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Defence class cover

Liens on sub-freight

Introduction

Time charters commonly provide an owner with two rights of lien which they can use to enforce the right to payment of hire and other sums due under the charter. The first is a lien over cargo, which is covered in the club's publication: [Liens on Cargo](#). This article concerns the second, liens on sub-freight.

This type of lien gives an owner a contractual right to claim the cost of freight, or possibly (sub)hire, payable to their contractual charterer by sub-charterer(s) and offset it against the payment of hire or any other amounts otherwise due to them under the head/subject charter. There need to be suitable contractual provisions in the head/subject charter if an owner is to be entitled to exercise this right down the line.

Clause 18 of the NYPE 1946 form provides the owner with the right to exercise a lien over freight:

'That the Owners shall have a lien upon all cargoes, and all sub-freights for any amounts due under this Charter...'

Exercising a lien over sub-freight can constitute an invaluable remedy for an owner when a charterer defaults on a hire payment. It has been especially important to owners in recent years, due to the global financial crisis where insolvencies by a party in the contractual chain have become more common.

An owner's lien under the NYPE form can be exercised in respect of hire but also *'any amounts due under this charter'*. These include disbursements made by the owner which are properly the charterer's responsibility under the terms of the charterparty, for example, bunker payments which are ordinarily the charterer's responsibility under a time charter.

The nature of the lien on sub-freight

A lien on freight is a contractual right only, which is granted by the charterer to the owner either in a charterparty or a bill of lading. The nature of the lien on freight has been the subject of much discussion. Unlike a lien on cargo, a lien on freight is not a possessory lien, i.e. it is not a right to retain possession of something already in the owner's possession, but rather a right to intercept funds which are moving from a third party to the charterer.

Although its nature is subject to academic debate, it seems to be agreed that a lien on freight is an equitable assignment by the (time) charterer to the owner by way of security¹. This means that an owner needs to take certain steps in order to exercise its right to lien freight.

For example, in some jurisdictions, it will be necessary for the owner to register the lien on sub-freight in order to avoid it being considered void against a liquidator or other creditors. This is the position in England following the decision in the *The Uglad Trailer*² and *The Annangel Glory*³. As a result, an owner's lien on sub-freight as an equitable assignment must be registered as a charge under Section 680 of the Companies Act 2006 within 21 days of the charge being created for it to be valid against third parties⁴. This is particularly important when dealing with an insolvent charterer.

Exercising the right to lien

An owner exercises its lien by giving notice to the sub-charterer(s), shippers or other party that owes the freight which they are claiming. There is no special requirement regarding the form of the notice, as long as it brings the assignment to the attention of the party that owes the freight⁵. The club can assist with drafting suitable wordings.



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However, it must be remembered that the lien can only be exercised in respect of hire already accrued and due at the time that it is exercised, while the freight is still owing. Once the freight is paid, the lien is lost⁶. It will not always be known when freight is paid and sometimes an owner will have to send notices down the charterparty chain without knowing for certain whether the exercise of a lien will intercept any sub-freight.

The lien is not only lost when the freight is paid directly to the charterer, but also when it is paid to the agents appointed by the charterer to collect it. The timing of exercising the lien is, therefore, critical.

Once notice of the lien is given to the party who owes the freight, the only way they can discharge the freight debt is by paying the owner and not the charterer or sub-charterer(s). Until then, the freight debt remains outstanding. This places the party who has been served with a notice of lien in a dilemma, facing two claimants for the freight monies and not knowing which party to pay to avoid having to pay twice. The outcome of this scenario often entails tripartite negotiations to have the freight paid into escrow. However, in order for this to be effective, the agreement of all parties is required.

Does sub-freight also include sub-hire?

The question often arises as to whether a lien on sub-freight also includes sub-hire. This becomes particularly important in a long charterparty chain, where there may be time and voyage charters below the head/subject charter. Clause 18 of the NYPE 1946 form only refers to liens on sub-freight.

There are two conflicting decisions on this question. In *The Cebu*⁷ a wider interpretation to the words 'all sub-freights' was given and it was held that it also included sub-hire. However, in an identical dispute under the same chain of charterparties, *The Cebu* (No.2)⁸, the judge reached a different view and held that clause 18 of the NYPE form did not extend to sub-hire, on a strict reading of the (unamended) NYPE 1946 form.

Clause 23 of the NYPE 93 form adds the words 'and/or sub-hire' to 'all sub-freights' making this point expressly clear. The club therefore recommends that owner members include an express provision to that effect in the subject charterparty to avoid any uncertainty in the future.

Can an owner exercise a lien on freight that is owed to the sub-charterer or even sub-sub-charterer(s)?

In order to be able to do that, there must be back-to-back lien clauses in the charterparties down the line. This would, however, not be possible if the charters were on the Baltime form where the lien is limited to sub-freights 'belonging to the time-charterer'⁹.

Freight pre-paid bills of lading

The charterer is entitled to issue or present for signing freight pre-paid bills and, under the NYPE form, the master cannot refuse to sign them. If the bills of lading are marked 'freight pre-paid' but no freight has, in fact, been paid at the time the owner makes their claim (by sending lien notices), then the owner's right to lien freight is not prejudiced¹⁰.

The duty to account for any surplus

The freight that is liened will be applied to the debt owed under the head/subject charter and an owner must account for any surplus, if they recover more than what they are owed. If the freight they lien is owed to the charterer, they will be accountable to them for it.

An owner's right to intercept freight owed under an owner's bill of lading

Where an owner's bill of lading is marked 'freight payable as per charterparty' this incorporates the provisions of the charterparty (so dated on the face of the bill) regarding payment of freight. Freight will usually be collected by the charterer. However, if the charterer defaults on the payment of hire, is the owner entitled thereafter to direct the shipper to pay them the freight directly, bypassing the charterer? The answer seems to be 'yes' – following the Court of Appeal judgment in *The Bulk Chile*¹¹. This is a right different to that of a contractual lien and is known as a right to intercept freight. To exercise its right, an owner must serve a notice on the paying party (similar to a notice of lien) asking them to pay the owner the freight directly. *The Bulk Chile* related to a chain of charterparties as follows:

1. DBHH time-chartered the vessel to CSAV.
2. On behalf of CSAV, as undisclosed principal, DBHH then time-chartered the vessel to KLC on the NYPE form.



3. KLC, in turn, entered into a trip time charter with Fayette. This too was on the NYPE form. Both the NYPE forms contained the standard clause 18 as above.
4. Fayette then entered into a voyage charterparty with Metinvest on a Gencon 1994 form.

Three bills of lading were subsequently signed by Metinvest as shippers and Fayette 'as agents for and on behalf of the master'. It was common ground that those bills of lading were owner's bills. The bills provided 'freight payable as per charter-party dated 19.01.2011', referring to the voyage charterparty between Fayette and Metinvest.

KLC subsequently entered into Korean insolvency proceedings and failed to pay the first two instalments of hire due to DBHH. DBHH therefore sent two 'Notices of Lien' to Fayette and Metinvest, one over 'any balance of freight(s) and/or hire(s) due under any charters, bills of lading, or other contracts of carriage relating to the voyage(s) and cargo(es) covered by the above bills of lading'; and the other over 'cargo now loaded on board m/v BULK CHILE to be carried under bills of lading numbers...'. The Notices of Lien specifically required Fayette and Metinvest to 'arrange payment of all such freight(s) and/or hire(s) in your hands directly to our account when due'.

Metinvest instead paid the freight to Fayette, but this didn't stop DBHH and CSAV making lien claims against Metinvest for the freight so paid under the voyage charterparty.

The Court of Appeal held that the owner was entitled to intercept the freight due under the bills of lading. They concluded that, where a bill of lading provides for payment of freight to a party other than the owner, the proper analysis is that the third party is to be regarded as the owner's agent, who is collecting the freight on the owner's behalf. Ordinarily, that would be satisfactory to the owner, who receives hire under the charterparty, but an owner can decide to vary the authority of the agent.

The English courts have held that this is the natural consequence of a bill of lading being a contract between the owner and the shipper. A provision that freight is 'payable as per charterparty' does not exclude that right – the freight is still due to the owner, even though it may be payable to someone else. The words 'payable as per charterparty' are to be construed as meaning that the obligation is to pay the third party, or as the owner may direct.

This decision is obviously good for owners, who now have another useful tool available to them in the event of a charterer's default. It was not so welcome for the (end) charterers in this case, however, who were held liable to pay the freight twice – the second time to the owner.

Conclusion

Although liens on sub-freight are an invaluable remedy for owner members when a charterer defaults on the payment of hire or other amounts due under the charterparty, it is a complex area and the club encourages members to always seek advice from the club and/or their preferred lawyer before exercising such a lien.

Defence cover is, by its very nature, discretionary in that the club must be satisfied as to the merits and quantum of the claim in question and the likelihood of achieving a successful outcome, if it is to lend support.

The club has a good level of experience when it comes to giving advice to members on the exercise of liens under charterparties and bills of lading. Members requiring further information on this topic should direct their enquiries to their usual contact at the club.

- 1 See *The Cebu* [1983] 1 Lloyd's Rep.302; and *The Spiros C* [2000] 2 Lloyd's Rep. 319.
- 2 [1985] 2 Lloyd's Rep 372
- 3 [1988] 1 Lloyd's Rep.45
- 4 *The Ugland Trailer* [1985] 2 Lloyd's Rep 372; *The Annangel Glory* [1988] 1 Lloyd's Rep.45
- 5 *The Attika Hope* [1988] 1 Lloyd's Rep.439
- 6 *The Spiros C* [2000] 2 Lloyd's Rep. 319
- 7 [1983] 1 Lloyd's Rep.302
- 8 [1990] 2 Lloyd's Rep.316
- 9 *The Cebu* [1983] 1 Lloyd's Rep.302
- 10 *The Nanfri* [1979] 1 Lloyd's Rep. 201
- 11 *The Bulk Chile* [2013]

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