TERMINATION OF CONTRACTS, WHETHER THE ECONOMY CAN CREATE A FORCE MAJEURE SOLUTION, ENFORCEMENT OF CONTRACTS, COLLECTION OF FHREIGHTS AND RELATED ISSUES

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I. The Termination of Contracts under Chilean Law

1. Introduction

Over the past two years, we have witnessed how the world has been hit by one of the worst economic crisis since the big depression. A lot has been written about the origins of this crisis and how most of us failed spectacularly to see it coming. We are being judged now by the way in which we have reacted to the events that have unfolded over the past months. However the real test is, in my view, how well prepare we were to face the heavy weather we have been navigating.

As lawyers we have a duty towards our clients to hope for the best, but plan for the worst. But even when we have done everything we could to secure the rights of our clients, we may face situations where obtaining the fulfillment of the obligations of our counterparties may be difficult.

Under the current economic situation, what alternatives do we have to obtain the fulfillment of the obligations under a contract? Is the current economic climate a force majeure event that can provide a way out of the contract?

I will attempt to answer these questions in light of Chilean law, both from a general perspective and from a perspective specific to Maritime Law.

2. Legal Framework

The main regulations in respect to contracts are contained in the Chilean Civil Code, which in the absence of an express regulation or agreement between the parties will provide the general rules to apply. However, more specific contracts may be regulated by other codes, laws or international treaties as we will see later[1].

3. Termination of a Contract under Chilean Law.

Under Chilean law a contract may terminate for two reasons. First, by its natural extinction, that is to say, when all the obligations created by the contract have been fulfilled by the

[1] Chile is a signatory state of the "Hamburg Rules" which are applicable to certain contracts for the carriage of goods by sea.

parties. Secondly, a contract may terminate by *dissolution*, where the contract ceases to produce its normal effects.

There are different reasons for the *dissolution* of a contract, however we will focus on the dissolution due to impossibility on the execution.

3.1 Impossibility

Impossibility can be defined as "a way to extinguish an obligation when due to an event which cannot be attributable to the debtor, he is in no position to fulfill his obligations"[2].

From the definition of impossibility we can extract its requirements. First, the impossibility must occur after the birth of the obligation. Secondly, the impossibility must be absolute. Thirdly, the source of the impossibility must be an event which cannot be attributable to the debtor. We will focus on the latter requirement.

3.1.1 Event not attributable to the debtor. The Force Majeure Solution.

If an event is caused by the negligence or the willful misconduct of the debtor, then it will not give rise to impossibility and he is still obliged to indemnify damages to the counterparty. However, it is not enough with the absence of negligence or willful misconduct, the event that creates the impossibility must be attributable to force majeure.

According to article 45 of the Civil Code force majeure is the "unforeseen event impossible to resist". Hence, its elements are as follows:

- The event must be beyond the control of the debtor. But not only that, the force majeure event must not have occurred during the arrear of the debtor, in which case there is no force majeure.

- The event must be unforeseen, which means that the parties have not been able to foreseen the event at the time of entering into the contract, nor the debtor at the time of the occurrence of the event. In this respect The Chilean Supreme Court has ruled that an event is unforeseen when there is no particular reason to believe that could take place and no one under the same circumstances could have avoid its consequences.

- The event must be impossible to resist. This impossibility must be absolute; no one in the same circumstances could have stopped it from happening.

3.1.2. Determination of the Force Majeure

Force majeure is a matter of fact; what may constitute force majeure in one case and place may not be the same in another. Hence while the law can only provide general rules it would be for the courts to decide what is and what is not force majeure.

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[2] As a consequence of the extinction of the obligation any guaranty or privilege over the obligation will come to an end as well.

In light of the above, can the current economic environment constitute a force majeure event?

It is hard to imagine that Chilean courts would accept the current economic situation as an event of force majeure. It has been accepted that the sale of goods which currently the seller does not own but he expects to own in order to comply with his obligations, do not constitute force majeure if he fails to find those goods in the market, the seller should have foreseen that situation.

Likewise, if what is owed is a sum of money the argument that the current market conditions would constitute a force majeure event which prevents the debtor from paying said sum is likely to be rejected by Chilean courts. Most considerations for this rejection are based on public policy arguments. Sustain the opposite will open the flood gates to defenses based on economic conditions as a force majeure argument, creating great uncertainty among parties.

Even if an obligation can be only fulfilled through greater expense, this will not be considered as a force majeure event. However, this last situation may fall within what has been called by the doctrine as the Theory of the Unforeseen.

3.2 Theory of the Unforeseen

This theory has been defined as "the faculty of the debtor to request the termination or revision of the contract when an unforeseen circumstance, alien to the will of the parties, has transformed his obligation in an onerous one".

The requirements of this theory are the following:

i) The contract must not be of instant execution, therefore a sale of goods would be excluded, but not a lease and for extension a time charter if payments are made on regular basis;
ii) Unforeseen event; and
iii) The fulfillment of the obligation is too onerous for the debtor.

Regarding the effects of this theory there is no unique answer. While some have argued that the effects should be the same as in the case of force majeure; others have proposed that the judge is authorized to postpone temporarily the fulfillment of the contract while the circumstance that give rise to the unforeseen event subsist.

While not of general application under Chilean law there are some pieces of legislation that have accepted, with limited effects, this theory. The most accepted view is that this theory is not of general application to contracts governed by Chilean law and cannot be used as a valid defense in case of a breach of a contract beyond the cases specially recognized by law.

4. Breach of a Contract, What to Do?

Now we know that a Force Majeure defense based on the current economic climate is unlikely to be accepted by Chilean courts, we will look at the alternatives a claimant has in order to obtain the fulfillment of the obligations of his counterparty.

According to the Chilean Civil Code and the Civil Procedure Code, two remedies are available in case of a breach of a contract:

i) Forced execution of the contract; and
ii) Damages

4.1 Forced Execution

The requirements to obtain the forced execution of a contract under Chilean law are the following:

i) Executive Title. An executive title is a document which constitutes an undoubted evidence of a right as listed by the Chilean Procedural Code. This is a point of the utmost relevance. If the creditor does not have an executive title then he will have to go through a lengthy process to obtain, in the first place, the recognition of his right and for then claim under an abbreviate proceeding. Therefore, it is always advisable to obtain the relevant documentation that proves the creditor's rights beforehand (e.g. a credit evidence by public deed, a promissory note, etc.).

ii) The execution must be possible. If the subject matter of the contract has been destroyed there is not purpose in requesting the forced execution of the contract, however there is still a possibility to claim damages.

iii) The quantum of the debt must be known and the debt must be due at the time of the claim.

iv) The executive title must not be time barred.

If all these requirements are fulfilled then an abbreviate process know as "executive proceeding" can be filed with the benefit that a decision can be reached in a shorter period of time.

4.2 Damages

The second alternative the claimant has, in case of a beach of a contract, is to claim damages; these can be of two types:
i) Compensatory Damages; and
ii) Damages for Arrear

4.2.1 Compensatory Damages

This is a sum of money which represents that which the creditor would have obtained had the obligation been fulfilled.

In order to claim compensatory damages the claimant has to prove one of the following:

i) Breach of the obligation must be total and definitive; or
ii) Fulfillment of the obligation is just partial.

The general interpretation of the rules regarding damages, is that the creditor is prevented from claiming compensatory damages if the forced execution of the contract is still possible.

4.2.2 Damages for Arrear

The requirements to claim damages in case of arrear are the following:

i) Breach of the obligation;
ii) Damages;
iii) Causal relation between breach and damages;
iv) There must be negligence or willful misconduct of the debtor;
v) Absence of an exclusion of liability (e.g. force majeure); and
vi) Arrear

It is for the claimant to prove all these requirements except for the exclusion of liability, whose onus belongs to the defendant. In this case the claimant is allowed to claim damages for the arrear in addition to claiming the forced execution of the contract.

However, as we all know, waiting for the court to reach a decision might be a long and dangerous process. For instance, there might not be enough assets over which exercised our declared rights to damages. With this in mind, Chilean law has developed a set of measures which may prevent this from happening. These measures are known as “Pre-Judicial Measures” and “Precautionary Measures”.

4.3 Pre-Judicial Measures and Precautionary Measures

Pre-Judicial Measures can be exercised either by the claimant or the defendant and their main purpose is to gather evidence previous to the commencement of the proceedings. Examples of these measures are:

- Exhibition of private or public documents
- Exhibition of accounting books
- Recognition of a signature on a private document

On the other hand, Precautionary Measures can only be exercised by the claimant and their purpose is to secure the results of a claim and they can be exercised at any stage of the proceeding and at any instance. Among these measures we can find the following:

- Retention of defendant's property
- Prohibition to celebrate contracts over specific goods

Given the seriousness of these precautionary measures, the claimant must attach antecedents that constitute presumption of the right that he is claiming. Furthermore the court may order the claimant to produce a guarantee to answer for the results of the proceedings.

While the remedies and measures I have summarized above are of general application and will be heard by an ordinary civil court, Chilean law has contemplated specific solutions for maritime disputes which I will comment in the following chapters.

II. Maritime Disputes under Chilean Law

1. General Aspects

There are two aspects that make the resolution of a maritime dispute in accordance to Chilean law convenient. First, every maritime dispute will be heard by an arbitrator and, secondly, the range of evidence accepted by the court is very wide[3].

Article 1.203 of the Chilean Commerce Code establishes the general principle that the resolution of any maritime dispute, including those relating to marine insurance, is subject to mandatory arbitration.

2. Appointment of Arbitrators

The key principle is that the applicable rules are those to which the parties have agreed in writing. If the parties reach no agreement the matter is subject to the rules set out by the Tribunal Code and the Civil Procedure Code.

Under Chilean law there are three types of arbitrator:

- arbitrators at law;
- arbitrators *ex aequo et bono* (friendly mediators); and
- mixed arbitrators.

[3] In certain cases the ordinary civil courts may hear maritime disputes, including: i) if the parties mutually agree to this (either by including it in the contract from which the dispute originates or by prior written agreement); ii) if a criminal action could arise from the same facts (in this case the civil action can be filed before either the criminal court or an arbitrator); iii) claims relating to oil pollution according to the Navigation Law; iv) claims in which the state harbour or customs agencies are involved; and claims in which the amount at stake is less than 5,000 units of account (the special drawing right as defined by the International Monetary Fund), provided that the claimant submits its claim before the ordinary courts.

Arbitrators at law are arbitrators who must render a judgment in accordance with the positive law. In addition, the procedure through which the matter is resolved must be in accordance with the law that would be applicable to the claim had it been brought before the courts.

Arbitrators *aequo et bono* are arbitrators who are authorized to resolve a conflict in accordance with what they deem to be prudent and equitable. With respect to the judgment and procedure, these arbitrators must submit themselves to the procedures agreed by the parties that appointed them.

Finally, mixed arbitrators must render a judgment according to the positive law, but they may abide by the rules agreed upon by the parties.

2.1. Competence of the Arbitrator

The maritime provisions of the Commerce Code confer competence on the court of the location where the facts originating the dispute occurred or where the vessel is berthed or is arrested. However the parties are free to establish the arbitration tribunal in either the same place or a different place, provided that in the latter case they agree to do so in writing.

In Chile, contracts for the carriage of goods by sea are subject to the Hamburg Rules and domestic regulations contained in the Commerce Code. For these contracts there are special regulations to institute arbitration proceedings and the claimant can institute the proceedings in different places[4].

According to the Commerce Code, arbitrators have ample freedom to admit any evidence they may deem relevant; they can play a proactive role for the avoidance of delays within the trial; and they have the faculty to consider the evidence under the *reglas de la sana crítica*, which are special rules allowing the arbitrator to asses the evidence according to his or her own criteria.

3. Collection of Freight. Arrest of Vessel

As we mentioned earlier, Chilean law provides different alternatives in order to secure the result of an action. In this regard, the arrest of a vessel is recognized as one of the most useful tools to obtain fulfillment of an obligation in case of breach. For instance, if we are trying to collect the freight that is owed to us, how do we get a vessel arrested?

The first thing to note when arresting a vessel in Chile is that it can be requested before the commencement the proceedings or it can be requested during the proceedings. However, in order to be able to arrest a vessel it is essential to have a credit which entitles the claimant to do so.

[4] These places are the defendant's principal place of business or habitual residence; the place where the contract was made, provided that the defendant has there a place of business, branch or agency through which the contract was concluded; the port of loading or the port of discharge; or any place designated for the purpose of the arbitration in the arbitration clause.

The arresting party may resort to the civil court sitting in the place where the vessel is located or to the competent civil court sitting according to the rules provided by Book III of the Commerce Code to request an arrest against such vessel setting sail from the port or place where she is located.

3.1 Privileged Credits

Under Chilean Law a vessel may be arrested if the requesting party has a credit that entitles to do so. These credits may be of two types, namely:

(a) Privileged credits as set forth by articles 844, 845 and 846 of the Chilean Commerce Code; and
(b) Credits other than those mentioned in (a) above.

The number of credits established by the Commerce Code is fairly extensive; therefore we will focus on those credits established under article 846, namely;

1º Credits in respect of the sale price, construction, repair and equipping of the vessel;

2º Credits in respect of supply of products or materials, which are indispensable for the trading or conservation of the vessel;

3º Credits arising from contracts of passage money, affreightment or carriage of goods, including the indemnities for damages, lack and short deliveries in cargo and luggage, and the credits deriving from damages in respect to contamination or the spilling of hydrocarbons or other contaminating substances;

4º Credits in respect of disbursements incurred by the Master, agents or third parties, for account of the owner, for the purpose of trading the vessel, including agency service; and

5º Credits in respect of insurance premiums concerning the vessel, be they hull, machinery or third party liability.

3.2 Requirements to Arrest a Vessel

3.2.1 Arrest Based on a Privilege Credit

In this case the arrest is subject to the following preconditions:

a) The arresting party must invoke one or more of the privileged credits enumerated above[5]. The maritime privileges also confer upon the creditor the right to pursue the vessel in whosoever possession she may be.

[5] This refers not only to the privileged credits of article 846, but privileged credits according to articles 844 and 845 of the Commerce Code.

b) The arresting party must attach antecedents that constitute presumption of the right being claimed. If the court estimates that the antecedents attached are not sufficient (court's discretionary faculty) or the petitioner states they are not yet available to him, the court may require that counter security be provided for the eventual damages that may be caused if, subsequently, it is found that the petition lacked basis.

3.2.2 Arrest Based on Other Credits

An arrest requested by invoking a credit other than privileged ones is subject to the general rules set forth by the Code of Civil Procedure regarding pre-judicial and precautionary measures which we saw earlier.

If the arrest is requested as a pre-judicial precautionary measure, i.e. a measure to secure the results of the exercise of the upcoming action against the debtor, the measure to be requested is the "prohibition from sailing"[6], which is subject to the following preconditions:

(a) existence of qualified and serious grounds for requesting the measure;
(b) the value of the vessel upon which the precautionary measure falls must be determined, and
(c) security deemed as satisfactory by the court to cover the damages which may come up or fines which may be levied must be granted.

In this respect it is worthy to note that, when dealing with serious and urgent cases, the court may grant the measure without the required supporting documentation, for a term not longer than 10 days, until such documentation is submitted. In such a case the court must necessarily require counter security.

Having said the above, under Chilean practice it is unusual to request an arrest in accordance to the general rules of the Code of Civil Procedure as it faces more technicalities than an arrest based on the special system established by the Code of Commerce for privileged credits.

3.3 Form of application

Arrest of a vessel is commenced by filing an arrest petition at the civil court sitting at the place where the vessel is located or is expected. The complaint which initiates the proceedings must comply with the following requirements:

(1) Compliance with all formal requirements related to the presentation of a suit as per Chilean general procedural regulations[7].

[6] The "prohibition from sailing" may be also requested as a precautionary measure together with filing the principal action itself. In this case to obtain the measure it is necessary that either the defendant's wealth do not provides enough guarantee or that there are grounds to consider that he will try to conceal his assets. In addition, the claimant must provide supporting documentation to evidence at least a serious presumption of the right being claimed and counter security if requested by the court (discretionary faculty).

(2*)* In case of arrest based on privileged credits, when the arrest is requested as a preliminary precautionary measure, the petitioner must indicate the substantive action he intends to file later on and briefly state his grounds for such action. If the action concerns the collection of some pecuniary service, the petitioner must indicate the amount and form of guarantee he considers sufficient to secure the outcome of the action.

(3) As pointed out above, in case of arrest based on privileged credits, the arresting party must attach antecedents that constitute presumption of the right being claimed and eventually counter-security.

3.4 Proceedings Subsequent to the Arrest

In case of an arrest based on a privileged credit and provided that the conditions mentioned above are met, the court must accede to the petition without any formality. In doing so, the court must analyze quickly the antecedents submitted, granting the petition without hearings or service of the arrest order to the affected party. The court's analysis for granting an arrest usually takes from few hours up to one day. However, if the arrest is petitioned with occasion of a credit other than a privileged one and under the general rules of the Civil Procedural Code, which is seldom, the corresponding granting may take several days due to several procedural technicalities that are necessary to follow.

Having said that, in case of arrest based on privileged credits the person who establishes the guarantee or is affected by it may at any time request, for good reasons, that the guarantee be modified, reduced or lifted[8].

As soon as the requested guarantee has been given, the court must lift the arrest without further proceedings. It shall proceed in the same manner should the parties be in agreement on such matters. The court may also decide upon the sufficiency of the guarantee that the respondent offers. In this respect, there are no specific rules so a court may have ordered that a cheque be made, but, finally, may instead accept a deposit, bank guarantee or otherwise. P&I club letters of undertaking are accepted only if agreed by the parties. In all cases, the guarantee may not exceed the value of the detained vessel.

3.5 Enforcement of the Arrest Order

The arrest or retention of a vessel is carried out by service to the maritime authority in the place where the vessel is, or by official letter or notification to the Director General of the Maritime Territory and the Merchant Marine, should the vessel not be within the jurisdiction of the court that decreed such measure. Previous service to the person against whom the measure is requested is not necessary.

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[7] These requirements are: (i) to specify the court; (ii) to identify the claimant, his representatives and the nature of such representation; (iii) to state the facts surrounding the case and the applicable laws, and (iv) to make precise and clear petitions for the court's decision.

[8] The procedures for lifting the arrest do not impair the right of the petitioner to later allege or enter the motions or defenses he sees fit.

In urgent cases, the court may communicate the arrest via telegram, telex or other reliable means. In the case of a preliminary proceeding, the person against whom the arrest is requested must also be notified within a period of 10 days counted from the resolution that granted such measure. This period may be extended by the court for good reason. The lack of service within the aforesaid period or the last of its extensions shall cause the automatic forfeiture of the decreed arrest, which is communicated by the court directly to the maritime authority.

4. Related Issues

There are some issues related to the arrest of a vessel according to Chilean law which are worthy to note, these are:

(a) the lien on the ship granted by a privileged credit can be exercised not only against the actual ship which the privileged credit relates but also on a ship in the same ownership or a ship in the same administration or operated by the same person;

(b) arrest can be executed on a chartered vessel as far as it is comprised in one of the alternatives pointed out in letter a) above. In this respect the privileged credits give the creditor the right to pursue the ship in whosesoever possession it may be, and pay himself with the proceeds thereof;

(c) bunkers can be arrest under Chilean law but in accordance to the general rules of the Civil Procedure Code, unless the creditor has a privilege credit as discussed above.

5. Final Comments

We have seen that even though the current economic environment can be described as exceptional in terms of the impact it has had over the global economy, it is hard to envisage that Chileans courts will be willing to accept this as a force majeure event that may provide a solution for the party in breach of a contract.

It is of the utmost relevance to be clear about the alternatives we have when our counterparty is in breach of the obligations imposed by the contract and in this regard Chilean law provides a clear and simple system to enforce the terms of a contract, specially when it comes to a maritime dispute.

However nothing replace a carefully drafting of a contract and where possible is always good to have evidence of the obligations of our counterparties; it is always better to be safe than sorry.