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BUNKERSPOT

TALL ORDER

SINGAPORE RAISES THE BAR FOR THE BUNKER INDUSTRY

INSIDE:

SHIPPING OUTLOOK
ARBITRATION
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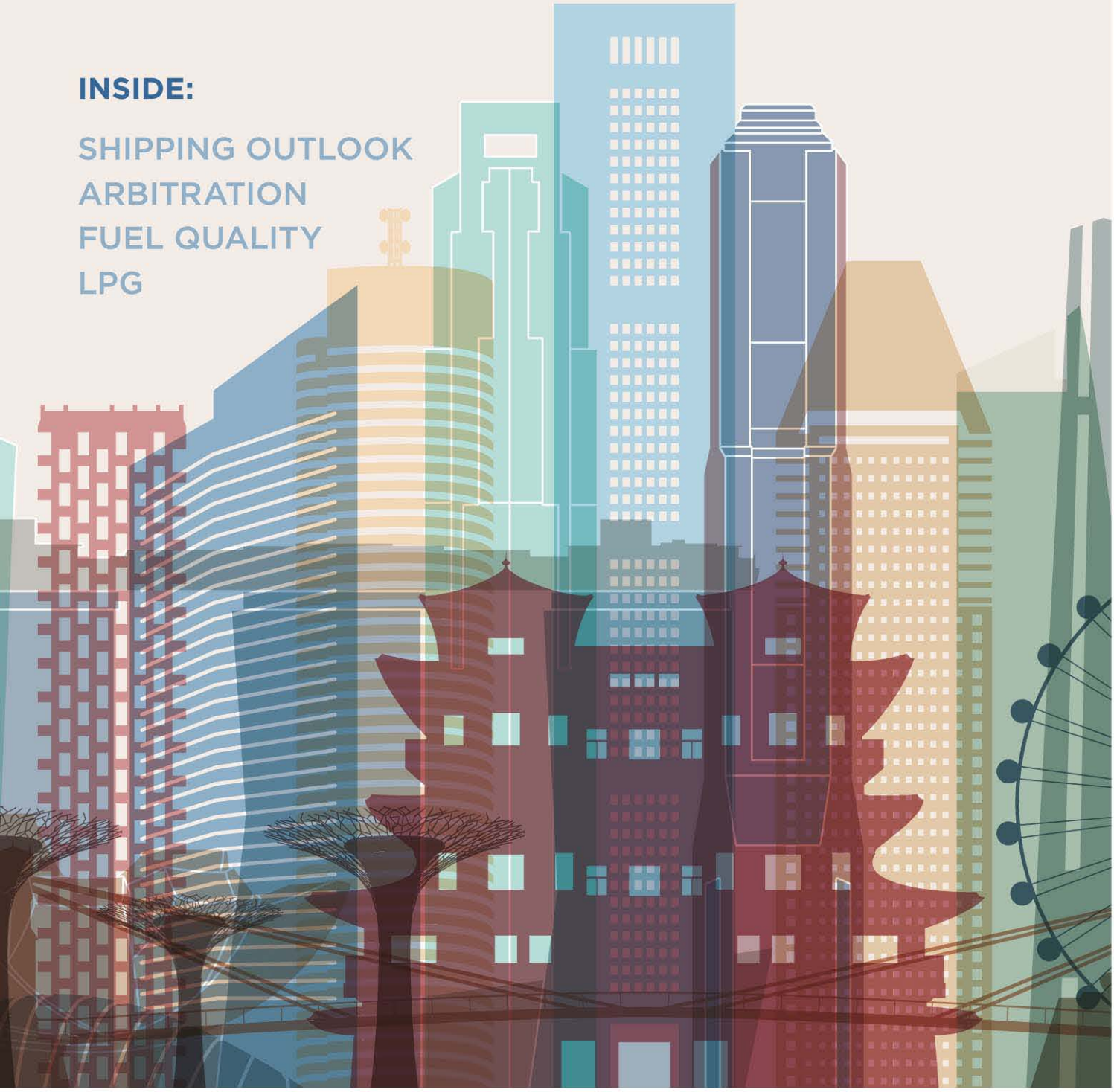
LPG



Time lapse

The bankruptcy of OW Bunker in 2014 and Hanjin Shipping's market exit last year together provided a salutary – and long overdue – wake-up call for the bunker industry and wider maritime sector. **Steve Simms** of Simms Showers reviews the subsequent legal and commercial changes and actions that have wrought further upheaval in the shipping world in such a short space of time

Sometime just before 7 November 2014 (the date of OW Bunker's insolvency filing in Denmark), a bunker trader named Rip finds a group of strangers. They invite Rip to take a drink with them (it could have been Aquavit, the potent Danish national distillate):

> *By degrees Rip's awe and apprehension subsided. He even ventured, when no eye was fixed upon him, to taste the beverage, which he found had much of the flavour of excellent [Denmark]. He was naturally a thirsty soul, and was soon tempted to repeat the draught. One taste provoked the other, and he reiterated his visits to the flagon so often that at length, his senses were overpowered, his eyes swam in his head, his head gradually declined, and he fell* into a deep sleep.[1]

Rip wakes up about three years later, in early October 2017. There's a lot that's changed in the bunker world.

Seven international container carriers now control 95% of the world container market. Rip learns that Hanjin Shipping, the world's seventh largest container carrier, filed insolvency proceedings on 31 August 2016. Hanjin's nearly-100 vessel fleet was stopped and many vessels arrested. OW, one of the world's largest bunker traders, is gone. Two things that were unthinkable, before Rip fell asleep in November 2014.

Rip hears of things entirely new to him, like 'disintermediation' and digitised, on-line trading. Few of Rip's old customers will still talk with him (Rip finds that many are gone) and they ask: 'Why should we buy through you and not direct from physical suppliers?' Rip's expertise had always added fair value for those customers, so what has changed? Rip arrests a ship to collect on some old charterer accounts. The owner's first question to him is, 'Did you pay the physical supplier?'

Rip then gets a new set of sales terms from an old friend, a physical supplier. The supplier won't sell to Rip on credit, unless Rip assigns the supplier all rights (including arrest of the vessel) against Rip's customer, and incorporates the supplier's sales terms (including explicit arrest right for the supplier). The supplier insists that Rip must confirm he hasn't assigned the receivable to any bank, and that Rip has no 'no lien' notice from the customer.

Physical suppliers didn't use to think this way. The supplier explains to Rip that it lost hundreds of thousands of dollars when OW went bankrupt. He's sorry, but they can't any longer take the risk that when a trader doesn't pay them, they can't arrest the ships which didn't pay for their bunkers.

Rip also hears some words that are new to him, like 'interpleader', 'private treaty sale', 'cross-border insolvency', and 'title retention'. Rip tries to find some of his old trader friends, but many of their companies are gone, bought by larger bunker traders. Some are being sued by their investors. Many are barely making a profit.

The character 'Rip' is taken from American author Washington Irving's 1819 short story about Rip Van Winkle. Deep in a forest, Rip finds a group of Dutch sailors from Henry Hudson's 1620 New York expedition. Mysteriously, they are alive from more than 100 years earlier. Rip drinks with them and wakes up 20 years later. He has slept through the entire American Revolution. His dog and many friends are dead, his now old gun is rusty, and American revolutionaries instead of the King run the country.

The 2017 bunker trader 'Rip' finds that the bunkering world also has changed much since he went to sleep in the first days of November 2014, to then wake up in October 2017.

The OW and Hanjin insolvencies have brought much of the change that has been seen in the global bunker industry. OW- and Hanjin-related court litigation, from vessel arrests and insolvency proceedings, to appeals, continue throughout the world. Their impact, as well as other developments in the bunkering world, such as the 2020 MARPOL 0.5% sulphur content limitations, overcapacity and technological developments, will continue the change.

Since OW's insolvency and then the many Hanjin vessel arrests, the first question traders now get is, 'have you paid your physical supplier?' It is now common for customers to require proof of payment before they will pay, and this has led to two industry changes.

First, there is an increased focus on the development of digital approaches – 'disintermediation' – which connect customers directly with physical suppliers. The goal

of this 'disintermediation' is to reduce bunkering costs, eliminating traders or reducing conventional broker commissions.

'Disintermediation' developers also intend to answer immediately the question of payment of physical suppliers, because they connect the supplier directly with the customer purchasing from them. The pre-OW market did not widely use the digital solutions then available. OW, and Hanjin, arguably promoted the development of better digital 'disintermediation solutions, which, over time, more customers and physical suppliers will use.

Second, however, it is important to remember how widespread bunker trading came about. Before the 1973 OPEC oil embargo, most bunkers were sold directly through long-term contracts, from major suppliers to customers. Trading began when those major suppliers cancelled the contracts, invoking 'force majeure' provisions after the suppliers couldn't obtain supplies.

Traders approached the majors, bought smaller quantities of bunkers that the majors did have available, and resold the bunkers to the vessel owner and operator customers. The majors were glad to have bunker sales, and credit, taken over by traders, since bunkers had always been a 'bottom of the barrel', lower margin product and marine credit had always been more complicated (i.e. ships moving around the world) than credit to land-based customers.

Pushing back against disintermediation, then, is the question of whether physical suppliers want to take on a credit function (and be faced with the further expense of arresting ships if unpaid). On the customer side, traders and traditional brokers also continue to provide valuable functions in assuring that physical suppliers are reliable and that they can provide product at required (including MARPOL-compliant) specifications. Also, traders more often will extend customers credit, where suppliers, and banks, will not.

This is where interpleader comes in. Interpleader is a procedure available in many legal systems, including the United States, the United Kingdom and Canada. Party 'X' agrees that it must pay a certain amount to someone, but 'X' is worried that more than one other party may lay claim to the money. 'X' therefore deposits the money with the court, and then the court requires that anyone else claiming the money, must enter the court proceedings to establish its claim. Ideally for 'X', it not only can exit the proceedings, but also recover its attorney's fees and costs for initiating them.

Before OW and Hanjin, interpleader rarely was used where there were unpaid bunkers and potential vessel arrests, but it is now a common beginning of US proceedings involving OW debts.

OW and Hanjin make it likely that interpleader, brought well away from the location of the physical supplier, trader, or vessel involved, will be commonplace where there is a question of whether more than one party should be paid for all or part of a bunker supply.

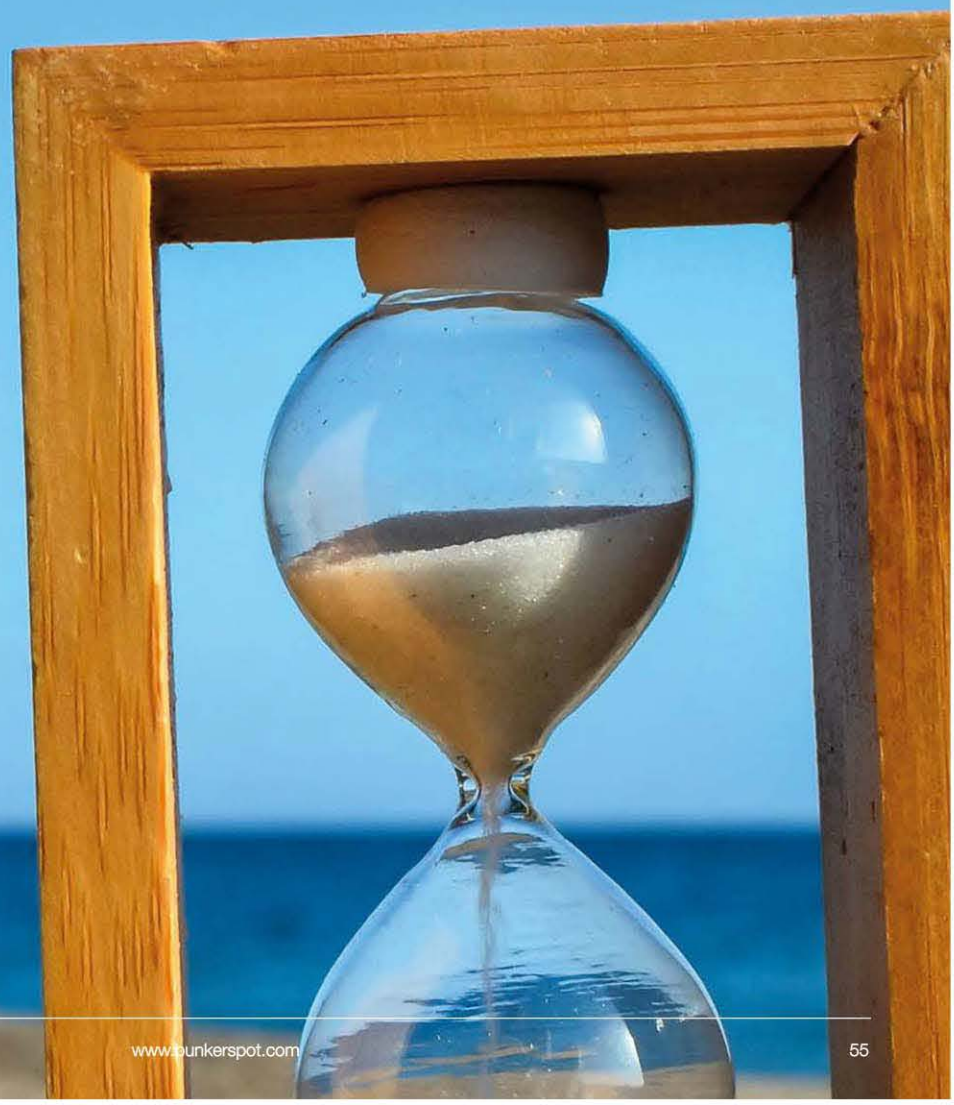
Before OW and Hanjin, physical suppliers often extended traders more or less unsecured credit. Many assumed that if the trader didn't pay them, they could still arrest the vessel that they had supplied with bunkers. Since November 2014, most world wide courts have surprised the physical suppliers by deciding that because they had no direct relationship with OW's customers, the physical supplier had no rights to instigate vessel arrest.

Compounding the situation is that ING Bank (actually a consortium of lenders, and now the funds which have purchased most of their interests, which extended credit to OW) has insisted that OW had assigned it not only all accounts receivable against OW's customers, but also arrest rights for vessels. These assignments were not only for the margin which OW was to make re-selling each purchased from physical suppliers, but also for the amounts which OW never paid the physical suppliers.

There are two notable exceptions to these decisions, however (both interpleader cases): in the United States, *Martin Energy Servs., LLC v. M/V Bravante IX*, 233 F. Supp. 3d 1269, 2017 U.S. Dist. LEXIS 11833 (N.D. Fla. Jan. 26, 2017), now on appeal to the United States Court of Appeals for the 11th Circuit, and, in Canada, *Canpotex Shipping Services Limited v. Marine Petrobulk Ltd.*, 2015 FC 1108 (CanLII), *reversed in part, ING Bank N.V. v. Canpotex Shipping Services Limited*, 2017 FCA 47 (CanLII), now returned (after an unsuccessful appeal by Canpotex to the Supreme Court of Canada) to the trial court (Federal Court of Canada).

Final decisions in each are forthcoming, as are many appeals (most in the United States) challenging the denial of physical suppliers' arrest rights.

The initial Canada Federal Court decision in the case of *Canpotex* perhaps provides the better answer of the two cases for unpaid OW physical suppliers. The Court looked to the explicit (numbered 'L.4') clause in the OW sales terms, stating that 'where the ►



physical supply of the fuel is being undertaken by a third party which insists that the Buyer is also bound by its own terms and conditions... the Buyer shall be deemed to have read and accepted the terms and conditions imposed by the said third party.'

The physical supplier in *Canpotex* had sales terms which provided for a maritime lien by the physical supplier, for unpaid bunkers. The Federal Court held that the OW 'L.4' clause meant what it says, so that, the interplead amount paid the physical supplier, not ING (claiming as 'assignee' through OW).

ING appealed and the appeals court found the evidence unclear as to which version of OW's sales terms (the one which the physical supplier relied on, or another one not extending the physical supplier's rights) applied. This question is now back before the Federal Court.

Well-advised physical suppliers have developed terms and conditions for sales to traders, which expressly assign to physical suppliers all rights of arrest and direct recovery from customers which have not paid for the physical supplies. They establish the traders as the agents and fiduciaries for the physical suppliers, to collect all amounts due for the physical supply.

They expressly permit the physical suppliers to proceed if they are not paid, and assign back the rights to the traders, when the traders pay the physical suppliers. They also require the traders to confirm that the traders have not assigned to any third party (like a bank) any of the rights that the physical suppliers have (through their sales terms) to directly recover each amount owed to the physical suppliers, including through vessel arrest.

Well-advised physical suppliers are also now aware of the sales terms of the traders they sell to, assuring (and requiring) that the traders have received no 'no lien' notices, that the traders' sales terms effectively provide for arrest based on maritime liens *in rem*, and that the traders' sales terms effectively preserve any title retention which the physical suppliers make in their own sales terms.

These physical suppliers also have contact with the customer, including communicating their sales terms in each communication with the customer (as a part of confirming details of physical supply, for example, by web link in messages to customers and their local husbanding agents) and through their bunker delivery notes.

This is a development, given a further US court decision, that traders should welcome. In a second opinion issued in connection with the *M/V Temara* and other vessels, the court decided that because OW had never paid the physical suppliers, it (and thus ING) had no maritime lien rights, either. The result, concluded the Court (somewhat inconsistently), between the two opinions, was in one opinion, that the unpaid physical supplier without a direct customer relationship (with the vessel owner/charterer) had no maritime lien (even though the physical supplier had paid for the bunkers and physically provided them to the vessel).

'Panama remains a jurisdiction where recovery, including vessel arrest, is not restrained. A further part of Panama procedure provides for the entry through Panama's maritime court of injunctions which prohibit the transfer of a Panamanian-titled vessel, until the claims against the vessel are paid'

In the second opinion, the Court concluded that OW had no maritime lien (and no arrest right) either, with the overall conclusion being, that no party had any arrest right (so the vessel owners, essentially, received free bunkers). The Court in the second *Temara* opinion, writes as follows:

> The key issue in determining whether OW Bunker has a maritime lien is what the term 'provided' means under [the US law providing for maritime liens in rem, the Commercial Instruments and Maritime Lien Act, "CIMLA"]. *Dresdner Bank AG v. M/V OLYMPIA VOYAGER*, 465 F.3d 1267, 1274 (11th Cir. 2006)(a lien for necessaries arises, pursuant to clear statutory language, when the claimant provides necessaries to the vessel.) (emphasis in original). Can OW Bunker, steps removed from the physical provision of bunkers and never having had a tangible financial risk with regard to them, be deemed to have 'provided' them?

ING Bank N.V. v. M/V TEMARA, 2016 U.S. Dist. LEXIS 146251 (S.D.N.Y. Oct. 21, 2016).

The Court continues as follows:

> The undisputed facts make it clear that OW Bunker does not have a maritime lien for the provision of bunkers to the vessels herein. With the exception of the placement of sales order with the charterer, nothing in the record suggests OW Bunker took on any risk in connection with providing necessaries: It did not itself physically supply any of the bunkers, and it is undisputed that it never paid any supplier that did. Nothing in the record supports any payment obligation by OW Bunker to the physical supplier – either directly or indirectly. The record is devoid of information regarding OW Bunker's arrangements down the chain. Thus, a maritime lien here would not fulfill its essentially protective function; it would instead award a windfall. Had OW Bunker paid the physical suppliers, the outcome might be different. But OW Bunker is in bankruptcy and ING has made it clear that even if it were to recover on OW Bunker's behalf, it has neither obligation and nor intention to pay the physical suppliers. To establish a maritime lien requires more than the initial sales order OW Bunker received from the charterer. The sales order and confirmation only establish the 'authorisation' portion of the test under CIMLA. CIMLA also requires that the necessaries be provided by the entity seeking the lien. The term 'provided' directly implies an out-of-pocket expense or liability worthy of protection. Here, OW Bunker meets certain first steps of the CIMLA test (necessaries and authorisation), but fails the final one (providing).

ING Bank N.V. v. M/V TEMARA, 2016 U.S. Dist. LEXIS 146251, at 26-27.

This decision also is presently on appeal to the United States Court of Appeals for the Second Circuit.

With well-advised, clear assignment of rights from the trader to the physical supplier, there will not be the odd result above, where neither the trader nor physical supplier has security for payment for the supply, including no right to arrest. The trader receives its margin for re-selling and other valuable services it provides, and the physical supplier assures that the trader, or if not the trader, the ultimate customer or its vessel, pays for the physical supply.

Rip also awoke to learn of the UK Supreme Court's *PST Energy 7 Shipping LLC v OW Bunker Malta Limited* decision, in May 2016 (the *Res Cogitans*). The ►

shipowners argued that OW had sold goods (bunkers) and that through the UK *Sale of Goods Act*, had no right to collect anything because OW had never paid for the goods.

The Supreme Court upheld lower court and arbitrators' decisions, that because OW's sales terms retained title (until OW was paid for bunkers) the UK *Sale of Goods Act* didn't apply. No goods were actually sold, instead OW only gave the right to consume them.

Before November 2014, title retention clauses were common in bunker sales terms. *Res Cogitans* has led to questions about whether they should remain. The short answer is, that they should, both for traders and physical suppliers (and the latter should insist that traders incorporate those terms). *Res Cogitans* still gives arrest rights to both traders and physical suppliers, which have retained title. Continuing rights to at least un-consumed bunkers (and arguably to those replacing consumed bunkers, where the title retention clause extends to those) have been recognised under UK law since the House of Lords' decision in *THE SPAN TERZA*, [1984] 1 Lloyd's Rep. 119.

Since before OW and *Res Cogitans*, it remains ultimately the vessel owners' responsibility either to assure that they (if buying directly) or any charterers, pay for the bunkers their vessels take on, whether or not the sales terms include title retention. Properly-drafted title retention clauses allow traders, and physical suppliers, to at least reclaim un-consumed bunkers which have not been paid for.

They also keep the unpaid-for physical supply from being claimed as assets of a defendant vessel owner or charterer, including when a vessel is returned by a charterer to an owner and the bunkers aboard otherwise credited against unpaid charter hire (or to otherwise fulfil a duty to return a vessel with a certain fuel amount). Well-drafted retention clauses also prevent unpaid-for bunkers being included in the bankruptcy assets ('estates') of customers, or from reverting to the customers' banks under loan assignment or security clauses.

Along with this, well-drafted retention clauses will provide for UK law to control them (only), even if the sales terms otherwise provide (as they should) for US maritime law right of arrest *in rem*. This is because in the United States, title retention is considered to be a security interest, which must have a properly filed Uniform Commercial Code (UCC) Form 1 to be perfected. Even then those relying on retention clauses should file UCC-1s if there is any chance that the bunkers may have to be recovered in the United States or (as more likely) the customer would be involved in US insolvency proceedings.

Both OW and Hanjin saw almost immediate cross-border insolvency proceedings brought in many major world jurisdictions. This was, and will be, a further difference from trader Rip's pre-November 2014 world.

Soon after OW's main insolvency proceeding filing in Denmark, and Hanjin's in South Korea, there were corresponding proceedings for assistance filed in the United States (under US bankruptcy law 'Chapter 15), the United Kingdom, Canada, Australia, Japan, New Zealand, Singapore and Germany. These quickly prevented any creditors from filing proceedings in those jurisdictions against OW or Hanjin assets, or against Hanjin-owned or chartered vessels. The result was to prevent even those with direct claims against Hanjin vessels, from recovery.

The vessels called on the ports protected, discharged cargo, obtained revenue and then their banks sailed the vessels to friendly jurisdictions, where they could conveniently have the vessels judicially sold.

Hanjin's banks frequently had the vessels sold by 'private treaty' sales, with little if any public notice, giving unpaid bunker providers, and others, little immediate chance to object (and the jurisdictions involved, frequently expensive or difficult, in which to raise any objections in the first place).

> '"I don't give a rip" is an English idiom, meaning, basically, 'I don't care'. Some in the bunkering industry, even with the events since November 2014, have continued the same practices, imagining nothing has changed'

Often, both the Hanjin vessels, and those with bunker supplies unpaid-for by OW, escaped from arrest under command of their owners, using the unpaid-for bunkers to enable that. In the case of Hanjin, those owners used the unpaid-for bunkers to sail the vessels for scrap, after which, of course, the vessels could not be arrested. The case was (and is) similar for the vessels taken over by their mortgage holders. The mortgage holders used the unpaid-for bunkers to power the vessels to the arrest locations, where the vessels further consumed the bunkers.

In all of these situations, for the first time widespread since November 2014, mortgage holders and vessel owners were able to use unpaid-for bunkers, at the expense of the unpaid suppliers and traders. Consequently, unpaid suppliers and traders have looked for further ways to recover from the mortgage holders and owners. Against mortgage holders, at least for Hanjin, mortgages frequently were unpaid for months as the mortgage holders allowed Hanjin to take on bunker supplies which the mortgage holders (as its lenders, carefully monitoring Hanjin's cashflow) at least should have known Hanjin could not pay for. The same was the case for the owners of vessels which Hanjin was chartering, who had not been paid charter hire for months.

Against the mortgage holders, the unpaid suppliers and traders may have the right of equitable subordination. This is available where a security holder with an otherwise superior claim, fails to exercise it to the detriment of otherwise less secure claimants (like bunker suppliers/traders).

Against owners, there may be the right of proceeding for unjust enrichment, namely, that but for consumption of the bunkers which owners should have paid for, the owners never would have been able to get their vessels to scrap or favourable sale.

Trader Rip had never had to consider equitable subordination, or unjust enrichment action, before OW or Hanjin. But he has noticed, that at least in the container market, there are now only seven carriers which control 95% of the world's container trade. There also is overcapacity, which with the likely bunker market price rise occurring around 2020 (and 0.5% sulphur fuel content limitations) will place continued pressure on not only the seven large container carriers, but particularly on the smaller ones making up the remaining 5% of world container trade.

He also has noticed that although there are fewer bunker traders since November 2014, with many having been purchased by larger traders, there still are many more bunker traders than the present low-margin market (certainly lower than November 2014) allows to do business profitably. Which traders will continue to operate, and, he wonders, in order for Rip to continue to operate, what will he need to do? Certainly, traders must prepare for more considerations that OW and Hanjin have made commonplace.

There was one thing that Rip recognises has remained the same – and his observations of his 'time asleep' during OW and Hanjin unquestionably reinforce this.

That is, pre- and post-November 2014, traders and suppliers must act almost instantly when there is an insolvency situation, ideally, before it is filed but certainly after. The OW and Hanjin lessons enforce those of before. Be ready to arrest quickly. Have able counsel ready to do that, who know your operations, and who have a network of correspondents who they are able to lead to act on a simultaneous, international basis. Make sure you have documented each transaction well, including the communication and incorporation of your sales terms and conditions. Know where the vessels you have sold to are going, know the credit situation of your customers, and know where you can arrest and recover where you have to do that. Act before the vessel or debtor is covered by any insolvency stay, be well-prepared to do that, and don't hesitate.

A development related to this in both Hanjin and OW, highlights Panama as an important place for recovery. Panama is not part of any international cross-border insolvency system. So, as cross-border insolvency injunctions were entered across the world, Panama remains a jurisdiction where recovery, including vessel arrest, is not restrained. A further part of Panama procedure provides for the entry through Panama's maritime court of injunctions which prohibit the transfer of a Panamanian-titled vessel, until the claims against the vessel are paid. Many Hanjin-chartered vessels were Panama registered, and many others, and those fuelled by OW, also had to transit the Panama Canal. Recognising this, a number of well-advised bunker traders were able to use Panama procedure to arrest vessels and prohibit title transfers, allowing them to recover where others did not.

Rip continues to be amazed at the profound changes in his industry. That, plus the crazy talk about LNG-powered container vessels (which he learns isn't so crazy) and low sulphur bunkers (necessary, he agrees, but no one in 2014 ever thought it would really happen), seems overwhelming.

But, trader Rip does get the point. Things that worked before OW and Hanjin, that the industry believed were 'good' for it, won't work now. Rip thinks for a minute and with thanks sees that three years of sleep gave him a unique, and valuable perspective. He resolves to call his maritime lawyer (who, in contrast, hasn't slept much for the past three years) to make sure all that's needed is in place and to tell his industry friends about what he's learned so they can take action, too.

'I don't give a rip' is an English idiom, meaning, basically, 'I don't care'. Some in the bunkering industry, even with the events since November 2014, have continued the same practices, imagining nothing has changed.

Hopefully, trader Rip's story is encouragement to 'give a Rip' about the changes since November 2014 and those certain to follow.

1 Rip Van Winkel, a short story by the American writer Washington Irving (1783-1859), Great Short Stories by American Writers (Thomas Fassano, Ed.), at 7, Coyote Canyon Press 2011.

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