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Termination of Contracts
whether the economy can create a force majeure solution;
enforcement of contracts, collection of freight, security and related issues

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1 Introduction

Briefly saying, Japan is not a country in favor of those who wish to terminate the contract due to change of the economy which either or both of the parties did not expect at the time of signing the contract. However, because of the recession started from the summer last year, my firm has various consulting cases regarding the termination of the marine contract, especially the time charter and the shipbuilding contract. Here, I try to describe the situations under Japanese laws by referring to some recent problems in the charter party and the shipbuilding contract, as well as guarantee therefor.

2 Principle

The situation or background the parties relied on at the time of contract may change during the period of contract. If enforcement of contract as is becomes unfair for the parties to contract, either party may terminate the contract or may demand to amend the terms of contract. This is so-called *clausula rebus sic stantibus* or *impediment theory*: the principle for case of the change of situation. Typical example is Article 79, para 1 of *Vienna Convention*, which is said to correspond to *frustration theory* in UK, *commercial impracticability* in US, *imprevision* in France and *Wegfall der Geschaftsgrundlage* in Germany.

There is no particular provision in statute in Japan, which provides in general for this principle. However, there are some statute which is considered as coming from this principle. For instance, Articles 11 and 32 of *Landlord & Tenant Law (Shakuchi Shakka Ho: Law No. 90 of 1991)* provides *inter alia* that either party to a landlord and tenant contract may demand to the other party to increase or

decrease the rental fees in case the rental fees becomes unreasonable in comparison with the rental fees of those nearby due to the change of economic conditions such as change of tax and other impositions on real estates and of the price of real estates. But this Law aims to protect tenants in Japan having so many people in small land, and could not extend its theory to the other commercial contract.

It is submitted that in order to apply the principle of *clausula rebus sic stantibus*, we need the following situations: -

(i) After the contract was made, there occurs radical change in the objective situations which were the premises for the contract;

(ii) Neither of the parties could foresee such change of the situations;

(iii) Such change of the situations has arisen not due to any of the parties; and

(iv) Enforcing the contract to the parties will be against fairness and sincerity between the parties.

What is "radical change in the objective situations". The scholars consider it such as extraordinary inflation after the war or the Act of God, and so do the practitioners. Such radical change would rarely happen. There is no Supreme Court case so far, which applied this principle for change of the situations.

It is further submitted that the parties to the contract shall make their attempts to keep the contract, and therefore the parties shall make attempts to amend the terms of the contract so as to fit them with the prevailing situations. From this theory, it is also submitted that the parties shall not unreasonably reject the negotiation for such a purpose, and if a party did so, that party shall be considered to be in breach of contract.

3 Increase/decrease of charter hire

In the late 90s, the charter hire was low in the market and kept low for a long period. The ship owners in Japan had considered at that time if there was any way to raise the hire in the negotiations with the charterers. The ship owners often borrow the theory of *clausula rebus sic stantibus* in their negotiation. As mentioned the above, the situations at that time was absolutely not those to apply the principle. However, the ship owners, though they were not obligated

to do so under the contract, sometimes fully disclosed their financial situations and some succeeded in raising the hire to keep their business. Some of the charter party was changed to raise the hire but narrowing the range of the hire in the next term. Sometimes, the ship owner could not succeed in raising the hire in its negotiations, and refer the dispute to the arbitration of Japan Shipping Exchange. JSE arbitration in this kind of cases reviewed the financial situations of the ship owner and the charterer, and in many cases, the arbitrator strongly recommended amicable settlement with increase of the charter hire. The arbitrators were also taking account of a long relationship between the parties by the charter party such as 5 to 10 years.

It is submitted that the contract with a long term shall be construed with consideration of the parties' relationship to be kept for a long time. For instance, even without provisions to be applied, a party could delay its performance if the other party has financial trouble and could not secure its performance in the future. Mutual reliance is in such cases considered as one of the essence for such kind of long term contract. However, in most of time charter cases, there are the other provisions to apply to a particular situation, while there is no provision to apply in a situation to terminate or revise contract, where the charterer has financial trouble or goes into bankruptcy, reorganization or other similar procedure. Instead, usual time charter terms obligate the ship owner to wait the charterer's failure to pay the hire. In 5 to 10 year time charter, usually it has a provision to fix the hire in each of several years, by which the above principle of *clausula rebus sic stantibus* or *impediment* would not apply to the situation.

Since the last fall, there were many discussions between the ship owners and the charterers in order to lower the hire. The initiative is of course on the charterers, and the ship owners are now often reviewing the financial status of the charterers at present and in the near future. Considerable number of ship owners, having faced recessions in the market, tried to make their business smaller. The quicker the better is their way of thought. Many charter parties, which already entered into but the ship is not yet built or delivered, was terminated with the charterer's lump sum settlement payment upon termination of the charter.

4. Shipbuilding contract

In the mid-2000s, the steel price jumped up and the ship builders had difficulties to obtain necessary volume of steel to build ships under their shipbuilding contract. Often, shipbuilders declared their delay in delivery. The situations however would not allow the principle to apply. But there were many discussions to raise the ship price or to delay the time for delivery. In many cases, discussions involved disclosure of financial situations and steel market, as well as the shipyard's schedule, and some reached to an agreement to revise the shipbuilding contract.

In shipbuilding contracts between Japanese shipbuilders and the ship owners, there is a provision to say, the parties shall mutually discuss with sincerity if there is any issue which is not provided in the contract, such a provision prompts the parties to have discussions, and very often they are taking account of their long term relationship which have already accrued or is expected to establish in the future, in order to consider a possible settlement. The standard form of building contract in Japan provides for the constructor's right to demand the increase of the construction fee in a situation where the construction fee becomes inappropriate due to change of laws, prices or employee salaries, which is similar to *BIMCO Wreckfix*, for instance. Also, the building contract sometimes has a provision to impose the parties to the contract duties to discuss the increase or decrease of the construction fee in case of change of law, prices or employee salaries. In the former form of contract, in case the parties could not reach to an agreement for a revised construction fees, Japanese courts would fix it, while the latter provision in the contract would not give the court discretion to decide an appropriate construction fee, and the court would dismiss the constructor's action to increase its fees in case the parties have failed to fix the revised construction fees. Sometimes, Japanese shipbuilding contracts have similar provisions, and Japanese courts would treat them as same as in the building construction contract.

Since the last autumn, many shipbuilders have fallen into troubles by the ship owner's cancellation of the contract. There is no right in most cases for the ship owner to cancel the contract. However, some ship owners went out of business or because of their financial difficulties could not help but cancel the contract.

The shipbuilders are facing difficulties to get quick recovery for their claim against such ship owners, and some shipbuilders, though still having good shipbuilding contracts with the other financially stable ship owners, applied for bankruptcy or reorganization proceedings. The bank's intention if they could continue financial support, such as by delaying the interest payment, is critical in this kind of cases. In the reorganization proceedings, the court or the trustee often press the banks and the creditors to revise their contracts to keep the shipbuilder alive in business. The process of the principle is being accomplished in that way.

5 Guarantee

A guarantor who guarantees performance of the charterer or the ship owner rely on the financial status of such principal debtor at the time of his guarantee. So is considered, Japanese courts often stop enforcing the guarantee against the guarantor in cases of a landlord and tenant contract and a guarantee letter for employee and ex-spouse. The courts try to make the scope of application of the conditions of the guarantee narrower so as to enable the guarantor to escape from the duties under the guarantee. However, the guarantee for the time charter, the shipbuilding contracts and the other most maritime contracts is commercial and is made by expectation that the guarantor will assume overall obligation for the principal's performance under the contract, and the guarantor has difficulties to be exempted from his liability under the guarantee.

6 Tentative conclusion

Due to short of time, I wish to close my speech, not referring to further cases which avoided to apply *clausula rebus sic stantibus* or *impediment theory* but apply the other provisions of the contract. Japanese courts and so we the practitioners, have avoided the theory as far as possible. Let's talk about a story of 'Kakkontoh':

Kakkontoh (葛根湯) is a traditional and long-used herbal medicine in Japan, consisting of arrowroot gruel, adding crude drugs like tree's wigs, grass roots, etc., all-mixed up. Old and junk doctors were giving patients Kakkontoh, every occation. Say, a patient has a headache, give Kakkontoh. S/he is catching a

cold, Kakkontoh! Hangover, Kakkontoh!! If you are pregnant... Congraturation! Have Kakkontoh!! Who are you? A hasband? waiting for your wife during my consultation? You must be bored. Have Kakkontoh!!! Fell down the stair from 2nd to 1st floor? 'Kakkontoh', and said, "why you did not take Kakkontoh before fell-down!" *Clausula rebus sic stantibus* shall never be Kakkontoh like this. We should not use it always, but depending on what and how you mix up crude drugs and when you use it, Kakkontoh will be a good medicine.

[End]