Commodities

July 2013

COMMODITIES BULLETIN

Insolvent vessel owners: problems for commodities traders – and some solutions

Over recent months, there have been a number of trends developing in the global commodities sector. One in particular is likely to give commodities traders cause for concern. The current climate of very low charter rates and high operating costs has increased the number of vessel owners feeling the squeeze. Some have struggled - and ultimately failed - to remain solvent. In the past few months, STX Pan Ocean, Excel Maritime Carriers and Sanko Steamship have all entered into bankruptcy protection to allow them an opportunity to restructure and salvage their business.

Against this backdrop, a number of commodities traders have had to deal with the disruption and inconvenience of unpaid suppliers arresting, or threatening to arrest, vessels and/or bunkers of vessels with their cargo on board. This article considers the problem in more detail and suggests some contractual solutions.

In an FOB contract, the buyer must nominate the vessel. FOB sellers should consider including a clause in their contracts permitting them to reject a nominated vessel and nominate an alternative if the first vessel owner enters into bankruptcy, administration or some other form of insolvency proceedings by a specified date prior to loading. This would offer some protection and flexibility to the FOB seller, without being unduly uncertain for the FOB buyer.

In a C&F contract, it is the seller's responsibility to source a vessel. C&F buyers should consider protecting their position by including an express clause in their contracts obliging the seller to charter in a vessel from a solvent owner. An alternative would be to seek an indemnity from the seller against any losses incurred as a result of vessel owner insolvency. These contractual mechanisms pass the risk of owner insolvency from the buyer back to the seller, as the party responsible for chartering in the vessel. They offer the C&F buyer a contractual remedy against the seller should they incur additional costs as a result of vessel owner insolvency. This is an additional,

and specific, layer of protection: most sale contract insolvency clauses do not extend to the chartered tonnage and only concern themselves with the parties' insolvency.

In charters or COAs which specify that the vessel is "TBN" – to be nominated – there is an added risk. Usually this type of charter will specify the characteristics of the "TBN" vessel, allowing scope for including a specific characteristic that the vessel owner be solvent. However, there is a greater likelihood of an owner swapping or subchartering in vessels at a late stage. Charterers and owners should together agree a mechanism to prevent the nomination of unsuitable vessels. This can be achieved by incorporating an obligation on the disponent owner to nominate vessels from solvent owners, coupled with a charterer having a reasonable right of rejection similar to that of an FOB buyer set out above.

In a C&F contract, or a contract providing that the vessel is "TBN", there may be scope to specify in the contract either a list of owners from whom a vessel must be chartered, or a list of owners from whom vessels must not be chartered. Whilst such an approach has the benefit of certainty, it does carry the risk of an unsuitable vessel owner being omitted in error. It may also significantly increase the price. C&F sellers, who will obviously want to ensure that their exposure in relation to owner insolvency is kept to a minimum, may prefer this approach because of the certainty it offers, despite the restriction it will place on their choice of vessel.

The timing associated with any requirement of solvency is likely to require negotiation. For example, C&F buyers and vessel charterers under a COA will ideally want to be able to specify that the owner be solvent at the date of nomination and remain so throughout the duration of the voyage. C&F sellers and vessel owners are unlikely to want to accept a commitment involving future uncertainty.

The risk of vessel owners becoming insolvent is not, of course, entirely new. However, given that the recent market has brought it to the fore, it is important that commodities traders ensure that their affected contracts, both charterparties and sale contracts, address this risk and allocate it adequately so as to avoid disruption to their business.

For further information, please contact Brian Perrott, Partner, on +44 (0) 207 264 8184, or brian.perrott@hfw.com, or your usual contact at HFW.

This is an additional, and specific, layer of protection: most sale contract insolvency clauses do not extend to the chartered tonnage and only concern themselves with the parties' insolvency.

BRIAN PERROT

Australian oil pollution penalties: update

Commodities traders chartering vessels which travel through waters subject to Australian federal law will already be aware that, as a result of Australian federal legislative changes in 2012, slot, voyage, time and demise charterers all now face potential strict liability, penalties and criminal fines in the event of pollution or threat of pollution from a chartered vessel, alongside the master and vessel owner.

This means that charterers could find themselves liable as a result of an act or negligence of the owner, for example, where a navigational error results in a collision and a spill from the vessel. Equally, an owner could be held liable as a result of the act or negligence of the charterer, for example in ordering the vessel to an unsafe berth.

When the changes were introduced, HFW advised traders chartering vessels to load or discharge in Australian ports that they should be actively considering what additional protection they could negotiate into their charters by way of indemnities from vessel owners.

Some charterers have tried to introduce clauses into charterparties, passing any and all liabilities they might face from a pollution incident back to vessel owners, frequently seeking an absolute indemnity. Such clauses are commonly found in voyage charters where charterers consider they have no control over the operation of the vessel.

The proliferation of "bespoke" clauses and sometimes inadvertent assumption of liabilities by vessel owners resulted in P&I clubs developing a standard risk allocation clause, which was published by Circular in March 2013 and formally endorsed by BIMCO at a meeting of its

Documentary Committee in Paris on 27 May 2013.

The new clause imposes a fault-based mutual indemnity regime in relation to fines, penalties and related legal costs, and other expenses incurred in the event of proceedings being commenced against one party, irrespective of whether a fine or penalty is ultimately imposed. The vessel owner and the charterer provide reciprocal indemnities to each other to the extent that a pollution incident results from the indemnifying party's own negligent act or omission, or a breach of charterparty. The obligation to indemnify is limited by the extent to which the fault of the party claiming indemnity has contributed to a pollution incident. It is also subject to the law governing the charterparty permitting recovery of fines.

This caveat with regard to governing law is included because of uncertainty as to whether an indemnity in respect of a criminal fine imposed under a strict liability would be enforceable. The general position is that indemnities for criminal liability (where the offence involves an element of fault) are void. Australian texts note uncertainty with regard to strict liability offences, but the view is expressed that a party may be entitled to rely on an indemnity when not at fault or culpably negligent. In some English authorities, parties have been successful in obtaining damages for fines levied against them where they were not personally at fault or negligent, but had nonetheless committed a strict liability offence due to the negligence of a third party. This suggests that a contractual indemnity may be enforceable in some circumstances for penalties for strict liability offences.

The BIMCO clause is not intended to and does not govern circumstances where an owner or charterer incurs a strict liability penalty or fine due to pollution or threat of pollution caused 100% by a third party. In such circumstances, the loss lies where it falls and no indemnity or contribution obligation applies under the clause.

There has been one further development in relation to the new penalties under Australian federal law. Financial penalties for federal offences committed on or after 28 December 2012 have increased from A$110 to A$170. As a result, the previous maximum fines imposed under the legislation of AU$2.2 million for an individual and AU$11 million for a corporation are now AU$3.4 million for an individual and AU$17 million for a corporation.

For further information, please contact Hazel Brewer, Partner, on +61 (0)8 9422 4702 or hazel.brewer@hfw.com, or your usual contact at HFW.

HFW Trade Seminar

On 25th September 2013, HFW will be hosting a Trade Seminar in its London offices. We are honoured to have recently retired Lord Justice of Appeal, Sir Bernard Rix of 20 Essex Street to give a keynote address. In addition, we are delighted that Alex Gray, CEO of Clarkson Securities Limited, Dan Basse of AgResource Company in Chicago, Paul Marland, Global Head of Grains and Oilseeds at Noble and David Goldstone QC have agreed to speak. HFW Partners Brian Perrott and Katie Pritchard will also be presenting.

For further information, please contact events@hfw.com.

Conferences and Events

Australia Grains Industry Conference

Crown Conference Centre, Melbourne
(29-31 July 2013)
Chris Lockwood, Stephen Thompson

Trade Seminar

Friary Court, HFW London
(25 September 2013)
Brian Perrott, Katie Pritchard

Lawyers for international commerce

HOLMAN FENWICK WILLAN LLP
Friary Court, 65 Crutched Friars
London EC3N 2AE
T: +44 (0)20 7264 8000
F: +44 (0)20 7264 8888

hfw.com

© 2013 Holman Fenwick Willan LLP. All rights reserved

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

Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please contact Craig Martin on +44 (0)20 7264 8109 or email craig.martin@hfw.com