

Grand China – contractual termination rights and remedies at law for breach

In the landmark decision of *Grand China vs. Spar Shipping*, the Court of Appeal confirmed that, in the absence of an express term, a charterer's failure to pay hire punctually is not a breach of a condition (which would entitle the shipowner at law to terminate the charterparty, withdraw the vessel and claim loss of bargain damages). Further, a contractual termination right exercisable upon such non-payment will not alter this conclusion, without more. The decision raises important considerations for shipowners and for other parties involved in asset lease financings.

Classification of contractual terms

A condition is a major term, any breach of which will deprive the innocent party of substantially the whole benefit of the contract and thus that party is entitled at law to terminate the contract and, crucially, to claim loss of bargain damages. In contrast, a warranty is a minor term, no breach of which entitles the innocent party to terminate. Between these extremes lie "innominate" or "intermediate" terms, a breach of which may entitle the innocent party to terminate, depending on the nature and gravity of the breach. If the consequences of the breach, which may be actual (a repudiatory breach) or anticipatory (a renunciatory breach), are sufficiently serious, then the innocent party may treat the contract as at an end. This will depend on the specific facts.

The facts

In 2010, Spar Shipping AS ("Spar") entered into three separate time

charterparties with Grand China Shipping (Hong Kong) Co Ltd ("GCS") (using amended NYPE 1993 standard forms) in respect of three bulk carriers it owned. The charterparties provided for parent company guarantees to be issued by Grand China Logistics Holding Group Co Ltd ("GCL").

Clause 11(a) of each charterparty provided that "failing the punctual and regular payment of the hire or on any fundamental breach..." Spar was entitled to withdraw the vessel from service "without prejudice to any claims they (the Owners) may otherwise have on the Charterers."

From April 2011 and throughout the summer, there were substantial arrears of hire on all three vessels and a "chronology of missed or delayed payments". In September 2011, Spar called on GCL to pay under the guarantees, terminated the charterparties and withdrew the vessels.

Spar commenced arbitration proceedings against GCS, claiming the balance of hire due and damages

Key lessons

- A charterer's obligation to pay hire is not a condition, unless expressly stated.
- A contractual right to terminate and/or withdraw the vessel from service will not alter the above conclusion, without more.
- Breach of an intermediate term does not entitle the innocent party to terminate the contract and claim loss of bargain damages, unless the breach is sufficiently serious to allow such party to treat the contract as at an end.
- Owners and lessors should consider their express contractual rights upon a default, including any indemnity from the charterer, lessee or other obligor, as well as their remedies at law for breach of contract.

for loss of bargain for the unexpired term of the charters. Shortly before

the hearing, GCS went into liquidation and the arbitration was stayed. Spar then brought proceedings in the English courts against GCL under the guarantees.

First instance decision

A central question was whether the charterer's obligation to make punctual payment of hire is a condition in standard form time charterparties (subject to express wording in the specific agreement).

At first instance¹, Popplewell J held that such obligation was not a condition. Pursuant to the express withdrawal provisions under Clause 11(a), Spar was entitled to terminate the charterparties and claim the balance of hire due. However, a *mere* breach of GSC's payment obligation would not entitle Spar to claim loss of bargain damages at law, as the obligation was an intermediate term of the contract.

Instead, the court held that GCS had renounced the charterparties and upon such renunciation being accepted by Spar, it was entitled to its "common law right to damages for loss of bargain arising out of such termination". The court awarded Spar damages exceeding US\$25 million plus the costs of the arbitration.

GCL appealed, arguing that Popplewell J at first instance had erred in concluding that GCS had renounced the charterparties (the "Renunciation Issue"). In turn, Spar contended that judgment should have been given in its favour on the

additional ground that payment of hire by GCS was a condition and that Popplewell J erred in failing so to hold (the "Condition Issue").

Court of Appeal Decision

The Court of Appeal dismissed the appeal and upheld Popplewell J's decision on both issues².

On the Condition Issue, the court found that, on a true construction of the specific charterparties, punctual payment of hire was not a condition. Its reasoning may be summarised as follows:

- Requiring an express withdrawal clause for failure to make timely payment of hire supports the argument that the parties did *not* view timely payment as a condition;
- Further, the inclusion of an express contractual termination right for breach of a term will not, of itself, lead to the relevant clause being treated as a condition;
- Whether a term is a condition depends on the parties' intentions; if the parties have not made a particular term a condition and if the consequences of a breach of that term may vary from the trivial to the grave, then the term is intermediate;
- In the specialist context of payment of hire in a time charterparty, there is no general presumption as to time being of the essence of the contract (and

thus that the obligation is a condition), unless expressly provided; and

- An anti-technicality clause (such as that in Clause 11, allowing a grace period for payment where failure is due to negligence or error) does not make timely payment of hire a condition.

Essentially, the court felt that it should not be too ready to interpret terms as conditions and while it recognised the need for certainty in commercial contracts, classifying a clause as a condition at the cost of disproportionate consequences from trivial breaches would be an unsatisfactory balance. "It is one thing to give effect to an express contractual termination clause but quote another to treat that clause as a condition" (Gross LJ). It appears that the court would prefer a "stringent application of the termination provisions entitling owners to withdraw a vessel where charterers have not made a timely payment of hire" than to classify timely payment of hire as a condition, without express wording.

On the Renunciation Issue, the court approved the test adopted by Popplewell J., namely that conduct is *repudiatory* if it deprives the innocent party of substantially the whole of the benefit of the contract and conduct is *renunciatory* if it evinces an intention to commit a repudiatory breach. Actual breaches which might be insufficient to amount to a repudiation might nevertheless constitute a renunciation, depending on the facts.

In applying the test for renunciation to the facts of the case, the court took a three-stage approach, asking:

¹ *Spar Shipping AS v. Grand China Logistics Holding (Group) Co. Ltd* [2015] EWHC 718 (Comm)

² *Grand China Logistics Holding (Group) Co. Ltd v. Spar Shipping AS* [2016] EWCA Civ 982

1. What was the intended benefit of the charterparties to Spar, that is, *what was the contractual bargain?*
2. What was the *prospective* non-performance shown by GCS' conduct; and
3. Was the prospective non-performance such as to go *to the root of the contract*, that is, to deprive Spar of substantially the whole benefit?

The essence of the bargain under a time charterparty is that the shipowner is entitled to regular payment of hire, as stipulated, in advance of performance. The shipowner requires advance payment to perform its services under the charterparty, including maintaining, crewing and insuring the vessel and servicing its own mortgage/funding arrangements. Given GCS' history of late payments from the outset, admitted cash flow difficulties and lack of concrete proposals, a reasonable owner in Spar's position could have no realistic expectation that GCS would in the future pay hire punctually and in advance. The best that could be hoped for was payment in arrears and this would unilaterally convert a contract for payment in advance into a "radically different" transaction for unsecured credit, without any provision for payment of interest. Thus, the judge was entitled to conclude that GCS had objectively evinced an intention not to perform the charters in future in a way which deprived Spar of substantially their whole benefit.

Notably, the court concluded that any failure to pay a single instalment punctually does not amount to breach of a condition, but an evinced intention not to pay hire punctually in the future "is very different and..goes to the root of the charterparties."

Considerations going forward

If the parties to a charterparty intend for punctual payment of hire (or any other major term) to be a condition, then this should be expressly stated. A similar approach may be warranted in operating leases of aircraft and other assets in relation to payment of rental and other amounts (or any other major obligation).

In the absence of such clear provision, the owner/lessor may be required to assess the nature and gravity of any payment (or other) breach by the charterer/operator/lessee, in order to determine if it is entitled to terminate the agreement and claim loss of bargain damages. An owner/lessor who terminates improperly risks being found to have repudiated the contract.

In parallel with considering (and preserving) their remedies at law for breach, owners and lessors should examine their contractual rights upon a breach or any other event, noting that in most asset lease financings, there will be a negotiated spectrum of events which may give rise to the option for the owner/lessor to terminate the leasing and take other prescribed action, including recovering its asset and claiming for unpaid amounts due, as well as for expenses and losses suffered from the relevant event and/or from a termination. The contractual framework of rights available on a default and/or a termination will depend on the specific structure and the parties' commercial agreement.

Postscript

It should be noted that in Grand China, the specific charterparties did not provide, upon the shipowner's

withdrawal of the vessel for non-payment, for a payment by the defaulting charterer of an amount to reflect the loss of future charterhire for the remaining term. In the absence of such contractual provision, Spar had to rely on its remedies at law for breach to seek loss of bargain damages.

In contrast, the equivalent clause in standard form charterparty NYPE 2015 (which was introduced in October 2015, prior to the first instance decision) expressly provides that a shipowner may withdraw a vessel from hire and claim damages for the unexpired term of the charter, subject to a 3 day grace period. NYPE 2015 also extends the shipowner's right to suspend performance of its obligations at any time while hire is outstanding, removing the reference to any grace period.

Contacts



Pat Saraceni
Director of Litigation and
Dispute Resolution, Perth
T: + 618 9262 5524
E: pat.saraceni
@cliffordchance.com



Gervais Green
Partner, Asset Finance
T: + 65 6410 2252
E: gervais.green
@cliffordchance.com



Kate Sherrard
Partner, Asset Finance
T: + 65 6661 2023
E: kate.sherrard
@cliffordchance.com



Julian Acratopulo
Partner, L&DR
T: + 44 20 7006 8708
E: julian.acratopulo
@cliffordchance.com



Oliver Hipperson
Partner, Asset Finance
T: +44 20 7006 4767
E: oliver.hipperson
@cliffordchance.com



William Glaister
Partner, Asset Finance
T: +44 20 7006 4775
E: william.glaister
@cliffordchance.com



Yumin Kim
Counsel, Seoul
T: + 82 2 6902 8007
E: yumin.kim
@cliffordchance.com



Marisa Chan
Senior PSL, Asset Finance
T: +44 20 7006 4135
E: marisa.chan
@cliffordchance.com

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