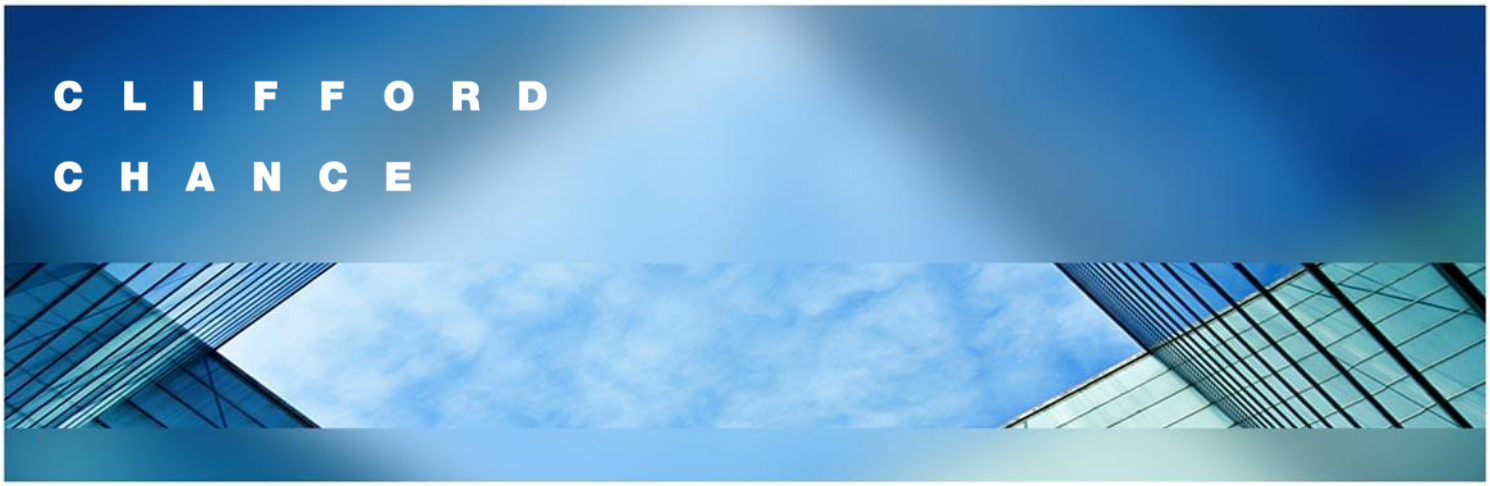

PANDEMIC, PORT BOTTLENECKS AND DEPLETED INVENTORIES – THE ROLE OF DEMURRAGE CLAUSES AS A MECHANISM FOR RISK ALLOCATION IN VOYAGE CHARTER PARTIES

The continued pandemic-induced global crises in international trade has seen commercial parties focussing their attention on contractual risk allocation mechanisms. Many have sought refuge in liquidated damages clauses, such as demurrage clauses in voyage charter parties. Counterparties should give careful consideration when negotiating and drafting their commercial terms and conditions, paying particular attention to the scope and operation of such clauses.

Key issues

- Demurrage clauses in shipping contracts need to be carefully scrutinised to ensure clarity in their scope and operation.
- A recent decision by the English Court of Appeal found that the liquidated damages covered by demurrage is the exclusive remedy of the shipowner whose claim for additional damages was dismissed.
- The current position in England found that for a shipowner to recover damages beyond the agreed rate of demurrage, the shipowner must establish two breaches of the charterparty – one breach does not suffice.

OVERVIEW

The COVID-19 pandemic has posed enormous challenges for global trade and commerce, impacting on all modes of transport. With over 80% of internationally traded goods,[1] shipping remains the nucleus of international trade. This briefing note focuses on the impact of the pandemic on maritime transportation. [The pandemic has significantly disrupted (if not decimated) global supply chains - massive port congestion, and vessels breaching permitted loading and discharge times are now common occurrences. This has widespread ramifications such as logistical and operational dilemmas for vessels and ports alike, disruption to global supply chains, depletion of inventories and increase in transport costs. In short, delayed shipments are cause for significant concern. At the same time, freight rates and profit margins from maritime activity have continued to escalate (and were expected to increase from $25.4 bn to $100 bn globally in 2021).[2]

This evolving situation has focussed the attention of both ship owners (or disponent owners) and charterers alike on the scope and operation of demurrage clauses, and their role in allocating risks among the counterparties. Demurrage (or liquidated damages for delay) is intended to incentivise the swift movement of cargo and the release of the carrying vessel to enable it to proceed on to its destination as expeditiously as possible. Ideally cargo operations are completed within the agreed laytime specified in the voyage charter party. Where the laytime expires before completion of loading or

[1] UNCTAD Secretariat, *Review of Maritime Transport 2021* (UNCTAD/RMT/2021) ('*Review of Maritime Transport 2021*').

[2] *Review of Maritime Transport 2021*.

discharge, the vessel goes on demurrage until loading or discharge is completed (as the case may be)[3].

Shipowners generally rely on demurrage clauses to recover costs arising from vessels being delayed at ports beyond the permitted laytime (or "free time" for cargo operations). Charterers often invoke the protection of demurrage clauses to ensure vessels do not sail away notwithstanding the charterer's breach of the charter party and remain available for cargo operations, and as a means of capping their potential liability to the agreed rate of demurrage. The current crisis has seen a rise in disputes between shipowners and charterers as to the meaning and scope of demurrage clauses.

It has also directed renewed attention on the contentious issue of whether demurrage is the only remedy available to shipowners whose vessels are detained beyond the agreed laytime, or whether shipowners are also able to recover from charterers general damages, in addition to their demurrage entitlements. The English Court of Appeal in the recent decision of *Eternal Bliss*[4] has provided clarity on this issue for contracts of affreightment governed by English law and this will also be important for other common law jurisdictions which traditionally follow English law in this area.It is imperative that parties entering into contracts of affreightment pay due attention to the negotiation and drafting of demurrage clauses, so as to clearly delineate which losses are, and which losses are not covered by the demurrage clause and what, if any, damages fall outside that clause. This is important for a number of reasons, including determining the scope of a charterer's potential liability in damages to the shipowner for delayed cargo operations. It will also be relevant in the context of time limitation clauses requiring a shipowner to submit a demurrage claim within a specified period of time, and to liens, both of which are frequent features of contracts of affreightment.

INTRODUCTION

"Demurrage" originates from a French term (*demeurage*) meaning "to linger" – it refers to the time that a vessel remains in the voyage charterer's possession or control after the time permitted for loading or discharge of cargo. Demurrage clauses generally entitle the ship owner to liquidated damages for breach of the laytime provisions, that is to say liquidated damages for delay in loading or discharge operations.

Historically, academics, judges and the shipping community have been divided on the scope of demurrage clauses and whether demurrage is the sole remedy available to a shipowner whose vessel had been delayed beyond the permitted laytime, or whether the shipowner can claim general damages over and above demurrage for other losses caused or contributed to by the charterer's delay in loading or discharging cargo. This has long been a vexed question. For example, can a shipowner seek to recover from a charterer damages the shipowner has paid to a third party holder of a bill of lading to settle a claim for damage to cargo caused by a delay in cargo operations due to port congestion, or is the shipowner only able to claim demurrage against the charterer under the voyage charterparty?

[3] Hence the adage "*once on demurrage always on demurrage*"; see *The Dias* [1978] 1 WLR 261. Generally, laytime exceptions only cover (or suspend) demurrage if the clause expressly purports to do so – there are however some exceptions.

[4] *K Line PTE Ltd v Priminds Shipping (HK) Co., Ltd* [2021] SWCA Civ 1712.

The English Court of Appeal has recently sought to quell the debate in the significant decision of *K Line PTE -v- Priminds Shipping (HK) Co., Ltd*[5] (**Eternal Bliss**), by finding that on the facts of that case, the charterer was not liable to pay damages to the shipowner beyond demurrage for its failure to complete discharge operations within the permitted laytime. The Court of Appeal determined that on the facts of that case, demurrage was the only remedy available to the shipowner for the charterer's breach of laytime under the charterparty. The Court of Appeal held that in the absence of any contrary indication in the charterparty:

> "*demurrage liquidates **the whole of the damages** arising from a charterer's breach of charter in failing to complete cargo operations within the laytime…*"[6] (emphasis added)

In so doing, the Court of Appeal dealt with the demurrage clause in a manner analogous to any standard liquidated damages clause, rather than limiting it to a particular genre of damage (i.e. loss of use of the ship to earn freight).

Based on the Court of Appeal's decision, for a shipowner to recover consequential losses (in addition to the agreed rate of demurrage) arising from the charterer's failure to complete cargo operations within the permitted laytime, a shipowner is required to establish a separate breach of the charterparty, in addition to the breach in failing to complete cargo operations within the permitted laytime. An example of a separate such breach is a charterer's failure to nominate a loading port within a reasonable time, which could delay cargo operations. Further, a shipowner is not able to recover for separate losses that arise solely from the charterer's delay in completing cargo operations.

FACTUAL BACKGROUND

The Eternal Bliss was referred to the Commercial Court to determine a question of law pursuant to section 45 of the *Arbitration Act 1996* (UK). The relevant facts were that Priminds (**Charterer**) entered into a contract of affreightment with K-Line (**Shipowner**) for 9 separate voyages (one laycan per month) between February and October 2015, inclusive. The cargo for each voyage was to be approximately 60,000 mt "*heavy grain, soya or sorghum*" from South American ports to the Far East.[7] The voyage the subject of the dispute was one of several voyages completed under the contract of affreightment between the parties. The charterparty provided for demurrage of maximum of US$20,000 per day or pro rata. The laytime was calculated by reference to a discharge rate of 8,000 mt per weather working day with weekends excepted.[8]

In June 2015, the Eternal Bliss was nominated for a voyage from Tubarao, Brazil to Longkou, China. The vessel was loaded with 70,133 mt of soybeans and bills of lading were issued. On 29 July 2015, the vessel tendered a Notice of Readiness at Longkou, however, due to port congestion and lack of storage space ashore, the vessel was kept at anchorage for approximately 31 days before berthing.

[5] [2021] EWCA Civ 1712.

[6] *Eternal Bliss* at [52].

[7] See additional assumed facts in *Eternal Bliss* at [9].

[8] *Eternal Bliss* at [8].

Discharge of the soybeans was completed on 11 September 2015. On discharge of the soybeans, significant "*moulding and caking*"[9] was discovered throughout the stow in most cargo holds. As a result of the cargo damage, the receivers claimed in excess of US$6 million[10] against the Shipowner. The Shipowner settled the receiver's claim for US $1.1 million.

In addition to demurrage, the Shipowner sought to recover from the Charterer the settlement sum of US $1.1 million, and initiated arbitration proceedings. The only breach relied upon by the Shipowner was the Charterer's failure to discharge the cargo within the laytime. The Charterer argued that the Shipowner's exclusive remedy against it was for demurrage for the delayed loading operations, and that as such, the Shipowner was precluded from seeking to recover the settlement sum it had paid the receivers.

At first instance, Justice Baker found that "*agreeing a demurrage rate gives an agreed quantification of the owner's* ***loss of use of the ship to earn freight*** *by further employment…****nothing more***" (emphasis added).[11]

The effect of the decision at first instance was that where, as a consequence of the breach of laytime, a shipowner suffers both:

- loss of freight by way of loss of use of the vessel; and
- a separate genre of loss unrelated to the loss of use of the vessel,

the shipowner need not establish a separate breach of the charterparty to recover that separate loss. In so doing he disagreed with the reasoning of the Court in the 1990 decision of *The Bonde*,[12] describing it as "*clearly faulty*"[13]. In *The Bonde*, Mr Justice Potter had found that a shipowner seeking to recover damages in addition to demurrage would have to establish a different genre of loss arising from an "*additional and/or independent breach*"[14] i.e. two breaches of the charterparty.

COURT OF APPEAL'S DECISION

The Charterer successfully appealed Justice Baker's decision to the Court of Appeal. Ultimately, Court of Appeal had to determine whether the Shipowner had to establish "two breaches" of the charterparty or whether "one breach" sufficed[15]. In determining the matter, the Court of Appeal considered the jurisprudence since *Aktieselskabet Reidar v Arcos Ltd* (**Reidar**), as to whether 1 breach[16] or 2 breaches[17] of the charterparty were required to give rise to special damages (discussed below). The Court of Appeal determined that **two breaches** of the charterparty were required:

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[9] *Eternal Bliss* at [7].

[10] *Eternal Bliss* at [15]: A US$6m letter of undertaking was provided by China Reinsurance (Group) Corp.

[11] *K Line Pte Ltd. V Priminds Shipping (HK) Co., Ltd.* [2020] EWHC 2373 (Comm) at [61].

[12] *Richco International Ltd v Alfred C. Toepfer International* ("*The Bonde*") [1991] 1 Lloyd's Rep. 136 (**The Bonde**).

[13] *K Line Pte Ltd. V Priminds Shipping (HK) Co., Ltd.* [2020] EWHC 2373 (Comm) at [127].

[14] *The Bonde* at 142.

[15] *Eternal Bliss* at [29].

[16] *Chandris v Isbrandtsen-Moller Co Inc* [1951] 1 KB 240; *The Altus* [1985] 1 Lloyd's Rep 423

[17] *Suisse Atlantique* [1965] 1 Lloyd's Rep 533; *Richco International Ltd v Alfred C. Toepfer International* ("*The Bonde*") [1991] 1 Lloyd's Rep. 136; *The Luxmar* [2007] 2 Lloyd's Rep 542.

"*in the absence of any contrary indication in a particular charterparty, demurrage liquidates the* ***whole of the damages*** *arising from a charterer's breach of charter in failing to complete cargo operations within the laytime and* ***not merely some of them****. Accordingly, if a shipowner seeks to recover damages in addition to demurrage arising from delay, it must prove a breach of a* ***separate obligation***."[18] (emphasis added)

The Court of Appeal's stated reasons for its decision included:

- **First**, it would be "*unusual and surprising*" for commercial people to agree that a liquidated damages clause would liquidate only some (rather than all) of the damages arising from a particular breach, and there is no support in the standard definitions of demurrage for this;[19]
- **Secondly**, the rate of demurrage is the result of negotiation between the parties in which the loss of prospective freight earnings is likely to be only one of several factors determining that rate;[20]
- **Thirdly**, if demurrage only liquidated the owner's loss of use of the ship to earn freight by further employment, there would inevitably be disputes as to whether particular losses fall within the demurrage clause;[21]
- **Fourthly**, limiting the scope of a demurrage clause to only cover loss of use of a ship and permitting claims for unliquidated damages would transfer the risk of those claims from the shipowner (who is typically insured against those claims) to the charterer (who is typically not);[22]
- **Fifthly**, the Court's decision in *The Bonde*[23] has stood for 30 years without causing issues in the industry or a significant number of cases to arise,[24] and was not *"clearly faulty*";
- **Sixthly**, the decision is said to provide clarity and certainty "*while leaving it open to individual parties or to industry bodies to stipulate for a different result*" by drafting express clauses limiting the scope of demurrage to identified categories of loss.[25]

The Court of Appeal's sixth reason highlights the steps that parties seeking to overcome the effect of the Court's decision should take – that is when negotiating a charterparty, if the parties intend for demurrage to only cover certain losses, they should ensure that a 'dictionary' is included in the charterparty, defining the precise losses that are agreed to be covered by the demurrage clause.

[18] *Eternal Bliss* at [52].

[19] *Eternal Bliss* at [53].

[20] *Eternal Bliss* [54].

[21] *Eternal Bliss* at [55].

[22] *Eternal Bliss* at [56].

[23] [1991] 1 Lloyd's Rep 136; In *The Bonde*, Jusice Potter held that "*where a charter-party contains a demurrage clause, then in order to recover damages in addition to demurrage for breach of the charterers' obligation to complete loading within the lay days, it is a requirement that the plaintiff demonstrate that such additional loss is not only difference in character from loss of use but stems from breach of an additional and/or independent obligation*".

[24] *Eternal Bliss* at [57] and [58].

[25] *Eternal Bliss* at [59].

CURRENT POSITION - AUSTRALIA, HONG KONG AND USA

Globally, the impact of the Eternal Bliss decision is likely to require consideration regardless of whether the governing law of your contract of affreightment is English law. Common law jurisdictions such as Australia, Singapore and Hong Kong have traditionally followed, or been guided by, English law with respect to demurrage, and may well continue to do so.

Traditionally, Hong Kong has recognised a shipowner's entitlement to claim dead freight for charterer's failure to provide a full cargo in addition to claiming demurrage. In this regard we refer to Halsbury's Laws of Hong Kong, which cites *Reidar* in support of the proposition that the rate of demurrage payable under a charterparty by a charterer who fails to load or discharge within the permitted laytime does not cover damages for "*consequential loss of freight by the shipowner, who may recover for that loss, where the charterer has failed to provide a full cargo, in addition to the liquidated demurrage*."[26] As a consequence of the Eternal Bliss, if Hong Kong continues to follow English jurisprudence, this position may need to be reviewed.

With respect to the position in the USA, the Courts have generally determined demurrage to be "*a charge allowed to a vessel for delaying her in unloading, in the nature of compensating her for the freight she might have earned, had she not been so delayed*"[27]. In assessing the quantum of demurrage, the US Supreme Court has expressly stated "*In all the cases in which we have allowed demurrage the vessel has been engaged, or was capable of being engaged, in a profitable commerce, and the amount allowed was determined either by the charter value of such vessel, or by her actual earnings at about the time of the collision*"[28] and "*demurrage will only be allowed when profits have been, or may be reasonably supposed to have been, lost, and the amount of such profits is proved within reasonable certainty*"[29]

TAKEAWAYS

Ultimately the Court of Appeal adopted a "*two breach*" approach. As a consequence of the Eternal Bliss decision, shipowners need to pay particular attention when negotiating demurrage clauses to ensure they expressly state the categories of loss the parties intend demurrage to cover and ensure this is reflected in the agreed demurrage rate, where possible.

It is worth noting that unusually in the Eternal Bliss case the Hague-Visby Rules appeared not to apply. Where the Hague-Visby Rules operate then, absent wrong-doing, shipowners will not generally be liable to the cargo receivers, particularly if it can be established that there were defects with the goods at the point of loading.

Contracting shipowners, charterers and insurers alike eagerly await further developments in this area.

[26] LexisNexis, *Halsbury's Laws of Hong Kong* (online at 3 February 2022) Remedies 'Amount recoverable' [340.178].

[27] *California & Eastern S. S. Co. v 138,000 Feet of Lumber 23 F.2d 95* (1927) (District Court, District of Maryland), citing *The Saturnus* (C. C. A.) 250 F. 407, 3 A. L. R. 1187 (Appeal from the District Court of the United States for the Southern District of New York to the Circuit Court of Appeals, Second Circuit).

[28] *The Conqueror* 17 S. Ct. 510 (1897) at 4, affirmed in *Central State Transit & Leasing Corp. v. Jones Boat Yard* 206 F.3d 1373 (2000).

[29] *The Conqueror* 17 S. Ct. 510 (1897).

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