

PAYMENT OF HIRE IS A CONDITION – AN END TO A CHARTERER’S ABILITY TO DEDUCT FROM HIRE?

High Court decision of Mr Justice Flaux in - **Kuwait Rocks Co v AMN Bulkcarriers Inc** **(The MV “Astra”) [2013] EWHC 865 (Comm)**

Mr Justice Flaux has held that the obligation upon a charterer to make punctual payment of hire in clause 5 of the NYPE 1946 form charter, especially one containing an anti-technicality clause, is a contractual condition, a breach of which entitles an owner to terminate the charter and claim damages for future loss of earnings. Although the decision is based on the NYPE 1946 form, which is itself very common, it has wider application to other charterparty forms. The case arose out of an appeal from an arbitration award on a point of law.

It was previously widely believed that a non-payment of hire would allow an owner, where he had a contractual right of withdrawal, to withdraw the vessel from the service of the charterer and claim only any unpaid hire up to the date of that withdrawal. However, it was generally accepted that the payment of hire was not a condition of the contract and, as a result, in order for the owner to be entitled to damages for future losses, he would

need to establish that the charterer had repudiated the contract by evincing an intention no longer to be bound by the contract or to fulfil the contract in a manner that deprived the owner of substantially the whole benefit of the contract (repudiatory breach).

In practice this was hard to evidence, which meant that it was notoriously difficult to state with any real certainty how many missed hire payments (or indeed deductions/short payments of hire) would allow the owner to successfully argue that the charterer was in repudiatory breach. This was particularly problematic in cases where an owner was faced with a defaulting charterer in a rapidly falling market, because if the owner terminated the contract too soon he could forfeit a potentially substantial damages claim for future loss of income.

Background

The “Astra” was fixed in October 2008 by the owner on a five year time charter on an amended NYPE 1946 form. Clause 5 of the charter required punctual and regular payment of hire 30 days in advance, breach of which would give the owner the option to withdraw the vessel and terminate the charter. An anti-technicality clause was incorporated at clause 31, requiring the owner to give the charterer two banking days to rectify any failure to make payment.

Owing to the charterer’s financial difficulties, there were several defaults in the payment of hire, culminating in the owner sending an anti-technicality notice to the charterer in August 2010. Following charterer’s failure to pay, the owner both withdrew the vessel and claimed that the charterer was in repudiatory breach.

An arbitration was commenced by the owner, who claimed prospective damages from the date of withdrawal to the earliest redelivery date under the charterparty. The Tribunal did not accept that clause 5 was a condition, but they did however find that the owner was entitled to his prospective damages on the basis that the charterer’s conduct amounted to a repudiatory breach of the contract.

The charterer appealed and the owner also challenged the Tribunal’s finding that clause 5 was not a condition. The charterer’s appeal was dismissed by Mr Justice Flaux on separate grounds, however on the parties’ request he proceeded to determine whether or not clause 5 was a condition of the charter. The effect of this is that his findings on the issue are arguably obiter, and are not therefore binding but persuasive.

The Judgment

Mr Justice Flaux found that clause 5 of the NYPE (the obligation to pay hire) was a condition of the contract for a number of reasons, the most important of which we list below:

1. Clause 5 treats a failure to make punctual payment of hire by the charterer as sufficiently serious as to entitle the owner to withdraw/terminate the contract. This was a strong indication that a failure to pay hire goes to the root of the contract and that the provision was a condition.
2. In mercantile contracts where there is a time provision, such as a term requiring payment to be made by a certain date, then time is generally considered to be of the essence and is hence a condition. It should be noted that the Judge’s decision was that failure to pay hire was a condition whether or not a charterparty contains an anti-technicality provision.

3. The importance of certainty in commercial transactions. In particular, the Judge thought it preferable to avoid situations where the right to withdraw the vessel for non-payment of hire left an owner with no remedy in damages in a falling market, save in cases where the charterer’s conduct could also be said to be repudiatory. This created uncertainty for the owner as to whether to withdraw the vessel or to soldier on with a recalcitrant charterer until such time as the owner was in a clear position to say that the charterer was in repudiatory breach. The charterer’s “wait and see” approach to the question of when a repudiatory breach of the charterparty would occur was rejected.

Commentary

As indicated above, Mr Justice Flaux’s conclusions as to the status of the clause 5 obligation to pay hire are arguably obiter. However, until we have a clear and binding decision directly on point, Mr Justice Flaux’s findings will possibly be persuasive.

Existing Disputes

The decision may affect the outcome of a number of current “credit crunch” cases that are in progress, where there are issues regarding repudiatory breach.

Future Disputes

Going forward, the decision in the “Astra” puts owners in a stronger position and arguably significantly increases an owner’s options when faced with a defaulting charterer – especially in a falling market. If the case is correct, it significantly reduces the risk to an owner if he wishes to terminate and allows him to crystallise a damages claim for future losses. However, an owner must still ensure that he terminates correctly (adhering





to any contractual requirements such as anti-technicality clauses) to avoid being in repudiatory breach himself. An owner also has a potential risk in that the judgment in *The Astra* is, on this issue, obiter, and may be subject to appeal, particularly given the prominence of this issue.

Charterers also need to think carefully about any failure to pay hire on time/ making disputed deductions from hire. It may be that owners utilise this decision to dissuade charterers from making deductions. In this regard:

- A failure to pay hire on time will be a breach of condition entitling an owner to terminate and claim damages for the balance of the charter period; and
- A deduction from hire may now expose a charterer to the risk that his action was a breach of a condition and therefore repudiatory. All may turn on whether or not the deduction was valid. If the owner terminates and the deduction is later found to be valid, then the owner will himself be in repudiatory breach and liable in damages to the charterer. If the owner terminates and the deduction is later found to be invalid, then the charterer will be liable in damages to the owner. Thus making deductions from hire is a game of high stakes if an owner decides to press the issue.

If a charterer is unsure about the validity of any deduction from hire, then the best advice may be, absent an express contractual right to deduct, to:

- Seek to agree the deduction with the owner first (this may be problematic given the strong position owners are now in);

- Pay hire under protest, reserving the right to pursue recovery by legal proceedings; or
- Pay the disputed sum into escrow (the owner's agreement would be required) and then start legal proceedings.

Of course, the above are only general comments and an owner or charterer's exact legal position will depend on the precise wording of their contract and their particular factual background, on which specific legal advice should be taken.

Contract wordings

The exact effect of the judgment will only become clear over time, but it will no doubt lead parties to consider payment of hire issues in a new way. It may lead charterers to seek amendments to their standard form charters aimed at revising provisions regarding payment of hire and changing the contractual regime to provide better protection when making deductions from hire.

The decision may also be of relevance to other types of contract. On the face of it, this judgment is of significant benefit to owners. However, whilst the decision is potentially ground-breaking, it remains to be seen whether it will be followed either at first instance level or in the appeal courts, and further decisions on the point will be closely watched.

For further information, please contact [Rory Butler](#), Partner, on +44 (0)20 7264 8310 or rory.butler@hfw.com, or [Menelaus Kouzoupis](#), Associate, on +44 (0)20 7264 8482 or menelaus.kouzoupis@hfw.com, or your usual HFW contact.

For more information, please also contact:

Paul Dean

London Partner
T: +44 (0)20 7264 8363
paul.dean@hfw.com

Guillaume Brajeux

Paris Partner
T: +33 (0)1 44 94 40 50
guillaume.brajeux@hfw.com

Jeremy Davis

Geneva Partner
T: +41 (0)22 322 4810
jeremy.davis@hfw.com

Dimitri Vassos

Piraeus Partner
T: +30 210 429 3978
dimitri.vassos@hfw.com

Hugh Brown

Dubi Partner
T: +971 4 423 0501
hugh.brown@hfw.com

Paul Aston

Singapore Partner
T: +65 6305 9538
paul.brown@hfw.com

Paul Hatzer

Hong Kong Partner
T: +852 3983 7788
paul.hatzer@hfw.com

Nicolas Poynder

Shanghai Partner
T: +86 21 5888 7711
nicolas.poynder@hfw.com

Gavin Valley

Melbourne Partner
T: +61 (0)3 8601 4523
gavin.valley@hfw.com

Stephen Thompson

Sydney Partner
T: +(0)2 9320 4646
stephen.thompson@hfw.com

Hazel Brewer

Perth Partner
T: +61 (0)8 9422 4702
hazel.brewer@hfw.com

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Lawyers for international commerce

HOLMAN FENWICK WILLAN LLP

Friary Court, 65 Crutched Friars

London EC3N 2AE

T: +44 (0)20 7264 8000

F: +44 (0)20 7264 8888

hfw.com

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