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Cover Story

Inadequate passage plan could amount to unseaworthiness of the vessel

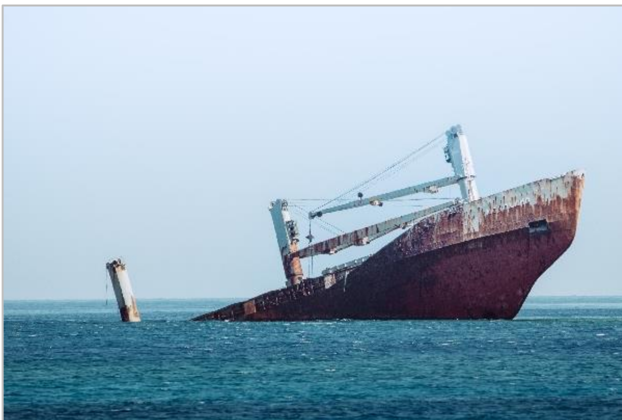
Introduction

Under Article III rule 1 of the Hague Rules (which apply to contracts of carriage), the carrier shall be bound, before and at the beginning of the voyage, to exercise due diligence to make the ship seaworthy. In the recent case of *Alize 1954, CMA CGM SA v Allianz Elementar Versicherungs AG and Others* [2019] EWHC 481 (Admlty), the Admiralty Court of the United Kingdom (the "**Court**") considered that the seaworthiness of a vessel extends to have in place an adequate passage plan at the beginning of the voyage to ensure that the vessel is reasonably fit to carry the cargo safely to the destination.

Background

On 17 May 2011, the CMA CGM LIBRA (the "**Vessel**"), a container vessel, grounded whilst leaving the port of Xiamen, China on a shoal in an area outside the buoyed fairway which carried the risk of uncharted shoals. The owners of the Vessel (the "**Ship-owners**") funded the salvage and claimed general average (a claim under the York-Antwerp Rules which allows sharing of loss in an unfortunate incident involving carriage of cargo in the maritime practice) against the owners of the cargo on the Vessel (the "**Cargo Interests**"). 8% of the Cargo Interests refused to pay their contributions to the general average on the ground of the Ship-owners' actionable fault in breach of Article III rule 1 of the Hague Rules, by alleging that the cause of the casualty was the unseaworthiness of the Vessel due to the failure to put in place an adequate passage plan and that due diligence was not exercised to make the Vessel seaworthy.

As a general rule, there can only be actionable fault within the meaning of the York-Antwerp Rules which discharges the Cargo Interests from liability to contribute in general average if the grounding was caused by a failure by the Ship-owners to exercise due diligence to make the Vessel seaworthy. The burden of proof lies on the Cargo Interests to establish unseaworthiness which caused the grounding, which then shifts to the Ship-owners to establish that due diligence has been exercised to make the Vessel seaworthy.



Decision

Unseaworthiness

Article III rule 1 of the Hague Rules places a seaworthiness obligation upon the carrier "before and at the beginning of the voyage". The usual test of unseaworthiness is whether a prudent owner would have required the relevant defect, had he known of it, to be made good before sending his ship to sea. (*The Cape Bonny* [2018] 1 Lloyd's Reports 356 and *Scrutton on Charterparties and Bills of Lading* 23rd ed.) Seaworthiness extends to having on board an adequate passage plan at the beginning of the voyage to ensure that the Vessel is reasonably fit to carry the cargo safely to its destination.

The Court considered that mariners would ordinarily regard the charted depths as shown on the passage plan as being accurate. It would therefore be necessary to ensure that, when the navigator of a vessel leaving Xiamen was faced with a decision whether to remain within the buoyed fairway or to navigate outside the buoyed fairway, he had in mind the warning that charted depths outside the buoyed fairway might be unreliable. Prudent passage planning required the danger created by the presence of numerous depths less than those charted outside the fairway to be noted on the Admiralty chart.

In the present case, the Admiralty chart did not contain any direct warning to ensure that the navigator was aware of the danger created by the numerous depths in the approaches to the port in Xiamen which were less than the charted depths. Expert evidence showed that there ought to have been noted on the Admiralty chart that any area outside the charted fairway was a "no go" area. The Court held that the facts that (i) the Vessel carried an Admiralty chart which the officer failed to correct to ensure that it was up to date and (ii) the Vessel carried a passage plan which was defective as it lacked an appropriate warning of "no go" areas, were aspects of the Vessel's documentations which were capable of rendering the Vessel unseaworthy at the beginning of the voyage. A prudent owner would have insisted on the correction of such a defective passage plan before the voyage was commenced. Therefore, the Vessel was held to be unseaworthy at the beginning of the voyage.

Causation

Following the establishment of unseaworthiness,

the Cargo Interests had to prove that such unseaworthiness was causative of the grounding of the Vessel.

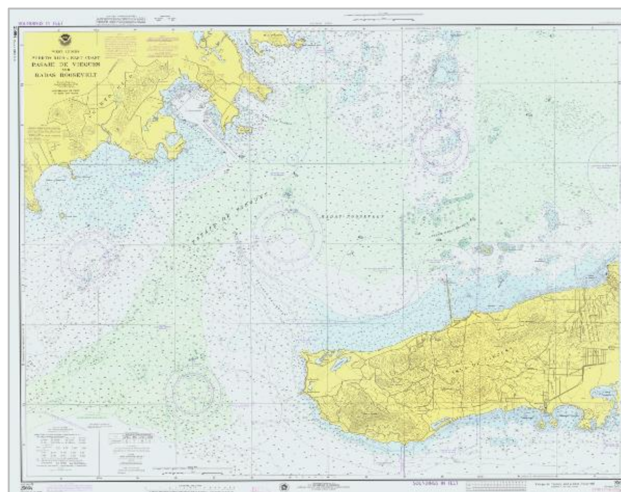
The Notice to Mariners issued in December 2010 contained both a warning to mariners that it was unsafe to rely upon charted depths and advice as to the least depth in the fairway. An ordinarily prudent mariner should have understood that it is safe to navigate within the fairway having regard to there being a certain least depth but not outside the fairway where no information was given as to the least depth and where there were numerous depths less than those charted. The Court considered that the decision of the master of the Vessel (the "**Master**") to depart from the passage plan and to navigate outside of the buoyed fairway was negligent, being a decision which a prudent mariner would not have taken.

From examining the facts of the present case, it was considered that the Master did not have in mind the contents of the Notice to Mariners when he navigated away from Xiamen. The Court thus held that it was more likely than not that the defect in the passage plan was causative of the Master's decision to leave the buoyed fairway, which was where the Vessel grounded on an uncharted shoal.

Due diligence

Article IV rule 1 of the Hague Rules provides that neither the carrier nor the ship shall be liable for loss or damage arising or resulting from unseaworthiness unless it was caused by the want of due diligence on the part of the carrier to make the ship seaworthy in accordance with Article III rule 1 of the Hague Rules.

Scrutton on Charterparties and Bills of Lading 23rd ed. further elaborates that the above imposes an inescapable personal obligation on the ship-owners. The due diligence required is the due diligence by the carrier and all persons, whether servants or agents or independent contractors whom he employs or engages in the task of making the ship seaworthy, and cannot be discharged by engaging competent experts to perform such tasks on his behalf. The Court further rejected the allegation by the Ship-owners that it had exercised due diligence to make the ship seaworthy by implementing a safety management system. The Court provided that the Ship-owners must show that the servants or agents relied upon by the Ship-owners to make the Vessel seaworthy before and at the beginning of the voyage had exercised due diligence. The level of standard required is the common law duty of care, i.e. the exercise of reasonable care and skill.



The present case involved failure to prepare an appropriate passage plan. The Court held that with exercise of due diligence, an appropriate passage plan with a warning about the unreliability of the charted depths out of the fairway should have been prepared, in order to minimise the risk that the mariner navigating

the Vessel might decide to navigate outside the buoyed fairway.

Conclusion

By reasons of the above, the Court held that the vessel was unseaworthy before and at the beginning of the voyage from Xiamen as it carried a defective passage plan, which was causative of the grounding of the Vessel. The Ship-owners did not exercise due diligence to make the Vessel seaworthy as reasonable skill and care were not shown in the preparation of the passage plan. Accordingly, the grounding of the Vessel was caused by the actionable fault of the Ship-owners and thus the Cargo Interests were not liable to contribute in general average. The case serves as a reminder to ship-owners of the utmost importance of careful passage planning by the relevant navigational officers on the Vessel before commencement of the voyage.

Shipping industry calls for speed limits on vessels to cut emissions

Shipping companies are urging global maritime regulators to impose mandatory speed limits on the global fleet to reduce greenhouse gas emissions. In a letter to the International Maritime Organization, more than 100 signatories, which include shipping companies and environmental organizations such as Dynacom and Dynagas, Euronav and Tsakos, state their commitment to reducing GHG emissions from shipping and support speed limits differentiated by vessel type.

In the letter, the signatories urged to set maximum annual average speeds for container ships, and maximum absolute speeds for the remaining ship types. Shipowners and operators, including charterers, should be obliged to follow these rules. Nevertheless, major box carriers have not signed the letter. This campaign has faced opposition owing to the anticipated negative effect it could have on developing countries who are dependent on maritime trade. The IMO's ultimate environmental authority, the Marine Environment Protection Committee is gathering in London this month to discuss potential decarbonisation measures the industry can take, particularly by 2023.

New Malaysia rail link gives further options for shippers

Malaysia's East Coast Rail Link project, which was controversially canned by Malaysian Prime Minister Mahathir Mohamad due to high costs, was earlier revived with a significantly lower budget in April. The revised project will now cost RM44 billion (US$10.6 billion), a third less than the original estimate of RM65.5 billion.

Image source: http://www.mrl.com.my

The revival of the East Coast Rail Link project is expected to provide new options for shippers as well as opening up additional trade routes for industrial hubs on the relatively less developed South China Sea-facing coast. The project will connect Malaysia's main container port of Port Klang on the west coast with China-linked Kuantan Port and other infrastructures on the east coast of Malaysia. It will link several key east coast industrial hubs, such as Kertih Port, Kemaman Port and Kuantan Port, directly to the west coast of Malaysia. Some port operators could benefit although industry analysts differed on what possible spillover effects there might be.

Indian Ocean originating or transiting inbound cargos to the east coast of the Malaysia might switch from transshipment in Singapore to feedering by rail from Port Klang via the East Coast Rail Link, CTI Consultancy partner Andy Lane suggested. He noted, however, that volumes are small and these would be "rather modest" in quantity, and while transit times would be faster via rail, market penetration would be dependent on end-to-end supply chain costs.

Macquarie buys OOCL's Long Beach terminal for US$1.78 billion

Macquarie Infrastructure Partners has beaten 52 other bidders, including big names such as Seaspan, EQT Infrastructure and Yildirim Group, and won the race for Long Beach Container Terminal. Orient Overseas (International) Ltd ("**OOIL**"), which was taken over by China's Cosco Shipping Holdings Co ("**COSCO**"), said it had agreed to sell the Long Beach Container Terminal for US$1.78 billion to Olivia Holdings, a company under Macquarie Group. COSCO had agreed with the U.S. government to sell Long Beach Container Terminal in order to gain clearance for the US$6.3 billion purchase of OOIL.

The Long Beach Container Terminal is part of the Long Beach port's US$1.4 billion Middle Harbor project and will be the largest automated terminal in the US upon the completion of the project. The Long Beach port is the nation's second busiest and along with Los Angeles port, the US's main gateway for trade with Asia. OOIL said it expected to generate an estimated gain (before tax) of about US$1.29 billion from the sale of the terminal to Olivia Holdings.

Singapore launches a one-stop maritime data repository

Singapore has unveiled a new centralized data platform to accelerate the digital transformation of the city-state's maritime sector. The data repository, dubbed Singapore Maritime Data Hub, or SG-MDH, will help to facilitate the co-development and test-bedding of digital applications and data-driven services to enhance the safety of navigation, operations efficiency and overall port productivity, the Maritime and Port Authority of Singapore said in a statement on 9 April 2019.

SG-MDH shall be developed as a global collaborative platform to enable cross-border digital connectivity and data sharing. The regulatory body has already made available via SG-MDH, public real-time access to ship-related data such as vessel information, vessel arrival and departure time and vessel position and movement.

Two Singapore-based start-ups have already tapped SG-MDH for the development of their digital applications. Using SG-MDH's vessel position data, SG Smart Tech's SeaCabbie platform is capable of assigning the nearest available boat to users of its platforms.

Another Singapore start-up company, Claritecs, has latched on to SG-MDH to monitor vessel arrivals and locations for the scheduling of bunker deliveries on a just-in-time basis. The Bunker MAESTRO platform offered by Claritecs aims to enhance utilization of bunker fleet by up to 30% and increase operational efficiency by up to 50%.

Globalink Transportation and Logistics Worldwide LLP v DHL Project & Chartering Limited

[2019] EWHC 225 (Comm)

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The facts

In 2014, DHL Project & Chartering Limited ("**DHL**") was engaged by its clients to arrange the transport of various units of refinery plant from China to Atyrau in Kazakhstan. DHL arranged the units to be shipped by sea from China to Novorossiysk in Russia. DHL then engaged Globalink Transportation and Logistics Worldwide LLP ("**Globalink**") to carry out freight forwarding services from Novorossiysk to the refinery in Atyrau, which involved transport by barge along a canal. An agreement entitled "Freight-Forwarding Services Contract" was entered into under which Globalink was referred as the "Forwarding Agent" (the "**Agreement**").

Two barges were arranged to carry 14 units under the Agreement. However, one of the barges delayed at arriving at the canal and was unable to proceed to Atyrau, because the water levels of the canal at Kuryk were too low for the draught of the loaded barge. The canal was then closed to navigation for the winter. The parties then had a meeting and signed a "Protocol of the meeting", and subsequently entered into a supplementary agreement for some units to be carried to Atyrau by road. The remaining units were stored at Kuryk over winter until the canal was re-opened.

Globalink applied for summary judgment against DHL for US$1,647,780 in respect of unpaid instalments of the contract price due under the supplementary agreement and the storage charges incurred over winter. DHL cross-claimed for Globalink's failure to perform the initial Agreement. It sought the difference between the cost of transporting the cargo under the initial contract and DHL's actual liability to Globalink, namely US$2,364,976.05. DHL maintained that it is entitled to set off the counterclaim against Globalink's claim.

Whether the counterclaim has a reasonable prospect of success

The Court had to first decide on whether there are merits in DHL's counterclaim.

DHL argued that Globalink had breached its duty to use reasonable skill and care in arranging the transportation of cargo and avoiding circumstances that could adversely affect the timely delivery of the cargo. On the other hand, Globalink argued that the low water levels in the canal constituted a force majeure event such that it is released from any liability for failing to fulfill and/or the delayed fulfilment of its obligation under the Agreement. To rebut, DHL argued that the low water levels were

foreseeable and Globalink's failure to fulfil its obligations was brought about by its failure to arrange a suitable barge and ascertain whether there were circumstances that would affect the timely delivery of the cargo.

The Court held that the counterclaim was well arguable and had a reasonable prospect of success. Globalink had agreed to arrange the transportation and it was at least arguable that it was obliged to exercise reasonable care and skill in doing so. Although Globalink had made a force majeure argument, it was at least doubtful that such argument could provide any answer to the counterclaim. The DHL's criticism was that Globalink had failed to plan for the contingency of a force majeure event, and not that a force majeure event occurred.

Availability of set-off in the present case

The Court would have to dismiss the summary judgment application if the counterclaim can operate as a defence by way of set-off.

Relevant legal principles

It is a long established principle that a claim in respect of cargo cannot be asserted by way of deduction from the freight (*The Aries* [1977] 1 W.L.R. 185). This rule has been extended in terms of the type of carriage to which it applies and in terms of the type of cross claim which it covers. But its operation has been limited so as to apply to only some forms of charge which are referable to the transport of goods.

Decision

The starting point is to consider the nature of the contract between Globalink and DHL. The contract described itself as a freight forwarding agreement, and not as a contract of carriage. The essential nature of the obligation is not an obligation to carry but an obligation to procure that carriage is achieved by others. The fact that Globalink could incur a liability under the Agreement for delayed delivery of the cargo does not mean Globalink is a carrier, nor that Globalink accepted an obligation to deliver on a particular date. It just meant that if Globalink did not arrange for others to deliver the cargo by that date, it would incur a penalty to DHL.

Although a freight forwarder might on occasion be a carrier, and having taken on an obligation to arrange carriage, it was open to fulfil the carriage obligation itself. This would not however convert the contract to arrange into a contract of carriage.

The Court considered that the rule in *The Aries* does not extend, and should not be extended, to cover the services provided by a freight forwarding agent. The Court did not find it justifiable for extending the ambit of the rule beyond contracts of carriage into a new area, since to do so would run

counter to the general principle of the law which is that a cross claim can in principle operate as a defence by way of set off.

However, in deciding, the Court considered *Britannia Distribution v Factor Pace* [1998] 2 Lloyds Rep 420, under which it was held that if the claimant could show that it had paid freight to a carrier, and that that was a payment falling within *The Aries*, the defendant was obliged to reimburse the claimant for that freight with no set-off being available.

Conclusion

In light of the above, the Court refused the summary judgment application. However, the Court identified $113,000 of Globalink's claim was potentially freight payable to the carriers engaged by Globalink, despite Globalink failed to produce documentary evidence of payments of the said sums. The Court therefore made a conditional order requiring Globalink to bring into court the sum of $113,000 as a condition of being able to defend DHL's counterclaim as to that sum.

KAEFER Aislamientos SA de CV v AMS Drilling Mexico SA de CV

[2019] EWCA Civ 10

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The facts

This is an appeal against an Order that the Court had no jurisdiction to try the claim of the appellant (the "**Claimant**") against the third and fourth defendants (D3 and D4). The Claimant initially commenced proceedings in the UK against four defendants to recover sums due under a contract for works performed by the Claimant to the accommodation areas of a cantilever jack-up rig (the "**Rig**"). The works included the removal and disposal of various items, the abatement of asbestos, the supply and installation of insulation and refurbishment. The Rig was owned by D3, a wholly-owned subsidiary of D4, and had been chartered to the second defendant (D2) under a bareboat charterparty.

The relevant contract was a purchase order signed between the Claimant and D2 (the "**Purchase Order**"), which stipulated that invoices were to be addressed to D1. The Purchase Order contained an English exclusive jurisdiction clause. The Claimant argued that the Court has jurisdiction to determine the claim against D3 and D4 under Article 25 of the Brussels I Regulation (Recast) (Regulation (EU) 1215/2012) and the Purchase Order bound D3 and D4 acting as undisclosed principles.

The trial judge dismissed the claim on the basis that the Claimant failed to provide direct evidence to proof its case. It was held that in relation to the relationship between D2 and D3 there was a "good arguable case" that D3 was an undisclosed principal to the Purchase Order but D3 "has the better of the argument" that it was not an undisclosed principal. In addition, there was "no good arguable case" that D4 was an undisclosed principal. On appeal, the Claimant submitted that the lower court erred in including "the better argument" limb into the "good arguable case" test.

The test to be applied

In relation to a challenge to jurisdiction, the proper test to be applied is the three-limb test established in *Brownlie v Four Seasons Holdings Inc* [2018] 1 WLR 192 and *Goldman Sachs International v Novo Banco SA* [2018] UKSC 34 (both decisions of the Supreme Court), which is set out as follows:

1. Claimant must supply a plausible evidential basis for the application of a relevant jurisdictional gateway;
2. If there is an issue of fact or some other reason to doubt whether the gateway applied, the Court

had to take a view on the material available if it can reliably do so; and

3. If the limited evidence available at the interlocutory stage meant that the Court could not make a reliable assessment, the Court should find there to be a good arguable case for the application of the gateway if there was a plausible (albeit contested) evidential basis for it.

The application of the three-limb test

For limb (1), the test is solely on plausibility instead of on the balance of probabilities, requiring there to be a "reference to an evidential basis that the Claimant has the better argument". The Claimant bore the burden of proof and the test is context specific. The Court should not express any view on the ultimate merits of the case even if there is a close overlap between the issues going to jurisdiction and the ultimate substantive merits.

Limb (2) is an instruction to the court to overcome evidential difficulties and arrive at a conclusion if it "reliably" can, which shows that it is a relative test. It recognizes that jurisdiction challenges are invariably interim and the Court should use judicial common sense and pragmatism to overcome evidential disputes.

Lastly, limb (3) provides flexibility for the situation when the Court is unable to form a decided conclusion as to who has the better argument, and introduces a test combining good arguable case and plausibility of evidence.

Approach applied by the judge at first instance

Since the decision of the lower Court was handed down before the two Supreme Court decisions, the Court held that the trial judge erred in applying a two-part test by first considering the "good arguable case" and then moved on to decide who had "much the better argument". However, the Court considered that in practice the trial judge applied a relative test by asking who had the "more plausible" argument, and therefore ultimately applied a test which was very close to that now reflected in the reformulation in the two Supreme Court decisions.

Conclusion

Given the complex facts of the present case, and the series of disputes and uncertainties about the evidence, the Court is reluctant to second-guess the evaluation conducted by the trial judge on the evidence in close details. The Court considered that the trial judge had sensibly and pragmatically addressed the strengths and weaknesses of each piece of evidence and set out the inferences and conclusions that he drew. The Court saw no basis for interfering with the trial judge's conclusions on the facts. The appeal was therefore dismissed.

Silverburn Shipping (IOM) Ltd v Ark Shipping Co LLC (THE M/V "ARCTIC")

[2019] EWHC 376 (Comm)

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The facts

This is an appeal pursuant to s.69 of the Arbitration Act 1996 by the Claimant owners (the "**Owners**") against a partial final award (the "**Award**") of a LMAA arbitral tribunal (the "**Tribunal**"). The Owner let M/V ARCTIC (the "**Vessel**") to the Defendant charterers (the "**Charterers**") under a charterparty for 15 years (the "**Charterparty**"). The Charterparty contained a Clause 9A on classification obligation, which provided that the Charterers "*shall keep the Vessel with unexpired classification of the class indicated in Box 10 and with other required certificates in force at all times*". The parties agreed that the classification obligation lay on the Charterers. The Vessel's class certificates were then expired and the Owners terminated the charter and applied for a final injunction requiring the delivery up of the Vessel on the basis that the Charterers were in breach of Clause 9A.

The Tribunal rejected the Owners' application by the following reasons:

1. the Charterer's obligation to maintain the Vessel's class was not different from their obligation to maintain and repair the Vessel;
2. the classification obligation was not an absolute obligation but merely an intermediate obligation which would allow termination of the charter only if any breach was serious enough to deprive the party of the substantial benefit of the charter;
3. on construction of Clause 9A, the Charterer must immediately take steps to carry out the necessary repairs and reinstate the class certificates "within a reasonable time" before the Owners can terminate the Charterparty; and
4. the Owners had failed to prove a breach of the Charterparty.

The Owners appealed to the High Court. The issues for the Court to decide were (1) whether the Charterer's obligation in Clause 9A is an absolute obligation or merely an obligation to reinstate expired class certificates "within a reasonable time" and (2) whether the classification obligation is a condition of the contract or an innominate term.

Arguments raised by the parties

The Owners argued, among others, that stipulations as to time for performance are of the essence in mercantile contracts. The obligation to keep the Vessel in class is an integral feature of a bareboat charterparty. Loss of class is likely to have potentially immediate and irreversible consequences for owners. Imposing the classification obligation has no resulting undue hardship on charterers. If the classification obligation is innominate, it will lead to considerable uncertainty since owners will be

required to second-guess the termination of a charter.

On the other hand, the Charterers argued that the Court should not easily interfere with the value judgment of the experienced maritime arbitrators. They also argued, among others, that their obligation to maintain and repair goes hand in hand with and is part and parcel of their obligation to maintain class. The overall purpose of Clause 9A was to put the Vessel at the absolute disposal for all purposes of the Charterers; maintenance is simply ancillary to this. Since Clause 9A did not provide for an express right of withdrawal, the remedy for a failure to maintain class is not a right of withdrawal but a right to require the Vessel to be dry-docked.

The decision

For the first issue, the Court held that the classification obligation is to be treated as distinct from and additional to the maintenance obligation. The two obligations are different in quality. There is a natural and ready distinction between a vessel's physical condition / maintenance status and its classification status. The obligations might be related, but they were not "part and parcel of" a single obligation as the Tribunal appeared to have held. Although Clause 9A included the obligation of Charterers to take immediate steps to have the necessary repairs done within a reasonable time, it did not qualify or dilute the absolute nature of the classification obligation.

The Court therefore held that the Tribunal erred in law in finding the classification obligation was only an obligation to reinstate expired class certificates within a reasonable time. The classification obligation was an absolute one.

As to the second issue, the Court held that a breach of a classification obligation is immediately, readily and objectively ascertainable. The Vessel's class must be maintained "at all times". Therefore, the classification obligation was a condition of the contract. The language of the Charterparty imposes a clear and absolute obligation with a fixed time limit, redolent of a condition. A breach of the classification obligation could not be said to be trivial or "ancillary". Breach of the classification obligation has significant sequencing consequences, which are not merely commercial or affecting the parties alone, but also affect the cargo interests and subcharterers. The fact that the classification was not labelled a condition was not determinative. Upon the proper construction of Clause 9A, the obvious intention of the parties would be that the Owners would have the right of termination.

Further, such construction produced a commercially sensible result. Charterers will be on notice when a vessel's class certification was due to expire and could take the necessary steps to renew classification before expiry. In other words, the Charterers accepted an absolute obligation to maintain class. Thus, the Court overturned the Award and held that the Owners were entitled to terminate the Charterparty.

How to get prepared for the 2020 global sulphur limit? (Part III)

Recap of the last issue

In light of the upcoming 2020 global sulphur limit for sulphur in fuel oil used on board ships of 0.50% m/m (mass by mass) commencing from 1 January 2020, the last issue of Shipping Q&A discussed various contracting issues facing ship owners and charterers, and provided suggestions of clauses to be incorporated in their charterparties.

Among other things, the last issue highlighted the likely surge in the price of low-sulphur compliant fuels and how parties should address the sharing of such costs in the course of negotiating new charterparties. Another important issue that should not be overlooked by parties is their need for financing solutions, which can raise pertinent legal questions.

Financing of scrubbers

As mentioned in previous issues, in order to continue using high-sulphur non-compliant fuel, ship owners will have to consider fitting scrubbers on their ships, and the costs of purchasing and installing scrubbers are estimated to be between two million US dollars to five million US dollars. How ship owners manage to finance such huge costs can raise various legal questions. In light of the huge costs and complexities surrounding the financing of scrubbers to be fitted in ships, there is a pressing need for viable financing solutions. This issue of Shipping Q&A will look at some of the potential solutions and the related legal issues.

Where ships are encumbered

If ship owners opt for financing through debt, they need to consider what types and forms of security will be mutually acceptable to themselves and lenders. A popular

arrangement currently discussed in the shipping industry is to let lenders take security over scrubbers installed on the ships. However, this may not be feasible for encumbered ships, as the scrubbers, which are generally considered as part of the ship upon their installation, are likely to be subject to any prior security over the ship as a whole by default, such as a prior mortgage to secure a bank loan. The mortgage documents may restrict what the ship owner can do to the ship, and may prevent the ship owner to let lenders have security over the scrubber installed on the ship without prior consent from relevant financers. Such consent may be difficult, if not impossible, to obtain. Without the prior security holder's consent, the financier of the scrubber may not be able to

hold valid security interest over the scrubbers.

Even if the ship owner successfully obtains consent from the prior security holder, the security to be held by the financier of the scrubber will rank lower than the prior security holder, and therefore the financier of the scrubber are likely to be reluctant to lend on this basis. A possible solution for ship owners is to use the public sector backed export credit guarantees, such as the Norwegian Export Credit Guarantee Agency (Garantiinstituttet for eksportkreditt (GIEK)) which aims to promote Norwegian export and foreign investments by issuing guarantees on behalf of the Norwegian State. Nevertheless, this scrubber finance solution may only be feasible for ship owners that intend to install larger quantities of scrubbers. Such public sector backed export credit guarantees may also come with rather stringent requirements that should not be overlooked by shipowners, such as requiring a certain amount of components to be produced in a certain country.

Where there is an existing loan facility

Depending on the type and form of the existing loan facility, the shipowner may have the power to increase the amount of the existing loan facility. Examples of such loan facility arrangement are a revolving credit facility and a green-shoe option under a syndicated loan. In such cases, the financier of the scrubber may be able to finance the ship owner's purchase of scrubbers by way of debt through sub-participating in the existing loans, and may therefore enjoy a first priority security interest on a pari-passu basis. Of course, given the risk-exposure of the scrubber financer (considering the cost of the scrubbers) is likely to be significantly lower than that of the financer of the ship, the latter may only agree to such an arrangement with some contractual subordination imposed on the part of the former.

As the scrubbers to be fitted are often regarded as part of the ship, a more mutually-acceptable financing solution may be a contractual agreement between the financier of the ship and the financier of the scrubbers for a waterfall payment scheme, under which upon receipt of security proceeds under the loan agreement (usually as a result of enforcement action against the ship), either the financier of the scrubber will share in the security proceeds or be paid out of the excess once the financier of the ship has been repaid fully. This contractual agreement will cause relatively less disruption to any existing financing arrangement of the ship itself.

Where title to the scrubbers can be retained by their financiers

A possible financing arrangement is to let the financier of the scrubbers retain title to the scrubbers and then lease them back to the ship owner (such as by way of a hire-purchase agreement). If the lease is properly drafted and the materials and hardware constituting the scrubbers are sufficiently identifiable so that they are not regarded as an integral part of the ship, the financier of the scrubbers may be able to retain title to the scrubbers.

However, practically speaking, it may be difficult to make the scrubbers sufficiently identifiable. Even more importantly, in the event of the ship owner's default in its payment obligations to the financier, the financier will find it hard and costly to remove the scrubbers from the ship in order to recover them for sale to cover the initial

amount of financing. Another practical issue is the re-sale value of scrubbers. Re-installing such used and removed scrubbers in another vessel may be difficult and not cost-effective, and therefore not a viable method for the financier of the scrubber to get back its original financing costs.

Where the charterer is willing to finance the scrubbers

Another option is for the charterer of the ships to finance the purchase and installation of scrubbers. In such cases, parties may insert terms regarding an additional set-off right in the charters that can be set off against any vessels for the ship owner's default under the loans for the scrubbers. Alternatively, a discount can be applied to the charter rate under the charters. This is a relatively straightforward arrangement to be implemented between parties and to mitigate the risks of default of loans for scrubbers.

Conclusion

We expect that various scrubber financing solutions or products will be introduced to the shipping industry soon in light of the soon-to-be-commenced 2020 global sulphur limit. Ship owners (and other related parties, as the case may be applicable) should think carefully and consult their legal advisors before agreeing to any financing arrangement. In particular, they should be extra-cautious when their ships or any parts thereof are subject to existing security interests, the restrictions of which can often create obstacles for creation of further security interests. Parties are advised to start early to negotiate a mutually acceptable financing arrangement for scrubbers, the process of which is expected to be lengthy and difficult.

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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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