

RENEGOTIATING

IN THE CURRENT shipping crisis, with collapsing freight rates, many charterers suffer from having entered long-term charterparties, which have turned out to be unprofitable. In order to cut losses and stay in business some charterers seek to get out of, or renegotiate, the terms of the fixture. In other situations with increased performance costs caused by new ship safety regulations, or similar, it could well be the shipowner who wants to get out of the deal. This article examines

some practical and legal issues relating to renegotiating charterparties.

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Commercial renegotiation

In many cases where the charterer is suffering under an unprofitable charterparty there will be commercial pressure on the shipowner to renegotiate. If the parties have a close business relationship the shipowners may agree to an adjustment of the rate to preserve good relations; a renegotiation of the charterparty becomes a trade-off for future business opportunities.

If the charterer is at risk of being driven out of business by the unprofitable fixture, the shipowner may be caught in a dilemma. If he does not agree to renegotiating, the charterer may be forced to repudiate the charterparty and enter into insolvency. The shipowner then faces losing the underlying business and being forced to conclude a charterparty at a lower market rate. On the other hand, renegotiating the deal may not only mean less profit for the shipowner but cause financial difficulties and breach of covenants under the loan agreements.

Legal issues have little role to play in renegotiations driven by commercial considerations. However, shipowners considering renegotiating a charterparty should examine if this will have any effect on their loan agreements (including security agreements) and on the shipbroker's commission.

Legal arguments for renegotiating

In situations where a commercial renegotiation of the charterparty is not a realistic alternative, or perhaps as a prelude to such renegotiations, charterers may consider invoking legal arguments for escaping from or renegotiating the charterparty, due to the radically changed market conditions. How the arguments are framed will depend on the applicable law, but charterers will generally seek to argue that they should be discharged from their obligations, or that the charter rate should be adapted as a result of the changed circumstances.

English law has developed the doctrine of frustration,



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which operates to bring the contract to an end when, after the contract was concluded, events occur which make performance of the contract impossible, illegal, or something radically different from that which was in the contemplation of the parties at the time when they concluded the contract. The effect of the doctrine is to discharge the parties from any further obligation under the charterparty. However, the doctrine operates within narrow confines and it is not sufficient to bring about frustration that a contract becomes more burdensome and expensive to perform. English judges possess no general power to adapt contracts or relieve contracting parties of their obligations on the grounds of hardship (*British Movietonews Ltd. v. London & District Cinemas Ltd* [1952] AC 166).

It is sometimes claimed that English law is especially strict on enforcing contractual obligations in order to foster certainty and predictability, whereas other legal systems may take a more lenient or "fairness-based" approach in giving effect to changed circumstances on the parties' obligations under the contract. One may question whether this claim is wholly warranted.

Under Section 36 of the Contracts Acts, Scandinavian law gives the courts the possibility of modifying a contract term if it is considered unreasonable with regard to, amongst other things, the contents of the agreement and subsequent circumstances. Notwithstanding the broad wording of this provision, it has a very limited application to commercial agreements and it will not be applied to upset the risk allocation agreed between the parties under a charterparty. Nor will other doctrines developed in case law to deal with changed circumstances, such as the doctrine of assumptions, be successfully relied on by a charterer to escape from a bad bargain because of changed market conditions. It is another matter that remedies may be available if a certain price adjustment or currency conversion mechanism turns out to have unintended consequences which do not reflect the parties' original intention (see ND 1985 s. 234, Norwegian arbitral award).

The doctrines developed in other legal systems to deal with these problems may vary in approach and effect but it is difficult to find legal systems which would allow a charterer to

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escape from an unprofitable charterparty even in radically changed market conditions (for a recent survey of the laws of European legal systems, see Hondius (ed.) *Unexpected Circumstances in European Contract Law*, 2011). It may be noted that the Belgian Court of Cassation in a recent and much discussed judgment (*Scafom International BV v Lorraine Tubes SAS*, 19 June 2009) held that a seller was entitled to renegotiate a contract for the sale of steel tubes where the steel price, after the conclusion of the contract and before delivery, rose by about 70%. The Court applied the UNIDROIT Principles of International Commercial Contracts, which rarely, if ever, would apply to a charterparty.

Renegotiation clauses

In view of the narrow confines of the legal doctrines to alleviate the consequences of financial hardship due to changed circumstances, parties sometimes want to include an express renegotiation clause in the contract. The clauses, known as “renegotiation”, “review” or “hardship clauses”, typically stipulate that under certain defined circumstances a party shall be entitled to request renegotiation of the charterparty, or a certain contract term (generally the charter hire). Some clauses are designed to protect the shipowner and not the charterer from increased costs due to changes in maritime state aids legislation, ship safety regulations etc. (one can refer to the situation in *The Elli and Frixos* [2008] 2 Lloyd’s Rep 119).

A renegotiation clause should ideally be drafted to meet the particular needs of the parties and carefully set out the conditions for operating the clause. The enforceability of a renegotiation clause may vary depending on the wording of the clause and the applicable law. A bare agreement to negotiate in good faith has been held unenforceable as a matter of English law (see *Walford v. Miles* ([1992] 2 AC 128). However, recent case law suggests that it will be enforceable if the contractual provision goes further and gives some guidelines as to the result to be achieved by the renegotiation (see *Petromec Inc v Petrolio Brasileiro SA Petrobras* (No 3) [2006] 1 Lloyd’s Rep 121).

Renegotiation clauses that do not give any guidance as to the consequences of the parties’ failure are likely to cause difficulties in interpretation. Some generally worded clauses may be construed as nothing more than a right for a party to request renegotiating. If the parties want something more they should be specific. One alternative is to provide that an

expert or arbitrator to adapt the contract with the view to restoring contract equilibrium. This alternative preserves the contract relationship but may lead to many practical problems: What is the contract equilibrium and how should an arbitrator go about restoring it? Arbitral proceedings take time and what contract terms should apply before an award is issued? If the contract is adapted by arbitration can the terms set by a binding award be changed by further operation of the renegotiation clause? If the parties are not careful there is a risk that the operation of the clause creates more questions than it is intended to solve.

Another alternative is to provide that failure to agree within a certain period should entitle a party to terminate the charterparty. This will create pressure on the party responding to a request for renegotiation to agree, and avoids procedural difficulties. Termination in

the case of a failed renegotiation is the default alternative provided by the ICC Hardship Clause 2003. However, the question whether the conditions for the operation of the clause are met could be tricky to determine, especially in relation to “excessively onerous” or similar expressions.

A word of caution

Changing conditions is a part of the game in shipping and the law is not there to discharge the parties from unprofitable bargains as a result of changed circumstances. Renegotiation clauses could provide a safety valve for some long-term contractual relationships, but it should be recalled that this comes at the expense of contractual certainty. Even if the renegotiation clause is set to operate within narrow limits, the mere presence of the clause in the charterparty may generate spurious claims for renegotiating as soon as the fixture becomes unprofitable. Therefore, parties should carefully consider the consequences before inserting a renegotiation clause in their charterparty. If they still decide to do so they should draft the clause to fit the particular contractual relationship and are strongly recommended to seek legal advice in order to avoid the legal difficulties that may arise from the operation of the clause.



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