SEMAPHORE

Newsletter of the Maritime Law Association of Australia and New Zealand

Trading Our Way Out – Covid-19, Some Legal Issues for Shipping and Trade

Introduction

Over 90% of the world's trade is seaborne. Shipping and international trade will be central as countries pursue the difficult task of finding a path to recovery after the economic shutdown which has followed varying forms of state regulation and decree aiming to prevent the spread of COVID-19. For New Zealand and Australia, our proven ability to trade effectively internationally will be centrally important in restoring economic wealth and welfare.

Just like shipping and trade generally, the legal principles which regulate shipping and trade, only seem to receive attention when something goes wrong. The issues which can arise as a result of a global pandemic bring the legal principles to the fore.

Paul David QC

The Changed Circumstances

All commercial parties involved in selling, shipping and carrying goods are now operating, and appear to be likely to operate for some time, in changed, more unpredictable circumstances.

In this environment it is important that those who sell and ship goods have as much information as possible about operations in countries where their goods are to be discharged, and about the effect of the situation on the parties with which they contract, before they enter into contracts.

It is equally important that they and those who advise them understand how their contracts allocate risk and responsibility in circumstances which may arise.

While the global nature of supply chains means that all aspects of economic activity are affected, that interconnectedness also allows for collaboration to share information quickly in order to address the problems in trading operations.

The degree of collaboration across the shipping world means that information is freely available from such organisations as BIMCO and P&I and cargo insurers on the position in countries and ports worldwide.

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Central Role of Contracts

Entering into any contract to sell and/or to ship goods has risks which commercial parties allocate and seek to guard against in their contracts for sale or shipment and/or by insurance. Shipping is underpinned by contract documents and contractual principles and, while, in my experience, parties work to resolve problems practically, ultimately they will rely on their contractual rights.

What the current rapidly-evolving situation highlights is the need to have a clear understanding of the risks in a particular transaction, how a contract addresses those risks and to be prepared to address changing circumstances. A decision to enter into a particular contract to ship cargo on a particular ship to a particular port should always be carefully considered, but now perhaps has to be scrutinised more closely than might have been the case a few weeks ago.

A shipper from New Zealand or Australia is, perhaps, more likely to enter into a contract of carriage evidenced by the carrier's standard bill of lading terms. A shipper with a significant cargo may hire a ship or part of it under a voyage charterparty for the carriage of its cargo to destination. Or, perhaps more rarely, a party may enter into a long-term contract for the shipment of cargo over a period of time on a bill of lading and/or voyage charterparty terms or, perhaps, enter into a contract to hire a ship for period of time – a time charterparty. Different contracts on standard forms will have different terms which allocate risk, in particular the economic consequences of delay, in different ways. A bill of lading issued by a carrier to a shipper may incorporate charterparty terms so that parties to the contract of carriage are bound by terms relating to the payment of demurrage where the ship is delayed.

The global pandemic has impacted, and will continue to impact, commercial activity and contracts in many different ways. However, in international shipping the legal issue which may have to be resolved in many instances is a familiar one – who has to bear the financial responsibility for delay caused at loading or discharge ports. Generally, bill of lading terms will seek to exclude such liability on the part of the carrier under the contract of carriage; charterparty terms will seek to allocate the risk between shipowner and charterer by provisions relating to the payment of hire in time charters or demurrage in voyage charter parties. Financial claims of this nature and disputes over them consistently arise in shipping but in the current environment, the possibility for delay and consequent expense has been increased.

Some Possible Scenarios

Commercial parties currently have to work out the effect of the disruption caused by the pandemic on their existing contractual obligations (and some of the disputes may keep arbitrators and courts busy for some time) and consider the effect of the circumstances on their contracts going forward.

A range of problems may arise as a result of the pandemic – a port may not be working at all as a result of government order or be operating on a limited basis, a ship may be prevented from berthing until crew have been tested for COVID-19 or it may be quarantined and discharge delayed, a charterer may not be able to produce cargo to be loaded, or bills of lading may not be available at the discharge port. The problems may arise today because of a much-changed commercial landscape but they are not entirely novel and can generally be addressed by interpreting and applying the terms of contracts and by reference to existing principles. Maritime law and shipping contracts have had to address many different circumstances affecting trade over the years.

The scenarios below aim to provide examples of some of the issues which commercial parties and their advisers might have to consider. Of course, where problems of the kind outlined arise, the legal answer will depend (and I know that you will be disappointed, but perhaps not surprised, to read) on the exact factual circumstances and what the particular contracts provide. In some areas, such as disputes under charterparties, the disputes arising from delay in loading and discharge seem likely to keep lawyers and maritime arbitrators busy for some time.

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Before looking at the possible issues, two areas of law which are potentially relevant where unexpected events disrupt contractual performance should be mentioned.

Where unforeseen events affect the performance of a contract, contractual provisions which excuse breach or suspend performance, or provide for a party to vary performance where such events occur, may be potentially applicable. Shipping contracts often contain such clauses under force majeure, exceptions or other headings. Whether a particular clause applies will depend on its interpretation and application to the particular circumstances.

The possible application of the common law doctrine of frustration may also have to be considered. A contract may be discharged by frustration when unforeseen circumstances or events make the performance of the contract impossible or radically and essentially different from that which the parties agreed. Where contract performance is delayed as a result of extraneous events not attributable to either party, it can frustrate a contract but only where the delay has the effect of making the performance of the contract fundamentally different from that which was contemplated in the contract. Assessing whether a contract has been frustrated involves an objective evaluation of what the parties contemplated as regards performance in their contract at the time they entered into it, and what the effect of supervening event has been on the performance of the contract for the future. Consistent with the common law's insistence on contracts being performed, the doctrine of frustration is applied within narrow limits and is not to be lightly invoked.

Scenario A

A shipper enters into a contract of carriage for goods to be shipped to an overseas port on the carrier's bill of lading terms. As the vessel is approaching the discharge port, the shipowner receives information that the port is affected by COVID-19 and is not working regularly. Under local law the port has declared that the circumstances represent force majeure. The master decides not to enter the port but instead leave and discharge the cargo at another port.

Comment

Generally, under New Zealand (or English) law it will be the contractual arrangements and Hague-Visby Rules which regulate the relationship between carrier and shipper not a local declaration of force majeure by a third party. Where it is possible for arrangements to be made to discharge the cargo at the port, it is unlikely that a shipowner could refuse to enter and discharge at the agreed port and proceed to another port. The terms of the bill of lading would have to be considered, in particular whether the shipowner could rely on any provision providing for it to depart from the discharge port under the contract and take the goods to another port in certain circumstances. Unless the deviation from the agreed discharge port could be said to be necessary to save life or property, it seems unlikely that it would be reasonable and justifiable under the contract of carriage. The shipowner might well be in breach of contract.

Scenario B

A ship arrives at the discharge port named in a voyage charterparty and in bills of lading gives notice of readiness to discharge. The vessel is then refused permission to berth because the master declares that one crew member is sick, as required by local law. The government authorities place the ship in quarantine for 14 days. That period could be extended depending on whether other crew members fall ill. A shipper with cargo on the ship will lose a valuable sale in the local market if discharge is delayed.

Comment

In this situation the consequences of delay would be regulated by the contractual provisions between the parties. As between a shipowner and a charterer, the financial cost of delay to the ship would be allocated under the terms of the charterparty, in particular the laytime and demurrage regime. The

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varying circumstances which may arise will produce disputes as to demurrage payable for delay. An important aspect of such disputes is likely to be whether the ship was able to give a valid notice of readiness as a result of sickness onboard so that laytime began to run under the charterparty. The charterparty terms could also impose financial liabilities for delay on parties to the contracts of carriage if the terms are incorporated into the bills of lading. A delay of this length with the possible further delay would be unlikely to lead to a finding that a charterparty was discharged by frustration.

A claim for losses by a cargo owner caused by delayed delivery would potentially be available at common law (although a claim for lost profit would require specific knowledge of the intended sale on the part of the carrier) but the terms of the contract of carriage are likely to expressly exclude such a claim.

Scenario C

A shipper is considering entering into a voyage charterparty for the carriage of a cargo. The shipowner proposes that the BIMCO Infectious Diseases Clauses be included in the charterparty.

Comment

The BIMCO infectious diseases clauses were developed by BIMCO for inclusion in time or voyage charterparties to provide some certainty in factual situations where there a ship is going into an area where there is a risk of exposure to highly-infectious disease. They do not specifically refer to COVID-19.

The clauses provide for the shipowner/master not to proceed to, or to leave, an area affected by risk of exposure to a highly-infectious or contagious disease and to require a charterer to issue alternative voyage orders. If new orders are not given, the shipowner can discharge cargo onboard at any port or place, and the charterer will bear the cost.

The clauses also provide for the consequences if the vessel does proceed to an affected area – the charterer has to meet the additional costs and expenses. While the clauses aim to provide greater certainty for shipowners, charterers and shippers, they have not been considered by courts or in maritime arbitrations. The clauses require the exercise of reasonable judgment by the shipowner and/or master in determining that an area is affected by a disease as defined, and the charterers have no input in that decision. The clauses prevail over any other express or implied terms of the charterparty to the extent of any conflict. It seems likely that decisions made under the clauses, their application in particular circumstances and their economic consequences will be considered in future claims. Overall, charterers will, no doubt, consider the clauses and their operation carefully if they are put forward for inclusion in a charterparty. Whether alternative clauses or existing provisions are put forward as more appropriate ways of addressing risk will be a matter for the particular negotiation.

Scenario D

A company has agreed to sell product to an overseas buyer over a period of 12 months. It has entered into a long-term contract to ship the product with a shipowner under which it agrees to provide monthly cargoes for shipment over that period. The effect of COVID-19 means that the company cannot produce any product for two months and it has already not been able to provide one cargo. The company wants to cancel the shipping contract because it does not believe that the commitment to supply and ship the product will be economic.

Comment

The company's position with the shipowner will depend on the terms of the contract of affreightment. Its liability is likely to depend on whether the contract contains a force majeure clause or hardship clause, what any clause provides, and whether the company can show that it is entitled to rely on the clause in the circumstances.

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It is, of course, important to remember the basic position under common law. If a party cannot perform its obligations under a contract, and there are no provisions excusing or suspending the breach of obligation, then it will be in breach of contract. That breach may well allow the other party to the contract to terminate the contract, whether under the terms of the contract or at common law, and claim damages. This means that the company may face significant claims in damages from the shipowner, if it cannot rely on any defence or exception under the contract. The loss of two months of production, while it creates economic hardship, would be very unlikely to support a claim that the contract was discharged by the operation of the doctrine of frustration at common law.

Force majeure is a distinct legal concept in civil law systems existing independently of contract. In contrast, in common law systems like ours, a party which wishes to say that its obligations under a contract are suspended or ended as a result of a force majeure event, has to rely on a clause in the contract providing for this and prove that it applies. A party seeking to rely on a force majeure clause will have to show that the event relied on falls within the clause, that the performance of the contract has been affected by the event as provided for by the clause (that performance was rendered impossible as a result solely of the event or, perhaps, under some clauses, that performance was delayed or made more costly) and that it has done everything to avoid the effect of the event on its contractual performance. A party will also usually have to show that it was ready, willing and able to carry out its obligations had it not been for the event. Whether the clause provides for an end to obligations or suspension for a period of time depends on its wording.

The English Court of Appeal recently considered the interpretation and application of a clause which provided for force majeure situations in *Classic Maritime Inc v Limbungan Makmur Sdn Bhd* [2019] EWCA Civ 1102. The case pre-dates COVID- 19 events but provides an instructive example of how common law courts approach the interpretation and operation of such clauses.

Scenario E

The bills of lading for a cargo are delayed by disruption to the courier system due to COVID-19. Can the cargo be delivered to the consignees at the discharge port without a bill of lading being produced?

Comment

Delays in the arrival of bills of lading can cause significant delay in discharge. Such delays may be more common in the current environment. The usual solution is for goods to be discharged against the provision of a letter of indemnity in an approved form indemnifying the shipowner against potential claims by bill of lading holders. Care needs to be taken in the wording of indemnities, and where a shipper or charterer agrees to provide the letter of indemnity to the carrier, it should seek counter-indemnities from those who will receive the goods without producing the bills of lading.

Some Practical Suggestions in Conclusion

Commercial parties cannot be expected to address and analyse all possible issues as if they were lawyers before they agree to sell and ship goods. This is not possible, and if it was attempted, parties might never enter into contracts at all! But a good general understanding of the rights and obligations under the contracts by which goods are to be sold and carried is always important and, more so, in a more unpredictable trading environment. Running some “what if” scenarios under proposed contract terms, particularly around questions such as the responsibility for and consequences of delayed discharge, is an essential exercise. It assists in negotiating a contract and in understanding how a contract operates; it makes addressing a problem easier if the need arises.

If you are trading and shipping goods, you should have a good general understanding of the contracts under which you sell or buy and ship and any provisions which have been specifically agreed to address the possible effect of COVID-19. You should also understand the scope of your insurance and its exclusions.

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If a major problem arises after you have entered into the contract, if possible, seek some guidance on your legal position before you seek to resolve it – this can help with the approach to any negotiation.

If you try to resolve a problem by negotiation, reserve your legal position. Commercial parties can often agree to disagree on the legal position, but still move rapidly to find a workable commercial solution in the interim, leaving any final reckoning on who is responsible to any later negotiation, litigation or arbitration.

My personal perspective is that those involved in international shipping and trade show considerable resourcefulness and skill. To a significant degree the scale and spread of the current crisis requires a collaborative effort to rebuild economic wellbeing, but commercial parties have to remain aware of the contracts which regulate their relationships.

As shipping and trade plays its vital role in the economic rebuilding exercise in our countries and globally, there will be significant opportunities, but be as prepared as you can before you contract and ready for changes of circumstances which may affect the performance of your contracts.

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