Yoshida & Partners

7th fl. Inamura bldg. 1-9-2 Nihonbashi-kayabacho,
Chuo-ku, Tokyo 103-0025, Japan
tel: +81-3-5695-4188 fax: +81-3-5695-4187
e-mail: tetsuro@japanlaw.co.jp

Termination of Contracts
whether the economy can create a force majeure solution;
enforcement of contracts, collection of freight, security and related issues

for International Shipping Law Seminar
at London on September 30, 2009
by Tetsuro Nakamura, Yoshida & Partners

1 Introduction

Briefly saying, Japan is not a country in favor of those who wish to terminate the contract due to change of the economy which either or both of the parties did not expect at the time of signing the contract. However, because of the recession started from the summer last year, my firm has various consulting cases regarding the termination of the marine contract, especially the time charter and the shipbuilding contract. Here, I try to describe the situations under Japanese laws by referring to some recent problems in the charter party and the shipbuilding contract, as well as guarantee therefor.

2 Principle

The situation or background the parties relied on at the time of contract may change during the period of contract. If enforcement of contract as is becomes unfair for the parties to contract, either party may terminate the contract or may demand to amend the terms of contract. This is so-called *clausula rebus sic stantibus* or *impediment theory*: the principle for case of the change of situation. Typical example is Article 79, para 1 of *Vienna Convention*, which is said to correspond to *frustration theory* in UK, *commercial impracticability* in US, *imprevision* in France and *Wegfall der Geschaftsgrundlage* in Germany.

There is no particular provision in statute in Japan, which provides in general for this principle. However, there are some statute which is considered as coming from this principle. For instance, Articles 11 and 32 of *Landlord & Tenant Law (Shakuchi Shakka Ho: Law No. 90 of 1991)* provides *inter alia* that either party to a landlord and tenant contract may demand to the other party to increase or

decrease the rental fees in case the rental fees becomes unreasonable in comparison with the rental fees of those nearby due to the change of economic conditions such as change of tax and other impositions on real estates and of the price of real estates. But this Law aims to protect tenants in Japan having so many people in small land, and could not extend its theory to the other commercial contract.

It is submitted that in order to apply the principle of *clausula rebus sic stantibus*, we need the following situations: -

(i) After the contract was made, there occurs radical change in the objective situations which were the premises for the contract;

(ii) Neither of the parties could foresee such change of the situations;

(iii) Such change of the situations has arisen not due to any of the parties; and

(iv) Enforcing the contract to the parties will be against fairness and sincerity between the parties.

What is "radical change in the objective situations". The scholars consider it such as extraordinary inflation after the war or the Act of God, and so do the practitioners. Such radical change would rarely happen. There is no Supreme Court case so far, which applied this principle for change of the situations.

It is further submitted that the parties to the contract shall make their attempts to keep the contract, and therefore the parties shall make attempts to amend the terms of the contract so as to fit them with the prevailing situations. From this theory, it is also submitted that the parties shall not unreasonably reject the negotiation for such a purpose, and if a party did so, that party shall be considered to be in breach of contract.

3 Increase/decrease of charter hire

In the late 90s, the charter hire was low in the market and kept low for a long period. The ship owners in Japan had considered at that time if there was any way to raise the hire in the negotiations with the charterers. The ship owners often borrow the theory of *clausula rebus sic stantibus* in their negotiation. As mentioned the above, the situations at that time was absolutely not those to apply the principle. However, the ship owners, though they were not obligated

to do so under the contract, sometimes fully disclosed their financial situations and some succeeded in raising the hire to keep their business. Some of the charter party was changed to raise the hire but narrowing the range of the hire in the next term. Sometimes, the ship owner could not succeed in raising the hire in its negotiations, and refer the dispute to the arbitration of Japan Shipping Exchange. JSE arbitration in this kind of cases reviewed the financial situations of the ship owner and the charterer, and in many cases, the arbitrator strongly recommended amicable settlement with increase of the charter hire. The arbitrators were also taking account of a long relationship between the parties by the charter party such as 5 to 10 years.

It is submitted that the contract with a long term shall be construed with consideration of the parties' relationship to be kept for a long time. For instance, even without provisions to be applied, a party could delay its performance if the other party has financial trouble and could not secure its performance in the future. Mutual reliance is in such cases considered as one of the essence for such kind of long term contract. However, in most of time charter cases, there are the other provisions to apply to a particular situation, while there is no provision to apply in a situation to terminate or revise contract, where the charterer has financial trouble or goes into bankruptcy, reorganization or other similar procedure. Instead, usual time charter terms obligate the ship owner to wait the charterer's failure to pay the hire. In 5 to 10 year time charter, usually it has a provision to fix the hire in each of several years, by which the above principle of *clausula rebus sic stantibus* or *impediment* would not apply to the situation.

Since the last fall, there were many discussions between the ship owners and the charterers in order to lower the hire. The initiative is of course on the charterers, and the ship owners are now often reviewing the financial status of the charterers at present and in the near future. Considerable number of ship owners, having faced recessions in the market, tried to make their business smaller. The quicker the better is their way of thought. Many charter parties, which already entered into but the ship is not yet built or delivered, was terminated with the charterer's lump sum settlement payment upon termination of the charter.

4. Shipbuilding contract

In the mid-2000s, the steel price jumped up and the ship builders had difficulties to obtain necessary volume of steel to build ships under their shipbuilding contract. Often, shipbuilders declared their delay in delivery. The situations however would not allow the principle to apply. But there were many discussions to raise the ship price or to delay the time for delivery. In many cases, discussions involved disclosure of financial situations and steel market, as well as the shipyard's schedule, and some reached to an agreement to revise the shipbuilding contract.

In shipbuilding contracts between Japanese shipbuilders and the ship owners, there is a provision to say, the parties shall mutually discuss with sincerity if there is any issue which is not provided in the contract, such a provision prompts the parties to have discussions, and very often they are taking account of their long term relationship which have already accrued or is expected to establish in the future, in order to consider a possible settlement. The standard form of building contract in Japan provides for the constructor's right to demand the increase of the construction fee in a situation where the construction fee becomes inappropriate due to change of laws, prices or employee salaries, which is similar to *BIMCO Wreckfix*, for instance. Also, the building contract sometimes has a provision to impose the parties to the contract duties to discuss the increase or decrease of the construction fee in case of change of law, prices or employee salaries. In the former form of contract, in case the parties could not reach to an agreement for a revised construction fees, Japanese courts would fix it, while the latter provision in the contract would not give the court discretion to decide an appropriate construction fee, and the court would dismiss the constructor's action to increase its fees in case the parties have failed to fix the revised construction fees. Sometimes, Japanese shipbuilding contracts have similar provisions, and Japanese courts would treat them as same as in the building construction contract.

Since the last autumn, many shipbuilders have fallen into troubles by the ship owner's cancellation of the contract. There is no right in most cases for the ship owner to cancel the contract. However, some ship owners went out of business or because of their financial difficulties could not help but cancel the contract.

The shipbuilders are facing difficulties to get quick recovery for their claim against such ship owners, and some shipbuilders, though still having good shipbuilding contracts with the other financially stable ship owners, applied for bankruptcy or reorganization proceedings. The bank's intention if they could continue financial support, such as by delaying the interest payment, is critical in this kind of cases. In the reorganization proceedings, the court or the trustee often press the banks and the creditors to revise their contracts to keep the shipbuilder alive in business. The process of the principle is being accomplished in that way.

5 Guarantee

A guarantor who guarantees performance of the charterer or the ship owner rely on the financial status of such principal debtor at the time of his guarantee. So is considered, Japanese courts often stop enforcing the guarantee against the guarantor in cases of a landlord and tenant contract and a guarantee letter for employee and ex-spouse. The courts try to make the scope of application of the conditions of the guarantee narrower so as to enable the guarantor to escape from the duties under the guarantee. However, the guarantee for the time charter, the shipbuilding contracts and the other most maritime contracts is commercial and is made by expectation that the guarantor will assume overall obligation for the principal's performance under the contract, and the guarantor has difficulties to be exempted from his liability under the guarantee.

6 Tentative conclusion

Due to short of time, I wish to close my speech, not referring to further cases which avoided to apply *clausula rebus sic stantibus* or *impediment theory* but apply the other provisions of the contract. Japanese courts and so we the practitioners, have avoided the theory as far as possible. Let's talk about a story of 'Kakkontoh':

Kakkontoh (葛根湯) is a traditional and long-used herbal medicine in Japan, consisting of arrowroot gruel, adding crude drugs like tree's wigs, grass roots, etc., all-mixed up. Old and junk doctors were giving patients Kakkontoh, every occation. Say, a patient has a headache, give Kakkontoh. S/he is catching a

cold, Kakkontoh! Hangover, Kakkontoh!! If you are pregnant... Congraturation! Have Kakkontoh!! Who are you? A hasband? waiting for your wife during my consultation? You must be bored. Have Kakkontoh!!! Fell down the stair from 2nd to 1st floor? 'Kakkontoh', and said, "why you did not take Kakkontoh before fell-down!" *Clausula rebus sic stantibus* shall never be Kakkontoh like this. We should not use it always, but depending on what and how you mix up crude drugs and when you use it, Kakkontoh will be a good medicine.

[End]

Yoshida & Partners
7th fl. Inamura bldg. 1-9-2 Nihonbashi-kayabacho,
Chuo-ku, Tokyo 103-0025, Japan
tel: +81-3-5695-4188 fax: +81-3-5695-4187
e-mail: tetsuro@japanlaw.co.jp

Arrest of Properties in Japan for the Ship Owner's Claims against the Charterers

for International Shipping Law Seminar
at London on September 30, 2009
by Tetsuro Nakamura, Yoshida & Partners

A Ship owner's claims against charterers

Major claims the ship owner may have against the charterer are unpaid hire. Under Japanese law, like the other continental law countries, the rights in properties, including maritime lien and possessory lien, shall be the one stipulated in the law. Thus, lien as provided in the contract such as the charter party or bill of lading could not be exercised in Japan as provided in the contract terms. Under Japanese law is no maritime lien for the ship owner's claim for unpaid hire on bunker or any other property of the charterer on board the ship. Neither does the ship owner has any lien for the same on the other property, such as sister ships, of the charterer not on board the ship.

If the property of the charterer, not limited to bunker or cargoes on board the ship is in custody of the ship owner, the ship owner has a possessory lien on such property. (Article 521[1] of *Commercial Code: Shoho; Law No. 48 of 1899*) Therefore, in case the sub-charterer owns the bunker, the ship owner could not enforce lien on bunker. However, the creditor has the right to enforce the debtor's right to a third party, if the debtor does not have sufficient fund to repay the debt and if the creditor's claim has close relevance to the debtor's claim (Article 423[2] of *Civil Code: Minpo; Law No. 89 of 1896*). The creditor thus could enforce lien on bunker if neither of the charterer and sub-charterer pays unpaid hire.

Enforcing lien here is similar to possessory lien under English law, and therefore,

[1] Article 521 of *Commercial Code* The creditor has any claim due arisen out of the commercial acts between and for the two commercial men, the creditor has the right to enforce lien on the property or the valuable paper which is owned by the debtor but in custody of the creditor due to its commercial act with the debtor until the creditor receives the payment of the claim, except in case where the parties agree otherwise.

[2] Article 423 of *Civil Code* The creditor, in order to preserve its claim, is entitled to enforce the rights belonged to the debtor....

not effective during the charter term, but only at the end of the charter where the charter is withdrawn or the charter term comes to the end. In real situations however, the charterer in most cases has claims against the ship owner for the bunker price at the end of the charter. If the ship owner also has the claims against the charterer, the ship owner could set off its claims against the charterer's claims for the price of the bunker, by which the ship owner could recover its claims partly or wholly.

Usually, the ship owner, due to ineffectiveness of arresting bunker, should look to the arrest of sister ship or the other property in the foreign countries, if the law of such a country grants the ship owner more effective rights to enforce their claims. Otherwise, in Japan, they have to look to the provisional attachment on the other properties of the charterers, unless the ship owner has obtained a final and conclusive judgment or award in a country, which ratified New York or Hague Conventions.

> *Civil Execution Law* (*Minji Shikko Ho: Law No. 4 of 1979*) sets forth sort of claims by which the claimant or the creditor could arrest a ship in way of enforced auction sales, which are claims based on, (i) a final and conclusive judgment, (ii) a judgment with effect of temporal execution[3], (iii) a Japanese court's final and conclusive judgment for enforcing a foreign judgment, (iv) a Japanese court's final and conclusive judgment for enforcing an arbitral award, (v) an agreement certified by the notary public for the claim to seek payment of money or its equivalent, which includes the debtor's covenants to accept the enforced auction sale of his asset immediately upon having the claimant's demand (Article 22)[4]

B Provisional attachment in general

To pursue provisional attachment, the claimant should prepare substantial amount (around 1/4 to 1/3 of the claim amount) of security for provisional attachment, and only limited types of security, such as cash or cash equivalent or Japanese bank or insurance company's guarantee in a special form, will be accepted by the court. There are no available bond company who could issue a guarantee acceptable to the court with a minor percentage of the commission, while, for instance, Korea has such

[3] Japanese judgment in most cases have a sentence upon the plaintiff's request to allow the winner plaintiff to enforce the judgment temporarily. To stop the enforcement based on such judgment, the defendant should appeal the case and make deposit of the amount equivalent to the amount awarded by the judgment.

[4] Article 22 sets forth the other claims which have also reached to the level equivalent to a final and conclusive judgment, but for my purpose here, I omitted them, since they rarely occur.

bond companies, who could issue a guarantee acceptable to the court.

You have to apply for provisional attachment, which procedures are provided in *Civil Preservation Law* (*Minji Hozen Ho: Law No. 91 of 1989*). Provisional attachment will be ordered by the court if without preserving the debtor's asset your monetary claim would become impossible or very difficult to enforce against the debtor's assets in the future. This requirement of impossibility or difficulty to enforce your claim on assets in the future could be satisfied easily in most of the charterer's claims. If provisional attachment of one asset would not satisfy your claim amount, you can attach another asset.

Targets of the provisional attachment maybe any of the charterer's properties, such as the real estates, movables, ships, automobiles, valuable properties, the claim against third parties (including the claim against the bank for its bank account).

In the attachment of movables, including bunker, the sheriff shall retain the attached property. The ship owner could not retain the bunker, nor use it. The ship owner shall prepare for the storage of the attached property, especially the one which the sheriff would have difficulties to hold, such as bunker, in some place where the sheriff could control easily. This attached property should be preserved until the judgment of the case, unless the charterer submit to the court the money to release the bunker, which the charterer would not do. If the attached property would deteriorate in its nature or significantly decrease its value during the sheriff's custody, the property could be sold by auction and its proceed will be held by the court.

The court will attach the real estate by registration of such provisional attachment on the register of the real estate. If there is any condition of the real estate, which need the preservation of the real estate, the court by its own or upon having the creditor's application will appoint the custodian to preserve the value of the real estate. The procedure is similar to those for the ship.

In case of the application for provisional attachment, if the judge finds the application in order, he will determine the amount of security, which the claimant should submit. The amount of the security is in a range between 1/4 to 1/3 of the claim amount, but if the asset's value is far more or less, compared with the claim

amount, the amount of the security would be adjusted. The court will have the discretion to decide the amount of security, depending on the merits of the case and the presented evidence. The security should be cash, cash equivalents such as the government bond, and the guarantee letter issued by Japanese banks, insurance companies, and the other admitted financial institutions. As the form of the guarantee provides for the strict liability of the guarantor, Japanese banks would not offer to be the guarantor with a commission base arrangement, but demand the cash deposit account without the right to withdraw until cancellation of the guarantee. Thus, sometimes, the cash deposit is easier and quicker to arrange. In exchange of submission of the security, the court will issue the provisional attachment order. The arrest procedure is the same as in case of enforced auction sales.

In order to release the asset from provisional attachment, the types of counter security acceptable to the court are same as in the security to be submitted in case of provisional attachment application; i.e. cash, cash equivalent and Japanese bank or insurance company's guarantee letter in a special form.

C Jurisdiction

Civil Procedure Law in its Article 5 has the venue provisions, by which the court having the venue where the security for the claim or the defendant's asset (ship) is located has the jurisdiction over the claim (Article 5(4)). Thus, for the claimant, it would be convenient to attach the asset, and at the same time to bring a suit against the defendant before the same court.

Besides a place of ship or security, the claimant could choose the court at a place where the defendant shall perform its duties (Article 5(1) of *Civil Procedure Law*); in both tort and contract claims mostly the defendant shall make payment at the claimant's business place, and thus the claimant could bring a suit at the court where his office is located. Article 5(5) of *Civil Procedure Law* provides for jurisdiction of the court at a place of defendant's business place or office. These option given to the claimant will be narrowed or excluded by the jurisdiction clause in the relevant contract, such as bill of lading, charter parties, salvage contract or by the parties' agreement after the incident, such as a typical jurisdiction agreement exchanged shortly after the collision.

In case of provisional attachment, if the claimant agrees to accept a separate security to be issued by the club, the underwriter or the bank, mostly with a jurisdiction agreement, the case of provisional attachment is finished. If not, the defendant has to submit cash as a counter security, and the ship will be released but the security will not be released until the completion of the case for the claim. The claimant, which succeeded in provisional attachment, shall bring a suit against the defendant without delay, and the defendant can prompt the claimant to do so. If he fails to do so, the court shall order the claimant to bring a suit against the defendant, and if he does not follow the order, the court will release the ship if not yet released or the cash as the counter security. The claimant can choose the court for his claim in accordance with the venue provisions in *Civil Procedure Law*. Even if there is no other factor to give the jurisdiction to some court in Japan over the claim in question, at least, the court where the provisional attachment was made has the jurisdiction because of the ship or the security there (Article 5(4) of *Civil Procedure Law*). The provisional attachment procedure does not include the auction procedure, and thus, the claimant at its disbursement shall pay the cost to preserve the asset until his action will reach to a judgment. By the judgment, the provisional attachment procedure will be replaced to the enforced auction sales procedure upon the claimant's application.

[End]