FOB contract - laytime - opening of a letter of credit - condition of precedent - seller's duty to load

Kronos Worldwide Ltd v Sempra Oil Trading SARL
[2004] EWCA Civ 3

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FOB CONTRACT – LAYTIME – OPENING OF LETTER OF CREDIT – CONDITION PRECEDENT – SELLER'S DUTY TO LOAD

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Facts

This case revolves around a single question of law – 'whether (subject to waiver) laytime did not run under the contract in question until after a letter of credit had been opened'.

Kronos (seller) had agreed to deliver gasoil to Sempra (buyer) 'FOB one safe port/berth Constanza'. Payment was to be secured by a letter of credit which under the contract was 'to be opened promptly through a first class bank'. The contract further provided that any demurrage payable would be paid for by the sellers. In respect of the cargo in question, the loading range was 20–30 June 2001. Kronos indicated to Sempra that it was unable to supply the gasoil during that time due to slippage problems and asked to postpone delivery to 1–5 July. Sempra did not agree but stated that it intended to narrow the vessel's arrival to 28–30 June.

The *Spear 1* arrived at Constanza on 28 June but loading did not commence until 9 July and was completed on 11 July. For the purposes of the appeal see below, it was assumed that notice of readiness was given on 28 June. Laytime thus commenced on 28 June and, under the contract,

expired on 30 June. On that basis, Sempra claimed that Kronos was liable to pay demurrage for 11 days 1 hour and 16 minutes (a claim totalling US$160,265.26).

Kronos refused, relying on the fact that Sempra was in breach of contract for failing to open the letter of credit prior to the arrival of the ship. The letter of credit was not opened until 5 July. Kronos's case was that the opening of a letter of credit was a condition precedent to any duty on its part to load cargo and that laytime therefore could not commence until a reasonable time after the provision of the letter of credit.

The High Court agreed with Sempra that it should not be assumed that laytime under the contract would necessarily run when Kronos first became obliged to load. The judge said that the fact laytime may have started to run before the provision of the letter of credit was 'nothing to the point'. The judge thought that the obligations may be viewed separately, and the fact that one obligation (the duty to open a letter of credit) was a condition precedent did not preclude another obligation (the duty as regards laytime) to arise. The court considered that to equate the seller's duty to load with the commencement of laytime would involve 'an impermissible elision of Sempra's obligation for demurrage under the charterparty at which the demurrage provision in the contract is aimed with the separate contractual obligation between Sempra and Kronos arising from Sempra's failure promptly to open the letter of credit'. Judgment was thus entered for the buyer.

Kronos appealed against that decision.

Decision

The Court of Appeal allowed the appeal. It held that it was incorrect in principle to suggest that the laytime and demurrage provisions of the contract can be separated from the contractual provision requiring presentation of a letter of credit. Mance LJ held that the opening of the letter of credit must be a condition precedent to Kronos's duty to load. The court's view was that the laytime and the provision of the letter of credit bear on the same subject matter. Laytime refers to the time allowed for the loading operations whilst the provision of a letter of credit is a condition precedent to the seller's duty to perform any part of the loading operation. It was not correct to try to distinguish the physical parting with possession of the cargo from other aspects of the loading operation.

Comment

The fundamental question in the present case was whether it was right to construe the laytime and demurrage clauses as separate from the provisions on the opening of the letter of credit. The High Court saw the two issues as distinctive, perhaps on the basis that in a 'normal' situation, the laytime and demurrage provisions would be lodged in the contract of carriage whilst the letter of credit provisions would be lodged in the contract of sale. In the present case, though, both sets of obligations are found in the contract of sale. The Court of Appeal was thus correct to hold that it would be artificial and incorrect to find the two sets of contractual provisions as unrelated.

The court also saw no incongruity in recognising that, by tying laytime/demurrage provisions to the stipulation for a letter of credit, laytime under the sale contract between the buyer and seller may begin at a different time to laytime under buyer's sub-sale (if any) or under the original charterparty (the contract of carriage). The court drew attention to the fact that it was always possible if different contracts had different laycan dates. It was the buyer's own responsibility to ensure that its contractual relations (as regards laytime/demurrage) are capable of operating on a proper back-to-back basis. It is difficult to find fault with the principle there – the laytime provisions in the contract of sale must be construed within the four corners of that contract. Regard need not be had as to parallel or back-to-back relationships. Nonetheless, the present case does reveal a serious gap in existing practice. The fact that such 'proper back-to-back relations' are seldom provided for in standard form contracts of sale (especially on FOB terms) would seem to suggest a belief that the term of laytime is generally an autonomous term, to be construed in the context of the original contract of carriage (eg the charterparty) without reference to other provisions in the contract of sale. Such an assumption is unsustainable in the light of the present case. Lawyers

drafting the sale contracts (and, possibly, the contracts of carriage) must take heed that 'proper back-to-back relations' are provided for.

It was also argued that laytime can run and demurrage accrue despite the failure by the buyer to open a letter of credit, because the seller could exercise a set-off against the buyer if it could show that it had cargo to load which it did not load because there was no letter of credit in place. The High Court saw no difficulty, in principle, with that proposition. Chambers J reasoned:

> 'There is no reason in principle why the occurrence of a condition precedent should not result in an obligation to be responsible for an expense incurred before the condition occurred. For instance, expenses may have been incurred in connection with an anticipated contract which the other party to the eventual contract undertakes to reimburse in the event that a condition is met at a later time.'

It is clear that such a reasoning would not work in the area of international sale contracts, especially FOB contracts where there are mutual obligations between the parties. Indeed the Court of Appeal rejected this analysis, stating that it does not give proper effect to the principle that the provision of the letter of credit is a condition precedent to the seller's duty to load. As far as the court was concerned, it was not possible to disregard the link between the duty to open a letter of credit and the duty to load (and thus trigger the laytime provisions). The court emphasised that the link was important because it allowed the parties to know where they stood, contemporaneously. The mutuality of the duties in the FOB contract means that until one duty is performed, the corresponding duty on the other party need not commence. Until the letter of credit has been opened, the seller is fully entitled to do nothing. After all, for all the seller knows, the letter of credit might never be opened. This is clearly in line with the requirements of commercial certainty. Thus, it would not be appropriate for the buyer to argue that the provision of the letter of credit as a condition could be satisfied retrospectively.

JC