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Charterparty Guarantees - A Timely Reminder

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Charterparty guarantees are often sought by Owners as a condition to entering into a fixture with a particular charterer because either the Owner is not familiar with that charterer or the charterer is a relatively small company albeit part of a larger group. Whatever the charterers standing Owners are not unreasonably anxious to ensure a charterers' obligations – the payment of sums due under a charterparty, will be performed.

Given the importance of ensuring cash flow - particularly in the current market, it is therefore perhaps surprising that greater care is not taken in some cases when agreeing a fixture to make sure performance guarantees are binding on the guarantor.

A recent London Arbitration award (LMLN 3/16) has again highlighted some of the pitfalls an owner might face after having accepted a guarantee; for example, authority to provide a guarantee and enforcement.

Authority to Bind

Problems can arise if as is often the case a charterparty contains a provision simply stating *'to be guaranteed by "xxxx"'* and the party named as the guarantor subsequently alleges it is not bound by these words and, therefore, the guarantee is not enforceable.

Under English law for a guarantee to be enforceable it is required, by section 4 of the Statute of Frauds 1677, that the guarantee is -

(a) made or recorded in writing; and

(b) signed by the guarantor or by someone with authority from the guarantor to do so.

Whether (a) and (b) are satisfied will depend on exchanges or negotiations between the parties to determine if xxx actually ever expressly agreed to provide a guarantee. This often turns on what authority a charterer, or broker acting on behalf of a charterer, agreeing and signing a charterparty has to hold out xxx as a guarantor, which in turn raises issues of actual, or ostensible, authority.

Actual authority is where a power has been expressly conferred on a party to act on behalf of another party. As an example, an owner can give a broker express authority to agree charterparty terms, or a company can give an employee express authority to give a guarantee either directly or by another party binding the company.

In the absence of actual authority, a party might still be bound by ostensible, or apparent, authority. This is authority that appears to a third party to be legitimate; so for example, where a third party believes another has authority to bind a different company. In these circumstances it is possible that a company is bound even if the party acting on behalf of the company does so in breach of its authority.

"The UNTA"

In Mitsui Osk Lines Ltd V SMI[1] the English High Court considered whether a guarantee was entered into with proper authority specifically whether a chartering broker had authority to enter into a contract on an owner's behalf.

Owners of MV UNTA chartered the vessel to Trustworth, guaranteed by SMI, for a period of ten years. The charterparty ran until 2013 when Trustworth repudiated the contract claiming that the vessel did not comply with the contractual description. Owners accepted the repudiation as wrongful and claimed against SMI, under the guarantee, for damages for Trustworth's repudiation. The High Court considered whether the guarantee was signed by a person with actual authority.

Owners argued that the broker had actual authority and not just apparent authority. This was established by email exchanges between the broker and Mr Salgaocar of SMI in which the broker was provided with authority both to negotiate the charterparty terms, and on behalf of SMI, guarantee the Charterers' performance.

The High Court agreed with Owner's and the agreement was held to be enforceable.

The Statute of Frauds and Evidence of an Enforceable Agreement

In Golden Ocean v SMI,[2] the Court of Appeal considered whether a guarantee had been entered into in accordance with the Statute of Frauds 1677 which requires guarantees to be recorded in writing and signed by a person authorised by the guarantor.

Owners of a new build offered to charter to Trustworth Shipping PTE Ltd, guaranteed by SMI. Twenty days prior to delivery Trustworth and SMI denied a contract had been agreed and that SMI had agreed to be guarantor. Owners started arbitration against Trustworth and later commenced proceedings in the High Court against SMI under the guarantee in respect of Trustworth's repudiation of the charterparty. SMI sought to challenge service of the High Court proceedings on them on the basis that the Statute of Frauds had not been satisfied because there was no single document containing the whole of the contract of guarantee and, since there was no single document which could be identified as the contract of guarantee, there was, in effect, nothing to sue on.

It was common ground that there was no signed document of guarantee but the Owners relied on an email from the broker confirming the terms of the charterparty that was "electronically signed" with the broker's name.

The Court held there was no limitation as to the number of documents in which an enforceable guarantee might be found, all of the terms of the charterparty, and of the guarantee, were to be found in two emails sent by the broker to the Owners, and that it would be a 'serious blot on English commercial law if SMI could avoid liability because its obligation was to be found written in two documents rather than in one'.

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See also 'Is the Statute of Frauds Satisfied? Guarantees by Email'.

LMLN 3/16

Whilst the Owners claim was successful these issues were again raised in LMLN 3/16, but with the added complication of whether authority to bind a guarantor was to be determined by English law or Chinese law, and if to be enforceable the guarantee should have been approved and registered with the Chinese State Administration for Foreign Exchange.

Charterers, a Hong Kong company, had no significant assets and so Owners, also a Hong Kong company, required a letter of undertaking ("LOU") before entering into the charterparty. The LOU was issued by Y Ltd (a Chinese company), sealed with Y Ltd's seal and on the face of it signed by the company's chairman, Mr B. The LOU was expressly governed by English law.

When Charterers failed to pay hire and damages awarded to Owners arbitration was started by Owners under the LOU against Y Ltd for the sums due from Charterers. But Y Ltd denied that they were obliged to pay on the basis that the seal was not applied to the LOU with proper authority, they were unaware of the LOU, the signature on the LOU had been forged, and that the LOU did not adhere to Chinese law.

Without discussing the decision in any detail the Tribunal decided:

1. On the balance of the evidence disclosed by Y Ltd, and whilst the LOU had not been signed by the person in whose name the LOU has been issued it had been signed by someone within Y Ltd with authority to do so and sealed with actual authority from Y Ltd.

2. Notwithstanding the LOU was expressly governed by English law the issue of actual authority was to be determined by Chinese law because questions of authority were not matters of contract.

3. However, if that was wrong it was necessary to consider ostensible authority, which the parties agreed was a matter of English law. In this respect, a party acting in good faith was entitled to assume all relevant procedures of Y Ltd had been complied with, and that since at least two directors of Y Ltd knew Owners required an LOU and that the LOU has been signed and sealed (chopped) by an individual with authority from Y Ltd to do so, the LOU was issued with the ostensible authority of Y Ltd.

4. The Chinese courts would not decline enforcement of the LOU on the basis that the guarantee should as a matter of Chinese law have been approved by SAFE for Y Ltd to make a payment under the LOU since this was an administrative requirement, so that a failure to register the LOU did not mean payment thereunder was unlawful.

5. Chinese law did not, as Y Ltd had argued, apply to the LOU on the basis of Article 3(3) of the Rome I Regulation' - "Where all other elements relevant to the situation at the time of choice [of applicable law] are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of the provisions of the law of that other country which cannot be derogated from by agreement", because all other elements were not connected with China alone.

Conclusion

These cases highlight the numerous issues that can arise when a guarantor of a charterer's liabilities seeks to avoid payment under a guarantee. Whilst correspondence prior to agreeing a charterparty can provide the necessary evidence of the authority pursuant to which a guarantee has been given, it is best to seek that confirmation in advance that the party that has been put forward as a guarantor has agreed to provide that guarantee, and the person providing that confirmation has authority from the guarantor to do so.

Members may find the guidance issued in the following Steamship articles, a useful reference.

» https://www.steamshipmutual.com/publications/Articles/Articles/SV_Mar97_14.asp

» https://www.steamshipmutual.com/publications/Articles/Articles/PerfGuarantees1104.asp

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[1] MITSUI OSK LINES LTD v SALGAOCAR MINING INDUSTRIES PVT LTD (THE "UNTA") [2015] 2 Lloyd's Rep. 518

[2] Golden Ocean Group Ltd v Salgaocar Mining Industries PVT Ltd [2012]

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