LIFTING THE LID ON SUBJECTS: THE DECISION IN NAUTICA V TRAFIGURA

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In *Nautica Marine Limited v Trafigura Trading LLC*[1], a case which will be of interest to all those engaged in contract negotiation, the English High Court has provided helpful guidance on the legal effect of agreements on "subjects" or "subs", and in particular, whether an outstanding subject will be construed as a pre-condition to the formation of a binding contract or as a performance condition which excuses a party from performing an otherwise binding contract if unsatisfied. The decision, which concerned the negotiation of a crude oil voyage charter, provides an important reminder of the need for clarity and precision when using "subjects".

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BACKGROUND

This dispute began back in early January 2016 when the claimant shipowner, Nautica, offered a vessel to the defendant charterer, Trafigura, for a crude oil fixture. A non-binding agreement in principle was reached "on subjects", a general term used in the maritime sector when the main terms for a charterparty are agreed but the parties are yet to enter into contractual relations. It signals that there are pre-conditions to a contract and the conclusion of a binding contract is reliant on events/subjects occurring or the agreement of the relevant party or parties to lift the subjects. In this case the relevant "subjects" were Stem[2], Suppliers' Approval, Receivers' Approval and Management Approval.

Following further negotiations Trafigura offered to lift all subjects, with the exception of Suppliers' Approval, in return for a reduction of the demurrage rate and an extension to the deadline for the lifting of Suppliers' Approval. Nautica agreed, but later the same day Trafigura purported to pull out of the charterparty, explaining that in fact it was unable to lift all subjects on the vessel. Nautica contended that the charterparty had been concluded, albeit that it would cease to be binding if Trafigura was unable to lift the Suppliers' Approval subject, despite taking reasonable steps to do so. However, Trafigura disagreed arguing that Suppliers' Approval was a pre-condition, without which the charterparty was not binding. The Court accepted Trafigura's argument and in so doing, it addressed the following points:

The differences between pre-conditions and performance conditions

The Court explained that the difference between a pre-condition and a performance condition is that a pre-condition prevents a binding contract from coming into existence, but a performance condition does not. Instead, a performance condition has the effect that performance does not have to be rendered if the "subject" is not satisfied for reasons other than a breach of contract by one of the parties. Thus, obtaining an export licence will typically be a performance condition to an international sale contract, whereas a "subject" dependent on one party concluding a contract with a third party has frequently been treated as a pre-condition.

The Court emphasised that each case will depend on its own individual facts and commercial context but that a "subject" is more likely to be a pre-condition as opposed to a performance condition if fulfilment requires personal or commercial judgment by one of the proposed parties to the contract. Further, where the conclusion of a contract is seen as dependent on the agreement of one or both parties to remove or lift a subject, rather than occurring automatically or on the occurrence of some external event such as the granting of permission or a licence, the Court considered that the "subject" is more likely to be a pre-condition.

It is possible for a pre-condition to be waived by conduct

The Court noted that it is possible for the parties to subsequently agree to change the legal status of a pre-condition. However, in this case, Nautica's agreement to reduce demurrage in return for lifting all subjects other than Suppliers' Approval did not radically change the nature of the parties' dealings, as Nautica contended.

Similarly, the Court explained that a party can waive a pre-condition by conduct and render the underlying contract binding without the satisfaction of the relevant "subject". However, the Court warned that this is not something that will be lightly inferred and only in rare cases would something short of actual performance be sufficient to constitute an implicit agreement to waive or remove a pre-condition.

"It is incompatible with the concept of binding contracts that one party has an effective option to fulfil the performance condition or not."

Parties should nevertheless take care when agreeing changes to agreements to avoid potential arguments that a pre-condition such as Suppliers' Approval has transformed into a performance condition, particularly where, as here, only one "subject" is outstanding and the risk of a binding contract coming into existence is live.

Parties will be obliged to take reasonable steps to arrange fulfilment of performance conditions

The Court explained that where a performance condition exists, this presupposes the existence of a binding contract and it is incompatible with the concept of binding contracts that one party has an effective option to fulfil the performance condition or not. In this case the point was academic given the finding that the Suppliers' Approval was a pre-condition, but parties should be mindful that where a contract does contain a performance condition, it will be necessary to take reasonable steps to fulfil that condition. In the case of obtaining an approval, particularly where approval will only be of commercial significance if obtained by a particular deadline, the Court considered this would include taking reasonable steps to obtain a timely approval.

The principles on burden and standard of proof in "subject to licence" cases do not operate more widely

In *obiter* comments the Court added that even if it had construed the Suppliers' Approval as a performance condition, it would not have accepted that the principles on burden and standard of proof applicable in "subject to licence" cases should apply. In those cases, it has been held that it is for a defendant to show that, even if reasonable steps have been taken, an import or export licence would not have been granted, effectively reversing the usual burden of proof. However, the rationale for this approach is that the defendant is effectively relying on the absence of a licence as an excuse for non-performance and so the words "subject to the licence" operate as a something akin to an exemption clause. The Court held that the Suppliers' Approval subject did not share this status. Instead, there was no good reason why the ordinary legal principles of causation and quantification of loss should not apply, including the doctrine of loss of chance.

"Parties should take care to ensure that they do not inadvertently waive a pre-condition unless they intend to, as this may have the effect of rendering a contract binding."

KEY TAKEAWAYS

- Agreements on "subjects" and other "subject to" wording may well be of assistance in drawing up terms and, as the judge highlighted, are frequently encountered when negotiating charterparties. Generally, the use of these terms should cause parties to stand back and consider whether binding obligations are being created.
- However, as this case demonstrates, such wording can also introduce an unwelcome element of uncertainty into contractual relationships. The disparity between the parties' understanding of supplier's approval is another example of the need for clarity. Had the parties been clear about this throughout their negotiations, time and money on both sides could have been saved.
- As this case shows, caution should be taken, particularly in circumstances where the consent or approval of a third party is required before the contract can be entered into.
- Parties should take care to ensure that they do not inadvertently waive a pre-condition unless they intend to, as this may have the effect of rendering a contract binding.
- Parties should also take care when negotiating and communicating to ensure that they do not inadvertently change the meaning of a pre-condition into a performance condition which may also have the effect of rendering a contract binding (albeit with the potential that contractual obligations may amount to nothing if the performance condition cannot be fulfilled).

[1] [2020] EWHC 1986 (Comm)

[2] As the court noted, an acronym for "subject to enough material", which meant subject to the charterers confirming that they had sufficient cargo to load on the Vessel.

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