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*Ship Building, Sale and Finance*

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CHAPTER 12

Lease Finance and Demise Charters- Lessors’ Risks and Liabilities

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I. INTRODUCTION

An alternative to financing the purchase of a ship by a loan secured by a mortgage is through lease financing. This will generally be used for tax reasons whereby the lender can obtain the benefit of capital allowances on the vessel and is thereby able to reduce the cost of the loan.¹ Under UK taxation rules this was possible for finance leases entered into prior to 1 April 2006 unless there was an option for the borrower to purchase the vessel before the end of the loan.² The new rules which apply to leases entered into on or after 1 April 2006 allocate capital allowances under long funding leases to the lessee, not the lessor, so that long funding lessors are taxed in a similar way to which the way in which they would have been taxed had they made a loan, and long funding lessees in a way that is similar to the way in which they would be taxed had they purchased the asset.³

¹ In the US there was a boom in finance leases in the 1970s to take advantage of federal income tax incentives and many of the first generation of Alaska crude carriers were financed in this way. “Lease Financing for Vessels Engaged in the Coastwise Trades.” http://www.marinemoneyoffshore.com/node/5684 (accessed 23 August 2014).
² A finance lease with an option for the lessee to acquire the asset falls within s.67 of the Capital Allowances Act 2001 if the option to acquire the asset is below the expected market value of the asset at the date the option is exercised. In this case capital allowances will be claimable by the lessee and not the lessor. This is because the payments under the lease contain an element that is regarded as capital. If there is no option to purchase the charter will still be a finance lease unless ownership passes automatically to the lessee at the end of the lease. It could be a finance lease if the total rentals over the initial lease period represent at least 90% of the value of the equipment. Chapter 11 of the Capital Allowances Act 2001 Chapter 11, ‘Overseas Leasing’ is directed at limiting the extent to which the benefit of 25% UK writing-down allowances on the acquisition of capital assets can flow through to non-UK residents.
³ Finance leases of more than five years will constitute long funding leases, but a lease of between five and seven years will constitute a short lease if: (a) It is treated as a finance lease under generally acceptable accounting principles and (b) the residual value of the equipment is not more than 5% of its market value at the commencement of the lease and (c) the rentals in each year must generally not vary more than 10% from the value of the rentals due in the previous year.
Under a finance lease legal title to the vessel being bought will be transferred to the lender who will then execute a bareboat charter to the borrower for the term of the loan.\(^4\) This will transfer possession of the vessel for the term of the charter to the borrower, who will crew the vessel. The lender’s primary security will be its ownership of the vessel, although this will be supplemented by guarantees from various parties associated with the borrower. The bareboat charter will reflect the fact that this is a conditional sale. Loan repayments will be made through payments of hire throughout the life of the charter at the end of which the borrower will obtain ownership of the vessel. Alternatively, a ship may upon expiry of the financing charter be scrapped or disposed of at her then current scrap or market value or at a price driven by tax considerations. The charter may include an option to acquire ownership before the end of the charter term. It may also provide the lender with a right to mortgage the vessel to obtain additional finance, together with an assignment of the ship's earnings, insurances and requisition compensation as security for any loan that the owners take, subject to a direct undertaking from the mortgagee bank that they will allow the charterers quiet enjoyment of the vessel. The owners will usually be given the express right to sell or otherwise transfer their rights in the ship together with the charter to a third party provided that, in so doing, they do not increase the charterers’ obligations. The charter may also provide for a set fee to be paid on termination reflecting the remaining hire instalments due under the charter, discounted for early payment, and providing that on sale of the vessel any excess over this sum is to be paid to the charterers as a refund or rebate of rental.

This paper will examine three issues arising out of the use of bareboat charters as a means of financing ship purchase. First, what are the potential liabilities to which the lender will be exposing itself by taking ownership of the vessel during the course of the charter? How will these be addressed by charter provisions as to indemnity and insurance? Second, what are the lender’s rights in the event of default by the charterer? Thirdly, what is the lender’s position in the event of the borrower’s insolvency? I shall look at these issues from the perspective of UK law and US law and will refer to the standard bareboat form, BARECON 2001.

II. OWNERS’ LIABILITIES

A) In personam claims

Under a bareboat charter possession of the vessel will be transferred to the charterer and it is the charterer who will crew the vessel. Accordingly, there will generally be no contractual liability under bills of lading issued during the currency of the demise charter as the charterers will have no actual or ostensible authority to bind the owners. In *Baumwoll Manufactur Von Carl Scheibler v Furness*\(^5\) the bill of lading was signed for the master, but the master being the servant of the charterers, the bill of lading constituted a contract with the demise charterers and not the owners. Nor were the owners bailees of the cargo. It is also extremely unlikely that the owners will incur any liability in negligence in respect of the operation of the vessel during the charter, except possibly as regards damage caused by unseaworthiness existing at the time the vessel was delivered and of which the owners were, or should have been aware.\(^6\) Where damage

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\(^4\) Under a ‘synthetic lease’ additional finance may be obtained by the lender who will then execute a mortgage on the vessel.

\(^5\) [1893] AC 8.

\(^6\) Part III of Barecon deals with purchase of a new build and contains a provision in clause 1(d) which precludes charterers’ from raising claims in respect of the vessel's performance or specification or defects arises except as regards defects which manifest themselves within the first 12 months from the date of delivery of the vessel. In this event, the owners obligation is to endeavour to compel the builders to repair, replace or remedy any
is caused by concurrent causes of initial unseaworthiness and negligence/unseaworthiness arising after delivery, the owners would still be liable if the initial unseaworthiness was a material cause of the damage.\(^7\)

However, it is possible for the owners to incur personal liabilities in the interim period between termination of the charter and redelivery of the vessel. In *The Chem Orchid* \(^8\) the charter was terminated in April 2011 and bills of lading were issued in June and July 2011 before the physical redelivery of the vessel. The High Court of Singapore held that there was an arguable case that the vessel had been constructively redelivered in mid-April 2011 which meant that from that moment on the possession and control of the vessel passed to the owners, even though the crew continued to be employed by the charterers. The owners had placed the demise charterers in the position as their representatives in respect of bills of lading issued and indirectly represented to shippers that the demise charterers were authorised to bind the owners to the bills of lading; and the shippers had relied on this conduct.\(^9\) After the termination of the charter, the owners could have made it clear that the vessel no longer had their authority to take on cargo and issue bills of lading.\(^10\) Although the owners had repeatedly demanded the return of the vessel after the termination of the charter, they took no steps to recover possession of the vessel as expressly provided for in article 26(5) of the Lease Agreement whereby in the event that the charterer delayed return of the vessel, the owner was to be allowed unilaterally to retrieve the vessel at the charterer’s expense.

The lender’s exposure to owner’s liabilities during the currency of the charter may be limited by vesting ownership in a subsidiary of the lender. Under UK law the courts will not pierce the corporate veil to make the parent company liable\(^11\), although there may a greater chance of this happening in the US. However, most personal liabilities that can be incurred by a shipowner will be subject to mandatory insurance provisions, which are discussed later in this paper.\(^12\)

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7. In *IBA v EMI and BICC* (1980) 14 BLR 1 a television aerial mast collapsed due to oscillation of the mast during high winds. The collapse was caused by two forces of stress on the mast but the party who designed the mast was liable only in respect of one of them and the other stress was, for which they were not liable, was “by far the more important cause” of the collapse. However, as the first stress “materially contributed to the collapse” the House of Lords held that the designer was liable in full. Lord Fraser, at 37 and 38, applied the statement of Lord Reid in *McGhee v National Coal Board* [1973] 1 WLR 1, 4: “It has always been the law that a pursuer succeeds if he can show that fault of the defender caused or materially contributed to his injury. There may have been two separate causes but it is enough if one of those causes arose from the fault of the defender. The pursuer does not have to prove that this cause would of itself have been enough to cause him injury.” Although the House of Lords in *Fairchild v Glenhaven Funeral Services Ltd* [2002] UKHL 22, [2003] 1 AC 32 cast doubt on certain dicta in McGhee’s case, it is suggested that it remains authority for the proposition just stated.


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a) **Liability under International Conventions**

The owners of a vessel will also come under two strict liability regimes in relation to oil pollution and bunker spills by reason of two international conventions which the UK has ratified. The first is the 1992 International Convention on Civil Liability for Oil Pollution Damage (‘1992 CLC’) which imposes strict liability on all shipowners\(^{13}\), irrespective of their nationality or flag, in respect of discharges or escapes of ‘persistent oil’ from laden bulk oil tankers and to escapes of oil from oil tankers on ballast voyages following the carriage of oil, unless it is proved that no residues from the carriage of any such oil remain in the ship. Liability is also imposed in respect of escapes from combination bulk carriers, for example, oil, bulk, ore carriers (OBOs). The Convention applies:

(a) to pollution damage\(^{14}\) caused:

(i) in the territory, including the territorial sea, of a Contracting State, and

(ii) in the exclusive economic zone of a Contracting State, established in accordance with international law, or, if a Contracting State has not established such a zone, in an area beyond and adjacent to the territorial sea of that State determined by that State in accordance with international law and extending not more than 200 nautical miles from the baselines from which the breadth of its territorial sea is measured;

(b) to preventive measures\(^{15}\), wherever taken, to prevent or minimize such damage.

Liability is strict, but the shipowner may escape liability if it can prove that the discharge or escape or the threat of contamination:

(a) resulted from an act of war, hostilities, civil war, insurrection or an exceptional, inevitable and irresistible natural phenomenon; or

(b) was due wholly to anything done or left undone by another person, not being a servant or agent of the owner, with intent to do damage; or

(c) was due wholly to the negligence or wrongful act of a government or other authority in exercising its function of maintaining lights or other navigational aids for the maintenance of which it was responsible.\(^{16}\)

Article III.4 provides: “No claim for compensation for pollution damage may be made against the owner otherwise than in accordance with this Convention.”

The shipowner is entitled to limit its liability as follows.\(^{17}\)

- for vessels not exceeding 5,000 gross tons, a flat rate of 4.51 million SDRs;
- for vessels between 5,000 and 140,000 gross tons, 4.51 million SDRs plus an additional 631 SDRs for each additional gross ton above 5,000 gross tons;

\(^{13}\) Defined in Art 1.3 as “the person or persons registered as the owner of the ship or, in the absence of registration, the person or persons owning the ship.”

\(^{14}\) Defined in Art 1.6 as “(a) loss or damage caused outside the ship by contamination resulting from the escape or discharge of oil from the ship, wherever such escape or discharge may occur, provided that compensation for impairment of the environment other than loss of profit from such impairment shall be limited to costs of reasonable measures of reinstatement

(b) the costs of preventive measures and further loss or damage caused by preventive measures.”

\(^{15}\) Defined in Art 1.7 as “any reasonable measures taken by any person after an incident has occurred to prevent or minimize pollution damage.” “Incident” is defined in Art 1.8 as “any occurrence, or series of occurrences having the same origin, which causes pollution damage or creates a grave and imminent threat of causing such damage.”

\(^{16}\) Article 3.2.

\(^{17}\) Subject to Art 4.2 which provides: “The owner shall not be entitled to limit his liability under this Convention if it is proved that the pollution damage resulted from his personal act or omission, committed with the intent to cause such damage, or recklessly and with knowledge that such damage would probably result.”
• for vessels of 140,000 gross tons and above, the limit is 89.77 SDRs.

Under Art.7 all ships carrying in bulk a cargo of more than 2,000 tons of persistent oil are required to supply a certificate confirming liability insurance covering their CLC liabilities. Each Contracting State must ensure that insurance or other security is in force in respect of any such ship wherever registered, entering or leaving a port in its territory, or arriving at or leaving an off-shore terminal in its territorial sea, if the ship actually carries more than 2,000 tons of oil in bulk as cargo.

The second international convention is the 2001 International Convention on Civil Liability for Bunker Oil Pollution Damage. This came into force on 21 November 2008. This applies a similar liability regime to that imposed by the CLC in respect of spills of bunker oil outside the vessel, wherever they occur, which cause damage in the territory of State Parties. The Convention, however, defines ‘shipowner’ in terms wider than those used by the CLC, as ‘the owner, including the registered owner, bareboat charterer, manager and operator of the ship’. There is no separate provision for limitation of liability. Instead, claims under the Convention will fall to be limited under either the 1957 or 1976 Limitation Conventions. Article 7 provides that for vessels over 1,000 gross tons, the registered owner, but not the other persons falling within the definition of ‘owner’, must maintain insurance equal to the amounts of liability under the applicable national or international limitation regime applicable in the flag state, but not exceeding the limits in the 1976 Convention, as may be amended. In the UK’s 168 of the Merchant Shipping Act 1995 provides that any liability under the Convention shall be deemed to be a liability to damages in respect of such damage to property as is mentioned in Art 2(1)(a) of the 1976 LLMC.

Strict liability is also imposed on shipowners under two other international conventions, neither of which are yet in force: the 2010 International Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea in respect of damage caused by carriage of hazardous and noxious substance; the 2007 Nairobi International Convention on the removal of wrecks which makes shipowners liable for the costs of locating, marking and removing wrecks located beyond the territorial sea but within the exclusive economic zone of a State Party. The Convention, which has been ratified by the UK, will come into force on 14th April 2015.

b) Liability under Statute

The demisors may also become liable under a UK statute imposing liability on the ‘owners’ of a vessel. In BP Exploration Operating Co Ltd v Chevron Shipping Co the House of Lords considered the meaning of s.74 of the Harbours, Docks, and Piers Clauses Act 1847 under

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18 A public law liability for water pollution by ships carrying hazardous substances is imposed on the ‘operator’ of the ship by the Environmental Liability Directive 2004/35/EC, as an activity falling within Annex III. Directive 2012/30 on safety of offshore oil and gas operations amends the Environmental Liability Directive so that the ambit of damage to surface water extends from coastal waters all water up to one nautical mile seaward from the baseline to all EU waters including the exclusive economic zone (about 370 km from the coast) and the continental shelf where the coastal member states exercise jurisdiction. The Environmental Liability Directive defines “operator” as “the person who operates or controls such an activity, including the holder of a permit or authorisation relating to that activity, or the person registering or notifying such an activity. Where there is a bareboat charter the ‘operator’ would be the demise charterer who is the person who operates or controls the relevant activity, the carriage of dangerous cargo, and would not cover the registered owner.

19 The convention has also been ratified by: Bulgaria, Denmark, Germany, India, Iran, Malaysia, Morocco, Nigeria, and Palau.

which strict liability was imposed upon the owner of a vessel which caused damage to any harbour, dock, pier or quay. It was held that for the purposes of s.74 of the 1847 Act, the "owner" of a vessel meant the registered owner and did not include a charterer, even a bareboat charterer.

Liability for breach of statutory duty may also arise under s.100 of the Merchant Shipping Act 1995 which places a duty on the owner of a ship to take all reasonable steps to secure that the ship is operated in a safe manner and creates a criminal offence if there is a failure to comply. In *Littlejohn v Wood & Davidson Ltd*21 the Scottish Outer House considered that s.31(1) of the Merchant Shipping Act 1988 (since replaced by s.100 of the Merchant Shipping Act 1995), created a civil liability and hence a crew member who was injured while carrying out repairs while the ship was docked was entitled to sue the owner of the ship. The section provided, "It shall be the duty of the owner of a ship to which this section applies to take all reasonable steps to secure that the ship is operated in a safe manner…. “ and subsection (4) indicated that in addition to the owner of a ship, a charterer or manager could also be involved in criminal conduct if involved in the operation in question. At the time the vessel was being operated under a contract that was probably a demise charter. It was held that for the purposes of s.31(1), a ship was being operated when at sea, afloat in port, under repair, or loading and unloading cargo.22 Although failure to comply with the section was a criminal offence, civil claims for damages could also be allowed as the legislation was aimed at protecting a particular class of persons, ie. all those on board ship, whether at sea or not.23 Another potential source of liability in the Act is to be found in s. 49 which provides that the owner and master shall be guilty of an offence if the ship is dangerously unsafe. Subsection 2, however, provides:

(2)Where, at the time when a ship is dangerously unsafe, any responsibilities of the owner with respect to the matters relevant to its safety have been assumed (whether wholly or in part) by any person or persons other than the owner, and have been so assumed by that person or (as the case may be) by each of those persons either—

(a) directly, under the terms of a charter-party or management agreement made with the owner, or

(b) indirectly, under the terms of a series of charter-parties or management agreements,


22 Section 31(1) provides Lord Johnston noted that “where an owner had simply appointed a manager or had let the ship on demise charter and was not to any extent involved in its management, it would be a sufficient defence for him to aver that he took all reasonable steps as required by subs (1) by either effecting such a management arrangement or by effecting the charter. On the other hand one can envisage situations where both an owner and a manager could be involved in the event or matters to which the subsection related and therefore joint responsibility was possible.” However, the defendants did not advance this as a defence.

23 Lord Johnston stated: “With regard to the secondary question of civil liability, I am clearly of the view that this legislation and particularly s.31 falls firmly within the exception clearly stated in the law for over 100 years where particular legislation is conceived for the protection of a particular class of people. Here the class is enormous, namely all those at sea, including those on board a ship in port, but is nevertheless a specific and definable class totally akin to those who work in factories wherever they may be, I am therefore firmly of the view that this section admits a claim for civil liability in principle and the defenders' attack in this respect also fails.”
the reference to the owner in subsection (1) above shall be construed as a reference to that
other person or (as the case may be) to each of those other persons.

Section 42 implies an obligation into every contract between the owner of a UK ship
and the master of or any seamen employed on the ship that the owner of the ship shall use all
reasonable means to ensure the seaworthiness of the ship for the voyage at the time when the
voyage commences and to keep the ship in a seaworthy condition for the voyage during the
voyage. This must apply to the demise charterer as ‘owner’ as there will be no contract of
employment between the registered owner and the master and any seaman.

c) In rem Admiralty jurisdiction

An in rem action may be brought in the Admiralty Court against the vessel in respect of
maritime liens. If a claim is a maritime lien it will attach to the res from the date of the claim
and will be unaffected by subsequent changes in its ownership. The maritime lien also attaches
notwithstanding that at the time of the incident the vessel was on demise charter. Therefore,
in rem proceedings may be brought against a vessel in respect of a collision notwithstanding
that it has been sold to purchasers, without notice of the claim, before the issue of the writ.
However, the owners of the demise chartered vessel will not be liable in personam and their
liability will be limited to the value of the res. Further, a maritime lien will be lost if the res is
sold by an order of the court. A maritime lien may be exercised only against the vessel against
which the claim arose and not against any other vessel in the same ownership. At common law
the following claims have been established as giving rise to maritime liens.

(a) damage caused by a ship – This will cover claims arising out of a collision but will not cover
cargo claims unless they are brought against a vessel that has collided with the vessel on which the cargo
was being carried;
(b) salvage –
(c) seamen’s wages –
(d) master’s wages and disbursements –
(e) bottomry and respondentia –

An in rem claim may also be brought against the vessel in respect of the claims listed
in headings s. 20(2)(e) – (r) of the Senior Courts Act 1981:

(e) any claim for damage done by a ship .
(f) any claim for loss of life or personal injury sustained in consequence of any defect in a ship or
in her apparel or equipment, or in consequence of the wrongful act, neglect or default of:
(i) the owners, charterers or persons in possession or control of a ship; or
(ii) the master or crew of a ship, or any other person for whose wrongful acts, neglects or defaults
the owners, charterers or persons in possession or control of a ship are responsible, being an act, neglect
or default in the navigation or management of the ship, in the loading, carriage or discharge of goods on,
in or from the ship, or in the embarkation, carriage or disembarkation of persons on, in or from the ship;
(g) any claim for loss of or damage to goods carried in a ship;
(h) any claim arising out of any agreement relating to the carriage of goods in a ship or to the use
or hire of a ship;
(j) any claim in the nature of salvage;
(i) under the Salvage Convention 1989;

25 (2) In the case of any such claim as is mentioned in section 20(2)(a), (c) or (s) or any such question as
is mentioned in section 20(2)(b), an action in rem may be brought in the High Court against the ship or property
in connection with which the claim or question arises.
under any contract for or in relation to salvage services;

(iii) in the nature of salvage not falling within (i) or (ii) above, or any corresponding claim in connection with an aircraft.

(k) any claim in the nature of towage in respect of a ship or an aircraft;

(l) any claim in the nature of pilotage in respect of a ship or an aircraft;

(m) any claim in respect of goods or materials supplied to a ship for her operation or maintenance;

(n) any claim in respect of the construction, repair or equipment of a ship or in respect of dock charges or dues;

(o) any claim by a master or member of the crew of a ship for wages (including any sum allotted out of wages or adjudged by a superintendent to be due by way of wages) . . . ;

(p) any claim by a master, shipper, charterer or agent in respect of disbursements made on account of a ship;

(q) any claim arising out of an act which is or is claimed to be general average;

(r) any claim arising out of bottomry;

The right to proceed in rem against the vessel in respect of such claims is subject to s.21(4) of the Senior Courts Act 1981 which provides.

In the case of any such claim as is mentioned in section 20(2)(e) to (r), where—

(a) the claim arises in connection with a ship; and

(b) the person who would be liable on the claim in an action in personam (“the relevant person”) was, when the cause of action arose, the owner or charterer of, or in possession or in control of, the ship, an action in rem may (whether or not the claim gives rise to a maritime lien on that ship) be brought in the High Court against—

(i) that ship, if at the time when the action is brought the relevant person is either the beneficial owner of that ship as respects all the shares in it or the charterer of it under a charter by demise; or

(ii) any other ship of which, at the time when the action is brought, the relevant person is the beneficial owner as respects all the shares in it.

Therefore, if the demise charterer as ‘the relevant person’ is liable on the cause of action when the cause of action arose, the in rem action can be brought against the ship. If security is not provided for the claim the ship can then be sold. An in rem action can also be brought against a sister-ship of the demise charterers, but not against a sister-ship of the owners. For there to be an in rem action against the vessel for a statutory lien the demise charterer who is liable in personam must have been in possession or control of the ship when the cause of action arose.

This provision, or its equivalent, has given rise to some litigation in some common law jurisdictions when the demise charterer incurs a liability and subsequently the vessel is withdrawn from the demise charter with proceedings being commenced after the date of withdrawal. The issue is whether when the action is brought the relevant person is still the demise charterer of the vessel which depends on whether redelivery of the vessel is required for the relevant person to cease to be the demise charterer of the vessel. The authorities on this are mixed. Some cases have required redelivery for termination26; others have not.27

In The Chem Orchid28 the High Court of Singapore has recently held that redelivery is required, but a symbolic or constructive redelivery will suffice. The essence of a demise charterparty was that the owners conferred possession and control of the ship on the charterer


for the duration of the charter, so placing charterers in the same position as the owners. An effective termination of a demise charter required the withdrawal of both possession and control of the ship. The guiding principle was that termination and redelivery was required to bring the charter to an end but this was subject to the provisions of the charter itself. In *The Rangiora*\(^ {29}\), redelivery was held to be required as it was specifically stated in clause 10(a) of the charterparty that hire was to be paid until the day and hour of redelivery of the possession of the vessel, which meant that possession of the ship continued until it was redelivered to the owner. However, the charterparty in *The Soconi Stream*\(^ {30}\) did not contain any clause requiring hire to be paid till redelivery. The charterparty contained a clear contractual right to terminate the charterparty. The charterparties in *ASP* and *The Hako Fortress*\(^ {31}\) were on Barecon 2001 form where the position is even clearer with cl. 29 providing that once a notice of termination is issued, the charterer shall hold the vessel as gratuitous bailee pending physical repossession by the owner. Accordingly, once the notice of termination was issued, both control and possession of the ship were terminated and the charterer held the ship on bailment for the owner.

*The Sea Empire*\(^ {32}\) was the odd man out in these cases, as the charterparty there provided for hire to be paid until the day and hour of delivery of possession of the vessel, as had been the case in *The Turakina* and *The Rangiora*, but the Hong Kong court held that redelivery was not required and the charterparty was terminated once the notice of termination was issued. The Singapore High Court declined to follow the decision noting that *The Sea Empire* had been decided before the full analysis of the law relating to demise charters by Tamberlin J in *The Turakina*. However, there would be constructive or symbolic redelivery once the charterers acknowledged their intention to surrender the ship, and this had happened before the issue of proceedings by the claimant.\(^ {33}\)

**d) Compulsory Insurance**

The Merchant Shipping (Compulsory Insurance of Shipowners for Maritime Claims) Regulations 2012 SI 2012/2267\(^ {34}\) came into force on 5th October 2012.\(^ {35}\) The Regulations provide that ships may not leave or enter UK ports unless the shipowner has insurance which must cover at least maritime claims subject to limitation under the 1996 Protocol to the 1976 Convention.

Where the Hague-Visby Rules are incorporated into the contract for the carriage of goods, and that contract imposes liability for loss resulting from delay in the carriage by sea of

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33 In *The Rangiora*, a letter from the liquidators acknowledging receipt of the notice of termination and accepting the termination was sufficient to constitute constructive redelivery of the ship. In *The Turakina* (at [125]) Tamberlin J indicated that a “statement of intent by the charterer to the effect that possession was surrendered or redelivered” would be an act of symbolic delivery of possession and also (at para 126) that “some step or acknowledgement by the charterer to give effect to the redelivery” was required to show constructive redelivery.
35 Except for regulation 3(3)(b) which comes into force on the date of commencement of Part 9A and Schedule 11ZA(1) of the Merchant Shipping Act 1995 which were inserted by the Wreck Removal Convention Act 2011 (c.8).
cargo, the insurance must cover maritime claims in respect of loss resulting from delay in the carriage by sea of cargo. The insurance must cover maritime claims in respect of loss resulting from delay in the carriage by sea of passengers or their luggage, but only where the delay is consequent upon—(a) an incident involving a collision, stranding, explosion, fire or other cause affecting the physical condition of the ship so as to render it incapable of safe navigation to the intended destination of the passengers and their luggage; or (b) any other incident involving a threat to the life, health or safety of passengers.

The Regulations apply to seagoing ships of 300 gross tonnes or more but do not apply to warships, auxiliary warships or other State owned or operated ships used for a non-commercial public service.
B) US Law

a) Liability at common law

The vessel owner owes an absolute duty to seamen and those doing seamen’s work to provide a seaworthy ship. The warranty continues when the vessel is under a demise charter, if the injury was caused by an unseaworthy condition present when the charter was made. There are dicta in the Fifth Circuit in Baker v Raymond that the owner of a demise chartered vessel will be liable in respect of injuries caused by an unseaworthy condition arising after delivery under the charter, but the general consensus of circuits is against this. In The Marine Sulphur Queen the proximate cause of loss of vessel and its crew could be inferred from several aspects of unseaworthiness, some occurring prior to delivery of the vessel to the demise charterer and some occurring after the delivery. This raised a difficult question of causation which the Second Circuit did not have to resolve due to its finding that the owner was the wholly owned subsidiary of the charterer, and was therefore held to be liable along with the demise charterer.

The owners will not be liable in tort in respect of loss or damage arising out of the operation of the vessel during the period of the demise charter, unless the loss or damage is due to unseaworthiness that was present when the charter was made. Gabarick v Lauren Maritime involved a collision involving a barge that had been demise chartered by its owner ACL to DRD, who had then time chartered it back to ACL. A basis for ACL’s liability would be in negligence for knowingly placing an unsafe vessel into the hands of unsafe vessel operators and that this placement caused the collision. Although the vessel was in a poor state at the date of the demise charter, this was not causative of the collision. This was caused by the fault of DRD’s employees. DRD had knowledge of its employees’ misconduct which created an environment conducive to repetitive safety violations by its employees, especially the

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36 The Osceola, 189 US 158 (1903) in which the Supreme Court held that an owner of a ship is liable to indemnify seamen in his employ for injuries caused by the unseaworthiness of the vessel or its appurtenant appliances and equipment.
37 In Seas Shipping Co. v. Sieracki, 328 US 85, 89 (1946) the Supreme Court held that “seamen” are individuals who perform work onboard vessels traditionally performed by seamen and who are not covered by the Longshore and Harbor Workers' Compensation Act (33 U.S.C. §§ 901–950).
39 Baker v. Raymond International, Inc., 656 F.2d 173, 184 (5th Cir. 1981). The decision in the case was that the owner could not make a valid bareboat charter relinquishing control.
40 However, a claim in rem may be made against the vessel itself in respect of injuries caused by unseaworthiness, whenever arising. In the Barnstable, 181 U.S. 464 (1901); Reed v. Steamship Yaka, 373 U.S. 410 (1963).
41 460 F.2d 89 (2d Cir. 1972).
42 Per Judge Anderson at 100-101 “Where, as here, the court inferred proximate cause from several aspects of unseaworthiness, some occurring prior to delivery of the vessel to MTL and some occurring after the delivery, we might appear to be faced with an insoluble problem whether MSTC, as owner-demisor, can properly be held liable to the Death Claimants. However, on the peculiar facts of this case, we need not decide that interesting question. Where, as here, the owner-demisor is a wholly owned subsidiary of the charterer, the stock of which would clearly be available to satisfy the claims of the Death Claimants if MTL's other assets were insufficient, we see nothing which, as a practical matter, bars us from affirming liability as to MSTC. We emphasize that we do not decide whether in a case of unexplained disappearance where the owner-demisor is not a wholly owned subsidiary of the parent-demise charterer, the owner could properly be held liable when it was responsible for only some of a group of defects which, in their totality, were inferred to be the proximate cause of the loss.”
43 The Lotus Maru, 615 F.Supp. 78 (SDNY 1985) where it was held that the owners were under no personal liability in tort in respect of an alleged shortage of a cargo of gasoline.
44 900 F.Supp.2d 669 (ED La 2012)
captain and steersman. The owners, ACL, however, had acted reasonably in the vetting process, although its vetting was imperfect and needed improvement.

If the owners are liable *in personam* they can limit to the amount of vessel’s value absent privity or negligence on their part. With a corporate owner this depends on privity or knowledge on the part of managerial employees.\(^{45}\) An owner can be vicariously liable for negligence of non-managerial employees and still be entitled to limit.

However, the vessel may still be liable *in rem* up to the amount of her value if service can be effected on her and if the claim is a maritime lien. Maritime lien claims in the US are wider than in the UK and include: ship repairs; ship supplies; towage; use of dry dock or maritime railway or other necessities to any ship; crew wages; tort claims arising from a collision; personal injury claims (excluding Jones Act claims against employer); wharfage; stevedoring; cargo damage/loss; certain maritime contracts (e.g. – breach of charter party); preferred ship mortgages; salvage; claims for maritime pollution.

**b) Statutory liabilities**

Section 107 of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (‘CERCLA’)\(^{46}\) imposes liability on the owner and operator of a vessel or facility from which there is a release, or a threatened release, which causes the incurrence of response costs, of a hazardous substance. There are three defences available to the person who would otherwise be liable if they can establish by a preponderance of the evidence that the release of the hazardous substance was caused *solely* by:

1. an act of God, or
2. an act of war, or
3. an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant. The defendant must establish by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions

The limitation figure for vessels carrying hazardous substances is the greater of $5,000,000 or $300 per gross ton. For vessels not carrying hazardous substances as cargo or residue, the limitation is the greater of $500,000 or $300 per gross ton. For incineration vessels, defined as "any vessel which carries hazardous substances for the purpose of incineration of such substances, so long as such substances or residues of such substances are on board," the limitation is the total of all costs of response plus $50 million. The right to limit will be lost if (A)(i) the release or threat of release of a hazardous substance was the result of willful misconduct or willful negligence within the privity or knowledge of such person, or (ii) the primary cause of the release was a violation (within the privity or knowledge of such person) of applicable safety, construction, or operating standards or regulations; or (B) such person fails or refuses to provide all reasonable cooperation and assistance requested by a responsible public official in connection with response activities under the national contingency plan with respect to regulated carriers subject to the provisions of title 49 or vessels subject to the provisions of title 33 or 46, subparagraph (A)(ii) of this paragraph shall be deemed to refer to Federal standards or regulations.\(^{47}\)

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\(^{45}\) *In Re Norfolk Dredging Co.*, 2006 WL 3182761 (E.D.Va.).

\(^{46}\) 42 U.S.C. § 9607.

\(^{47}\) In addition "If any person who is liable for a release or threat of release of a hazardous substance fails without sufficient cause to properly provide removal or remedial action upon order of the President pursuant to section 9604 or 9606 of this title, such person may be liable to the United States for punitive damages in an amount
Section 108 then provides: “The owner or operator of each vessel (except a non self-propelled barge that does not carry hazardous substances as cargo) over three hundred gross tons that uses any port or place in the United States or the navigable waters or any offshore facility, shall establish and maintain, in accordance with regulations promulgated by the President, evidence of financial responsibility of $300 per gross ton (or for a vessel carrying hazardous substances as cargo, or $5,000,000, whichever is greater) to cover the liability prescribed under paragraph (1) of section 9607(a) of this title.”

A similar regime was introduced by the Oil Pollution Act 1990 which imposes liability on the ‘responsible party’, for a vessel or a facility from which oil is discharged, or which poses the substantial threat of a discharge of oil, into or upon the navigable waters or adjoining shorelines or the exclusive economic zone. The ‘responsible party’, which in the case of a vessel means the owners, operators, and demise charterers, will be liable for the removal costs and damages specified in OPA 90 that result from such incident, up to prescribed limits of liability, subject to the three defences set out in CERCLA 1980. 33 U.S.C. 2716(a) of OPA 90 requires owners and operators, including demise charterers, of certain vessels to establish and maintain evidence of financial responsibility sufficient to meet the maximum amount of liability to which they could be subjected under OPA. These requirements apply to responsible parties for any vessel over 300 gross tons (except a non-self propelled vessel that does not carry oil as cargo or fuel) using any place subject to the jurisdiction of the United States; and any vessel using the waters of the exclusive economic zone to transship or lighter oil destined for a place subject to the jurisdiction of the United States. The current limits of liability for vessels are.

1. For an oil cargo tank vessel greater than 3,000 gross tons with a single hull, including a single-hull tank vessel fitted with double sides only or a double bottom only: the greater of $3,200 per gross ton or $23,496,000.
2. For a tank vessel greater than 3,000 gross tons, other than a vessel referred to in (1): the greater of $2,000 per gross ton or $17,088,000.
3. For an oil cargo tank vessel less than or equal to 3,000 gross tons with a single hull, including a single-hull tank vessel fitted with double sides only or a double bottom only: the greater of $3,200 per gross ton or $6,408,000.
4. For a tank vessel less than or equal to 3,000 gross tons, other than a vessel referred to in (3): The greater of $2,000 per gross ton or $4,272,000.
5. For any other vessel: the greater of $1,000 per gross ton or $854,400.

c) Insurance and Indemnity

Barecon 2001 addresses the shipowner’s exposure to liabilities arising out of the charterer’s operation of the vessel in three ways; by insurance; by indemnity; and by a non-lien clause.

d) Insurance

Clause 10 (iii) requires charterers to “maintain financial security or responsibility in respect of third party liabilities as required by any government, including federal, state or municipal or other division or authority thereof, to enable the Vessel, without penalty or charge, lawfully to enter, remain at, or leave any port, place, territorial or contiguous waters of any country, state or municipality in performance of this Charter without any delay.” This will cover mandatory insurance, such as that required under CLC or under OPA. The necessary arrangements are to

48 ‘Oil’ is widely defined and will include bunker oil.
be made at charterers’ sole expense and charterers “shall indemnify the Owners against all consequences whatsoever (including loss of time) for any failure or inability to do so.”

Clause 13 is the general insurance and repairs provision which requires charterers to keep the vessel insured against hull and machinery, war, and P&I risks, as well as any financial security required under cl.10(iii). The insurances are to be arranged to protect the interests of both Owners and Charterers and the insurance policies “shall cover the Owners and the Charterers according to their respective interests.” Charterers “shall effect all insured repairs and shall undertake settlement and reimbursement from the insurers of all costs in connection with such repairs as well as insured charges, expenses and liabilities to the extent of coverage under the insurances herein provided for.” Charterers must also make the necessary documents available to the owners in order for the latter to comply with the insurance provisions of the Financial Instrument. If the charterers fail to arrange and keep any of the insurances the owners are given a right to withdraw under clause 28(a) (ii) which allows the owners the option of giving the charterers a respite of a specified number of days to rectify the position. Barecon 2001 contains an alternative provision in clause 14 whereby the registered owner will pay for hull insurance, with the charterer still being responsible for P&I cover, with a specific provision that the registered owner and insurers will have no rights of recovery or subrogation against the demise charterer, a provision that does not appear in clause 13.

The effect of clause 13 on the charterer’s obligations to the owners and the right of owners’ insurers to proceed against charterers by way of subrogation for breach of charter was recently considered in The Ocean Victory which concerned a demise charter on Barecon 1989 and the effect of the equivalent clauses, 12 and 13. The vessel had become a total loss and a claim was being pursued by owners’ hull insurers against the time charterers for breach of the safe port warranty. Time charterers argued that the demise charterers had no claim against them as the demise charterers had incurred no liability under the safe port warranty under the head charter because of cl. 12. It was submitted that clause 12 of the demise charterparty contained a complete code for the treatment of insured losses as between the parties in the event of a total loss. Accordingly, it could not have been intended by the parties that the demise charterer would have been liable to the registered owner for breach of the safe port warranty in respect of losses covered by the hull insurance taken out by the demise charterer at its expense in the joint names of both the registered owner and demise charterer. The charterers pointed to the express waiver of subrogation in deleted clause 13 which did not appear in clause 12.

Teare J held that cl. 12 was not comparable to the war risks clause in The Evia (No 2) and it did not codify the rights and liabilities of the parties with regard to insured risks:

“It provides for the provision of insurance and who is to pay for it, for the demise charterers to be responsible for insured repairs and to reimburse themselves from the proceeds of the insurance policy, for the demise charterers to be responsible for other repairs and for the claims on a total loss to be paid to the mortgagee for distribution to the registered owner and demise charterers in accordance with the their respective interests. I do not consider that this “codifies” in the required sense the rights and


50 The value of the vessel was US$88.5 million and the amount paid by the insurers was US$70 million which would mean that Gard’s claim would have to be reduced by that amount if the time charterer’s argument was correct.
liabilities of the parties with regard to breach of the safe port warranty where the casualty caused by the breach has given rise to a claim on the insurance.”

Teare J then went on to consider the effect of the provision that the owners and demise charterers were to be co-assureds. Did this bring into play the principle that, generally, an insurer cannot exercise rights of subrogation to pursue a claim in the name of one co-assured against another? He referred to Rix LJ’s explanation of the basis of this principle in *Tyco Fire & Integrated Solutions (UK) Ltd v Rolls-Royce Motor Cars Ltd* 52, that the true basis of the contract between the parties needed to be construed. The contract’s terms may provide “a highly detailed and developed code which made it completely clear that they were designed to supplant any possible liability for negligence on the part of the contractor”53 or “the underlying contract envisages that one co-assured may be liable to another for negligence even within the sphere of the cover provided by the policy”. In the latter case Rix LJ was “inclined to think that there is nothing in the doctrine of subrogation to prevent the insurer suing in the name of the employer to recover the insurance proceeds which the insurer has paid in the absence of any express ouster of the right of subrogation . . .”

Looking at the contract in the instant case, there was an express safe port warranty by the demise charterers, there was no code of rights and obligations in clause 12 with regard to insured losses caused by a breach of the safe port warranty and there was no express ouster of the right of subrogation in clause 12. These features all pointed to an intention that the demise charterer would be liable to the owner for breach of the safe port warranty, notwithstanding that they were joint assured and could take the benefit of the insurance in the manner set out in clause 12. There would be no double recovery by the owner because their recovery from the charterers would go to the insurers by way of subrogation. The decision has since been overruled by the Court of Appeal who held that the port was not unsafe and then went on to express the view that clause 12 did constitute a complete code for the treatment of insured losses as between the parties in the event of a total loss. 55 The parties intended there to be an insurance funded result in the event of loss or damage to the vessel by marine risks (and war risks) so that even if the charterers had been in breach of their safe port obligation the owners, and their subrogated insurers, would not have been able to recover from them.

e) *Indemnity*

Clause 17 provides a scheme of mutual indemnity whereby charterers are to indemnify the Owners against “any loss, damage or expense incurred by the Owners arising out of or in relation to the operation of the Vessel by the charterers, and against any lien of whatsoever nature arising out of any event occurring during the Charter Period.” In the event of arrest or detention by reason of claims or liens arising out of the vessels operations, the Charterers at their own expense “take all reasonable steps to secure that within a reasonable time the Vessel is released, including the provision of bail.” Without prejudice to the general indemnity charterers are to indemnify against all consequences or liabilities arising from the Master,

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51 [198].
52 [2008] Lloyd’s Rep IR 617; [2008] 2 All ER (Comm) 584.
53 [36].
54 [77].
officers or agents signing Bills of Lading or other documents.\textsuperscript{56} The indemnity does not cover liabilities arising out of negligence in the operation of the vessel or by reason of its unseaworthiness, and the clause should be amended to make specific reason to loss or damage arising thereby. As a co-assured, the owners will be liable for unpaid calls under the P&I cover and it would be prudent to make specific provision for this in the indemnity provisions. The indemnity should also extend to any fines incurred by the owners due to charterers’ operation of the vessel. The principle of \textit{ex turpi causa non actio oritur} would generally render unenforceable a provision to be indemnified in respect of a fine. However, an indemnity against a strict liability fine where there is no element of fault on the part of the party subject to the fine, has been held to be enforceable.\textsuperscript{57}

If the vessel is arrested or detained by claims against owners, the owners, at their own expense, shall “take all reasonable steps to secure that within a reasonable time the Vessel is released, including the provision of bail” and to indemnify the Charterers against “any loss, damage or expense incurred by the Charterers (including hire paid under this Charter) as a direct consequence of such arrest or detention.”

Clause 20 provides for a further indemnity in relation to wreck removal, as follows: “In the event of the Vessel becoming a wreck or obstruction to navigation the Charterers shall indemnify the Owners against any sums whatsoever which the Owners shall become liable to pay and shall pay in consequence of the Vessel becoming a wreck or obstruction to navigation.” The indemnity will not arise until the Owners have become liable to pay a sum and have paid a sum in consequence of the vessel becoming a wreck or obstruction to navigation. This will be after the charter has come to an end. In consequence, the owners will not be able to secure their claim by arresting a sister-ship of the charterers under s.21(4)(ii) of the Senior Courts Act 1981.\textsuperscript{58}

\textbf{f) Non-lien}

Clause 16 is an attempt to prevent maritime liens from arising by giving notice to parties dealing with charterers, such as suppliers, that charterers have no authority to create a maritime lien on the vessel in respect of claims by such parties against the charterers. It provides:

“The Charterers will not suffer, nor permit to be continued, any lien or encumbrance incurred by them or their agents, which might have priority over the title and interest of the Owners in the Vessel. The Charterers further agree to fasten to the Vessel in a conspicuous place and to keep so fastened during the Charter Period a notice reading as follows: “This Vessel is the property of (name of Owners). It is under charter to (name of Charterers) and by the terms of the Charter Party neither the Charterers nor the Master have any right, power or authority to create, incur or permit to be imposed on the Vessel any lien whatsoever.”

\section*{III. OWNERS’ REMEDIES FOR CHARTERERS’ DEFAULT}

\textsuperscript{56} Claims under the indemnity would be made where the owners became liable under bills of lading signed by the master in jurisdictions in which such bills were regarded as evidencing a contract with the registered owner, notwithstanding that the master was the servant of the demise charterer.

\textsuperscript{57} Osman v J Ralph Moss Ltd [1970] 1 Lloyd's Rep 313 (CA); more recently, Griffin v UHY Hacker Young & Partners (A Firm) [2010] EWHC 146 (Ch); [2010] P.N.L.R. 20.

\textsuperscript{58} The Faial [2000] 1 Lloyd's Rep 473.
In the event of default by charterers, the owners will want to get their vessel back. This will require termination of the charter and then repossession of the vessel. Clause 11 provides that hire is to be paid punctually in accordance and time shall be of the essence. Hire is to be paid continuously throughout the charter period and there is no provision for off-hire.

A) **Clause 28 – Termination**-

This provides for withdrawal of the vessel in the event of:

(i) charterer’s failure to pay hire in accordance with cl. 11, subject to an anti-technicality provision whereby owners are to give charterers a set number of clear banking days within which to rectify the failure, where the failure is due to oversight, negligence, errors or omissions on the part of the Charterers or their bankers

(ii) the Charterers failure to comply with the requirements of:

(1) Clause 6 (Trading Restrictions)

(2) Clause 13(a) (Insurance and Repairs)

Under this sub-clause the Owners “shall have the option, by written notice to the Charterers, to give the Charterers a specified number of days grace within which to rectify the failure without prejudice to the Owners' right to withdraw and terminate under this Clause if the Charterers fail to comply with such notice;”

(iii) the Charterers fail to rectify any failure to comply with the requirements of sub-clause 10(a)(i) (Maintenance and Repairs) as soon as practically possible after the Owners have requested them in writing so to do and in any event so that the Vessel's insurance cover is not prejudiced.59

The clause also provides for the charter to be deemed to be terminated if the Vessel becomes a total loss or is declared as a constructive or compromised or arranged total loss.

Both charterers and owners are entitled to terminate this Charter with immediate effect by written notice to the other party “in the event of an order being made or resolution passed for the winding up, dissolution, liquidation or bankruptcy of the other party (otherwise than for the purpose of reconstruction or amalgamation) or if a receiver is appointed, or if it suspends payment, ceases to carry on business or makes any special arrangement of composition with its creditors.”

The clause concludes by providing that “The termination of this Charter shall be without prejudice to all rights accrued due between the parties prior to the date of termination and to any claim that either party might have.” The obligation to pay hire will be a condition as time is expressed to be of the essence.60 Should the charter be terminated on this ground the

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59 The clause also provides for termination due to owners’ default, as follows:

“If the Owners shall by any act or omission be in breach of their obligations under this Charter to the extent that the Charterers are deprived of the use of the Vessel and such breach continues for a period of fourteen (14) running days after written notice thereof has been given by the Charterers to the Owners, the Charterers shall be entitled to terminate this Charter with immediate effect by written notice to the Owners.”

owners will be entitled by way of damages to the outstanding instalments discounted for early payment. However, the other clauses which will trigger a right to terminate are not expressed to be conditions but, rather are innominate terms, and a termination on these grounds will not entitle the owners to damages for future sums. For this reason, it is common to include a term providing for a termination fee to be paid in the event of any termination. As a liquidated damages provision the sum stipulated will become payable without any enquiry into the nature of the losses sustained by the owners or without reference to the duty to mitigate. However, the clause must provide for a genuine pre-estimate of loss in the event of default, otherwise it will be classed as a penalty and will be unenforceable.

The classification of a termination clause in a demise charter used as a finance lease was recently considered by the tribunal in London Arbitration 14/13. The charterers and their guarantors argue that the Termination Sums were penalties because they were “extortionate and extravagant in amount” and were not a genuine pre-estimate of any loss suffered by owners, relying partly on the fact that the Termination Sum was always 5 per cent greater than the Option Price by which the charterers could purchase the vessel before the end of the charter. The owners submitted that the law of penalties only applied where the relevant sums were payable upon a breach of contract and the termination clause provided for payment after any termination event which included a series of events unrelated to any breach by charterers. The tribunal rejected this argument because the owner had terminated because of the charterer’s failure to pay hire, which was a breach of contract. The charterers bore the burden of showing that the Termination Sums were unlawful penalties and the modern cases suggested that the court or tribunal was to ask whether there was a “commercial justification” for the clause in question. Recent cases such as Philips Hong Kong Ltd v Attorney General of Hong Kong indicated that the courts should be slow to strike down clauses as penal, especially in commercial contracts between parties of equal bargaining power.

The tribunal considered what the owners would have been entitled to by way of damages for breach of the obligation to pay hire on time under which time was expressed to be of the essence. Damages would be equal to the unpaid and remaining future hire payments under the charters plus the Option Price which the charterers would have been required to pay. To account for accelerated receipt, those future payments would need to be discounted to present value. This gave a figure of US$31,875,356. In comparison, the total of the Termination Sums payable as at the Termination Date was US$24,681,963.10. In the circumstances, the tribunal would accept the owners’ submission that the Termination Sums were “commercially justified” and were not intended to be a deterrent to the charterers from breaching the charters. The termination provisions in the charters were negotiated by two commercially sophisticated parties of equal bargaining power. Although, on any given date the Termination Sum would generally be 5 per cent higher than the Option Price, such a margin, where the termination of the charter was the result of a default in payment by the charterers (or other circumstances evidencing the weakening of the credit underlying the transaction) was “commercially

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61 This is assumed to be the measure of damages for a termination of a bareboat charter for breach of condition, London Arbitration 14/13. However, the measure of damages for termination of a time charter for breach of condition is the difference between the charter hire rate and that obtained under a substitute charter for the unexpired period of the charter. The Astra [2013] EWHC 865 (Comm); [2013] 2 Lloyd's Rep. 69.


65 (1993) 61 BLR 41.
justified” and consistent with market practice for such transactions. The Termination Sum was not intended as a “deterrent”, but was a reasonable, if necessarily unscientific, pre-estimate of the internal and other costs which might be incurred by the owners in such a default situation and which were not otherwise recoverable under the charters.

In the event of default charterers may be able to obtain relief from forfeiture by applying to the court and tendering the outstanding sums owing to owners. In *The Jotunheim* Cooke J held that relief from forfeiture was available when an owner exercised a right of withdrawal under a demise charter. In *Shiloh Spinners Limited v. Harding* Lord Wilberforce identified two well-recognised heads of the jurisdiction. The first was “where it is possible to state that the object of the transaction and of the insertion of the right to forfeit is essentially to secure the payment of money.” The second was the case of fraud, accident, mistake or surprise. In *On Demand Plc v. Gerson Plc* Walker LJ identified a third head of jurisdiction arising out of Lord Wilberforce’s judgment, where the forfeiture provision is security for the production of a stated result which can effectively be attained on the hearing of an application for relief. Applying these principles, Cooke J concluded that the withdrawal clause was either within the first or the third of these categories and that the court did have jurisdiction to give relief from forfeiture.

In exercising its discretion the court would look at the conduct of the party seeking relief from forfeiture, in particular whether his default was wilful, of the gravity of the breaches, and of the disparity between the value of the property in respect of which forfeiture is claimed as compared with the damage caused by the breach. In the present case the demise charterers’ case was not meritorious in that they had deliberately flouted their obligation to pay hire on time over three months despite owners’ constant protests. The court also had to consider the gravity of the breach as compared with the disparity between the value of the property of which forfeiture is claimed and the damage caused by the breach. The demise charterers had paid three months hire and a $25,000 deposit in order to earn the freight under contracts under 33 bills of lading, which they had apparently received, as well as incurring some £12,000 expenditure on the ship at the loading port. This was not a case where they had paid the majority of the hire or price for the vessel since the transaction is still at a very early stage. What they would lose, however, was the right to pay further hire over 45 months and to pay further deposits of $200,000 in order to purchase the ship at the end of that period and they would also lose the use of the ship as a profit-earning chattel for the duration of that period. In addition, sums already expended would be wasted and potential liabilities have been incurred, either under the bills of lading or under the sub-charter-party or both. Taking all these factors into account, and in particular the attitude of the charterers towards their payment obligations, Cooke J declined to give relief from forfeiture.

Clause 29 deals with repossession following termination. Termination under cl.28 gives owners the right to repossess the Vessel from the Charterers at her current or next port of call, or at a port or place convenient to them without hindrance or interference by the Charterers, courts or local authorities. Pending physical repossession the charterers hold the vessel as

66 [2004] EWHC 671 (Comm); [2005] 1 Lloyd’s Rep. 181. In *The Scaptrade* [1988] 2 Lloyd’s Reports 253 the House of Lords had held that relief from forfeiture was not available where an owner exercised a right of withdrawal under a time charter, but had left open the position so far as demise charters was concerned.
69 The clause continues;
gratuitous bailee of the owners. This provision means that charterer’s legal possession of the vessel ceases on termination of the charter and any claims against charterers that arise out of the operation of the vessel between termination and physical redelivery will fall outside the provisions of s.20(4) of the Senior Courts Act 1981. However, owners need to take all possible steps to recover physical possession of the vessel after termination if they are not to risk being liable on contracts made by the charterers in this interim period by way of ostensible authority.

Following repossession the lender will then seek to recover the sums outstanding under the sale contract by sale of the vessel, proceedings under guarantees, and attachment of the borrower’s assets. If the borrower owns other ships the lender may then consider an arrest. The fact that the demise charter is in fact a contract of sale by instalments will probably prevent an arrest of a sister ship of the demise charterer. The issue has recently arisen in the US in *The Icon Amazing* 70 where the owner was unable to attach a sister ship of the demise charterer under supplemental rule B of The Federal Rules of Civil Procedure (F.R.C.P.)’s Supplemental Rules for Certain Admiralty and Maritime Claims (hereinafter “the Supplemental Rules”) govern the procedure for arresting or attaching a vessel in the United States. Rule B allows a party to obtain quasi in rem jurisdiction over a defendant’s property for any debt arising out of a maritime claim, when the defendant “cannot be found within the district.” The Texas court held that the owner’s claim was not a maritime claim.71 The charter required the charterer to purchase the vessel at the end of the term, the charter hire payments were not market-based but rather instalments of the full purchase price for the Vessel, and the claim was not only for unpaid charter hire, but also for additional security in the event of a depreciation in the value of the vessels under a loan to value clause. Taking these factors into account, the court held that this was not a "conventional maritime charter party" but, rather, an "inseparable component of a larger non-maritime vessel sale/financing transaction." In particular the claim for nearly $3,000,000 under the loan to value clause distinguished the case from a previous decision in *Jack Neilson, Inc. v. Tug Peggy*,72 in which the charter party was found to be severable from the sale agreement as the plaintiff had amended its complaint to eliminate claims related to the purchase price and only requested damages specifically related to the “lease.” In this respect it is worth noting that from March 2013 it has become possible for finance charters over vessels registered in the Marshall Islands to be registered as a preferrred mortgage.73 This would give the owner an independent ground of access to the US District Courts for claims against the demise charterer.

B) **Insolvency.**

a) **UK law**

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70 951 F.Supp.2d 909 (2013 S.D.Texas)
71 The general rule is that contracts for the sale of vessels are not maritime claims: *The Ada*, 250 F. 194 (2d Cir.1918).
72 428 F.2d 54, 58 (5th Cir.1970)
The compulsory or voluntary winding-up of a bareboat charterer will not normally prohibit or otherwise prevent the finance lessor/owner from exercising its right to repossess its own property (i.e. the ship) then in the hands of the company, and this is also the case when the charterers are in administrative receivership. It is unlikely that the conditional sale contained in the bareboat charter will be recharacterised as a security interest. The provisions of the Insolvency Act 1986 (as amended by the Enterprise Act 2002) relating to administration covers all hire purchase agreements and chattel-leasing agreements such as bareboat charters. Paragraph 111 of Schedule B1 defines “hire-purchase agreement” as including a conditional sale agreement, a chattel leasing agreement and a retention of title agreement. Under s.43(3) of Schedule B the owners will need the consent of the administrator or the court to take possession of the vessel. If the hire remaining to be paid under the bareboat charter is considerably less than the current market value of the ship and the bareboat charterers are ready, willing and able to carry on paying the charter hire it is possible that the court will prevent the finance lessor/owner from exercising its right to recover possession of the ship and permit the bareboat charterers to carry on performing their obligations under the charter, so as to preserve their existing rights under the charter.

Under paragraph 72(1) of Schedule B an administrator has the power, exercisable with the court's agreement, to dispose of goods (including a ship) in the possession of the company in administration under a chattel-leasing agreement (such as a bareboat charter) “as if all the rights of the owner under the [chattel leasing] agreement were vested in the company”. The court is charged with the responsibility of ensuring that this provision is only invoked in promoting one or more of the purposes for which the administration order was made. The disposal proceeds must also be used to pay down or discharge all amounts outstanding under the charter. This could mean that the administrator is not liable to account for the full value of the ship if (as is likely) it exceeds the amounts due under the charter (unless an order to account for the full value is obtained from the court).

There is little English law authority as to whether a clause in a financing bareboat charter which purports automatically to terminate the charter on presentation of a petition for

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75 Since the introduction of the Enterprise Act 2002, the holder of a floating charge cannot appoint an administrative receiver unless that floating charge was created before 15 September 2003 or if a statutory exemption applies, none of which is likely to apply in the case of a bareboat charter. See sections 72A to 72G of the Insolvency Act 1986 (as amended by the Enterprise Act 2002), and Order 2003, SI 2003/2095, article 2.
76 See, for example, Welsh Development Agency v Export Finance Co Ltd [1992] BCC 270 (CA).
77 Defined in s.251 of the Insolvency Act 1986.
78 Following the decision in Transag Haulage Ltd v. Leyland DAF Finance Ltd [1994] BCC 356.
79 In order to avoid attracting other claims against him such as wrongful detention or interference with goods. See Barclays Mercantile Business Finance Ltd v. Sibec Developments Ltd [1992] 1 WLR 1253 (Ch D).
a winding-up or an administration order is effective.\textsuperscript{81} Davis\textsuperscript{82} suggests that the automatic termination should be expressed to be effective before presentation of the petition, since on presentation of the petition the automatic stay on rights comes into effect (including the right to take possession).\textsuperscript{83}

b) US Law

Lease financing for ship finance is not in favour in the US due to the risk of a ‘recharacterisation’ of the charter so that the ship is treated as the property of the demise charterer in the event of the charterer’s insolvency being determined before the US bankruptcy courts. Under U.S. law, an agreement in the form of a lease which vests most of the economic benefits in the lessee may be recharacterized by the courts, particularly in bankruptcy, as in reality a security agreement. If the courts determine that the named lessor does not truly retain the economic benefits of the property ownership, but rather appears to be a creditor secured by its possession of title to the assets, the nominal lessee may be deemed the owner of the asset.\textsuperscript{84} It is possible that a security interest in the bareboat charterer’s rights to vessel earnings can be perfected by a UCC Financing Statement and perhaps an account control agreement (UCC §9-102(a)(2)(vi)), but the security interest is of low value and will yield to maritime liens, tax liens and other tort liens in any vessel foreclosure.

Until recently, no flag state legal system afforded a means for a ship lessor to perfect a security interest in vessels to which it held title.\textsuperscript{85} However, on March 6, 2013, the Marshall Islands became the first flag state to adopt such a system for lease finance of vessels. Nitijela Bill No. 25 amends and adds to the Republic of the Marshall Islands Maritime Act (the “Act”) to create new definitions for “documented owner,”\textsuperscript{86} “financing charter”\textsuperscript{87} and “finance charterer.”\textsuperscript{88} A new Section 302A of the Act allows either party to file a financing charter with the Marshall Islands registry. A properly-filed financing charter will enjoy the status of a preferred mortgage on the vessel in favour of the documented owner. The new law provides that, even if the owner and charterer agree in the charter that the charter constitutes a “financing charter,” this declaration alone is not binding on third parties or courts hearing the question. Under the new law, the documented owner may itself grant conventional preferred mortgages on the vessel, subject to whatever restrictions may exist in prior agreements entered into by the documented owner. It should be possible to continue to argue that the charter is a true lease

\textsuperscript{81} But see Transag Haulage Ltd v. DAF Finance plc (cited above) where the court exercised its equitable jurisdiction to grant relief against forfeiture of a hire purchase agreement which had been terminated in accordance with a provision making it terminable upon the appointment of a receiver.
\textsuperscript{82} M.Davis, Bareboat Charters (2nd ed 2005) Informa Law, 35-38.
\textsuperscript{83} See Re David Meek Plant Ltd [1994] 1 BCLC 680.
\textsuperscript{84} A “documented owner” is the person who appears in the application for documentation, even if he may hold only legal title and not the full benefits and indicia of ownership.
\textsuperscript{85} Unlike the position with commercial aircraft finance, in which lessors have long been able to record leases or memoranda of leases with governmental authorities for purposes of establishing the priority of rights in the aircraft.
\textsuperscript{86} A “financing charter” is “a demise or bareboat charter, regardless of duration, between the documented owner and the finance charterer, which is agreed by the parties to be or is determined in judicial or arbitral proceedings to create in favor of the documented owner a security interest in the vessel” in favor of the finance charterer.
\textsuperscript{88} A “finance charterer” is the person identified as the charterer in the financing charter.
but, in the alternative, if it is determined in any court or tribunal or by any governmental authority not to be a true lease, then the charter is agreed to be a financing charter entitled to the status of a preferred mortgage under Marshall Islands law. Enforcement of this new preferred mortgage outside the Marshall Islands will depend on the jurisdiction of arrest. Under US law foreign mortgages are enforceable provided they meet certain minimum requirements of central filing and availability for inspection.