Shipping

October 2013

SHIPPING BULLETIN

Welcome to the October edition of our Shipping Bulletin

This edition of the Bulletin provides an update of the latest key shipping cases and reviews judgments both of the English courts and European Court of Justice (ECJ).

The recent English Court of Appeal decision in the *Bulk Chile* case has confirmed that owners are entitled to demand payment of freight under the bill of lading, provided that the demand is made before freight has been paid to that other party. This will be welcome news for owners seeking to recover payment due from an insolvent charterer, but is potentially onerous for charterers, who could end up paying freight twice.

We look at the latest seller-friendly decision of the English High Court on the Norwegian Sale Form 1993, which has overturned the previous market understanding that where a buyer fails to pay the deposit, an innocent seller may only claim compensation for the loss actually suffered. The High Court has now held that the seller can in fact claim the whole deposit regardless of the seller's actual loss.

The ECJ recently decided that France's exemption of pleasure boats from VAT was contrary to EU law, being a breach of VAT Directive 2006/112/EC. We analyse the implications.

Finally, we feature our regular Case Update, which provides a brief summary of the other major recent English court cases relevant to shipping law.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin or your usual contact at HFW.

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Liens on sub-freights continued: owners' right to intercept freight confirmed

On 14 March 2013, the English Court of Appeal upheld the High Court's decision in the *Bulk Chile*[1] that an owner is entitled to demand payment of freight under the bill of lading (even if the charter stipulates for payment to another party), provided that the demand is made before freight has been paid to the other party.

The facts of this case are set out in detail in our March 2013 Shipping Bulletin[2]. In summary:

- Owners (DBHH/CSAV) chartered the MV BULK CHILE to KLC. KLC then sub-chartered the ship on a time charter trip to Fayette. Fayette then sub-sub-chartered her to Metinvest on a voyage charter.
- The head charterparty provided that Owners had a lien on all cargoes and sub-freights for any amounts due under the charter.
- KLC became insolvent and was unable to pay hire to Owners.
- On 1 February 2011, Owners sent Fayette and Metinvest a "Notice of Lien" (the First Notice) requiring them to pay any balance of freight and/or hire to Owners.
- On 5 February 2011, Owners sent a "Notice of Lien on Cargo" (the Second Notice), which attached a copy of the First Notice and stated that the lien was extended to *"cargo now loaded on board m/v BULK CHILE to be carried under bills of lading numbers..."*

This is likely to be a welcome decision for owners who find themselves with a ship on hire to a charterer who becomes insolvent.

- The bills stated on their face "freight prepaid" and provided *"freight payable as per [the voyage charterparty between Fayette and Metinvest]"*. Freight had in fact not been pre-paid.
- After the First Notice, Metinvest proceeded to pay freight to Fayette.

Owners brought proceedings against Metinvest for freight under the bills and voyage charter. The High Court allowed Owners' claim. Metinvest appealed to the Court of Appeal. Owners also cross-appealed on the right to lien sub-hire payable by Fayette under the trip charterparty (which the High Court rejected).

The Court of Appeal confirmed the High Court's decision and dismissed the appeal.

The bill of lading evidenced a contract between Owners and Metinvest. By the terms of that contract, Owners had directed Metinvest to pay the freight due under the bills to Owners' nominated agent (Fayette). However, an owner reserves the right to receive the contractual remuneration and may revoke the agent's authority (the *Spiros C* [2000] 2 Lloyd's Rep 319).

An owner is therefore entitled to intercept freight due under the bills at any time before it has been paid as initially directed.

Although the Notices were directed towards Owners' contractual lien under the charterparty, the Notices were sufficient to put Metinvest on notice that they were required to pay the bill of lading freight to Owners and not to Fayette. They contained explicit warnings to Metinvest that they risked paying freight twice.

It did not matter that the bills were marked *"freight prepaid"* in circumstances where the freight had not in fact been paid.

This is likely to be a welcome decision for owners who find themselves with a ship on hire to a charterer who becomes insolvent, as the decision confirms an owner's ability to intercept freight due from the shipper under the bill of lading and also, depending on the wording of the relevant charter, exercise a lien over any sub-freights (and sub-hires) due in the charterparty chain.

On the other hand, the decision is potentially hard-hitting for sub-charterers who are also the shippers as they might conceivably end up paying freight twice. It is also arguably unfair to Fayette, who paid hire to KLC, but received no freight in return.

Issues also arose concerning the requirement for Owners to account for any surplus received after deducting sums owed under the head charterparty and whether this could lead to an unfair result. The Court of Appeal recognised that although the need for an owner to account for any surplus may be problematic to charterers where as in this case, one party in the charterparty chain becomes insolvent, such potential difficulties cannot of themselves

It did not matter that the bills were marked "freight prepaid" in circumstances where the freight had not in fact been paid.

1 Dry Bulk Handy Holding Inc v Fayette International Holdings Ltd [2012] EWHC 2107 (Comm)

2 Our March 2013 Bulletin can be found at http://www.hfw.com/Shipping-Bulletin-March-2013

obstruct the existence of an owner's contractual right. Future cases on this point can be expected.

The Court of Appeal indicated (but without deciding the issue) that where a charterer continues to pay hire under the head charterparty, he would arguably be entitled to restrain an owner who sought to collect bill of lading freight. The Court added that, for commercial reasons, an owner would rarely seek to take this step in any event, but suggested that a charterer might be able to rely on clause 8 of the NYPE form, or a similar employment clause, to prevent this.

In the meantime, it is recommended that an owner send separate messages to exercise rights of lien over sub-freights, sub-hires and over cargoes, and to intercept bill of lading freight.

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Norwegian Sale Form 1993: the status of buyers' deposit

A recent English High Court decision[1] has clarified the status of the buyers' deposit under the most commonly used form for ship sale and purchase, the Norwegian Sale Form. The judgment related to a contract on the Norwegian Sale Form 1993 (NSF 93) and has overturned the previous market understanding that where a buyer fails to pay the deposit, an innocent seller may only claim compensation for the loss actually suffered. The High Court has now held that in this situation a seller can claim the whole deposit regardless of the seller's actual loss.

The judgment...has overturned the previous market understanding that where a buyer fails to pay the deposit, an innocent seller may only claim compensation for the loss actually suffered.

Background

The Sellers entered into a memorandum of agreement (MOA) with the Buyers for the purchase of the MV GRIFFON for US$22 million. The MOA was on a standard NSF 93. Clause 2 of the MOA provided as follows:

"As security for the correct fulfilment of this Agreement the Buyer shall pay a deposit of 10% (ten per cent) of the Purchase Price within 3 (three) banking days after this Agreement is signed by both parties and exchanged by fax/ email. This deposit shall be placed in the Sellers' nominated account with the Royal Bank of Scotland plc, Piraeus and held by them in a joint interest bearing account for the Sellers and the Buyers, to be released in accordance with joint written instructions of the Seller and the Buyers..."

Clause 13 of the MOA provided as follows:

"Should the deposit not be paid in accordance with Clause 2, the Sellers shall have the right to cancel this Agreement, and they shall be entitled to claim compensation for their losses and for all expenses incurred together with interest. Should the Purchase Price not be paid in accordance with Clause 3, the Sellers have the right to cancel the Agreement, in which case the deposit together with the interest earned shall be released to the Sellers. If the deposit does not cover their loss, the Sellers shall be entitled to claim further compensation for their losses and for all expenses incurred together with interest."

A deposit of 10% (US$2,156,000) was payable within three banking days of signature. The deposit was not paid and Sellers accepted Buyers' conduct as repudiation of the MOA. Buyers accepted that their failure to pay the deposit was a repudiatory breach.

The damages recoverable by the Sellers on the conventional measure of the difference between contract and market price were said to be US$275,000, which is significantly less than the deposit. Thus a large sum of money turned on the correct interpretation of the MOA wording in this case.

Arbitration decision

Sellers commenced arbitration and the question for the Tribunal was whether the Sellers could recover the amount of the deposit as a debt or by way of damages. In the arbitration, Sellers' case was that the right to payment of the deposit had accrued before the MOA was terminated and they were therefore entitled to claim the deposit either as a debt or as damages for breach of contract in accordance with Clause 2 of the MOA. Conversely, Buyers argued that on the true construction of the MOA, and in particular Clause 13, in the event of non-payment of the deposit, Sellers were only entitled to claim "compensation for losses". The Tribunal's award held that Sellers were not entitled to recover the deposit and were restricted solely to their claim in damages under Clause 13.

1 Griffon Shipping LLC v Firodi Shipping Ltd (the Griffon) [2013] EWHC 593

Given that the nature of a deposit is to encourage the performance of the contract, not compensate a Seller for more loss than they suffered, the issue was whether the Sellers could claim the deposit if the Buyers repudiated before paying it.

Decision

On appeal to the Commercial Court, Mr Justice Teare considered the principles applicable to deposits and part-payments. He concluded that the language of the MOA entitled the Sellers to recover the deposit in any event. Clause 2 expressly described the payment as a deposit for the purpose of providing *"security for the correct fulfilment"* of the MOA. If a deposit is paid and the contract comes to an end as a result of Buyers' breach, the deposit is to be forfeited because it is paid as *"an earnest of performance"*. This indicates that when the deposit accrued due, as it did before the MOA was terminated, it accrued due unconditionally. By contrast, a part payment may be recoverable after termination because the price is no longer payable.

The Court relied on existing case law to determine that where the Buyers repudiate before paying the deposit, the Sellers' right to claim depends on whether that right accrued before the termination of the contract. Mr Justice Teare determined that there had been such an accrual, given that termination occurred after the due date for payment of the deposit. Therefore, the Sellers' right to payment under Clause 2 was unconditional and not lost upon termination. It was clear that if the deposit was paid before the Buyers had repudiated, the Sellers would have been entitled to keep the deposit. Given that the nature of a deposit is to encourage the performance of the contract, not compensate a Seller for more loss than they suffered, the issue was whether the Sellers could claim the deposit if the Buyers repudiated before paying it.

The Court determined that clear language was needed to deprive the Sellers of the right to the deposit. Clause 13 did not satisfy this requirement. Furthermore, it was not appropriate to infer from the absence of a reference to the deposit in Clause 13 that the parties intended to exclude the right to recover the deposit otherwise provided for by Clause 2. The effect of Clause 13 was to give a remedy in addition to the deposit, not to replace it.

Further if the construction of Clause 13 was held to be ambiguous such that there may be two possible constructions of it, one which excluded the Sellers' right to payment of the deposit and one which conferred additional rights, the latter was to be preferred as it was more consistent with good business sense (referencing the *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900 decision).

The arbitrator's decision was therefore overturned. Leave to appeal the decision has been granted.

This may be perceived as a surprising result, as the judgment enables Sellers to claim a deposit in excess of the actual loss suffered. However, the judgment emphasises the commercial reality that the purpose of a deposit is to secure Buyers' performance.

Buyers wishing to try to limit the Sellers' right to claim a deposit where the contract has been terminated will now need to utilise clear wording in the MOA to expressly exclude the right, if commercially achievable.

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VAT exemption on yachts: the end of French exceptionalism

The European Court of Justice (ECJ) recently decided that France has failed to fulfil its obligations under Council Directive 2006/112/EC (the Directive) on the common system of value added tax (VAT) because France has exempted pleasure boats from VAT.

The Directive provides for a VAT exemption for certain transactions intended for vessels (i) carrying passengers for reward, or (ii) used for the purpose of commercial activities, in both cases subject to the condition that the vessels must be used for navigation on the high seas.

However, under French rules, any yacht, which includes a pleasure boat, may benefit from a VAT exemption, provided the following conditions are met:

a) The vessel has a commercial registration certificate from France or any other EU state.

b) It has a permanent crew.

c) It is to be used for commercial activities.

The European Commission questioned the compatibility of the French national measures, which it stated impermissibly extended

the exemptions provided for by the Directive, and consequently, on 21 November 2012, sent France a Reasoned Opinion – which is the first stage of the infringement procedure – requesting the removal within two months of the VAT exemption for yachts used for pleasure boating.

Back in 2010, the ECJ had already confirmed that the VAT exemption provided for in Article 148 of the Directive (previously Article 15) did not apply to luxury vessels used by individuals for recreational purposes.

As a result of the submission of the Reasoned Opinion, France amended its tax legislation – incorporated in Article 262 of the French Tax Code – in order to comply with the Directive.

However, in practice, France still did not comply with the Opinion and maintained its initial interpretation of the rules. This is because the French tax authorities claimed that it would be too difficult to implement the concept of navigation on the high seas and to ensure that the benefit of the VAT exemption would be limited to the vessels specifically envisaged in the Directive. In practice, the tax authorities therefore did not require this condition to be met before exempting yachts (i.e. pleasure boats) from VAT.

The matter was accordingly referred to the ECJ. In a judgment of 21 March 2013 (European Commission v France (C-197/12), the ECJ declared that France had failed to fulfill its obligations under the Directive, specifically Article 148(a), (c) and (d). This was because France had not made the exemption

As a result of the submission of the Reasoned Opinion, France amended its tax legislation – incorporated in Article 262 of the French Tax Code – in order to comply with the Directive.

from VAT of transactions referred to in Article 262 Part II(2), (3), (6) and (7), of the French Tax Code (Code général des impôts) conditional on the necessary requirements. That is, that the vessel must be used for navigation on the high seas and is either (i) a vessel carrying fee-paying passengers for remuneration or (ii) used for commercial activities.

The French tax authorities were, as a result of the judgment, obliged to remove the relevant rule and to implement new provisions which state that the VAT exemption does not apply to the provision of services by which a vessel is made available, for remuneration, with a crew, to individuals for the purposes of leisure travel on the high seas. The French tax authorities further specified that these new provisions extend to leasing and chartering agreements for the purpose of leisure travel entered into from 15 July 2013 onwards.

While the French tax rules now comply with the provisions of Article 148 of the Directive, the customs administration, on the other hand, has not yet revised its regulations which therefore still remain in breach of the Directive.

In practice, companies renting out yachts should (from 15 July 2013 onwards) invoice their clients with VAT included, and the amount of tax charged should appear on such an invoice. It is also recommended that companies incorporated outside the European Union, which are involved in leasing and chartering operations in French territorial waters for the purpose of leisure travel, now appoint a tax representative in France.

In this respect, the French tax authorities allow the taxation of pleasure boats in proportion to the time spent in Community territorial waters (i.e. when the lessor is established in France) or in proportion to the time spent in French territorial waters (i.e. when the lessor is established in a non-EU country), and specify that this time will be estimated at a flat-rate of 50% of the total hire period. It must nevertheless remain a concern that a systematic application of this flat rate by the French tax authorities is, in due course, likely to attract the wrath of the European Commission.

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Back in 2010, the ECJ had already confirmed that the VAT exemption provided for in Article 148 of the Directive (previously Article 15) did not apply to luxury vessels used by individuals for recreational purposes.

Quarterly Case Update

1. Yuzhny Zavod Metall Profil LLC v EEMS Beheerder BV – the "EEMS SOLAR" LMLN 29 July 2013
   Cargo claim and requirements to incorporate validly the terms of clause 5 of Gencon 1994 Charterparty and the effect of this on responsibility for stowage as between a carrier and cargo interests.

2. Metal Market OOO v Vitorio Shipping Ltd – the "LEHMANN TIMBER" [2013] EWCA Civ 650
   Court of Appeal overturn High Court decision on recoverability of Owners' costs of exercising GA lien.

3. Kuwait Rocks Co v AMN Bulkcarriers Inc – the "ASTRA" [2013] EWHC 865 (Comm)
   The obligation upon a charterer to make punctual payment of hire in clause 5 of the NYPE 1946 form charter is a condition of contract.

4. Griffon Shipping LLC v Firodi Shipping Limited – the "GRIFFON" [2013] EWHC 593 (Comm)
   MOA – NSF 1993 and the payment of the Buyer's deposit - where a Buyer fails to pay the deposit, an innocent Seller may claim the whole deposit regardless of the Seller's actual loss.

5. Dry Bulk Handy Holding Inc. and another v Fayette International Holdings and another – the "BULK CHILE" [2013] EWCA Civ 184
   Lien on sub-freight and intercepting bill of lading freight. More questions than answers?

6. White Rosebay Shipping SA v Hong Kong Chain Glory Shipping Limited – the "FORTUNE PLUM" [2013] EWHC 1355 (Comm)
   Repudiation of time charter by non-payment of hire by Charterers. Unintended affirmation of the charter by Owners.

7. Navig8 Pte Ltd v Al-Riyadh Co for Vegetable Oil Industry – the "LUCKY LADY" [2013] EWHC 328 (Comm)
   Jurisdictional dispute – service out of the jurisdiction.

8. UST-Kamenogorsk v AES Kamenogorsk [2013] UKSC 35
   Supreme Court. Anti-suit injunction in support of arbitration where no arbitration proceedings commenced or contemplated by claimants.

9. Kingsway Shipping Co Ltd v STX Gulf Shipping DMCCO – the "YONG JIN" [2013] EWHC 1149
   Guarantee given in correspondence by a sub-charterer to the Master of the ship. The Court held this was not a contract of indemnity with Owners and was sub-charterers' guarantee only.

10. Beijing Jianlong Heavy Industry v Golden Ocean and Beijing Jianlong Heavy Industry v Ship Finance International [2013] EWHC 1063 (Comm)
    Section 67 challenge to the jurisdiction of London arbitration Tribunal on the basis that the guarantees were unlawful as a matter of Chinese law (failure to satisfy SAFE requirements in China), and this rendered the arbitration clause unlawful. The Court held the Tribunal had jurisdiction.

11. Versloot Dredging BV v HDI Gerling Industrie Verischerung AG and others [2013] EWHC 581 (Comm)
    Application for an injunction arising from a request to interview an opponent's witness. The case discusses the extent of the no property in a witness rule and questions of confidentiality and privilege.

12. Standard Chartered Bank v Dorchester LNG Ltd [2013] EWHC 808 (Comm)
    Letter of Indemnity for delivery without production of bills of lading. Financing bank having title to sue Owners.

13. Great Elephant Corp v Trafigura Beheer BV - the "CRUDESKY" [2013] EWCA Civ 905
    Delay at load port due to export irregularities and heavy fine. Responsibility for delay under CP and Sales contracts.

14. Bunge SA v Kyla Shipping Co Ltd - the "KYLA" [2013] EWCA Civ 734
    Unsuccessful attempt to set aside High Court decision to refuse permission to appeal.

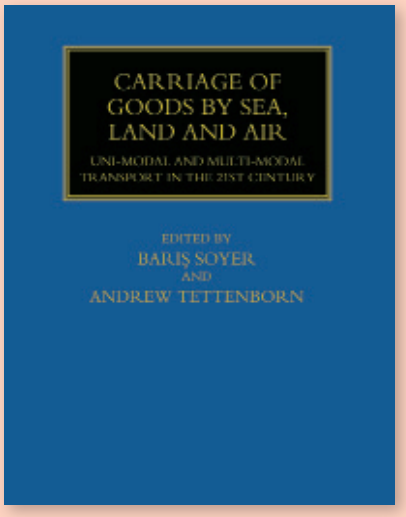
15. Review of recent Court authorities on strict compliance with Court deadlines/orders
    Beware the Court's stricter approach to Court orders.

16. Cosmotrade S.A. v Kairos Shipping Ltd. & Ors [2013] EWHC 1904 (Comm)
    Can a Limitation Fund in England be constituted by way of an IG P&I Club LOU? The answer is presently no.

NEWS

Carriage of Goods by Sea, Land and Air

Uni-modal and Multi-modal Transport in the 21st Century



Written by a combination of top academics, industry experts and leading practitioners, this book offers a detailed insight into both uni-modal and multi-modal carriage of goods. It provides a comprehensive and thoroughly practical guide to the issues that matter today on what is a very complex area of law.

HFW Partner Craig Neame contributed Chapter 6 – 'Who Contracts with Whom? An Analysis of Chinese Exports to the United Kingdom'.

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Conferences and Events

Lloyd's List Middle East and Indian Subcontinent Awards Dinner
Dubai
29 October 2013
Attending: Hugh Brown, plus colleagues from the Dubai office

Payment of hire is a condition – an end to charterers' ability to deduct from hire? The "Astra"
Geneva, Switzerland
7 November 2013
Presenting: Menelaus Kouzoupis

Marine Money Korea Ship Finance Forum
Seoul
7 November 2013
Attending: John Forrester

2013 Seafarers Forum Perth, WA
27 November 2013
Presenting: Ben Buckhurst – Psychological injuries under the Seafarers Rehabilitation and Compensation Act 1992
Attending: Gavin Vallely and Peter Leslie

Maritime Emergencies and their aftermath
Genoa, Italy
28–29 November 2013
Presenting: Andrew Chamberlain – dealing with mega–casualty incidents

For more information about any of these events, please contact us at events@hfw.com

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