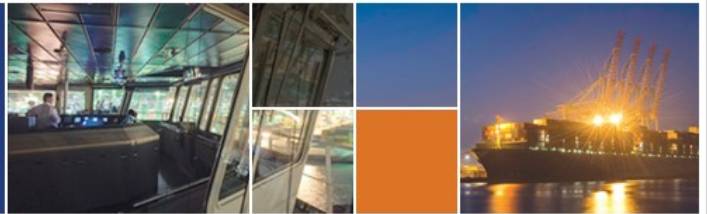




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Non-Payment of Hire – Right to Withdraw

July 2013

In *Kuwait Rocks Co v AMB Bulkcarriers Inc (the "Astra")* [2013] EWHC 865 (COM) Mr Justice Flaux, whilst hearing charterers' application for permission to appeal under Section 69 of the Arbitration Act 1996, took the opportunity to deal with an issue raised by owners in their Respondents' Notice. The question was whether the Tribunal "should also have decided that the owners were entitled to recover substantial damages for the charterers' non-payment of hire on the basis that Clause 5 [of the NYPE form] (whether on its own or with the anti-technicality Clause 31 and/or the Compensation Clause in the two addenda) was a condition, breach of which entitled the owners to recover not only unpaid hire at the date of withdrawal but damages for future loss of earnings".

Flaux J determined that the obligation to make punctual payments of hire (whether in Clause 5 on its own or in Clause 5 in conjunction with the anti-technicality provision in Clause 31) was a condition of the contract, breach of which entitled owners to withdraw the vessel and claim damages for loss of bargain.

In this article, Reed Smith LLP, the solicitors acting for the successful owners in *The Astra*, consider whether a single hire default now entitles owners to withdraw and to claim loss of profits for the remaining charter period, and the impact of the decision on charterers' ability to deduct from hire.



Facts

The "Astra" was the subject of a five year time charter on an amended NYPE 1946 form. Clause 5 of the charter required hire to be paid punctually and regularly in advance, failing which owners could elect to withdraw the vessel and terminate the charter. Clause 31 was an anti-technicality provision, requiring owners to give charterers two banking days' notice to rectify any failure in payment which was due to oversight, negligence, error or omission.

After a history of problems, owners issued an anti-technicality notice in respect of unpaid hire and when payment was not received the owners withdrew the vessel and held the charterers in repudiatory breach of contract.

Owners commenced arbitration and claimed damages for loss of earnings for the period from the date of withdrawal to the earliest date when the vessel could have been properly redelivered by charterers. They argued that the obligation to pay hire under clause 5 was a condition, breach of which entitled owners to those damages. The Tribunal had rejected this argument, but did find that owners were entitled to damages because, *inter alia*, the charterers had by their conduct renounced the charter.

It was charterers' appeal, but owners also contended in their Respondents' Notice that the Tribunal had erred in finding that clause 5 was not a condition of the charter. Although this issue was academic because charterers' appeal was dismissed on other grounds, Flaux J decided the point at the request of both parties. He held that clause 5, both on its own and in conjunction with the anti-technicality provision, was a condition of the contract. Charterers' breach therefore entitled owners to withdraw the vessel and claim damages for loss of bargain in respect of the unexpired charter period.

A "condition" of the contract

Where an obligation is classified as a condition of a contract, any breach of that obligation will entitle the innocent party to treat himself as discharged from further performance of the contract. He may do so even if he has suffered no prejudice as a result of the breach. Where loss has been suffered, he can claim damages. In a charter context, this includes damages for loss of profit for the remaining charter period.

The position before *the "Astra"*

Prior to *the "Astra"*, the punctual and regular payment of hire was generally seen as an intermediate contractual term. The remedy for breach depended on the effect of the breach at the time it occurred. If the innocent party was deprived of the whole or substantial benefit of the contract, then the breach would be a breach of condition, as above.

Where owners had a contractual right of withdrawal, they could withdraw the vessel from charterers' service and claim unpaid hire up to the date of withdrawal. In order to claim damages for the remaining charter period, however, owners would have to prove that charterers were in repudiatory breach of charter. They would need to show that charterers had either evinced an intention not to be bound by the charter terms, or had expressly declared that they were or would be unable to perform their obligations in some essential respect. The general view was that a failure to pay hire punctually and regularly very rarely amounted to such a breach.

A repudiatory breach entitling owners to withdraw and claim damages was difficult to prove. Questions were raised as to how many missed or short hire payments amounted to an "intention no longer to be bound" on the part of charterers. If owners did decide to terminate the charter, they needed to be confident that they had acted correctly. If they terminated the charter too early, i.e. at a point when charterers' hire defaults to date did not amount to a repudiatory breach, then they themselves could be faced with a substantial damages claim.

The question of whether payment of hire was a condition of the contract had received very little attention before *the "Astra"*, and the question of whether breach would entitle owners to damages for loss of future earnings had received none at all. The issue does not arise on a rising market, where owners would have no need to claim damages and indeed might profit from withdrawal. It will only arise in a market where owners are likely to suffer loss and damage as a result of early withdrawal.

Mr Justice Flaux's decision in *the "Astra"* has brought some clarity and detailed reasoning to the issue. It should be borne in mind, however, that although dealt with in detail, the decision on this point may strictly be *obiter*, and so not binding, merely persuasive. Courts and Tribunals may be persuaded to distinguish *the "Astra"*, or not to follow Flaux J's judgment whilst the question remains undecided by a higher court. That being said, *the "Astra"* represents the most definitive judicial pronouncement on this issue to date.

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In respect of how the decision will affect owners' and charterers' commercial dealings, two key questions arise.

Can owners withdraw and claim damages after a single hire default?

Where a condition is concerned, the parties are taken to have agreed that any failure of performance, however seemingly trivial, entitles the other party to elect to bring the contract to an end. This means that, on a strict analysis, owners would be entitled to withdraw a vessel and claim damages where a single hire payment is missed or not made in full.

Owners should, however, act with some caution. If this decision is to be seen as persuasive rather than binding, then the way is open for subsequent cases to be distinguished on their facts and/or applicable charter terms. Wrongful withdrawal by owners will itself be a repudiatory breach of charter, for which owners are likely to face a damages claim. Each case should be considered on its own facts.

There are also commercial issues for owners to consider. Once owners withdraw a vessel they run the risk of being unable to fix her on favourable terms. The vessel may also face a period of unemployment before the start of any substitute fixture. Any damages to which owners may be entitled are unlikely to be paid either quickly or without incurring potentially substantial legal fees. Owners may find themselves significantly out of pocket for some time, even if their legal position against charterers has been strengthened.

Owners must also be careful to ensure that any withdrawal is in accordance with the charter terms, and that they have done nothing which could render the withdrawal invalid. The recent case of *White Rosebay Shipping SA v Hong Kong Chain Glory Shipping* [2013] EWHC 1335 (Comm), for example, highlights the risk of affirming the charter prior to withdrawal, which could mean that owners' withdrawal is itself a repudiatory breach.

What is clear is that this decision places owners in a far stronger position in respect of charterers' failure to pay hire. They will be able to place significant pressure on charterers who do not pay hire in full and on time. Charterers must appreciate that even if the precise effect of this decision remains to be seen, the risk of owners withdrawing after only a single late or incomplete hire payment and pursuing a damages claim has significantly increased.

Deductions from hire

The payment clause in *the "Astra"* required charterers to make each hire payment on time and in full. Most payment clauses will have similar requirements. This may create some tension between charterers' obligation to pay, and their right to deduct items from hire in specified circumstances. On the basis of *the "Astra"*, if charterers make a deduction from hire prior to payment, however justified they think it may be, owners are strictly entitled to withdraw when the lower hire payment is received and then pursue a damages claim.

Although this again appears to place owners in a strong position, they too will face some risks. The relative strength of the parties' positions will turn on whether the deduction from hire was valid. If owners terminate and withdraw on the basis of deductions which are eventually found to be valid, then owners themselves will be in repudiatory breach of charter by withdrawing the vessel. It will then be charterers who are entitled to damages. As such, whilst this decision does give owners some leverage where charterers are seeking to make deductions from hire, in reality owners may be unlikely to take drastic action unless the position in respect of the validity of the deductions is very clear cut.

Charterers should, nevertheless, be cautious when making deductions from hire, particularly where there is any uncertainty as to their validity. Options other than making a straight deduction should be explored. They may wish to seek to agree the deductions with owners, although many owners may be unwilling to give their agreement given their strengthened negotiating position. More acceptable options may be to pay hire in full but under protest, or to pay the disputed sums into an escrow account (although owners' agreement would be necessary to pursue the latter option).

Where does *the "Astra"* leave us?

The "Astra" is a decision of potentially great significance. The precise nature of the obligation to pay hire, and owners' rights where charterers fail to comply, have required clarification for some time. In the current market the issue of whether owners can claim damages is crucial to their decision as to whether to withdraw a vessel or to continue with a charter. This decision goes a significant way to providing clarity. Owners are now in a stronger position to give a legal basis to a decision to withdraw their vessel from charterers' service and claim damages for loss of profit after only a few missed or part hire payments, or even a single such payment. Owners' position is also strengthened where charterers are seeking to make deductions from hire. It should be remembered, of course, that each case must be considered on its own facts and charter terms.

Nevertheless, whilst both parties should appreciate how this decision affects their respective positions, *the "Astra"* is unlikely to provide the final word on this issue. Given the importance of the point, it may well be considered again by a higher court. Until there has been a final determination, and for the reasons discussed above, owners should use caution in relying solely on this decision in support of a damages claim where they withdraw after a single or a small number of missed or part payments.