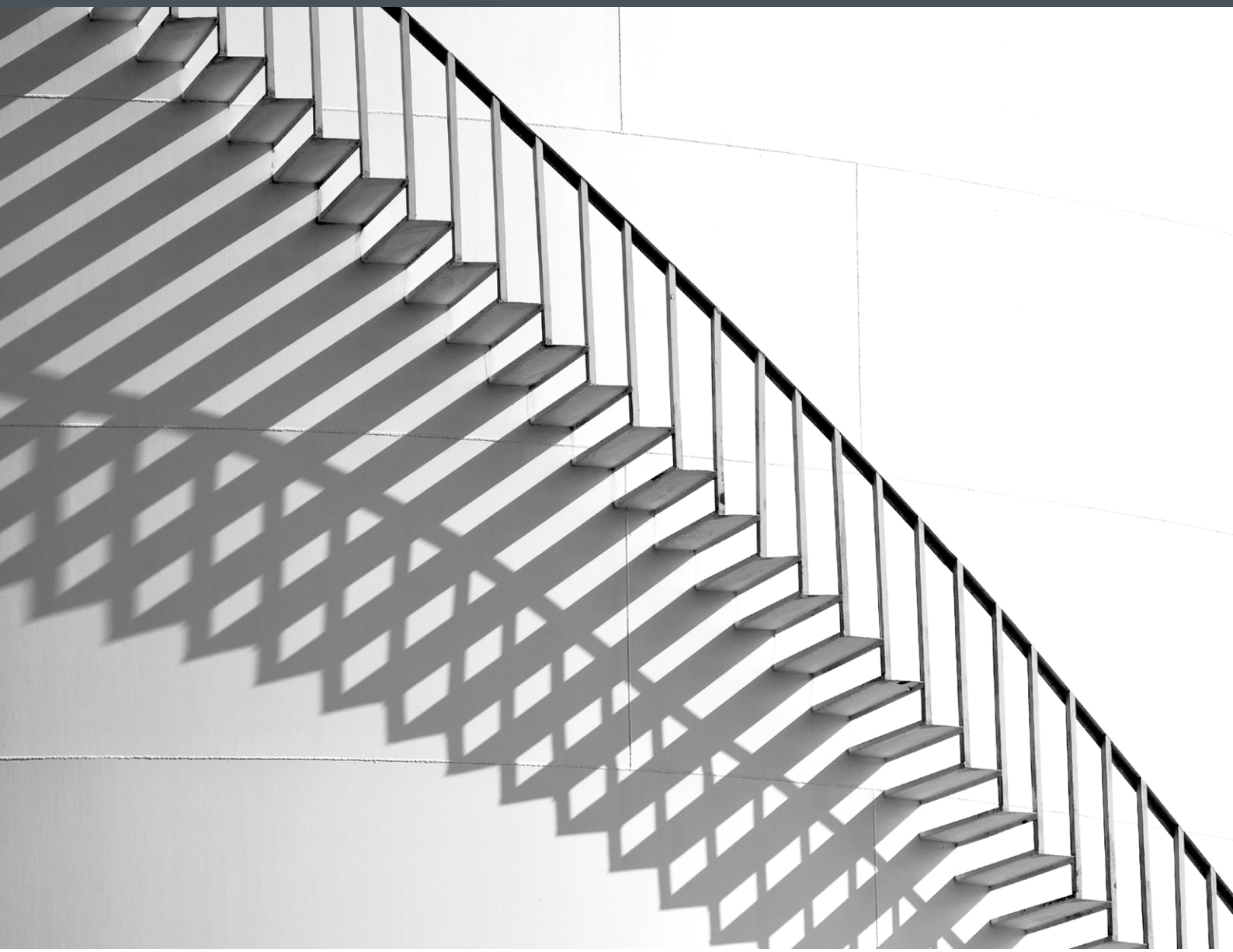

COMMODITIES: COMMON ISSUES IN OIL TRADING CONTRACTS – DEMURRAGE IN SALES CONTRACTS

This is the third in our series looking at common problems which can arise in oil trading contracts. In a previous article, we looked at issues arising from the use of the term "laycan" in sale contracts. Here, we consider why and how demurrage clauses are included in sale contracts and what effect they have.

"English law will not imply terms regarding laytime and demurrage into a contract, so express written terms must be included if the parties want this option."

Why is a demurrage clause needed in a sale contract?

A demurrage clause in a charterparty is a means by which the parties agree upfront what the charterer will pay to the owner if laytime - the time allowed for loading and unloading the cargo - is exceeded.

If the charterer is also a buyer or seller under a sale contract, it will not have full control over how much time is spent in loading and discharge. It may therefore find itself with a demurrage liability under the charterparty that it wants to pass onto its counterparty under the sale contract, because the counterparty was the cause of the delay. In order to achieve this, demurrage provisions are often included in sale contracts.

However, a sale contract is very different from a charterparty in terms of rights and obligations. This can lead to confusion as to whether or how much demurrage is due, where the delay is not simply to the vessel, but in giving or taking delivery of goods. For example, what if the vessel arrives before (or after) the agreed time for delivery; what if no letter of credit ("L/C") is opened on time; what if an FOB buyer fails to nominate a vessel, or give the ETAs required under the sale contract?

Is an express term required in order to claim demurrage?

Yes: English law will not imply terms regarding laytime and demurrage into a contract, so express written terms must be included if the parties want this option.

Can I just incorporate the charterparty provisions?

There are risks associated with just incorporating charterparty provisions:

- You may not know what the charterparty terms are, especially if it has not yet been agreed.
- It will not work if you have a time charter, since time charters do not include demurrage provisions.[1]
- It may give a false sense of security that you are "back-to-back" when you are not. The obligations in the sale contract will override those in the charterparty. For example, if payment under the sale contract is by L/C, and that L/C is not opened, the seller will have no obligation to deliver and laytime cannot start to run[2].
- As the seller, you may want time to start running (or end) at a particular time or date – for example, the beginning of the delivery date range ("DDR").
- Importing the charterparty laytime and demurrage regime into the sale contract will incorporate all rules of interpretation, including the rule that demurrage is the sole remedy for delay[3]. This is restrictive, in that demurrage then becomes the only remedy available for breach of loading rate or laytime. You will only be able to claim damages in addition to demurrage if you can prove a separate breach of contract, for example, a failure to deliver within the DDR.

Case study: *"Demurrage as per charterparty"*

In *OK Petroleum v Vitol*[4], the English Commercial Court considered what terms would be incorporated into a sale contract which stated that demurrage was "*as per charterparty*" and laytime "*36 hours + 6 hours SHINC*." As is not uncommon in the sale of goods, the charterparty was not drawn up until after the sale contract had been signed. The Court made the following findings:

- The term had the effect of incorporating "*the provisions in the charterparty specifying the rate of demurrage and those clauses going to the calculation of demurrage*" (not laytime), if not in conflict with express terms of sale contract.

1 Malozzi v Carapelli [1976] 1 LLR 407.

2 Kronos Worldwide Ltd v Sempra Oil Trading SARL [2004] EWCA Civ 03.

3 See Bonde, Richco v Toepfer [1991] 1 LLR 136. The Claimant could not recover back carrying charges, (additional storage costs at the loadport) which it had had to pay.

4 OK Petroleum v Vitol [1995] 2 Lloyd's Rep 160.

- It did not incorporate "ancillary" or collateral provisions, such as the arbitration, jurisdiction and time bar clause. A specific incorporating provision was required for that.
- Such general terms of incorporation will only incorporate provisions which are "*germane and relevant*" to the contractual rights and obligations arising under the sale contract.

Can you recover demurrage under a sale contract even if you have not paid demurrage under the charterparty?

In *Fal Oil v Petronas*[5], the Court was asked to decide whether Fal Oil (as shipper under the charterparty and seller under the sale contract) could claim demurrage from Petronas (the buyer) under the sale contract even though no demurrage was due from Fal Oil under the corresponding charterparty.

At first instance, the English Commercial Court held that the obligation to pay demurrage operated as an indemnity, so that Fal Oil could not claim from Petronas. On appeal, the Court of Appeal held that it was not an indemnity and that the provisions in the sale contract operated as an independent code. It found that each case will depend on the language of the provision. If there is reference to a charterparty in the sale contract, then the nature, purpose and effect of that reference is critical.

This matters because if demurrage is not an indemnity:

- you can make a profit from demurrage.
- you cannot demand to see the owners' claim from your counterparty.
- clear words must be used if you want your demurrage clause to operate as an indemnity.

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5 [2003] EWCH 2225 (Comm).

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