Insight Article

Cancellation clauses and other means by which owners may protect against defaulting charterers

This article highlights some alternative steps which owners may consider when entering into a voyage charter in order to protect against certain failures on the part of charterers. In particular, it refers to charterers' failure to provide cargo on time or at all and to pay freight and demurrage once owners have performed their duties under the charterparty.

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Charterers' obligations at load port are to provide a cargo and to load it within the specified laytime. All too often, however, owners send a

vessel to the nominated load port only to find that no cargo is available immediately and there is uncertainty as to whether it will become available at all. Whilst the non-availability of cargo may, prima facie, amount to a breach on the part of charterers, it may not necessarily amount to a repudiatory breach entitling owners to terminate the charterparty. Owners must therefore seek monetary compensation for the time lost usually by way of demurrage after laytime has expired, or by way of damages for detention, if for some reason the unavailability of cargo prevents the vessel from becoming an arrived ship. Depending on the precise wording, the laytime exceptions clause may also apply to unavailability of cargo (in addition to delay in loading) and therefore laytime may be interrupted if the unavailability of cargo has been caused by one of the events contained in the exceptions clause, for example strikes or causes beyond charterers' control. In such a case, owners are faced with possible long delays causing substantial losses and yet demurrage may not accrue. Even where demurrage does accrue, it may not fully compensate owners if the delay is considerable. Furthermore, owners may have difficulties in recovering large amounts of demurrage from charterers in such circumstances.

Often, the best commercial solution for owners would be to "cut their losses" and leave the load port once they are aware that cargo is not available. In coming to such a decision, however, owners face a dilemma: do they leave and look for business elsewhere and in doing so risk being in repudiatory breach of the charterparty themselves, or do they remain and wait longer and risk not being able to recover demurrage? In normal circumstances there can be no temporary withdrawal of services although some standard forms provide for a right to withhold services whilst hire remains unpaid.1 Withdrawal of a vessel is recognised as a remedy with severe consequences and it must be done correctly and timely, failing which the owner will be held liable for repudiation of the charter. Furthermore, in most cases withdrawal of the vessel is of practical assistance only when the vessel is free of cargo. Thus where the owner has loaded the cargo he is bound to deliver the cargo in accordance with the bills of lading.

In an attempt to avoid the above problems, it is, therefore, preferable to include a cancellation clause in the charterparty, by which owners may elect to cancel the charterparty in specified circumstances

Suggested wording for cancellation clause

The following are wordings which may be used in order to avoid some of the problems described above.

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1. In the event that the cargo is not available for loading upon:
vessel's arrival in port or the usual waiting place or
vessel's tendering Notice of Readiness or
vessel's arrival off the port in circumstances where the vessel is prevented from entering due to unavailability of cargo and the vessel being in all respects ready to load, Owners have the option to cancel this charterparty by giving written notice of such cancellation (including by fax, telex or cable) to Charterers or their agents within [ ] hours thereafter. (Owners should select i), ii) or iii), whichever is the most appropriate point in time. This may vary from fixture to fixture.)*

2. Further, whether cargo is available or not, in the event that loading has not commenced within [ ] hours of [ ] unless such delay is caused by Owners, Owners shall have the option to cancel this charterparty by giving written notice of such cancellation (including by fax, telex or cable) to Charterers or their agent,s but such notice must be given within [ ] hours of the option to cancel arising. (*Owners should select either i or ii from Clause A above or expiry of laytime.)*

Cancellation shall be without prejudice to any claim for damages and/or demurrage which Owners may have.

If the charterparty contains a laytime and demurrage exceptions clause such as the wording of Clause 8 of the Asbatankvoy Part II, 2 it is suggested that the following additional wording be inserted to protect owners in the event that any stoppage is prolonged. However, if using part B of the above clause, care must be taken to ensure that no conflict arises in respect of the time at which the charterparty may be cancelled.

"If laytime is interrupted or demurrage is incurred at port of loading by reason of strike, lockout, stoppage or restraint of labour or breakdown of machinery or equipment in or about the plant of the charterer, suppliers or shipper and such stoppage continues for a period of [ ] days/hours from the time of the vessel being ready to load, Owners shall have the option to cancel this charterparty provided no cargo has been loaded. Notice of cancellation must be given in writing to Charterers or their agents within [ ] hours of the option to cancel arising.

Cancellation shall be without prejudice to any claim for damages and/or demurrage which Owners may have."

Further steps aimed at protecting against charterers' failure to make payments
Prepaid freight

Prepaid freight is one of the most secure ways for owners to ensure payment of freight. In the Asbatankvoy form the charterer's obligation to pay freight is set out in clause 2 of Part II. 3 Freight is payable upon delivery of cargo and the charterer is not entitled to deduct any sums other than those stated in Clause 2 or otherwise specifically set out in the charterparty. Arbitrators have consistently held that the wording and content of Clause 2 is "absolute" and accordingly the withholding of freight by charterers as security is wrongful, not only for cargo loss, but also for a variety of other claims. However, in reality, we know that charterers do withhold freight to secure their claims or assist their own cashflow. Prepaid freight would not only avoid any attempt to make set-offs but also hopefully help to avoid mere non-

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payment.

Under the Asbatankvoy and BeePeevoy standard forms, freight is payable upon or after delivery of cargo. It may be that due to the special nature of the oil trade, whereby cargoes may be sold many times before arrival at the discharge port, that freight is customarily paid upon delivery or after discharge. For this reason it may be difficult to negotiate the payment of freight in advance.

Payment "before breaking discharge"

Where freight is expressed to be payable "before breaking discharge", freight is payable once the vessel has arrived at the discharge port but before discharge commences. The fact that freight is payable before discharge commences enables owners to exercise a lien for freight if it is not paid on time (see below).

Demurrage at load port

It may be advisable to collect any demurrage incurred at load port as soon as possible, so in the event of non-payment owners may exercise a lien in respect thereof at the discharge port. Therefore owners may wish to consider inserting a clause to this effect in the charterparty. It is important at this point to remember that under English law there is no lien for non-payment of demurrage and therefore it is necessary to provide for such a lien by a clause in the charterparty.

Performance guarantees

An owner may also strengthen his position by including a performance guarantee in the charterparty. When freight and/or demurrage due to owners becomes subject to dispute, charterers would, under the terms of the charterparty, be obliged to provide a bank guarantee for the disputed amount, pending settlement of the dispute. This kind of clause could be balanced by providing that the party who is ultimately unsuccessful in the arbitration/legal proceedings shall bear the costs of the guarantee. The status of the bank should be investigated before accepting the guarantee and it is obviously preferable that a first-class bank issues the bank guarantee. Letters of indemnity issued by charterers should, as a general rule, not be accepted.

Cancellation clauses linked to performance guarantees

The benefit given by a performance guarantee clause is increased if it is linked to a cancellation clause. We set out below an example of such a clause.

"If Charterers have failed to pay freight or demurrage or to provide a bank guarantee as per clause [ ]of this charterparty, when such freight or demurrage is due, Owners may give notice to Charterers that unless they pay or provide a bank guarantee within [ ] hours of receipt of Owner's notice, Owners shall be entitled to cancel the remaining part of this charterparty. This option to cancel must be exercised no later than [ ] after the expiry of the [ ] hours delay, but shall cease to exist after actual payment, even if late."

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Suspension

A suspension clause may also assist owners' position vis-à-vis charterers. However,

this will depend on the circumstances and in particular the time at which freight becomes due. Following is an example of such clause:

Charterers' obligations at load port are to provide a cargo and load it within the specified time.

"As long as freight or demurrage under this charterparty is due but not paid, Owners shall not be obliged to:- nominate further tonnage hereunder,- let vessel proceed to loading or discharging port,- load or receive cargo for shipment,- issue bills of lading for any cargo received or loaded, or- discharge or deliver cargo.

Time lost thereby to any vessel held ready for loading or for nomination shall count as laytime or as time on demurrage. Charterers shall hold Owners harmless in respect of any third party claims arising from such suspension."

In order to avoid claims from charterers for compensation based on owners' breach of the charterparty, the rights given to owners by the suspension clause should only be exercised when the freight and/or demurrage due to owners is undisputed or where charterers appear to have no *bona fide* defence.

Lien clauses in charterparties and bills of lading

Both the Asbatankvoy and BeePeevoy 3 standard forms contain lien clauses in respect of freight, deadfreight and demurrage, see: *i) Asbatankvoy clause 21 PART II* 4 *ii) BeePeevoy 3 form clause 32* 5

However, the effectiveness of such a lien clause may be questionable. Under the Asbatankvoy freight is payable upon delivery. In theory, this creates two simultaneous obligations - owners must be ready and willing to deliver the cargo and charterers must be ready and willing to pay the freight. Owners may interrupt discharge to exercise a lien if freight is not forthcoming, but the speed at which oil cargoes are discharged, coupled with problems in checking instantly whether monies have been received in a bank account, may mean that in practical terms it may be difficult to exercise a lien prior to discharge. The Asbatankvoy form does provide that the lien shall continue after delivery of the cargo into the possession of charterers or bill of lading holders, although it is doubtful to what practical extent owners may exercise a lien in such circumstances.

The BeePeevoy provides for freight to be paid after completion of discharge. Again whilst in theory a cargo may be discharged and owners may still retain some control over it, this may not always be the case and will vary from jurisdiction to jurisdiction.

If owners lien cargo for outstandings under the charterparty, they may be exposed to a claim for interfering with the rights of third party bill of lading holders. Therefore, owners should also ensure that the bills of lading issued pursuant to the charterparty incorporate the terms of the charterparty, so that the bill of lading holder has in theory notice of the lien clause and, certainly under English law, will be bound by it. 6

Lien on sub-freights

Owners should consider the option of exercising a lien on any sub-freight.

It should be noted that owners may exercise a lien on sub-freights only if owners have a contractual right against charterers to do so. To exercise a lien on sub-freight, payment by charterers to owners must be due and owners must give notice to the sub charterers or shippers (as the case may be) that payment must be made directly

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to them. Such notice must be given prior to sub-charterers/shipper making payment to charterers, otherwise no lien can be effective.

A lien on sub-freights may be exercised even if the amount due under the sub-charter or bill of lading is unliquidated or in dispute.

Pre-fixture enquiries

Finally, the value of extensive pre-fixture enquiries cannot be underestimated. Such enquiries should preferably be done by obtaining credit references from bankers, brokers and/or credit reference agencies, as well as company searches. Furthermore, it is wise to ascertain the identity of the charterer's main bank prior to fixing. This will assist in taking prompt action against charterers' funds (so far as the law permits) in the event of non-payment.

See clause 11(a) of the NYPE 1993 form.

The clause reads: "DEMURRAGE. Charterer shall pay demurrage per running hour and pro rata for a part thereof at the rate specified in PART I for all time that loading and discharging and used laytime as elsewhere herein provided exceeds the allowed laytime elsewhere herein specified. If, however, demurrage shall be incurred at ports of loading and/or discharge by reason of fire, explosion, storm or by a strike, lockout, stoppage or restraint of labour or by breakdown of machinery or equipment in or about the plant of the Charterer, supplier, shipper or consignee [illegible] per running hour or pro rata of an hour for demurrage so incurred. The Charterer shall not be liable for any demurrage for delay caused by strike, lockout, stoppage or restraint of labor for Master, officers and crew of the Vessel or tugboats or pilots".

The clause reads: "FREIGHT. Freight shall be at the rate stipulated in PART I and [illegible] and/or discharge and cost of insurance thereon. No deduction of freight shall be made for water and/or sediment contained in the cargo. The services of the Petroleum Inspector shall be arranged and paid for by the Charterer who shall furnish the Owner with a copy of the Inspector's Certificate."

The clause reads: "LIEN. The Owner shall have an absolute lien on the cargo for all freight, deadfreight, demurrage and costs, including attorney fees, of recovering same, [illegible] of the Charterer, or of the holders of any Bills of Lading covering the same or of any storageman".

[illegible]

See article "Demurrage [illegible]" in this edition of Gard News.

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