Charterparty law in the context of flexibility and risk allocation in long term contracts

By Trond Solvang

I. There may be many fruitful suggestions of what could be suitable research topics under the label “flexibility and risk allocation in long term contracts”. This label “flexibility” (in contracts), is of course in itself fairly flexible, which makes good sense in such an opening forum for a research project.

My contribution will be to provide some thoughts originating from the area of charterparty law. My aim is to highlight a selections of topics which may be worthy of further study. To some extent my selection is random; there could be more or there could be fewer than those mentioned. And I do not venture to give any clear answer to the questions raised; I merely raise them.

I have chosen to split my review in two: first some remarks on substantive law aspect, then some remarks on methodical points. By “methodical” I mean questions of construction of contracts in an international setting. Since the charterparty law is highly influenced by English (and partly American) law, the review is based on a comparison between Norwegian and English law.

II. On the topic of substantive law time chartering is an obvious candidate under the label “flexibility in long term contracts”. For example in a ten year time charter with trading limits worldwide, and with a wide combination of contractual cargoes, and with a right for charterers to decide the nature of cargo documents to be issued, and so on, the notion of flexibility constitutes so to speak the very essence of the contract. Obviously there are restrictions to such flexibility, provided for in the contract itself. There are safe port clauses, war clauses, ice clauses etc. But there are plenty of remaining areas outside the scope of these clauses.

One example: To what extent has the shipowner assumed the risk of damage to the vessel outside of safe port or war risk or ice clauses? In recent times that type of question has come up, following the piracy threat in the Gulf of Aden. The answer may of course depend on facts, but it also depends on

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1 The article is based on the author’s speech given at the opening seminar 14 June 2012 of the research project established in February 2012 at the Faculty of Law, University of Oslo, with the working title: “Flexibility and risk allocation in long term contracts – an international perspective”.

2 Some might prefer the term “methodological” rather than “methodical” but to me the former becomes too ambitious as it connotes some kind of systemized scheme of methods. In my context that is not the case; it is merely a question of adopting ways to construe contracts.

3 See e.g. my article: Piracy in the Gulf of Aden, Nordisk Membership Circular, No 568, 2009. See also the recent English Court of Appeal case, The Triton Lark, ...., dealing with the question whether there must be an increase in risk from the time the contract was entered into, for a party to be entitled to invoke the rights under a war clause.
notions of law, like the notion of assumption of risk and, in Norwegian law, the doctrine of “bristende forutsetninger” (frustrated expectations).\(^4\)

Another example: What is the extent of a shipowner’s right of indemnity against the charterer for suffering inconvenience by complying with charterer’s orders? Also this may be covered by clauses, or it may not be. Some time ago we had at Nordisk a case where the ship was ordered to load a grain cargo at a Russian port. This order was legitimate under the charter. However, there was a risk of insects (gipsy moths) in cargoes from that area, and this had caused U.S and Canadian health authorities to place a 6 months ban on all vessels having traded there. After redelivery of the vessel, the shipowner suffered losses by obtaining reduced hire rate under the next employment, due to those trading restrictions. Could the shipowner recover such loss of income from the previous charterer? There was hardly any breach of charter. Are there doctrines outside the scope of breach which may provide a remedy?

Under English law there is the doctrine of indemnity for complying with charterers’ orders.\(^5\) Under Norwegian law there may be something similar, like the notion that “risk should follow function.”\(^6\) Admittedly, this “risk-follows-function” principle primarily refers to remuneration risk, not “risk” in terms of liability for damages. But also on this point there is in Norwegian law some indication that “liability should follow function”, like in the arbitration case, Jobst Oldendorff,\(^7\) where the shipowner was awarded indemnity against the charterer for third party liability, which the shipowner had incurred in consequence of an event within the charterer’s “functions”.

But the scope of these doctrines is fairly loose, both under English and Norwegian law. And perhaps for good reasons, since they – at least in time chartering – may involve intricate aspects of causation, and also aspects of adjacent areas of law, like liability for breach of contract. Moreover, they often become intertwined with the construction of the terms of the contract: does the contract exclude the application of such doctrines, or are the doctrines perhaps already consumed by the contract terms?

My point in raising this is simply to illustrate that what could be termed “flexibility” in contracts may have a flip side of partly unexplored legal terrain. And - this gipsy moth case was settled amicably, since the English law position was far from clear.

Off-hire is another feature of time chartering, falling squarely within our label “risk allocation in long term contracts”. As will be known, the essence is that charter hire is not payable if charterers are deprived of the use of the vessel, by certain events. The details of this we shall not go into. But viewed from a more general perspective the phenomenon of off-hire is not much explored in the

\(^4\) As regulated in Section 394 of the Maritime Code (MC).

\(^5\) See e.g. Coghlin et al., Time Charters, London, ..., page ...

\(^6\) See e.g. Viggo Hagstrøm, Obligasjonsrett, 2002, page 40 and 320-22.

\(^7\) Nordiske Domme (ND), 1979.364.
context of contract law principles. Is off-hire “mislighold” (failure of performance), is it gjensidighetsbeføyelse (right of retention), or is it a mere right of set-off in payment for certain events? Perhaps it is a mixture of various things.

This type of structural thinking may be of value, not only academically, but also in practical cases. For example: What if the vessel is off-hire but at the same time the charterer is prevented from using her, for example by lack of employment? What is the decisive factor for whether or not the vessel is off-hire – is it the (hypothetical) deprival of use, or the fact that the charterer does not suffer any loss of time? Clauses are surprisingly silent on this and the Maritime Code is also not very clear. The answer may therefore turn on more fundamental analyses of contract law.

Another example: What is the limit to charterers’ right to invoke off-hire if the off-hire event is brought about by charterer’s conduct? Must the charterer be in breach of contract to be deprived of the remedy - for example when supplying the vessel with bad bunkers which damages the machinery, thus putting the vessel prima facie off-hire? Or are there other criteria which are decisive, like a more balanced approach based on the proximity of charterer’s conduct to the off-hire event? Also here clauses are surprisingly silent, and the Maritime Code seems to take too narrow an approach in that only conduct for which the charterer is liable appears to deprive him of the remedy. Also this topic could therefore benefit from a more fundamental study, and it has a link to the doctrines already mentioned; the Norwegian notion that “risk should follow function”, and the English doctrine of “indemnity for compliance with orders”.

The development of off-shore supply contracts has further expanded the charterparty topics and introduced new contractual phenomena. Traditional off-hire may now be replaced by a variety of hire rates depending on the cause of delay, extending from “traditional” off-hire events being at the shipowner’s risk, to events traditionally being at the charterers’ risk. There may be standby off-hire rates, force majeure off-hire rates, vessel maintenance off-hire rates, and vessel defect off-hire rates. Obviously this is driven by a combination of bargaining power and an assessment of the parties’ proximity to the various causes of delay. From a theoretical viewpoint this clearly is of interest as it illustrates a bridging of new and traditional contractual phenomena. And it sheds further light on my above point about the legal nature of off-hire.

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9 MC Section 392.

10 MC section 392 states i.a.: “Time charter hire is not payable for time lost to the charterer by reason of ... maintainence of the ship or repair of damage to the ship for which the charterer is not liable”. Arguably the mention of charterer’s “liability” is confined to incidents of damage to the ship, where it makes good sense that charterer’s risk for lost time of use should coincide with charterer’s liability for repair costs – hence the clause is silent on other cases of deprival of use of the ship (more or less) attributable to the charterer’s conduct.
Similar hybrids in off-shore supply contracts can be found in the area of liability regimes. For example in the Supplytime there is a system of knock for knock when the vessel is employed at the oil field, while a traditional system of liability for breach is retained in other areas of performance, such as the shipowner’s delivery obligations, and the charterer’s obligation to supply good bunkers to the ship, and the charter’s obligation to nominate safe ports outside the oilfield area. Also this opens for theoretical analyses addressing hybrids of regimes adopted within one and the same contract.

III.
From this review of time charters we shift to voyage charters. A traditional voyage charter would probably not be associated with “flexibility in long term contracts”. There is simply a voyage from A to B which is not really “long term” and with no real “flexibility” built in.

However, it should be recalled that voyage charters often form the basis of long term contracts, like consecutive voyages or contracts of affreightment (volume contracts).

Moreover, the “traditional” charter from A to B may not be that traditional any more. Influenced by the tanker trade, with oil traders wishing to have the option of where to ship and land cargoes, the system of ranges of ports has been increasingly developed. And as part of this, the charterer is often given an option to redirect the vessel en route, or to direct the vessel to areas to await further sailing orders. Since freight is earned upon performance of the voyage, there is clearly a need to adjust the earning of freight to whatever delays caused by such ordering to wait or to deviate. This is basically achieved by linking the extra time to the charter party regime of laytime and demurrage.

This type of flexibility in voyage chartering has had an impact on traditional legal thinking. For example charterers’ liability for ordering the vessel to unsafe ports, may turn out differently in a “flexible” voyage charter with ranges of ports, than in a traditional port A-to- B charter. Instead of the owner having traditionally assumed the risk of going to port A, he is now at the mercy of the charterer’s right of instruction.

There may also be other aspects linked to the right of instructions. In one English case the vessel was re-routed while under way to load port, and this caused her not to meet the cancelling date. The charterer cancelled. The shipowner claimed damages for wrongful cancellation, and succeeded. The

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11 Supplytime 2005 clauses ...

12 See e.g. Asbatankvoy clause 4.

13 In English law the question of charterers’ liability for ordering the ship to unsafe ports, is generally less settled in voyage than in time chartering, see Cooke et al., Voyage Charters, ..., pages .... In Norwegian law MC Section 328 imposes liability for negligence upon charterer for damage to the ship caused by ordering it to unsafe ports, but there may be a fine-line balancing of such liability against the owner’s assumption of risk, see NOU 1993: 36 page 62.

14 Shipping Corp. of India v. Naviera, Lloyd’s Rep 1976, 1, 132 C.C.
court held that the charterer could not invoke a contractual right which was brought about by his own conduct – even though that conduct was in itself lawful. Under Norwegian law that result probably would follow from the principle of “kreditormora” (mora accepiendi). In English law such labels are not used but the result was the same. It belongs to the story that the charterer tried an alternative way to justify the right to cancel: Among the ports within the range, some were so far away that it was unlikely that the vessel would have arrived there in time, even without any deviation caused by the charterer. The charterer’s argument was therefore: why should the cancellation be unlawful when it was within his power to order the vessel to a port where he clearly would have had a right to cancel. The court declined to go into that type of hypothetical reasoning. Rather the charterer was held to the directions actually given.\textsuperscript{15}

Other questions have arisen as to when an option to re-direct the vessel must be considered exhausted. For example if the vessel has commenced loading at a port to which she is ordered, charterers can hardly be entitled to “re-direct” her by ordering her to discharge the cargo already onboard, and go to a different load port as part of one and the same order. Exactly where that cut-off point may occur, is unsettled under English law.\textsuperscript{16}

My point in going through these topics is again to indicate some general aspects arising from this type of flexibility. There is for example some resemblance between this right of re-direction in voyage charters, and the system of variation orders in construction or shipbuilding contracts.

On the topic of risk allocation, laytime and demurrage must be mentioned. This is essentially a system for allocating the remuneration risk for unforeseen delays during the vessel’s port stays. I shall not dwell too much on it as the topic is extensively covered in legal literature.

It should however be mentioned that it is not uncommon for a vessel to be delayed during port stays for periods exceeding the intended duration of the whole charter. Therefore the allocation of risk in laytime and demurrage clauses may be as important to the shipowner as the agreed freight, and in that sense the notion of “flexibility” in contracts may to some extent merge with the notion of “risk allocation”.

IV. This brings us to another aspect of “flexibility”, having to do a party’s possible abusal of rights. A good illustration of this is the English House of Lords\textsuperscript{17} case, The General Guisan\textsuperscript{18}. That case

\textsuperscript{15} Some thoughts on this type of hypothetical consequences following “kreditormora” are given by Per Augdahl, Den norske obligasjonsretts alminnelige del, 1978, page 210. See further remarks in my book, Forsinkelse i havn, pages 212 and 266-68.

\textsuperscript{16} Although indications are that an option to re-direct will be exhausted upon the vessel’s tendering of Notice of Readiness at the relevant port, see The Batis [1190] Lloyd’s Rep. 345 QB, where the arbitrators so held and this point was not part of the appeal of the award.

\textsuperscript{17} Now named the Supreme Court.

\textsuperscript{18} Suisse Atlantique v. NV Rotterdamsche Kolen Sentrale, [1966] Lloyd’s Rep. 529 HR.
concerned a consecutive voyage charter with duration of two years. The demurrage rate had been set artificially low, compared to the freight rate. The background for it was that the demurrage rate formed part of a settlement of an earlier dispute. During the contract period the market dropped. As a consequence, it suited the charterer to have the vessel lie idle at load port, earning demurrage rather than performing voyages and earning freight. In that way the vessel performed only about half the voyages which could have been performed during the two years, and the shipowner claimed damages, in excess of the demurrage rate, for the value of the non-performed voyages.

The shipowner lost. The House of Lords held that there was no restriction in the contract on how the charterer could use the agreed laytime. Moreover, the exceeding of laytime is under English law considered breach of contract, and demurrage which then becomes payable, is considered liquidated damages for such breach. The House of Lords found nothing in the wording of the contract which indicated that the shipowner could claim anything in excess of demurrage.

This case is perhaps of old age but it is important authority under English law still today. It provides a fairly clear answer to the question whether shipowners are entitled to damages in excess of the demurrage rate, even when charterers deliberately delay vessels in port.

V.
This brings us to the second part of my introduction; the methodical aspect.

For a start: If one were to imagine a different outcome in the General Guisan, this could probably be achieved in different ways. One could, as was argued by the shipowner in that case, say that there must be implicit in the intention of the parties that a normal sequence of voyages would be performed. It could also be said that the general purpose of laytime and demurrage is to allocate the risk of external delays, which should not extend to charterers’ deliberate detention of the vessel. Or it could perhaps be said that there must be a covenant of loyalty and good faith which prohibits exploitation of contractual rights.

Or one could, with the House of Lords, say that the contract was clear in its terms and that the need for certainty in contract law requires this type of restrictive construction. And: if the shipowner wanted a minimum number of voyages to be performed, he could have provided for it in the contract. He did not do so and must bear the risk. And finally; if a certain number of voyages were to be implied, where is the line to be drawn? Is it up to the courts to venture into that type of speculation?

The General Guisan may serve as illustration of what may be called differences in mentalities in different legal systems.

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19 Page 534 of the judgement.
The case has not been followed in US law. In a decision by the first instance court in New York from 1974\textsuperscript{20}, a shipowner was awarded damages in excess of the demurrage rate, under a similarly worded consecutive voyage charter, and on the same type of facts. The court stated amongst other:

“Charterer relied upon the decision in a recent English case, Suisse Atlantique v. NV Rotterdamsche ... affirmed by The House of Lords ... . . . This decision is contrary to the above-quoted American decisions. The charterparty clearly specifies ... that it is to be construed and governed by the laws of the United States.” \textsuperscript{21}

And in summary of those previous American decisions, the court stated:

“It requires no situation of authority for the proposition that every contract contains an implied covenant of good faith and fair dealing ..., a covenant with an implied obligation to cooperate with the other so that he may obtain the full benefits of performance.” \textsuperscript{22}

Under Norwegian law there is no clear parallel to the General Guisan case. It may, however, be worth quoting the sentiment of a legal scholar, Per Gram, opposing the General Guisan decision (in my translation):

“The decision illustrates the result of excessive adoption of the so-called commercial legal approach (det såkalte handelsrettslige syn) to construction of contracts; that a contract has to be construed strictly according to its wording because the parties must be given certainty as to their rights and obligatio. This should, however, not lead to results which are far beyond what the parties reasonably can have intended. The fact that the contract was vulnerable according to its wording, should not lead to acceptance of disloyal exploitation of that wording.” \textsuperscript{23}

The perhaps obvious point I wish to make is that differences in mentalities are of importance. And this may be of particular importance under Norwegian law, with arbitration awards illustrating the dilemma of so to speak bridging different types of mentalities in legal thinking.

The Arica case\textsuperscript{24} concerned time chartering and off-hire. The ship had a breakdown en route from the US West Coast to Japan, and was towed at reduced speed across the Pacific. The charterparty contained a so called period off-hire clause, providing for off-hire from the off-hire event until the ship is again in an efficient state for charterers’ use. The majority of the arbitrators held that when the drafters of the standard contract had chosen that particular wording, they must be taken to have

\begin{itemize}
  \item \textsuperscript{20} Concord Petroleum v. Mobil Ship & Transport, 1974 AMC 103.
  \item \textsuperscript{21} Page 106 of the judgement.
  \item \textsuperscript{22} Page 105 of the judgement.
  \item \textsuperscript{23} Per Gram, Fraktavtaler og deres tolkning, 1977, page 160.
  \item \textsuperscript{24} ND 1983. 309.
\end{itemize}
intended a solution of “period off-hire” as laid down by the English House of Lords in a decision from 1891, the Westfalia.\(^{25}\) In the Arica such a period solution led to a very unbalanced result in that charterers effectively got the value of the cross-Pacific carriage for free. Application of the Maritime Code would have given a net off-hire solution, crediting the shipowner with the value of the cross-Pacific voyage.

The Arica has generated a fair amount of legal commentaries which I shall not go into.\(^{26}\) Instead I wish to point to certain connections between what may be viewed as mere construction of wording, and adjacent substantive law. The result in the Arica may raise questions about undue enrichment: why should charterers have the service of the vessel for free? In the preparatory works of the Swedish Maritime Code of 1994, it is stated that from a Swedish law perspective, the Arica solution would mean “a plain situation of unjust enrichment”.\(^{27}\)

One slight paradox on this point of enrichment is that in the Westfalia, from 1891, there was a question of adopting the doctrine of quantum meruit in favour of the shipowner. Quantum meruit has a similar function as undue enrichment. It provides for market based remuneration for performance outside the scope of the contract. Quantum meruit was not applied in the Westfalia but that had to do with the facts of that case, which were quite different from those of the Arica.

In the Westfalia the time charterer was also the owner of the cargo and had paid general average contribution to the shipowner much in excess of the disputed hire. In addition the charterer had expended the costs of towing the ship the last leg towards the destination. Lord Watson stated: “\textit{In that state of facts, I cannot find any consideration which points to the propriety of making an allowance based on quantum meruit to the appellants.}”\(^{28}\)

A paradox is therefore that on the facts of the Westfalia, a period off-hire solution did all-in-all give the most balanced outcome, while in the Arica that was not the case. And one may perhaps ask: Would the House of Lords in 1891 have applied the doctrine of quantum meruit to the facts of the Arica?

And one may perhaps also ask rethorically: Is it likely that the draftsmen of the standard charter in the Arica had in mind these aspects of the Westfalia decision? This is of some importance since in the Arica the majority did not adopt the English law position as such, they adopted what the draftsmen must be taken to have intended. The majority stated: “\textit{The Westfalia decision gets its significance,}”

\(^{25}\) Hogarth v. Miller [1891] A.C. 48 HL.

\(^{26}\) For references, see footnotes 56, 68 and 71 in Del I (Part I) of my book, Forsinkelse i havn.

\(^{27}\) SOU 1990: 13 page 85: Befrakter ville “rent av såges ha gjort en ubehörig vinst”.

not as a reflection of English law, but because the decision in a clear way forms the background of and gives meaning to the off-hire clause.”

One last paradox in this respect is that, unlike many House of Lords decisions, the Court toned down the suitability of this decision as precedence for later cases. There were two dissenting fractions, each construing the clause differently from the majority, and there was the aspect of quantum meruit. Lord Bramwell ended his speech by stating: “This case is of no great consequence in point of amount, nor I should think in point of precedent – there is not very likely to be another case like this, I should think.”

Another case which illustrates the complexity between construction of wording and its link to substantive law, is the arbitration case, Hindanger. Also this case concerned what under English law is considered a period off-hire clause. The clause had here the effect of being unbalanced the other way around, in favour of the shipowner.

While under way from US East Coast to the Arabian Gulf, the vessel suffered breakdown west of Brazil. The shipowner looked for options for where to repair. Palermo in Italy would be one option, which was in the direction of the voyage. The shipowner instead selected a yard at New York and the vessel was towed there for repairs. During that tow the vessel was obviously off-hire but according to a period clause she was again on-hire when having completed repairs, at New York. The effect of this was that the charterer would have to pay hire twice for the distance from the US East Coast to the point of deviation off Brazil.

In the Hindanger the charter was governed by English law, with arbitration in Norway. The arbitrator felt bound to apply the English law construction of a period clause. On the other hand, he managed to achieve a balanced result by finding that the shipowner was under a duty to “economize with charterer’s time”, a concept he derived from a clause obliging the master to prosecute voyages with due dispatch. Having selected New York rather than Palermo, the arbitrator held the shipowner to have breached that duty of “economizing with charterers’ time”. And what would otherwise been payable as hire under the offhire clause, was set-off against charterers’ entitlement to damages.

One difficulty with this case is that under English law it is very doubtful that such a duty of “economizing with charterer’s time” would be derived from the mentioned clause. Moreover, English law would hardly imply a general duty of the shipowner to “economize with charterers’ time”. In fairness, the arbitrator did not assert that such duties existed under English law. He was given little evidence on the English law position, and admitted that his finding was influenced by Norwegian

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29 Page 323 of the award.

30 As quoted from Weale l.c. page 672.

31 ND 1962. 68.

32 Page 87 of the award.
principles of construction on this point\textsuperscript{33}– after having adopted the English law construction of a period off-hire clause.

What I wish to point out is again the risk of ending up with a mixture of English law solution of construction of contract wording, and the supplementing with Norwegian substantive law, such as a duty of loyalty, or as in the Hindanger: a duty “to economize with charterer’s time”. Or perhaps more to the point in the Hindanger: an English construction of the off-hire clause and a Norwegian construction of the dispatch clause.

It might be added that after these Norwegian arbitration cases, most standard charter forms have been amended to rectify the imbalance of the English law construction. In modern “period off-hire” clauses, like in the Shelltime, there is wording to the effect that “distance made good” during offhire shall be credited to the shipowner.\textsuperscript{34} And there is wording to the effect that if the vessel deviates during offhire, hire shall only re-commence when she is in an equidistant position to that from where she deviated\textsuperscript{35} – thus confirming the Hindanger solution. I am certainly not saying that these amendments were the result of the Arica and Hindanger cases. I am merely saying that a more balanced solution has been adopted by the market players, including Shell who, under English law, would not benefit from the “distance made good” amendment.

VI.
We have been through some illustrations of what might be possible directions in a research project. To summarise on the substantive part: Are there parallels to be seen between different type of contracts which could increase our insight into more general contractual phenomena? And, would it be worthwhile going in some debth into selected phenomena, like off-hire, which might have the benefit of shedding light both on off-hire and on general principles of contract law? Some further examples on an international level: What is frustration under English law compared to the Norwegian principle of “bristende forutsetninger” (frustrated expectations)? Obviously not all of this needs to be elevated into an ambitious research project, but I believe this type of fundamental thinking has the benefit of increasing consciousness both of our own legal system and that of others.

The second point raised is the methodical: Differences in mentalities in the construction of contracts, and awareness of the relationship between what can be called mere construction of wording and the supplementing with substantive law. Also research on such aspects can be done in different ways and at different levels of ambition. But generally I would think that the more we know of English law and the thinking behind the end-result of English precedents, the better positioned we are to see the ramifications of adopting, or not adopting, those solutions. Such increased awareness is obviously not of academic benefit only. It involves practical aspects, both in the drafting of English language contracts and in dispute resolution of such contracts. And there may be reasons to differentiate: The

\textsuperscript{33} Page 87 of the award

\textsuperscript{34} Shelltime 4 clause 21 line 229.

\textsuperscript{35} Shelltime 4 clause 21 line 228.
charterparty law is probably the area mostly embedded in English law by a multitude of case law related to the contract wording. But this does not mean that other areas of long term contracts, containing flexibility and risk allocation, would not benefit from it.