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MARITIME: BRIEFING
LETTERS OF QUIET ENJOYMENT
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- INCREASING NUMBER OF PROJECTS FALLING INTO DISTRESS
- ALL PARTIES LOOKING MORE CLOSELY AT THEIR CONTRACTUAL ARRANGEMENTS
- LETTERS OF QUIET ENJOYMENT (“LQE”) ARE DESIGNED TO ADDRESS THE CHARTERER’S RIGHTS IN THE EVENT OF AN OWNER DEFAULT



With the offshore sector and various segments of the shipping market experiencing difficult times, an increasing number of projects are falling into distress – which has charterers, owners and lenders looking increasingly closely at their contractual arrangements (including at their security and any related letters of quiet enjoyment).

“...THE TERM “QUIET ENJOYMENT” REFERS TO THE LEGAL RIGHT OF A LESSEE OR CHARTERER TO THE UNDISTURBED USE AND ENJOYMENT OF THE VESSEL OR UNIT THAT IT HAS LEASED OR CHARTERED.”

In the context of the charter of a vessel or offshore unit, the term “quiet enjoyment” refers to the legal right of a lessee or charterer to the undisturbed use and enjoyment of the vessel or unit that it has leased or chartered. A charterer that enters into a long term charter arrangement with an owner will quite reasonably expect to have unfettered use of the vessel for the period of the charter – provided of course it continues to pay hire. As a consequence the charterer will often request that the owner of a vessel provides a letter of quiet enjoyment (or “LQE”) from any lender that has been granted security over such asset or charter when entering into a long term charter or contract of employment.

What is meant by an LQE?

Whilst charter or employment contracts are contractual arrangements between an owner and a charterer, an LQE establishes a direct relationship between the mortgagee of a vessel and the vessel’s charterer, with the intention (at least from the charterer’s perspective) to secure an agreement from the mortgagee that it will not enforce its security against a vessel provided the charterer continues to perform its obligations under the underlying charter contract – or if it does enforce it will only do so in a way which preserves the charterer’s use and enjoyment of the vessel.

“...THERE IS NO STANDARD FORM OF LQE ...THE WORDING OF AN LQE WILL ULTIMATELY DEPEND ON THE BARGAINING POWER OF THE RELEVANT PARTIES.”

What does an LQE comprise of?

However, there is no standard form of LQE and whilst an LQE may impose certain limitations on the ability of the mortgagee to enforce its security in the event of an owner's default, it also presents an opportunity for the mortgagee to secure some additional rights of its own. In addition and by its very nature, an LQE can operate to address some of the legal uncertainties under English law that surround the relationship amongst an owner, its charterer and the mortgagee which are referred to further below.

The wording of an LQE will ultimately depend on the bargaining power of the relevant parties. But for a charterer that has entered into a long term charter arrangement (especially in respect of assets that are specific to a particular project, such as LNG carriers, FPSOs and drilling units), it will want to ensure that in the event of an owner's default, it has the right to maintain the charter in order to minimise the impact to its own commercial operations. As a consequence, charters often include a provision preventing an owner from granting security over the vessel, or from assigning its rights in the charter without the consent of the charterer. The inclusion of such a provision in a charter may in itself require the owner's lenders to enter into discussions with the charterer – with the charterer only being prepared to consent to any security upon the receipt of an LQE from the lenders in a form and substance acceptable to the charterer.

On the other hand, in the event of an owner's default the lenders will wish to be able to enforce their security including exercising any contractual step-in rights that they may have to replace the owner, whilst ensuring that the charterer maintains the charter and continues to pay charter hire. This introduces an interesting dynamic because whilst the lenders will be keen to maintain the cash flow under the charter, and the charterer to maintain its use of the vessel, it is likely that the charterer will also want to be able to exert some influence over the identity of the company that the mortgagee intends to replace the defaulting owner with, rather than for the charterer to have an unacceptable owner or operator unilaterally imposed on it by the mortgagee. As a consequence, these conflicting positions tend to be discussed (and settled) by the parties when negotiating the terms of the LQE.

In addition, the mortgagee will want the LQE to include a provision whereby the charterer is obliged to notify the mortgagee of an owner's default and grant the mortgagee a right to remedy such default prior to the charterer exercising any right it may have to terminate the charter.

In view of the complexities involved in negotiating an LQE (which by its nature is designed to address circumstances that at the time the LQE is entered into are unknown), the parties often agree to a standstill period during which time they are obliged to work together to try to find a permanent solution. During such a standstill period, the mortgagee will not be entitled to enforce its security and the charterer will maintain its quiet enjoyment of the vessel. However, in the event a solution is not forthcoming within such timeframe the mortgagee will generally insist on the right to sell or dispose of the vessel – even if such sale or disposal is subject to the terms of the underlying charter.

So whilst the provision of an LQE is often viewed as being a requirement of the vessel's charterer, its terms can also be beneficial to the mortgagee – especially if it is

accompanied by the charterer's acknowledgment of an all-rights assignment of the charter in favour of the mortgagee.

Governing law

Otherwise and irrespective of its terms, the effectiveness of an LQE will be dependent on the application of various laws. These include the law of the vessel's flag state, the governing law of the mortgage (which is likely to be the same as the law of the flag state), the governing law of the LQE itself (which again may follow that of the mortgage), and ultimately the law of the jurisdiction in which the mortgagee is seeking to enforce its mortgage. As a consequence, the mortgagee should seek legal advice on all applicable laws before commencing any enforcement action.

"...WHAT ARE THE RESPECTIVE RIGHTS OF THE PARTIES IN THE EVENT THAT AN LQE IS NOT REQUESTED OR CANNOT BE AGREED?"

However, the issues mentioned above raise the question as to what are the respective rights of the parties in the event that an LQE is not requested or cannot be agreed.

Assuming that the owner has granted a mortgage over the relevant vessel in the first instance then as a matter of English law, performing charterers (whether under a time charter or bareboat charter) automatically benefit from a level of quiet enjoyment protection, as the law tries to balance a mortgagee's rights of enforcement against the rights acquired by a performing charterer with respect to the vessel. However, the law in this area is complex and the rights of the parties will depend on various factors, including the law of the vessel's flag state, the nature of the charter (i.e. whether a bareboat or a time charter) and whether the underlying charter pre-dates or post-dates the mortgage.

Nevertheless in very general terms as a matter of English law, where the owner of a vessel has entered into a charterparty or other contract for the employment of a vessel and subsequently defaults in paying amounts secured by way of a mortgage, the mortgagee is restricted from taking possession, selling or arresting the vessel unless the security created by the mortgage is imperilled or the owner is unwilling and/or unable to perform the charter contract. This is the case even though under the terms of the mortgage, the mortgagee may contractually be entitled to take any of the aforementioned steps as it chooses. However, the laws of the jurisdiction where enforcement takes place will also be relevant – and the position may well be different from that under English law.

Therefore mortgagees should take considerable care when enforcing their security, and in the absence of any clearly defined set of rights between the relevant parties as set out in an LQE, it is preferable if a mortgagee seeks to enforce its security at a time when the vessel is charter-free so as to avoid the complications highlighted above.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with the author, Joe McGladdery, a member of our team below, or your regular contact at Watson Farley & Williams.

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