



## Defence Guides

# Repudiatory Breach & Non-payment of hire: when can owners cancel a charter party?

### Introduction

The non-payment of hire is one of the common problems faced by owners and may result in owners wishing to terminate the charter and to re-fix the ship. *(For the purposes of this article, we will only be looking at the non-payment of hire in the strict sense, i.e. charterers' failure to pay hire, not where charterers have deducted hire, as to which, please see <https://www.westpandi.com/globalassets/about-us/claims/claims-guides/west-of-england-defence-guide---off-hire.pdf>.)*

*(Note also that the right of cancellation discussed in this article is different from owners' right of withdrawal of a vessel where this right is expressly included in the charter party - see <https://www.westpandi.com/globalassets/about-us/claims/claims-guides/west-of-england-defence-guide---withdrawal-and-suspension-of-service-of-a-ship.pdf>.)*

Whether owners can validly terminate/cancel the charter, re-fix the ship and claim damages for lost profit for the remaining period of the cancelled charter party (as opposed to simply claiming the hire that has been unpaid prior to owners'

termination of the charter party) depend on whether the charter party has been repudiated.

"Repudiation" is a specific term in English law and in this regard, a contract is repudiated either:

- i) when the contractual term that has been breached, namely the obligation to pay hire, is what English law calls a "condition" or, alternatively,
- ii) when the breach of the contractual term is so serious that it "goes to the root of the contract".

In the event of a long-term charter, an early termination of the charter party allows owners to claim for a potentially large sum of damages, representing the lost profit for what would have been the remaining period of the cancelled charter party. In this scenario, owners have the burden of proving that they have suffered losses that cannot be adequately compensated by re-fixing the vessel, e.g. where the charter party rate has decreased since the original charter was fixed (see <https://www.westpandi.com/globalassets/about-us/claims/claims-guides/west-of-england---defence-guide---cancellation.pdf>.)





### What are the dangers if owners wrongfully cancel a charter party?

If owners wrongfully cancel a charter party and if it is found in subsequent proceedings that owners were not entitled to cancel the charter party, the tables are turned against owners because in that scenario, owners will themselves be in repudiatory breach of the charter party and charterers will be able to cancel the charter party and claim damages and/or an indemnity against owners.

### What happens if charterers have not paid hire - can owners cancel the charter party?

As outlined at i) above, if English law finds that the obligation to pay hire is a “condition” of the charter party, then charterers’ non-payment of even one instalment of hire will automatically (subject to the requirements of any anti-technicality clause in the charter party) entitle owners to cancel the charter party.

For a long time, there were conflicting English law cases on whether payment of hire was a “condition” or a mere term of the charter party (*The Astra* [2013] 2 Lloyd’s Rep 69 for the former position and *The Brimnes* [1972] 2 Lloyd’s Rep 465 for the latter). Certainty on this issue is important because as we have seen above, the consequences of breaching a term or condition of payment are very different.

The issue of whether a payment of hire was a condition was finally put to rest by the Court of Appeal in *Spar Shipping AS v Grand China Logistics Holding (Group) Co Ltd* [2016] 2 Lloyd’s Rep 447 (“*Spar Shipping*”). In overruling *The Astra*, the Court of Appeal decided that the obligation to pay hire is not a “condition” but a mere term of the charter party. This provides a measure of certainty, namely, that owners do not

have an automatic right to terminate the charter party and claim for loss of profits where charterers fail to pay hire.

However, as can be seen by ii) above, this is not the end of the story. This is because, despite coming to a conclusion that payment of hire by itself is not a condition, the court in *Spar Shipping* nonetheless found that charterers’ conduct as a whole amounted to a repudiatory breach so that owners had validly cancelled the charter party and were successful in their claim for damages and loss of bargain in respect of the future hire that owners would have earned under the charter party had the charter party not been repudiated.

When there is a non-payment of hire it is therefore important to understand what constitutes a repudiatory breach.

### What factors are relevant in determining whether a breach is repudiatory?

A conduct is repudiatory if it “goes to the root of the contract” or deprives the other party (i.e. owners) of substantially the whole benefit of the contract. In this regard, the intention of the defaulting party (charterers) is not entirely relevant. What is important is charterers’ manner and conduct leading up to the breach.

The following factors are relevant in ascertaining whether charterers’ conduct in relation to non-payment of hire was a repudiatory breach:

- a) The amount of arrears accumulated as compared to the entire duration of the charter party.
- b) Failure to come up with a concrete payment plan to settle arrears.
- c) Failure to explain in proper detail why hire was unpaid.

## **a) The amount of arrears accumulated and the duration of the charter party**

It has been suggested that a comparison of the arrears against the entire duration and sums which could have been earned under the charter party is a way of determining whether the non-payment of hire had substantially deprived owners of the benefit of the contract. For example, a late payment of hire for two to three months would be a small proportion of the total amount of money which owners could have earned under a five-year charter. Can such an insignificant proportion be said to deprive owners of substantially the whole benefit of the contract?

Whilst the above is a starting point, the court cautioned that such a mathematical comparison of arrears would not be conclusive as to whether a breach is repudiatory. Such a position negates the fact that a charter party is a contract where the charterer is essentially obtaining services on credit if he fails to make payment. As such, this mathematical comparison may not be definitive in determining whether charterers' breach was a repudiatory one.

## **b) Failure to come up with a concrete payment plan to settle arrears**

One of the important factors which led to the finding of a repudiatory breach was charterers' failure in coming up with a concrete payment proposal. A suitable payment plan should include a detailed and reasonable timetable to pay off certain portions of the debt. The inclusion of an interest rate for late payment may also lay further credence to the payment plan. A vague promise to make punctual payment will not usually be accepted as a reasonable payment plan.

The proposal of a payment plan should be carefully drafted as it may be construed as an admission of liability. For charterers, such a payment plan should be accompanied by "without prejudice" qualifications and clear words stating that the payment plan is not an admission of liability nor does it affect charterers' rights to set-off damages for other matters.

As for owners, accepting such a payment plan has its drawbacks too. The payment plan may be seen as a compromise of the claim under the charter party, thereby extinguishing owners' rights to arrest any of charterers' vessels for security. In accepting the payment plan, owners may qualify and state that such acceptance does not extinguish their rights to arrest the vessel if there was a subsequent breach of the payment plan. However, whether such words would actually extinguish the rights of arrest would depend on the local admiralty laws of the country where the prospective arrest would take place.

## **c) Failure to explain in proper detail why hire is unpaid**

A pattern of non-payment (or underpayment) of hire with no explanation or a refusal by charterers to explain the underlying reasons may be viewed by the tribunal as a repudiation by charterers. For example, where charterers seemed set upon paying US\$7,000 per day below the charter rate for the remainder of the charter (a period of more than three years), it was held that the arbitrators were entitled to conclude that this amounted to a breach which went to the root of the contract (*The Astra*).

In order to mitigate any allegations of repudiatory conduct, charterers should be candid with the reasons why they failed to pay hire. Usual explanations include having cash flow problems, experiencing a falling market or facing an economic downturn as well as unpaid sub-hire.

There may be a concern amongst charterers that divulging too much information may be seen as a commercial weakness or may even be seen as prejudicing charterers' legal position. That said, a certain level of candidness is needed because the courts have found that charterers' failure to give details of when he expects to have incoming fresh funds is one of the types of conduct amounting to a repudiatory breach.

## **What factors are irrelevant in determining whether a breach is repudiatory?**

There are a number of considerations that tribunals have found to be irrelevant in determining whether a party is liable for a repudiatory breach.



First, as mentioned above, the intention of the defaulting party (charterers) is irrelevant. Evidence that charterers have the willingness or intention to perform the contract and pay hire would not change the fact that there was a non-payment of hire. As the court in *Spar Shipping* succinctly said, “To say: ‘I would like to but I cannot’ negatives intent just as much as ‘I will not’”.

Second, the financial strength of owners is also irrelevant. Therefore, it is no defence for charterers to argue that because owners have deep pockets, owners could have absorbed charterers’ failures and prospective inability to perform the charter party. The fact that owners have a stronger financial backing does not mean that owners are obliged to accept payment of hire in arrears especially when the parties’ intention under a charter was for hire to be paid in a timely fashion.

## Conclusion

As seen from above, there are several key factors which would determine whether charterers’ conduct in not paying hire is such as to constitute a repudiatory breach of the charter party that entitled owners to terminate the charter party.

If charterer members have failed to pay hire for one reason or another, they should take note of such factors and ensure that adequate steps are being taken so that allegations of a repudiatory breach can be rejected. On the other hand, owner members should review the above factors so that they can judge whether charterers’ conduct amounts to a repudiatory breach.

It is also important to note that the factors as discussed in this article are not exhaustive and a tribunal’s determination of whether a breach is repudiatory or not would depend on the specific facts of the matter. In particular, a tribunal is likely to look closely at the correspondence between the parties in order to assess whether or not charterers are in repudiatory breach of the charter party. It is therefore important that members – both owners and charterers - think carefully about the content and timing of such correspondence. *If in doubt, please contact the Managers.*

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