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Cover Story

Who shall bear the burden of proof in cargo damage claims?

Introduction

In a recent case *Volcafe v CSAV* [2018] UKSC 61, the Supreme Court of the United Kingdom (the "**Supreme Court**") discussed for the first time as to who shall bear the burden of proof in cargo damage claims against the shipowner under the Hague Rules.

Facts

Background

The Claimants, who are the cargo owners and bill of lading holders, claimed against the Defendant, who is the shipowner and the carrier, for breach of Article III Rule 2 of the Hague Rules since it had failed to, among others, properly and carefully carry and discharge the goods carried, namely the bagged coffee beans. The Claimants argued that wet damage was caused to the beans and the Defendant had failed to use adequate or sufficient Kraft paper to the walls of the container to protect the coffee beans. On the other hand, the Defendant argued that the condensation damage to the coffee beans was caused by an inherent vice of the coffee beans. Coffee is hygroscopic which will absorb and emit moisture. The coffee beans will inevitably emit moisture and thereby cause condensation to form on the walls and roof of the container when they were carried from warm climates to cool climates in unventilated containers. Hence, the Defendant argued that it could rely on the defence under Article IV Rule 2(m) of the Hague Rules.

The appeal

The High Court Judge held that the doctrine of *res ipsa loquitur* (a doctrine that infers negligence from the nature of an accident in the absence of direct evidence on how the defendant behaved) was available to the

Claimants in the present case. Since the beans have been received in good order and condition but have later been delivered in a damaged state, there is a factual presumption that damage ascertained on discharge of the coffee beans was due to negligence. It is accepted by the High Court that there was an undisputed damage on the cargo, which therefore required the Defendant to produce evidence to prove the contrary.

The Court of Appeal set aside the decision of the High Court Judge and held that, if the Defendant shows a prima facie case for an "inherent vice" defence, the burden of proof shifts to the Claimants to establish negligence and prove that the defence under Article IV Rule 2(m) of the Hague Rules does not apply. Moreover, since the exception under Article IV Rule 2(q) of the Hague Rules provided a catch-all exception which expressly placing the burden of proof on the Defendant to disprove fault or negligence; therefore, in the case of other exceptions under Article IV of the Hague Rules, the Defendant does not bear the burden to disprove negligence so that the exception will apply.

The Claimants appealed against the Court of Appeal's decision to the Supreme Court.

The relevant rules

Article III Rule 2 of the Hague Rules provides that, "subject to the provisions of Article IV, the carrier shall properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried".

Article IV Rule 2 of the Hague Rules provides that, inter alia, neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from:

> "… (m) Wastage in bulk of weight or any other loss or damage arising from inherent defect, quality or vice of the goods. …
>
> (q) Any other cause arising without the actual fault or privity of the carrier, or without the fault or neglect of the agents or servants of the carrier, but the burden of proof shall be on the person claiming the benefit of this exception to show that neither the actual fault or privity of the carrier nor the fault or neglect of the agents or servants of the carrier contributed to the loss or damage."

Issues

The issues before the Supreme Court are:-

1. Does the Claimants bear the legal burden of proving the breach of Article III Rule 2 of the Hague Rules or is it for the Defendant to prove compliance of the Article III Rule 2 of the Hague Rules once loss or damage to the cargo has been ascertained?
2. Is it for the Claimants to prove that it was the negligence of the Defendant which caused the inherent vice to operate on the cargo after the carrier has proven the facts which render the case falling under the exception under Article IV Rule 2 of the

Hague Rules?

The Court's ruling

The Supreme Court overturned the Court of Appeal's ruling and held that the Defendant bears the burden of disproving negligence under both Article III Rule 2 and Article IV Rule 2 of the Hague Rules. To start with, the Supreme Court said that the principles of bailment at common law are an essential background against which the Hague Rules were drafted. Therefore, even though the bill of lading in the present case incorporated Hague Rules, it is necessary to examine the common law principles of bailment, that is, a bailee of goods only bears limited duty to take reasonable care of the goods, and shall bear the legal burden of proving the absence of negligence. It is necessary for a bailee to show he has taken reasonable care of the cargo or the cause of the damage sustained is not the lack of reasonable care. Nevertheless, the bailee is not required to show how the damage or injury occurred.

Article III Rule 2 of the Hague Rules

The Defendant submitted that first, the burden of proving a breach of duty to take reasonable care of the cargo during the voyage should be on the Claimants since there is a general rule in the English law that he who asserts must prove. Also, the reason why the bailee has a common law obligation to disprove negligence was that a bailee has a strict obligation to redeliver the goods in the same condition as when delivered. However, under Article III Rule 2 of the Hague Rules, there is a qualified obligation to take reasonable care of the cargo.

The Supreme Court disagreed with the Defendant's submission and held that the bailee's common law obligation is not strict, and therefore, the bailee's obligation to take reasonable care under common law is always treated as consistent with the rule which imposes the burden of disproving negligence on the bailee. The Court relied on the cases *The "TORENIA"* [1983] 2 Lloyd's Rep 210 and *Homburg Houtimport BV v Agrosin Pte Ltd* [2003] 1 AC 715 to arrive at a conclusion that the burden of proof under the Hague Rules is the same as that in the case of bailment for carriage. Further, Article III Rule 2 of the Hague Rules has expressly been made subject to the exceptions in Article IV of the Hague Rules, and it is well-established that the burden to prove that the exceptions in Article IV should apply rests on the Defendant. As such, the Supreme Court concurred with the Claimants that the Hague Rules must logically impose the same burden of proof on the Defendant for the purpose of both Article III Rule 2 and Article IV of the Hague Rules, that is to disprove negligence in respect of the damage to the cargo sustained during the carriage.

The Defendant also submitted that the Hague Rules, as a complete international convention, shall not be construed in light of particular features of any domestic system of law, such as

English law.

The Supreme Court also disagreed and held that, since the Hague Rules did not deal with the mode of proving a breach and questions of evidence, these will be governed under the law of evidence and the rules of procedure in the appropriate forum. If the English Court is the appropriate forum, then the English rules of evidence and procedure will apply. Further, some researches show that many countries, such as Belgium, the Netherlands, Italy, Germany, Norway and Spain, also apply principles that the fact that a damage has been sustained during carriage will cast the burden of proving the absence of fault on the carrier and there shall be a conclusive breach of Article III Rule 2 of the Hague Rules unless the carrier can prove that the exception under Article IV Rule 2 of the Hague Rules applies.

Article IV Rule 2 of the Hague Rules

The Defendant relied on *The 'Glendarroch'* [1894] to argue that if it has successfully proved that the cargo suffered from inherent vice, the burden of proof will be shifted to the Claimants to prove that those inherent vice of the cargo resulted in damage because of the Defendant's negligence.

The Supreme Court disagreed with the Defendant and overturned *The Glendarroch* since it was technical, confusing, immaterial to the commercial purpose of the exception and out of place in the context of the Hague Rules, which was made effective on 1968. Also, *The Glendarroch* case is concerned about the perils of the sea defence and thus not applicable to the exception for inherent vice in the present case. The Supreme Court held that there is not a general principle that a cargo owner shall bear the burden of proving negligence. It is the carrier who bears the legal burden to prove that the exception under Article IV of the Hague Rules applies. For a carrier to rely on the inherent vice exception, he shall prove that the cargo will be damaged anyways no matter what reasonable steps he has taken to prevent such damage, or that he has actually taken reasonable care of the cargo but the damage was still sustained nevertheless. This is because, if the carrier could take steps to prevent inherent characteristics of the cargo from resulting in damage, this characterises is not inherent vice.

Conclusion

Over four centuries, the Supreme Court has not provided a definite answer to the question of the burden of proof in cargo damage claims since there were usually some persuasive evidence in the prior cases. This landmark case has clarified this question and held that the carrier shall bear the legal burden to disprove that the loss or damage sustained was caused by its breach of Article III Rule 2 of the Hague Rules or to prove that the defence under Article IV Rule 2 of the Hague Rules applies.

Shipping News Highlights *(from Lloyd's List)*

Competition Commission scrutinizes the alliance of the big four terminal operators

The four major terminal operators in Hong Kong, namely, Cosco-HIT Terminals, Asia Container Terminals, Hong Kong International Terminals and Modern Terminals, have entered into Hong Kong Seaport Joint Operating Alliance Agreement, where the parties plan to collaborate for a better management and operation of the 23 berths across 8 terminals in Kwai Tsing. The operators pointed out that cities with single port group, such as Shanghai and Singapore, are more effective at driving investments.

After the alliance, it is expected that the four operators, which already handled more than 95% of the port's container terminal business, will continue monopolizing the market. The negative impact on the competition imposed by the alliance triggers the investigation of the Competition Commission. Under the First Conduct Rule of the Competition Ordinance (Cap 619), an undertaking must not make an agreement if the object or effect of the agreement is to prevent, restrict or distort competition in Hong Kong.

The Competition Commission pointed out that the question is whether the alliance will lead to potential pricing or collusion notwithstanding the alleged benefits of single port group. The investigation is still ongoing and we will know whether there will be a change in port operation in due course.

China cut purchases of US crude oil

The bunkering industry has been keeping all eyes on the US-China trade war.

Although the Chinese government has not yet imposed a tariff on US crude imports, there is great concern over the potential impact of the proposed tariff on in-transit cargoes. Chinese buyers have been cutting crude purchases from the US from 360,000 barrels per day for the month of July to 260,000 barrels per day for the months of August and September.

It is expected that China's crude oil imports will keep plateauing for the year of 2019.

Brightoil's VLCC arrested in China

On 4 January 2019, pursuant to an order made by China's Haikou Maritime Court, a very large crude carrier was arrested. The arrest was requested by a French bank, one of the ship-owner's creditors which had provided the ship-owner with loans in the sum of US$45.5 million.

The detained vessel is likely to be the 2013-built, 319,819 dwt Brightoil Gem which matches the descriptions of the vessel made by the Court. The ship-owner is one of the subsidiaries of the Hong Kong listed company Brightoil Petroleum (Holdings) Limited ("**Brightoil**") and the vessel worth more than US$60 million.

Brightoil has had several vessels arrested by the creditors recently. In mid-January 2019, Brightoil announced on the Hong Kong Stock Exchange that it is currently assessing its financial position and considering debt reorganization after the spate of claims brought by the creditors.

Positive results of quality of low sulphur fuel

For ships operating outside Emission Control Areas, the limit for sulphur content of ship's fuel oil is 3.50% mass by mass. With a view to reducing harmful impacts of ships on the environment, the International Maritime Organization decided to reduce the sulphur limit to 0.50% mass by mas, effective from 1 January 2020. There is not much of a market for the fuels produced specifically to meet the 0.50% sulphur limit yet. This may be partly attributed to the widespread industry concerns over the fuel quality.

Recently, the 0.50% sulphur fuel being used was tested and there was positive news on the quality of the fuel. However, it should be noted that mixing low-sulphur paraffinic fuels into an existing aromatic heavy fuel onboard the vessel risks compatibility issues and, worse still, ultimately engine damage. Therefore, the focus should not only be the quality of the low-sulphur fuel but also the technical competence and fuel management.

A v B

[2018] EWHC 2325

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Facts

A (the "**Owners**") applied to the English Commercial Court to challenge an arbitration award made in favour of B (the "**Charterers**") based on serious irregularity under section 68 of the Arbitration Act 1996 (the "**Act**"), and for permission to appeal the award on points of law under section 69 of the Act. In the underlying arbitration, the Owners were the respondents. The Charterers had time-chartered the Owners' vessel, the GA, a very large crude oil tanker, which they then placed in a pool by way of sub-charter with similar tankers, which is called the S tankers pool.

In short, under the three relevant contracts, including the time charterparty between the parties, the Owners were obliged to ensure that a valid report would be registered on the Sire system (the database of the Ship Inspection Report Programme), and that such report should not be more than six months old. It was also a requirement that on delivery the vessel should be eligible for the business of at least four named oil majors at all times.

During the course of the charter the vessel received an unfavourable Sire report, as a result of which the vessel was discharged in a different port and was subsequently rejected by various oil majors. Eventually the Charterers placed it off hire and commenced arbitration (which a tribunal of the London Maritime Arbitrators Association (the "**Tribunal**") was formed) against the Owners to claim for (1) loss of profits by reference to two realistic voyage calculations had there been no breach and (2) wasted expenditure for hire and bunkers incurred.

The arbitration award

The arbitration award (the "**Award**") was granted on 9 May 2017, in which the Tribunal found that the Owners had breached the oil major eligibility clause because the vessel was not acceptable to at least four of the named oil majors, and also because the Sire report became more than six months old. The Tribunal then found and declared that the Charterers' claim for damages succeeded in the sum of US$3,278,169.

The Owners challenged the Award for serious irregularity pursuant to section 68 of the Act. The Owners argued that each of these serious irregularities caused them substantial injustice and called out for the court's intervention.

Issues

The main issues for the Court's consideration are:

1. whether it was consistent with the compensatory principle for the Tribunal to award both loss of profits and wasted expenditure; and
2. whether, where there is an available market which is weak and loss making, damages should be assessed by reference to that available market or by reference to lucrative fixtures which charterers contend they would have entered into but for breach discounted by reference to loss of chance principles.

Decision

On the first issue, the Owners argued that the Award had placed the Charterers in a better position than they would have been if they had not breached the charterparty due to the Tribunal's overcompensation.

The Court held that leading texts recognise situations where wasted expenses up to contract's date of termination can be claimed, along with loss of profit, if the latter is calculated net of the expenses incurred. The net loss of profits must have been calculated by deducting from the expected gross returns the cost of performance, expenditure to the date of termination and the cost of the further expenditure which would have been incurred if the contract had run its full course.

In the present case, the Tribunal had taken the notional profit figures for two voyages from the Charterers' expert as the basis for calculating lost profits, which in outline are the voyage revenues minus bunker and other expenses, divided by the voyage duration in days. Therefore the profit figures are net figures, and there is no overlapping between the lost profits and wasted expenditure for bunkers and hire.

On the second issue, the Owners argued that given that the market was soft, there was an error of law for the Tribunal not to discount in relation to the two lost fixtures for loss of chance.

The Court cited that "where there is a relevant market and where the court can and does make a finding as to the profit that would probably have been made (and has been lost), there is no place for a discount from that figure to reflect the chance that the vessel would not have been employed." In the present case, the Tribunal found that there was an available market and the vessel would probably have performed two oil major fixtures in the absence of the Owners' breach. Therefore there was no error of law in the Tribunal's conclusion.

Based on the above reasoning, the Court dismissed the Owner's application..

Classic Maritime Inc v Limbungan Makmur SDN BHD

[2018] EWHC 2389

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Facts

The shipowner, Classic Maritime Inc. ("**Classic**") entered into a long term contract of affreightment (for "**COA**") with the charterer, Limbungan Makmur Sdn Bhd ("**Limbungan**") for the carriage of iron ore pellets from Brazil to Malaysia.

The claim in this action arises under an addendum to the COA entered into between the parties, under which Limbungan had undertaken to ship further cargoes of iron ore pellets on tonnage provided by Classic from Tubarao or Ponta Ubu in Brazil to Port Kelang or Labuan in Malaysia. Clause 32 of the COA (the "**force majeure clause**") provides that:-

> "***Exceptions***
>
> *Neither the vessel, her master or Owners, nor the Charterers, Shippers or Receivers shall be Responsible for loss of or damage to, or failure to supply, load, discharge or deliver the cargo resulting from: Act of God,…floods….accidents at the mine or Production facility….or any other causes beyond the Owners' Charterers' Shippers' or Receivers' control; always provided that such events directly affect the performance of either party under this Charter Party…*"

Limbungan's group companies contracted directly with mining companies which shipped from two separate ports: Samarco Minercao SA ("**Samarco**") which shipped in Ponta Ubu, and Brazil and Vale SA ("**Vale**") which shipped in Tubarao, Brazil for the supply of iron ore pellets.

On 5 November 2015, the Fundao dam in Brazil burst (the "**dam burst**"), resulting in Samarco's cease of iron ore production and operation. On 6 November 2015, Samarco suspended all deliveries of iron ore and gave notice of a force majeure on account of the dam burst.

Limbungan has relied upon the dam burst as a force majeure event excusing it from liability for failing to provide the shipment of iron ore pellets from Brazil to Malaysia. Classic argued that there is no causation between the dam burst and the failure to provide shipment, and claimed damages for breach of the COA in respect of five shipments.

Issues

There are three main issues for the Court to consider in relation to the reliance of the force majeure clause:

1. Whether Limbungan had made all reasonable efforts to arrange the shipment of cargoes from other ports;
2. Whether the dam burst was the true cause of the charterers' default (i.e. "but for" test); and
3. Whether Classic was entitled to recover substantial damages.

Decision

Issue 1: principles of relevant arrangements and alternative modes of performance

Classic argued that at the time of the performance of the COA, Limbungan, who undertook an absolute and non-delegable obligation to provide cargo, did not arrange sale and purchase contracts in place with the mining companies and its sole supplier Vale refused to supply cargo. Therefore, the dam burst was legally irrelevant.

On the other hand, Limbungan submitted that it had alternative modes of performance available i.e. to ship either from Ponta Ubu or from Tubaraao. It had the intention, arrangements and settled practice to perform its obligations under the COA but the said arrangements were prevented by the dam burst, which is a force majeure event.

The Court held that the general principle regarding alternative modes of performance was capable of applying to Limbungan's entitlement to ship from other ports. If Limbungan was to be regarded as having made arrangements to ship from those ports and then, following the dam burst, as having made all reasonable efforts to ship from those ports with no success, then the dam burst could be regarded as the cause of its failure to supply cargoes. The Court considered that Limbungan had made no relevant arrangements when its sole (after the dam burst) supplier Vale refused to supply iron ore pellets. The charterer has a non-delegable duty to provide a cargo and its supplier's failure or refusal to do so provides it with no defence. As a matter of fact, Limbungan had made no arrangements to provide cargo at Punta Ubu or Tubarao, which made it difficult for Limbungan to establish its default resulted from the dam burst. The finding is also relevant to the second issue.

Issue 2: "but for" test

Classic argued that but for the dam burst Limbungan would have fulfilled its obligations under the COA. Limbungan rebutted by citing case laws to show that the force majeure clause applies as a "contractual frustration clause" which the "but for" test has no application.

The Court rejected Limbungan's argument and held that there was an important difference between a contractual frustration clause and an exceptions clause. A contractual frustration clause was concerned with the effect of an event on a contract for the future. It operated to bring the contract to an end so that thereafter the parties had no obligations to perform. An exceptions clause was

concerned with whether a party was exempted from liability for a breach of contract at a time when the contract remained in existence and was the source of contractual obligations. In the present case, the words within the force majeure clause must be construed in the context of an exceptions clause and require Limbungan to show that but for the dam burst the cargo would have been supplied but due to the dam burst it was not.

Applying the "but for" test to the facts, the Court doubted whether but for the dam burst Limbungan would have been able and willing to supply cargoes for shipment pursuant to the COA. Therefore, Limbungan was unable to rely upon the force majeure clause to excuse its failure to supply cargoes for the five shipments in question.

Issue 3: damages – compensatory principle

The issue is whether Classic was entitled to recover substantial damages from Limbungan in respect of its breach. The recoverability of substantial damages depends upon the compensatory principle and therefore upon a comparison between the position of Classic as a result of the breach and the position it would have been in had Limbungan performed its obligations.

However, the realistic comparison in this case is between the position that Classic is in with the position it would have been in had Limbungan been able and willing, but for the dam burst, to supply and ship the five cargoes. Accordingly, the Court held that Classic could not be put in a better position than it would have been in, had Limbungan been able and willing to perform. Therefore, Classic was not entitled to substantial damages for Limbungan's default notwithstanding that Limbungan is unable to excuse its failure by reference to the force majeure clause of the COA.

CSSA Chartering and Shipping Services SA v Mitsui OSK Lines

[2018] EWCA Civ 2413

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Facts

The Defendant was the owner of the VLCC "PACIFIC VOYAGER" (the "**Vessel**") which was chartered under a charterparty on the Shellvoy 5 form dated 5 January 2015 to the Claimant, the charterers, for a voyage from Rotterdam, or ship-to-ship transfers off Rotterdam, to the Far East. The charterparty, among other things, contained the term that *"…the vessel shall perform her service with utmost despatch and shall proceed to [Rotterdam or STS off Rotterdam] … and there … load a full cargo…"*.

Under a previous charter, the Vessel was to discharge load or discharge the cargoes at certain ports and fully discharge the cargoes at Antifer, Le Havre. While the Vessel was transiting the Suez Canal, she suffered rapid water ingress in no. 1 starboard ballast tank. There was no suggestion that the Vessel or the Defendant was in any way at fault, or could reasonably have prevented what happened. The Vessel was expected to have repairs for months. The cancellation date was at 11:59 p.m. on 4 February 2015. On that day, the Defendant informed the Claimant of the incident and the prospects for future performance of the charter voyage. On 6 February 2015, the Claimant terminated the charterparty and subsequently brought a claim for damages.

The charterparty specified the details of an anticipated timetable for completion of previous charters but did not give a date of expected time of arrival ("**ETA**") or expected readiness to load ("**ERTL**") at the loading port, i.e. Rotterdam.

Issue

1. Whether, in a charterparty which contained no expected time of arrival or readiness to load at the loading port but did contain an expected time of arrival at the last discharge port under a previous charter, there is a similarly absolute obligation to begin the voyage to the loading port; and
2. if so, when will that obligation take effect.

Lower court's decision

The judge held that, although there was no ETA or ERTL, there was an expected time of arrival at the last discharge port under the previous charter. Accordingly, the Defendant had come under an

absolute obligation to begin the voyage from the previous charter at the end of its reasonable discharging period. The Defendant appealed against the judge's decision to the Court of Appeal.

Decision of the Court of Appeal

It is well settled that, where a voyage charter contains a provision that the shipowner will proceed with all convenient speed (or with utmost despatch) to a loading port and also gives a date of ETA or ERTL at the loading port, there is an absolute obligation to commence the voyage to the loading port at such time as it is reasonably certain that the vessel will arrive on or around the expected date.

The Court of Appeal held that the obligation of utmost despatch is an important obligation and is intended to give comfort to a charterer. If the obligation is to be given any effect at all, some time for sailing must be put in. That must mean that the vessel must either proceed "forthwith" at the date of the charter or "within a reasonable time".

In the present case, the inclusion of the itinerary shows that "forthwith" cannot be meant, the itinerary was an important information and should be used to decide what is the reasonable time at which the obligation of utmost dispatch is to attach. Otherwise, there is little other reason for the itinerary to be included. On this basis, the reasonable time is such time as it is reasonable to suppose the Vessel will leave Antifer for Rotterdam once a reasonable time for discharging has elapsed.

The Court of Appeal therefore dismissed the appeal and held that the Defendant was in breach of the charterparty.

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

Recap of the last issue

To recap, the United Nations International Maritime Organisation (IMO) has implemented a global limit known as the 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. According to market surveys, shipowners will generally opt for one of the following two ways so that their ships will be in compliance with the 2020 global sulphur limit:

1. using low-sulphur compliant fuel; and/or
2. continuing to use high-sulphur non-compliant fuel while installing scrubbers on their ships to clean up sulphur emissions.

Sanctions for non-compliant ships

As discussed in the last issue, ships will be subject to sanctions by the Individual State Parties to MARPOL in the event of non-compliance with the new sulphur limit. Shipowners of non-compliant ships will face fines if their ships are found not using the right fuel. There are also other potential consequences. For instance, ships may be declared "unseaworthy" which would prohibit them from sailing. Shipowners may be considered to be in breach of seaworthiness, class or other warranties under their insurance policies. This may enable insurers to avoid liability for losses which would otherwise be covered under insurance policies.

I. <u>Ships burning low-sulphur compliant fuel</u>

Market survey reveals that most shipowners will opt for the first method, i.e. using low-sulphur compliant fuel, but not the second method in view of the considerable cost of installing scrubbers. It should be noted that the IMO has now formally adopted a total ban on ships without scrubbers (or equivalent technology) to carry high-sulphur non-compliant fuel "for combustion purposes, for propulsion or operation on board". Intended as an additional measure to the 2020 global sulphur limit, this fuel carriage ban will come into force on 1 March 2020.

Photo by Chris LeBoutillier from Pexels

Therefore, for ships not fitted with scrubbers, all remaining high-sulphur non-compliant fuel on board the ship after 1 January 2020 should be unloaded latest by 1 March 2020.

<u>Renegotiating terms of charter contracts</u>

In a time charter, the time charterer needs to provide the right type of fuel for the shipowner to stay out of trouble under the 2020 global

sulphur limit. As such, it is essential for shipowners to insert a clause in their time charterparties which provides that if the charterer does not deliver compliant fuel, the charterer, but not the owner, will be responsible for any fines or other consequences if he gets caught.

Furthermore, it is not unusual for charterparties to contain clauses under which a shipowner is obliged to buy back unused bunkers from the charterer. Depending on the exact terms in the charterparty, the shipowner's obligation may be extended to the buy-back of unused high-sulphur non-compliant fuel bunkers. If that is the case, the unused bunker that the shipowner is obliged to buy back is likely to have very limited value for the shipowner. Shipowners should negotiate with the charterers if they wish to avoid such buy-back obligations.

As for charterparties under which redelivery is scheduled to take place at sometime in January 2020, shipowners are advised to negotiate on the volume and price of high-sulphur non-compliant fuel bunkers for their redelivery under the charterparties. Subject to parties' existing contractual obligations, parties may want to negotiate on and/or rearrange the redelivery of fuel so that no more or fewer high-sulphur non-compliant fuel will be delivered on dates closer to 1 March 2020, i.e. the deadline of the fuel carriage ban, or preferably 1 January 2020, i.e. the date of the commencement of the new sulphur limit.

As for shipowners who are in the course of negotiating new charterparties, the following issues should be addressed:

1. What should be the appropriate redelivery range and price of high-sulphur non-compliant fuel bunkers specified in the charterparty in view of the upcoming sulphur limit?
2. Whether sufficient low-sulphur complaint fuel for redelivery is available for shipowners?
3. Whether the quantity of bunkers redelivered is sufficient for ships to arrive at a bunkering port that supplies enough low-sulphur compliant fuel?

It is important for parties to consider the issue of the practicalities of bunkering. While low-sulphur compliant fuel will most likely be available at larger bunkering ports, smaller or remote bunkering ports may face difficulties in supplying sufficient low-sulphur compliant fuel, or may even lack the necessary bunkering infrastructure for storing the reserves of such fuel.

<u>Disposal of remaining non-compliant fuel</u>

While fuel with a sulphur content exceeding 0.50% only becomes "non-compliant" since the 2020 global sulphur limit comes into force,

parties ideally should burn all non-compliant fuel in stock before 2020. If time does not allow for all high-sulphur non-compliant fuel to be consumed, then parties should put into

place arrangement(s) for the offloading or disposal of the remaining stocks of non-compliant fuel well before 2020.

As such, parties may consider inserting clauses which set out the respective obligations of shipowners and charterers in this regard. For instance, the obligations of the charterer can be set out in the charterparty as follows:

1. the charterer shall dispose of high-sulphur non-compliant fuel in accordance with local regulations before 1 January 2020;
2. the charterer shall be responsible for the fines or other relevant penalties in relation to improper disposal of non-compliant fuel; and
3. the charterer shall be responsible for all expenses incurred in removing and disposing of such non-compliant fuel, and shall reimburse expenses that the shipowner has paid for (if any).

As for shipowners:

1. the owner shall clean the tanks and make sure that the ship is fit and proper for loading of low-sulphur compliant fuel on board; and
2. the owner shall be responsible for all expenses incurred in the cleaning of the tanks, and shall reimburse expenses that the charterer has paid for (if any).

In addition, both shipowners and charterers should use reasonable endeavors to reduce quantities of high-sulphur non-compliant fuel carried by ships from now on to 1 January 2020.

II. <u>Ships fitted with scrubbers</u>

On the other hand, some shipowners may decide to install scrubber systems so that they can continue to use high-sulphur non-compliant fuel, which will be much cheaper than low-sulphur compliant fuel. Charter rates in charterparties should be adjusted to cover the installation cost initially borne by shipowners, which is of a significant amount. This is an issue particularly relevant to the parties to a long-term time charterparty, as it would only seem fair for the charterer, who will benefit greatly by being able to buy cheaper fuel, to share the costs of scrubbers. Therefore, shipowners and charterers should set out clauses in charter contracts to clearly allocate responsibility for and costs incurred as a result of the installation, maintenance and repair of scrubbers.

Parties may also include a clause that addresses the possibility of scrubber breakdown. For instance, there can be a mandatory requirement for ships to carry a certain amount of reserve of low-sulphur compliant fuel to mitigate the risk of malfunctioning/breakdown of scrubbers, which can result in incompliance with the global sulphur limit and legal liabilities.

Conclusion

It requires much time and planning ahead for shipowners and charterers to prepare a ship in compliance with the new global sulphur limit. Parties are encouraged to review the terms of their charterparties earlier and make

appropriate adjustments. Needless to say, the contracting issues discussed in this issue of Shipping Q&A should be addressed on a case-by-case basis. As such, parties are advised to seek legal advice first before incorporating any of the aforementioned clauses into their contracts.

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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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