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A Guide To LNG Charter Agreements



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CONTENTS

INTRODUCTION	2
HISTORICAL NATURE OF LNG PROJECTS	3
The Shipbuilding Contract	3
The Financing Requirements	4
LNG CHARTER TERMS	5
Operating Issues	5
- Condition of the Vessel at Delivery	5
- Maintaining the Vessel	6
- "Drydocking"	7
- "Change in Law"	8
- Trading Range	8
- The Performance of the Vessel	8
- Cool Down	9
Structural Issues	10
- Charter Hire	10
- The Off-Hire Regime	10
- Liability and Exceptions	11
- Termination and Associated Rights	12
- Security	13
A MORE FLEXIBLE ERA	14

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INTRODUCTION

The LNG business is thriving today. The Global LNG trade has doubled from 55m tonnes in 1990 to 110 m tonnes today and the number of LNG projects currently in planning or development suggests that this growth will develop substantially further. The projects currently under development in such places as Norway, Egypt, Yemen, Sakhalin, Angola and Iran will increase the total capacity of liquefaction plants by around 30% by 2004 and many others are in the planning stage.

There are several factors driving these changes. Firstly the development of new and expanding markets in India, China and Brazil will substantially boost demand. Secondly the substantial cost reductions in the LNG supply chain achieved over the last decade in particular has increased markedly the relative competitiveness of LNG. Thirdly the deregulation of markets around the world particularly in the Far East, U.S.A. and Europe is likely to loosen the control of the major utility companies and open up opportunities for new entrants into the market. The U.S. market is particularly vital; the present share of LNG in this market, which consumes around one-third of all the natural gas produced is less than 1% but demand is growing for more. There is also the prospect, as yet unrealised, of the development outside the USA of a "spot" market matching uncommitted liquefaction with the seasonal and other supply needs. Underlying all of these developments are the "green" credentials of LNG, the cleanest of the fossil fuels, environmentally friendly and with a remarkably good safety record.

Each of these developments poses new challenges and offers enormous opportunities for the LNG shipping industry. There are now around 50 vessels on order world wide (with options for around another 25) as compared with the existing world fleet of 128 vessels. The great majority of these orders have been placed to service existing projects but it appears that some were placed on a speculative basis. It is clear however that the drive to eliminate costs from the shipping element of the supply chain is leading to the increasingly innovative use of new technologies, in cargo containment, in propulsion systems, and in the construction of floating liquefaction plants.

These developments will place the terms of LNG transportation contracts under new and greater scrutiny. The LNG industry has not, unlike oil and other transportation industries¹, developed any standard form contracts for either long or short term charters. Most LNG charters are "bespoke" contracts negotiated to meet the requirements of a specific project. Many have however utilised the Shelltime 4 form² as a starting point though this is almost invariably significantly amended to reflect the requirements of the LNG trade. In this booklet we have looked at the Shelltime 4 form and considered the ways in which this should be amended to meet the requirements of the LNG trade. We have also considered how some of the developments outlined above may affect the terms commonly agreed in the industry.

¹ As in the oil transportation industry where many of the oil majors have developed their own standard forms time and voyage charters e.g. Beepeetime, ExxonVoy and Shelltime itself.

² A tanker time charter form



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THE HISTORICAL NATURE OF LNG PROJECTS

Historically the development of an LNG project has been based around a long term “take or pay” sales contract. Partly for this reason, and partly due to the cost of an LNG newbuilding, the world’s LNG fleet has generally been constructed to meet the requirements of a specific project and against a long-term charter, typically of at least fifteen years duration. Such charters are subject to various constraints imposed by the nature of the project:

The Shipbuilding Contract

The terms of the shipbuilding contract are usually determined in large part by the type of standard form employed by the shipyard. It is critical from the Owner’s perspective that the “delivery” provisions in the charter are “back to back” with those in the shipbuilding contract. In particular he will be concerned to ensure that the delivery “date” or “window” in the charter is extended by the same events of “permissible delay” as are found in the shipbuilding contract, that his liability to pay liquidated damages for delay in delivery under the charter “matches” the liability of the shipyard to pay liquidated damages for delay in delivery and that the “cancelling” dates under the shipbuilding contract “match” those under the Charter.

Two further issues commonly give rise to difficulties. Firstly the Charterer for whom the Vessel is an integral part of a wider project, will be anxious to ensure that he controls the exercise (or otherwise) by the Owner of any “cancelling” rights that accrue under the

shipbuilding contract. Where construction is substantially delayed the shipyard will almost invariably seek to contend that these delays are due either to force majeure or to “delay and disruption” caused by changes to the specification or other actions attributable to the Owner, rendering it difficult for the Owner to determine whether he is entitled to terminate.

The prospect of a substantial dispute with the shipyard is likely to be unattractive to the Owner, particularly as the “market” risk rests with the Charterer, and he will be reluctant to exercise a “cancelling” right in contentious circumstances where the benefit can accrue only to the Charterer. He will in any event be reluctant to incur the substantial financing and supervision costs associated with the cancellation of such a project.

The second issue arises out of the technical condition of the Vessel at delivery. Under the shipbuilding contract the Owner will have the right to “reject” the Vessel if the sea trials reveal that the Vessel does not conform to the requirements of the Contract and Specification.

The Charterer will obviously be concerned to ensure that the technical condition of the Vessel is satisfactory and will frequently insist on the right to send his own technical representatives to the shipyard to satisfy himself on this point. Although the process by which defects in the Vessel identified at delivery are rectified is largely co-operative and consensual, the presence of a substantial technical defect will often give rise to difficulties. The Owner will be reluctant to take the potentially hazardous step of rejecting the Vessel and incurring the risk of a complex technical arbitration without suitable assurances from the Charterer.



The Financing Requirements

Financing has typically been arranged on a “project” basis. The financiers’ principal concern will be to secure ready access to the credit of the Charterer and to eliminate “risk” from the charterparty terms. The financiers have typically preferred that:

- (a) The charter should be for a lengthy period and preferably on bareboat terms;
- (b) The Charterer’s obligations must be secured by a guarantee from the Charterer’s ultimate parent company or a sufficiently credit worthy intermediate entity;
- (c) To create a securitisation structure (to allow the owner to finance at rates closer to those applicable to the charterer) the charter should be “irrevocable”. They will therefore wish to ensure that hire is payable on a “grossed up” basis into a safe tax free jurisdiction and that the capital cost element of the hire is payable on a “hell and highwater” basis.

This latter requirement means in simple terms that the capital costs element should be payable irrespective of any events otherwise constituting breach or off-hire, throughout the period of the charter. The Charterer’s rights, in the event of default will frequently be restricted to the right to change the operator of the vessel and will very rarely extend to a right to terminate the charter other than in very limited circumstances.

This structure is driven by the reluctance of the owner’s financiers to take the “unemployed” residual value risk of the vessel. This reluctance in turn is a function of the “illiquid” nature of the LNG shipping market and the lack of historical data on which to base an assessment of the extent of the risk involved. It is very difficult to predict to what extent there will be employment for the crop of LNG carriers currently under construction at the end of their initial charter terms.



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LNG CHARTER TERMS

Operating issues

The condition and availability of the Vessel will of course be of paramount importance to the Charterer. The essence of the bargain embodied in the time charter is that the Owner undertakes throughout the period of the charter to make the Vessel available to serve the commercial purposes of the Charterer. These purposes are substantially simplified where the Vessel is to be dedicated to a specific project, and is intended in essence to act as a “floating pipeline” for the passage of LNG through certain limited terminals. In such a situation the task of negotiating the “key” operational issues will often be relatively straightforward; where however the Vessel must be available to “trade” worldwide for a range of potential charterers and sub-charterers the task is considerably more complex.

The Condition of the Vessel at Delivery

The Shelltime 4 form imposes a number of absolute obligations on the Owner at delivery. The Vessel must be (i) in Class, (ii) tight, staunch, strong in good order and condition and in every way fit for service³, (iii) in compliance with regulations enabling her to pass through the Suez and Panama canals, and (iv) have on board “*all certificates, documents and equipment required from time to time by any applicable law to enable her to perform the charter service without delay*”. In addition the Vessel must have on board a “full and efficient complement of Master, officers and crew” that

³ This has been held to amount to an express undertaking of seaworthiness.

complies with the requirements of the flag state and international convention.

These requirements will however usually be specifically tailored to meet the requirements of the LNG trade by insertion of additional documentary and crewing requirements. The Owners will generally be required for example to warrant that the officers and crew are skilled and experienced in the carriage of LNG and acceptable to the International Transport Federation. One particular issue here will be the degree of experience required from the Vessel's crew; the world LNG fleet is expanding substantially as the stream of newbuildings are delivered and this is likely to lead to an increasing scarcity of experienced personnel particularly at the higher levels.

Two further points are worthy of note. Firstly it appears that these requirements are absolute in nature; the Owner will therefore be liable in damages for breach of contract if these requirements are not met as at delivery irrespective of whether or not he has failed to exercise due diligence.

Secondly this scheme will frequently be inconsistent with the requirements of the financiers of a newbuilding. Such financiers will be reluctant to permit the Owner to assume the risk that the Vessel is “deliverable” under the shipbuilding contract but not under the Charter. Given the more extensive quality and other obligations imposed by most standard form shipbuilding contracts, this risk might perhaps be regarded as limited. The Owner's financiers will however usually insist that the Vessel on delivery under the shipbuilding contract is automatically deemed to be accepted by the Charterer and delivered into the charterparty.



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Where the Vessel is not a newbuilding different considerations will arise. The Shelltime 4 form does not contain any provision for payment of liquidated damages where delivery of the vessel is delayed beyond the intended delivery window thus exposing the Owner to the possibility of an unliquidated claim in damages for any losses the Charterer may incur as a consequence of a delay in delivery. The form does however expressly permit the Charterer to cancel the Charter if the Vessel is not "ready and at their disposal on or before" a specified date.

Maintaining the Vessel

This issue will be of critical importance to the Charterer in at least two respects. Firstly although the LNG industry has a consistently good safety record, the Charterer will frequently and understandably be concerned, that the Vessel should not attract any unfavourable publicity that might influence public perceptions either of the Charterer or of the industry in general. Secondly the Charterer will be concerned to ensure that the Vessel remains continuously available so as to enable the Charterer to fulfil the obligations it has assumed under its sale and purchase contracts.

The scheme of the duty to maintain contained at Clause 3 of the Shelltime 4 form is not however straightforward and has been the subject of several judicial decisions. These make it clear that the clause distinguishes between those defects in the Vessel that exist at the time of delivery and those that come into existence only after delivery.

Under Clause 3(ii). "*if at any time whilst the vessel is on hire under this charter the vessel fails to comply with the requirements of Clauses*

1, 2(a) or 10 then hire shall be reduced to the extent necessary to indemnify Charterers for such failure". As discussed above the Owner's obligations under Clauses 1 and 2(a) are absolute, and he will therefore be liable under the indemnity for any breaches of these provisions irrespective of whether he has exercised due diligence. In The Fina Samco (1995) however the Court limited this indemnity to defects in existence at delivery. The Court considered that an indemnity from the Owner covering a breach of Clauses 1 or 2(a) arising at any time after delivery would in effect put the Owner under an absolute obligation to maintain the Vessel.

Following delivery the "*the Owners shall whenever the passage of time, wear and tear or any event (whether or not coming within Clause 27 hereof) requires steps to be taken to maintain or restore the conditions stipulated in Clauses 1 and 2(a), exercise due diligence so to maintain or restore the Vessel.*" If the Owner fails within a period of thirty days to demonstrate to the Charterer's "*reasonable satisfaction*" that he is exercising the requisite due diligence, the Charterer is entitled to place the Vessel off-hire and then to terminate the Charter.

As has been frequently remarked the effect of the decision in The Fina Samco is to render the words "*at any time while the Vessel is on hire*" largely ineffective from the Charterer's perspective. For this reason the Charterer will frequently seek to amend the Shelltime form so as to ensure that the obligations in Clauses 1 and 2(a) apply "*throughout the Charter*". The Owner should however treat this amendment with some care since it may be regarded as converting the Owner's customary obligation to exercise due diligence to maintain the Vessel



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into an absolute obligation. Given the potentially expensive consequences of any loss of efficiency of an LNG carrier the Owner would be well advised to ensure that this conflict either does not arise or is suitably resolved.

There is one further issue. The maintenance obligations imposed on the Owner under a long term LNG charter will typically be substantially expanded from those contained in the Shelltime 4 form. The Charterer may require the Owner to produce detailed written a preventative maintenance and quality programme for review and approval by the Charterer. This programme may deal with such issues as (i) health and safety, (ii) adherence to recommendations of equipment suppliers and manufacturers and (iii) ISM compliance. Whilst it is of course in the Owner's interest also to maintain the Vessel in good operating order, views can legitimately differ as to the extent and appropriateness of the maintenance that is required. It will therefore frequently be prudent for the parties to agree the specific maintenance programme before entering into the Charter.

Drydocking

One key part of the maintenance provisions will be the drydocking; the Charterer will be anxious to ensure that this is carried out with the minimum disruption to the Vessel's intended trading pattern. It may not however be easy to reconcile this requirement with the Owner's objectives of maintaining the Vessel in a timely and cost effective manner.

Under the Shelltime 4 form, the Owner is obliged to dry dock the Vessel at regular, agreed intervals. He is required to propose, in

advance, a date for the drydocking and the Charterer is then required to offer a port for the drydocking and "*to take all reasonable steps to make the Vessel available as near to such date as practicable*". If the Owner elects to drydock in this port the Vessel will be off-hire from the time of arrival at the port until the drydocking is complete and the Vessel is "*at the position at which she went off-hire or a position no less favourable to Charterers, whichever she attains first*". The Owner is however entitled to drydock the Vessel at an alternative "special" port of its selection. In this case the Vessel will be off-hire "*from the time when she is released to proceed to the special port until she next presents for loading in accordance with Charterer's instructions.*"

This provision can give rise to difficulties particularly if there is no available or suitable capacity in the drydock port offered by the Charterer. The Owner is apparently required in such circumstances either to wait for available capacity or to drydock the Vessel at a "special" port.

Moreover these provisions will often be unsuitable for the trading pattern of an LNG tanker. The Owner will often be unwilling to permit the Charterer to select the drydock port particularly where the Vessel's projected trade does not easily accommodate a cost effective drydocking by an experienced shipyard. Equally the Charterer will frequently seek much greater rights to influence or determine the timing of any drydocking to ensure that it does not take place during the busy season. There will often be considerable tension between the Owner's objectives and those of the Charterer and the attendant cool down and boil off costs must obviously be taken into account in calculating any compromise.



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Change in Law

One specific aspect of the Owner's obligation to exercise due diligence so as to maintain the Vessel in Class, and in accordance with the various regulatory requirements is the possibility that these requirements will change over the period of the Charter. This possibility is not addressed in the Shelltime 4 form but the Owner will rarely be willing to accept the entire risk of a change in the regulatory regime and will usually insist either that the cost of any modifications necessary to adapt the vessel to such changes is shared between the parties, or that he is entitled, if these costs exceed a certain level, to terminate the Charter.

Trading Range

The Charter will generally permit the Charterer to order the Vessel to carry LNG in any part of the world "*subject to the limits of the current British Institute Warranties*". Under the Shelltime 4 form the Charterer is obliged to exercise due diligence to ensure that the Vessel is only employed at and between safe places. The Charterer is permitted to order the Vessel to ice-bound waters or to unsafe ports provided that the Owner consents (such consent not to be unreasonably withheld).

The more critical issue in an LNG charter will generally be the agreed list of "primary" terminals to which the Charterer intends to trade the Vessel. Where the Vessel is to serve as a "floating pipeline" for a specific project these are likely to remain constant throughout the charter period, and the Vessel will be specifically constructed to meet such requirements.

Increasingly however the development of new LNG terminals (including prospectively offshore terminals) is likely to place greater emphasis on the ability of the Vessel to comply physically with the requirements of a wider range of terminals. Ensuring this adaptability will be an important issue during the Vessel's construction.

In addition the Charter will therefore usually contain provision allocating responsibility for the costs of, and time spent on, any modifications or upgrade necessary to enable the Vessel to trade to different terminals.

The Performance of the Vessel

The performance of the vessel is of course critical to the commercial value it holds for the Charterer. The Shelltime 4 form provides for a guarantee from the Owner of the Vessel's fuel consumption and speed. This performance is calculated on each voyage on an annual basis excluding any time during which the Vessel is or would but for a permitted exception, be off-hire. The calculation also excludes "Adverse Weather Periods" when the ship's speed is reduced for safety reasons in congested waters or poor visibility and any days when the wind speed exceeds force 8 on the Beaufort Scale for more than 12 hours.

Where the Vessel's performance is deficient the Charterer is entitled to deduct an amount equal to the value of the additional bunkers consumed and/or an amount equal to the value at the hire rate of the time lost. It should be noted however that this reduction of hire is "*without prejudice*" to any other remedy available to Charterers". The effect of this wording has not so far been considered by the English Courts but would appear, at least, to preserve Charterer's remedies available under



Clause 3(iii) and possibly also Charterer's remedies more generally where the Owner has breached the terms of the Charter.

The fuel consumption provisions should be amended to include within the calculation both fuel oil consumed during the passage and also (where the Vessel is conventionally powered) the fuel oil equivalent of the volume of LNG lost as boil off. The parties will therefore typically amend the charter to include provision both for the detailed measurement of this LNG boil off and to enable determination of the fuel oil equivalent.

The traditional measures of performance may not however be appropriate to a LNG Charter.

The key issue for the Charterer will often be not the Vessel's performance as such but its ability to meet its prescribed arrival and discharge times. Scheduling at the LNG terminal is complex and any delay in the arrival or discharge rate of the Vessel can have a substantial financial impact on the Charterer. The performance clause may therefore be more substantially amended by measuring the Vessel's performance against its ability to achieve such arrival and discharge times.

In addition for a LNG carrier performance encompasses not simply the speed and fuel consumption of the vessel but also cargo capacity, and rates of loading, discharge and boil off. The Shelltime 4 form will therefore usually be amended to include specific "guarantees" of cargo capacity, rate of boil off and loading and discharge periods. The loading and discharge periods may be of particular significance under the Charterer's sale and purchase agreements and the Charterer may seek the right to increase the delivery pressure and to charge the Owner for any incremental cost incurred where these "guarantees" are breached.

The Charter may also permit Owners and Charterers to "spray cool" either to maximise the use of the available boil off for propulsion or to enable the Vessel to commence bulk loading after arrival at the load port.

Cool Down

The Charter will contain provisions dealing with the costs and time associated with purging and cooling down the vessel's cargo tanks and handling systems, and then maintaining them at the necessary temperature to enable carriage of liquefied LNG. In addition to the off-hire events considered above, "Cool down" will be necessary in a variety of situations including first loading following drydocking and where the vessel is delayed in arrival at the load port. Delay in arrival at the load port may be for reasons due to charterer, owner or beyond the control of either and the allocation of time and costs in these situations is likely to be one of the most contentious issues in negotiations.

Moreover the Vessel will frequently be required to undertake at least one leg of its voyage in ballast and must therefore retain a sufficient quantity of LNG in its cargo tanks as "heel" to maintain its cooled down "ready to load" condition. Such "heel" will usually be provided at Charterer's cost but the Charter must contain provision for determining the quantity of LNG "heel" that is to be retained for this purpose.



Structural Issues

Charter Hire

The Hire payable under a long term LNG newbuilding charter is customarily divided into at least two elements, the capital cost (or Capex) element and the Operating (or Opex) element. The Capex element will usually be fixed throughout at least the initial term of the charter and will represent the financing costs of the Vessel.

The treatment of the Opex element is more variable. The Owner can sometimes particularly where it cedes a substantial element of control over the maintenance obligations, secure payment of its operating costs on a "pass through" basis. Perhaps more generally the Opex element (the insurance element may be treated separately in this regard) will be adjusted from a base year in accordance with an agreed consumer index.

The Shelltime 4 form permits the Charterer to deduct three categories of amounts from hire:

- (a) any hire that the Charterer has already paid but which they reasonably estimate relates to off-hire periods. It should be noted that the Charterer is not permitted to make deductions in respect of any anticipated off-hire (other than under Clauses 3 and 24);
- (b) any disbursements, advances and other charges which are for the Owner's account under the Charter; and
- (c) Any amounts due or reasonably estimated to become due under Clauses 3(ii) or 24.

The Owner's ability to agree these and the further rights of deduction the Charterer may seek will ultimately be dependant on the terms of his financing. Under a more traditional "hell and highwater" structure, the Charterer will not be permitted to make any deductions at least from the Capex element of the Charter Hire.

The Owner may also seek to amend the Shelltime 4 form to add a "grossing up" mechanism to ensure that the charter hire received by him is not affected by withholding tax requirements in any jurisdiction to which the Vessel trades.

Off-Hire

An LNG charter will of course adhere to the principle that the Charterer is entitled to place the vessel off-hire (and to deduct at least the opex element of the hire) where there is an interruption to the vessel's service or a reduction in performance. Under the Shelltime 4 form the Vessel will be off-hire "*on each and every occasion that there is a loss of time*" resulting from a range of different events including (i) breakdown of the Vessel, time in and waiting to enter into drydock for repairs, overhaul, maintenance, collision, stranding, accident or damage to the vessel, or other similar cause preventing the efficient working of the vessel; and such loss continues for more than three hours (if resulting from an interruption to the vessel's service) or cumulates to more than three hours (if resulting from a partial loss of service), (ii) industrial action, (iii) for the purposes of medical treatment, (iv) quarantine and (v) detention of the vessel.



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In each such case the vessel will be off-hire from the commencement of the loss of time until the vessel is *“again ready and in an efficient state to resume her service from a position not less favourable to Charterers than that at which such loss of time commenced.”* The Shelltime 4 off-hire clause is a “net loss of time” (as opposed to a “period” clause) in that *“any service given or distance made good by the vessel whilst off-hire shall be taken into account in assessing the amount to be deducted from hire”*.

It is important to recognise that the occurrence of an off-hire event does not constitute a breach of charter by the Owner. An off-hire clause simply interrupts, in certain defined circumstances, the obligation of the Charterer to pay hire; it does not entitle the Charterer to damages in addition. There are however additional costs associated with the off-hire of an LNG carrier, particularly the increase in boil-off and where the Vessel is unable to maintain its “ready to load” temperature, the costs of cooling down the cargo tanks to receive LNG. The Shelltime 4 form will however be typically amended to reflect the agreed allocation of these costs (which will often, though not invariably, be predominantly for Owner’s account) during any period of off-hire.

Liability and Exceptions

Under general English law principles, both the Owner and the Charterer will be liable including where appropriate in damages for any breach of the terms of the Charter. Such damages will extend to any foreseeable loss incurred by the other contractual party as a consequence of the breach. Liability of this extent is unacceptable in the great majority of international transportation

contracts and the parties will usually therefore agree that certain “force majeure” events, termed “exceptions” will excuse the parties from any liability *for failing to perform their obligations*.

The list of “exceptions” contained in the Shelltime 4 form is unlikely to be the subject of detailed negotiation in the context of a LNG Charter. Certain general points are however relevant and will often be the subject of negotiation:

- (i) the list which encompasses a number of causes of Vessel breakdown, including *“bursting of boilers, breakage of shafts or any latent defect in hull, equipment or machinery”* does not affect the obligations of the Owner under Clauses, 1, 2, 3 and 24. These clauses set out the Owner’s obligations in respect of the condition of the Vessel at delivery, crewing, maintenance and performance;
- (ii) Exceptions will generally be construed strictly against the party seeking to invoke their protection, and will not protect a party against its own negligence. Under the Shelltime 4 form the Owner is however entitled to protection against *“loss or damage or delay or failure arising from or resulting from any act, neglect or default of the master, pilots, mariners or other servants of Owners in the navigation or management of the vessel”*;
- (iii) The exceptions do not affect any provision of the Charter relating to off-hire or reduction in hire;



(iv) Although the Charterer is protected under Clause 27(b) against a standard list of “force majeure” events, including act of God, act of war, seizure under legal process, strikes, lock outs and restraint of labour, this list is unlikely to match the list of force majeure events in the Charterer’s sale and purchase agreements. The Charterer will therefore remain liable to pay hire in such circumstances irrespective of the duration of the force majeure event.

In addition the exceptions in Clause 27(a) do not affect the liability of the Owner for loss or damage caused to the receiving terminal or in connection with the cargo. In the latter case all such claims are subject to either the Hamburg Rules or the Hague-Visby Rules.

Termination

The Shelltime 4 form permits the Owner to withdraw the Vessel where the Charterer defaults in “*proper and timely*” payment of hire and fails within seven days of notice from the Owner of this default, to pay the amount due including interest. In the context of a long term Charter the Charterer will frequently seek to increase this notice period; moreover the Owner’s financing arrangements will usually depend on obtaining suitable security. In such circumstances the Owner’s ability speedily and effectively to recover any outstanding balance of hire under this security will (provided the Charterer and its associated companies remain solvent) often prove a more effective remedy than a right of termination.

Under the Shelltime 4 form, the Charterer is entitled to terminate the Charter (i) at any time while the vessel is off-hire pursuant to Clause 3, (ii) where the vessel is a total loss, or constructive total loss, and (iii) if war or hostilities break out between two or more of U.S.A., U.S.S.R.⁴, P.R.C., U.K. or Netherlands⁵.

These termination rights will rarely be considered adequate in the context of a long term charter. Importantly neither party has a specific contractual right to terminate the charter in the event that the other party (or its guarantor) enters into some form of insolvency procedure. As a matter of general English law principles, the fact that one of the parties to a charter (even less so a guarantor) has entered into some form of insolvency procedure does not in the absence of such specific provision entitle the other party to terminate the charter.

The innocent party will usually be required to wait until the consequences of the other’s financial difficulty trigger an express contractual right to terminate⁶. This can give rise, particularly where the national insolvency procedures in the country in which the relevant party is incorporated permit a period for restructuring of the insolvent company, to a prolonged period of uncertainty.

The precise nature of the events that are included to trigger an express right to terminate will depend on a range of factors including the bankruptcy laws in the affected party’s country of domicile, but will usually include (i) the appointment of a receiver over all or a substantial part of its assets, (ii) voluntary winding up or compulsory liquidation or (iii) the

4 In this respect at least the form needs to be updated.

5 The Owner is also entitled to terminate in this last situation.

6 The failure to pay hire is an obvious example.



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conclusion of a scheme of arrangement with creditors.

The Charterer may also seek rights to terminate the Charter in the event that the performance of the Owner or the manager of the vessel is persistently deficient. It is important to recognise however that a right of termination will not usually (at least in a favourable) market provide a satisfactory remedy for the Charterer, at least while the availability of replacement tonnage remains circumscribed. The Charterer may therefore seek the right to replace the manager of the vessel (where the default is of a technical nature) to convert the charter into a bareboat charter. This latter right at least will permit the Charterer to retain the use of the vessel following default by the Owner.

The extent of the termination rights permitted to the Charterer will also depend on the terms of the Owner's financing. Under the traditional "hell and highwater" structure the Owner's financiers will not be willing to permit the Charterer to terminate the charter in any other than very limited circumstances⁷. Even under the more flexible financiers will view with concern any attempt to introduce widespread rights of termination into a long term LNG charter.

Security

The recent demise of Enron is a salutary reminder of the risks for an Owner of entering into a long term charter even with an apparently credit worthy charterer. Both Owner and Charterer will usually insist

therefore that the obligations of the other is secured either by a parent company guarantee or by a letter of credit, bond or other security provided by an independent financial institution.

The terms of such security and in particular the extent to which it is "on demand" will be key issues for the parties. The Charterer may also insist on provision by Owner's financiers of a letter of "quiet enjoyment" under which the financiers undertake not to interfere with the Charterer's use of the Vessel other than in certain defined circumstances.

⁷ For example on a total loss following recovery by the financiers of the insurance proceeds.



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A MORE FLEXIBLE ERA

Although long-term charters remain the preferred method of transportation, industry participants are seeking to increase the flexibility of their shipping arrangements through short term contracts, cargo “swaps” and other arrangements. As indicated above however, the industry does not have any standard form contracts appropriate to such “trades” and these therefore require careful and separate consideration. The Owner (or disponent Owner) will typically be anxious to ensure that such charters are “back to back” with his long-term charter but this objective will often be difficult to achieve. The key structural and operational issues relevant to a long term charter will differ from those applicable to a short term arrangement. The performance, off-hire, cool down, hire and maintenance obligations considered above for example do not fit readily into a very short-term contract, and will frequently need significant adjustment. This in turn opens up the possibility that the disponent owner may incur a liability to the head owner that is greater than his own liability to the charterer.

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The author of this booklet, David Gardner is a partner of Curtis Davis Garrard, a firm of international lawyers based at London's Heathrow Airport which specialises in handling shipping and offshore oil and gas development projects and disputes. He has been involved in a number of recent high profile LNG newbuilding and chartering projects and advises regularly on the terms of LNG charters. His e-mail address is david.gardner@cdg.co.uk.

Curtis Davis Garrard is an international law firm based at London's Heathrow Airport. Founded in 1996, the practice was established and designed around the needs of its internationally orientated clients. Curtis Davis Garrard specialises in providing expert commercially led legal advice to the shipping, offshore and energy sectors and also advises on a wide range of commercial disputes. The firm has a simple business philosophy aiming to provide clients with the highest quality, commercially-led legal advice at a sensible cost.

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The firm has the unique advantage of being based at London's Heathrow enabling it to offer a more convenient location for its international clients and take advantage of the lower cost environment than the City.

This guide is not intended to represent in any way a substitute for specific advice in relation to matters involving existing or anticipated arbitration proceedings in England and Wales. We would be pleased to assist further in this regard as required.

Further information regarding the firm may be found on our web site at www.cdg.co.uk

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