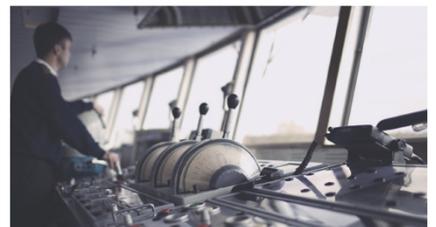


Shipping

October
2014

GREEN SHIPPING BULLETIN



Welcome to the October edition of our Green Shipping Bulletin.

The new year is now on the horizon and will bring with it the new and controversial stricter limits on sulphur oxide and particulate matter emissions within Emissions Control Areas. We look at the key changes coming into force from 1 January 2015 and analyse the expected impact on the shipping industry, including the allocation of increased fuel costs and likely enforcement.

With ongoing oversupply of tonnage and the delivery of supersized newbuild bulk and container vessels, we assess the potential environmental impact of a temporary upturn in ship recycling.

Global demand for marine space is rapidly growing and, in turn, the scope for conflict between competing categories of marine users has also increased. In an attempt to address this, the new Maritime Spatial Planning Directive was adopted by the Council of the European Union in late July and we look at its key features.

Finally, with investment in the Arctic seeming set to increase, we review the IMO's draft Polar Code, which is intended to reduce the risks of operating within polar waters, improve ship design and increase overall safety of ships navigating the North and South poles.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

Jonathan Webb, Partner, jonathan.webb@hfw.com

Rebecca Warder, Professional Support Lawyer, rebecca.warder@hfw.com



hfw Not just hot air: tightening SOx emissions limits from 2015

The new year fast approaches, ushering in increased limits on sulphur oxide and particulate matter emissions within the IMO's designated Emissions Control Areas (ECAs). Considerable concern has been expressed on this issue, not least by those faced with the prospect of complying with the tighter limits. This article seeks to outline key changes in the rules that will take effect from 1 January 2015, and provides an overview of the anticipated impact on the industry.

Background

Pursuant to Annex VI to the IMO's MARPOL 73/78 Convention (MARPOL Annex VI), as of 2010, global shipping has been subject to regulations as to emissions of nitrogen oxides (NOx), sulphur oxides (SOx) and particulate matter. These have been acknowledged to have a negative effect on health and the environment.

Fuel oil-based bunkers have been identified as contributing to global SOx levels. MARPOL Annex VI therefore imposes limits on bunker sulphur content, measured as a percentage of sulphur content of overall mass (% m/m), in order to curtail SOx emissions¹. MARPOL Annex VI also set the framework for more stringent limits to be implemented in ECAs, currently designated in the North Sea, Baltic Sea, North American coastline and US Caribbean.

Changes on the horizon

The implementation of MARPOL Annex VI has been graduated to afford time for operators to adapt. Sulphur content limits are currently at 3.50% m/m globally (as from 1 January 2012) and 1.00% m/m in ECAs (as from 1 July 2010). On 1 January 2015, the content limit within ECAs will be reduced further to 0.1% m/m. Operators of vessels that do not comply are likely to face significant financial penalties.

Compliance

Three broad solutions for compliance are open to operators:

- 1 Supply vessels with bunkers with compliant sulphur content (e.g. LSMGO or LSIFO).
- 2 Fit vessels with exhaust gas cleaning systems, commonly known as scrubbers.
- 3 Fit vessels for burning alternative bunkers (e.g. LNG).

None of these options are free from costs and risk in some form or another. We considered the relative advantages and disadvantages of each solution in our previous Bulletin (see "Emissions regulations: a brave new world for the bunkering industry", March 2014 - http://www.hfw.com/Green-Shipping-Bulletin-March-2014#page_3).

Enforcement

Questions have been raised on how SOx emissions regulations will be enforced. Within the European ECAs in particular, where many states' coastal zones overlap, effective cross-border policing will be particularly challenging. This has been recognised by some North Sea maritime authorities, who have expressed the desire to co-

ordinate their enforcement efforts. In particular, Denmark plans to launch "sniffer" drone technology, and install SOx detectors on the Great Belt Bridge, to identify non-compliant vessels. The extent to which other governments within ECAs will expend similar efforts remains to be seen.

The impact: direct and indirect costs

Direct fuel cost increases have been the focus of much industry attention. Prices for low-sulphur bunkers are significantly greater than higher sulphur equivalents. Absent any agreement to the contrary, under voyage charters, owners will face the impact of increased bunker prices. For time charters or bareboat charters, charterers will shoulder this burden. Several container lines have already announced new low sulphur fuel surcharges for shippers due to be implemented in January 2015.

This price differential is not expected to improve if refineries do not increase output of low-sulphur distillates in the near term. In any event, if refineries do prioritise low-sulphur distillates, the opportunity cost would be lower supply (and consequent rise in price) of other fuels, such as diesel. This would impact upon other stakeholders, such as road transport and end consumers. Finally, low sulphur bunkers have also been cited by some to increase engine wear, and the risk of power loss, a further hidden cost of the fuel shift which must be borne by owners.

Rising fuel costs have been identified (for example, by the European Community Shipowners' Association) as undermining the economic viability of low-volume and/or long distance routes within ECAs, especially for ferries and LoLo services. Increased

1 Regulation 14, MARPOL Annex VI



Direct fuel cost increases have been the focus of much industry attention. Prices for low-sulphur bunkers are significantly greater than higher sulphur equivalents. Absent any agreement to the contrary, under voyage charters, owners will face the impact of increased bunker prices. For time charters or bareboat charters, charterers will shoulder this burden.

MAX THOMPSON, ASSOCIATE

costs may not easily translate into increased short-sea freight rates, where shipping faces strong competition from rail and road hauliers.

Operators seeking to avoid exposure to fuel costs risk must contemplate making capital investments, by either retrofitting scrubbers or alternative fuel burning technology (most notably, LNG), or incorporating these solutions into newbuilds. Some eco-technologies, such as turbocharger cut-outs and hydrodynamic paints, readily justify capital expenditure through fuel efficiency savings. Nevertheless, evidence suggests that emissions abatement technologies such as scrubbers could result in energy efficiency losses, harming their cost effectiveness and therefore their attractiveness to operators.

What does the future hold?

A practical case which will be of interest to both operators and governments is that of California,

where tighter 0.1% m/m limits have been in place since 1 January 2014. A sunset review of the effect of this legislation is due to be published next year, when the state regulations will fall in step with the rest of the North American ECA. Indications have been that whilst fuel supply has not been a critical issue, power losses on vessels are reportedly higher owing to the use of low-sulphur distillates.

Industry opinion indicates that 2015 could prove to be a crucial year for operators seeking to adapt to tightening regulations in the face of less than ideal market conditions. We will continue to monitor the impact of MARPOL Annex VI and provide updates on new developments.

For more information, please contact Max Thompson, Associate, on +44 (0)20 7264 8230 or max.thompson@hfw.com, or your usual contact at HFW.

hfw Breaking bad: new builds, more scraps?

Concern over the environmental impact of ship recycling is nothing new. As we mentioned in our previous Bulletin, the European Union in particular has emphasised its intention to curtail the perceived negative impact of certain ship recycling practices (see “The European Ship Recycling Regulation comes into force”, March 2014 - http://www.hfw.com/Green-Shipping-Bulletin-March-2014#page_0).

Few would be surprised to hear that recycling capacity is highest in developing countries such as Bangladesh, China and India, where regulation for the protection of the environment is not necessarily a priority. Nevertheless, in an era of ongoing oversupply of tonnage, and the introduction of supersized newbuild bulk and container vessels into the world's fleet, this article explores whether sufficient attention is being paid to the potential environmental impact that could arise from a temporary surge in recycling volumes.

The international community has striven through the implementation of a legal framework to better control ship recycling via the management of hazardous wastes. All three of the key ship recycling nations referred to above are signatories to the Basel Convention¹, and around two thirds of the parties to the Convention have enacted national legislation to give effect to its aims, namely the control of transboundary movements and management of hazardous wastes. Nevertheless, it is believed that in many signatory states the national institutions

1 The Basel Convention on the Control of Trans-Boundary Movements of Hazardous Wastes and their Disposal 1989



empowered to enforce local legislation are still lacking the necessary resources, training and expertise. Further, attempts to bring into force the Hong Kong Convention² to bolster international regulation on ship recycling have not yet come to fruition. Consequently, the reality is that there is a huge volume of tonnage being recycled each year, with measures in place to protect the environment which are arguably open to criticism.

Why is this issue important?

According to statistics provided to us by Lloyd's List Intelligence, 2013 saw the highest volume of ship recycling of any year in over a decade, taking the scrapped gross tonnage to over 30 million that year, compared to 25 million in 2011 and just 4 million in 2007. This cannot be simply attributed to one cause. Oversupply of tonnage in the market is an obvious factor underlying these figures, and presumably the addition of increasingly large newbuild vessels into the market can only accentuate the issue. Scrapping may be an obvious solution; theory dictates that the more ships that are scrapped, the quicker the oversupply can be addressed; the sooner freight rates should increase and the sooner the market should recover.

Beyond that, some owners will receive financial incentives to scrap tonnage and replace it with new tonnage. For example, in late 2013, China introduced a new policy whereby owners will receive 1,500 RMB (equivalent to around US\$240) per gross ton for ships scrapped in China between 2013 and 2015. The catch? In order to qualify for the cash incentive, the owner has to place a new order with a shipyard in China for



Further, attempts to bring into force the Hong Kong Convention to bolster international regulation on ship recycling have not yet come to fruition.

LAURA WRIGHT, SENIOR ASSOCIATE

tonnage of at least the same volume as that scrapped. This may not address oversupply issues, but it looks certain to bolster both the recycling and newbuild industries in China at least.

What is the cost?

Ship recycling touches upon a host of potential social and environmental issues. Critics have highlighted that if proper care is not taken during the recycling process, workers and the environment may be exposed to potentially harmful substances. These can include:

- Toxic paint coatings, such as lead.
- Oily residues.
- Asbestos.
- Heavy metals and radioactive material.

What does the future hold?

It remains to be seen how ship recycling will respond to the uptake in demand from owners, especially at a time when the adequacy of international regulation of ship recycling has been called into question. When tonnage oversupply remains a real concern and recycling old tonnage is financially attractive for owners, the question increasingly raised is whether the environment is bound to pay the price.

Whilst regulation has its part to play in setting international minimum standards, some market participants have made the choice to proactively change their own practices. The European Union's "Green and Safe" AA rating has been awarded to a number of yards across the world (including in China) which meet and exceed Hong Kong Convention standards.³ Furthermore, some owners have made the decision to pursue sustainable recycling policies. To this end, they are identifying suitable ship recycling facilities with a view to placing market pressure on those yards not conforming to international standards. Undoubtedly both regulation and market forces will have a key role to play in shaping future ship recycling practices.

For more information, please contact Laura Wright, Senior Associate, on +44 (0)20 7264 8791 or laura.wright@hfw.com, or your usual contact at HFW.

2 The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships 2009

3 http://ec.europa.eu/environment/waste/ships/pdf/bio_ship%20dismantling.pdf



hfw Spatial awareness: a look at the new maritime spatial planning directive

In our March 2014 Bulletin we discussed the proposals for a new Maritime Spatial Planning Directive (the Directive). On 23 July 2014, the Council of the European Union adopted the Directive. We now look at its key features and some of the practical implications that will flow from its adoption.

Objectives

As demand upon the world's marine space rapidly grows, so too does the scope for conflict between competing maritime users. With an estimated increase of 50% by 2030 in maritime transport alone, it is ever more important to co-ordinate these interests and promote sustainable growth.

The Directive hopes to achieve this through the management of competing maritime and coastal activities such as fishing, shipping, maritime infrastructures such as cables, pipelines, shipping lanes and oil, gas and wind installations, both nationally and at a cross-border level.

Through the Directive, the European Commission hopes to:

- Reduce conflicts between sectors by creating clear, predictable and transparent rules.

- Secure the energy supply for the EU by encouraging investment in renewable energy sources, oil and gas.
- Promote the development of cost effective shipping routes across Europe.
- Increase coordination between Member States and reduce red tape in cross-border planning.
- Foster sustainable development and growth of fisheries and aquaculture.
- Protect and improve the environment by establishing marine protected areas.

The Directive forms part of the EU's long term Blue Growth strategy as one of the essential components to develop maritime knowledge and ensure legal certainty in the maritime economy.

What is new?

While the Directive does not introduce any substantive legal changes, it does prescribe certain minimum requirements. As a minimum, EU Member States must produce both maritime spatial plans (MSPs) and integrated coastal management (ICM) strategies. Both MSPs and ICM strategies stop short of imposing any new environmental policy targets and are largely procedural in nature. Many countries including Germany, France, the Netherlands and the UK have in

fact pre-empted the implementation of the MSP Directive and already have maritime planning systems in place.

MSPs are arrangements which set out how, when and where maritime space is allocated and identify the most effective way of managing these activities. This will include mapping out areas closed to fishing or other human activities, designating precautionary areas, security zones and marine protected areas. MSPs will also set prescribed areas for specific uses such as wind farms, military operations, sand and gravel mining, waste disposal and maritime transportation.

The ICM strategy is a mechanism to co-ordinate all policy processes affecting coastal zones. The Directive obliges Member States to produce and keep an inventory of existing measures applied in coastal zones and analyse whether any additional actions are needed to achieve their objectives.

Implementation

Member States will have to designate competent authorities who will be responsible for implementing and monitoring the application of the Directive. Those States that have already developed planning systems are free to continue operating through their existing management bodies and under existing plans, provided the minimum requirements are met. In the UK for example, these responsibilities are likely to remain with the Marine Management Organisation.

In preparing MSPs and ICM strategies, the competent authorities will need to establish a means of public participation. This means that interested parties must be consulted on the draft plans and strategies, including the publication of review results.

As demand upon the world's marine space rapidly grows, so too does the scope for conflict between competing maritime users. With an estimated increase of 50% by 2030 in maritime transport alone, it is ever more important to co-ordinate these interests and promote sustainable growth.



Some doubt still remains over how effective trans-boundary co-operation will be where national interests are in conflict and indeed how such conflicts will be resolved. We will continue to monitor the situation and report on developments in this area.

Stakeholders will naturally be concerned with how, when and where the competent authorities are defining important environmental and ecological areas and to what extent their interests might be restricted. It is therefore highly important that stakeholders actively engage in the processes to ensure that both their existing and future interests are represented.

Given the nature of the activities concerned, a central element of the Directive is minimising cross-border conflicts over marine use. Part of the role of these competent authorities will be to ensure effective trans-boundary co-operation between Member States, national authorities and relevant stakeholders. It is hoped that this co-operation will build on the successes of existing transnational organisations, such as OSPAR in the North-East Atlantic.

As part of this requirement, and in order to plan effectively, competent authorities will have to collect and share data to ensure that their MSPs are not in conflict with those of other States. The mechanisms used for this information sharing have not been prescribed in the Directive, so how this will work in practice remains to be seen.

EU Member States must transpose these new rules into their national laws by 2016, and draw up national maritime spatial plans by 2021. MSP and ICM strategies will then have to be reviewed every six years.

Impact

In the face of growing demand for Europe's marine space, a framework for co-ordinated and consistent decision making is to be welcomed. From a stakeholder perspective these plans will, for the first time in many cases, address competing interests together. Inherently this will provide greater certainty for those setting trade routes or requiring approvals for exploration and energy projects.

Some doubt still remains over how effective trans-boundary co-operation will be where national interests are in conflict and indeed how such conflicts will be resolved. We will continue to monitor the situation and report on developments in this area.

For more information please contact Orla Isaacson, Associate, on +44 (0) 20 7264 8101 or orla.isaacson@hfw.com or Max Thompson, Associate, on +44 (0)20 7264 8230 or max.thompson@hfw.com, or your usual contact at HFW.

Polar Code update

The benefits of new polar shipping routes and reportedly significant oil and gas reserves and mineral deposits has not gone unnoticed by the maritime industry. According to the Lloyd's 2012 Arctic Opening Report, investment in the Arctic could exceed US\$100 billion within the next decade.

While creating significant opportunity, opening the gateways to the polar seas has also highlighted the special degree of care required when ships navigate these volatile waters and the need to provide the highest levels of environmental protection of the marine ecosystem.

To combat the risks, the International Maritime Organization (IMO) is developing the International Code for Ships Operating in Polar Waters (the Polar Code) to cover the full range of design, construction, equipment, operational, training, search and rescue and environmental protection matters relevant to ships operating in the waters surrounding the two poles. The Code aims to provide a comprehensive set of internationally agreed standards, including environmental and safety procedures and to serve as a binding international framework to protect the two polar regions from maritime risks.

While creating significant opportunity, opening the gateways to the polar seas has also highlighted the special degree of care required when ships navigate these volatile waters.



The Code sets out goals and requirements, including:

- Ship structure.
- Stability and subdivision.
- Watertight and weathertight integrity.
- Machinery installations; operational safety.
- Fire safety/protection.
- Life-saving appliances and arrangements.
- Safety of navigation.
- Communications.
- Voyage planning.
- Manning and training.
- Prevention of oil pollution.
- Prevention of pollution from noxious liquid substances from ships.
- Prevention of pollution by sewage from ships.
- Prevention of pollution by discharge of garbage from ships.

A key change being introduced by the Polar Code is that ship operators will need to carry a Polar Ship Certificate, which would classify the ship as either (i) Category A ship (designed for operation in polar waters at least in medium first-year ice, which may include old ice inclusions); or Category B ship (a ship not included in category A, designed for operation in polar waters in at least thin first-year ice, which may include old ice inclusions); or Category C ship (a ship designed to operate in open water or in ice conditions less severe than those included in Categories A and B). Ships would also need to produce a Polar Water Operational Manual to provide the owner, operator, master and crew with adequate information regarding the ship's operational capabilities and limitations in order to support their decision-making processes.

The Polar Code is making its way through the approval process and once approved will become mandatory, via amendments to the SOLAS and the MARPOL Conventions, for ships operating in the North and South poles. This should allow it to be implemented without conflicting with

current practices. IMO's Maritime Safety Committee (MSC) has approved, in principle, the draft Code and related amendments to make the Code mandatory under SOLAS. The Polar Code is expected to be finalised at the end of this year.

Once ratified, the intention is for the Code to compel owners to mitigate the risks associated with operating within polar waters. One means of achieving this is to raise standards of ship design, to improve vessel safety in what is acknowledged to be a high-risk climate zone. This development is expected to be welcomed in particular by insurers.

While the Polar Code recognises the need to respond to the ever increasing number of ships navigating the North and South poles, critics are concerned that the Code is not stringent enough and that its implications have not been fully thought through. There is an increasingly popular view amongst environmentalists that there are important aspects that the Polar Code fails to address, particularly in relation to marine safety and environmental protection issues.



The Polar Code is making its way through the approval process and once approved will become mandatory, via amendments to the SOLAS and the MARPOL Conventions, for ships operating in the North and South poles.

KARIS BARTON, ASSOCIATE

The Code does however come as the first step in enhancing Arctic marine safety and environmental protection and it is likely that additional research and understanding will eventually bring stronger protections to the polar regions.

For more information please contact Karis Barton, Associate, on +44 (0)20 7264 8327 or karis.barton@hfw.com, or your usual contact at HFW.

Conferences and events

IBA Annual Conference

Tokyo

19 – 24 October 2014

Presenting: Elinor Dautlich

Attending: Alexis Kyriakoulis

Seatrade Middle East Awards

Dinner

Dubai

27 October 2014

Presenting: Stephen Drury

Attending: Simon Cartwright

Seatrade Middle East Maritime

Dubai

28 – 30 October 2014

Presenting: Stephen Drury

BIMCO Mock trial – “Trial by Media, Trial by Law”

London

3 November 2014

Attending: Marcus Bowman and

Andrew Chamberlain

Informa Bills of Lading Seminar

London

12 – 14 November 2014

Presenting: Matthew Wilmshurst

Lawyers for international commerce

hfw.com

© 2014 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

São Paulo London Paris Brussels Geneva Piraeus Dubai Shanghai HongKong Singapore Melbourne Sydney Perth