WATSON FARLEY & WILLIAMS

BRIEFING

COURT OF APPEAL CONFIRMS PAYMENT OF HIRE UNDER TIME CHARTERPARTIES IS NOT A CONDITION

DECEMBER 2016

- THE OBLIGATION TO PAY HIRE PUNCTUALLY AND IN ADVANCE IS AN "INNOMINATE" TERM RATHER THAN A CONDITION
- CONSEQUENCES OF BREACH WILL DEPEND ON THE NATURE AND GRAVITY OF THAT BREACH
- WITHOUT MORE, A SHIPOWNER WILL NOT BE ENTITLED TO CLAIM DAMAGES FOR LOSS OF BARGAIN

The effect of a charterer's failure to pay an instalment of hire punctually and in advance under a time charterparty has long been somewhat unsettled, and certainly controversial, as a matter of English law. In particular, conflicting High Court decisions[1] have raised the question as to whether such a failure by a charterer constitutes a breach of a condition, entitling the shipowner to terminate the charterparty and claim damages for loss of bargain, extending to loss of profits in respect of the entire balance of the charter.

In a landmark decision the Court of Appeal has held unanimously that the answer to that question is "no"[2]. The obligation to pay hire punctually and in advance under a standard form time charterparty is not a condition, but an "innominate" term, for which the consequences depend on the nature and gravity of breach and not the inherent importance of the term. Without more, therefore, such a failure "merely" entitles a shipowner to withdraw the vessel from service in accordance with the express provisions of a withdrawal clause and to claim balances already due under the charterparty as at the date of termination, but not damages for loss of bargain.

[1] See the decisions of Mr Justice Flaux in *Kuwait Rocks Co v AMN Bulkcarriers Inc (The Astra)* [2013] EWHC 865 (Comm), [2013] 2 All ER (Comm) 689 and Mr Justice Popplewell in *Spar Shipping AS v Grand China Logistics Holding (Group) Co Ltd* [2015] EWHC 718 (Comm), [2015] 1 All ER (Comm) 879.

[2] *Grand China Logistics Holding (Group) Co Ltd v Spar Shipping AS* [2016] EWCA Civ 982.

The background to the case

By three charterparties dated 5 March 2010 on amended NYPE 1993 forms, the shipowner, Spar Shipping AS ("Spar") let three supramax bulk carriers on long-term time charterparties to Grand China Shipping (Hong Kong) Co Ltd ("GCS"). Performance guarantees were issued by the parent company of GCS, Grand China Logistics Holding (Group) Co Ltd ("GCL").

"GCS WAS IN SUBSTANTIAL ARREARS WITH HIRE PAYMENTS, WHICH CONTINUED FOR AROUND SIX MONTHS, DESPITE REGULAR BUT NON-SPECIFIC ASSURANCES FROM GCS THAT THE ARREARS WOULD BE RECTIFIED"

By April 2011, GCS was in substantial arrears with hire payments, which continued for around six months, despite regular but non-specific assurances from GCS that the arrears would be rectified. Spar sent regular anti-technicality notices until 16 September 2011, at which point it gave notice of withdrawal of the vessels from service with immediate effect and terminated the charterparties. At that time, two of the charterparties had about four years left to run and the third had about 18 months remaining.

Spar commenced arbitral proceedings against GCS, which were subsequently stayed after it went into liquidation. Spar then claimed in the High Court against GCL under the guarantees for the balance due under the charterparties prior to termination, damages for loss of bargain in respect of the unexpired terms of the charterparties, and the costs of the arbitration.

At first instance, Popplewell J held that payment of hire in accordance with clause 11 of the amended NYPE 1993 form was not a condition. However, he concluded that GCS had renounced the charterparties and that Spar was therefore entitled to US$24m in damages for loss of bargain in respect of the unexpired terms of the charterparties. GCL appealed that decision and, as well as defending the judge's decision on the renunciation issue, Spar contended that in any event, judgment should have been given in its favour on the additional ground that payment of hire by GCS in accordance with clause 11 was a condition.

The Court of Appeal reasoning

Gross LJ, with whom the rest of the Court of Appeal agreed, commenced his judgment with a useful restatement of the principles on classification of terms[3]. In a nutshell:

a) A condition is a major term of the contract, breach of which will deprive the non-defaulting party of substantially the whole of the benefit that it was intended he should obtain. Any breach of a condition entitles the innocent party to terminate the contract and sue for loss of bargain.
b) A warranty is, in contrast, a minor contractual term. A breach will entitle the innocent party to sue for losses caused by the breach, but will not entitle that party to terminate the contract and sue for loss of bargain.
c) An "innominate" term is neither a condition nor a warranty. Where a term is innominate, the question as to whether the innocent party can terminate the contract and sue for loss of bargain will depend on the seriousness of the consequences of the breach.[4]

[3] Gross LJ's restatement relied on *Hongkong Fir Shipping Co. Ltd. v Kawasaki Kisen Kaisha Ltd.* [1962] 2 QB 26 (EWCA) at pp69–70 and Andrew Burrows, *A Restatement of the English Law of Contract* (2016) at pp113–114.

[4] In *Bremer Handelsgesellschaft Schaft m.b.h. v Vanden Avenne Izegem p.v.b.a.* [1978] 2 Lloyd's Rep. 109 (HL) at 113, Lord Wilberforce spoke of the consequences of a breach of an innominate term hinging on the "nature and gravity" of the breach.

Accordingly, a non-defaulting party will be able to treat a contract as terminated and seek damages for loss of bargain:

a) in the event of a breach of condition;
b) where an "innominate" term has actually been breached and the consequence is of the requisite seriousness to treat the contract as at an end (a repudiatory breach); and
c) where, in advance of the due performance date , the other party makes clear that it is not going to perform the contract at all; is going to breach a condition; or is going to breach an "innominate term", the consequence of which is so serious it would entitle the non-defaulting party to terminate (a renunciatory breach). In each case, the non-defaulting party can accept the renunciatory breach at once and terminate the contract, without waiting for the performance date.

Was punctual payment of hire under the time charterparties a condition?

The Court of Appeal held unanimously that the obligation to make punctual payment of hire in full was not a condition in the standard form NYPE 1993 time charter, but an "innominate" term. The principal reasons given by Gross LJ were as follows.

"THE COURT OF APPEAL HELD UNANIMOUSLY THAT THE OBLIGATION TO MAKE PUNCTUAL PAYMENT OF HIRE IN FULL WAS NOT A CONDITION IN THE STANDARD FORM NYPE 1993 TIME CHARTER, BUT AN 'INNOMINATE' TERM"

First, the inclusion of the express withdrawal clause did not provide an indication as to whether clause 11 was a condition. Withdrawal clauses are included in charterparties to put beyond argument the shipowner's entitlement to terminate the charterparty where the charterer had failed to make a timely payment of hire. However, the argument that their inclusion showed that the parties did not consider clause 11 to be a condition, on the basis that the withdrawal clause would be redundant if it was, was not convincing. Also unconvincing was the opposite argument that the draconian consequences of the withdrawal clause showed that the parties must have considered clause 11 to be a condition. The "simple and important point to keep in mind is that all conditions entitle the innocent party to terminate the contract – but not all contractual termination clauses are conferred for breaches of condition alone".

Second, the authorities emphasise the need not to be "too ready" to interpret contractual clauses such as clause 11 as conditions and to do so only if the relevant contract, on its true construction, makes it clear that the clause is to be so classified[5]. Thus, if the parties have not made a particular term a condition, and if a breach may result in minor or very grave consequences, then that term is "innominate". In this case, the charterparties did not make it clear that clause 11 was a condition. Clause 11 did not expressly make time of the essence. Furthermore, compliance was not a condition precedent to performance by Spar of inter-dependent obligations under the charterparties in the sense that any failure to pay hire punctually in advance, no matter how trivial, would without more derail Spar's performance. Nor did clause 11 spell out the consequences of breach, in contrast to the NYPE 2015 form, which made the clause a condition.

Third, any general presumption of time being of the essence in mercantile contracts was not of assistance. First, a general presumption as to time being of the essence (even if applicable) would not produce a different conclusion given that, on their true construction, the charterparties did not make it clear that clause 11 was to be

[5] For example, *Bunge v Tradax* [1981] 1 WLR 711 (HL) at pp715–717.

classified as a condition. Second, any presumption that time is generally of the essence in mercantile contracts does not generally apply to time of payment, unless a different intention appears from the contractual terms.

Fourth, the anti-technicality clause did not strengthen the case for the timely payment of hire being a condition. That clause did no more than protect the charterers from the serious consequences of a withdrawal in the case of a failure to pay hire on "technical grounds".

"CERTAINTY AND COMMERCIAL COMMON SENSE ARE OF MAJOR IMPORTANCE WHEN CONSTRUING COMMERCIAL CONTRACTS, BUT IT IS A QUESTION OF 'STRIKING THE RIGHT BALANCE'"

Fifth, certainty and commercial common sense are of major importance when construing commercial contracts, but it is a question of "striking the right balance":

> "Classifying a contractual provision as a condition has advantages in terms of certainty; in particular, the innocent party is entitled to loss of bargain damages (such as they may be) regardless of the state of the market. Where, however, the likely breaches of an obligation may have consequences ranging from the trivial to the serious, then the downside of the certainty achieved by classifying an obligation as a condition is that trivial breaches will have disproportionate consequences. In a time charterparty, it is only necessary to contemplate a 5 minute delay in the payment of a single instalment of hire, for whatever reason not covered by an anti-technicality clause."

Where a breach triggers a contractual termination clause, the trade-off between the attractions of certainty and the undesirability of trivial breaches carrying the consequences of a breach of condition was, in the judge's view, "most acceptably achieved" by treating clause 11 as a contractual termination option only.

Sixth, the "general view" of the market has been that the obligation to make timely payments of hire is not a condition. Legal and industry circles "expressed surprise and concern at the decision in *The Astra* and have welcomed the judgment of Popplewell J"[6]. Furthermore, it was "telling" that prior to *The Astra*, when the prevailing view was that punctual payment of hire was not a condition, the major standard forms of time charterparty had not been amended to turn that obligation into a condition.

Did the charterers renounce the time charterparties?

The Court of Appeal confirmed that the test of whether there has been a renunciation was whether a breach went to the "root of the contract", which was the same as asking whether an actual or threatened breach has deprived the innocent party of substantially the whole or a substantial part of the benefit of the contract.

In the time charterparty context, Gross LJ endorsed and applied Spar's suggested three-stage analysis:

1. What was the contractual benefit Spar was intended to obtain from the charterparties?
2. What was the prospective non-performance foreshadowed by GCS' words and conduct?

[6] For instance, *Wilford on Time Charters* (7th ed, 2014) and *Scrutton on Charterparties and Bills of Lading* (23rd ed, 2015) both questioned the reasoning applied by Flaux J, with the latter commentary expressly endorsing Popplewell J's analysis.

3. Was the prospective non-performance such as to go to the root of the contract?

Turning to the present facts, he concluded that Popplewell J's conclusions were "entirely fair and well-founded". As to the first question, it was "hornbook law" that:

> "… the essence of the bargain under a time charterparty that the shipowner is entitled to the regular, periodical payment of hire as stipulated, in advance of performance, so long as the charterparty continues; hire is payable in advance to provide a fund from which shipowners can meet the expenses of rendering the services they have undertaken to provide under the charterparty; shipowners are not obliged to perform the services on credit; they do so only against advance payment."

"THE FACT THAT SPAR COULD BETTER ABSORB GCS' FAILURES AND PROSPECTIVE INABILITY TO PERFORM THAN SOME OTHER OWNERS DID NOT MEAN THAT SPAR WAS OBLIGED TO ACCEPT PAYMENT OF HIRE IN ARREARS WHEN IT HAD CONTRACTED FOR PAYMENT IN ADVANCE"

The financial strength of the particular shipowner has no bearing on the nature of the bargain entered into. In this case, the fact that Spar could better absorb GCS' failures and prospective inability to perform than some other owners did not mean that Spar was obliged to accept payment of hire in arrears when it had contracted for payment in advance.

As to the second question, the test for prospective non-performance was whether "a reasonable owner in the position of Spar could have no, certainly no realistic, expectation that GCS would in the future pay hire punctually in advance". On GCS' own case, performance in the future would depend on the market. It was not enough that it was willing to pay hire, but in arrears – that translated into GCS wishing to perform but being unable to do so.

As to the third question, whether prospective non-performance was such as to go to the root of the charterparties, given the history of late payments, the amounts and delays involved, together with the absence of any concrete or reliable assurance from GCS/GCL as to the future, Popplewell J had been amply entitled to conclude that GCS had renounced the charterparties.

The point that weighed heavily with the Court of Appeal was that "[GCS'] prospective non-performance would unilaterally convert a contract for payment in advance into a transaction for unsecured credit and without any provision for the payment of interest". Thus, in "GCS evinced an intention to turn each of the contracts into something radically different from its terms" and that deprived Spar of substantially the whole benefit of the charterparties. Popplewell J was therefore right to have concluded that such conduct was an anticipatory breach amounting to a renunciation of each of the charterparties.

Comment

It is not particularly surprising that the Court of Appeal has declined to follow *The Astra*, despite that decision having dictates of commercial certainty in its favour. Although commercial certainty was an important consideration, the Court of Appeal could not conceive that parties intended a withdrawal clause to operate so that a single payment of hire a few minutes late but outside the ambit of an anti-technicality clause would entitle a shipowner to throw up a five- or three-year charterparty and claim loss of bargain damages.

At its heart, therefore, the injustice of such a draconian sanction against charterers weighed especially heavily with the court. For as Professor Peel had already noted in

a Case Note, if the term were a condition, loss of bargain damages would not only be available against the "recalcitrant" charterer but against any charterer "guilty of late payment, however minor", subject to the mitigating effect of an anti-technicality clause[7]. In any event, by contrast, it did not appear to the Court that the market required the payment of hire to be a condition. Such a result could be achieved simply by express wording (e.g. clause 11 of the NYPE 2015).

From the point of view of shipowners, the Court was not persuaded by the extra-judicial "provisional view" expressed by Lord Phillips in the 2015 *Cedric Barclay Lecture* that the obligation to pay hire is a condition because otherwise the right to withdraw would be "worthless" in a falling market. The Court of Appeal considered that sufficient certainty is provided by a stringent application of the withdrawal clause, which achieves a sensible commercial result in a rising or flat market.

"IT SHOULD BE NOTED THAT THERE IS AN OBVIOUS DIFFERENCE BETWEEN THE LEGAL TREATMENT OF PAYMENT DEFAULT UNDER A LOAN AND UNDER A TIME CHARTER, RESPECTIVELY"

It should be noted that there is an obvious difference between the legal treatment of payment default under a loan and under a time charter, respectively. It will invariably be the case that a missed payment of principal or interest under a loan will give the lender an express right to accelerate and enforce its security (after expiry of any applicable - usually short – grace period). An owner is potentially exposed to the risk of precipitate enforcement action – even though this may be unlikely in practice - if it misses a loan payment but it might not be able to withdraw the vessel from hire and recover loss of bargain damages where there is an equivalent payment default under the time charter – even if that charter payment default has led or contributed to the payment default under the loan.

The solution would be for the owner to insist on wording in the charter expressly entitling the owner to sue for liquidated damages, or perhaps common law loss of bargain, if it withdraws following any missed hire payment. However, changing industry standards is usually easier said than done (see the low levels of use of the NYPE 2015). Owners and also lenders, as assignees, should pay greater attention to the owner's ability to claim damages against its charterer, particularly if the charterer is substantial or has a substantial guarantor – and/or the financing is underpinned by the charterer.

Furthermore, it should be borne in mind that the shipowners still succeeded in their claim for loss of bargain damages in respect of the balance of the charterparty based on the renunciatory breach. The Court of Appeal was clear that charterers are not entitled to "unilaterally convert a contract for payment in advance into a transaction for unsecured credit and without any provision for the payment of interest". Nor are shipowners required to accept some "limping performance and attendant uncertainty".

Thus, although it will always depend on the precise facts, shipowners may nevertheless be able to establish a repudiatory or renunciatory breach in cases where charterers have repeatedly failed to make timely payments of hire in full. Whether such a breach can be established will require a nuanced factual assessment, as to which legal advice should be sought, and the circumstances leading to the alleged repudiation or renunciation carefully documented.

[7] Edwin Peel "*Withdrawal for late payment of hire under a charterparty*" (2016) 132 LQR 177.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.

ANDREW WARD
Partner
London

+44 (0)20 7863 8950
award@wfw.com

ARMANDO NERIS
Associate
London

+44 (0)20 7814 8077
aneris@wfw.com

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