



A PRACTICAL GUIDE TO
CONTRACTS OF AFFREIGHTMENT
AND HYBRID CONTRACTS

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and Hybrid Contracts**

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Preface

The international shipping scene now has several characteristics which hitherto did not prevail or, at least, were much less distinct.

As examples we can mention changed trade patterns, cargo reservation schemes, cargo sharing agreements, specialized vessels, new cargo handling equipment and the break-up of traditional functions due to cost increases. The operations of a shipowner, traditionally vested in one person or one entity, may now be distributed between several persons or entities: the actual ownership (responsibility for financing), manning, management, and possibly the operation and trading of the vessel. All these changes are also reflected in the commercial employment of the vessel.

Elements from traditional chartering forms have moulded into new variations. The contract of affreightment (the volume contract) is one example of this development.

It is our hope that the growing use of the contract of affreightment and hybrid contracts will make a basic introduction useful. Some reservations should be made. An introduction necessitates certain generalizations and, also, a text that is not aimed at legal specialists lacks legal precision. Furthermore, common law recognizes a number of particular principles and expressions which cannot be specifically taken into consideration; instead we aim to give a general survey.

November 1985

LARS GORTON
ROLF IHRE

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CHAPTER 1

Introduction

1.1 Contracts of affreightment and chartering

It is well known that a transport user may employ different methods when utilizing vessels in ocean transportation. He may choose to charter the whole or a part of a vessel for one voyage: *voyage charter*. When having only a parcel or a limited quantity of cargo he may directly or indirectly, through a forwarding agent, send his goods as general cargo with a *liner* operator. If he has large quantities of cargo during a period he may charter a whole vessel for a certain time, three months, six months or any period agreed: *time charter*. Under special circumstances he may also charter a vessel without a crew and for an agreed time: *bareboat charter*. These are the four traditional types of freight or charter contracts.

However, over a long period, several mixed forms have evolved resembling voyage charter or time charter, but with a number of specific features. We will, in section 1.4.5, give examples of such mixed (hybrid) forms. In particular, our aim is to describe and, from a practical point of view, analyse a type of contract which is often a hybrid contract (definition on page 73) and which will be referred to here as a *contract of affreightment (COA)*.

Instead of an agreement for one voyage only, there may be a contract for several voyages, either with the same vessel with one voyage directly after another (consecutive voyages, time-chartering or bareboat chartering), or with different vessels upon the request of the charterers within the framework of the overriding contract. In both cases there is a time element which may, depending on the agreement, be decisive as to the number of voyages to be performed. Thus sometimes the number of voyages is fixed and in other cases the period is overriding. The transport user's choice depends on several factors.

1.2 The sales contract and the contract of carriage

The contract of carriage is normally a consequence of a sales contract having been concluded. Thus, even if the contract of carriage is a contract on its own merits its contents and design are largely influenced by the sale. Depending on whether the sale is made on f.o.b., c.i.f. or other bases it will be the seller or the buyer who will arrange and pay for the transportation. The different terms and conditions of the sales contract will have an important impact on the terms and conditions of the contract of carriage.

If the seller/buyer has to handle a large quantity of goods during a period he may then appear as a time-charterer, taking the benefit of a relatively lower freight (hire) to be paid but also taking on a number of operational risks, costs and duties. Certain large industries with a need for regular transportation may involve themselves in time chartering and may even set up their own shipping companies, running a fleet of owned and/or chartered tonnage.

If the transport user decides that he does not want to take on those operational risks and duties he may instead make a COA with an owner or he may even set up a joint venture with a shipowner where the shipowner supplies shipping knowledge and vessels and the cargo owner supplies cargo. If the quantities of cargo are small but regular the cargo owner may make his deal with a liner operator for partial shipments under a COA.

When deciding the method of transportation the cargo owner should make careful calculations. In order to get the best practical and economical solution it is necessary for shippers and receivers to have a good knowledge of all the above methods. They must also know how costs, risks, etc. (basic components in contracts of carriage) are allocated in the traditional charter forms (bareboat chartering, time chartering, voyage chartering and carriage on liner conditions). Before we go into details about the contract covering several shipments, we shall therefore first make a short presentation of the basic systems and some introductory remarks about definitions, terminology and the need for long term contracts of carriage, as well as the connection between sales and carriage agreements and the subject in general.

1.3 Definition of the contract of affreightment

Although it is in no way necessary to have a precise definition of the kind of contracts dealt with in this book we shall attempt to define the subject and give an explanation of the terminology used. This will be done by giving examples of the types of contract intended, a description of the significant characteristics of these contracts, and a discussion of the terminology used.

1.3.1 Examples

Long term contracts of carriage have various bases. The following examples illustrate typical situations in which long term contracts of affreightment are used.

- An owner undertakes to carry between 200,000 and 250,000 metric tons of grain from port X to port Y over a period of two years.
- An owner undertakes to carry all vehicles a charterer exports during the years 1983–1984.
- An owner undertakes to carry all crude oil imported by a charterer, a minimum of 1,000,000 tonnes and a maximum of 1,750,000 tonnes, during 1985.

The base and nature of these so-called contracts of affreightment vary greatly and in

order to find a definition in common one can first look at the characteristics of contracts of affreightment.

1.3.2 *Characteristics and definition of the contract of affreightment*

Typically, the COA is recognized as a contract covering a specified, homogeneous cargo; large quantities; long periods; certain ports, and several voyages. None of these features can, however, separately provide a basis for a definition of the COA.

Many types of cargo are transported under contracts of affreightment. Quite often raw materials and semi-finished products are carried, such as oil, coal, iron, cement, woodpulp, lumber, grain, rice, sugar, fruit, etc. High technology products such as cars, tractors and prefabricated houses are also carried under contracts of affreightment. The cargo is not always homogeneous. It is not unusual for contracts of affreightment to cover a variety of products, for instance for a turnkey project where a contractor/industry has agreed to deliver various parts and knowhow for a functioning factory. Finally, it is also possible to have a COA for a certain space or a certain part of the vessel's capacity without any specification other than for instance "general cargo". Although many contracts of affreightment cover large quantities, small quantities may also be transported under such contracts.

The situation is the same with respect to the contract period. Quite often the COA period is one or several years but the agreement can equally be recognized as a COA when it covers a period which is much shorter, and may be only a few weeks. The number of voyages in the contract is usually more than one but this is not significant for contracts of affreightment. Contracts for consecutive voyages and time charterparties also cover several voyages and long periods, and an agreement *may* be defined as a COA even if it covers only one voyage.

What then are the characteristics and definition of a contract of affreightment? One important characteristic is that such a contract is mainly linked to a cargo and an obligation on the owner to transport that cargo, rather than linked to a named vessel. It is thus a *generic* obligation. However, this characteristic is doubtful. The COA may be so specific in its description of the vessel that only one or a few vessels may be used and then the contract is in fact linked to a certain or a few particular vessels. On the other hand, a voyage charterparty may include a very broad substitute clause which gives the owners a more or less unlimited right, and perhaps also an obligation, to choose a vessel for the transportation and to nominate another vessel when the intended one cannot take the cargo.

The conclusion is that it is hard to give a precise and clear definition of the COA, nor is it important to have one. The important thing is that the contract clearly states how different costs, liabilities, risks, etc., are to be shared between the parties. As long as the contract is worded clearly it is thus less important whether it is defined as a COA or a voyage or time charterparty or otherwise.

1.3.3 *Terminology*

A contract with the characteristics outlined in the above section is often referred to as

a “contract of affreightment”, a name which does not really say anything about its details. Other terms have been introduced to replace the concept of “COA”, such as “Tonnage Contract”, “Volume Contract”, “Quantity Contract”, “Cargo Contract” and “Transport Contract”. Some of these concepts are more logical and in a way better describe the fact that the contract of affreightment is closer to the cargo and the obligation to transport than other contracts of carriage which are also connected to a certain vessel.

Sometimes the term contract of affreightment is applied as a blanket term for all charter contracts (freight contracts) but in practice the concept of COA has been largely assigned to this particular type of charter contract. Thus Intertanko has adopted this concept for its standard contract, Intercoa 80. Bimco has a slightly different approach when in their standard contract Volcoa they use the term “Volume Contract of Affreightment”.

We have chosen to use the term contract of affreightment, or the short form COA, and the understanding is that a COA is a contract having at least some of the features and characteristics described above. The term “contract of carriage” is used to cover all kinds of contract for the carriage of goods by sea (charterparties, bills of lading and contracts of affreightment).

1.3.4 Standard forms for contracts of affreightment

There are two standard forms for contracts of affreightment in use. The Intercoa 80 is issued by Intertanko in Oslo and adopted by Bimco. Intercoa 80 is a so-called steering contract (see Chapter 5) intended to be used in combination with the voyage charterparty form Intertankvoy 76 or any other voyage charterparty form. The Intercoa 80 is designed especially for the carriage of petroleum products.

The Volcoa is issued by Bimco and is designed mainly for the transportation of bulk dry cargoes. Also, the Volcoa is a steering contract intended to be used in combination with a voyage charterparty. As most contracts of affreightment have to be tailor-made for the specific situation, the standard forms Intercoa 80 and Volcoa are useful mainly as check lists when a charterer and an owner negotiate a COA. In this book we will use Intercoa 80 and Volcoa as illustrations of different possible ways of handling all questions that must be dealt with in a COA.

1.4 The components in contracts of carriage

1.4.1 General

In all commercial contracts of carriage a number of functions, costs and risks must be allocated either to the owner or to the charterer. The parties must also sort out liability questions both between themselves and against third parties.

These functions, costs, risks and liabilities—referred to below as the basic components—are more or less the same in all commercial shipping, independent of charter form or charter document. The distribution of the components, however,

differs from agreement to agreement. Basically the parties are free to make whatever distribution they like, but in practice a number of standard ways of allocating the components to the charterer and the owner have developed. These standards are, in many cases, sufficient, but in other cases and especially in contracts covering large quantities and long periods—the parties must find other and new ways to distribute the basic components. The particular trade involved plays an important role and, furthermore, the power of negotiation of the respective party is decisive.

The art of drafting a long term COA covering large quantities is very much the art of being able to disregard elements of the established charter forms. In the following sections we will go briefly through the basic components and the traditional ways of allocating them. In section 1.4.5 we will briefly describe some established deviations from the traditional ways of allocating the basic components.

1.4.2 The basic components

COSTS

As to the costs involved, attention must first be paid to the ship's capital costs, i.e. interest with respect to own and external capital (from a cash flow point of view the repayment of external capital must also be taken into the picture). The vessel has to be continuously maintained and repaired. There will be costs for insurance, for hull and machinery as well as liability and other special insurances. Bunkers, lubricants and other materials for consumption have to be paid for. The ship must be manned (embracing wages, social costs, sickness costs, travel costs, education costs, etc.) Port charges and other fees and charges have to be paid, loading and discharge must be paid for. Beside this, there are administrative costs which are dependent on the size of the business generally and the engagement in the individual vessel.

FUNCTIONS

Commercial use of the vessel also means that a number of things must be arranged. Someone must seek cargo for the vessel and arrange for loading and discharging, which includes contact with agents, stevedores, etc. The vessel must be bunkered and, naturally, also manned. Maintenance, repairs and inspections as well as insurance and necessary routine contacts with authorities must be continuously planned and arranged.

RISKS

The commercial venture may, for several reasons, result in ways other than originally planned by the charterer and the owner. A number of circumstances beyond the charterers' and owners' control may in a positive or a negative way influence their plans and their calculations. As examples we may mention the risks of war, ice, adverse weather, fire, altered exchange rates, strikes and cost variations. The voyage may take a longer or shorter time than planned, and the parties thus have a time risk at sea and a time risk in port to consider. Furthermore, the freight market may move

upwards or downwards, which means that charterers' and owners' respective calculations will be more or less favourable compared with current market rate.

LIABILITIES

Third parties may direct a claim against the parties involved in the charter agreement. We may mention as examples claims for personal injuries, damage to cargo, delay, damage to quays, locks, oil spillage, etc. When such claims are dealt with or analysed there are two questions which must be considered separately: (a) who is primarily liable against the third party? and (b) how will the liability be shared finally between owners and charterers?

As between the parties, questions of liability for damage and delay to cargo or vessel, are important liability areas. Liability questions are often dealt with indirectly in charter contracts. Quite often they are thus only dealt with in clauses in which the parties intend to exempt themselves from liability. The distribution between owner and charterer of these basic components will depend on the type of agreement and the individual situation.

1.4.3 Components not dealt with by the parties

It is essential that all components are recognized and considered before negotiations take place. It is, however, not necessary—and not even possible—that all components are discussed and inserted into the written contract. If the answer to certain questions cannot be found in the written text, and thus the relevant component is left outside the written contract, the answer has to be found elsewhere, and the courts or arbitrators may then apply different methods to construe the contract. The method used to find the answer varies depending on which law the parties have chosen for their agreement. This will be discussed briefly under sections 2.1 and 3.1.

Also if it is technically possible to foresee and solve many situations and problems, the theoretical discussion during negotiations can be so complicated that it may jeopardize the entire negotiation and the possibility of coming to an agreement. Many questions should therefore be left for discussion when—and if—problems arise. It is especially essential in long term contracts for the parties to have good cooperation and if such cooperation is once established, most disputes can be settled amicably and without disturbances between the parties. If these problems are discussed beforehand during the negotiation, the parties can, as already mentioned, easily jeopardize the whole negotiation, *cf.* the comments about disputes in Hybrid Contracts (section 6.3).

1.4.4 The traditional ways of allocating the basic components

(For a more detailed presentation of this topic we refer the reader to Gorton, Ihre and Sandevärn, *Shipbroking and Chartering Practice* (London: Lloyd's of London Press Ltd., 2nd ed., 1984).) As already mentioned, the parties are basically free to

make whatever arrangement they like as regards distribution of the components in the charter agreement. A number of standard models have, however, been formed in shipping and most of the existing fixtures in shipping can be sorted into one of the following four models.

BAREBOAT CHARTERING

Bareboat charter (or demise charter) means that the vessel is put at the disposal of the charterer for a certain period of time. The charterer takes over virtually the entire responsibility for the operation of the vessel and the functions and expenses connected thereto. Only the actual ownership and the capital expenses rest with the owner. Sometimes the owner may arrange hull insurance and sometimes he has a right to influence maintenance, repairs and choice of senior officers. All other components are left for the charterer.

TIME CHARTERING

The main difference between bareboat chartering and time chartering is that in time chartering the owner, in addition to his components in bareboat chartering, is also responsible for the manning of the vessel and the maintenance, repairs and arrangements and costs of the vessel's insurances (mainly hull and/or P. and I.). Time risks and other risks, costs and functions directly connected with the commercial operation of the vessel are for the charterer's account. The basic idea is that the owner is responsible for the technical operation and navigation of the vessel, but the time charterer is responsible for the employment (commercial operation) of the vessel.

VOYAGE CHARTERING

The main difference between time chartering and voyage chartering is that in this form of charter the owners also take over the commercial operation of the vessel and the functions, risks and costs connected therewith. The charterer retains responsibility for certain functions, risks and costs connected with loading and discharging and also part of the harbour dues. Here we have big differences between various voyage charterparties.

LINER SHIPPING

In liner shipping nearly all components rest with the owner. The charterer, who in liner shipping is seldom called charterer but instead shipper, receiver, merchant or similar, has an obligation to deliver the cargo to the vessel "as fast as vessel can receive" and, at the discharging port, to take delivery of the cargo "as fast as vessel can deliver".

Naturally in liner shipping as well as in voyage chartering the merchant also has an obligation to pay the freight. As regards the freight it is, however, not always clear in advance who will actually pay it. It may be the one who made the cargo booking in the vessel, but it may also be someone else, such as, for instance, the receiver of the cargo.

1.4.5 *Special arrangements within the traditional ways of allocating the basic components*

Section 1.4.4 briefly describes the four standard models for the distribution of components in charter agreements. For various reasons, the shipping business has developed irregularities and variations within the standard models.

A charterer and an owner may agree that the owner will put at the charterer's disposal one or several vessels employed for several voyages following consecutively upon each other. Such contracts for *consecutive voyages* are characterized both by time elements and voyage elements. The vessel or vessels load the charterer's cargo, carry and discharge it at the port of discharge and thereafter return in ballast to the port of loading for a new cargo. Sometimes there is an understanding that the owner has the right to take return cargo, something which may affect the schedule, and which then has to be covered by the contract.

The basic idea is that each particular voyage is performed under voyage charterparty terms with freight per voyage, time counting in ports, etc. The contract period is sometimes a result of the time the vessel needs to perform the agreed number of voyages. The parties can, however, also agree that the vessel shall perform as many voyages as possible during a certain fixed period. In the latter case the contract contains a typical time chartering element.

A common hybrid form is the *time-chartered trip/voyage*. This is a charter made out on a time charterparty basis but in which some basic features are those of a voyage charter. Thus the ports of loading and discharge and the voyage are described in the same way as in voyage chartering and the period is described as the time it will take to perform the agreed voyage. Besides this "voyage charter way" to describe the time charter period, the trip time charterparty often contains an indication of the period, e.g. "90 days, 10 days more or less in charterers' option, without guarantee (WOG)".

Another example where a typical voyage charter solution is applied in a time charterparty is an agreement that "vessel's average speed from pilot to pilot all weather conditions agreed to x knots". A stipulation like this in a time charterparty means that time risk at sea (i.e. risk for delay resulting from bad weather or similar) is allocated to the owner and not as normal to the time charterer. This irregularity is often found in tanker time charterparties, where the negotiating strength of the oil companies has allowed them to introduce this deviation from the time charter pattern.

The above examples are commonly used and show that charterers and owners can very well disregard the traditional ways of allocating basic components as described above in section 1.4.4. The charterer and the owner are thus free to make whatever distribution of charter components they like. If one disregards market aspects, business relations, etc., most chartering negotiations can be described as an allocation of charter components, which is made in three steps.

The first step is to agree about the form of charter (time chartering, voyage chartering etc.). After this first step the parties have a rough idea about distribution of charter components. The next step is often to agree about a standard form. If, for

example, the parties have agreed to make a time charter agreement they may then in step two discuss whether they should base the contract on, for instance, a Produce form or a Baltime form. As the Produce form is said to be more favourable to the charterer and the Baltime form more favourable to the owner, the parties have, after this second step, a more precise idea about the final allocation of components. The third step is to agree about all amendments to the printed text and to all additional clauses. When this third step is taken the parties have made the final allocation of charter components. Another way to describe it is—and this is the normal one—to say that the parties first negotiate about the “main terms” and then about “details”.

1.4.6 The specific COA components

The components in a COA are basically the same as in all other commercial charter contracts. Considering the characteristics of a COA some of the components must be designed in another way in order to meet the specific COA requirements. The long contract period especially creates problems. Contracts of affreightment also give rise to specific COA questions and problems. We thus have specific COA components. These are related mainly to the characteristics of the COA having both a time element and a voyage element and to the often long contract period. As an example we can mention the clauses dealing with nomination of vessels and cargoes for individual shipments and also clauses related to cost variations, which are often well developed in contracts of affreightment. The components in contracts of affreightment will be dealt with in Chapter 2, below.

1.5 Why a contract of affreightment?

For both the charterer and the owner it is sometimes practical and convenient to have one contract covering a number of shipments. It is then not necessary to spend time on negotiations for each shipment, and the persons and companies involved have a good possibility of co-operating and of learning how to improve all the practical details relating to loading, carriage and discharging. The necessary administration and planning may also be easier to handle if the same persons and companies are well acquainted with each other. Disturbances and difficulties arising during the first shipment may be resolved by co-operation and mutually accepted amendments to the written contract. Personal knowledge between owners' and charterers' respective staffs usually makes it easier to anticipate and prevent problems that might arise and also to solve problems if they do arise. It should be mentioned that changed market conditions may tempt one of the parties to avoid his contractual duties. This is of course, nothing unusual for contracts of affreightment.

CHARTERER'S POINT OF VIEW

For many commodities transportation and the handling costs in connection with transportation are a considerable part of the final cost. Transportation may also

indirectly be of great importance as difficulties with carriage may cause a short-fall in necessary components for production at the factory and thereby serious delays.

For a seller or a buyer of a commodity problems with transportation can easily cause considerable extra expense in the form of extra storage, extra handling, etc. Furthermore, the cargo owner often calculates and compares transportation costs with interest incurred in having large stocks. A reliable owner, from such a *logistics* point of view, is of primary importance. Between seller and buyer the party responsible for transportation may be held liable for consequential damages if he fails to arrange transportation as agreed. Considering this, it is advantageous for a charterer, whether he is a seller or a buyer or someone else who is responsible for the transportation, to make sure beforehand that tonnage will be available for the necessary sea carriage. We have indicated above different ways for a shipper or receiver to arrange sea transportation and one of the most convenient ways is to enter into a COA with a reliable owner or operator.

Another factor which may be important for a seller or a buyer is that through a COA he can avoid fluctuations in the freight market and thereby make more accurate calculations and avoid disastrous differences in costs. The same end may be reached via a time charter, but the charterer will then also take on the commercial operation of the vessel, something that he may wish to avoid.

OWNER'S POINT OF VIEW

For the owner, too, a COA may give economic stability. If he has part of his fleet employed for longer periods, or if the spot market totally collapses, he will still have an assured income. It may also be that through the existence of a COA he will get better opportunities to finance new vessels. It is not unusual that vessels are designed, financed and built especially for a certain COA. The owner or operator, of course, also has these advantages when his vessel is employed on long term time chartering, but with such an arrangement he is less flexible than if he has the same carriage capacity covered by a COA.

1.6 Disposition of the subject

In Chapter 2 we shall give an overview of general contract principles and of certain contractual issues, which are particularly important in connection with contracts of affreightment, and in Chapter 3 the basic components will be discussed in the light of the COA situation. In the same chapter we will also discuss the specific COA components.

Chapter 4 discusses the various charter forms in relation to a COA.

The documentary construction and the documents are dealt with in Chapter 5.

When the parties agree to make a charter construction which is fully or partly independent of the traditional charter forms, they have to consider some additional problems, and these will be discussed in Chapter 6 (Hybrid contracts of carriage).