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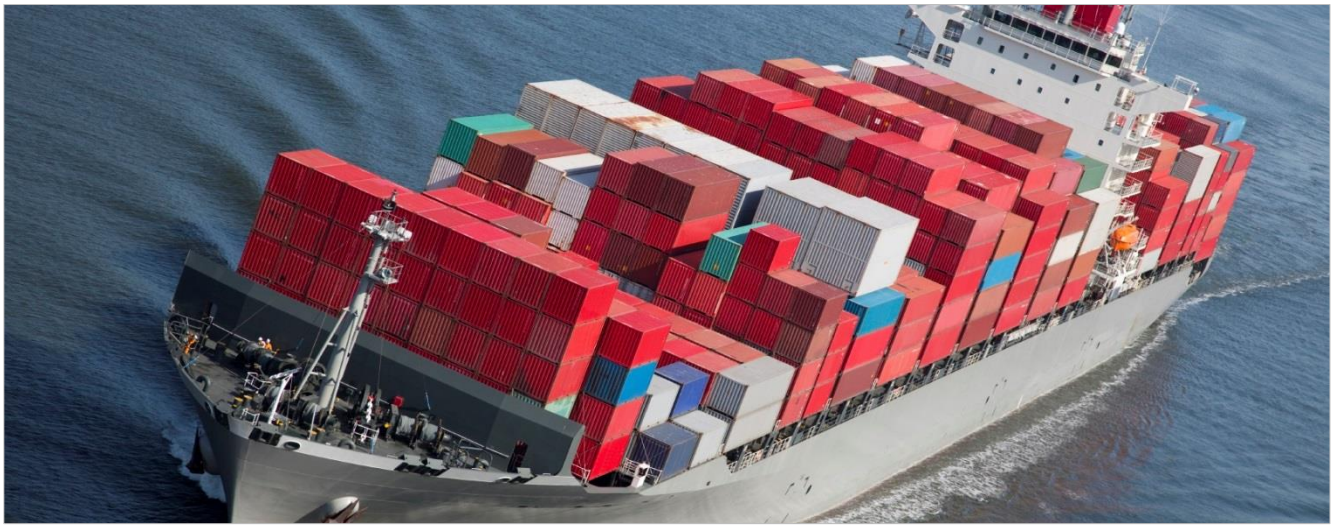

Cover Story

How Far Will Owners Be Responsible for Their Vessels' Underperformance?

Introduction

It is common for charterparties to have performance warranties to ensure that vessels will not underperform during the term of the contract. Nevertheless, vessels sometimes have to operate under unfavourable conditions which may make it difficult for their owners to perform the charterparty up to the specifications warranted. Such underperformance may constitute a breach of the charterparty, in which the owners will be liable to pay damages to the time charterers, even when it is a result of the Owner's compliance with the time-charterers' instructions.

In the recent case of *Imperator I Maritime Company v Bunge SA and Bunge SA v C Transport Panamax Ltd ("The Coral Seas")* [2016] EWHC 1506 (Comm), the High Court had the opportunity to examine a continuing performance warranty in charterparties, and held that the owners are responsible for the underperformance of the vessel even though it was an indirect result of the time-charterer's instructions to keep the vessel in tropical waters.

Background

Imperator I Maritime Company (the "**Owners**") was the owner of the vessel "Anny Petrakis", which was subsequently renamed as "The Coral Seas" (the "**Vessel**"). By consecutive time charters on an amended NYPE form, the Vessel was chartered by its previous owner to Bunge SA (the "**Head Charterers**") for around 23 to 25 months, which had then sub-chartered it to C Transport Panamax Ltd (the "**Sub-charterers**") on back-to-back terms (except the rates). Pursuant to a subsequent agreement, ownership of the Vessel was transferred to the Owners.

The charterparties contained the following clauses:

1. **Vessel's description:** *"About 14.5 knots ballast/about 14 knots laden on about 33.5 mts ISO 8217:2005 (E)RMG 380 plus about 0.1 mts ISO 8217:2005 (e) DMA in good weather*

condition up to Beaufort scale four and Douglas sea state three and calm sea without adverse current ..." [in the case of the sub-charterparty the equivalent provision concluded "... up to Beaufort Scale 4 and Douglas Sea State 3 with not current and/or negative influence of swell (sic) …"];

2. **Speed Clause:** *"Throughout the currency of this Charter, Owners warrant that the vessel shall be capable of maintaining and shall maintain on all sea passages, from sea buoy to sea buoy, an average speed and consumption as stipulated in Clause 29(a) above, under fair weather condition not exceeding Beaufort force four and Douglas sea state three and not against adverse current." [In the case of the sub-charterparty the equivalent provision concluded ... not exceeding Beaufort Force 4 and Douglas Sea State 3 with not against adverse current (sic)…"]*

3. **Weather Routing and Speed/Consumption Deficiencies Clause:** *"Charterers may supply Ocean Routes advice to the Master [the sub-charterparty stated "may supply Ocean Routes or equivalent advice"] during voyages specified by the Charterers. The Master to comply with the reporting procedure of the routing service selected by Charterers ..."*

Under the charterparties and the Sub-charterers' instructions, the Vessel had to stopover in Brazil for one month for loading before it departed to China. In accordance with the Sub-charterers' instructions, the Vessel first discharged cargos at Praia Mole of Brazil before it sailed to Guaiba Island (also in Brazil).

However, immediately after the Vessel departed Guaiba Island, her performance began to fall off significantly. She had to take on emergency bunkers at Jarkata and sailed to Singapore to carry out underwater inspection subsequently. The underwater inspection reviewed that the fall off in performance of the Vessel was due to heavy fouling of the propeller during her prolonged stay in the tropical waters near Guaiba Island.

The propeller was cleaned underwater, and then the Vessel sailed to China to complete her voyage under the charterparties and in accordance with the Sub-charterer's instructions.

The Sub-charterers thereafter made deductions from hire, asserting their right to set-off damages for the breach of the continuing performance warranty under the Speed Clause of the charterparties. The Head Charterers took the same stance against the Owners. The Owners then commenced arbitration against the Head Charterers, seeking to recover the hire deducted by the Head Charterers. The Head Charterers then in turn commenced arbitration against the Sub-charterers on the same ground.

The Issue

The issue before the Arbitration Tribunal and subsequently in the Owner's appeal to the High Court was "*where under a time charter the owner warrants to the time charterer that the vessel shall maintain a particular level of performance throughout the charter period, and the time charterer alleges underperformance in breach of that warranty, is it a defence for the owner to prove that the under- performance resulted from compliance with the time charterer's orders?*"

The Arbitration Tribunal's Decision

The Arbitration Tribunal made the following rulings on facts:

1. the Vessel did not maintain the warranted speed, extending the voyage by 90.345 hours;

2. the cause of the Vessel's reduced speed was underwater fouling of the Vessel's hull and propeller which developed during the Vessel's prolonged stay in the tropical waters at Guaiba Island; and

3. the fouling of the Vessel's hull could not be regarded as unusual or unexpected, but constituted fair wear and tear incurred in the ordinary course of trading.

The Arbitration Tribunal ruled in favour of the Sub-charterers and dismissed the Owners' claim on the basis that the Owners had assumed such risk of underperformance of the Vessel which might result from her compliance with the Sub-charterer's lawful instructions.

The Owners argued that the reasoning of the arbitrators was wrong and appealed.

The High Court's Decision

Before the Court, the Owners contended that the decision of the Arbitration Tribunal was wrong as it was in contradiction with the following statement in Time Charters 7th Ed. (2014) paragraph 3.75:

"*Where the owners give a continuing undertaking as to performance of the ship, and the ship has in fact underperformed, it is a defence for the owners to prove that the underperformance resulted from their compliance with the charterers' orders: see The Pamphilos [2002] 2 Lloyd's Rep 681 per Colman J., at page 690. In that case, the ship's failure to achieve the promised performance resulted from marine fouling, which was in turn the result of the owners' complying with the charterers' order to wait for 21 days at a tropical port.*"

However, the Court rejected the Owners' contentions for the following reasons:

1. The language of the Speed Clause was in wide and unqualified terms. It is clear that the Speed Clause was not intended to apply only to a vessel with a clean hull and propeller. It is a warranty for the Vessel's actual continuing performance.
2. The parties expressly restricted the performance warranty to passages under fair weather conditions, but do not exclude the performance warranty in respect of occasions such as prolonged waiting in tropical waters. Therefore, it was not the parties' intention to construe the warranty in such a way as argued by the Owners.
3. Marine fouling was an ordinary incident of trading in accordance with the time charterer's orders.

Accordingly, the Court concluded that the continuing performance warranty in question applies when the Vessel was underperformed due to fair wear and tear as a result of the Owners' compliance with the Sub-charterer's instructions. In particular, the Court said that paragraph 3.75 of Time Charters is too widely stated, and it is not a defence to a claim on underperformance for the owners to prove that the underperformance resulted from compliance with the time charterers' orders, unless the under-performance was caused by a risk which the owners had not contractually assumed and in respect of which they are entitled to be indemnified by the charterers.

Conclusion

This case serves as a reminder to owners of vessels that time charterers will still enjoy the benefit of performance warranties in charterparties even when the vessels had to operate in unfavourable environments and conditions as a result of the time charterers' instructions. If the owners wish to avoid being liable in such circumstances, it is advisable for the owners to limit the scope of the performance warranties and exclude warranties to situation where the vessel had to operate in unfavourable environments and conditions in accordance with charterers' instructions.

What could Brexit mean for the shipping industry?

On 23 June 2016, voters in the United Kingdom (the "**UK**") voted that the UK should leave the European Union (the "**EU**") ("**Brexit**"). The landmark referendum has provoked much public debate between those supporting and opposing Brexit, and the outcome of Brexit has also brought about concerns and attention on the possible commercial and legal impacts on the marine sector.

Concerns have been raised that laws in the UK which affect the shipping industry may be changed drastically as a result of Brexit. For instance, certain laws created by the EU authorities that were automatically incorporated into UK laws, EU court decisions and rulings on trading, dispute resolution, insurance, contract, competition law and trade treaties with non-EU states that were previously applicable in the UK may have to be modified. Nevertheless, as the UK would have two years to figure out the exact terms of its exit under the relevant EU exit treaty, the impact of Brexit on the shipping industry is yet to be seen, and will depend heavily on the relationship among the UK, the EU and individual corporates.

Dynagas in landmark deal for two regas vessels in China

Dynagas, a company owned by the Greek billionaire George Prokopiou, has recently contracted with Hudong-Zhonghua Shipbuilding for the first newbuilding contract in the floating regasification and storage unit arena of China. The vessels, with a size in 170,000 cu m to 180,000 cu m range, isare believed to be able to provide regasification and to operate as a regular LNG carrier. Delivery date of the two vessels is estimated to be in around 2019 to 2020. Mr. Prokovpiou said that the vessels could offer "great flexibility and compatibility" for 120 ports all over the world.

Hong Kong eyes co-operation with Greece in maritime service cluster

The Hong Kong Maritime and Port Board (the "**Board**") is a Hong Kong government body set up in April 2016 with a view to boost Hong Kong's position as a leading international shipping centre. To build a close bonding with the Greek maritime industry, the Board has reached an agreement with the Greek Minister of Maritime Affairs and Insular Policy recently, in which both parties agreed to work on a possible memorandum of understanding for the exchange of maritime personnel. It was reported that the port of Ningbo in China has outperformed that of Hong Kong last year. This move has therefore been seen as an indication of the Hong Kong government's determination to strengthen Hong Kong's position in the shipping industry.

Tribunal rules against China's claims in the South China Sea

The Permanent Court of Arbitration in The Hague (the "**Tribunal**") has recently made a ruling against the validity of Beijing's territorial claims in relation to the "nine-dash line", and ruled in favour of the Philippines (the "**Ruling**"). Experts believe that the ruling will no doubt increase the tensions in the region, and may also raise questions as to the freedom of navigation in international waters for the marine community. In fact, before the Ruling was made, China had already taken a strong stance that if the Tribunal shall rule against its claim, it might withdraw from the United Nation Convention on the Law of the Sea. There had also been reports that offshore vessels in the South China Sea were hassled by Chinese vessels.

Nevertheless, there have been no signs of direct impact of the ruling on commercial shipping in the Southeast Asia so far. Among the countries located near to the affected waters, Singapore, being the largest shipping hub in the region, is believed to have the largest stake. "We strongly support the maintenance of a rules-based order that upholds and protects the rights and privileges of all states," said Singapore.

NYK Bulkship (Altantic) NV v Cargill International SA (The "Global Santosh")

[2016] UKSC 20, Supreme Court, Lord Neuberger, President, Lord Mance, Lord Clarke, Lord Sumption and Lord Toulson, 11 May 2016

NYK Bulkship ("**NYK**") time chartered a vessel to Cargill International SA ("**Cargill**") on an Asbatime form. Cargill later sub-chartered the vessel to Sigma Shipping Limited under a voyage charter. The vessel carried shipments of cement sold by Transclear SA ("**Transclear**") to IBG Investment Limited ("**IBG**"). Under the contract of sale between Transclear and IBG, IBG has to pay demurrage to Transclear if there is delay by IBG in unloading cargo. Due to the port congestion which was partly caused by breakdown of IBG's off-loader, the vessel proceeded to a berth two months after she arrived the port. Yet, Transclear obtained an arrest order to secure a claim for demurrage against IBG, in which the vessel was mistakenly named as the object of the arrest. The order prohibited IBG from unloading the cargo. Cargill refused to pay hire to NYK during the arrest period.

According to clause 49 of the time charterparty, the vessel was off hire for any period of detention or arrest, unless such detention or arrest was "occasioned by any personal act or omission or default of the Charterers or their agents". The key issue was therefore whether the arrest of the vessel was occasioned by Cargill's "agents".

The Court of Appeal overturned the decision of the arbitration tribunal and held that clause 49 applied because IBG was Cargill's "agents". However, the Supreme Court allowed Cargill's appeal by a majority and held that clause 49 did not apply, and Cargill does not need to pay NYK during the arrest period for the following reasons:

1. The word "agent" in its broader sense should include those "availing themselves of the facility contractually derived either directly or indirectly from the charterers". Accordingly, rights and obligations of the time charterer were passed down the contractual chains, and Transclear and IBG would vicariously exercise the right of Cargill and perform its obligation under the time charter.

2. There was no sufficient nexus between the arrest and the function of sub-contractor who acted as an agent of Cargill. As Cargill's responsibility under the time charterparty were to "perform all cargo handling at their expense" at any particular time, Cargill was not liable for the arrest which was caused by a dispute on demurrage between Transclear and IBG under sub-charter which is not related to the time charterparty.

In reaching its decision, the Supreme Court had rejected the test formulated by CA, namely whether the arrest was attributable to matters within the time charterer's sphere of responsibility.

FSL-9 Pte Ltd v Norwegian Hull Club (The "FSL New York")

[2016] EWHC 1091 (Comm), Queen's Bench Division, Commercial Court, Mr Justice Blair, 10 May 2016

Damage had been done to a chemical tanker during its loading process, which resulted in the loss of some cargos. Both the owners and charterers asserted claims against each other, and the owners threatened to arrest the charterers' vessels. The issue was then resolved by the mutual provision of security by way of issuing of three letters of undertaking ("**LOU**"). One of the LOU (in the amount of USD 3.5 million) was issued by the Charterer's P&I Club, Norwegian Hull Club (the "**Club**") to the owners, which contained a provision "it is agreed that both Charterers and Owners shall have ***liberty to apply*** if and to the extent the Security sum is reasonably deemed to be excessive or insufficient to adequately secure Owners' reasonable Claims." The owners later found the Security sum mentioned in the LOU insufficient and thus requested the Club for additional security. The request was refused, and hence the owner sought a summary judgment to order the Club to increase the Security Sum relying on the words "liberty to apply" in the LOU. In response, the Club applied to strike out owner's claim.

The issue in the case was therefore whether an LOU beneficiary had a right of action against the Club in the circumstances, and the Court ruled in favour of the Club. It was held that "charterers" in the LOU could not be interpreted as "charterers and/or their club" since charterers only refer to "charterers or associated companies/entities" in other parts of the LOU. Accordingly, the LOU beneficiary did not have a direct right to sue the Club.

Neon Shipping Inc v Foreign Economic & Technical Corporation of China and Another

[2016] EWHC 399 (Comm), Queen's Bench Division, Commercial Court, Mr Justice Burton, 2 March 2016

The parties entered into a shipbuilding contract to build a bulk carrier (the "**Contract**"). The Contract provided for a guarantee period of 12 months from the date of delivery of the vessel, and specified that notice of defects for which claim is made have to be given within 30 days after the end of the guarantee period. The buyer alleges that the cargo cranes were faulty, but the guarantee period has already expired and no notice of complaints has been made. In the arbitration, the arbitrators rejected the buyer's arguments that the Contract has an implied term as to fitness for purpose and that the time bar did not apply to claims made after the delivery of the vessel. The buyer appealed.

In dismissing the buyer's appeal, the Court held that the arbitrators were right in interpreting the Contract to mean that a 12-month time-bar period applied so as to exclude all claims not notified within the requisite notice period, including the claimant's claim. The Court held that it would be artificial to clarify which claims were to be excluded from the time bar period.

Although the buyer's claim was held to be time barred, the Court nevertheless commented that a term as to fitness for purpose can be implied into a shipbuilding contract if it was consistent with the other terms therein. Therefore, an implied term as to fitness for purpose could apply in cases where goods are ordered for their normal purpose (including ships being built for standardised trades). However, whether the implied term is consistent with other clauses in the contract such that it can be implied into the contract would depend on the facts of each case.

What is a Limitation Fund?

A ship owner or other person may limit their liability for claims related to a ship or other properties by constituting a limitation fund in accordance with Order 75 of the Rules of the High Court ("**RHC**"), which is a right granted under the Convention on Limitation of Liability for Maritime Claims 1976 ("**LLMC**"). It should be noted that pursuant to section 12 of the Merchant Shipping (Limitation of Ship owners Liability) Ordinance (Cap. 434) (the "**Ordinance**"), provisions in the LLMC have the force of law in Hong Kong.

What can be the subject of a Limitation Fund?

Pursuant to section 15 and 16 of the Ordinance (which referred to Article 2 and 3 of the LLMC), the following claims are excluded from a Limitation Fund in Hong Kong:

1. Claims for oil pollution damage within the meaning of the International Convention on Civil Liability for Oil Pollution Damage dated 29 November 1969 or of any amendment or Protocol thereto which is in force, in respect of any liability incurred under section 6 of the Merchant Shipping (Liability and Compensation for Oil Pollution) Ordinance (Cap. 414);
2. Claims subject to any international convention or national legislation governing or prohibiting limitation of liability for nuclear damage, by virtue of section 3 or 4 of the Nuclear Material (Liability for Carriage) Ordinance (Cap. 479); and
3. Claims in respect of the raising, removal, destruction or the rendering harmless of a ship which is sunk, wrecked, stranded or abandoned, including anything that is or has been on board such ship, unless an order has been made by the Chief Executive under section 15(1) of the Ordinance.

All other claims referred to in the LLMC, including the following, can be the subject of a Limitation Fund in Hong Kong:

1. Claims in respect of loss of life or personal injury or loss of or damage to property (including damage to harbour works, basins and waterways and aids to navigation), occurring on board or in direct connection with the operation of the ship or with salvage operations, and consequential loss resulting therefrom;
2. Claims in respect of loss resulting from delay in the carriage by sea of cargo, passengers or their luggage;
3. Claims in respect of other loss resulting from infringement of rights other than contractual rights, occurring in direct connection with the operation of the ship or salvage operations;
4. Claims in respect of the removal, destruction or the rendering harmless of the cargo of the ship; and
5. Claims of a person other than the person liable in respect of measures taken in order to avert or minimize loss for which the person liable may limit his liability in accordance with this Convention, and further loss caused by such measures.

It should also be noted that according to *Fong Yau Hei v Gammon Construction Ltd* (2008) 11 H.K.C.F.A.R. 212 and Article 4 of LLMC, a party could not limit their liability in the case of personal injury caused on board or related to the operation of ships, if it is proved that the loss resulted from his personal act or omission, committed with the intent to cause such loss, or recklessly and with knowledge that such loss would probably result.

Who can apply for Limitation Fund?

Under the LLMC, ship owners, salvors, charterers, ship managers and operators are entitled to apply to limit their liability. Under section 13 of the Ordinance, the word "ship" in the LLMC includes (i) any air-cushion vehicle designed to operate in or over water while so operating; and (ii) any structure (whether completed or in the course of completion) launched and intended for use in navigation as a ship or part of a ship. By virtue of section 14 of the Ordinance, the right to limit liability under the Convention applies in relation to any ship whether seagoing or not.

How to apply for Limitation Fund?

Pursuant to Order 75 Rule 37 of the RHC, limitation proceedings are commenced with the filing of an *in personam* writ on behalf of the persons entitled to limit to constitute the Limitation Fund. The writ must name one of the defendants who has a claim against the applicant, and it must also be served on at least one of the defendants named therein. If the defendants are out of jurisdiction, the applicant can apply for leave to serve out of jurisdiction under Order 75 Rule 4 of the RHC.

Constitution of limitation fund also requires payment of a sum of money into the court, which is calculated in accordance with section 17 of the Ordinance and Article 6 of the LLMC. For a ship with a tonnage not exceeding 2000 tons, the maximum liability for claims for loss of life or personal injury is 2 million units of account (approximately HK$21,490,000 as of 20 July 2016) and for other claims is 1 million units of account (approximately HK$10,745,000 as of 20 July 2016).

Within 7 days after the acknowledgement of service of the writ by one of the defendants named therein or, if none of the defendants acknowledges service of writ within 7 days after the time limited for acknowledging service, the applicant could take out a summons with an supporting affidavit to apply to the Court for a decree (i.e. order) limiting his liability under Order 75 Rule 38 of RHC. Such summons has to be served to the defendants named who have acknowledged service of the writ within 7 days before its return date.

Upon consideration of the application and the supporting materials, the register will then determine whether a limitation decree should be granted and if so, the appropriate amount of the liability that is to be limited. If a decree is granted, but there are defendants not named in the writ, the applicant should advertise their limitation action in three newspapers as stated in Order 75 Rule 39 of RHC.

Can limitation fund be constituted by letter of undertaking?

In the United Kingdom, other than by payment into court, a limitation fund can also be constituted by production of an acceptable guarantee including but not limited to a letter of undertaking provided by the owners' Protection and Indemnity Club (*Kairos Shipping Limited v Enka & Co LLC* [2014] 1 All ER (Comm) 909). It is however uncertain whether such principle will be adopted by the Hong Kong Courts.

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