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Defence class cover

Legitimate deductions from charter hire

Introduction

A charterer's obligation to pay the full amount of agreed, contractual, charter hire on or before its due date is absolute. In turn, an owner's right to withdraw its ship in the event of delayed payment is also absolute and applied stringently. The importance of this advance payment was described in *Tankexpress*¹ as the core substance of the agreement between an owner and charterer for the use and service of a ship and its crew. Without payment, there is no valid consideration and therefore no agreement – under English common law an owner has every right to withdraw in the absence of charter hire.

The entitlement to withdraw a ship is often mitigated in a charterparty by the express inclusion of what is termed as an 'anti-technicality' clause. These clauses require an owner to provide three (but this can be more or less) clear days' notice to the charterer, before it can withdraw a ship for unpaid hire. This notice thereby gives a charterer the opportunity to remedy its defect and pay hire, albeit late. Before withdrawing any ship from a charterparty, a member should always look at the charterparty in question carefully and obtain legal advice from their preferred lawyer.

However, in certain situations, a charterer is entitled to make legitimate deductions from their charter hire. There are three such scenarios:

- where there is an express right of deduction under the terms of the charterparty;
- when the charterer is entitled to an adjustment, following a period of off-hire;
- where the charterer has a claim for damages, for which they are permitted to set-off against hire otherwise due and payable (more commonly known as 'equitable set-off').

The express right of deduction

Both the New York Produce (NYPE) form and the Baltimore form make express provision for valid deductions from hire in certain scenarios. These include a deduction for: lost time, consumed fuel and any expenses incurred as a result of a reduction in speed caused by a defect within the ship's hull, machinery or equipment². They also include advances for ship's disbursements³ and the cost of fuel used for domestic consumption⁴.

Hire adjustment due to a period of off-hire

An adjustment is a type of deduction where the owner owes money to the charterer, due to a period of off-hire within the period of the charterparty. In principle, the owner is obliged to pay this adjustment forthwith, but in practice, it is often off-set against the next month's charter hire. However, no deduction is permitted in anticipation of a period of off-hire.

Damages: Equitable set-off

The right to equitable set-off is a well-established principle under English law. The leading case on this is *The Nanfri*⁵ whereby an eminent judge in the Court of Appeal laid out the three criteria for equitable set-off against charter hire. These are as follows:

- both the claim and counterclaim must arise from the same contract (i.e. charterparty);
- the counterclaim must be 'directly connected with the claim'; and
- there must be a 'manifest injustice' in allowing the claim to be asserted without taking into account the counterclaim (often still to be adjudicated).

The second criterion is the most problematic from a charterer's perspective. It has been established through case law that there are



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only two circumstances that are 'so directly connected with the claim' that an owner's breach of charter may entitle the charterer to make a valid deduction from the next month's hire. These are:

- when the charterer has been wrongfully deprived of the use of the ship; or
- when the charterer has been wrongfully prejudiced in their use of the ship.

In other words, the breach (by an owner) must genuinely deprive the charterer as to the use of the ship itself for this to entitle them not to pay the owner in full for hire otherwise due. **Valid** deductions on this basis have included:

- breach of a speed and performance warranty⁶;
- a failure to load a full cargo⁷;
- time lost by having to dispose of contaminated cargo as a result of an owner's breach of contract⁸;
- delay due to an owner's failure to perform hold-cleaning obligations⁹.

If the claim does not relate to the use of the ship itself, it will be rejected as too remote and therefore will be considered an **invalid** deduction from hire. These have included:

- compensation for damage to cargo¹⁰;
- a failure to keep accurate logs¹¹;
- the master's involvement in producing false documentation from bunker suppliers¹²;
- an owner's breach of duty, when acting as bailee of the charterer's bunkers¹³;
- a refusal by a master to load bunkers¹⁴.

When and how much?

As soon as the charterer has a right to make a deduction from hire, they can apply it to the next, forthcoming, hire payment. This will be so regardless of whether the deductible amount has yet to be ascertained by arbitration or court award, or by mutual agreement.

So long as the charterer deducts a **bona fide** sum that has been assessed on a **reasonable** basis, they should not be held in default and the owner cannot withdraw its ship on account of non-payment of hire. If the amount deducted is subsequently found (by arbitration or court award) to be too much, the owner may do no more than simply recover the balance.

Conclusion

A charterer's subjective belief in a bona fide and reasonable right to make a deduction from hire is not sufficient and will not prevent an

owner from exercising its right of withdrawal for non-payment of hire. Instead, both the claim and counterclaim must arise from the same charterparty and the breach by the owner must have wrongfully deprived or prejudiced the charterer's use of the ship for them to be entitled to make a deduction from hire. If this criterion exists then, if the charterer makes the deduction from hire based on a reasonable assessment made in good faith, this will be a valid deduction so far as withdrawal is concerned.

However, unless there is an express provision in the subject charterparties (which is rare), a charterer **cannot** offset one deduction permitted under one charterparty against hire otherwise due under a separate charterparty, even if the parties are the same.

The parties are still at liberty to dispute the deduction made and it may well be that a judge or arbitrator subsequently holds that a charterer must return some or all of the deduction made to the owner. However, if the deduction is a valid one then the owner will not be allowed to withdraw the ship from the charter service and if they do so, they themselves run the risk of being held in breach of charter.

Defence cover is, by its very nature, discretionary in that the club must be satisfied as to the merits and quantum of the claim in question and the likelihood of achieving a successful outcome, if it is to lend support.

Members requiring further information on this topic should direct their enquiries to either their usual contact at the club or to olivia.furmston@ctplc.com. The club wishes to thank Charlotte Baly for her valued contribution to this article.

1. *Tankexpress v. Compagnie Financière Belge des Pétroles* [1948] 82 LIL Rep. 43 (HL)
2. For example, see clause 15 of the NYPE 1946 form
3. For example, see clause 5 of the NYPE 1946 form
4. For example, see clause 20 of the NYPE 1946 form
5. *The Nanfri* [1978] 1 Lloyd's Rep. 581, [1978] 2 Lloyd's Rep. 132 (CA) and [1979] 1 Lloyd's Rep. 201 (HL)
6. *The Chrysovalandou Dyo* [1981] 1 Lloyd's Rep. 159
7. *The Teno* [1977] 2 Lloyd's Rep. 289
8. *The Sargasso* [1994] 1 Lloyd's Rep. 412
9. *The Aditya Vaibhav* [1991] 1 Lloyd's Rep. 573
10. *The Nanfi* [1978] 2 Lloyd's Rep. 132 (CA), see pages 141 and 144
11. *The Leon* [1985] 2 Lloyd's Rep. 470
12. See 11 above
13. See 11 above
14. *The Li Hai* [2005] 2 Lloyd's Rep. 389

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