

Time Charters - Anti-Deduction Clauses: A legal and commercial dilemma?

Time charters are contracts for the use of a vessel for a specified duration, with charterers taking responsibility for the vessel's commercial employment, and in exchange paying hire in advance to the owners. However, disputes often arise in relation to the hire paid in advance, leading charterers to deduct hire — for instance, the price of redelivery bunkers, off-hire claims, damages from the loss of vessel use, or owner expenses. **This is where anti-deduction clauses play a pivotal role.**

What is an Anti-Deduction Clause?

Under English law, charterers are entitled to, in certain circumstances, deduct hire for alleged claims relating to off-hire, breach of contract or counterclaims or costs by way of equitable set off. If deductions are made in good faith and on reasonable grounds (*when made*), Owners are likely to struggle in lawfully exercising their contractual rights like withholding performance or withdrawing the vessel.

To counter this unilateral right afforded to charterers, modern time charters include anti-deduction clauses, which prohibit charterers from deducting hire, even in the event of alleged breaches of contract, off-hire events, or counterclaims – **effectively turning the conventional approach from “deduct now, argue later” to “pay now, argue later”.**

Are Anti-Deduction Clause enforceable?

The enforceability of anti-deduction clauses is rooted in the “pay now, argue later” principle and has been upheld in English judgments and LMAA arbitration(s). The effectiveness of an anti-deduction clause depends on its precise wording, the alleged claim and conduct of the parties. In *The Anna Dorothea* [2023] EWHC 105 (Comm), the English High Court upheld the enforceability of an anti-deduction clause, with the result that charterers were obligated to pay hire first, even if the vessel might ultimately be proven to have been off hire.

Common Disputes and Practical Implications

Anti-deduction clauses frequently come into play during disputes concerning:

- **Off-Hire Periods:** Charterers often deduct hire for alleged periods when the vessel is not fully or partially in their service (e.g., due to machinery breakdown, crew illness, hold failure etc).
- **Performance Claims:** Disputes over the vessel's speed or fuel consumption, or other performance warranties under a charterparty.
- **Damages:** Claims for breach of contract or costs for which charterers believe owners are responsible for (e.g., failure or delay in complying with employment orders, deviation etc).

Charterers Perspective

For charterers, making deductions from hire always has some risks, but these risks are significantly more elevated where an anti-deduction clause is agreed. These include:

- **Suspension:** The owner may have the contractual right to suspend or withhold the vessel from the charterer's service.
- **Vessel Withdrawal:** The owner may have the contractual right to withdraw the vessel from the charterer's service.
- **Lien Notices:** The owner may exercise a lien on the cargo or freight or hire or other sums that may be payable to the charterers.
- **Damages for Late Payment:** The owners may claim damages for late or non-payment of hire.
- **Legal Proceedings:** Owners may take steps to secure and recover hire. LMAA tribunals have not hesitated in passing interim awards requiring charterers to pay hire first, and dispute later.

If, despite these risks, a charterer intends to deduct hire (*a commercial decision which should be taken after consulting with lawyers*), they would be recommended to:

- Review the charterparty to ascertain if there are other clauses which permit deductions or if deductions can be made from other payments or costs payable to owners instead of hire.
- Substantiate the claim with documents and ask owners to either agree with the deductions or give valid reasons for refusing the deduction.
- Consider offering to deposit the deducted hire in an escrow account or providing alternative security.
- Consider commencing security proceedings by arresting a ship or bunkers owned by the owners and/or proceeding with legal proceedings for recovery of the overpaid hire.

While the above may not deter an owner from exercising their contractual rights, it may have an owner reconsider their strategy.

Owners' Perspective

Anti-deduction clauses are owner friendly, but they also expose owners to potential risk,

- **Breach:** If there is no genuine dispute, but owners refuse deductions and suspend performance or withdraw the vessel or exercise a lien, charterers may be able to hold owners in breach, and if not rectified even repudiate the charterparty.
- **Damages:** Any excess hire paid must be returned to charterers. Where an owner refuses deduction from hire, they risk having to return the hire (in full or partially) on a future date along with interest.
- **Arrest or Attachment:** The charterers may, subject to the jurisdiction, arrest the ship or other ships in the same or associated ownership of owners or bunkers owned on the ship or other ships. They may also explore other security actions.
- **Legal Proceedings:** The charterers may initiate legal proceedings for recovery of the overpaid hire, which may result in exposure to legal cost and interest.

When faced with a hire deduction, owners must act promptly to consider:

- If the deduction made is from hire or other amounts. In case, other amounts, is it covered under the anti-deduction clause.
- Are there any other clauses allowing deductions for hire, and can they be read consistently with the anti-deduction clause.
- Is there a genuine dispute regarding the deduction from hire.
- Instead of invoking the anti-deduction clause and other contractual rights, are there alternative options such as commencing security proceedings by arresting a ship or bunkers owned by charterers.

Parting Comments

Every dispute is different, and before exercising the rights under the charterparty, parties should consider both the legal and commercial repercussions their action or inactions may have. Time is of essence and prompt strategic legal advice is extremely important.

At Binnacle Legal, we provide advice and assist owners, charterers and operators with drafting and reviewing contracts (including anti-deduction clauses) and navigating issues relating to payment and/or non-payment of hire.