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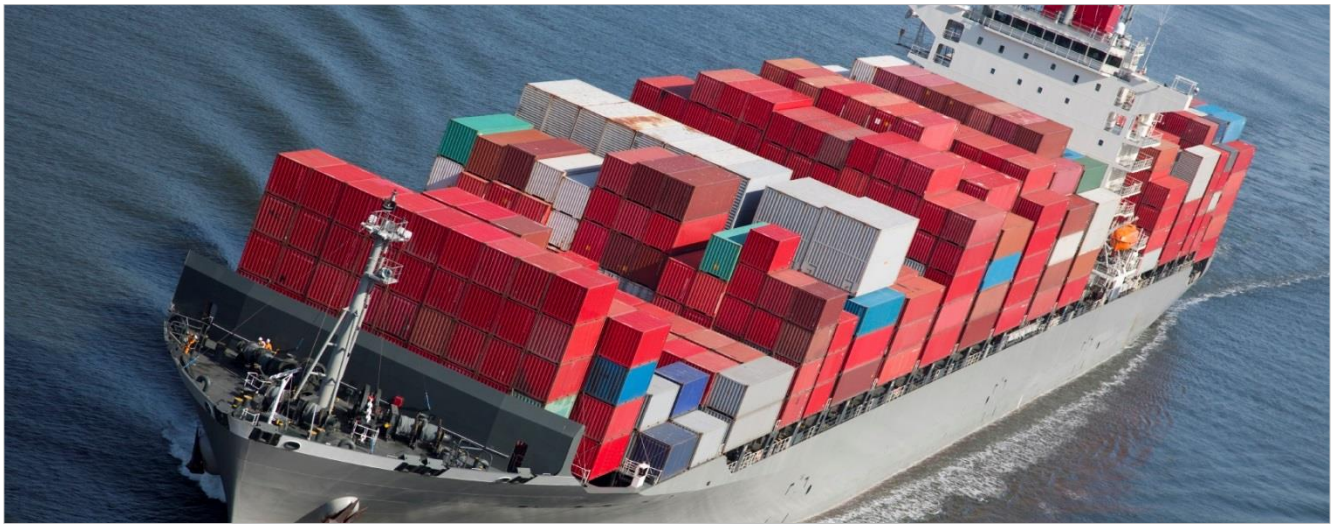

Cover Story

The Court of Appeal Confirms that Failure to Pay Charter Hire is Not a Breach of Condition

Introduction

What happens when a time charterer fails to pay hire? Will it constitute a breach of condition which entitles the shipowner to terminate the charterparty and claim damages?

In 2013, to the surprise of many in the shipping community, the English Commercial Court held that the answer to the above question is "yes" in the case of *The Astra* [2013] 2 All ER (Comm) 689 ("***The Astra***") (as discussed in our previous newsletter "Charterers May Face Severe Consequences for Not Paying Hire Punctually"). However, recently on 7 October 2016, the Court of Appeal decided otherwise in *Grand China Logistics Holding (Group) Co Ltd v Spar Shipping AS* [2016] EWCA Civ 982 (the "***Grand China Case***") and concluded that Flaux J's decision in *The Astra* was wrong.

The *Grand China* Case – Background

The Facts

By three time charterparties dated 5 March 2010 on amended NYPE 1993 forms, Spar Shipping AS ("**Spar Shipping**") agreed to let three vessels on long term time charter to Grand China Shipping (Hong Kong) Co Ltd ("**GCS**"). The charterparties were on identical terms, save as to rate of hire, period, delivery laycan and vessel details. The performance of the three vessels under the charterparties was guaranteed by three letters of guarantee executed by Grand China Logistics Holding (Group) Co Ltd (the "**Grand China**"), the parent company of GCS.

Since April 2011, GCS began to have difficulty in paying the hire and hence defaulted in payment. Spar Shipping eventually withdrew the vessels and terminated the time charterparties. As at the date of termination, one of the charterparties had about eighteen months left to run. The remaining two charterparties each had about four years left to

run. After GCS went into liquidation, Spar Shipping sued Grand China for the balance of unpaid hire before termination under the guarantees. In addition, Spar Shipping also claimed for the resulting damages for loss of bargain for the unexpired term of the charterparties under the guarantees.

The Commercial Court Decision

At first instance, Popplewell J rejected the decision in *The Astra* and held that payment of hire by GCS in accordance with clause 11 of the charterparties was not a condition. However, he concluded that GCS had renounced the charterparties and gave judgment in favour of Spar Shipping for the balance due under the charterparties prior to termination and damages for loss of bargain in respect of the unexpired term of the charterparties. Grand China then took out the present appeal, while Spar Shipping crossed appealed against Popplewell J's decision that payment of hire was not a condition of the charterparties.

The Grand China Case – The Appeal

The appeal was heard by Sir Terence Etherton MR, Gross and Hamblen LJJ in June 2016. There were two issues before the Court of Appeal:

1. whether a time charterer's failure to pay an instalment of hire in a time charterparty is a breach of condition, thereby entitling the shipowner to terminate the charter and claim damages ("**the Condition Issue**"); and
2. whether or not GCS's conduct in the case amounted to a renunciation of the charterparties ("**the Renunciation Issue**").

The Condition Issue

Regarding the Condition Issue, the Court of Appeal unanimously held that the answer to the question of whether a time charterer's failure to pay an instalment of hire in a time charterparty is a breach of condition is "No". It held that *The Astra* was wrongly decided and whether a term in a time charterparty is a condition is a question of construction of the charterparty concerned. There is also no general presumption in a mercantile contract that a stipulated time for payment is a contractual condition.

On the facts of the case, the Court is of the view that the construction of the clause 11 in question did not make it clear that it was to be regarded as a condition, and hence it was not a condition but rather an innominate term. Accordingly, GCS's failure to pay hire, without more, merely entitles Spar Shipping to withdraw the vessel from service in accordance with the withdrawal clause. The decision therefore confirms that the obligation to pay hire under a time charterparty constitutes no more than an intermediate or innominate term.

In reaching the above conclusion, the Court of Appeal (in particular Lord Justice Gross in his leading judgment) placed considerable emphasis on what was described as the key question of "striking the right balance" between certainty and the undesirability of treating trivial breaches as carrying the consequences of breaches of condition. The Court is of the view that such trade off or balance is most acceptably achieved by treating the withdrawal clause as no more than a contractual termination option.

The Renunciation Issue

In relation to the Renunciation Issue, the Court of Appeal affirmed the lower Court's decision and held that GCS's conduct in the case amounted to a renunciation of the charterparties. In reaching that conclusion, the Court endorsed and applied the three-stage analysis suggested by Spar Shipping, namely:

1. What was the contractual benefit Spar was intended to obtain from the charterparties?
2. What was the prospective non-performance foreshadowed by GCS's words and conduct?
3. Was the prospective non-performance such as to go to the root of the contract?

Applying the test to the present case, the Court held that the contractual benefit that Spar Shipping

intended to obtain from the charterparties as a shipowner was the regular, periodical payment of hire in advance of performance and so long as the charterparty continues. The prospective non-performance foreshadowed by GCS's words and conduct was payment in hire but in arrears and with attendant uncertainty. Such prospective non-performance goes to the root of the contract.

Further, the Court rejected the novel argument of "accountancy" raised by Grand China, namely that the test for repudiation or renunciation in relation to defaults in payment of hire should be reduced to an arithmetical comparison between the arrears and the total sums payable over the life of the charterparties. The Court held that Grand China's approach was wrong and whether or not the combination of the past and anticipated breaches of the time payment stipulation amounted to a renunciation of each of the charterparties involved a multifactorial assessment by the trial judge. The practical implication of this ruling is that each case will still have to be analysed on its own facts.

Conclusion

To conclude, the unanimous decision in the *Grand China* Case, for all practical purposes, finally settles the controversial issue of whether a failure to pay hire was a breach of condition thereby entitling the shipowners to terminate the charterparty and claim damages, providing welcoming certainty to the shipping community.

For now at least, the orthodox position that a term as to payment of hire in a time charterparty was not a condition is reinstated by the Court of Appeal in this case. That said, it remains open to the parties to include a term in their charterparties with clear wordings to the effect that the obligation to pay hire is a condition, giving the shipowners the right to withdraw the vessel and claim damages in the event that the charterers fail to pay hire punctually. Further, if the charterers evinced an intention not to pay hire or pay hire punctually for the remainder of the charterparty, the charterers' conduct may amount to a renunciation of the charterparty which allows the owners to terminate the charterparty and claim damages.

Hanjin to offload Asia-US assets to Korea Line for $32m

Following its receivership on 1 September 2016, South Korea's Hanjin Shipping Co. ("**Hanjin**") has recently announced that it will sell its Asia to US container operations to Korea Line Corporation, an affiliate of construction conglomerate SM Group, in order to raise funds to pay off its debts. Under the deal, Korea Line will purchase various logistics systems, data and the relevant subsidiaries of Hanjin in the US, China, Vietnam and four other countries. The parties aim to complete the deal by 5 January 2017.

Korea Line has indicated to the press that its rationale in the acquisition is to become an all-round shipping company since it is already active in the dry bulk, product tanker and car carrier segments. They believe that the acquisition will allow them to participate in the container shipping sector.

Pacific Radiance issues arbitration notices to two Chinese shipbuilders

The Singapore-listed Pacific Radiance Ltd (the "**Group**") has sent arbitration notices to two Chinese shipbuilders Shanghai Waigaoqiao Shipbuilding and China Shipbuilding Trading (Shanghai) over two cancelled vessel orders.

The contracts for the two platform supply vessels were signed by Pacific Radiance Pte Ltd ("**PRP**"), one of the Group's subsidiaries, on 18 December 2013. PRP claims, among other things, for the refund of the pre-delivery instalments paid to the Shipyards for the construction of platform supply vessels, totalled US$10,632,000, plus interest.

The arbitration proceedings will be held in Hong Kong. As the arbitrations are currently still at their initial stages, the Group will make further announcements at the appropriate times in the event of any material developments in relation to the arbitrations. The Group also reassured its investors that the arbitrations are not expected to have any material impact on PRP's net tangible assets and earnings for the current financial year ending 31 December 2016.

Hyundai Merchant Marine launches direct service to Vietnam

Hyundai Merchant Marine ("**Hyundai**") has introduced a new direct service connecting South Korea to Danang in Vietnam on 23 November 2016 – the Haiphong-Danang Express Service ("**HDX**"). The HDX was launched with a view to strengthen Hyundai's network in the Asia-Pacific region. The HDX port rotation is as follows: Gwangyang - Busan - Shanghai - Haiphong - Danang - Hong Kong - Gwangyang.

To further enhance Hyundai's competitiveness in the global market, Hyundai indicated to the press that it was finalising the details of a potential partnership with 2M alliance members Maersk Line and Mediterranean Shipping Co. The parties wish to reach an agreement in late November or early December 2016.

Further, although Hyundai was not selected as the preferred bidder for Hanjin's Asia to US assets, there have been rumours that it is still considering to acquire Hanjin's terminal in Algeciras, Spain.

Swiber to sell laid up vessel for $10.3m

The Singapore-listed Swiber Holdings has recently announced that its subsidiary has signed a memorandum of agreement with WAG SPV I for the sale of the vessel named "Sea Horizon". Sea Horizon, one of the group's oldest fleet, is an 8,867-gross tonne vessel that was built in 1977. It will be sold to WAG SPV I on an "as-is-where-is" basis for a consideration of US$10.3 million in cash.

Sea Horizon has been laid up at a shipyard in Singapore since 20 June 2016. Swiber decided to dispose of it because the vessel did not conform with certain classification standards required by its class society, the American Bureau of Shipping, while to upgrade it to conform with those standards would require a minimum of US$600,000. The proposed disposal will not result in any material change to the nature of the group's core business, said by Swiber to the press.

Vinnlustodin HF and Another v Sea Tank Shipping AS (The "Aqasia")

[2016] EWHC 2514 (Comm) – QBD (Comm Ct) (Sir Jeremy Cooke, sitting as a Judge of the High Court)

This claim arose out of damage to a cargo during carriage on board by the motor tanker "AQASIA", which was under charter from the Defendant to the First Claimant by a charterparty in the form of a "Fixing Note" at the relevant time. The "Fixing Note" provides that the charterparty was to be on the "London Form", and the "London Form" charterparty gives owners rights and privileges contained in certain part of the Carriage of Goods by Sea Act 1924, which contains the Hague Rules.

Article IV r.5 of the Hague Rules ("**Article IV r.5**") provides that neither the carrier nor the ship shall in any event be liable for any loss or damage to or in connection with goods in an amount exceeding £100 per package or unit, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading. The issue before the Court was whether the package limitation provisions in Article IV r.5 was applicable to bulk cargoes, and if yes, how should it be applied to the damaged cargo in the case.

The Defendant argued that Article IV r.5 should be applicable to bulk cargos by interpreting the word "unit" as a reference to the unit used by the parties to denominate or quantify the cargo in the carriage contract, such that it can limit its liability in the sum of £54,730.90 pursuant to Article IV r.5. In response, the claimant argued that the Defendant was not entitled to limit its liability because when a cargo is shipped in bulk, there are no relevant "packages" or "units and hence the word "unit" does not apply to a liquid or bulk cargo.

After hearing both parties' submissions, the Commercial Court rejected the Defendant's argument and held that whilst it was already established that the word "package" in Article IV r.5 could not apply to bulk cargoes, the word "unit" could not do so either. "Unit" meant a physical unit for shipment and not a unit of measurement such as a kilogram, a cubic metre, a bushel, a barrel or a metric tonne. Therefore, the Defendant was not allowed to limit its liability by relying on Article IV r.5.

Versloot Dredging BV and Another v HDI Gerling Industrie Versicherung AG and Others (The "DC Merwestone")

[2016] UKSC 45 – 20 July 2016 – Supreme Court (Lord Mance, Lord Clarke, Lord Sumption, Lord Hughes and Lord Toulson JJSC)

This case concerns with a marine insurance claim. The vessel "DC Merwestone" suffered a flooding incident, which resulted in irreparable damage to its engine. The shipowners claimed from its insurer for the cost of replacing the damaged engine, and their claim was supported by what was later found to be a lie from their general manager that the crew had heard an alarm on that day but had failed to investigate the alarm due to the rolling of the ship in the heavy weather. In fact, the crew had never heard any such alarm. The issue before the Supreme Court was whether insurers were entitled to avoid liability on the ground that the insured had told a lie in presenting the claim, if the lie later proved to be irrelevant to the insurer's liability.

The Supreme Court allowed the shipowners' appeal by a majority of 4 to 1, and held that the "fraudulent claim rule" does not apply to claims where the claim itself can be justified, but is supported by collateral lies which are immaterial to the insured's right to recover. In other words, the Court distinguished between a fraudulent exaggerated claim (where the insured is trying to get what something that they are not entitled to – e.g. to claim a larger amount than what they are entitled to) and a claim which is a justified one, albeit supported by an irrelevant lie (where the insured is simply attempting to get what the law states he is entitled to). An insured in the latter scenario will still be entitled to compensation under the insurance policy regardless of whether he had lied or not. Accordingly, the decisions of both the Court of First Instance and the Court of Appeal were reversed and the shipowners could recover the damage to the ship despite the fact that they had lied about the reason that such damage occurred.

Star Polaris LLC v HHIC-Phil Inc

[2016] EWHC 2941 (Comm), Queen's Bench Division, Commercial Court, Sir Jeremy Cooke, 17 November 2016

In late 2011, the vessel "Star Polaris" was built by the defendant shipbuilder and delivered to the claimant buyer under a shipbuilding contract. In the shipbuilding contract, there is a warranty clause ("**Article IX.4**") which stipulates that "except as expressly provided in this paragraph…the BUILDER shall have no liability or responsibility whatsoever or howsoever arising for or in connection with any consequential or special losses, damages or expenses…".

On 29 June 2012, the vessel suffered a serious engine breakdown. It was subsequently found in the arbitration commenced by the claimant that there was a causative breach of the warranty of quality by the defendant shipbuilder. However, as the defendant's liability for consequential loss (including financial loss and diminution of the vessel's value) was excluded under Article IX.4, the buyer was unable to recover all of its losses under the interim arbitral award. Therefore, the buyer took out the present appeal.

At the appeal, the English Commercial Court ruled that on a correct interpretation of Article IX.4, the defendant shipbuilder's obligation was limited to the repair or replacement of defects and physical damage caused by such defects only, as it was common ground that Article IX.4 provided a complete code addressing the obligations of the parties. Further, the wordings of Article IX.4 are clear enough to limit the obligations of the defendant to exclude financial losses caused by guaranteed defects, above and beyond the cost of replacement and repair of physical damage because the phrase "consequential or special losses…" in these circumstances must be taken to have a wider meaning than damages that fell within the scope of the second limb established in Hadley v Baxendale. Accordingly, the buyer's claim for diminution of value is also a claim for "consequential or special loss" and hence the appeal was dismissed.

Conducting Maritime Arbitration in Hong Kong (Part I)

Introduction

The use of arbitration as a mechanism for resolving shipping disputes has a very long pedigree in most maritime nations. In Hong Kong, there has also been a phenomenal growth of arbitration in the recent years. Given its informal and confidential nature, arbitration is often the more preferable option for businesses to resolve their disputes as it is usually relatively less damaging to the business reputation of the parties in dispute.

What are the advantages of arbitration?

Arbitration has a number of inherent advantages over litigation, for example:

- **Free choice of arbitrator(s)** – maritime disputes often involve technical issues, and hence the parties may wish to appoint someone with sufficient experience and expertise to determine their disputes
- **Cost-effectiveness** – going to trial can be expensive and time-consuming. Arbitration sometimes can be more cost-effective as the parties may themselves agree to reduce the costs of arbitration, e.g. appoint a sole arbitrator and proceed with "documents only" arbitration
- **Privacy** – the entire arbitration process including the hearing is held privately and is confidential; irrespective of the nature of the dispute, media attention is most unlikely
- **Finality** – unlike a court judgment, an arbitral award is subject to very limited rights of review by the Court (but this may also be a disadvantage, especially in cases where the decision made was unfair)
- **Enforceability** – arbitral awards made in Hong Kong are easily enforceable in more than 150 jurisdictions through the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and several bilateral arrangements on mutual enforcement of arbitral awards, including the Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region which confirms that arbitral awards in Hong Kong are enforceable in the PRC.

Why arbitrate in Hong Kong?

- **Expertise** – Hong Kong has an enormous pool of experienced professionals in all aspects of the maritime industry. In fact, Hong Kong is ranked the third most preferred and used seat worldwide and the most favoured seat outside of Europe by Queen Mary and White & Case's 2015 International Arbitration Survey.
- **Geographical location** – Hong Kong locates at the centre of Asia Pacific and is within 5 hours' flying time of half of the world's population. The city is well developed in terms of communications, transport, financial services and accommodation.
- **Law** – Hong Kong upholds the rule of law through its common law legal system overseen by an independent judiciary comprising local and international judges who are independent, professional and efficient; the Arbitration Ordinance (Cap. 609 of the Laws of Hong Kong), which has recently undergone a substantial overhaul to incorporate the latest international practice, provides a comprehensive legal framework for arbitration in Hong Kong; the Arbitration Ordinance now extends the application of the UNCITRAL Model Law to all types of arbitration in Hong Kong.

- **Culture** – Hong Kong has a unique position in culture – simultaneously part of China but also a special administrative region retaining its English common law-based legal system, which is generally regarded as a fair and familiar forum with sufficient neutrality for resolving commercial disputes.

The Hong Kong International Arbitration Centre ("HKIAC")

Established in 1985 by a consortium of leading businessmen and professionals in Hong Kong, the HKIAC is one of the longest-standing arbitral institutions in the Asia-Pacific region. Being one of the busiest centres in the world, it is equipped with world-class facilities for dispute resolutions. It is an independent, financially self-sufficient and non-profit organization which provides one-stop services in relation to arbitration, mediation and domain name cases etc. to parties in dispute.

- **Language** – The normal working languages of the HKIAC are English and Chinese (including Cantonese and Mandarin). Parties may also arbitrate in any other language or languages which they choose. The HKIAC is equipped with excellent facilities for simultaneous translation and can arrange for simultaneous translators and translation of documents and transcripts. Arbitral awards may be rendered in any language chosen by the parties.
- **Ad hoc Arbitration** – The HKIAC provides facilities for "ad hoc" arbitrations upon request and charges only HK$8,000 or about US$1,026 for appointment of an arbitrator. This is particularly attractive in cases where the dispute involves a huge amount of money, as an institutional arbitration would require the parties to pay upfront a certain percentage of that amount in dispute.
- **Open legal representation** – While some countries still place restrictions on legal personnel coming to conduct arbitration, Hong Kong allows open legal representation. Anyone from another jurisdiction – who is qualified there – can act as an advocate or arbitrator in Hong Kong.

Hong Kong Maritime Arbitration Group ("HKMAG")

In response to demands from the shipping industry, the HKMAG was formed in February 2000 as a division of the HKIAC. Maintaining a list of arbitrators with commercial or legal experience in maritime fields, it has the specific aim of promoting the use of maritime arbitration in Hong Kong.

Hong Kong Arbitration Clause

To submit a maritime dispute or any dispute to arbitration at the HKIAC, the HKIAC recommends the incorporation of the following arbitration clause into a contract:

> *"Any dispute, controversy or claim arising out of or relating to this contract, including the existence, validity, interpretation, performance, breach or termination thereof or any dispute regarding non-contractual obligations arising out of or relating to it shall be referred to and finally resolved by arbitration administered by the Hong Kong International Arbitration Centre under the Hong Kong International Arbitration Centre Administered Arbitration rules in force when the Notice of Arbitration is submitted.*
>
> *The seat of arbitration shall be... (Hong Kong). *The number of arbitrators shall be... (one or three). The arbitration proceedings shall be conducted in... (insert language)."*
>
> * = optional

Legal advice should, however, be sought where there is doubt as to the suitability of any of the recommended clause.

Please watch out for our next issue for a more detailed discussion on the procedures of maritime arbitration in Hong Kong.

(Part II will be in the next issue)

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