MEALEY'S™
International Arbitration Report

A Modern Twist On A Charter Party Contract "Approvals" Clause

by
Timothy Semenoro
and
Robert E. O'Connor

Montgomery McCracken Walker & Rhoads LLP
New York

A commentary article reprinted from the September 2014 issue of Mealey's International Arbitration Report

LexisNexis®

Commentary

A Modern Twist On A Charter Party Contract "Approvals" Clause

By
Timothy Semenoro
and
Robert E. O'Connor

[Editor's Note: Timothy Semenoro is a partner in Montgomery McCracken's Maritime and Transportation practice group in the firm's New York office. Prior to joining Montgomery McCracken, he was a naval architect and engineer. Timothy may be reached at tsemenoro@mmwr.com. Robert E. O'Connor is an associate in Montgomery McCracken's Maritime and Transportation group in the firm's New York office. Robert may be reached at roconnor@mmwr.com. Timothy and Robert have both arbitrated maritime disputes before the Society of Maritime Arbitrators. Any commentary or opinions do not reflect the opinions of Montgomery McCracken Walker & Rhoads or Mealey Publications. *Responses are welcome.]*

Introduction

The Oil Companies International Marine Forum ("OCIMF") is an association of oil companies that formed in response to growing concerns about marine pollution.[1] The OCIMF is recognized as the "voice of the oil industry" with respect to the safe transportation of oils at sea and on land.[2] Its 96-company membership includes all of the Oil Majors, i.e., BP, Chevron, ExxonMobile, etc.[3]

The OCIMF's Ship Inspection Report ("SIRE") program was launched in 1993.[4] The SIRE database is accessible by registered companies, such as tanker charterers, vessel owners, and government authorities. The database contains vessel particulars, questionnaires, and inspection reports which allow registered companies and government authorities to assess a vessel's safety risk.[5] Each inspection report is prepared by an OCIMF-accredited inspector.[6] These reports include concerns raised by the inspector. In response, the vessel owner can post comments and address any discrepancies.

Traditionally, vessels were vetted prior to contracting for the carriage of petroleum cargoes. Each Oil Major would vet and approve a vessel using an in-house department or third-party contractor. If acceptable, the Oil Major would issue the vessel an approval letter.[7] Naturally, with so many parties independently vetting vessels and issuing subjective reviews would lead to inconsistent and, perhaps unfair, results.[8] This situation concerned vessel owners and charterers alike because these resulting approvals would predicate whether a vessel could be hired.

Over time, the SIRE program "gained industry-wide acceptance as a benchmark for vessel inspections and standards."[9] Within the last 12 months alone, there have been over 22,500 SIRE reports on over 8,000 vessels.[10] Accordingly, the SIRE program and database are extensively used in the context of tanker charter party contracts, so that charterers can determine if the vessel can be gainfully employed in advance of "fixing" a charter party contract.

The subject arbitration award involves a dispute between long-term business partners over the use of a vessel in the wake of the 2008 world financial crisis. In the end, the panel took a modern view of a classic "approvals" clause.

Dispute

Over the course of several years, Falcon Carrier Shipping, Ltd. ("Owner") and ST Shipping and Transport

Pte. Lte. ("Charterer") entered into a series of time and voyage charters for the use of the tanker vessel FALCON CARRIER.[11]

On May 15, 2008, the parties entered into a two-year time charter party, on a Shelltime (1984) 4 form, for the continued use of the FALCON CARRIER.[12] Just over ten days later, and prior to the Charterer taking delivery, the vessel was inspected by a BP SIRE inspector and rejected as unacceptable for use by the BP Group.[13] On May 28, 2008, Charterer gave the Owner a notice to cancel pursuant to charter party contract Clause 48.[14]

Clause 48, entitled "Approvals," stated:

> The vessel shall hold at least 3 (three) out of the following oil majors: Conoco / Chevtex / Exxonmobil / BP Amoco / Shell / Stat oil.
>
> Owners further warrant that they will exercise due diligence to maintain vessel approved by the oil company listed above. However, Charterers also recognize that oil company approvals are subject to the vessel's trading pattern, Charterers early notification of discharge ports and oil company vetting inspectors availability. If during the Charter any of the approvals will [b]e withdrawn or expired. Owners shall take necessary steps to rectify the faults and/or maintain acceptance.
>
> Should Owners fail to maintain at least 3 (three) approvals out of Conoco / Chevtex / Exxonmobil / BPAmoco / Shell / Statoil, Charterers to notify Owners and Owners to have 45 (forty five) days after notification or 3 (three) discharge ports, whichever occurs later, to rectify' same. If after such time vessel still fails to maintain at least 3 (three) oil companies approvals and that Charterers have made sufficiently early notifications of discharge ports and that oil company vetting inspectors have been available and that inspections have actually taken place, only then Charterers have the option to cancel the Charter Party by giving redelivery notice latest by 1700 hours London the first day after expiry of 45 (forty five) days or negative results of inspection at the third discharge port has arrived whichever later.[15]

Subsequently, the vessel continued to trade based on Charterer's orders and underwent two additional SIRE inspections on June 20, 2008 and September 5, 2008, both during the rectification period allowed under Clause 48.[16] The Owner contended that these inspections were favorable.[17] The Charterer disagreed and sent notices for cancellation of the charter party and redelivery of the vessel.[18] On September 15, 2008, the vessel was redelivered to the Owner.

Two days later, Charterer requested that the charter party contract be continued.[19] Owner agreed on the condition that the Charterer's re-delivery notice pursuant to Clause 48 was withdrawn and ignored.[20] Eleven days later, Charterer agreed that the redelivery notices could be considered withdrawn, but insisted that the May 28, 2008 cancellation notice remained in force.[21] The vessel continued to trade pursuant to Charterer's orders.[22]

After a third SIRE inspection was conducted on December 5, 2008, the vessel completed 5 additional voyages under the charter party contract before Charterer issued its second notice of cancellation and redelivery under Clause 48 on February of 2009.[23] The vessel was finally redelivered on March 3, 2009.[24]

At issue in this arbitration is whether Charterer's cancellation under the Approvals Clause (i.e., Clause 48) and redelivery of the vessel on March 3, 2009 were wrongful.[25]

Pursuant to the charter party's Arbitration Clause, the dispute was submitted to arbitration in New York, before the Society of Maritime Arbitrators, and U.S. law was applied.[26]

Liability

arbitration panel considered three issues: (1) whether Charterer's Clause 48 notice on May 28, 2008 was effectively withdrawn; (2) whether the Owner was in breach of the approvals requirement when Charterer gave its second notice of redelivery; and (3) whether the second redelivery notice was proper.[27]

1. The Effective Withdrawal Of The May 28, 2008 Clause 48 Notice

After Charterer issued the first cancellation notice on May 28, 2008, Charterer continued to make use

of the vessel under the charter party contract.[28] Specifically, Charterer sub-chartered the vessel to carry crude oil on a voyage from Tampico, Mexico to Mobile, Alabama, and gave the Owner corresponding orders for the vessel to sail for Tampico.[29]

The arbitration panel determined that Charterer's continued performance under the charter party contract implied to the Owner that the May 28th Clause 48 notice was withdrawn.[30] Moreover, the Owner agreed to perform the Tampico to Mobile voyage on the condition that Charterer's prior notices of cancellation and redelivery were withdrawn.[31] Since the Charterer waited 11 days to contest Owner's condition of waiver, the Owner's right to refuse the voyage instructions and retain commercial control of the vessel was "severely prejudiced."[32] Under these circumstances, the arbitration panel held that the May 28, 2008 Clause 48 notice was effectively withdrawn.[33]

2. Owner Was Not In Breach Of The Approvals Requirement At The Time Of The Second Redelivery Notice

Prior to certain high-profile oil pollution incidents in early 2000, Oil Majors inspected tankers, reported the results through the SIRE database, and also "issued pre-fixture blanket approval letters generally effective for six to twelve months."[34] However, after those incidents, the Oil Majors "refused to grant pre-fixture blanket approvals and now merely acknowledge on the SIRE database that the vessel had been inspected."[35]

This change in industry custom had a significant impact on the effect and meaning of the standard Approvals Clause found in tanker vessel charter party contracts. According to Owner, to comply with the Approvals Clause, "approval" meant having an oil major conduct a SIRE inspection, the resulting SIRE inspection report being posted in the OCIMF website along with Owner's comments, and the oil major having no further questions.[36] In contrast, Charterer contended that Owner must prove that three oil majors actually approved the vessel for specific voyages.[37]

Despite the fact that Clause 48 requires the vessel to be "approved" by at least three Oil Majors at all times, the parties agreed that Oil Majors no longer issues such approvals.[38] The arbitration panel acknowledged that a strong argument could be made to consider Clause 48 null and void because it created a condition was due to current industry practices was impossible to meet.[39] However, as the acceptance of a vessel to carry cargo significantly impacts its ability to be marketable, the arbitration panel opted to provide a reasonable construction of the clause in light of industry practice.[40]

First, the arbitration panel noted that the terms of the Approvals Clause allows Owner an opportunity to rectify the faults before the vessel can be redelivered by the Charterer.[41] Second, the Approvals Clause does not mention actual acceptance of the vessel for a specific voyage.[42] Third, Charterer's interpretation of the Approvals Clause places too heavy of a burden on Owner since Charterer controls the vessel's employment and tendering of the vessel to an oil major for the performance of a specific voyage.[43]

As to the facts of this case, during the rectification period, two Oil Majors posted inspection reports on the SIRE database, to which Owner responded, and in each case the respective Oil Majors advised that no further information was required.[44] In fact, each Oil Major commented that, in the absence of any changes to the vessel, no further SIRE inspections would be required for six months.[45] This, reasoned the arbitration panel, was sufficient evidence that the two Oil Majors found the vessel generally acceptable.[46]

Nonetheless, the arbitration panel noted that, even with successful SIRE inspections, vessels might still be rejected by Oil Majors for specific voyages.[47] For example, an Oil Major might reject a vessel for a specific voyage, despite a successful SIRE inspection, because the voyage would require the vessel to sail within an environmentally sensitive area where higher safety standards apply.[48] Such an occurrence still would not necessarily mean that Owner was in breach of the Approvals Clause. In order to show that Owner was in breach of the Approvals Clause, Charterer would have to show that the oil majors would not accept the vessel for "any" voyage without an additional SIRE inspection.[49]

Given the successful SIRE inspections during the rectification period, the arbitration panel found that Owner did not breach the Approvals Clause.[50]

3. The Second Notice Of Redelivery In February 2009 Was Improper

The arbitration panel acknowledged that, since Oil Majors no longer issue approvals, one of the triggering elements in Clause 48 could not occur.[51] Regardless, this issue was rendered moot because the arbitration panel found that Owner did not breach the Approvals Clause.[52] Therefore, even under a modern view of the vetting process, the FALCON CARRIER was acceptable to at least three Oil Majors, so the Charterer's second notice of redelivery was improper.

The arbitration panel went on to clarify that even assuming, arguendo, that the vessel has only two approvals at the time, "the time for giving the notice of redelivery would be measured from the time the vessel either failed a SIRE inspection or an approval lapsed because of the passage of time from the date of the relevant SIRE inspection."[53]

Damages

Since the Charterer breached the charter party contract by redelivering the vessel prematurely, the Charterer was responsible for the charter hire for the balance of the charter party contract duration – from March 3, 2009, when the vessel was redelivered, until April 26, 2010, when the charter party naturally concluded.[54] In this period, the Owner was able to find other employment for the vessel under three other charter parties and, during an off-hire period, vessel underwent repairs.[55] More critically and contrary to the Charterer's position, the arbitration panel found that Owner's mitigation efforts were reasonable since Owner was faced with a depressed shipping market.[56] Accordingly, the arbitration panel awarded Owner the hire lost, less the three mitigation voyages, less the off-hire period, plus interest, plus the Owner's attorney's fees, and plus the arbitration costs and fees.[57]

Conclusion

Despite the fact that the Approvals Clause did not reflect the current industry practice, the arbitration panel rationalized an interpretation that gave meaning to its terms. The equitable result kept the Charterer from distorting the language of its own boilerplate clause in order to prematurely discharge a contract in the face of tough commercial times.

In short, Approvals Clauses will only make sense if the parties accept the current practice of vetting vessels by Oil Majors and update them to reflect the modern method of using SIRE inspections.

Endnotes

1. http://www.ocimf.com/Organisation/Introduction.
2. http://www.ocimf.com/Organisation/Introduction.
3. http://www.ocimf.com/Organisation/Members.
4. http://www.ocimf.com/SIRE/Introduction.
5. http://www.ocimf.com/mf.ashx?ID=b6bf5b19-b09c-4f4f-aa03-1a8650eeae06.
6. http://www.ocimf.com/mf.ashx?ID=b6bf5b19-b09c-4f4f-aa03-1a8650eeae06.
7. In the Matter of the Arbitration Between Falcon Carrier Shipping, Ltd. and ST Shipping and Transport, Pte. Ltd., S.M.A. No. 4217, 1999 WL 34976641, *5 (Arb. at N.Y. Sept. 20, 2013).
8. Id.
9. http://www.ocimf.com/mf.ashx?ID=b6bf5b19-b09c-4f4f-aa03-1a8650eeae06.
10. http://www.ocimf.com/SIRE/Introduction.
11. In the Matter of the Arbitration Between Falcon Carrier Shipping, Ltd. and ST Shipping and Transport, Pte. Ltd., S.M.A. No. 4217, 2013 WL 5409218, *1 (Arb. at N.Y. Sept. 20, 2013).
12. Id.
13. Id.
14. Id.
15. Id. at *2.
16. Id. at *1.
17. Id.

18. Id.
19. Id.
20. Id.
21. Id.
22. Id. at *1-2.
23. Id.
24. Id. at *2.
25. Id.
26. Id.
27. Id. at *6.
28. Id. at *1-2, 6.
29. Id. at *6.
30. Id.
31. Id.
32. Id.
33. Id. at *6-7.
34. Id. at *5.
35. Id.
36. Id. at *7.
37. Id.
38. Id. at *6.
39. Id. at *8.
40. Id.
41. Id. at *7-9.
42. Id.
43. Id.
44. Id. at *7.
45. Id.
46. Id.
47. Id.
48. Id. at *8.
49. Id. at *8-9.
50. Id. at *9.
51. Id.
52. Id.
53. Id. at *10.
54. Id.
55. Id.
56. Id. at *10-11.
57. Id. at *11-13. ■

MEALEY'S: INTERNATIONAL ARBITRATION REPORT
edited by Lisa Schaeffer
The Report is produced monthly by

1600 John F. Kennedy Blvd., Suite 1655, Philadelphia, PA 19103, USA
Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1089-2397