

Dealing with Demurrage in the UAE

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Demurrage claims are an everyday battleground for vessel charterers and owners alike. Traditional arguments surrounding time calculations are routinely exchanged, for instance, suspension due to poor weather, shifting time, premature notice of the vessel's readiness, etc. Parties may be surprised to learn of further potential defences and entitlements if their contracts are subject to UAE law. Many such entitlements available to parties remain underutilised in practice.

This article considers demurrage under UAE law. Attention will be given to the stipulated time periods in the UAE Commercial Maritime Code (Federal Law 26 of 1981) (the "Maritime Code"). Consideration will then be given to the possible adjustment of demurrage by a court pursuant to the Civil Code (Federal Law 5 of 1985) (the "Civil Code").

What is Demurrage?

A claim for demurrage arises in the context of a voyage charterparty when a charterer exceeds the permitted time period for loading and/or discharging its cargo (commonly known as 'laytime'). An owner is then entitled to charge the charterer for its continuing breach of the permitted laytime. This charge is referred to as 'demurrage', and is calculated on an agreed, and predetermined, demurrage rate against the excess time actually spent on the loading/discharging operation.

It is settled law in most common law and western jurisdictions that demurrage is considered a claim for liquidated damages. Under UAE law, demurrage is considered, for a finite time period, part of the hire owed by the charterer to the owner and, thereafter, is considered a claim for liquidated damages.

Example of Demurrage Calculation -Without UAE Law

For the purposes of this article, the following straightforward example will be used to demonstrate the applicable principles. A vessel is carrying a relatively small cargo of steel pipes. The parties enter into a standard form voyage charterparty, for instance, BIMCO's 'GENCON 94', and agree that the permitted laytime for discharging will be 24 running hours. It is further agreed that the demurrage rate will be US\$ 15,000 per day or part thereof. UAE Law does not apply.

The vessel in our example, in fact, takes 72 hours to discharge its cargo, with no applicable exceptions. On the face of it, the demurrage calculation will accordingly be:

72 hours (actual time) - 24 hours (permitted time) = 48 hours (on demurrage time)

48 hours × (US\$ 15,000/24 hours) = US\$ 30,000

The charterers consequently owe the owners US\$ 30,000 in demurrage.

Applying UAE Law to Demurrage - The Two "Additional Periods"

In the instance where UAE law does apply to the same charterparty, two additional periods will be considered.

(i) The First Additional Period

Article 231(2) of the Maritime Code states;

If loading or discharge does not take place within the original period specified in the contract, or by custom, there shall be given an additional period not exceeding the original period and the disponent owner shall be entitled to daily compensation in respect thereof to be defined by the contract or by custom without the need for any step in that behalf being taken by the disponent owner. (Emphasis added).

Article 231(2) seemingly permits parties to stipulate a demurrage rate in their charterparty. If a demurrage rate is not agreed to in the relevant contract, guidance may be sought from 'custom'. Such demurrage rate will then apply for a 'period not exceeding the original period.' It is suggested that the 'original period' is a reference to the agreed laytime period.

In the previously provided example, the laytime period was 24 hours. Following Article 231(2), the 'additional period' would accordingly be any time during the 24 hours after laytime had been utilised. For this period, the agreed demurrage rate may apply. Accordingly, should the charterers exceed the permitted laytime by 24 hours, owners shall be entitled to:

24 hours (additional period) × (US\$ 15,000/24 hours) = US\$15,000

(ii) The Second Additional Period

Article 231(3) of the Maritime Code states:

If loading or discharge does not take place within the said additional period there shall be given a second additional period not exceeding the first period and the disponent owner shall be entitled to compensation in respect thereof equal to the daily compensation laid down in respect of the first additional period plus one half without prejudice to such other compensation to which he may be entitled.

Under this article, a 'second additional period not exceeding the first period' may apply. For this second additional period, demurrage will be applicable as per the agreed rate, plus one half. Using the aforementioned example, should the charter exceed laytime by 48 hours, the owners will be entitled to:

24 hours × (US\$ 15,000/24 hours) = US\$ 15,000 [First Additional Period]

+

[24 hours × (US\$ 15,000/24 hours)] × 1.5 = US\$ 22,500 [Second Additional Period]

= US\$ 37,000

Accordingly, should UAE law apply in our example, the owners would be entitled to US\$ 37,000 for a demurrage period of 48 hours. This is compared to US\$ 30,000 (as previously calculated) should UAE law not apply and the contract is upheld directly.

Demurrage as an Addition to Hire under the Maritime Code

Article 232(4) of the Maritime Code states;

The daily compensation due in respect of the additional periods shall be deemed to be appurtenances of the freight and the provisions relating to freight shall apply thereto.

The above article, read in isolation, may appear to be a somewhat curious provision. It does, however, stand to have a profound impact on a demurrage claim. The effect of the article is that any demurrage incurred during the two 'additional periods,' as described above, are considered part of the 'freight' (hire). This amount is, therefore, simply added to any hire owed by the charterer to the owner. This raises the question - what happens if demurrage exceeds the two additional periods?

Demurrage as a Provision for Liquidated Damages under UAE Law

Our opinion is that any demurrage, beyond the two additional periods, should be considered a claim for liquidated damages. The reason for such proposition is twofold:

Firstly, Article 8(2)(a) of the Maritime Code stipulates that:

The following shall apply in matters for which there is no special provision in this Law:

(a) Maritime customs which do not conflict with the provisions of the Islamic Shari'ah.

As previously mentioned, it is widely accepted under common law and western jurisdictions, which are commonly employed in maritime contracts, that demurrage, in the context of a voyage charterparty, is a provision for liquidated damages. This may be considered a 'maritime custom' as mentioned in Article 8(2)(a).

Secondly, Article 390(1) of the Civil Code specifically permits liquidated damages under UAE law and provides a brief description of its nature, which corresponds with the fundamental elements of a demurrage provision. It states:

The two contracting parties may fix, in advance, the amount of damages either in the contract or in a subsequent agreement subject to the law provisions.

What are 'Liquidated Damages'?

A liquidated damages provision stipulates that a predetermined amount of compensation shall be owed by a party who is in breach of a particular obligation to the other party. The reasoning behind the concept is that contracting parties are not required to deliberate about the quantum of the damages incurred after the breach occurs; the compensation owed for damages is agreed beforehand. In common law jurisdictions, should the specific breach occur, the innocent party is generally not required to prove its loss, only that such breach occurred. This stands to save time and provides commercial certainty because the harm is quantified from the outset.

Liquidated Damages under UAE Law

Once demurrage exceeds the described statutory 'additional periods' and is considered part of a liquidated damages provision, there are a variety of legal issues that arise under UAE law. Arguably the most significant issue is that a judge may amend a liquidated damages provision to equal the harm actually suffered. To this extent, Article 390(2) of the Civil Code states:

The judge may, in all cases, at the request of one of the parties, amend such an agreement, in order to make the amount assessed equal to the prejudice. Any agreement to the contrary is void.

Article 390(2), therefore, provides judges with a corrective mechanism to adjust a previously agreed liquidated damages amount to 'make the amount assessed equal the prejudice'. This amendment may be made by either increasing or decreasing the previously agreed amount. A demurrage rate may, accordingly, be adjusted, after the two additional periods, to equal the prejudice (harm) suffered by the owner. This adjustment may be applied for by the vessel owner (to increase the demurrage owed) or by the charterer (to decrease the demurrage owed).

The rationale behind Article 390(2) appears to be to ensure the concept of liquidated damages (being of western origins) is compliant with fundamental Shari'ah principles. Article 7 of the Constitution of the UAE confirms that Shari'ah is the principle source of legislation in the UAE. When considering damages under Shari'ah, the fundamental elements required are:

1. damages must be quantified;

2. damages must be substantiated;
3. damages must be only awarded to the extent suffered.

Quantifying damages before they are incurred will likely result in a difference between the actual damages suffered and the predetermined amount. For instance, considering the provided example of a demurrage rate of US\$ 15,000, it is unlikely that the 'loss' suffered by the delay in loading/offloading the cargo is exactly US\$ 15,000. It is more likely that it is either more or less than the agreed amount.

A difference between the agreed liquidated damages amount and the harm actually suffered stands to infringe the Shari'ah principle of gharar. This principle prohibits the profiting, or incurring loss, due to circumstances that are unknown at the time the agreement is concluded. A classic example of this is gambling. Article 390(2) aims to address the potential infringement by permitting judicial intervention to adjust the liquidated damages amount to accord with the loss actually suffered.

Liquidated Damages before the UAE Courts

The UAE Courts have taken different approaches to the application of Article 390(2). The Dubai Court of Cassation (Appeal No. 222 of 2005) suggests that a judge is empowered to adjust the compensation owed under a liquidated damages provision to equal the loss actually suffered. Accordingly, any difference between the agreed liquidated damages amount and the actual loss suffered may be adjusted to reflect the former.

The Abu Dhabi Court of Cassation (Appeal No. 941 of 2009) found that an adjustment under Article 390(2) should only be made when the amount claimed is excessive. The court held that;

The judge has to abide by the agreement of the parties and give effect to it unless the party against which the clause is invoked proves that the agreed compensation is excessive.

It is suggested that the Dubai Court of Cassation's finding in this regard is more in line with a strict interpretation of Article 390(2) and the principle of gharar.

In Summary - What to do if your Demurrage Provision is subject to UAE Law

Demurrage under UAE law remains in relatively untrodden territory. Parties negotiating demurrage provisions should be aware that, under UAE law, the agreed compensation may be changed. The key factor in this regard is the amount of time the vessel is on demurrage.

During the 'first period' (which is equal to the agreed laytime) the demurrage rate will be what is recorded in the charterparty. Once this period is complete, during the subsequent 'second period' (which is also as long as the agreed laytime) the demurrage rate is automatically increased one and a half times. During these two periods, the demurrage rate is considered part of the hire, after which it may be considered a liquidated damages provision.

Practically, it is important that parties:

- are aware that demurrage is automatically adjusted after the first additional period is exceeded;
- are prepared if the other party requests a court to adjust the demurrage rate under Article 390(2) of the Civil Code;
- continually identify what may constitute a 'loss' during any demurrage period, for example, by identifying all operating expenditure incurred during the demurrage period;
- carefully document and record the losses as these documents may be required in court.