

In this series of FD&D Guides, developed by CJC, we provide brief notes on issues to address and practical steps to take in a situation where there is non-payment or short-payment of hire. This first Guide looks at the question of off-hire and equitable set-off.

Deductions from hire: Off-hire and equitable set-off

When a charterer fails to pay hire, the shipowner needs to verify whether the charterer is validly exercising a contractual or equitable entitlement to withhold hire or make a deduction against hire. The fact that the hire payment has not been made or there is a shortfall, does not necessarily mean that there has been an unlawful non-payment of hire.

There may be prescribed rights to deduct hire, such as if there has been an off-hire event, or if there is an express contractual right to deduct certain expenses or claims from hire. Also, there is a common law right to make deductions from hire in certain circumstances, known as an equitable set-off. It is only if none of these possibilities applies that the shipowner should consider its rights and remedies for non-payment or short-payment of hire.

We set out a brief summary as a guidance on deductions from hire. To keep matters relatively simple, we base our Guide on the industry standard NYPE form of time charter and English law.

Off-Hire

Burden of Proof

A time charterer's obligation to pay the agreed hire for its employment of the vessel is a key component of a time charter. The burden rests on the charterer to prove that it is exempted from this obligation by a clear contractual entitlement to withhold part or all of the hire that is otherwise due.

In order to make a valid deduction for off-hire the charterer must prove that:

- the full or efficient working of the ship has been prevented; by
- one or more causes or events listed in the off-hire clause; and
- (usually) that there has been a loss of time from that cause or event.

The off-hire clause typically specifies factual scenarios in which the exception will apply. The application of the clause does not necessarily mean that there has been a breach of contract by the shipowners.

Prevention of Full/Efficient Working of the Ship

The starting point is to identify whether, at the material time, the vessel was prevented from performing its chartered service, being careful to identify what in the ordinary way is the activity or operation required by the charterer as distinct from what in commercial terms the charterer might wish or expect to occur.

In *The Berge Sund* the vessel was unable to load its next intended cargo because further cleaning of its tanks was required to remove residues from its previous cargo, despite the fact that the crew had carried out tank

washing during the ballast voyage. The Court of Appeal held that in reality the service which the charterer required was not to load the cargo at that time, but rather to continue cleaning operations to put the tanks into a condition in which they were fit for the reception of the intended cargo. Whilst in commercial terms the charterer will employ the ship to load, carry and discharge cargoes, the chartered service is not limited to these functions alone. It includes operational requirements such as bunkering, ballasting, lightening and tank/hold cleaning.

A similar approach is taken where (to the charterer's commercial detriment) the cargo carrying voyage is delayed because of an external physical impediment or obstacle to navigation such as a sandbar, a boom or temporary shallow blocking the vessel. Despite the impediment the vessel remains fully functional within itself.

Where, however, the impediment delaying or detaining the vessel is not external in that it is directed at or relates to the specific ship, those matters can be treated as events which prevent the full working of that particular vessel, even if (aside from those matters) the vessel is not of itself inefficient or unoperational, such as seizure, detention or arrest.

Off-Hire Event

If it is established that the full/efficient working of the ship has been prevented, the vessel is not off-hire unless the charterer establishes that the situation has been caused by a feature within the scope of the off-hire events specified by the relevant off-hire clause(s).

Usually the off-hire events are expressly described, such as in clause 15 of the NYPE form which also includes the generic phrase "any other cause preventing the full working of the vessel". The generic phrase is limited to unspecified causes of the same type as those expressly stated which are intrinsic to the vessel (it does not extend to extraneous causes which are unrelated to the physical condition or efficiency of the vessel). For example, in *The Saldhana* it was held that the act of piracy which prevented the full working of the vessel was not of a similar nature to the specified off-hire events in clause 15 and therefore was not within the scope of the phrase "any other cause".

In some charters, the phrase "any other cause" is extended by the word "whatsoever", in which case the off-hire events are not restricted to those which are the same kind as those which are specified. It does still, however, require the full working of the ship to have been prevented.

Off-Hire Period

If the charterer is able to establish that the full/efficient working of the vessel has been prevented by an off-hire event, the amount which the charterer is contractually entitled to deduct from hire is usually measured by the time lost due to interruption or delay in the performance of the service required of the vessel caused by the off-hire event. Such provisions (for example clause 15 of the NYPE form) are known as "**net loss of time**" clauses. They are not measured by the duration of the off-hire event itself, but rather by the period of time lost within that duration.

Some charters contain clauses which entitle the charterer to withhold or deduct hire for a defined period that is measured by the duration of the off-hire event rather than by time lost during that period. Typically, such clauses use the phrase "... hire shall cease until the vessel is again in an efficient state to resume its service" or "... no hire shall be payable until the vessel is ready and in an efficient state to resume service from a position no less favourable to Charterers than that at which [the off-hire event] began". These are known as "**period**" clauses.

Once the off-hire event ceases to interrupt or delay the performance of the chartered service, the off-hire period comes to an end. For example, in *The Pythia* the obligation to pay hire resumed as soon as the vessel refloated following a grounding outside the port as it was then restored to its full working condition. Hire resumed despite the fact that the off-hire event (the grounding) resulted in consequential delay (waiting for a berth which became occupied during the period of the grounding – once the vessel refloated the service required was to wait for a berth to become available).

Contractual Entitlement to Deduct

The shipowner should also check the charterparty for any provisions which entitle the charterer to make a deduction from hire for items such as port disbursements (e.g. line 66 of the NYPE form), the cost of bunkers ROB on redelivery (from the final hire payment), fuel used while the vessel is off-hire (e.g. clause 20 of the NYPE form).

If there is an express right to deduct, the charterer can make the deduction from any hire payment:

- after the event/expense has occurred;
- of an amount which it claims bona fide and assesses on a reasonable basis;
- even if the precise amount of the deduction has not yet been ascertained by arbitration or agreed by the shipowner.

Equitable Set-off

If there is no express right of deduction, it is still possible for the charterer to make a deduction from hire by way of equitable set-off. As with off-hire deductions, the burden of proof rests on the charterer to establish its entitlement to make an equitable set-off.

Loss of Use

A charterer may set off against hire a claim for damages where the shipowner's breach deprived the charterer of the use of the vessel or prejudiced its use of the vessel (this contrasts with the position under a voyage charter where there is no equitable right to deduct from freight).

The charterer may not make an equitable set-off for more than the amount of the hire paid or payable in respect of the period during which it has been deprived or prejudiced in the use of the vessel in whole or in part.

Provisional Remedy

Equitable set-off is a provisional remedy. The charterer's claim for which the deduction is made must:

- be exercised in good faith and on reasonable grounds;
- arise out of the same transaction or be closely connected with it; and
- have such a close connection between the shipowner's right to hire and the charterer's claim that it would be manifestly unjust to enforce the right to hire without setting off the claim.

Examples where equitable set-off was upheld as valid:

- a claim in respect of an alleged breach of a speed warranty
- failure by the shipowner to load a full cargo ("shut out" cargo)

- time lost due to the vessel having to dump damaged cargo at sea
- period when the vessel was unavailable because of defective hold-cleaning

Examples where equitable set-off was held to be wrongful:

- cargo damage claim arising from the negligence of the crew
- loss of cargo fixture due to delay caused by repairs to the vessel resulting from negligent contact with a quay
- breaches in respect of: (a) failure to keep accurate logs; (b) involvement in creation of false documentation by bunker suppliers; (c) breach of duty as bailee of the charterer's bunkers
- a cancellation fee charged by a bunker supplier

The parties can, in principle, also agree to exclude the right of equitable set-off in the terms of the charterparty. It should be noted however, that if there is any ambiguity in such a clause, that this will be construed against the shipowner – see for example the decision of the Commercial Court in *The Teno* where it was held that the words “without discount” in relation to the payment of hire were insufficient to deprive the charterer of a right of set-off.

Incorrect “Lawful” Deductions from Hire

If, for example, a charterer makes a deduction from hire for a speed and performance claim where there is an express right to do so, but it is later found that the charterer assessed its claim incorrectly and deducted too much, it is doubtful whether the deduction would have been unlawful. Whilst the position is not fully settled in case law, the prevailing view appears to be that such a deduction would not entitle the shipowner to exercise its right of withdrawal provided that the deduction was made in good faith and based on a reasonable assessment. The shipowner is not of course prevented from exercising its right of redress for reimbursement of the excess sum that was incorrectly deducted.