WaveLength

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Tax Haven – Is it a real haven ?

*Yosuke Tanaka**

1. Introduction

Japanese Tax Law has provisions called as "Tax Haven Rule", which is intended to impose tax onto the profit earned by Japanese companies as the result of establishing their subsidiaries in countries where tax systems are more generous than in Japan.

Under the Japanese Tax Haven Rule, when a subsidiary company which is established by a Japanese company in such countries where the amount of tax is provided as less than 25% of the profit (hereinafter referred to as the "Tax Haven Country") makes a remaining profit as the result of taxation by such generous law, the Japanese parent company which established the subsidiary has to calculate its own tax amount by adding such remaining profit into the amount of its own profit.

However, the meaning of this rule and its adaption has been in dispute in some aspects among the academics and the case laws, and it can not be said that the meaning has been fully understood in practice and the rule has been completely adapted to all of the Japanese companies which have subsidiaries in the Tax Haven Country.

In September, 2007, the Japanese Supreme Court held the judgment[1] unfavorably for the appellant of a shipowner who has declared its tax amount to the authority for more than 20 years by adding both of loss and profit in its subsidiary in Panama into its own account. The shipowner was ordered suddenly from the Japanese Tax Authority that it could add the "profit" of the subsidiary but not its "loss" to its own account. The shipowner has struggled against the authority for more than five years, however, it turned out that its contention was not allowed by the court.

It is rare that Tax law is disputed and held in the Japanese Supreme Court, and it seems to be difficult for the people in foreign countries to understand the Japanese Tax Law, therefore, this report is intended to introduce the Japanese rule and the above-mentioned case to foreigners and try to make some comments about the judgment, rule and its future effect.

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[1] Judgment held by Supreme Court on 28th September, 2007 (cited in "Kaijiho Kenkyu Kaishi" published by Japan Shipping Exchange, November 2007 issue, p58)

2. Summary of Tax haven Rule

(1) Japanese Tax Law provides that a subsidiary located in the Tax Haven Country, which is established by Japanese companies, has to add its profit after the taxation in the Tax Haven Country into the amount of profit of the Japanese parent companies for their calculation of tax amount.

Such subsidiary is called as the "Specified Foreign Company" and it includes the subsidiaries into which any Japanese parent companies or Japanese citizens put the money of more than 51% of share capital in the subsidiaries.

(2) The Tax Haven Country had been specified before by listing up each name in the list attached to the Law, however, the current law defines it as the country where the tax amount is provided for as less than 25% of profit substantially.

According to the current definition, most of the countries as FOC ("flag of convenience") are included into the Tax Haven Country.

(3) As the calculation of the amount in the Specified Foreign Company to be added to the profit of Japanese parent companies (hereinafter referred to as the "Taxable Remaining Profit"), from the amount of profit after taxation in the Tax Haven Country, the loss carried over for seven years[2] should be reduced

In addition, some expenses, including the tax amount actually paid to the authority in the Tax Haven Country, labor cost and dividends, should also be reduced.

Under the following formula about some reductions from the profit in the Specified Foreign Company, the Taxable Remaining Profit shall be fixed.

[remaining amount of profit after taxation in Tax Haven Country]
— [carried over loss for seven years]
— [tax amount paid to Tax Haven Country, labor cost, dividends]
= [Taxable Remaining Profit]

(4) In case all of the following conditions are satisfied, the Specified Foreign Company and Japanese parent companies are exempted from such Tax Haven Rule.

(i) The Specified Foreign Company shall not be engaged in specified businesses, including the holding of shares, offering of patents and hiring of vessels or aircrafts.

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2 This period was provided as "five years" at the time of the judgment as described above.

(ii) The Specified Foreign Company shall have its own office in the Tax Haven Country.
(iii) The Specified Foreign Company shall conduct itself its management of business.
(iv) In case the Specified Foreign Company is engaged in specified businesses, including sales of goods, banking and transportation, it shall trade with the companies which do not have any special human or capital relationship between the parent companies.
(v) In case the Specified Foreign Company is engaged in businesses other than those specified in the above (iv),

However, it is very difficult in practice for companies to obtain exempted under this requirements.

3. Factual background

(1) Under the above-mentioned case, a company having its address in Japan, the plaintiff in this case, established its subsidiary at its 100% share in Panama in June, 1983, and has let the subsidiary own and register some vessels on its name.

Moreover, the plaintiff has declared and reported to the Japanese Tax Authority its tax amount by adding the profit and reducing the loss into and from its own account.

(2) In September, 1998, the relevant local office of Tax Authority noticed to the plaintiff that its calculation of tax amount by adding the loss of the subsidiary was incorrect, and imposed the tax onto the plaintiff for the amount as calculated by not reducing the loss of the subsidiary.

(3) The plaintiff claimed objection against the above decision and filing the case in the relevant District Court.

The District Court held in favor of the plaintiff, and the Japanese Tax Authority appealed the case to the relevant High Court as the 2nd instance. The High Court held in favor of the Tax Authority, so the plaintiff appealed again to the Supreme Court, which held in favor of the Tax Authority in the end.

4. Reasons taken by the court

(1) As the reason in favor of the plaintiff, the District Court mentioned the principle in the Japanese Tax Law that the tax should be imposed on the entity to which the loss and profit actually belong. In addition to that mentioning about the principle, the court construed the Tax Haven rule as the convenient method for the Tax Authority which may face with difficulty when they try to find the real entity on which the tax should be

imposed in accordance with the principle.

Further, the court construed that the Tax Haven Rule provides to add the profit in the subsidiary into the parent company only when the profit remains, but the Rule does not provide about the calculation in case the subsidiary holds the loss.

Therefore, the court concluded that the decision made by the Tax Authority on the ground of the Tax haven Rule only was against the law and should be dismissed.

(2) As the reason in favor of the Tax Authority, the High Court as the 2nd instance construed the Tax Haven Rule stricter than the District Court, not as "convenient" one. The court held that in case a Japanese company establishes a subsidiary in Tax Haven Countries, the Tax Haven Rule shall apply and the principle as described above shall not apply, irrespective of whether the subsidiary holds the profit or not.

Further, the court held that the loss in the subsidiary can only be taken into account as carrying-over in calculation of the Taxable Remaining Profit" as described above.

Therefore, the court rules that the decision made by the Tax Authority was legal and effective in this case.

The Supreme Court held its agreement with the judgment held by the High Court.

4. Comments

(1) Firstly, as the normal construction of the words in the law, it should be noted that carrying-over of the loss in the subsidiary is provided for as only the way of the calculation of the Taxable Remaining Profit. It can not be recognized clearly from the words that the parent company can not reduce the loss in the subsidiary from its own profit.

(2) However, once the Supreme Court makes the judgment to realize the importance of taxation by the Authority, the practice in this aspect which has not been clear for a long time seems to be changed.

According to the judgment by the High Court and the Supreme Court in this case literally, the shipowning company shall report the tax amount to the Authority by declaring the "share", not "vessel", as its one of the assets in calculation of the profit.

(3) It has been in dispute in practice in Japan for a long time how the share not listed in the public market without clear market vale can be calculated properly for taxation.

Therefore, though the Supreme Court seemed to decide in favor of the Tax Authority considering its "convenient" taxation, it can be said that the decision produced another difficulty for the Authority.

Summary of TOMAC Arbitration

Charterers' responsibility for damages to engine arising from fuel oil

The Claimants: Ship Owners (Panama)
The Respondents: Time Charterers (Japan)

Under the time charter party on the amended Produce form 1946 dated 23 June, 1997, between Owners and the Time Charterers, the Vessel was chartered for 10 years with one month more or less in Charterers' option, and delivered to the Charterers on the same day. The fuel oil was arranged and supplied by the Charterers. Whether the Charterers should be liable for damages to main engine.

Facts and Discussions

Claimants, Owners stated as follows:

1. During the service of the Charter the Vessel was replenished with bunker fuel on November 24, 2003 in Singapore by the Charterers' instruction and arrangement.

At about 5 p.m. on December 20, 2003, the 1st Engineer on duty found that the exhaust gas temperature of the main engine had abnormally risen to 380°C to 400°C ranges and immediately reported the fact to the Chief Engineer.

As instructed by the Chief Engineer, 1st Engineer reduced output of the main engine by reducing the revolution of main engine from 156 r.p.m. to 140 r.p.m so as to run the main engine without excessive rises of the exhaust gas temperatures.

After the Vessel arrived at Hong Kong on the next day, December 21, 2003, the main engine was opened and following damages were discovered;

Excessive abrasion of the cylinder liners,
Almost all piston rings were broken,
Excessive abrasion and cracks of seat and spindle of the exhaust valves No. 2 and No.5,
Excessive abrasion of the plunger and inner surface of the barrel of No.5 fuel pump.

2. The main engine of the Vessel was in good order and condition since she was built and delivered to the Charterers until November, 2003. The Vessel underwent Special Survey by the Classification Society in July 2002 and it was confirmed that there was no abnormality to the machineries on board. After the Special Survey in July 2002, her

machineries were inspected and routine maintenance was conducted at regular intervals, without any problem.

When the Vessel called at Hong Kong on 21 December, 2003, samples of the fuel oil were collected from the No.2 port and starboard fuel tanks in use then, which were inspected by a surveyor together with the sealed samples delivered by the bunker barge for analysis. The analysis revealed that the sealed samples were of normal property and condition, but the sample fuel taken from the Vessel's fuel tanks contained excessive FCC (Silica Alumina) and "waste lubricating oil".

For further investigation, broken piston rings and damaged cylinder liner were sent to a shipbuilding company. Then it was found that there was bitten FCC to the surface of the cylinder liner and piston rings and that excessive abrasions were caused by the FCC complex-oxide ingredient. As the result of the fuel containing FCC and waste lubricating oil, it was thought that the damages to the main engine were caused by excessive abrasions due to FCC complex-oxide ingredient.

3. Prior to the commencement of pumping in the fuel oil, a crew-member of the barge came on board the Vessel and requested the Chief Engineer to sign on the tag of empty sample bottle to which, he signed. After the completion of supply of the fuel, a crew-member of the barge came on board again with filled sample bottles. The Chief Engineer refused it because "sampling" was undertaken without attendance of the Vessel's engineer.

On the other hand, the Vessel's sample was taken on December 21, 2003, at Hong Kong by the 3rd Engineer through air vent of the F.O. transfer pump, as "sample" taken from No.2 port and starboard fuel oil tanks, after the aforementioned engine trouble had occurred.

As the Vessel's crew-members did not joined in collecting samples from the barge, the sealed sample is unable to prove identity of the fuel oil which supplied to the Vessel and therefore lacks evidential value. The Vessel's sample was taken directly from the F.O. Tank in use.

4. Between November 24 and December 2 including, the fuel oil in the No.1 (P&S) F.O.T. was consumed and on December 3 and 4, the fuel oil in No.2 (P&S) F.O.T. was consumed. Then from December 5 until December 10, the fuel oil in the No.3 (P&S) F.O.T. and from Dec 11 until Dec.21 in the No.2 (P&S) F.O.T. was consumed.

Further, it is absolutely not possible to make FCC and waste lubricating oil to be contaminated F.O. through supply and transfer lines. When and after the Vessel received the supply of the fuel oil, no work which may allow contamination of the fuel oil with FCC and waste lubricating oil.

5. Detailed specification of the quality of the fuel oil is not stipulated in the Charter. However, the Charter provides that the Charterers shall provide and pay for all the

bunkers except as otherwise agreed, which imply the obligation that the Charterers shall not supply any inferior fuel to the Vessel that may cause the damage to her machineries. ISO8217-(4) provides that fuel should not include any added substance or chemical waste which jeopardized the safety of ships or adversely affects the performance of the machinery. Nevertheless, the fuel supplier supplied the fuel of poor quality, which was a breach of the Charterers' obligation. The Charterers have to compensate the damages sustained by the machineries on board the vessel to the Owners.

The Owners sustained damages of Yen53,029,438

Respondents, Charterers stated as follows

1. The fuel oil supplied to the Vessel on 24 November, 2003 in Singapore was appropriate under the Charter. The analysis of sealed sample revealed that the sample oil was not off-spec quality. Even if damages occurred to the main engine of the Vessel, fuel oil supplied on 24 November, 2003, has nothing to do with the alleged damages.

2. The Owners insist that sampling procedure was inappropriate, but no specific evidence to prove that the sampling procedure had been inappropriate was submitted. The sample collection was conducted in accordance with the Singapore Standard CP-60: 1996 (amended 2001) (hereafter referred to as 'CP-60'), which stipulates about the method of proper procedure of sampling of fuel oil. Further, the Vessel's crew members were in attendance during the collection of the sample fuel oil from the Vessel's manifold. The Chief Engineer checked all the papers relating to the collected sample fuel oil and confirmed that the sampling procedure was appropriate and then he signed the papers. The Chief Engineer never refused the sealed samples and therefore the sealed samples in question were official samples collected in accordance with the every provision of CP-60.

Therefore, if the main engine of the Vessel was damaged, quality of the fuel supplied had nothing to do with the alleged damages thereto.

3. The sample oil collected from the Vessel was the oil which was affected by the conditions of the fuel tanks controlled by the Vessel, and is not same with the quality of the supplied fuel concerned. Therefore, the evaluation of the Vessel's sample has no value to support that the supplied oil was of inferior quality. If analysis of the Vessel's sample revealed abnormality of the quality, it meant that the inside condition of the Vessel's fuel tanks had been stained. The stained fuel oil tanks were concerned with the Vessel, not the quality of the supplied fuel oil. From the view point of due process of a sampling, the Vessel's sample was collected without any involvement of the Charterers and lacked legitimacy. Such a flawed sample will not be allowed as admissible evidence.

4. Accumulation of residual oil for long period of time causes accumulation of extraneous material on the bottom of the tanks. The Vessel received fuel oil in the tanks remained with residual bottom oil, not in the empty tank for long time. That is, the

Vessel's fuel tanks had been contaminated with accumulated extraneous material on the bottom, and therefore added fuel oil was affected by the residual bottom oil as a matter of course.

Decision and Reasoning

1. Clause 2 of the Charter provides *inter alia* "the Charterers shall provide and pay for all the fuel except as otherwise agreed." and no agreement in respect of quality of the fuel oil was provided. It is generally understood that the quality of the fuel oil shall be within the acceptable criteria among the shipping industry.

The said criteria is provided in the ISO8217 as follows:

> 4.1 The fuel shall be blends of hydrocarbons derived from petroleum refining. This shall not preclude the incorporation of small amounts of additives intended to improve some aspects of performance. The fuels shall be free from inorganic acid. Note.3. The fuel should not include any added substance or chemical waste which jeopardized the safety of ships or adversely affects the performance of the machinery
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> According to this provision, the fuel oil shall be free from additives and chemical waste, which affects adverse affects to the performance of the machinery.

2. It is well-known among the current shipping industries that in Singapore there exist a number of suppliers who supply to the vessels fuel oil of poor quality adulterated with residual oil contaminated by impurities such as alumina-silica, waste lubricating oil etc., which possibly damages the machineries. Under the circumstances, ship owners have to make their chief engineer pay utmost attention so as not to receive fuel oil containing harmful impurities.

3. CP-60 specifys that samples collected under attendance of the chief engineer shall be sealed, signed and preserved by each parties i.e., the Vessel and the bunker barge. The sealed sample of this case was examined and found that no impurities other than specified in the ISO Rules, that is to say the fuel oil supplied at the material occasion was sound fuel oil without any contamination of impurities.

Nevertheless, the Owners insist that the F.O. samples were collected prior to the commencement of bunkering operation without attendance of the Vessel's crew-members and that the Chief Engineer was required to sign on the blank forms of "Bunker Delivery Receipt" "Bunker Requisition form" and "Sample Label". They said that the Chief Engineer had no alternative but to sign the blank forms as the departure of the Vessel was imminent.

However, the Chief Engineer in the first place should refuse to sign to such blank forms. If the surrounding circumstances at the moment of bunkering was so imminent,

such facts should have been reported or protested to the Owners, Charterers and the Suppliers after his signing.

4. CP-60 provides that "G-4 The cargo officer shall invite the chief engineer to witness any adjustment of the needle valve on the sampling probe to control the rate of sample withdrawal. This is to ensure that a continuous drip samples is collected throughout the entire duration of bunkering". It means that sealed samples shall be collected during whole period of the bunkering.

The report of inspection in respect of the cause of "abnormal wears of piston rings" states that the surface of sliding edge of the piston rings have bitten oxidized alloy of almi-silica of over 10μm and maximum 25μm sizes, and so it is presumed that abnormal wears of liner, rings were caused by abrasion with oxidized almi-silica which had been existed in the supplied fuel oil. It is impossible to admix almi-silica, which causes damage to the engine, into the fuel oil by the Vessel's crew.

5. How the impurities such as almi-silica got mixed into the fuel oil tanks ?

(1) Her fuel oil has been supplied solely by the Charterers since her delivery.

(2) Any similar damages to the engine had not occurred until the time in question.

(3) Taking into consideration the fact that the chief engineer had no knowledge of CP-60 and the cargo officer of the bunker barge did not request the Chief Engineer to attend the adjustment of needle valve prior to collection of the sample oil, it can not be said that the sampling of the fuel oil in compliance with the CP-60 had been carried out throughout the entire duration of bunkering.

(4) Generally speaking, abnormal abrasive wears of the cylinder liner due to the fuel oil contaminated with almi-silica becomes visible by increase of exhaust gas temperature within after one to two weeks since the commencement of burning such fuel oil.

Therefore, it is concluded that the impurities was admixed at the moment of the bunkering concerned.

The Charterers, who shall arrange and pay for the bunkering cost under the clause 2 of the Charter, shall be liable for the act of the F.O. supplier and must bear the repair expenses for the damage of the engine.

The Charterers stated that the damages were occurred by the accumulation of the sediment in the fuel oil tanks due to poor maintenance of the vessel is not acceptable, as the damages were caused by the almi-silica.

The Owners were awarded Yen14,008,900

August 29, 2005 TOMAC Arbitrator: Shigeto YUNOKI

The Legal Nature of a Time Charter under Japanese Law— To Be or Not To Be

*Caslav Pejovic**

Introduction

The legal nature of a time charter was the topic selected for discussion at the 57th Annual Conference of the Japanese Association for Maritime Law held in October 2007.[1] The main focus of the discussion was on the issue of whether the practice of Japanese courts of relying on the legal nature of a time charter to resolve questions of liability will end after the *"Jasmine"* case[2] ("Jasmine Case") or will it continue. Since I have already written about the *Jasmine Case* in this journal,[3] welcoming the court's decision not to rely on the legal nature of a time charter (albeit taking a rather critical view of the sentence itself), this is a good opportunity to elaborate on my reasons for discouraging such reliance on the legal nature of a time charter.

The legal nature of a time charter is one of the most complicated issues in the whole field of maritime law. There are many divergent legal theories about what kind of contract a time charter is.[4] The purpose of this paper is not to add another view on this controversial issue, but rather, to offer an opinion on why focus on the legal nature of a time charter should not be reinstated in Japanese courts as a tool for deciding disputes arising from time charters. To support this view, one of the arguments will demonstrate that all the theories on the legal nature of a time charter can be challenged because of their inherent weak points. Another argument will show that reliance on the legal nature of a time charter is a futile and inappropriate way to identify the party liable under such charter.

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I would like to express my thanks to Marose Pereira who edited my text.

1 The reporters were Masako Yoshitake and Takayuki Matsui. The latter report is available at http://www.marinelaw.jp/download/resume_071008.pdf (in Japanese).

2 Oriental Fire & Marine Ins. Co. v. Kansai Steamship Co. (hereinafter, the "Jasmine Case"), 10 Kaiji-ho Kenkyu Kaishi 16 (Tokyo Dist. Ct. 1991); and the Supreme Court 27 March 1998 Hanketsu Minji No. 14 p.1495.

3 C. Pejovic, *The Identity of the Carrier under a Time Charter in Japanese Law (The Jasmine Case),* The Bulletin of the Japan Shipping Exchange 1, No. 33 (1996).

4 In Japanese legal theory, there are nine different views on the legal nature of a time charter as identified in Yoshitake's paper (*see,* note 1).

Development of Japanese Law on Time Charters

Liability under a time charter involves a number of different situations. The scope of this paper is limited to two situations related to the issue of liability to third parties of either the owner or the charterer. The first situation involves the liability arising from the contract of carriage performed by a ship under a time charter while the second one pertains to tort liability.

There are two possible ways to establish who is liable to a third party under a time charter. One is to define its legal nature and then apply the relevant legal provisions. Another way is to determine liability based on the content of a time charter, and other relevant documents and circumstances.

For several decades, the Japanese courts have focused on the legal nature of a time charter to determine the liability arising from such time charter to third parties. The prevailing view adopted by Japanese courts was that the time charter is a type of lease contract, and by applying Article 704 of the Commercial Code, the charterer was considered to be the carrier responsible to third parties under a contract of carriage.[5] This view was followed in a number of subsequent cases.[6]

This traditional attitude was brought to an end by the *Jasmine Case*, where the court ignored the issue of the legal nature of a time charter, and simply focused on the facts of the case,[7] basing its decision on the contents of the bill of lading. This decision effectively ended the practice of relying on the legal nature of a time charter to resolve the issue of liability to third parties. The same position was then adopted in a number of cases afterwards.[8]

Background of the Problem

In order to understand the complex issues related to the liability arising from time charters with respect to third parties, the background of those problems should first be examined. The initial issue concerns the causes of the difficulties in identifying the legal nature of a time charter as well the party liable under a time charter to third parties. The

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5 R.D. Tata & Co. v. Taiyo Shipping Co., 7 Minshu 519 (Sup. Ct. 1928) (Jap.). This view has the support of majority of the Japanese legal scholars. See, e.g., T. Ishii, Kaishoho 17 (1964); Kawamata, Teikiyosen keiyaku no seishitsu, in Shoho Soten 270 (2d ed. 1977); Kojima, 9 *Sogo* Hanrei Kenkyu Sosho Shoho302 (1963); and Tanikawa, Teikiyosen keyaku no hoteki kosei*,* 27 Hogaku Kyokai 618 (1955).

6 Supreme Court 4 September 1935 Minshu Vol. 14 p. 1495, Supreme Court 4 November 1937, Zenshu Vol. 4 p. 1086, Tokyo Dist. Ct. 17 June 1974 Hanrei Jiho No. 748 p. 77, Osaka Dist. Ct. 12. August 1983 Kaijiho Kenkyu Kaishi No. 57 p. 22, Takamatsu Court of Appeal 30 April 1985 Kiny*u* Shoji Hanrei No.730 p.28, Supreme Court 8 November 1990 Hanrei Jiho No. 1370 p. 52, Supreme Court 28 April 1992 Saibanshu Minji No.164 p. 309.

7 *Ibid*.

8 See for example, Tokyo District Court 30 September 1999 959 Hanrei Taimusu 262 ("Kamfair").

two main causes are: a) division of management in a time charter and, b) status of the master.

a) Division of management

A fundamental feature of a time charter is that there is a division of the ship's management between the owner and the charterer. A time charter is a contract where the owner undertakes to perform the voyages ordered by the charterer; he turns over a fully equipped ship with her master and crew to the charterer, operates the ship for the charterer's benefit, and is compensated by the monthly hire payments. The commercial purpose of the time charter is to divide the duties relating to the carriage of goods between the owner and the charterer with the expectation that both will benefit from the vessel's earnings. The time charter is often said to be a kind of joint venture in which the owner undertakes the carriage in a material sense while the commercial management is in the hands of the charterer.[9] The owner's responsibility is to keep the ship manned and in a seaworthy condition throughout the time charter, and navigate the ship under the charterer's orders.[10] The charterer's authority, however, is limited to the commercial management of the vessel. The charterer is only entitled to decide what cargo is to be loaded, where it is to be loaded, where the cargo should be transported, all within the framework of the charter contract.

Hypothetically, it is possible to make a clear distinction between the navigational and commercial management of a vessel. In practice, however, the division is not so simple because there is often a mixture of the navigational and commercial management components. Thus, for example, the owner conducts the voyage, but the voyage is performed pursuant to the charterer's orders. This means that the vessel fulfills two tasks at the same time: the owner's duty to the charterer to perform the voyage under the time charter, and the charterer's duty to the shipper to carry the goods under the contract of carriage. In other words, the charterer directs the service to be performed by the vessel while the owner directs the way the service is performed. As it can be seen, the owner's obligations under the time charter partly coincide with the charterer's obligations under the contract of carriage. Even if a time charter and a contract of carriage exist independently and autonomously of each other, they largely coincide during actual performance. This is one of the causes of confusion and difficulty in identifying which party should be considered the carrier under a time charter.

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9 W. Tetley, Marine Cargo Claims 242 (3d ed. 1988).

10 Clause 6 of the NYPE requires the owner to maintain the ship "in a thoroughly efficient state in hull and machinery and equipment for and during the service...." Clause 26 of the NYPE 93 provides that "[t]he Owners shall remain responsible for the navigation of the Vessel, acts of pilots and tug boats, insurance, crew, and all other matters, same as when trading for their own account."

b) Status of the master

The vessel is under the charterer's orders as to the ports of call, cargo carried, and other matters related to the commercial use of a vessel as defined by the time charter.[11] The master and crew, however, remain employees of the owner, and are subject to the owner's orders with regard to the navigation and management of the vessel.

The so-called "employment clause" can cause confusion because it implies that the master is a servant of the charterer, which is not the case. The charterer does not give the master authority to sign bills of lading, but merely orders him to do so - the actual authority comes from the owner, the master's true principal. The fact that the employment clause provides that the master will sign the bills of lading as presented by the charterer does not mean that the master is acting as the charterer's agent. Instead, the owner enters into a contract with the shipper through the master for the benefit of the charterer.[12] The clause ordering the master to sign bills of lading "as presented" by the charterer springs from the contract between the owner and the charterer. As such, the owner, and not the master, is responsible to the charterer with respect to the signing of the bills of lading. The master remains the owner's servant even when performing the charterer's orders because by doing so, the master is performing the owner's obligation under the time charter.

The master is entitled to refuse the charterer's orders that may put the ship, crew or cargo in danger, as the master remains responsible for their safety. The typical case is when the charterer orders the master to enter an unsafe port; the master may refuse such order. This is also in accordance with the charter party terms under which the charterer undertakes not to send the ship to unsafe ports or berths. Even without such express provision, the master can reject such orders. As stated by J. Roche in *Portsmooth S.S. Co. v. Liverpool & Glasgow Salvage Ass'n*, the master is obliged to follow the charterer's orders "within the limits of obviously grave danger."[13] The master can also refuse the charterer's order with respect to a final voyage, which would cause delay in the redelivery of the ship, or an order to load unlawful or dangerous cargo, to direct the ship outside agreed trade limits, to issue a clean bill of lading which would mean a material misrepresentation (e.g., the cargo is damaged), to deliver the goods without a bill of lading, etc. Normally, the master and crew do not see themselves as agents of the charterer, but as employees of the owner. So, they often ignore the charterer's orders, and wait for the owner's instructions.

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[11] Clause 8 of the NYPE provides that the master "although appointed by the Owners, shall be under the orders and directions of the Charterers as regards employment and agency."

[12] Smidt v. Tiden, (1874) L.R. 9 Q.B. 446.

[13] [1929] 34 Lloyd's rep. 459, 461 (K.B.).

Problems Related to Identifying the Legal Nature of a Time Charter

As it was mentioned in the introduction, the legal nature of a time charter is very complex. There are various theories that most often focus on the comparison between a time charter and a contract of lease or a contract of carriage. However, a time charter has some peculiar features which distinguish it from both these contracts. First, we shall compare the time charter with the lease contract and then, the contract of carriage.

Differences between a Time Charter and a Lease Contract

Time charters developed from lease contracts. Thus, naturally, there would be a number of similarities between these two contracts. However, the differences between these two contracts become clear when some of the main features of a time charter are compared with the typical features of a lease contract, such as the character of the right of use and possession, as well as the position of the master and crew.

Typically, in the case of a lease of a vessel (*locatio navis*), possession is transferred to the lessee, and the lessee has full control over the vessel within the scope of the lease contract. The master and crew are also employed by the lessee. In contrast, in a time charter, the right of use of the vessel is limited to the commercial employment of the vessel, while the owner retains control over the navigation of the ship. There is no such limitation in a contract of lease.

Unlike a lease contract, possession is retained by the owner in a time charter through the master and the crew, who are employees of the owner. The charterer only has a right to order the master and crew to perform certain acts related to the commercial operation of the vessel, which is something clearly different from the right of possession. Nevertheless, even though the master and crew remain the owner's employees, they are bound to obey the charterer's orders relating to the commercial employment of the vessel. The charterer may ask the owner to replace the master if he is not satisfied with him, but the charterer himself cannot replace the master.[14]

Another important difference is that the lease of a vessel binds third parties, e.g., subsequent purchasers of the vessel, whereas a time charter does not. This difference springs from the fact that a lease contract involves the transfer of possession, which is a property interest in the ship. As such, it binds not only the parties to the contract, but also third parties – the new owner of the vessel will be bound by the lease in the same way as the previous owner, as in the case of a lease of a building.

For the sake of objectivity and completeness of the argument, it should be noted that the transfer of possession is not a *sine qua non* of a lease contract. According to one view, the lessee does not acquire the right of possession but the right to use a thing, so that it is

[14] Clause 8(b) of the NYPE form.

sufficient to put a lessee in a position to use the leased thing.[15] Nevertheless, the transfer of possession is a usual feature of lease contracts.

Another key distinction between a time charter and a lease contract relates to the owner's obligations. In a lease contract, the obligation of the lessor is to put a thing at the lessee's disposal, after which the lessor has no further obligations. The lessor is just leasing a thing and his position related to the use of the leased thing is passive. On the other hand, in a time charter, the owner takes a more active role by undertaking duties related to the navigation of the vessel. Hence, in a time charter, in addition to the hire of ship space, the owner also provides the services of his master and crew. Incidentally, the obligation of providing services is the feature of another type of contract – the contract of work. This kind of obligation does not exist in lease contracts.

Differences between a Time Charter and a Contract of Carriage

A time charter and a contract of carriage both include the obligation to perform services, but the content and character of these obligations are different. The contract of carriage relates to the carriage of specific goods, which is its main subject matter. On the other hand, the obligations of an owner under a time charter, in addition to the performance of carriage-related services, include obligations related to putting the ship at the disposal of the charterer. This is a feature typical of lease contracts and not carriage contracts. While the carrier's liability in a contract of carriage depends on whether the goods are delivered to the consignee as described in a transport document without delay, the owner's liability under a time charter depends on his proper performance of the obligations defined in the time charter, which are mainly related to the transfer of the use of the vessel and the fulfillment of the charterer's orders.

The fact that the owner provides services related to navigation should not be construed as a performance of an obligation under a contract of carriage. An interpretation that equates the provision of navigational services with the performance of carriage duties only creates confusion between the instrument and the purpose. In a time charter, the owner merely provides services that are most often associated as an instrumental obligation in performing a contract of carriage. If navigation is understood only as a purpose of a contract of carriage, then, this would be the same as if we were to say that the purpose of walking is merely to walk. However, people on the street normally walk with a variety of purposes: shopping, going to work, meeting friends, exercising, etc. Thus, while carriage is the most common reason for chartering a vessel, there are other possible purposes such as fishing, "treasure hunting," scientific expedition, leisure, etc.

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[15] *See*, Papenheim, Handbuch des Seerecht Vol. I p. 91 (Leipzig, 1918).

Problem of Determining the Liable Party under a Time Charter

Our comparison of the time charter with the lease contract and the contract of carriage clearly shows that the time charter is different from both these contracts. The purpose of this paper, however, is not to determine what kind of contract the time charter is, but to demonstrate that the Japanese courts should not rely or focus on the legal nature of a time charter when determining the liability arising from a time charter.

When discussing the issue of liability to third parties under a time charter, a distinction should be made between: a) liability under a contract of carriage, and b) tort liability.

a) Contractual liability

In the case of a contractual liability, the issue is how to identify the person who should be held liable as a carrier to a third party.[16] The problem of identification of the carrier most often arises when carriage is performed by a chartered ship because in such kind of carriage, both the owner and the charterer can fit the role of a carrier. This is recognized by Article 2(a) of the Japanese Carriage of Goods by Sea Act, 1992, stating that "…the term 'carrier' means the owner, lessee and charterer of a ship ..."

In charter contracts, there is a division of responsibilities between the owner and the charterer, and sometimes it is not clear which of them should be responsible as a carrier in relation to third parties. This is especially true in the case of a time charter where the owner transfers the authority to order the master to sign bills of lading to the charterer. In general, the owner, through the master's signature, comes into a contractual relationship with the shipper, consignee or third party holder of the bill of lading. However, another scenario is possible whereby the charterer appears as a carrier. When the charterer issues in his name a bill of lading to a shipper, the former effectively exercises the duties of a carriage under a time charter and excludes the owner from being involved in a relationship with the shipper, consignee or third party holder of the bill of lading; in such a case, the charterer should be considered the carrier.

When faced with the problem of identification of the carrier, a court should look into the circumstances of the case. There are several criteria that can enable the court to identify the carrier: the signature of the bill of lading, the heading of the bill of lading, the name of the vessel, etc.[17] This factual-based approach is certainly more reliable than simply type-casting the legal nature of a time charter and automatically applying a set of legal rules. It enables the court to determine the party which actually entered into a contract with a shipper. That party may be either the owner or the charterer, depending on

[16] The author has already addressed the issue of identification of the carrier in C. Pejovic, *The Identity of Carrier Problem Under Time Charters: Diversity Despite Unification of Law* 31 J. Mar. L. & Com. 379 (2001).

[17] For more details, *see*, C. Pejovic, *op.cit,* at 394-402.

the circumstances of each particular case. If the court merely relies on a preconceived view of the legal nature of a time charter, the answer to this question would always be the same, regardless of the different circumstances of each case.

b) Tort liability

Under the general principles of tort law, the preconditions for establishing a tortious liability are: fault, injury/damage and the causal link between such fault and injury/damage. Unlike the contractual liability arising from a time charter, where either the owner or the charterer may be held liable as a carrier, in the case of a tort liability, such alternative liability as a carrier does not exist. Since the owner is in charge of navigation, and the charterer's role is limited to giving instructions related to the commercial employment of the ship, the owner will normally be held liable in tort cases. Given the limited obligations assigned to a charterer under the time charter, it follows that the time charterer's liability to third parties is restricted to a very few situations. If the charterer is negligent in performing any of his duties under the time charter and a third party suffers personal injury or property damage caused by such negligence, liability would likely follow. However, since by the very nature of a time charter, the owner retains sole responsibility for the management and navigation of the ship, this exposure to liability is quite limited. The owner is responsible for the operation, navigation and maintenance of a ship under a time charter; hence, the owner, and not the charterer, is most likely to be the party held liable for any accident. A plaintiff would have to demonstrate that a charterer's actions somehow changed his role beyond the duties that he would otherwise undertake under a time charter. Unless the charterer's negligence and its causal link with the damage suffered by a third party can be proven, a tort claim against a charterer would fail with respect to those areas of responsibility generally reserved to the owner, such as the navigation, operation and maintenance of a ship.

When a time charter clearly provides that the owner is responsible for the navigation, operation and maintenance of the ship, reliance on a preconceived view of the legal nature of a time charter to determine liability to third parties arising from negligence in the navigation, operation and maintenance of a ship can lead to clearly wrong outcomes. For example, if the time charter is attributed the legal nature of a lease contract, and the contract of lease rules are applied, there is a risk that the charterer would be held liable for a collision accident despite the fact that the owner retains navigational management of the vessel, while the charterer's role is limited to giving instructions to the master. This would lead to absurd situations where the charterer would be held liable for navigational errors even though the charterer had no influence in the nautical management of the vessel. This would be similar to the situation where a customer riding a taxi would be held liable for a traffic accident caused by the taxi driver's negligence. If the owner was

negligent, why should the charterer be held responsible? Such a finding would contravene the general principles of tort law under which liability should fall on the party whose negligence caused the damage to the injured party. If a navigation error is committed, the owner, and not the charterer, should be held liable.

Conclusion

This paper addressed the complex legal nature of a time charter. The ambition of the author, however, was not to enrich the Japanese maritime law theory by promoting a new theory on the legal nature of a time charter. The main purpose of the paper is to demonstrate that reliance on a preconceived view of the legal nature of a time charter in determining the liable party under such charter is not appropriate. Insisting on type-casting a time charter as a lease contract or a contract of carriage may lead to decisions that are clearly wrong.

The different rules on liability and the specific nature of a time charter make it difficult for a court to rely on a predisposed legal nature of a time charter. Since the charterer has control over the commercial management of the ship, it is possible that he might be held liable under a contract of carriage, which he entered into. On the other hand, the owner should normally held liable in tort cases caused by his negligence in the navigation, such as collision cases. These nuances weaken any attempt to rely exclusively on the legal nature of a time charter because one aspect of its legal nature may pertain to liability under a contract of carriage while a different one may involve tort liability. In view of such 'flexibility,' the law should be based, as a matter of principle, on clear and stable standards; this will bring about legal certainty and reduce the risk of different interpretations.

An overview of comparative law shows that courts in other jurisdictions do not look at the legal nature of a time charter.[18] This approach is an illustration that cases can be decided without touching on the issue of the legal nature of a time charter. If the courts in leading maritime nations do not rely on the legal nature of a time charter, there must be some convincing reason for the courts in Japan to deviate from such international practice. However, it seems that after the *Jasmine Case,* the Japanese courts stopped their deviant practice, and this paper provides, hopefully, sufficient arguments that will justify such action of the Japanese courts.

As a result of practical needs, various new types of contracts have been developed in practice and some of them do not fit in any category of traditional contracts. A time

[18] The author's above-mentioned article (C. Pejovic, *op.cit*, at 385-394) examines the identification of the carrier under a time charter under English, American, Canadian, French, German, Italian and Japanese law. None of these foreign jurisdictions rely on the legal nature of a time charter in identifying the carrier.

charter is one such new kind of contract. The theories on its legal nature, while interesting as a legal mind exercise, represent a risky basis for determining the liability arising from such contract. Each of these theories has its own "Achilles heel," and it is just a matter of careful examination of the arguments of each theory for one to find its weak points.

All theoretical conceptions would be fruitless exercises, even when based on logical premises and convincing arguments, if they do not meet the needs of practice and legal certainty. Theories can be not only interesting but also useful when they assist in obtaining a deeper understanding of certain issues. If this is not the case, and, instead, theories are used as instruments for determining facts, sometimes twisting the facts in order to fit the theories adopted by the courts, then, this would lead to an absurd situation where the facts are determined by the theories instead of the latter being applied the other way around.

As a conclusion, it is submitted that it is not appropriate for the Japanese courts to rely on the legal theories on time charters. Instead, the courts should make a proper evaluation of the facts of each particular case, and then apply the relevant rules and principles to those facts. It is hoped that this paper has provided at least some arguments that may contribute to clarifying certain difficult issues and dispelling any dilemmas that may still exist.

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