HFW

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HFW BUNKER PACK

TRADERS EDITION

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INTRODUCTION

As of 1 January 2020, the International Maritime Organisation will introduce the Global Sulphur Cap by way of amendment to Regulation 14 of MARPOL Annex VI. This will limit the sulphur content of ships' fuel oil from 3.5% m/m to 0.5% m/m. The lower cap of 0.1% m/m in Emission Control Areas, as introduced in 2015 will remain. In addition, as of 1 March 2020 vessels will be prohibited from carrying fuel with a sulphur content in excess of 0.5% m/m (except as cargo or where a scrubber is fitted). There are two broad options to ensure compliance with the new requirements:

1. To use fuels falling within the specific 0.5% m/m cap i.e. Low Sulphur Fuel Oil (LSFO)
2. To fit scrubbers to their vessels which strip the Sulphur Oxide from the exhaust before it is emitted.

The choice between these two options (although it should be noted use of LNG is an alternative means of compliance) presents significant commercial and legal considerations for traders, charterers and owners alike. Market reports indicate that LSFO is the overwhelmingly preferred means of compliance and that relatively few ships have been retrofitted with scrubbers. Nevertheless, as many as a quarter of new builds have been commissioned with scrubber technology fitted. The market is not, however, homogenous and the economics of scrubbers changes depending on the consumption of the vessel. Scrubber fittings are most heavily concentrated in the Capesize and larger classes. It should be noted that it is believed that all scrubber fitting capacity is full well beyond 1 January 2020, and thus any owners who have not yet committed to a solution will need to switch to LSFO at least in the short to medium term.

This pack and its follow up editions, which will be published over the coming year, provide an introduction for charterers and traders to some of the commercial and legal issues that will need to be resolved ahead of the introduction of the cap. Brookes Bell have also contributed a technical analysis of scrubber technology.

This pack also provides an update on the current state of the OW Bunker litigation following the 2016 Supreme Court decision. Montgomery McCracken Walker & Rhoads LLP provide an update on ongoing US proceedings and different states' findings on the availability of maritime liens to bunker suppliers. Bech Bruun offer a survey of the Danish side of the OW Bunker equation, including a review of a leading ISDA derivatives case in which HFW were instructed.

If you have any questions in relation to the bunker pack, please contact your usual contact at HFW, or the author of this pack, Brian Perrott.

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IMO 2020 SULPHUR CAP

SPOTLIGHT ON LEGAL AND COMMERCIAL ISSUES

IMO 2020 – Spotlight on Commercial and Legal Issues

The market is already moving to prepare itself for the introduction of the revised sulphur cap. However the change in regime will need to be adequately reflected in both future and existing contractual and commercial arrangements. Charterers and traders must ensure their contracts, whether charterparties, derivatives or bunker supply reflect these issues in the round. Two recently published BIMCO clauses highlight one approach, however there are a number of additional concerns to be considered.

BIMCO Clauses

BIMCO has recently published two highly anticipated clauses, entitled the '2020 Fuel Transition Clause for Time Charter Parties' and the '2020 Marine Fuel Sulphur Content Clause for Time Charter Parties' respectively. These clauses provide welcome guidance to the market, and present a sensible approach to allocating costs and risks of compliance with the IMO Sulphur Cap. However, traders and charterers will want to consider the extent to which they may want to supplement or amend these clauses before including them wholesale into their charterparties. A further BIMCO sulphur clause covering scrubber fitted vessels is due to be published later this year, and will be considered in a future edition of this pack.

2020 Fuel Transition Clause for Time Charter Parties

The 2020 Fuel Transition Clause for Time Charter Parties covers charterparties spanning the introduction of the IMO 2020 cap. It places obligations on charterers to furnish the vessel with sufficient compliant fuel (and take necessary preparatory steps for the vessel to burn said fuel), remove non-compliant fuel prior to the carriage ban date (1 March 2020) and to dispose of non-compliant fuel properly. Removal of non-compliant fuel is placed at charterers' risk, time and cost and is to take place before 1 March 2020, but charterers are to use 'reasonable endeavours' to do so before 1 January 2020. Under English law, 'reasonable endeavours' probably only requires the obliged party to take one reasonable course of action[1], and allows the consideration of commercial factors. Therefore, so long as charterers are able to justify commercially a decision to continue carrying non-compliant fuel oil between 1 January 2020 and 1 March 2020, for example due the unavailability of disposal facilities at interim ports, they will not be in breach of the clause.

In removing non-compliant fuel, the charterer is required to ensure tanks are left 'free of liquid and pumpable fuel'. Having done so, owners are subsequently obliged to ensure that tanks are fit to receive compliant fuel. It should be noted that an un-pumpable residue of higher sulphur content fuel oil left in the tanks may be sufficient to contaminate otherwise compliant fuel oil, and therefore to raise the sulphur content beyond the cap limit. This scenario is not expressly addressed by the clause, and both owners and charterers may therefore seek to impose stricter requirements e.g. to require a full cleaning of fuel tanks prior to the loading of any compliant fuel. It should be noted, however, that the clause as drafted only imposes cleaning obligations after 1 January 2020 and before 1 March 2020 – it does not therefore address the need to clean tanks or engines prior to the introduction of the consumption ban on 1 January 2020. Without such provision, there is a greater risk that LSFO might comingle with residual Heavy Fuel Oil (HFO) leading to inadvertent non-compliance with the cap, or indeed damage to engines. Parties may therefore wish to consider introducing a requirement both to run down reserves of HFO, and to provide sufficient time for adequate tank cleaning prior to the 1 January 2020 consumption ban deadline.

Parties may also want to consider whether, in the event of owners' failure to make tanks ready to receive compliant fuel oil, the vessel is to be placed off hire. This will need to be considered in light of other charterparty provisions. Likewise, the position as to redelivery will need to be considered.

2020 Marine Fuels Sulphur Content Clause for Time Charter Parties

The 2020 Marine Fuel Sulphur Content Clause for Time Charter Parties provides for charterers to only use and allow to be carried fuel that is compliant with MARPOL Annex VI, and to indemnify the owner for any non-compliance, save where the vessel is unable to burn such fuels – in which case all costs, penalties etc. are for the owner's account. The clause does not specify the sulphur content of fuel oil in the clause itself, but instead cross-refers to MARPOL Annex VI. This should future proof the clause against any future amendment to sulphur caps. Equally, the reference to restrictions imposed by 'any other

[1] *Rhodia International Holdings Ltd and another v Huntsman International LLC* [2007] EWHC 292 (Comm)

applicable lawful authority' means that the clause is broad enough to cover national or regional restrictions – for example Taiwan, which has already imposed the 0.5% cap at a national level. The obligation for compliance also refers to 'related requirements'. Such requirements are not defined. However, BIMCO envisions, as detailed in the Explanatory Notes that these obligations will include documentary requirements which may, for example, be imposed by Port State Control authorities. Nevertheless, the Explanatory Notes are unlikely under English law to be admissible as a guide to interpretation of the clause. As requirements that will be imposed by national authorities become clear closer to 1 January 2020, parties may wish to supplement the clause with a non-exhaustive list of such requirements in order to avoid disputes.

That the obligation for compliance rests on charterers is natural in the time charter context. However, parties should consider the implications of the requirement that charterers warranty the compliance of third parties such as bunker suppliers, bunker craft operators and bunker surveyors. Contracts ancillary to the charterparty should therefore also be reviewed closely to ensure that charterers are not ultimately left exposed for third parties' non-compliance. It may be appropriate for charterers to ensure their bunker supply contracts contain adequate undertakings and/or indemnities to protect charterers' positions in the event of claims by owners. Such provisions may help to avoid litigation and/or enable insurance claims in the event that bunker suppliers etc. fail to comply with the sulphur cap provisions.

Fuel price differentials, futures and indices

The decision whether to use Low Sulphur Fuel Oil (LSFO), or to fit scrubbers and continue to burn HFO will depend in part on expected differentials in price between the two oils. It is estimated that HFO will range between USD200 and USD350 per tonne cheaper than LSFO. Maersk, which has committed to the use of LSFO rather than fitting scrubbers estimates that its fuel bill is likely to rise by 50% from 2020[2]. Likewise Hapag-Lloyd estimates a US$900m increase in its fuel bill[3]. It is worth noting that such volatility is leading to the development of new products to enable owners to hedge against fuel price fluctuations caused by the introduction of the IMO 2020 cap[4]. More directly, such price differentials mean that scrubber fitted vessels can be time-chartered for a premium, and will attract higher margins for voyage charters. However, fitting scrubbers will only make sense if the expected fuel savings and consequent higher charter rates are sufficient to outweigh the significant capital expenditure. Period charters with 2019 and 2020 deliveries are already seeing premiums attached to scrubber fitted vessels, however the extent to which these premiums will be sufficient to earn any return over the significant capital expenditure, and over what period they may be maintained is not yet clear. While there has been some speculation that there will initially be shortages of LSFO, which would increase the price differential in the short term to medium term, the expectation is that as the market shifts towards LSFO generally the price differential will diminish significantly with the increased supply and standardisation of LSFO.

The differential in fuel rates presents a dilemma as to how to account for divergent hire rates in charterparty indices. The choice between scrubbers and LSFO will effectively divide the market in two, with scrubber fitted vessels attracting higher charter rates due to lower fuel costs, and vice versa for vessels using LSFOs. While in the long term, it is possible that this gap will narrow, in the short to medium term there is likely to be significant disruption to charterparty markets. Indices, such as the Baltic Exchange will need to decide how to reflect the changing shape of the market. One solution would be to run two alternative indices reflecting scrubber and non-scrubber fitted vessels. This would have the advantage of accurately reflecting the state of the market. However, concerns have been raised about whether there will be sufficient data, given the relatively low uptake of scrubbers. This will have a particularly pronounced effect on hedge funds trading in freight derivatives, especially where they are holding positions falling to be determined in 2020 and beyond.

Financing of scrubbers

Purchasing and retro-fitting a scrubber to a vessel is estimated to cost between USD2m and USD5m. How this is financed raises pertinent legal questions, in particular, if it is financed through debt what form of security the lender will take. In light of these issues, as explained below, it is not surprising to see a number of owners raising capital through equity to finance scrubber installations.

In exchange for finance, lenders are likely to want to take security over the scrubber. However, as the scrubber is fitted integrally to the vessel, the scrubber once fitted will be automatically subject to any

[2] Baker J, 'Maersk says low-sulphur fuel could push up costs by $2bn' Lloyd's Loading List 31/08/2018
[3] Baker J, 'APL and Hapag-Lloyd warn shippers low-sulphur fuel costs will be passed on' Lloyd's List 06/03/2018
[4] 'Firm to launch product to help shippers hedge their full bills ahead of new IMO rules' Manila Bulletin 08/01/2019

prior security over the vessel as a whole, such as a prior mortgage. Therefore, before the financier of the scrubber can take security over the scrubber/vessel, the prior security holder's consent will be needed, and may not be forthcoming. Further, as the scrubber-financier's security will rank lower than the holder of any previous security, they may not be willing to lend on this basis. One potential solution is to make use of public sector backed export credit guarantees, as for example has been trialled by GIEK, the Norwegian export credit agency. However, this is a solution that is likely only to be appropriate for larger quantities of scrubbers, and may be subject to significant restrictions such as requiring a minimum percentage of components to have been produced in a certain country.

Even if the vessel is not subject to any prior security, it may not be appropriate for the vessel owner to offer security over the scrubber. For the reasons outlined above, security over the scrubber will necessarily entail taking security over the vessel herself. Owners will need to consider carefully before granting security and associated rights and remedies e.g. arrest of a disproportionately valuable asset. Where owners own a number of vessels, offering security over a single vessel in exchange for financing of scrubbers for the fleet as a whole may be more appropriate.

Open loops and restricted jurisdictions

While scrubbers are designed to remove sulphur oxide from vessels' emissions, there is still significant debate about their overall environmental impact[5]. Of particular concern are open loop scrubbers which discharge the waste products into the sea. As well as sulphuric acid, which is neutralised on discharge by the alkaline sea water, open loop scrubbers may also release additional impurities. While the environmental significance of this is contested[6], the discharge of such impurities can lead to a public perception that scrubbers' environmental benefit in cleaning exhausts is offset by their discharge of pollutants into the sea. Irrespective of the merits of this argument or otherwise, it is a debate that traders and charterers would be well placed to watch. Open loop scrubbers have been banned from a number of jurisdictions, including Hamburg, China and Singapore. To the extent more jurisdictions follow, the premium that scrubber fitted vessels are able to attract may be eroded, particularly as open loop scrubbers are cheaper to run than closed loop scrubbers. Hybrid systems, capable of switching between open and closed loops may be one solution. However, owners and charterers may want to make provisions for the eventuality that a vessel is prevented from calling within certain jurisdictions during the term of the charter. For example:

- Should this constitute a force majeure event?
- Will the vessel be off hire if she is prevented from accessing a port due to a non-compliant type of scrubber?
- In such an event can the vessel be bunkered with LSFO compliant fuel? Will owners or charterers be responsible for additional costs, including removing traces of HFO from the vessel to enable LSFO to be burned?

Seaworthiness and delivery

On delivery, an owner is obliged to provide a seaworthy ship. Seaworthiness is classically defined such that: '"The ship must have that degree of fitness which an ordinary careful owner would require his vessel to have at the commencement of her voyage having regard to all the probable circumstances of it. Would a prudent owner have required that it should be made good before sending his ship to sea, had he known of it?"[7] Conversely, a ship is unseaworthy if "there is something about it which endangers the safety of the vessel or its cargo or which might cause significant damage to its cargo or which renders it legally or practically impossible for the vessel to go to sea or to load or unload its cargo..."[8] It is submitted that where a vessel is delivered in a state that she is unable to be compliant with the IMO 2020 cap that she is unseaworthy, and hence the owner will not have effected delivery if she is neither fitted with a scrubber, or she is carrying HFO. This contrasts with the position where there is a merely insufficient quantity of bunkers on board the vessel on delivery, for which the usual remedy is damages[9]. A prudent owner would ensure their vessel's compliance with the cap, and while penalties for non-compliance are

[5] Juliano M, 'Scientists weigh up potential impact of exhaust scrubbers' TradeWinds 20/12/2018

[6] Brady J, 'Ocean pollution from scrubbers? 'It's completely insignificant'' TradeWinds 06/12/2018

[7] Per Scrutton J in FC Bradley & Sons v Federal Steam Navigation (1926) 24 Lloyd's Rep. 446

[8] Per Webster J in The Arianna [1987] 2 Lloyd's Rep. 389

[9] *The North Sea* [1999] 1 Lloyd's Rep. 21

still to be determined it is conceivable that non-compliant vessels may be prevented from loading or unloading, or even entering certain ports. It should be noted that as well as contractual disputes under charterparties, Hull and Machinery, and Protection and Indemnity policies may be breached if a vessel is deemed unseaworthy as a result of non-compliance with the IMO 2020 cap.

Speed and performance

Charterparties will contain warranties from the owner that the ship on delivery is capable of achieving a minimum speed and level of fuel consumption, and is of a certain capacity. Such warranties almost always continue throughout the course of the charter. For period charters spanning 1 January 2020, it is important to consider the extent to which such warranties may be affected through any change to the vessel in order to comply with the IMO 2020 cap. For example, LSFO has a lower calorific value than HFO, and current engine designs favour the higher viscosity of HFO. As a result, vessels switching to LSFO may see increases in consumption and/or lower average speeds. Conversely, while scrubber fitted vessels are unlikely to see an effect on their speed, running the scrubber is likely to add to overall consumption of fuel, and tanks installed to store wash water from closed loop or hybrid scrubbers may reduce capacity. Nevertheless, the additional consumption is likely to be low (in the region of 1%) and given the lower cost of HFO this may not be significant.

It is worth remembering, however, that warranties as to performance, whether speed or consumption are generally held by the courts to be intermediate or innominate terms. This means that the remedy for their breach depends on the severity of the breach, and whether it goes to the root of the contract[10]. In most circumstances damages will be the most appropriate remedy. Further, where a charterparty warrants performance 'about' a certain level of consumption, speed or capacity a degree of tolerance either side is implied. For speed this is generally 0.5 knots or 5%, and 5% for consumption. It is likely that such tolerances will be sufficient to cover variations resulting from compliance with the sulphur cap.

Redelivery

On redelivery of a vessel under a time charter, the owner is obliged to repurchase remaining bunkers on the vessel. The price may be specified in the charterparty, or alternatively the charterparty may specify a means for calculating the price, often by reference to the market price of the relevant standard of bunkers at the place of redelivery. This presents potentially significant issues for charters that span the introduction of the cap, or that end shortly before it, particularly where a vessel is burning HFO, and will be switched to LSFO. If a vessel is redelivered with remaining HFO on or around January 2020, that HFO may be effectively worthless and there may be costs associated with its disposal. In addition, there may be no readily available market for HFO at the port of redelivery if it is primarily served by vessels that will be, or have already switched to burning LSFO. On that basis it is important for traders and charterers to ensure that charterparties provide an appropriate mechanism for calculating the price to be paid for any surplus HFO bunkers. Equally it may be worth revisiting clauses that provide for the level of bunkers that are permitted to be carried at redelivery.

Bunker fraud

The uncertainty and volatility introduced by the variable means of complying with the sulphur cap, combined with an almost complete lack of standardisation, whether of scrubbers or LSFO provides increased opportunities and incentives for bunker fraud. The potentially significant price differential between HFO and LSFO provides a strong incentive for bunker suppliers to provide non-compliant fuels. Similarly, uncertainties over greater consumption when using either scrubbers or LSFO mean that there is the opportunity for suppliers to make short deliveries. It is important, therefore that traders, charterers and owners work with trusted bunker suppliers, provide robust and clear performance warranties and consider the use of wholly independent third party surveyors to verify e.g. scrubber compliance, sulphur content and bunker deliveries.

[10] *Hong Kong Fir v Kawasaki Kisen Kaisha* [1962] 2 QB 26

Penalties and non-compliance

While the sulphur cap has been imposed by the IMO, penalties and enforcement has been reserved to member states. No state has yet detailed its proposed approach to enforcement or penalties, however it is likely that these will be targeted at owners. Notwithstanding direct legal responsibility, it remains open to parties to reallocate this risk through indemnities in charterparties.

SCRUBBER TECHNOLOGY

Scrubber technology provides one means of compliance with the IMO 2020 Sulphur Cap and as well as the legal and commercial factors outlined in the previous section, there are also a number of complex technical issues at stake. We have therefore invited Brookes Bell, with whom HFW have a longstanding relationship, to provide an introduction to scrubber technology and an overview of the key technical considerations when evaluating the use of scrubber technology.

Brookes Bell

Scrubbers are not a new technology, they have been used in land-based installations for many years. In addition, they have been incorporated into various models of inert gas plants used onboard tankers.

Their application as an exhaust gas cleaning technology to remove SOx from the exhaust gas of marine engines, is relatively new, but operational experience has been gained in recent years on ferries and cruise vessels, where the uptake of scrubber installations was much higher than on other vessel segments (primarily due to their area of operation in emission control areas).

The decision on whether or not to go down the scrubber route is still the subject of great debate within the industry. There are a number of other options available, such as changing over to a compliant fuel (MGO or LSFO <0.50 % sulphur) by using the existing onboard plant or opting for an LNG fuelled or other alternatively fuelled installation (which is more viable for a new build vessel rather than as a retrofit project).

In recent months, there has been increased interest in the installation of exhaust gas scrubbers on new and existing vessels. From a purely commercial perspective (at least in the near-term), there is a strong business case to install a scrubber onboard, however there are a number of additional aspects which need to be considered.

Exhaust Gas Cleaning Systems (EGCS)

Scrubbers can be broadly divided into four types.

- Open loop scrubbers – Seawater is used as the alkaline medium, with the washwater discharged overboard after dilution.
- Closed loop scrubbers – Uses seawater or fresh water which is recycled through the system. The washwater is cleaned and the alkalinity restored by the addition of a suitable material – typically (NaOH) Sodium Hydroxide (more commonly known as caustic soda).
- Hybrid scrubbers – have the ability to operate in both the open and closed loop modes - a combination of both systems. A more recent approach is to install an open loop scrubber with the option to convert it to a hybrid system at a later date (a so called 'hybrid ready' scrubber).
- Dry or Membrane type scrubbers – more commonly used in shore applications. However, due to their design and system requirements, they are less popular in marine applications. Membrane units have been previously used onboard for some inert gas plants / nitrogen generators.

Open Loop

Open loop scrubbers are not suitable for use in areas where the alkalinity of the water is low. Additional restrictions are being put in place to control the discharge of washwater in an increasing number of coastal and port areas. Open loop scrubbers also have a larger washwater demand than closed loop systems.

An advantage of an open loop scrubber is that it uses readily available seawater as the scrubbing medium, and therefore does not require the handling and storage of any hazardous chemicals (caustic soda). They are also comparatively less complex than closed loop scrubbers and are generally less expensive with a quicker return on investment.

Closed Loop

Can be used in all areas irrespective of the water alkalinity. There is no overboard discharge, besides effluent from the water treatment system, thereby making them more suited for use in areas with washwater discharge restrictions. Effluent can be stored onboard, for later discharge where permitted.

The negative aspects of a closed loop system are that they are generally more complex and therefore more expensive than open loop scrubbers of an equivalent capacity. Additional equipment is required for water treatment, meaning additional space is required onboard for the installation. They typically require a continuous supply of NaOH (or another alkaline material as specified) to replenish the alkalinity of the washwater, and therefore require additional measures to be put in place for the safe handling and storage of these materials.

Hybrid Systems

A hybrid system offers the option to operate as an open loop scrubber when the vessel is at sea (in unrestricted areas), where the washwater can be discharged overboard. They are also capable of operating as a closed loop scrubber when in restricted areas, and the washwater is not discharged. This adds another level of complexity to the installation, but it also offers flexibility. A hybrid system also requires the addition of NaOH when operating in the closed loop mode.

Approval & Compliance

The approval process of an EGCS is carried out in accordance with the requirements of MARPOL Annex VI, Regulation 4.

There are basically two concepts for approval, emission performance, compliance, and control of the operating parameters of the EGCS, which are divided into Scheme A and Scheme B. The specifics of each scheme are covered in detail within MEPC.259(68). In both cases, the discharged washwater used in the scrubbing process needs to be monitored and meet specific discharge requirements for pH, PAH, turbidity and nitrates. While the provisions of MEPC.259(68) were referred to as guidelines, they are given mandatory effect under MARPOL Annex VI.

Considerations before Installation

The installation of a scrubber for a new build project is relatively straight forward, as the space and system requirements for the scrubber can be considered during the initial design stages.

For a retrofit project, to install a scrubber on an existing ship, there are a number of technical aspects to consider.

- High upfront capital investment (CAPEX), availability of equipment, yard time, skilled labour and materials.
- The availability of space for the scrubber, additional exhaust piping, pumps and water treatment plant.
- Additional space required for the storage and handling of alkaline material for closed loop scrubbers.
- Compatibility and integration with existing ship systems. Build in sufficient redundancy in the design.
- Accuracy of the design, fit-up and measurement prior to installation to avoid delays and overruns during installation.
- Size of the existing seachests – they must be of sufficient capacity to handle the additional seawater flow requirements for open loop systems.
- Exhaust backpressure and down flooding considerations. Ensure appropriate consultation with the engine maker to avoid these potential issues.
- Increased electrical requirements, availability of electrical power.

Additional Considerations

There are also additional operation and commercial aspects to be considered before committing to scrubbers.

- Competitive advantage gained due to charterers' desire for scrubber equipped tonnage, premium on charter rates – depends on the uptake of scrubbers – high uptake may reduce this advantage.
- Additional crew training requirements in relation to the operation and maintenance of scrubber systems.
- Additional compliance requirements when a scrubber is installed. Necessary to maintain appropriate records in relation to plant maintenance, operation and emissions.
- Scrubbers require additional energy to operate, potentially increasing the vessel's CO2 emissions.
- Policy uncertainties – possibility of additional changes to future emission regulations.
- For both the closed and hybrid options, effluent is stored onboard for the duration that the designated storage tank volume permits. This may limit extended operation in emission control areas (ECA) without sufficiently sized tanks or shore discharge facilities.
- Additional costs involved in the supply and handling of NaOH and disposal costs for system residues.
- Availability of suitable reception facilities within the vessels trading area to handle disposal requirements.
- Concerns in relation to the long-term maintenance costs of the scrubber and related equipment and their resistance to the corrosion.
- An increasing number of states have introduced local regulations controlling the discharge of washwater from scrubbers, making the selection of an open loop system less attractive.
- Long term availability of HSFO may be dependent on demand - Will its use be mainstream or not? Will it continue to be available in the ports where the vessel trades?
- A quick return on investment (ROI) is largely based on a high price differential between HFO and compliant fuels. Concerns over the availability of sufficient low sulphur fuels may not materialise.
- As refiners increase production, by investing in blending and desulphurization capacity, the price differential between compliant fuels and HFO may narrow, eroding the expected commercial gains and economic case for scrubber installations.

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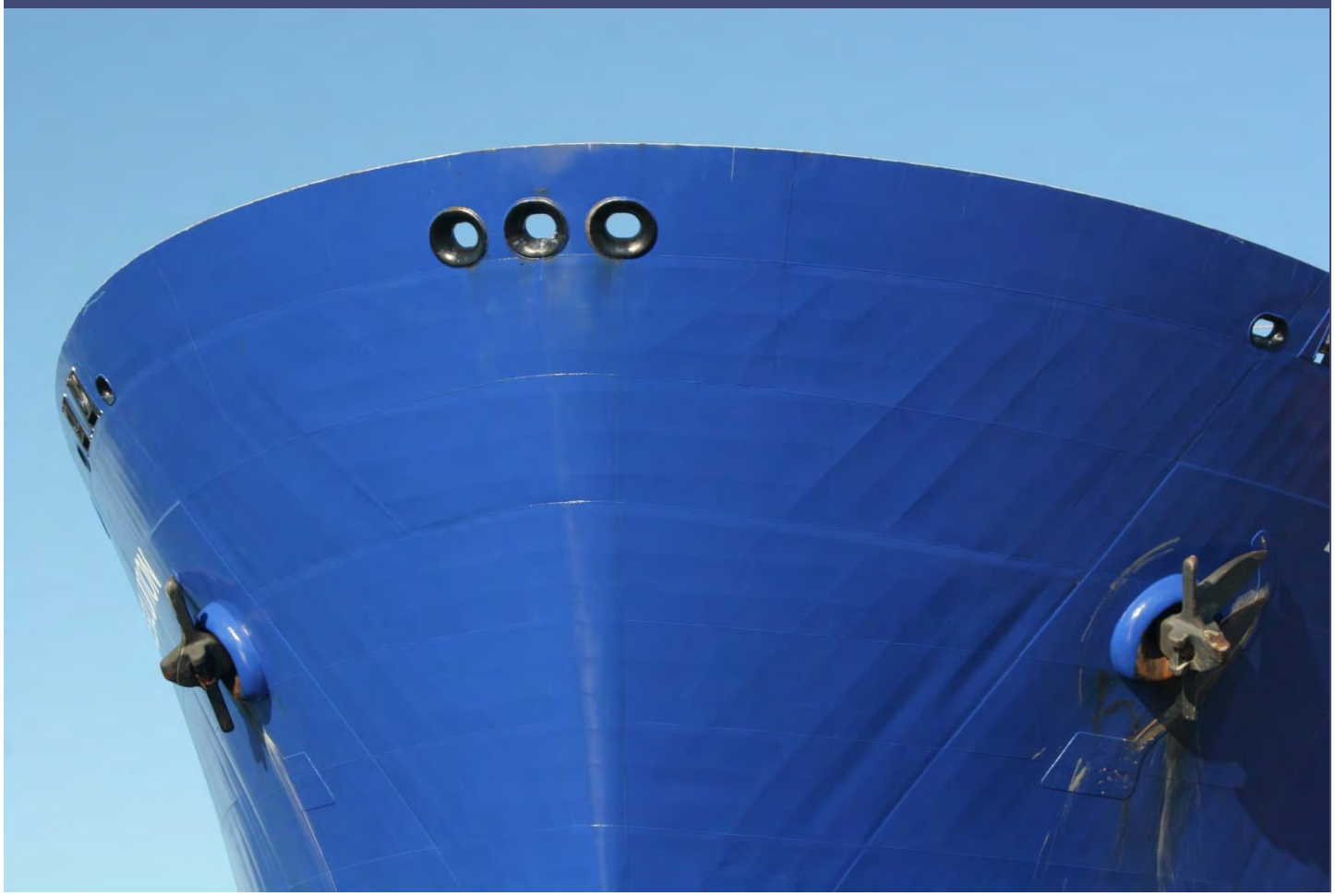
UPDATE ON THE OW BUNKER SAGA



RECAP ON ENGLISH PROCEEDINGS

The first edition of the HFW Bunker Pack (2016) considered the impact of the English High Court and Court of Appeal's judgment in the RES COGITANS case that flowed out of OW Bunker's insolvency. In 2016, the Supreme Court gave its decision, affirming the outcomes of the High Court and Court of Appeal proceedings.

By way of reminder, the Supreme Court held:

1. The contract was not a contract for sale, the contract was sui generis or unique and therefore did not fall within the scope of section 49(1) of the Sale of Goods Act 1979, which provides that a wrongfully unpaid seller may maintain an action for the price against the buyer where property in the goods has passed to the buyer. The key distinction was that owners had a right under the contract to consume all or any part of the bunkers without acquiring property in them. There was, therefore, no requirement for property in the bunkers to have passed (which it had not, as all of the bunkers had been used prior to the contractual payment date) in order for the ING, as administrators of OW Bunker, to bring a debt claim.
2. OW Bunker was not subject to an implied duty to perform its obligations to its suppliers i.e. paying them timeously. The only implied undertaking was that OW Bunker was legally entitled to grant owners permission to use the bunkers prior to payment.
3. (Obiter) Section 49 of the Sale of Goods Act 1979 is not a complete code stipulating the only circumstances in which a seller may maintain an action for the price under a sales contract. Express contractual terms are at least one means of enabling an unpaid seller to pursue a debt claim where property in the goods has not passed. If this point had fallen to be substantively determined, the Court of Appeal decision in F G Wilson (Engineering) Ltd v John Holt & Co (Ltd)1 (The Caterpillar Decision) would have been overturned.

THE US PERSPECTIVE

While English proceedings were primarily resolved in 2016, subject to any subsequent litigation as to quantum, US proceedings have continued apace. The US focus has been squarely on the availability of maritime liens to physical suppliers. US firm, Montgomery McCracken Walker & Rhoads LLP has been extensively involved in this litigation, and their leading maritime and transportation group here provides an update on the approach being taken in the US courts.

Montgomery McCracken Walker & Rhoads LLP

US maritime lien laws are generally understood to favour sellers and suppliers. Accordingly, many bunker supply contracts (e.g. OW Bunker) apply US law for the enforcement of maritime liens. An enforceable maritime lien arises under the US Commercial Instruments and Maritime Liens Act when a seller or supplier (1) provides necessaries (including bunkers); (2) to a vessel; and (3) on the order of the owner or a person authorized by the owner. Most OW Bunker maritime lien litigation in the US concerned the "on the order of the owner or a person authorized by the owner" requirement.

The statute itself contains a list of persons presumed to have authority: the owner, the master, local port agents, and charterers. Additionally, prior to OW Bunker, there were two lines of jurisprudence interpreting and applying the third statutory requirement – 'on the order of the owner or a person authorized by the owner'. In the "principal/agent" or "middleman" line of cases, US courts determine whether there was an unbroken chain of agency between the owner and the maritime lien claimant. In the "general contractor/subcontractor" line of cases, US courts determine whether the owner controlled and directed the contractor's selection of a specific maritime lien claimant. In the context of OW Bunker maritime lien litigation in the US, with very few exceptions, court of appeals in the Second, Fifth, Ninth, and Eleventh circuits held so-called physical suppliers acting on the order of OW Bunker—not the owner and not an authorized person—did not have enforceable maritime liens. The few exceptions occurred when, for example, courts found as a matter of fact that the owner controlled and directed the selection of a specific maritime lien claimant. The statute, "principal/agent" or "middleman", and "general contractor/subcontractor" rules are not inconsistent. Whether a maritime lien is enforceable under US law requires an intense factual analysis.

It is unlikely the US Supreme Court will grant petitions for review, but numerous cases remain pending in the trial and appellate courts. The law could change. In the meanwhile, owners and charterers wishing to minimize their exposure to maritime liens under US law should consider purchasing bunkers from independent traders who prior to contracting are given notice that the purchaser is not the owner and is not authorized by the owner.

THE DANISH PERSPECTIVE

As the centre of management of OW Bunker, Denmark has been and continues to be host to a maze of litigation flowing from OW Bunker's insolvency. Such litigation is striking due to its volume, variety and persistence. HFW was instructed in the leading ISDA derivatives contract case, and Bech Bruun with whom HFW worked closely on the case here provides a guide to help navigate the labyrinthine Danish litigation.

Bech-Bruun

The derivative cases

The Western High Court ruled in its judgment on 13 June 2018 that three ISDA derivative cases filed by the OW Bunker estates against three foreign former traders should be dismissed due to lack of jurisdiction in Denmark. The derivative contracts were subject to English law and jurisdiction and the Eastern High Court had already in March 2017 ruled that the law and jurisdiction clause in the derivative contracts could not be upheld, but in the Western High Court cases against foreign former traders, the OW Bunker estates still failed to find grounds for jurisdiction in Denmark.

Therefore, as the legal position is now, foreign (as opposed to Danish) former trading partners without any assets in Denmark will not be subject to Danish jurisdiction in matters relating to close out netting under derivative contracts entered into with OW Bunker prior to its bankruptcy.

Lawsuits for damages

A group of large investors (26 companies), including large Danish pension funds have filed a law suit against the OW Bunker estates, the previous management board, the previous board of directors, investments banks and a private equity fund.

The plaintiffs claim that the defendants are liable for damages of 767m DKK because the defendants knew or should have known about OW Bunker's speculation activities. The plaintiffs therefore argue that the defendants mislead the investors in their investment by not informing the investors properly in the investment prospectus and for not complying with the duty of disclosure.

The lawsuit is still in progress and the pleadings are still being exchanged.

Claim value: 767m DKK.

Private Group Law Suit

On top of the main lawsuit more than 2,500 OW Bunker shareholders have filed a group lawsuit against the previous management board of OW Bunker, the previous owner, and a private equity fund.

The plaintiffs claim that the defendants are liable for damages of 321m DKK because the defendants knew or should have known about OW Bunker's speculation activities. The plaintiffs therefore argue that the defendants mislead the investors in their investment by not informing the investors properly in the investment prospectus.

The lawsuit is still in progress and the pleadings are still being exchanged.

Claim value: 321m DKK.

Consortium with large investors and private fund

Five large investors have filed a lawsuit against the OW Bunker estates, the previous management board and the previous board of directors. The lawsuit is still in progress and the pleadings are still being exchanged.

In this case, the plaintiffs claim that the defendants are liable for 67m DKK relating to share purchases after OW Bunker's listing on the stock exchange, because leading employees according to the plaintiffs, failed to inform the market of substantial matters.

Claim value: 67m DKK.

OW Bunker estates against private equity fund, accountant and previous management

The trustees of the OW Bunker estates have filed a lawsuit against a private equity fund, the former auditor and the previous management board. The lawsuit is still in progress and the pleadings are still being exchanged.

The plaintiffs claim that the defendants are liable for damages of 400m DKK because the defendants knew or should have known about OW Bunkers' speculation activities. The plaintiffs therefore argue that the defendants mislead the investors in their investment by not informing the investors properly in the investment prospectus. Furthermore, the plaintiffs argue that Deloitte's auditing of OW Bunker's annual reports was faulty.

Claim value: 400m DKK.

OW Bunker estates against its former bank connections

The trustees in the OW Bunker estates recently won a procedural victory against its former bank connections in the Danish Maritime and Commercial High Court in a matter concerning collateral security provided by the banks.

Before the court actually decides on the substantive part of the case – the validity of the assignment provided to the banks of an outstanding of 652m USD, the court had to decide whether the case was to be decided in accordance with English (contractual) law or Danish law.

The court found in favour of the estates and held that the validity of the assignment was to be decided in accordance with Danish law.

Claim value: 652m USD.

Lars Møller case

On 30 May 2018, the Danish District Court in Aalborg ruled that the former CEO of OW Bunker's subsidiary in Singapore (Dynamic Oil Trading) Lars Møller, was guilty of contributing to a substantial financial loss for shareholders in OW Bunker and the OW Bunker company itself, by neglecting his duties as CEO. Lars Møller was sentenced to jail for 1.5 years.

Lars Møller has appealed the court's ruling to the Danish Western High Court.

This is reportedly the only criminal proceeding in the wake of OW Bunker.

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SUMMARY

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Taken in the round, there is a clear importance for charterers and traders to ensure, given current developments in bunker markets that they get their contracts right. Charterparties must be sulphur-proof, bunker supply contracts must be OW Bunker-proof, and ISDA contracts must be informed by the recent outcome of the Danish derivatives litigation. Such contracts must provide for future developments such as the IMO 2020 sulphur cap, while adequately addressing risks exposed by past events such as the insolvency of OW Bunker. HFW's extensive experience advising charterers and traders and its global coverage and network means we are well placed to help you navigate and address any of the issues raised in this pack. We will be providing further analysis of emergent bunker issues over the coming year in subsequent editions. Meanwhile, we at HFW, and the other contributors to this pack remain available to provide bespoke advice and assistance.

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CONTRIBUTORS

Whilst every care has been taken to ensure the accuracy of the information contained in this pack at the time of publication, the information is intended as guidance only. It should not be considered as legal advice.

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