

September 2019

Shipping and offshore: quiet enjoyment, step-in and direct agreements



What is quiet enjoyment?

Quiet enjoyment can be summarised as the right under common law of a charterer to the use and enjoyment of a vessel or offshore unit (hereinafter "vessel" or "offshore unit" referred to as "**vessel**") free from interference. The right of quiet enjoyment can be legal (it exists as a matter of English common law) or contractual (it exists because it is agreed pursuant to a contract).

How does it impact me?

- **Mortgagee** – if you are the mortgagee, your ability to enforce your rights in respect of the vessel (for example by way of arrest and sale) when the owner is in default of its obligation under any financing arrangements may be affected such that you will only be able to enforce such rights to the extent you do not interfere with the quiet enjoyment of the charterer.
- **Charterer** – if you are the charterer, you have certain (but not absolute) protections from the mortgagee in a scenario where the owner of the vessel is in breach of its financing arrangements.

Top Tier in Asset Finance

The Legal 500 Asia Pacific 2019



Competing interests

Quiet enjoyment and the issues that relate to the same revolve around the following competing rights in respect of a vessel:

- **mortgagee** due to its mortgagee rights;
- **owner** due to its ownership rights;
- **charterer** due to its contractual rights to use.

These competing interests are often contractually moderated by agreement. In particular, charterers seek to obtain contractual quiet enjoyment (to reinforce common law rights) and the mortgagee will typically seek to obtain contractual step-in rights (see below for further information under the heading "What about step-in").

English law quiet enjoyment – vs - contractual quiet enjoyment

English law quiet enjoyment: English law quiet enjoyment can be summarised as the legal right of a charterer to the undisputed use and enjoyment of a vessel that it has chartered, provided that:

- the charterer complies with its obligations under the charter;
- the security of the mortgagee is not impaired by the use of the vessel under the charter; and
- the owner of the vessel is able and willing to perform the charter.

Contractual quiet enjoyment: It is open to the parties to restrict or expand the English law position but the English law position is often the starting point, but modified so as to:

- reflect the bargaining power of each contracting party; and
- address other legal and commercial considerations (see below heading "Other considerations" for a summary of some of the other points that may need to be addressed).

Advantages of contractual quiet enjoyment

The charterer and the mortgagee can amend the scope of their respective quiet enjoyment rights and obligations by entering into contractual quiet enjoyment arrangements, which may be called a "quiet enjoyment letter", a "step-in letter" or a "direct agreement" etc.

Advantages of this approach include:

- **Contractual certainty** – having a written record of rights and obligations is commercially very useful in the context of knowing and enforcing your rights (and ensuring you do not breach your obligations);
- **Governing law and jurisdiction** – vessels operate in different jurisdictions and English common law may not apply depending on the jurisdiction where the vessel is located at any given time so it may be beneficial to pre-agree what law and jurisdiction should govern any dispute relating to quiet enjoyment and/or step-in;
- **Re-balancing** – it gives the parties an opportunity to document a structure that more fully reflects each of the parties' respective bargaining positions and their commercial intent and priorities;
- **Approach of the English courts** – under English law the right of quiet enjoyment is fact dependant and there is a general trend for the English courts to favour the rights of a mortgagee as such it can be beneficial for a charterer to contractually agree quiet enjoyment rights;

- **Enforcing common law quiet enjoyment rights** – the evidential burden on charterers seeking to enforce the common law right to quiet enjoyment or prove tortious interference can be challenging; and
- **Step-in** – a request by the charterer for contractual quiet enjoyment can make it easier for the mortgagee to then make the corresponding request for step-in rights (see below for further information under the heading "What about step-in").

What about step-in?

Step-in is relevant if the charter earnings are a key part of the financing structure and credit risk analysis i.e. the mortgagee is looking beyond the owner and/or the vessel and is relying on the credit enhancement provided by the particular charter.

If a charterer requests contractual quiet enjoyment then the usual corresponding request from a mortgagee will be to request step-in rights. Step-in is typically documented in the same "quiet enjoyment letter", "step-in letter" or "direct agreement" referred to above.

Step-in allows the mortgagee to substitute itself (or its nominee) in place of a defaulting owner in the event of the occurrence of certain defaults or repudiatory breaches (which can include insolvency of the owner) by the owner under the charter.

Step-in effectively allows the mortgagee to preserve a charter (or wider project) by ensuring that there is a pre-agreed contractual framework (which will, importantly, include provision for novation of all rights and obligations) to continue the charter without the involvement of the owner.

In this situation the mortgagee wants to preserve the charter and establish a contractual nexus to the charterer (which is achieved through the "quiet enjoyment letter", "step-in letter" or "direct agreement").

It is also worth noting that preservation of the charter may well also be in the commercial interest the charterer.

Step-in –vs – a charter assignment

It is important to note that security by way of an assignment of the charter does not give the mortgagee the ability to step-in and take over the charter via a novation to a nominee following an enforcement scenario. As a matter of English law an assignment can only transfer rights not obligations.

To achieve step-in the mortgagee needs a contractual nexus with the charterer i.e. a "direct agreement". This contractual nexus needs to include a clear and complete contractual obligation on the charterer to novate the charter in favour of the mortgagee (or its nominee) in the event of certain pre-agreed events. Any form of agreement to agree may not be enforceable.

Any ambiguity in such contractual arrangements creates uncertainty which, depending on the economics of the charter, could be used as a pretext to frustrate effective step-in.

Comprehensive direct agreements are a key feature in project financings and are now a common feature for LNG, FSRU, FPSO and other offshore financings.

"They are very aware of everything that is going on in the market."

Other considerations

Below is a broad overview of some of the other considerations:

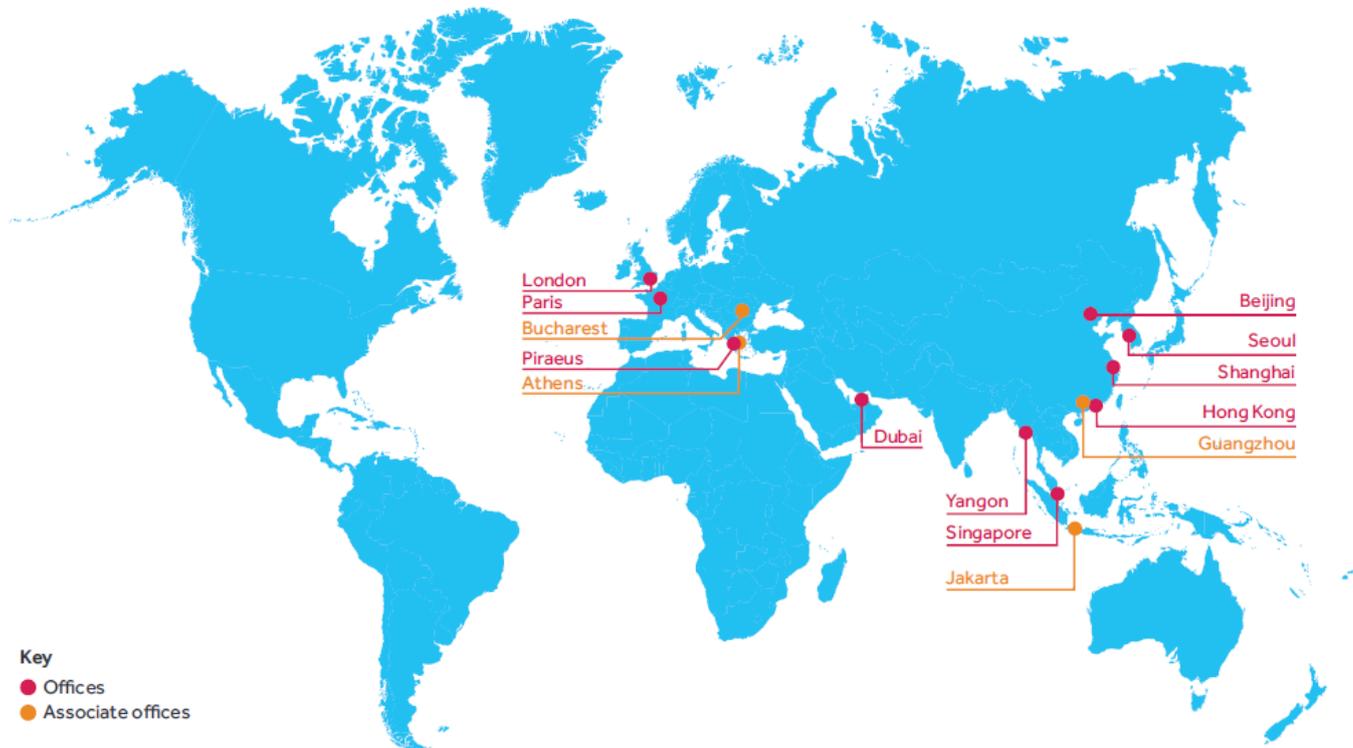
- **relying on a non-contractual position** – consider how strong your legal rights and strategies are for optimising legal position;
- **purchase options** – consider how purchase options will be dealt with and how this interplays with any security interests;
- **insurances** – consider where the proceeds get paid and when, as well as what security interests exist and the implication of such security interests;
- **cure/standstill periods** – consider what is commercially and practically realistic;
- **nominee identity** – consider any criteria that any incoming nominee must satisfy (for example, consider sanctions etc);
- **bankability** – will the mortgagee require any terms of the underlying charter to be amended;
- **contractual consistency** – avoiding potential contractual disputes due to inconsistency in contracts;
- **counterparties** – who will need to sign and who may need to accede;
- **boilerplate provisions** – what "must have" or "good to have" boilerplate provisions should be included;
- **cost and expenses** – who should be responsible and under what circumstances;
- **governing law and dispute resolution** – consider the implications of governing law and any practical consideration relevant to the project and if a dispute does arise where should it be heard and should arbitration or court jurisdiction be used;
- **bareboat charters and time charters** – is the treatment the same; and
- **insolvency** – what impact insolvency events and laws may have on quiet enjoyment and/or step-in (in particular how do moratoriums or rules governing ipso facto provisions interact with quiet enjoyment and/or step-in).

There are some consistent themes when it comes to negotiating and documenting quiet enjoyment and step-in but no quiet enjoyment letter or direct agreement will be the same, as the factual matrix and the bargaining power of the relevant contracting parties is always different. It is usually advisable to address these issues early on in the deal process as the negotiation of the issues can be protracted.

“The quality of their work and the delivery always exceeds our expectations.”

Chambers Asia Pacific 2017

Our international reach



Stephenson Harwood is an international law firm headquartered in London with ten offices across Asia, Europe and the Middle East.

180 Partners and over 1100 staff worldwide put their commitment and energy into achieving the goals of listed and private companies, institutions and individuals. With partners playing a central role, the highest calibre of legal talent is dedicated to overcoming your most complex issues.

With our focus on developing strong personal relationships at every level, you get the right advice from the right person at the right moment. Our team of people are as committed to your success as you are and we deliver clear advice that is set squarely in the real world.

*Virtus Law LLP (T13LL0339K) and Stephenson Harwood LLP (T13LL0821C) are registered as a Formal Law Alliance in Singapore under the name Stephenson Harwood (Singapore) Alliance. Both firms are registered in Singapore under the Limited Liability Partnership Act (Chapter 163A) with limited liability. The term "partner" is used to refer to a member in one of the constituent law firms.

Get in touch

If you would like more information about this briefing note, please contact:



Jeffrey Tanner

Senior associate

T: +65 6622 9653

E: jeffrey.tanner@shlegal.com

Other members of our team



Gregg Johnston

Partner

T: +65 6622 9663

E: gregg.johnston@shlegal.com



Martin Brown

Partner

T: +65 6622 6232

E: martin.brown@shlegal.com



Martin Green

Partner

T: +65 6226 1600

E: martin.green@shlegal.com



Iain Young

Partner

T: +65 6226 1600

E: iain.young@shlegal.com



Huay Yee Kwan

Partner

T: +65 6622 9678

E: huayyee.kwan@shlegal.com



John Simpson

Partner

T: +65 6622 9565

E: john.simpson@shlegal.com



Jason Yang

Partner

T: +65 6835 8673

E: jason.yang@shlegalworld.com



Dr Gregory Xu

Partner

T: +65 6622 9670

E: gregory.xu@shlegal.com



Pedram Norton

Senior associate

T: +65 6622 9651

E: pedram.norton@shlegal.com