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Defence Guides

Nutshell on Formation of contracts

This article seeks to provide guidance for members on issues relating to the formation of charter parties, the effects of "subject to" wordings as well as issues relating to parties to the contract.

Formation of the contract

Does a charter party need to be in any particular form?

A charter does not need to be made in any particular form. An oral agreement to charter a ship is binding on parties. The form of most charter parties includes a recap, the main terms and the riders.

"subject to" wordings

If, during negotiations, the charter contains "subject to" wordings, it means that the parties do not yet intend to make a binding contract. There is therefore no intention to create legal relations and a binding contract does not exist.

A binding contract is only created when parties expressly agree that all "subjects" are lifted. In **The Junior K** [1988] 2 Lloyd's Rep 583, the parties' negotiations led to a telex stating "sub dets Gencon CP". Although the telex contained all the essential terms of the charter and there were no unresolved operational issues between the parties, there was no binding contract because the contract was still subject to the details of the GENCON charter being finalised and such a subject was not lifted.

Parties may be deemed to have dispensed with the "subjects" if they had begun performing the charter. For instance, the delivery and acceptance of the ship would be deemed as a performance of the contract. Such performance will lead to a binding contract even if the charter was made subject to the signing of an agreement (see **The Botnica** [2007] 1 Lloyd's Rep 37).

A note of caution that the position as set out above under English law may differ from that of US law which focuses the inquiry on the existence of the "essential" or "main" terms of the charter.

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Examples and effects of "subject to" wording

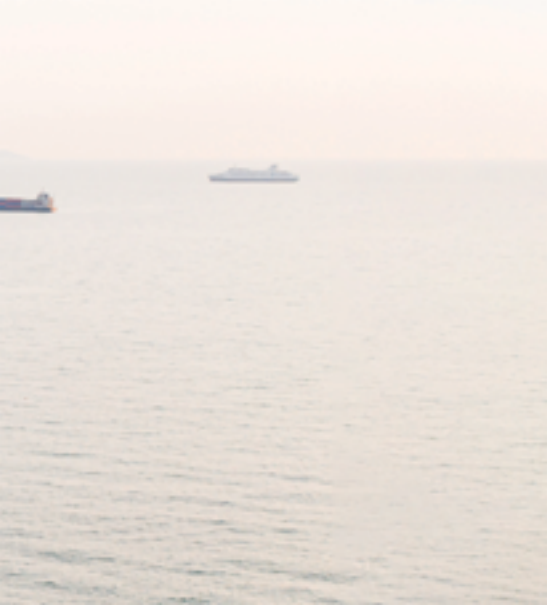
"Subject to" wordings can take many forms. These include "subject to contract", "subject to details", "subject to" a specific condition or requirement.

"Subject to contract" or "agreement to be finalised" suggests that a formal agreement must be entered before a contract is deemed binding. This is usually construed as a pre-condition to a contract, which has the effect of preventing a contract from coming into existence altogether. However, as mentioned above, the performance of a contract may waive a party's right to rely on the "subject to contract" wording.

When a contract is "subject to" a specific condition or requirement, the nature and construction of the parties' negotiations will decide whether such a condition is a pre-condition or a performance condition. In the former, no contract exists and a contract only binds when the relevant condition is fulfilled. In the latter, a binding contract exists and the parties are obliged to perform the condition. It can be difficult to determine whether a subject condition is a pre-condition or a performance condition and there are differing views in case law. In **Astra Trust v Adams** [1969] 1 Lloyd's Rep 89, the words "subject to satisfactory survey" were deemed as a pre-condition and there was no binding contract until a satisfactory survey was completed. However, in **The Merak** [1976] 2 Lloyd's Rep 250, the same words were deemed to be a performance condition instead. This meant that there was in existence a binding contract and the parties were obliged to carry out the survey. If the survey is then not carried out or not carried out properly, ie the performance condition is not satisfied, this may in turn lead to the termination of the contract.

A "subject" is more likely to be a pre-condition if the subject involves the exercise of a personal or commercial judgment by one of the parties. For instance, if the "subject" is dependent on one party concluding a contract with a third party, this is likely to be treated as a pre-condition. As a result, a "Suppliers' Approval" subject was deemed to be a pre-condition because it involved a commercial judgment, namely to choose third-party suppliers, the terminal as well as the cargo. Consequently, it was found that no binding contract was made when such a "subject" had not been lifted (See **Nautica Marine Ltd v Trafigura Trading LLC (The Leonidas)** [2020] EWHC 1986).

[1] For example, "subject to survey", "subject to enough material (STEM)", "subject to completion of two trial voyages" etc.



Under certain circumstances, even if the condition is satisfied, a further agreement must be reached between the parties before the contract is deemed to be binding. For example, in **The John S Darbyshire** [1977] 2 Lloyd's Rep 457, the words **"subject to satisfactory completion of two trial voyages"** meant that there was no binding contract until the trial voyages were completed and the parties had agreed to enter into a contract. The use of trial voyages suggests that the charterer would have an opportunity to evaluate the vessel and this meant that a contract was not automatically concluded once the trial voyages were concluded.

Do both owners and charterers have to sign a charter party?

A charter does not need to be signed in order for it to be binding. Under common law, three ingredients need to be present in order for a contract to be binding. These are (i) the offer and acceptance of terms by the parties, (ii) an intention to create legal relations and (iii) consideration. The presence of these will create a binding contract even if the contract is not signed.

What if there are contradictory terms in the recap, main terms and riders?

Certain standard form charters contain a clause which states that a particular portion of the charter shall prevail over the other portions. For instance, the GENCON 1994 states that the provisions in Part I shall prevail over those of Part II. In another example, the NYPE 2015 states that the provisions of the riders and additional clauses shall prevail over those of the main terms.

Unless otherwise stated, the terms and amendments in the riders will supersede the main terms and the recap will supersede the riders because the recap is viewed as the latest version of the agreement between the parties. The courts will however try to reconcile as far as possible terms which may appear to be contradictory.

However, if a formal charter is eventually drawn up and signed between the parties, the terms of the signed charter will take precedence. The recap will still be relevant as an aid in construing the final terms of the signed agreement.

The pre-contractual negotiations can also shed light on the parties' intentions as to whether certain portions of the charter would supersede others however these will not override the terms of the charter.

Parties to the contract

What if there is confusion over the identity of the parties? Will the charter still be binding?

If the terms of the charter are insufficient to identify the parties, the relevant factual background, including the correspondence between the parties, will be key to resolving any uncertainties. It is possible to look beyond a mistake and construe a charter as if the right name had been used.

For example, in **The Double Happiness** [2007] 2 Lloyd's Rep 131, the charter party mistakenly named the disponent owner as Front Carriers Inc instead of Front Carriers Ltd. It was found that there was a binding contract because Front Carriers Ltd attempted to rectify the error shortly after the fixture was concluded and the charterers failed to object to it in a timely fashion.

Are guarantors a party to the charter?

Guarantors are not a party to the charter. A guarantee is a separate contract between the guarantor and the owner. In the event of non-performance by the charterer, the owner's recourse against the guarantor is via the guarantee and not the charter.

Do charter party guarantees need to be signed or incorporated into the charter agreement?

Generally, guarantees need to be made in writing and signed. However, a guarantee is enforceable even it is electronically signed by a broker, so long as the broker has authority from his principal.

A guarantee is also enforceable even if there is no single document containing the whole contract of guarantee. For example, in **Golden Ocean Group Ltd v Salgaocar Mining Industries Pvt Ltd and Another** [2012] 1 Lloyd's Rep, the guarantee and the charterparty terms were found to be encapsulated in two separate emails sent by the broker to the owners.

In fixing a charter guarantee, owners need to ensure that the guarantee is properly issued and that they did not merely obtain a promise by the charterers to procure a guarantee. In **The Anangel Express** [1996] 2 Lloyd's Rep 299, the fixture contained the wordings "Charterers agree to performance guarantee to be as per Owners' wording on … letter headed paper and signed by…". This was deemed to be a promise by the charterers to procure a guarantee and not an actual enforceable guarantee.

Although English law can be flexible, parties seeking to call on the guarantee should always check what the requirements are in the country of residence/registration of the guarantor in order for the guarantee to be enforceable. Some countries may require that guarantees be registered.

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