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Paper

"FREIGHT : THE HIDDEN RISK IN INTERNATIONAL TRADE"

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PROFILE

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"FREIGHT : THE HIDDEN RISK IN INTERNATIONAL TRADE"

INTRODUCTION

The crucial factor that distinguishes international trade from domestic trade is the need to provide for the cross border transportation of goods. Whilst it is inevitable in all sales that goods have to be either collected from the distributor by the purchaser or alternatively dispatched to the purchaser by the distributor in all forms of sales, the distances involved in international sales mean that the costs of transportation form a significant cost factor in such transactions. Irrespective of who initially pays for transportation, the market price of delivered goods needs to be considerably enhanced by the advent of transportation to ensure the financial viability of the transaction, since transportation costs will have to be passed on the ultimate end-user. Furthermore, the fact that the buyer and seller are not in close proximity, being in different countries, alters the dynamics of the relationship, requiring the parties to put in place arrangements for mutually secure finance and insurance to protect against the vicissitudes of international transportation.

This paper addresses the risks involved in freight contracts and the commercial balance that has to be struck between low cost high risk freight and high cost low risk freight. During transportation the goods may be lost, damaged or delayed. The vehicle or vessel involved in transporting the goods may be lost, damaged or delayed. The question arises as to who will bear the risk of such eventualities, the buyer, the seller, the carrier or underwriter ? Where insurance is involved, which is the norm, who is responsible for taking out insurance and how effective is insurance cover ?

The wide range of alternative forms of international sales contract and alternative freight contracts make an analysis of the allocation of transportation risk difficult. Such contracts benefit from a degree of standardization, but nonetheless there is considerable scope within such contracts to allocate transportation risks to a greater or lesser extent to one or other of the parties to the contract. Furthermore, the necessity for multi-party relationships introduces many complications absent from simple domestic sales contracts.

THE FINANCE OF INTERNATIONAL SALES AND RISK ALLOCATION

Confidence between international sellers and buyers is less than that in domestic trade where the parties often have close relationships and enforcement of contractual terms is relatively straightforward in the local courts. The buyer needs a mechanism to ensure that the seller will ship the goods on time and in good order. The seller needs a mechanism to ensure that the buyer will pay for and collect the goods. The bill of lading performs this function since payment is due on endorsement of a shipped bill of lading that states that the goods are in apparent good order and condition. Whilst it does not provide a guarantee that the goods entirely conform to contract standards and are fit for purpose, dispatch is guaranteed. The seller can exercise the right of stoppage in transit if the goods are not paid for. Both parties have a reasonable degree of protection.

This protection can be further enhanced by the use of documentary credits which ensure early payment for the seller, provided the shipping documents are in good order. The banks will require insurance providing even more security to all concerned. The cost of the documentary credit is minimal since it can be off set against cash flow, releasing funds to the buyer for alternative use during the transportation period. However, apart from providing a security to all parties concerned the documentary credit does little for the allocation of transportation risks apart from ensuring that such risks are to a greater or lesser extent covered by insurance.

Where bulk transportation is involved, which is likely to be the case for the international sale of fertiliser, provision must be made for the financing of a vessel. Charterparties are usually backed up by bank guarantees or bonds. Whilst such arrangements provide a protection for the shipowner they again do little for the allocation of transportation risks, since having paid out to the shipowner for any default in payment by the contracting party, the guarantor or bondsmen will have recourse against the contracting party to recover the monies paid out.

THE INTERNATIONAL CONTRACT OF SALE

The three principal forms of international sales contract are c.i.f., f.o.b. and delivery. The core ingredients of each form of contract are discussed below. However, whilst it is possible to contract on internationally recognised standard form terms such as INCOTERMS 2000, the parties will frequently contract on the standard terms of one or other of the parties. The use of in house terms represents an attempt to allocate the risks of international transportation in favour of the contract drafter and such contracts should be approached with caution. Even where the intentions of the drafter are not value weighted there is a risk of introducing uncertain terms which if subsequently brought into question can result in expensive litigation costs to determine the scope of the provision.

Which of the three forms of contract are uses should have little or no effect on the delivered value of the goods. The principal differences relate to the allocation of duties regarding arrangements for transportation, issue of bill of lading, insurance and risk of loss or damage during transportation.

C.I.F. (Cost, insured, freight)

The c.i.f. contract is the most common form of international contract today. As the title boldly proclaims, the buyer pays a global sum as a package covering the cost of the goods, transport insurance and the cost of transport (i.e. freight). The principal risk differences between c.i.f. and f.o.b. relates to the responsibility to take out insurance and the risk of changing freight costs. The seller has to make an accurate prediction of how much insurance will cost at the time of shipment since there is no mechanism for the subsequent changing of the contract price in the event of an increase in market price.

The greatest risk relates to shipping goods through a war zone where the war develops after the contract is made. The requirement on the seller is to take out a policy that is normal in the trade. This has been defined as normal in the trade at the time of shipment. Thus, if a war develops after shipment, during transit and a normal policy has been taken out the buyer will have no complaint against the seller. If the goods are lost or destroyed due to war the buyer will have no insurance cover and will have to bear the loss himself. However, if the war breaks out after the contract of sale is made but before shipment the seller will have to take out a war policy and cover the additional cost of the war policy.

Because the seller is only required to provide a policy that is normal in the trade, the seller will usually take out an ICC(C) low cost insurance. If the buyer wants full cover then it is important to specify that when the contract of sale is negotiated. Likewise, any other coverage required such as strike insurance and held covered in event of errors in description should be specified in advance. The latter is valuable since it has been removed from the ICC policies and the effects of any error in description by the seller can be visited upon the buyer after endorsement of shipping documents and assignment of the policy.

The fact that the policy is initially taken out by the seller in his own name means that the seller benefits from insurance cover warehouse to warehouse (clause 8) which avoids the need for taking out independent coverage. This is particularly useful should the buyer default on the contract and fail to pay on endorsement and the goods are lost or damaged.

The c.i.f. contract is a contract of sale, fulfilled by the provision of compliant documents and places all post shipment and endorsement duties and liabilities upon the buyer. The seller's duties are thus discharged upon timely shipment of compliant goods and endorsement of documents. Duties regarding export paperwork traditionally fall upon the seller and regarding import paperwork, upon the buyer.

F.O.B. (Free on board)

The f.o.b. contract is the second most common form of international contract currently in use. The form of f.o.b. used by INCOTERMS 2000 is essentially a classic f.o.b. but parties frequently use strict f.o.b. terms and classic f.o.b. with additional terms. The principal difference between strict and classic f.o.b. lies in the fact that in strict f.o.b. the buyer contracts directly with the carrier, whereas in classic f.o.b. the seller makers the contract of carriage with the carrier on behalf of the buyer. Thus there is an allocation of duty to broker the contract of carriage and places any risks inherent in shipment on the buyer. Buyers who own their own transport often use strict f.o.b. Whether the buyer contracts directly with the carrier or nominates the vessel that the seller has to contract with, it is the responsibility of the buyer to choose the vessel carefully and no fault will fall upon the seller if a poor choice is made. If the vessel fails to arrive on time or to have sufficient capacity to carry the goods or is in some other way inappropriate for the carriage of the goods it will be an ineffective vessel and the seller has the right to refuse to ship and can repudiate the contract of sale and sue for damages.

The common factor in strict and classic f.o.b. is that the buyer is responsible for taking out his own insurance, the only protection under English Law being that risk will not pass to the buyer under s32 Sale of Goods Act 1979 if the seller fails to advise the buyer of any details about time and place of shipment unknown to the buyer and needed in order to take out insurance. The most usual additional duty is for the seller to also take out insurance as agent of the buyer.

F.o.b. contracts place the risk of changing freight rates firmly upon the buyer. Likewise the buyer has complete control over the terms of insurance. Where the seller brokers either on behalf of the buyer he can recover any increased costs due to market change or specification from the buyer.

The f.o.b. contract is a contract of sale for the shipment of goods. The seller's duties are thus discharged upon timely delivery of goods to the nominated vessel, at which time risk passes from seller to buyer and payment becomes due endorsement of documents.

The f.o.b. seller, even where the seller takes out insurance by and on behalf of the buyer provides the seller with no insurance cover. The f.o.b. seller is therefore well advised to take out independent insurance from warehouse to warehouse to protect against loss or damage, particularly in the event of a buyer refusing to endorse documents. Duties regarding export paperwork traditionally fall upon the seller and regarding import paperwork, upon the buyer.

One advantage of using INCOTERMS 2000 is that the f.o.b. form of contract clearly states that where a vessel is ineffective due to late arrival risk of deterioration of goods, pre-shipment automatically transfers to the buyer. This provision is frequently absent from in house contract forms. In such a case risk remains with the seller until shipment and the seller needs to promptly broker a variation in the contract to guard against such risks.

DELIVERY CONTRACTS

Delivery contracts take a number of forms, based around the point of delivery. Delivery can be at the seller's warehouse, frontier or aside ship pre-export shipment or at arrival port, frontier or buyer's warehouse. Thus the primary duty of shipment and carriage can be borne by either buyer or seller with the duties for export and import documentation being likewise allocated to one or the other party. The central factor about delivery contracts is that ownership and risk transfer from seller to buyer upon delivery and the party responsible for transportation bears all responsibilities and risks for transportation and insurance.

FREIGHT INSURANCE

The leading form of freight insurance is the ICC freight policy which replaced the traditional Lloyd's Ship & Goods policy in 1983. There are three standard policies, namely (A), (B) and (C). The main difference in these policies is in respect of the risks covered, though ICC(B) and (C) also exclude 4.4.7 deliberate damage to or deliberate destruction of the subject matter insured or any part therefore by the wrongful act of any person or persons. ICC(A) is the only policy to cover clandestine theft without express inclusion of a theft clause, by virtue of clause 9 Rules of Construction under the Marine Insurance Act 1906. That apart the Exclusion, Duration, Claims, Benefit of Insurance, Minimising of Risk, Avoidance of delay and Law and Practice are the same for all three policies.

The exclusions are significant and additional cover is required for war and strikes cover. Exclusions regarding unseaworthiness, Clause 5, will impact upon the shipper who is also a charterer since knowledge of such unseaworthiness is likely, but will not impact upon ordinary purchaser of freight.

Likewise Changes in destination and deviation, Clauses 9 & 10,beyond the shipper's control will normally have little impact upon the purchaser of freight who is not a charterer.

The charterer and shipowner are likely to have to shoulder duties in terms of minimising loss, Clauses 16 & 17, previously known as Sue and Labour, whereas again the mere freight purchaser seldom becomes aware of problems until it is too late to shoulder such duties.

It is important to be aware of the scope of risks provided against by the respective policies, which are as follows :-

INSTITUTE CARGO CLAUSES (A)

RISKS COVERED

1 This insurance covers all risks of loss of or damage to the subject-matter insured except as provided in Clauses 4, 5, 6 and 7 below.

2 This insurance covers general average and salvage charges, adjusted or determined according to the contract of affreightment and / or the governing law and practice, incurred to avoid or in connection with the avoidance of loss from any cause except those excluded in Clauses 4, 5, 6 and 7 or elsewhere in this insurance.

3 This insurance is extended to indemnify the Assured against such proportion of liability under the contract of affreightment 'Both to Blame Collision' Clause as is in respect of a loss recoverable hereunder. In the event of any claim by shipowners under the said Clause the Assured agree to notify the Underwriters who shall have the right, at their own cost and expense, to defend the Assured against such claim.

INSTITUTE CARGO CLAUSES (B)

RISKS COVERED

1 This insurance covers all risks of loss of or damage to the subject-matter insured except as provided in Clauses 4, 5, 6 and 7 below.

- 1.1 loss of or damage to the subject-matter insured reasonably attributable to
  - 1.1.1 fire or explosion
  - 1.1.2 vessel or craft being stranded grounded sunk or capsized
  - 1.1.3 overturning or derailment of land conveyance
  - 1.1.4 collision or contract of vessel, craft or conveyance with any external object other than water
  - 1.1.5 discharge of cargo at a port of distress
  - 1.1.6 earthquake, volcanic eruption or lightning,
- 1.2 loss of or damage to the subject-matter insured caused by
  - 1.2.1 general average sacrifice
  - 1.2.2 jettison or washing overboard
  - 1.2.3 entry of sea, lake or river water into vessel craft, hold, conveyance, container lift-van or place of storage,
- 1.3 total loss of any package lost overboard or dropped whilst loading on to, or unloading from, vessel or craft.

2 As in ICC(A) Above). 3 As in ICC(A) Above).

INSTITUTE CARGO CLAUSES (C)

RISKS COVERED

1 This insurance covers all risks of loss of or damage to the subject-matter insured except as provided in Clauses 4, 5, 6 and 7 below.

- 1.1 loss of or damage to the subject-matter insured reasonably attributable to
  - 1.1.1 fire or explosion
  - 1.1.2 vessel or craft being stranded grounded sunk or capsized
  - 1.1.3 overturning or derailment of land conveyance
  - 1.1.4 collision or contract of vessel, craft or conveyance with any external object other than water
  - 1.1.5 discharge of cargo at a port of distress
- 1.2 loss of or damage to the subject-matter insured caused by
  - 1.2.1 general average sacrifice
  - 1.2.2 jettison
- 1.3 total loss of any package lost overboard or dropped whilst loading on to, or unloading from, vessel or craft.

2 As in ICC(A) Above). 3 As in ICC(A) Above).

THE CONTRACT OF CARRIAGE OF GOODS

The contract of carriage is a separate contract made between the shipper and the carrier. As between the shipper and the carrier it is this contract which governs their relationships. The contract is usually between the shipper and shipowner where the owner operates his own vessel but it is frequently been shipper and charterer, since few shipowners deal with freight directly, concentrating rather on the management of vessels and leaving such matters to chartering organisations who then deal with freight forwarders and the like. In some circumstances this contract of carriage may be a charterparty contract of carriage where the size of the cargo is sufficient to justify the hire of a vessel.

Upon shipment, either the shipowner or the charterer will issue a bill of lading. The bill of lading governs the relationship between the buyer and the carrier in whose name the bill of lading is issued but the bill of lading will not govern the relationship between the shipper and the carrier where the shipper is also a party to the contract of carriage, which will in such circumstances prevail over the bill of lading.

Whilst it might be anticipated that the terms and conditions of the bill of lading and the contract of carriage will be the same this is often not the case, though frequently the bill of lading will seek to incorporate all "terms and conditions" of the contract of carriage and or charterparty terms. Particular care is needed to establish whether or not choice of law, jurisdiction and ADR clauses are incorporated into bills of lading. These must be expressly incorporated by clear words. The mere reference to terms and conditions without more will be insufficient since such provisions are separate personal contracts, severable from the main contract.

Where the terms and conditions of the various contracts differ, a party can often find that they bear the risk and liability for events but have no right to recover from another party. This is particularly so for charterers who can find themselves subject to considerable responsibilities for the seaworthiness and cargoworthiness of the vessel under international conventions such as the Hague, Hague-Visby and Hamburg Rules, but have no right to recover against the shipowner.

The standard term of most contracts of carriage and bills of lading place all pre-shipment responsibilities upon the shipper and all post shipment responsibilities on the buyer. The exception to this is the free in and out clause which places all responsibilities for loading and discharge on the buyer, relieving the seller of further duty once the cargo is put into the care of the carrier.

A hidden risk in carriage contracts relates to dangerous cargo. The contract of carriage, particularly if subject to the Hague and Hague-Visby Rules will place responsibilities upon the shipper to correctly identify goods, number and or weigh them and describe them in the bill of lading. The shipper will have primary responsibility to describe the goods accurately enough to warn the carrier of potential damage and on how to safely carry and store the goods. A failure to do so exposes the shipper to liability for loss or damage to the vessel and third party cargoes. Some bills of lading transfer the liability to buyers on endorsement and the Carriage of Goods by Sea Act 1992, for contracts governed by English Law and Jurisdiction enables the carrier to recover off either the shipper or the receiver of goods.

Furthermore, a failure to state the value of goods can seriously limit the amount of damages recoverable from the carrier for loss and damage to cargo. The conventions also restrict recoverable damages where the cause of loss is negligence of the carrier/servants in the navigation of the vessel and totally excludes liability for events beyond the control of the carrier. It is thus essential to have insurance cover against such eventualities.

CHARTERPARTIES

It is common for bulk cargo transactions to involve the chartering of a vessel, be it by the seller/shipper or by the consignee/buyer. This is particularly so where there is sufficient cargo involved to justify the hiring of a vessel, since it cuts out the costs of hiring a forwarding agent and considerable economies of scale can thus be made. The choices available to the charterer divide between simple or demise on the one hand and voyage or time on the other, with spot charters becoming very common at the present time.

SIMPLE OR DEMISE

The distinction between demise or what the Americans refer to as bare boat charter and simple lies in the degree of control and responsibility taken on by the charterer.

The demise charterer becomes the temporary owner of the vessel and becomes responsible for all aspects of the maintenance and operation of the vessel, including insurance, crew, fuel, orders, navigation etc. Demise charters are most useful for charterers who operate a fleet of vessels and need to augment the fleet. The demise charter is only cost effective for pre-existing fleet operators with spare crew and experience in ship operations. The charterer undertakes all risks but demise charter rates are low in comparison to simple charters.

The most common form of charter is the simple charterparty. Broadly speaking, operation and maintenance of the vessel remains the responsibility of the shipowner. The charterer merely organises freight and gives orders of employment of the vessel to sail from and to nominated ports and to load and discharge cargoes. The simple charter rate takes into account the services and supplies provided by the owner. Risk is shared more evenly between the parties but the exact share depends on the terms and conditions of each charterparty. Standard form charterparties provide a higher degree of certainty and predictability, having been subject to judicial interpretation over long periods of time. The greatest danger is in drafting in-house, non-standard charter-terms aimed at minimising the risk of one or other of the parties, which subsequently give rise to lengthy and expensive litigation costs if and when a dispute arises.

VOYAGE CHARTERPARTIES

The voyage charterparty is ideal for the delivery of dedicated cargoes and frequently used by exporters/importers of bulk cargoes such as fertilizer, grain, fuel and raw materials. Vessels tend in such circumstances to be specialised, for the carriage of a limited range of commodities, often with loading and discharge equipment suitable to the trade and a crew experienced in handling such commodities. Single voyages are as equally common as return trips. Multiple voyage charters are also possible. The most important risk factors for voyage charterers concern the seaworthiness, cargo worthiness of the vessel, its timely availability and accurately predicting the time needed for loading and discharge. It is important to ensure that terms governing these aspects are well considered and balanced.

Seaworthiness : whilst it might be expected that a vessel could and should be seaworthy this is not always the case. For shippers and consignees protected by The Hague and The Hague-Visby Rules there is a requirement that a vessel be seaworthy and any loss to cargo caused by an unseaworthy vessel is recoverable by the cargo owner. The Conventions however will only apply to charterparties if expressly incorporated. Many charterparties specifically exclude the liability of the owner for loss or damage to cargo, caused by the unseaworthiness of a vessel, with or without the knowledge and or actual fault of the owner.

If a vessel is unseaworthy at the time that the vessel is chartered, which is often some distance away from the delivery point, there is usually an express provision allowing the charterer to repudiate the charter. This is not overridden by any provision excluding liability for damage to cargo. Furthermore, under customary law, the courts will usually imply a right to repudiate the charter if a vessel is not fit to sail from the loading port and cannot be repaired within a reasonable amount of time. Reasonable time will depend upon the nature of the voyage and the nature of the cargo. A charterer may alternatively waive the breach and negotiate compensation for lost time during the repair period. Beware that saying nothing and failing to reserve the right to compensation may result in the right to damages for lost time being forfeited.

Cargoworthiness : Unseaworthiness includes uncargoworthiness. A charterer or cargo owner has the right to refuse to load cargo until the vessel is rendered safe and fit to carry the cargo. Again, if the vessel cannot be rendered cargoworthy within a reasonable period of time the charter may be repudiated.

Reasonable Dispatch : Whilst there is a requirement that a vessel be in a particular nominated place at the time of contracting, with the ability to reach the port of loading within a reasonable period of time, the exact time for sailing on a voyage charter is seldom specified. The vessel should sail within a reasonable time, which is again relative to the nature of the voyage and the cargo, and compensation may be due for a failure to do so. This is particularly so where the owner keeps a vessel in port for his own purposes or perhaps goes off on a short interim voyage perhaps to a fuelling port whereas the vessel should have arrived in port fully fuelled and ready to sail.

Laytime and demurrage : Laytime is the time allocated in a charter for a vessel to load and discharge cargo. It may be expressed in terms of days, working days, weather working days, 24 hour days, or even in hours. Demurrage is a liquidated damages clause, specifying the rate of compensation that a charterer must pay the owner for extensions to loading and discharge time. It is very important that the laytime calculation is realistic since otherwise and extension of time will be inevitable and will automatically lead to the penalty being imposed. Once established it is difficult to resist a claim for demurrage. Demurrage is likely to be expressed in terms of time. Once that time period expires, if the vessel is still held up in port, damages will become open or unliquidated and will be assessed by the court, taking into account the full expenses and lost profit of the owner. Unliquidated damages are usually far higher than the contractual demurrage rate. The owner cannot claim demurrage if the reason for the extension of time is the fault of the owner.

Notice of Readiness : By customary practice the owner has to give a notice of readiness to the charter before loading, but there is no customary duty to give notice of readiness to discharge. However, many charters also require the owner to give notice of readiness to discharge. Notice may be required to be written but otherwise an oral notice may be sufficient. Also, actual communicated and received, and even confirmed, may be specified. This ensures that notice does not arrive unnoticed by fax or email. Again it is possible to specify working time limits for notification. A notice will not be valid if the vessel is not in a fit state to load or discharge or the owner has not obtained necessary clearance from the port authorities, where that duty is placed on the owner. Be careful that such duties are not imposed on you as charterer because if they are and you have not complied, time may begin to run against you.

Port, dock and berth charters : These are the three basic variations of notice terms within a voyage charterparty. The berth charter is the most favourable to the charterer since permission to berth may be delayed by congestion in the port. The least favourable provision is one requiring the charterer to nominate an available berth. Often the vessel is deemed to be an arrived ship, berth or no berth.

Strike Clauses : A useful provision in a voyage charterparty is one that stops time running or prevents time from commencing in the event of a strike. The clause can cover dock strikes and even inland transportation strikes if carefully worded. Strike clauses will not extend to demurrage unless expresses stated to do so.

Events beyond control : Commonly known as force majeure clauses, these can remove the liability of either the owner or the charterer, or both, for loss and delay due to events beyond the control of the specified party or parties. A well drafted exclusion clause is better than a generally worded force majeure clause, but if drafted in a limited and restricted manner it may afford minimal protection.

TIME CHARTERPARTIES

Time charters are ideal for long term planning. Traditionally time charters tended to be for 6 months, a year or even several years. However, a recent trend has been for short term spot charters for 10 to 20 days. The more universal the use of the vessel the more practicable this form of charter is, otherwise much time can be lost in return ballast trips. The time charter provides the charterer with a far wider flexibility in terms of where to sail than the voyage charter where the single destination port is usually established in advance, though the range of a vessel is usually prescribed in the charter.

The principal areas of risk in a time charter party are payment of hire, off hire, employment and the timing for the return of the vessel. As with voyage charters the vessel should be seaworthy at point of delivery, but the relative time factor means that in longer time charters, provided sufficient time post repairs remains for the charter to provide an economic return to the charterer cancellation is difficult. It is wise to provide a final cut off point for the delivery of the vessel in the charter.

Payment of hire : From a commercial point of view the hire rate is clearly crucial to the economic viability of any transaction. However, the risk factor arises in terms of the strict application of payment terms by the courts. Payment is usually either monthly on a day certain or for a fixed number of days which results in monthly date changes which have to be carefully complied with. The usual terms are "payment cash in advance" which means that the cash must be in the shipper's account and available for use on that date. Payment by cheque on the due date is not sufficient so a careful calculation of the time that it will take for bank clearance is essential.

The consequence of late payment depends on how strict the terms of the charter are. If the charter states nothing more then the there is usually a provision that entitles the owner to withdraw the vessel, either immediately or after 24 hours of furnishing the charterer with notice of intention to withdraw. Once withdrawn the charter is at an end. The owner can re-charter to a third party or renegotiate the terms of the charter with the same charterer. A more favourable term for charterers is the "anti-technicality clause" which entitles the owner to withdraw the vessel if, having provided the charterer with notice of non-payment, the charterer fails to make good any short payment within a given period of time, for instance 24 or 48 hours.

The charterer is not allowed to deduct anything from on-going monthly payments to cover loss or damage claims, but may deduct sums for "off hire." It is advisable to reach an agreement on off hire periods and the amount that is to be deducted in advance, since in the absence of agreement the owner may claim that the amount deducted is excessive or not permitted and an assertion that there has been a short payment of hire, followed by withdrawal of the vessel. The inconvenience that such action causes is often more commercially important than the final terms of the settlement of any dispute about entitlement to off hire and is best avoided.

No hire is due if a vessel is off hire. Hire in such circumstances becomes due as and when the vessel returns to service. Furthermore, set off can be applied to the final period of hire.

Off Hire : These clauses define the circumstances when a vessel will be deemed to be off hire. There are many variations on these clauses and great care is required to ensure that a contract provides the charterer with sufficient protection. Since it is the owner's duty to maintain the vessel, hire will cease to be payable for any period of time when the owner has to withdraw the vessel from service for maintenance and repair. The central issue is when off hire starts and in what circumstances it is deemed that the charterer is no receiving a valuable service from the owner that has to be paid for. Off hire can, with appropriate wording in the clause, cover deficiencies of crew, break down of machinery or an inefficient vessel. Harsher terms may prevent off hire being triggered until there is a "total breakdown". If repairs to machinery can be carried out without disruption to service the vessel will not be deemed to be off hire and thus repairs to cargo handling gear during a voyage will not put the vessel off hire and likewise repairs to the engines whilst a vessel is loading or discharging will not put the vessel off hire. Where a vessel has loading and discharging gear formula are frequently used to determine permissible deductions from hire for partial breakdown of tackle and non-availability of hatches.

Employment and Indemnity : Indemnity clauses provide that the charterer must compensate the owner for losses incurred as a result of complying with lawful orders of the charterer. The most significant aspects here relate to orders to load cargo, issue bills of lading and orders to sail to ports.

Dangerous Cargo : As discussed earlier, there is a duty on the shipper to provide sufficient information to enable the owner to safely carry cargo. Where the cargo is potentially hazardous to the ship or other cargo interests, the charterer will be held to account by the owner for any loss or damage sustained arising out of a failure to forewarn the owner of such hazards. The owner is expected to have general knowledge of the dangers inherent in cargo commonly carried in the trade.

Bills of Lading : Where the shipowner issues bills of lading signed by the master on the orders of the charterer, or where bills of lading are issued by the charterer in the name of the owner, the owner usually reserves the right, by means of an E&I Clause, to recover loss or expense arising out of the issue of such bills of lading from the charterer. The owner's loss or expense will arise out of a claim by an endorsee of the bill of lading. The owner's immediate liability to the cargo owner under the bill of lading is often more extensive than the duties owed by the owner to the charterer. Thus the charterer can end up footing the bill for cargo damage caused by crew.

Safe Ports : The charterer is under a duty to nominate a port that is safe for the vessel to enter, use and depart from in safely, always remaining afloat. The port must be physically, meteorologically and politically safe. This duty is strict. It is not open to the charterer to deny liability simply because he was unaware of danger at a port. It is essential therefore that the charterer makes inquiries about the draft of the vessel and the port to be nominated and keeps up to date with navigational dangers in the approaches to a pert. However, if conditions change after the port has been nominated, assuming the port was prospectively safe at the time of nomination, the charterer will be protected from liability if the recent danger was not known to him and should not have been known to him. However, if the charterer becomes aware of a problem, or should have taken notice of the problem, there is a duty to nominate an alternative port.

The owner is under no duty to enter a dangerous port and has the right to call for an alternative nomination. The charterer has a duty to comply, even if this is highly inconvenient and means that cargo will go to the wrong destination and forwarding costs will be involved. There are circumstances where an owner will agree to go to a dangerous port, often because a premium charter rate is paid. Where an owner knowingly accepts an order to enter a dangerous port, he has no right to compensation is the vessel suffers damage unless the charter expressly provides for damage. However, the captain of the vessel retains the right to withdraw a vessel from a dangerous port and even to refuse to enter if he considers the danger too great for vessel and crew. The charterer will not be entitled to damages for such a withdrawal or refusal.

Last Voyage and return of vessel : Where a vessel is chartered for a period of time and is sent on a number of voyages it is difficult for the charterer to estimate precisely when the final voyage will be completed and the vessel can be returned to the owner. It is essential to ensure that the provisions in a charter for the return of the vessel allow the charterer sufficient flexibility to be able to maximise the commercial use of the vessel and for the charterer to be fully aware of and to comply with the requirements. Redelivery provisions can allow for early as well a late redelivery by stating that the time period is for X Period of Time + or – Y number of days. A part return of hire is then due for early redelivery. Likewise, additional pro-rate charterparty rate hire is due for any extension of time. Beware that an owner may be able to refuse to carry out a last order if it is clear that the vessel will not be able to comply with the final date for redelivery which can prove highly embarrassing and expensive for the charterer. If the vessel is redelivered after the final delivery date the charterer can be subject to a significant penalty.

Whilst the owner is responsible for the repair and maintenance of the vessel during the course of the charter, the charterer remains financially responsible for damage to the vessel arising out of orders for the employment of the vessel not due to ordinary wear and tear and effects of wind and weather. The charter will usually require the charterer to make good such damage before returning the vessel, which will not be deemed to be off hire whilst such reinstatement is carried out. If the charterer fails to reinstate the vessel the owner is entitled to commission reinstatement and bill the charterer for the costs.

INTERNATIONAL DISPUTE SETTLEMENT

The whistle stop tour of the respective rights and liabilities of cargo owners, charterers and shipowners above, highlights a large number of potential areas for dispute. Even where the contract terms are balanced and fair, as between the parties, and are sufficiently clear to prevent any unnecessary disputes as to what the rights and liabilities or the parties are, it is inevitable that from time to time disputes will arise that the parties cannot reach an amicable settlement over. The settlement of private international disputes, that is to say disputes involving private parties from different countries, is both complex and potentially expensive, time consuming and damaging to business relationships between the parties. It is thus essential to provide in the charter a satisfactory mechanism for settling any future disputes that might arise between the parties. Let us now consider what is involved in international dispute resolution, the legal problems involved and the mechanisms for settlement.

The striking feature about the maritime industry is that it is involves global activity, though it should be remarked that where the charterer and owner are of the same nationality and based in the same jurisdiction, disputes between them will be domestic and not international. The principal function of vessels is to carry goods from one country to another. The vessel is more likely to be owned by an organisation based in one country and chartered to an organisation that may well be based in yet another country. Neither organisation will necessarily have links to the countries where the goods are loaded and discharged. The insurance carriers for various aspects of the venture may well be based in another state. Tortious incidents can occur in foreign waters and affect the interests of people from many other lands.

Not surprisingly therefore, one of the first major hurdles to overcome in settling a dispute is to decide where the settlement process will take place, the laws of the State that will govern the conduct of the dispute resolution process and the law of the State that will govern the settlement of the dispute itself. These are separate issues even if they appear at first sight to be the same thing.

It is perfectly possible for the process to take place in Egypt, with the process governed by English Law, whilst the contractual or tortious rights are governed by the substantive law of Jordan.

The parties will seek to establish a venue for the process which is convenient and accessible to them. The parties will hope to ensure that the procedural law governing the dispute is fair, impartial and expeditious. The parties will hope to ensure that the substantive law governing their rights is certain, predictable and familiar to them. All of this is a tall order ! What can they do to achieve these aspirations ?

CHOOSING THE PROCEDURAL AND SUBSTANTIVE LAW

Whatever process is adopted for the resolution of a dispute there is still a need to establish the governing procedural and substantive law of a dispute. It is a general principle of "Private International Law" that the process is governed by the procedural law of the State where the resolution process is conducted. Furthermore, the governing substantive law is that of the State with the closest connection to the place where the central purpose of the business at hand is carried out. This all sounds straight forward enough until one realises that it is no easy task to determine exactly what is the central purpose of a multi-purpose contract and therefore no easy matter to establish where that duty will be performed. A variety of International Conventions regulate the legal default position in different parts of the world. The convention provisions are not uniform. The courts of different States have provided differing interpretations of the meaning of sections of these conventions. Much money, time and effort has been expended on settling these issues before the courts. It does not have to be this way.

The maritime industry is fortunate in that most of its business dealing are conducted by written, standard form contracts. With varying degrees of success, most standard form contracts have something to say about which dispute resolution process will be applied to future disputes about the performance of the contract, where the process will be conducted, the applicable procedural jurisdiction and the substantive law that will govern the dispute. By enlarge, the courts will respect the contractual choices of the parties and so expensive litigation to settle these issues is avoided by a well drafted jurisdiction and choice of law clause.

There are special circumstances where jurisdiction is prescribed by law. In particular special regard must be paid to the impact of The Hamburg Rules on jurisdiction and arbitration. Egypt is a signatory to the Hamburg Rules which affords jurisdiction to Egyptian courts for claims by Egyptian cargo owners for loss or damage to cargo, whether the cargo was being carried from or to Egypt. Charterers and owners within Egyptian jurisdiction will find themselves subject to the jurisdiction of the Egyptian courts, but the Egyptian court may have problems asserting jurisdiction of charterers and owners outside the territory.

The problem in inserting a choice of jurisdiction and law provision in a contract is that at the time of drafting it might not be possible to determine whose law will best satisfy your interests. That will only become apparent once the dispute arises. A simple illustration of this is that awards for damages tend to be higher in the US to the UK. If you are the claimant US law would be preferable. If you are a defendant UK law has much to commend it. Legal rights and duties are far from internationally uniform. International conventions have improved some aspects of international dispute settlement but provision is far from all embracing.

WHERE SHOULD ONE CHOOSE TO SETTLE A DISPUTE ?

In as much as the location of the dispute settlement process tends to determine the governing procedural law what difference does it make where the process is conducted ? If the location had no legal consequences the choice would depend simply on the most convenient location for the parties, their representatives and witnesses. The procedural law governs both the way that litigation is conducted and the role of the courts in respect of alternative dispute resolution processes.

Common Law countries may be more attractive to cargo owners and charterers because "Actions in Rem" and the concomitant power to arrest ships to provide security for an award are not available in many Civil Law jurisdictions.

Statutory time bars under various limitation acts and the extent of limitation of liability vary world wide despite attempts by way of International Conventions to impose a degree of uniformity on this area of the law.

Powers in relation to security of costs, disclosure, commanding witnesses to attend and seizure of assets vary from State to State. A simple illustration is that currently arbitration in the UK is governed by a new Arbitration Act 1996, which limits the scope for judicial interference with the process. The 1952 Malaysian Act, modelled on the old UK 1950 Arbitration Act continues to result in excessive and unwelcome judicial challenges to the arbitral process. Even the adoption of the UNCITRAL Model Code, to govern the conduct of an arbitration, is no guarantee that the courts will not, on the application of one of the parties, interfere with the process. Nonetheless, the jurisdiction of a state that has adopted and applied the UNCITRAL MODEL LAW and ARBITRAL RULES is a guarantee of some degree of uniformity, predictability and good practice.

Finally, location can have an impact on enforcement. There is little point in suing someone in a State where they have no assets unless the award can be enforced in the State where their assets are located. The efficiency of the legal systems of the world is variable. Perceptions of the quality of justice dispensed by these courts is equally variable reflecting cultural differences. In consequence a small band of States has captured the bulk of the global dispute resolution market. Despite the high costs involved, London is high on the list of chosen venue. Whether or not it is a wise choice is for the individual to decide. Note however, that where criminal charges are involved there is no choice about venue, jurisdiction or choice of law. Consequently, criminal issues are often settled locally whilst the civil issues are settled over seas.

The substantive law is yet another matter. There is a considerable degree of harmonisation in some areas, as with The Hague and Hague Visby Rules in relation to claims regarding the contract of carriage of goods. However, there is considerable variation in the international regimes governing the laws of obligations.

It may be impossible to predict in advance of a dispute whose law will be most favourable to a party should a dispute arise. The end result is that frequently even though a contract contains a choice of jurisdiction and a choice of law clause, a party, having realised that in the circumstance the choice is unfavourable, seeks to overturn the provision. Once in place however, this is very difficult to achieve.

LITIGATION

In the absence of choice to the contrary, a dispute will find itself before the courts. This is good news for lawyers. It is expensive to engage the services of lawyers. Even the best and most efficient judicial systems tend to be slow and laborious. However, State courts enjoy a great deal of power and have the authority to enforce the process. Confidence in the judicial system is the court's greatest asset. The legal knowledge and understanding of a judge may be highly valued by the parties. Judges are perceived as being dispensers of justice. Many maritime disputes are settled before the courts despite the problems of cost and delay. Indeed, delay often suits a party who does not want to pay, whilst the coercive powers of the court are the only way to ultimately ensure that a recalcitrant party appears at a hearing and is ultimately brought to account.

ARBITRATION

After litigation, this is the most common form of dispute resolution process adopted by the maritime industry. Arbitration has several distinct advantages over litigation. Arbitration is in essence a private court and the arbitrator is a private judge. The merits of arbitration are : -

Privacy : Arbitration is private so the dispute does not end up being discussed in the papers which can have adverse implications for public confidence and can give rivals an insight into your trading practices.

Speed : Assuming the court's role in the process is kept to a minimum, the process can be conducted relatively quickly. It should take no more than 6 months to get to Arbitration whereas 2 years or more is not unusual for the commencement of a trial. The time aspect went somewhat awry in the eighties and early nineties but globally arbitration is now regaining the time advantage over the courts – due to new regimes which encourage less formal arbitral procedures. Fast track arbitral systems can reduce the time factor to as little as 2 months for smaller claims.

Costs : Arbitration tends to be less expensive than litigation. However, this is not uniformly true. The procedural rules of some judicial systems have done much to improve judicial efficiency in particular by the introduction of strict time limits on aspects of the process. An inefficient arbitral process could result in excessive discoveries and argumentation which push the costs up to exorbitant levels. However, to a certain extent, the parties get the arbitral process they want, so there is little ground for complaint.

Industry Expertise : Despite the legal expertise of judges the parties frequently feel that a judge does not understand the commercial and technical realities of their industry. The lawyers can try to explain how it is to the judge but at the end of the day the judge is unlikely to have much understanding or empathy with the industry. Arbitration can solve this problem in that many arbitrators start out their professional life as architects, surveyors, mariners or whatever, before converting to ***"legal practice".*** There is less need to explain to an arbitrator with relevant industry experience how the process which went wrong should have been carried out. The arbitrator can make decisions of fact reinforced by his own personal expertise, knowledge and understanding of the industry. There is less likelihood of a party walking away from an arbitration complaining that the outcome was wrong because the judge did not understand the way things are done in practice in the industry.

Jurisdiction – choice of law – enforceability of awards. Arbitration has distinct advantages over the courts in terms of jurisdiction and procedural and substantive law. International arbitrators are far more familiar with foreign law than domestic judges and frequently apply foreign laws during the course of their deliberations. Arbitrators tend to be far more familiar with the provisions of International Conventions. It is common for international contracts to be governed by the provisions of such conventions rather than by domestic laws of obligations. The Vienna Convention on International Sales of Goods is a classic example. Most UK judges would only be familiar with the Sales of Goods Acts. Under the UNCITRAL Model Law it is possible to opt out of law altogether and to give the arbitrator a discretion to decide a dispute on "equitable principles" alone. Arbitration awards are enforceable in 128 countries world wide and are therefore more useful than court awards.

EXPERT DETERMINATION

Expert determination is where an expert is asked to express a contractually binding opinion on a question of fact. Frequently, the only issue to be settled in a dispute is "How much is this worth ?" or "Has the contractual duty been carried out or not ?" Questions of law and legal interpretation may have little or no role whatsoever in the settlement of such a dispute. An expert may well be far better suited to deciding the issue than a judge. Once the issue is settled it is clear what to do next. Pay the established price, or pay or not pay for the contractual service.

It is common to employ an expert evaluator to determine the contract price for something, be it the sale of a house or a ship. The role of surveyors in the classification and valuation of vessels is common place. However, there is no reason why an expert cannot be employed to settle other factual questions. The process is extremely quick and inexpensive. Judges and arbitrators can perform the same function but it is an expensive luxury. Sadly expert evaluation is used far less than it should be.

ADJUDICATION

What is an adjudicator and what is adjudication ? Whenever someone, duly empowered to do so, makes a decision affecting some one else's legal rights they adjudicate over that person's rights. Expert determinators, judges, arbitrators and government officials often perform an adjudicatory function. Clearly therefore, "adjudication" here refers to something else.

Adjudication was popularised by the FIDIC International Construction Contract and by the DOM1/ Construction Contract. The ICC Pre-Arbitral process is a form of adjudication. Adjudication was adopted in the UK and made compulsory for construction contracts by the Housing Grants Construction and Consolidation Act 1996. The Australians have recently adopted the process. Progress is being made in introducing adjudication into the USA.

In essence adjudication, whether statutory or contractual, is a form of fast track arbitration with special procedural rules and a fail safe mechanism that enables the decision to be re-examined and finally determined by an arbitrator or a court at a later date if either party wants a second opinion. Contractual, voluntary adjudication processes are not limited to the construction industry and are currently in the process of being considered for adoption by the Greek and Middle East maritime industries for chartering contracts and for ship building and port servicing contracts.

The distinct features of adjudication are that it is a private, immediately enforceable, temporarily-binding process and is carried out very, very quickly. The process is very inexpensive. It tends to be carried out on a documents only basis though it is possible to have oral hearings and pleadings. The role of the lawyers is kept to a minimum. Under the Housing Grants Act the process takes 28 days from reference to determination but a voluntary system could extend or limit that time scale at the behest of the parties or the organisation running the adjudication process. Adjudicators are drawn from industry just like arbitrators and expert determinators. They do not have to be qualified lawyers though many do in fact have dual qualifications.

The words "immediately enforceable" and "temporarily-binding" appear at first sight to be contradictory and demand some explanation. The award is immediately enforceable on the due date, often 7 days after the award. In the event of non-compliance the courts will enforce the award. There is scope to challenge the scope of jurisdiction and judicial review is available to supervise the conduct of the process, as with any other legal decision making process, but that apart the successful party will get his award. Very few cases have been successfully challenged on this basis. Above all, there is little point in refusing to pay. Enforcement before the courts is as simple and straight-forward as an action for the enforcement of payment of a debt.

The great value of this is that within a very short space of time the parties receive an authoritative statement of what their respective positions are. This enables them to get on with business quickly with a clear understanding of what is required of them. Compare this with arbitration or worse still litigation where clarity will not emerge for months at best or even years. Experience indicates that most disputes end at this stage. The parties tend to be more than satisfied with the outcome. The percentage of cases which have proceeded from adjudication to arbitration or to court determination is miniscule. For the greatest the adjudication decision has signified the end of the dispute process. As a definitive statement of rights an adjudication award also provides the basis for recovery under an insurance policy. If the insurance company does not like the result it can always move on to stage 2, described below, in subrogation of the assured's rights.

"Temporarily-binding" refers to the right of either party to seek a second opinion and to take the dispute forward to arbitration or litigation for final binding settlement. The subsequent process will take place without reference to the adjudication process. However, since the parties were initially forced to gather evidence and witness statements to present to the adjudicator, much of the preparation work for trial will already have been carried out, quickly before anyone had suffered from lapses of memory and whilst all the relevant persons were still available. Contemporary photographs and evaluation reports will be available for the trial greatly enhancing and facilitating the trial process. Both in the construction industry and in the maritime industry this often presents serious problems for subsequent dispute resolution processes because of the mobility of labour within both industries.

The arbitrator or judge makes an award without any reference whatsoever to the adjudication. The arbitrator or judge will be aware of who prevailed in the adjudication but will not know details of the award and will not therefore be influenced by the adjudication when assessing damages. However, as with a payment into court or settlement offer, the judge can take the adjudication award into account when making an award on costs. It can therefore be a risky business challenging an adjudication award and a party would need compelling reasons to take the matter to arbitration or to court.

MEDIATION

Unlike adjudication, arbitration, expert determination and litigation, which are third party dispute resolution processes where someone else decides the outcome of the dispute, mediation is a negotiated settlement process where the parties themselves decide, through agreement, the terms and conditions upon which the dispute is brought to an end.

At the present time mediation plays a small but significant role in the settlement of maritime disputes outside the US. P&I Clubs in London used mediation to settle disputes with over £2 Billion value in 2001. Mediation is being seriously considered by the Greek shipping community in tandem with adjudication as an alternative to arbitration. Mediation

has much to commend it and will hopefully have an important role to play in the industry in the not too distant future. Mediation can be used at a number of different points in the Maritime Insurance Claims process :-

i) To settle personnel disputes, cargo claims, charterparty disputes, collision claims, pollution claims and sale/supply disputes.
ii) To settle disputes that arise when a claimant / assured disputes a claim adjuster's evaluation or a claim rejection is challenged
iii) Disputes between the underwriter and third parties in subrogation of the assured's legal rights following a pay-out to an assured.
iv) A multi-party mediation between the assured as plaintiff, third party as defendant with claims adjusters for both underwriters in attendance.
v) Inter-underwriter negotiations over linked claims.

Mediation shares many of the benefits of adjudication in that it is private, quick and relatively inexpensive. However, the parties themselves maintain control over the decision making process rather than handing it over to a third party. There is an obligation to participate in the process but no obligation to reach a settlement. If no settlement is achieved the parties are free to proceed to adjudication, arbitration or litigation. However, having canvassed the issues thoroughly in advance pre-trial preparation will be at an advanced stage and many side issues will have been resolved resulting in a quicker and more efficient trial.

At a mediation, the mediator acts as a go-between, exploring issues with each of the parties in turn, facilitating them to find a way to broker a settlement. The process has much to offer where the parties realise that a settlement is necessary and are prepared to broker a settlement. Many court cases settle on the steps of the court. Mediation achieves a similar result but involves the parties directly and leads to far more satisfactory settlements than are brokered by the hands off approach of settlement through the auspices of lawyers. Mediation settlements frequently include agreements for the future conduct of business rather than a mere settlement of the dispute at hand.

Mediation has less to offer, apart from a reality check on the parties, in situations where one party simply adamantly refuses to recognise any liability whatsoever and refuses to pay or perform a service or put something right. Even here, participation in the process can result in the recalcitrant party realising that their stance is unrealistic, paving the way for a settlement. Apart from being relatively inexpensive mediation is a valuable tool for repairing damage to commercial relations. Mediation is a serious process and has been successfully used to settle disputes involving very large sums of money. A great advantage of mediation is that it lends itself to multi-party dispute settlement and can therefore replace an entire series of arbitrations or court actions. Mediation agreements are readily and easily enforceable before the courts if the mediation agreement is breached.

DISPUTE REVIEW PROCESSES AND BOARDS

Dispute Review Processes developed in the US. They initially applied to the labour market and to the construction industry and are ideal for ship building contracts and for ongoing relationships such as long term time charterparties or even to long term relationships such as repeat voyage charters. DRPs combine the concepts of negotiation, conciliation, expert determination, mediation and arbitration into one seamless operation. DRPs have been successfully employed in the UK and in Hong Kong. DRPs have resulted in major improvements in efficiency and have savaged the legal costs involved in disputes on major projects. There are many variants on the dispute review process and processes can be tailored to the specific needs of parties engaged in joint ventures. The process is particularly useful where several organisations work together on a project and therefore has much to commend it to the maritime industry, particularly for off shore operations involving oil drilling, transportation, storage and servicing. Employment DRBs are also highly commended to deal with grievance procedures and the employer/employee relationship.

DRPs involve the appointment of a Dispute Review Board, which may contain industry experts and perhaps a lawyer or an arbitrator / mediator. The Board is introduced to the technicalities of the operation at the initial stage and through regular consultations with all of the parties advises on any potential problems of pitfalls facilitating the brokering of solutions to those problems. If a dispute arises which cannot be settled informally the DRB determines the dispute. The outcome can vary depending on the terms of the Board and range from recommendations, temporarily binding decisions, to binding awards.

One advantage of this type of facility is that frequently disputes arise because an operative refuses to acknowledge that there is a problem. If senior management had had any inkling of the problem they would invariably have nipped the problem in the bud and settled the problem. The operative, perhaps fearing that his job is on the line, pushes the issue to one side. Since the operative is the point of contact there may be no way of getting past the operative to higher management in the early stages of the dispute. The problem festers and turns into a major problem requiring arbitration or litigation to settle. Major disruption to commercial activities ensues. The DRB process provides a way of getting such problems out into the open and dealing with them at an early stage.

CONCLUSION : Arbitration and litigation have a valuable role to play in the future of maritime dispute settlement. However, the new processes have much to commend them and the industry will be well advised to take a close look at what is now on offer. The maritime industry is continually evolving. The same is true of the dispute resolution industry. The industry must embrace change in order to prosper.

