or that the other person is the sole principal.

If an agent acts without authority there are two possible consequences. The principal may ratify the acts of the agent by effectively agreeing retrospectively to give the agent the necessary authority; or the principal may act in such a way as to be estopped from alleging that the agent did not have authority. In either case, the principal, not the agent, is bound by the contract. Otherwise, if the agent did not have authority it can be sued for breach of its warranty to the other party that it had authority to act on behalf of the principal.

Guarantees

Unlike other contracts, which can be agreed orally or, if in writing, need not be signed, an old English Act of Parliament, the Statute of Frauds 1677, provides in section 4 that actions to enforce a contract of guarantee can only be brought if the agreement, or a memorandum or note recording it, is in writing and signed by the guarantor or its authorised agent.

The types of problems that can arise were considered by the English Court of Appeal in the recent case of Golden Ocean v Salgaocar [2012] EWCA Civ 265. This involved the negotiation of a 10-year time charter of a newbuilding to company A, or company B to be fully guaranteed by company A. Mr S provided oral instructions on behalf of A and B to the brokers. After negotiations through brokers resulted in a recap but no written, signed charterparty, both companies A and B denied that a charter had been concluded, that company A had provided a guarantee or that Mr S had authority to bind either company.

Companies A and B argued that the final e-mail did not refer to the guarantee (it had been mentioned in exchanges before then, but the final e-mail did not expressly refer to those exchanges) and also referred to a further document being prepared to record the agreement.

The Court of Appeal held that the requirement that the contract of guarantee be recorded in writing could be satisfied if it were contained in more than one document, such as a sequence of e-mails, which is commonplace in ship chartering. It did not matter that the parties intended a written charterparty to be drawn up and signed. The guarantee was integral to the charterparty and it would not make sense to find that a binding charterparty had been concluded, but not a binding contract of guarantee.

As for the requirement for signature, this could be met electronically in an e-mail, even if it was a first name, initials or nickname, providing there was an intention to authenticate the document.

The judgment does recommend "the obviously sensible practice of incorporating a guarantee either in a readily identifiable self-standing document or otherwise providing for it as part of the terms of a formally executed document". So this remains the best practice to be sure that any guarantee can eventually be enforced.

"…it is important to ensure that any guarantor is entitled to provide a guarantee in accordance with any local laws and regulations"

In the earlier decision of the House of Lords in the Maria D [1992] 1 AC 21 it was held to be sufficient to bind brokers as guarantors, where they signed a charter containing a clause by which they guaranteed payment of demurrage and freight by the charterer.

Finally, it is important to ensure that any guarantor is entitled to provide the guarantee in accordance with any local laws or regulations, otherwise the guarantee may not be enforceable in due course. A common example is that of a Chinese bank or other company providing a guarantee, where the guarantee must be approved and registered with a Chinese state body, the State Administration of Foreign Exchange. Similar approval and registration requirements may exist in other jurisdictions.

Post-Fixing Issues

Security

When a party to a charterparty has a valid claim against the other party, especially one who may be experiencing financial difficulties, the priority may be to obtain security for that claim until an arbitral award or judgment can be obtained. Otherwise, there is a risk that there may not be assets against which enforcement can be made in due course.

One option that it is well-known throughout the shipping world is the arrest of a ship belonging to the other party as security for a claim. It is important that the ship is owned by the same company against whom the claim is made at the time the arrest is effected. Usually this is the same ship as the one in relation to which a charterparty is concluded or on which cargo is carried. However, there may be another ship, known as a "sister ship", owned by the same company which can be arrested. This is not always possible given the common practice of "one ship companies", where each ship in a particular fleet is owned by a separate company. In certain jurisdictions, such as South Africa, this can be overcome by an "associated ship" arrest, where the court is prepared to look at the common beneficial ownership of companies to allow a ship owned by one company to be arrested in relation to a claim against another.

The right to arrest does not only arise in relation to ships, but can also be aimed at any property, including bunkers, if owned by a time charterer, or cargo. These can be more problematic if still on-board the ship at the time of the arrest because other parties can sometimes intervene to try to set aside the arrest if their interests are adversely affected by the arrest.

Whilst some conformity has been introduced internationally by the 1952 and 1999 Arrest Conventions, there are still differences in how some jurisdictions apply those Conventions. One example that could be significant where a Member is considering whether to arrest, is if the jurisdiction where they are seeking to arrest requires the arresting party to provide counter-security. This can be substantial in amount and can take the form of either a bank guarantee or cash deposit.

Finally, another potential hazard faced by an arresting party is if the arrest is set aside and held to have been wrongful. This can be for a number of reasons, including wrong information about ownership of the property arrested, or even procedural irregularities arising from failure to draw the court's attention to all relevant information, even if unfavourable, at the time of applying for the arrest.

World-Wide Freezing Orders

Different from security, although sometimes similar in effect or sometimes resulting in the provision of actual security, is a freezing injunction or its international cousin, the world-wide freezing order.

The jurisdiction is two-fold. The first is to prevent a party from removing from the jurisdiction of the English courts assets that are located there. This is known as a freezing order or injunction (having been previously known as a Mareva injunction). The second is wider in scope, is known as a world-wide freezing order ("WWFO") and aims to restrain a party from dealing with any assets, wherever they are located.

The consequence of granting a WWFO is so serious that the court, when exercising its discretion to grant one, will always be careful to consider whether it is appropriate to do so. The English courts have developed this form of order more than in other jurisdictions, so it is likely that parties will make applications to the English courts more often than they would do to other courts. A WWFO can be granted before judgment has been obtained, or after judgment to assist with enforcement.

A WWFO can be granted in support of court proceedings in England and Wales. It can also be made in support of proceedings in countries that are parties to the Brussels or Lugano conventions, with the procedural advantage that permission for leave

to serve proceedings abroad is not required. Finally, a WWFO can also be made in support of proceedings in any other jurisdiction, but here an application for leave to serve proceedings out of the jurisdiction is required. However, the English court will be careful before making such an order if the foreign court does not have power to grant relief similar to a WWFO under its own procedural rules; or if it is more appropriate for the application to be made to the court where the proceedings on the merits are being heard, or where the assets are located. It might also decline to make an order where the foreign court has itself considered and refused such an application. The concern is not to interfere with the management of the case by the foreign court and to avoid inconsistent or conflicting orders. Finally, the court will only make the order if it believes that it can be enforced.

"The intention is not to provide the claimant with security, but to prevent a defendant from disposing of its assets in order to make itself "judgment-proof" and so prevent the claimant in due course from enforcing its claim."

A WWFO can be granted in support of arbitration proceedings, and the court may make it a condition that proceedings be commenced, if this has not yet been done.

The claimant needs to establish a "prima facie" case that the defendant has assets within the jurisdiction, even though the extent may be unknown. For example, the existence of a bank account may be enough. There may need to be additional evidence that, even if not presently within the jurisdiction, it is the nature of the defendant's business that assets can be expected in the future. Those assets will be caught by the injunction when later brought within the jurisdiction. The claimant will usually be required to provide an undertaking to pay the costs of any bank or other third party to enable it to investigate whether it has assets that are caught by the injunction.

When considering whether to grant a WWFO over assets that are outside the jurisdiction of the English courts, there are a number of qualifications that may be made to the order as eventually granted. These include:

- ensuring that third parties abroad are not directly affected by the order (at least until enforcement or recognition by a foreign court);
- an undertaking not to commence foreign proceedings in relation to the order without permission (to avoid the order being used in an oppressive way by the claimant bringing proceedings in a number of different jurisdictions);
- limiting the scope of the order to certain foreign jurisdictions;
- providing undertakings concerning the use of information obtained about the defendant's assets without the leave of the court; and
- ensuring that the order does not interfere with the defendant's ordinary course of business.

The nature of assets that may be caught may be very wide. The usual target is the defendant's funds, but other assets can also be caught by the order. This has included ships (as opposed to an arrest that creates a security interest), time charterer's bunkers and cargo. The difficulty with this is that it is relatively easy for a defendant to show that the assets are being removed in the ordinary course of business rather than to dissipate them, or for a third party to apply to discharge the order as it adversely affects its interests.

The assets must be those of the defendant. If any third party has a beneficial interest in all or part of the assets it can apply to vary or discharge the order.

A freezing order can be obtained against a third party in limited circumstances where there is a risk that the third party will dissipate assets beneficially owned by the defendant, or where the defendant has a claim against the third party via a receiver or liquidator and there is a risk that the third party will dissipate those assets.

The application is usually made initially "ex parte", and can be made at very short notice, whereby only the party seeking the WWFO is heard. It will need to be supported by an affidavit setting out the evidence and other matters supporting the application. There is a duty to make full and frank disclosure of all relevant facts to the court, even if unfavourable, such as possible defences, since the other party or parties are not being heard at that point. If this is not done there is a risk that the order may be discharged, with the applicant paying the defendant's costs, although this is a matter for the discretion of the judge, taking into account all the circumstances surrounding the failure to make proper disclosure.

There will follow a hearing at which all the parties will be present and able to make applications to discharge or vary the order.

The applicant must establish that it has a good arguable case (the court will not be prepared at this stage to look too closely at the merits – that will be for the court or arbitral tribunal with substantive jurisdiction over the merits to do in due course). However, this is more than simply establishing an arguable case. This may cause difficulties where there are likely to be complex issues of fact requiring factual and expert evidence, or where the evidence is in the hands of the defendant. The risk is that a claimant may obtain an initial injunction "ex parte", but that this will be discharged as soon as the defendant submits its evidence in support of an application to discharge the order. The claim must exist at the time of the application. For example, it is not possible to obtain a freezing injunction over the proceeds of sale of a ship where a buyer expects that the ship might be in defective condition on delivery. Until that happens, the claimant has no cause of action.

The applicant must establish that there are assets against which a judgment could be enforced in due course, whether those assets are located within or outside the jurisdiction, and whether the dissipation is by disposing of the assets within the jurisdiction or by moving them abroad.

It must also establish that there is a risk that the other party will dissipate its assets, other than in the ordinary course of business. The defendant will not be prevented, for example, from paying debts as they fall due and undertaking transactions as part of its normal business operations, even if the consequence is that assets will be dissipated as a result. The defendant must be doing something different from what it would ordinarily do, and doing so to avoid any judgment being enforced in due course.

The intention is not to provide the claimant with security, but to prevent a defendant from disposing of its assets in order to make itself "judgment-proof" and so prevent the claimant in due course from enforcing its claim.

The order will include a monetary limit based upon the amount of the claim plus interest. Where the claim is for a debt or liquidated damages, the amount can be more easily stated. Where it is for unliquidated damages, it must be a reasonable estimate. The defendant can freely deal with its assets to the extent that they exceed the limit.

If the order is granted by the court it will immediately be served upon the other party or parties, who are bound by its terms. However, the other party or parties can apply to the court to discharge or vary the terms of the WWFO.

The claimant is obliged to give a cross-undertaking in damages, agreeing to reimburse any losses that its application may cause to the defendant that the court later orders should be paid. The court may order that the claimant secure this undertaking by providing a bank guarantee or other suitable form of security. This can be an onerous commitment that needs to be carefully considered by any claimant before it proceeds with its application.

The order will require disclosure by the defendant of its assets overseas where there are no or inadequate assets within the jurisdiction and a risk that those assets will be dissipated.

There are a number of consequences that follow if an order is granted. The claimant must prosecute its claim on the merits without delay and must comply with any undertakings given to the court, otherwise the order may be discharged. Any party to whom the order is addressed must comply strictly with the order, otherwise it may be held in contempt of court. It is in this sense that the order does not provide a claimant with security for its claim (although this may be offered by the defendant as a result), but merely a right to enforce the order personally against the defendant or third parties against whom the order is made.

Liens

The general term lien has a wide generic meaning which, depending on the legal context, is then narrowed down to particular circumstances. Overall, however, liens provide powerful remedies and rights to all parties to marine ventures – be they owners, charterers, cargo owners, owners of other ships damaged in, for example, collisions or owners of other structures and types of property suffering damage.

Maritime Liens

This section will be concentrating on liens created by express contractual terms in charterparties. Nonetheless, it is worth reviewing other types of lien. The first of these is the maritime lien. This developed in the Admiralty Court on a case by case basis although that it was not until the 1850s what we now understand to amount to a maritime lien was first closely defined.

A maritime lien is created in respect of four main areas. As recorded in the important case of the Bold Buccleugh dating from 1851 these are:

1. Salvage
2. Seaman's wages
3. Bottomry and respondentia
4. Damage done by a ship

Maritime liens are sometimes described as "statutory liens", which can cause some confusion. A series of statutes over the years leading up to what is now the Supreme Court Act 1981 certainly defined and somewhat broadened the concept of maritime liens but the statutes' primary role was to found the jurisdiction of the courts and the procedures under which they worked. This has not changed the underlying position that maritime liens were developed on a case by case basis by the original Admiralty Court (just to further confuse matters there are some true statutory liens but they will not be dealt with here).

The important feature of a maritime lien is that it creates rights in rem. That is to say in the shipping context, a claim can be brought against the ship itself rather than against the owning company personally. The practical effect of this is that it will allow a claimant to detain a ship by arresting it. This is of particular significance to an owner where there is an allegation of damage caused to the cargo arising out of breaches of the contract of carriage.

Possessory Liens

In addition to maritime liens created by the Admiralty Court the common law also developed limited rights for a party to exercise a lien so as to retain possession of goods in certain circumstances.

Firstly, there is a right to lien cargo for freight due under a contract of carriage. It should be stressed, however, that this is a very limited right. It does not, for example, cover rights to demurrage.

"The important point to note is that common law liens differ from maritime liens in that they only give rights to retain possession of the property in question. They do not give rights against the thing itself. In practical terms that will mean that any common law rights of lien will be lost if possession of the cargo is given up. "

Secondly, it arises where an owner has incurred costs in protecting cargo. That may, for example, arise where costs have been incurred salvaging cargo when this has been necessary to protect cargo owner's interests during the course of a voyage.

Thirdly, there is a common law right of lien in general average cases. The owner is entitled to retain possession of the cargo until general average contributions have been made. In practice, of course, it is much like the situation where there is an arrest for a cargo claim – in most circumstances the owner will give up its rights of lien for an average bond.

The important point to note is that common law liens differ from maritime liens in that they only give rights to retain possession of the property in question. They do not give rights against the thing itself. In practical terms that will mean that any common law rights of lien will be lost if possession of the cargo is given up.

Difficulty in relation to common law liens sometimes arises in the case of freight. The concept revolves around the position that freight is payable on delivery of the cargo. If it has been contractually agreed that

payment will be made at some other time then there is no common law right to retain possession. Equally, considerable care has to be taken to exercise a lien only in respect of the particular consignment of cargo on which the freight is due. It does not provide the owner with rights simply to retain possession of all cargo. Equally, it should be stressed that the right exists only against the party responsible for paying freight. A consignee holding in its hand a freight pre-paid bill which has been endorsed to it would, in almost all circumstances, be able to successfully argue that an owner is estopped from seeking to exercise any rights of lien at common law.

Contractual Liens

Where charterparty disputes arise, by far the most commonly arising question of whether or not a lien exists originates from express contractual terms contained in the charterparty itself. Many standard charterparties contain these in their pro forma clauses.

By way of example the Gencon (1971) Form reads:

"Owners shall have a lien on cargo for freight, dead-freight, demurrage and damages for detention. Charterers shall remain responsible for dead-freight and demurrage (including damages for detention), incurred at port of loading. Charterers shall also remain responsible for freight and demurrage (including damages for detention) incurred at port of discharge, but only to such extent as the Owners have been unable to obtain payment thereof by exercising the lien on the cargo."

That clause has, in fact, been somewhat simplified in the later Gencon (1994) Form to take out its "cesser" provisions which will be looked at in more detail later. The applicable clause in the present version of Gencon reads:

"The Owners shall have a lien on the cargo and all sub-freights payable in respect of the cargo, for freight, dead-freight, demurrage, claims for damages and for all other amounts due under this Charter Party including costs of recovering same."

In the time charter context the commonly used NYPE form also has similar lien provisions reading:

"18 That the Owners shall have a lien on all cargo, and all sub-freights or any amounts due under this Charter, including General Average contributions and the Charterers to have a lien on the Ship for all monies paid in advance and not earned, and any overpaid hire for excess deposit to be returned at once. Charterers will not suffer, nor permit to be continued, any lien or encumbrance incurred by them or their agents, which might have priority over the title and interest of the owners in the vessel."

When considering if a contractual lien is applicable it is important to read the terms of the clause carefully. The usual English law rules of construction will apply in that the terms will be read strictly against the party seeking to rely on them. Most examples are very clear. If a lien clause gives an owner rights to lien cargo in respect of freight then this will not extend to liening the cargo for unpaid demurrage. Equally, something other than the cargo could not be liened, under the terms of the clause, for the unpaid freight.

Where there is room for interpretation, particularly in the light of what is commonly understood to be the meaning of phrases in the shipping community, there is room for more debate.

A good example of this comes from the case of Itex Itagrani Export S.A. v Care Shipping Corporation and Others (the Cebu) (No.2) [1990] 2 Lloyds Rep. 316. In this case the headowner was undoubtedly owed hire due to it from its charterer. Because of this the headowner sent a notice to the sub-charterer stating that it had a lien on any hire that was to be paid by it under that sub-charter.

In doing so, however, it relied on a lien clause in the standard NYPE form, which is quoted above. As can be seen, that clause confines the lien to "sub-freight". It does not specifically mention "sub-hire".

The owner may have felt that it was on strong ground because, in an earlier case in 1983 involving the same ship and much the same type of charterparty chain, in that case Lloyd J had held that this included sub-time charter hire. It has to be said that at the time this was felt to be a surprising conclusion.

In the Cebu (No.2), Steyn J took a different view; he was not prepared to find that a reference to freight could include a reference to hire. On this he said:

"Prima facia "sub-freights" in cl.18 mean sub-freights payable under bills of lading or a voyage charterparty. One accepts immediately that the word "sub-freights", like any other word in a contract, might receive a colour from the context, e.g., if the word freight had been used in the typed clauses instead of hire. But I find nothing in either the printed NYPE form nor in the typed conditions to justify the stretching of the ordinary meaning of freight to cover hire. On the contrary, a consistent use of the word "hire" in both parts of the charters points the other way."

Putting it more simply he stated later in his judgment:

"From my part I am satisfied that properly construed "sub-freight" in cl.18 does not include sub-time charter hire."

“One element to particularly focus on is whether the lien clause gives express contractual rights to recover the actual costs of exercising the lien. These could be substantial.”

One element to particularly focus on is whether the lien clause gives express contractual rights to recover the actual costs of exercising the lien. These could be substantial. There is clear law dating from the 19th century that a lien clause does not extend to this, but less clear that the costs are not then still recoverable from the charterer. The reason for saying it is less clear is that there may be other avenues of recovering these expenses. They might, for example, be recovered by way of damages arising out of the charterer's failure to pay freight for instance. The general rules of breach and the recoverability of damages would apply to that. Equally, in some circumstances local law may allow for the recovery of these expenses.

Exercise of Liens – Rights of Third Parties

A further point to consider is that, although one party to a contract has granted rights of lien to the other – in practice that usually means a charterer agreeing that the owner has such rights – the lien itself is normally going to be exercised against a third party owner of property. Again the usual scenario is that this third party is the owner of cargo carried against a bill of lading endorsed to it.

This third party may be entirely ignorant of the clauses contained in the charterparty. This is recognised in commodity sales and the documentary credit arrangements underlying them. Buyers of the cargo and banks providing the credit for them may well be entitled to reject documentation designed to support the transactions if they do not make the position clear as to what liabilities are being taken on. As Lord Diplock said, albeit in a slightly different context, "no business man who had not taken leave of his senses would intentionally enter into a contract which exposed him to a potential liability of this kind".

This stresses the importance that charterparty rights of lien have to be effectively incorporated into the contracts governing the third party owners of the property that is subject to the lien. In most circumstances, that is going to mean the holder of a bill of lading that has been endorsed over to it.

That raises the question of what, in these third party contracts, is sufficient to incorporate lien clauses from the charterparty. Perhaps surprisingly, even very narrow words of incorporation of charterparty terms into bills of lading have been found to be sufficient to incorporate the lien provisions. An often quoted case on this dates from 1871 – Gray v Carr (1871) LR 6 QB 532 – where the bill of lading terms simply read "…deliver unto…he or they paying freight and all other conditions as per charter".

It is suggested this should be treated with caution. The general basis relating to incorporation of charterparty terms is that they should be relevant or germane to the bill of lading contract of carriage. Here it was obvious from the terms of the bill of lading that it was the receiver who was to pay the freight. It is, therefore, no leap of logic to assume that express rights of lien were contained in the charterparty.

"In more general terms it has to be much safer to include express clear terms incorporating rights of lien mirroring those found in the charterparty. That is particularly the case as, although English law may be content that the lien clause has been incorporated, other jurisdictions may not accept this and look only to what is expressly stated in the terms of the bill of lading."

In more general terms it has to be much safer to include express clear terms incorporating rights of lien mirroring those found in the charterparty. That is particularly the case as, although English law may be content that the lien clause has been incorporated, other jurisdictions may not accept this and look only to what is expressly stated in the terms of the bill of lading.

How to Exercise a Lien

Having established that a right to lien does exist the next question is exactly what this amounts to. Again a difficult question, but the basic position is that it creates rights to retain possession of the matter liened until payment is made. The classic definition is given by Mocatta J in Santiren Shipping Ltd v Unimarine S.A. (the Chrysovalandou Dyo [1981] 1 Lloyds Rep.159) where he said it acts as:

"A defence available to one in possession of a claimant's goods who is entitled at common law or by contract to retain possession until he is paid whatever he is owed".

One effect of that, which is extremely important to remember in practice, is that, because the lien is of a possessory nature, it is lost as soon as the subject matter of the lien is given up to a third party. Once that is done it is no longer in operation.

Liens on Sub-Freights and Sub-Hire

The underlying possessory nature of a lien does not always stand up to close legal scrutiny when exercised in respect of things like financial interest rather than the property of a third party actually in the possession of the party seeking to enforce the lien.

Charterparties, as has been seen, commonly allow for rights to "lien" sub-freights or sub-hires. Fairly self evidently, however, those are not actually in the possession of the party seeking to enforce these rights. Instead they are said to act more by way of equitable assignments. In effect, it is said that the party who would in the normal course of events have been entitled to those sub-hires or sub-freights has assigned over rights to another party to intercept it and have them paid to them direct.

A very recent case has, at least at first instance, confirmed that such liens are to be treated in this way – or, to use the exact legal terminology, as an "assignment by way of charge". That case is Western Bulk Shipowning III A/S v Carbofer Maritime Trading ApS & others (the Western Moscow) [2012] EWHC 1224.

The facts are fairly typical of the normal scenario in that it was a long-term charter chain. The owner terminated the charter by reason of its charterer's failure to pay hire and sought to exercise liens over hire payable by the sub-charterer.

The case covered a number of areas but from the point of view of counterparty risks the most important ramifications are twofold.

Firstly, since the lien acts as an assignment, it is taken "subject to equities". In theory (although it could not on the particular facts) the sub-charterer could offset any sums it was itself entitled to deduct from the sub-hire otherwise due. In many circumstances that could extinguish that hire entirely.

Secondly, and more importantly, since the lien is a charge, it acts as a security interest and in many jurisdictions, including the UK, has to be registered against the debtor company as a matter of company law. Usually there is a time limit for doing this. In England that time limit is 21 days from the date it is first created, which would mean the date the charter itself is entered into.

Although the above is a gross over-simplification of the position, in practice registering such a charge may be near impossible. As such, a potentially very powerful tool for recovering unpaid hire may well be lost.

Contractual Liens over Ships

Where lien clauses purport to give rights over the ship itself this can cause even more difficulty. In the voyage charter context, for example, a charterer granted such rights of lien is never going to be in possession of the ship. In the time charter context it may well be completely impractical for a charterer to operate this lien and it should be remembered, if it were to refuse to give redelivery, then, in the ordinary course of events, hire continue to be payable.

One thing is clear, such a lien would not give rights in rem against the ship in the way that a maritime lien would. To date the law has rather dodged this question but the indication given is that the charterer should exercise this right by seeking an injunction against the owner preventing use of the ship until outstanding amounts are paid. That course of action would, in itself, be fraught with difficulty in that, once again, the costs of maintaining this injunction could be prohibitive.

Practicalities of Exercising a Lien

The next question to ask is how exactly the lien is to be exercised. The starting point is that notice of the lien has to be given to all appropriate parties. That will include not only the party from whom the sums for which the lien is being exercised are due but also any third party owner of the property that is being liened. It might be thought from this that an exact sum must be stated. In fact, although that is always desirable, what the law requires is that this is set out in sufficient detail and with sufficient supporting information to allow the other parties to make a reasonable calculation of what sums are due.

That principle was set out in very clear terms in the case of Albemarle Supply Co. Ltd v Hind & Co [1928] 1KB 307 Scrutton L.J held that:

"A person claiming a lien must either claim it for a definite amount or give the owner particulars from which he himself can calculate the amounts for which the lien is due. The owner must then, in the absence of express agreement, tender an amount covering the lien really existing. If he does not, unless excused, he has no answer to a claim of lien. He may be excused from tendering (1) If he has no knowledge or means of the knowledge of the right amount; (2) If the person

claiming lien for a wrong cause or amount makes it clear that he will not release the goods unless his full claim is satisfied, and that claim is wrongful. The fact that the claim is made for more than the right amount does not matter unless the claimant gives no particulars from which the right amount can be calculated, or makes it clear that he insists on the full amount of the right claim."

From this then it can be seen that the amount claimed does not necessarily have to be correct and can, indeed, be actually in excess of what is due, provided the other party is able on the information given reasonably to be expected to make its own assessment. On the other side of the coin, however, where it is quite clear that the lien is wrongly claimed the party is not going to be bound by the lien.

"I do not think that a shipowner can usually be said to be exercising a lien on cargo simply by refusing to carry it further. The essence of the exercise of a lien is the denial of possession of the cargo to someone who wants it. "

One further point on this is that the lien can, in normal circumstances, only be exercised for sums actually due. Those sums may increase, but a new notice of lien must be given. One strange consequence of this arises in demurrage situations. Demurrage is usually payable on a day by day basis. That may mean that discharge is actually completed before the entire sum due in demurrage is payable. Nonetheless, possession of the goods will self evidently have been given up such that the rights of lien for the last instalment of demurrage will have been lost.

That begs the question as to when in time the lien should be exercised. In normal circumstances, at least as regards a lien on cargo, this will mean that the voyage to the port of discharge has to be completed. In other words the ship must reach its destination. A good example of an owner seeking to enforce a lien prematurely is found in the case of The Mihalios Xilas [1978] 2 Lloyds Rep 186. This case covers a number of unrelated points but, in essence, the charterer had failed to pay hire under a time charter and, as part of a number of steps taken to try and remedy this, the owner relied on rights of lien over the cargo.

The owner did not do so, however, at the port of discharge. Instead, it delayed the ship in Augusta whilst bunkering took place. Donaldson J said that no such rights of lien existed at this stage. To quote from his judgment:

"I do not think that a shipowner can usually be said to be exercising a lien on cargo simply by refusing to carry it further. The essence of the exercise of a lien is the denial of possession of the cargo to someone who wants it. No-one wanted the cargo in Augusta and the owners were not denying possession of it to anyone. It may be possible to exercise a lien by refusing to complete the carrying voyage, but I think this can only be done when, owing to special circumstances, it is impossible to exercise a lien at the port of destination and any further carriage will lead to loss of possession of cargo following arrival at that port. In such circumstances a refusal to carry further can be said to be a denial of the receiver's right to possession. There is no finding that this was the case in the present instance."

As can be seen, therefore, the judgment did lay open the possibility of exercising the lien other than at the port of discharge but it is worth focusing in on the word "impossible" used in the quote above.

Once the ship has arrived at the discharge port, however, the owner may take any reasonable steps to maintain a lien. In fact, this has been held to include standing off the port. Again this was stated in the Chrysovalandou Dyo case quoted above. Equally, the lien can be exercised ashore by, for example, discharging into a warehouse over which the owner can exercise control such that the cargo is not released from its possession.

One point that should be borne in mind, however, is that even though English law may grant the right of lien at the discharge port, that may still be subject to local law. An owner may find that, despite its rights under a charterparty, it is compelled by the applicable local law to give delivery to the appropriate receiver in any event. Historically, that has particularly been applicable where the receiver is a government agency of some kind.

Cesser Clauses

So far matters have been looked at very much from the perspective of the rights of lien enjoyed by a party. Lien clauses also commonly impose burdens in that they will penalise a party who fails to exercise a lien in circumstances where this right was available to it. The background to this is very much historical but carriage regimes against which the law was developed still very much exist today.

Post-Fixing Issues (continued)

In the voyage charterparty context particularly, the position was once common that, when a charterer had loaded cargo, many of its responsibilities effectively ceased. Obligations, for example, to pay freight and discharge port demurrage did not lie with the charterer but with the cargo-owning receiver of the goods being carried under bills of lading issued pursuant to the charterparty. Naturally, therefore, the right to lien makes complete sense and, indeed, is why it existed as a common law right regardless of contractual terms because the owner would be entitled to retain possession of the cargo as against the receiver until it was paid.

In circumstances where a charterer wished to make it clear that any liability on its part came to an end once the cargo had been loaded, a variety of what are called "cesser" clauses were developed. Many of these found their way into the pro forma charterparties as these were drawn up. A good example of a broad cesser clause is found in the Baltimore Form C Berth Grain Charter, which states that:

"Vessel to have a lien on the cargo for all freight, dead-freight, demurrage or average… Charterer's liability under this charter to cease on cargo being shipped."

There are less broad examples of such clauses where it is stated that a charterer will retain liability for payment of various items but only to the extent that the owner cannot obtain payment by exercising the lien. The quote from the 1971 GENCON given above is a good example of this.

One interesting feature of such cesser clauses is that they have been held to be effective not just in respect of sums due in the future but for amounts which had already been incurred, such as load port demurrage, but remained unpaid.

In practice, therefore, an owner may face extremely onerous terms where the outcome viewed objectively would produce a very unjust result. The parties themselves often deal with this by careful thought in finalising their charterparties both by amending the pro forma clauses and introducing additional clauses.

The general law has also traditionally taken a very sceptical approach to cesser clauses in most situations and is reluctant to impose them rigidly where common commercial sense dictates otherwise.

That approach is illustrated extremely well in a case called Overseas Transportation Company v Mineralimportexport, The Sinoe [1971] 1 Lloyds Rep 514. This charterparty contained a clause stating "charterers' liability shall cease as soon as the cargo is on-board.

Owners have an absolute lien on the cargo for freight, dead-freight, demurrage and average." At first sight, therefore, it would appear that the charterer could walk away from at least future liability once cargo is loaded.

The voyage was for carriage of cement from Constantza to Chittagong. Considerable delays were caused at the port of discharge which was caused by the inexperience and incompetence of the stevedores. Demurrage was run up which the owner claimed against the charterer and the charterer defended this on the basis of the cesser provision. Donaldson J rejected this argument on the basis that it was impossible to have actually exercised the lien for legal and practical reasons. In doing so he stated:

"Cesser clauses are curious animals because it is now well established that they do not mean what they appear to say, namely, that the charterer's liability shall cease as soon as the cargo is on board. Instead, in the absence of special wording…, they mean that the charterer's liability shall cease if, and to the extent that, the Owners have an alternative remedy by way of lien on the cargo."

Obviously in this case it was found that, because for all practical purposes it was impossible actually to exercise a lien, the cesser clause did not operate.

Cesser provisions in lien clauses cannot, however, be ignored. It should be stressed that the case above was decided on its particular facts. Where there is clear evidence to show that a lien could have been enforced, but that the owner chose not to do so, then they are much less likely to escape its consequences. This leaves an interesting question whether, in certain circumstances, it may be possible to exercise a lien but as a matter of commercial common sense it is not a real option. It is to be hoped the Courts would take a flexible attitude to this and consider not just legal principles but the commercial aspect. To date, however, no case exists which really covers this.

It is also worth noting that cesser clauses are not just highly unpopular with most shipowners. Cargo owners can find them equally objectionable in circumstances where they are expected to take on liabilities which they may not even have been aware existed. They are being deleted not just by the parties in pre-contract negotiations but also from modern pro forma charter forms – a good example is the latest GENCON.

Withdrawal

Most time charters give the owner a right to withdraw the ship from the charterer's service where the charterer fails to pay the hire on time. There are two considerations for an owner when considering whether to exercise this right to withdraw. The first is whether the owner has complied strictly with the charterparty's requirements, and has not done anything previously to lose the right to withdraw. Otherwise the owner risks being the one who is held to be in breach of the charterparty and who faces a significant claim for damages from the charterer. The second is whether the owner has a claim for damages for the unexpired period of the charterparty.

Withdrawal is a contractual right to terminate that is not dependent upon any breach of the charterparty. The charterparty is brought to an end and both parties are discharged from further performance. However, there will have to be a final accounting between the parties. In particular the owner can bring a claim against the charterer for hire that is unpaid as at the date the ship is withdrawn. A separate question is whether the owner can claim damages for the difference between the hire that it would have earned under the charterparty for the balance of the charterparty period, and the hire it

"The owner must give notice to the charterer that is clear in stating that the owner is terminating the charterparty because of the non-payment of hire. Simply delaying further performance by, for example, waiting outside the discharge port until hire is paid is not enough. It may also mean that the owner is itself in breach of charter entitling the charterer (and any bill of lading holder) to claim damages."

actually earns under any substitute fixture or fixtures. To do this, an owner needs to show that the failure to pay hire is a repudiatory breach of charter, in other words a breach that entitles the owner to terminate the charter. This is separate from the right to terminate the charter by withdrawal. It is uncertain under English law whether the habitual late or non-payment of hire by a charterer is a repudiatory breach entitling the owner to terminate and claim damages.

In summary, an owner may be able to terminate a charter by withdrawing a ship from the charterer's service, and claim any unpaid hire; but may not be able to terminate on the basis of the charterer's repudiatory breach with regard to the payment of hire, and so may not be able to claim damages for the loss of future earnings. These can often be considerable.

The right to withdraw arises where a charterer pays hire late (even if it is paid before the owner withdraws), pays no hire at all or pays less than the full amount.

Care needs to be taken when a charterer habitually pays less than the full amount of hire, pays late or does not pay at all, but an owner does not withdraw on those previous occasions. The owner may lose its right to withdraw when there is a default by the charterer with regard to the next instalment of hire. Much will depend upon the facts and the advice of the Managers should be sought.

Most charterparties include an anti-technicality clause that aims to prevent a charterer from losing what may be a valuable charterparty as a result of a simple error by it or its bankers. This usually gives a short period of 48 or 72 hours within which the charterer can remedy its default by paying the hire. The notice should be clear in stating the ship will be withdrawn if hire is not paid. It does not need to include a figure that the charterer has to pay. The timing of the notice is also important. It must be given after midnight on the due date. If it is given before, it is uncertain whether it becomes effective on the next banking day. The better practice would be to serve a further notice without prejudice to the first notice.

The owner must give notice to the charterer that is clear in stating that the owner is terminating the charterparty because of the non-payment of hire. Simply delaying further performance by, for example, waiting outside the discharge port until hire is paid is not enough. It may also mean that the owner is itself in breach of charter entitling the charterer (and any bill of lading holder) to claim damages.

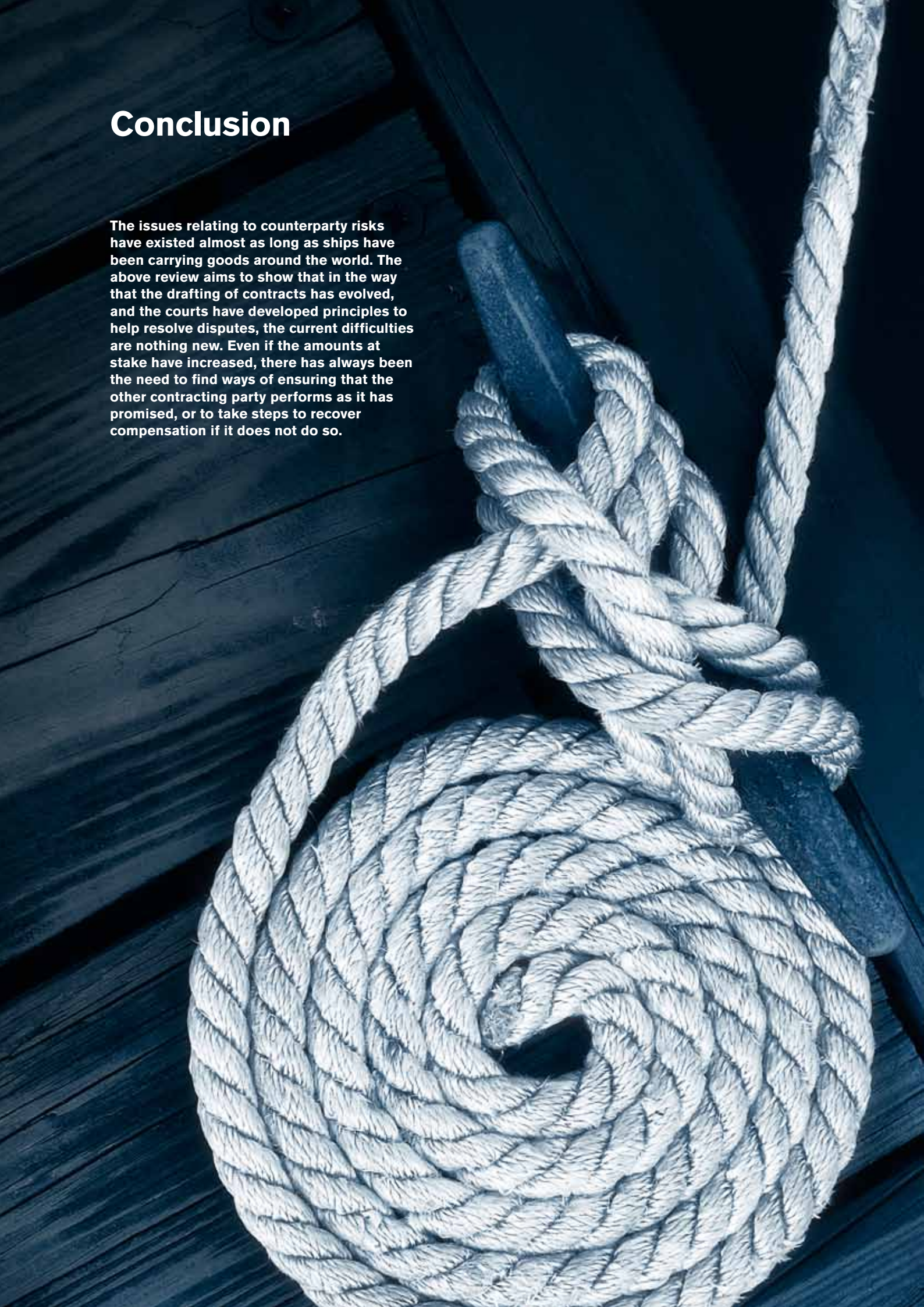
An owner may lose the right to withdraw the ship if it indicates to the charterer that it waives the failure to pay hire, or late or part payment of hire, and intends instead to allow the charter to continue. An owner has a "reasonable" time to give notice of withdrawal, which includes time to take legal advice and check whether the payment has been made. What is "reasonable" will depend upon the circumstances, and may be very short.

It is quite possible for another contract to arise after withdrawal if, for example, the owner agrees to do something that the charterer asks it to do. It will be a question of fact as to what has been agreed and upon what terms, with the owner perhaps being entitled to hire at the market rate.

Another factor to be considered by an owner when deciding whether to terminate a charterparty is the presence of cargo on-board. Here the owner may still be bound to deliver the cargo under the terms of the separate contract of carriage contained in or evidenced by the bill of lading (or, if not a party to the bill of lading, under the law of bailment).

Conclusion

The issues relating to counterparty risks have existed almost as long as ships have been carrying goods around the world. The above review aims to show that in the way that the drafting of contracts has evolved, and the courts have developed principles to help resolve disputes, the current difficulties are nothing new. Even if the amounts at stake have increased, there has always been the need to find ways of ensuring that the other contracting party performs as it has promised, or to take steps to recover compensation if it does not do so.



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