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About **YPSN**

The YPSN monthly newsletter aims to provide you with the latest developments affecting our members in shipping in Hong Kong and broader China.

If you are interested in registering as a member, sponsoring an event or suggesting activities for YPSN to organize, please feel free to get in touch with us on youngprofessionals.shipping@gmail.com

WEBSITE EVENTS CONTACTS

BUNKERS – WHO SHOULD BE PAID?

Following the unexpected collapse of the O.W. Bunker ("**OWB**") group in November 2014, scores of shipowners have been, through no fault of their own, facing the risk of being forced to pay twice for the same supply of bunkers. This has caused an outcry in an already cash-strapped industry.

At the time the news of OWB's insolvency became public, hundreds of supplies of bunkers had been delivered to vessels and had been, more often than not, partially or wholly consumed. However, because these bunkers were generally supplied on a credit period of 30 days or more, shipowners had not yet paid for them, nor had OWB paid the upstream physical suppliers who actually provided the bunkers.

Within days of OWB's insolvency, vessel owners began receiving demands for payment from suppliers who had delivered bunkers to the vessels, who were firm in their belief that the law (in particular US law) allowed them to claim directly against the ship by way of a maritime lien or maritime claim. To further complicate matters, ING Bank N.V. ("**ING**") also started sending notices to shipowners claiming that they were the assignee of OWB's receivables and that owners should pay ING for the bunkers. Since then, numerous vessels have been arrested worldwide by ING and/or physical suppliers as a result of these competing claims.

Vessel owners, charterers, ING and physical suppliers have churned up a legal maelstrom by turning to courts and tribunals around the world to seek the elusive answer to the question: who is entitled to be paid for the bunkers in question, ING / OWB or physical suppliers? The multi-jurisdictional nature of the shipping business has given rise to a number of inconsistent results in the courts of various jurisdictions in the year and a half since OWB collapsed. A significant proportion of the proceedings were commenced by ING / OWB in England, given that most of OWB's contracts with their customers were subject to OWB's standard terms and conditions, which provided for English law and LMAA arbitration.

In England, at least, the waters have become slightly less murky since the UK Supreme Court handed down its final judgment in the case of PST Energy 7 Shipping LLC and another (Appellants) v O W Bunker Malta Limited and another (Respondents) [2016] UKSC 23 on 11 May 2016 (the "**Res Cogitans**"). This case has been treated as a "test case" and eagerly awaited by owners, charterers, bunker suppliers, P&I clubs and insurers alike in the hopes that it would provide some much-needed clarity to legal tangles left by OWB's insolvency.

THE SUPREME COURT JUDGMENT IN RES COGITANS

The UK Supreme Court effectively upheld the decisions of the lower courts and LMAA tribunal that the contract between PST (the owner of the Res Cogitans) and OWB Malta, despite having all the appearances and language of a sale of goods contract, was not in fact a sale of goods contract. Instead, the Court unanimously held that the contract between PST and OWB Malta was a "sui generis" contract, meaning "of its own kind; in a class by itself; unique". According to the Court, OWB Malta had three obligations under the contract:

(1) to allow the vessel to consume the bunkers for the purposes of propulsion prior to payment falling due at the end of the 60-day credit period;

(2) the implied promise that OWB Malta had acquired the right to authorise such consumption of the bunkers from the suppliers further up the supply chain; and

(3) if any bunkers had still remained at the time payment was made, to transfer ownership or title in those bunkers to PST.

In return for the right to consume the bunkers before payment and the title to any bunkers that remained unconsumed at the time payment was made, an owner would be obliged to pay the entire contract price.

The key reason behind the Court's decision was that the parties clearly contemplated that some or all of the bunkers might be burnt before PST had made payment for them. Like many bunker suppliers, OWB's terms and conditions had contained a retention of title ("**ROT**") clause which provided that ownership of the bunkers would remain vested in OWB until PST paid for them. However, OWB's terms and conditions also contained an express term that the bunkers could be used for propulsion of the vessel. The Court also recognised that as a matter of commercial practice, it is widely known by bunker suppliers that the bunkers they deliver are likely to be used as soon as they are stemmed on board a vessel.

It is a well-established principle in English law that once material goods are destroyed or no longer exist, title in them is also extinguished. Accordingly, despite the existence of the ROT clause, once the vessel had consumed the bunkers, OWB could no longer have title to them. Under English law, the primary obligation of a seller in a sale of goods transaction is to transfer title in the goods to the buyer. However, as passing title was clearly impossible in circumstances where the bunkers might be consumed and no longer exist, the Court held that the transaction was not for the sale of goods. Instead, OWB's primary obligation under the contract was to make bunkers available for consumption by the vessel prior to payment.

IMPACT ON ING / OWB'S CLAIMS

This judgment is unsurprising, given that the lower courts and tribunal had all reached a similar conclusion. Nonetheless, it is disappointing for shipowners who had hoped that the Supreme Court would offer them a means to escape from the risk of double payment.

That said, the Supreme Court's decision in Res Cogitans should not be taken as an ironclad proclamation that all shipowners that purchased bunkers from OWB in the days leading up to OWB's collapse are irrevocably obliged to pay ING for those bunkers. In particular, it is important to note that:

(1) The Court's decision is based on a set of assumed facts which had been jointly agreed by PST and OWB Malta. If a shipowner is able to distinguish its own case from those assumed facts, that may mean that the reasoning in Res Cogitans is not applicable to AN owner's case. In fact, now that the preliminary issue of exactly what the nature of the bunker supply contract is has been decided by the Supreme Court, it is rumoured that the Res Cogitans arbitration will resume and proceed to a final award. It is likely that PST will now attempt to defend against liability by distinguishing the facts of the case from the assumed facts submitted to the Supreme Court.

(2) The Court was careful to restrict the scope of its decision only to the nature of the contract between PST and OWB, and deliberately avoided commenting on potential claims by physical suppliers. In particular, the Court declined to comment on whether the physical supplier in the Res Cogitans case did in fact give consent for the bunkers to be consumed prior to payment, as this question was not before the Court. Thus, it remains an open question as to whether an owner might have a defence to ING / OWB's claims if it can be shown that as a matter of fact, the upstream supplier did not actually give consent for the bunkers to be used before payment.

(3) The Court had held that OWB was obliged to transfer title in any bunkers that still remained in existence at the time payment was made by PST. This raises the following question: if a shipowner is able to show that at the time the 30-day credit period for payment expired, a large proportion of the bunkers supplied via OWB had not yet been consumed, yet OWB was not in a position to pass title in those bunkers (by reason of not having paid the upstream supplier for them), would this provide the owner with a defence against ING / OWB's claims – for example, by arguing that the contract is void for total failure of consideration?

IMPACT ON PHYSICAL SUPPLIERS' CLAIMS

It is a unique characteristic of the shipping industry that bunker suppliers frequently have the option to establish jurisdiction for its claims in a jurisdiction by arresting a vessel there. Under ordinary non-maritime chains of sale of goods contracts, the supplier bears the insolvency risk of his buyer when he offers credit terms. In such situations, an upstream supplier has little hope of leapfrogging over the intermediate contracts to strong-arm the downstream consumer into paying him. Nevertheless, in the maritime industry, it is possible that an especially persistent physical supplier may be undeterred by the Res Cogitans ruling, and instead to seek to initiate proceedings against vessel owners elsewhere via arrest or other means, particularly in non-common law jurisdictions.

LIFE AFTER RES COGITANS

In its current state, the nature of the global bunkering business does not lend itself easily to a solution to the double-payment dilemma faced by vessel owners. Setting legal niceties aside for the moment, a layperson observing the OWB debacle might very well have formed one of the following two views:

(1) The physical supplier is the only party that is out of pocket for the bunkers. All the intermediate suppliers had only made paper trades, and if everything had gone as it should have, the most they would have earned is whatever profit margin they had added to the price of the bunkers when selling them on. So it is only fair that the bulk of the purchase price goes to the physical supplier, and everyone else only gets their profit margin (assuming that they even had one).

(2) Every company doing business takes a risk on the solvency of their counterpart. The physical suppliers took a gamble on OWB, and they lost. Everybody in the contractual chain should just pay their immediate counterparty. This way, it is clear whom everyone should pay, there would have been no need to bother the Supreme Court about it, and the parties could have found far better ways to spend their money than on lawyers.

From a common sense standpoint, both approaches have merit, but they are fundamentally in conflict with one another. As long as a bunker supplier has the right to arrest a vessel or claim a maritime lien for unpaid bunkers, there will be no easy resolution to the double-payment risk faced by vessel owners each time they order bunkers through an intermediate trader.

The most obvious way for shipowners to counteract the risk of double payment is to cut out the middle man entirely, and purchase directly from physical suppliers. However, if owners decided to purchase bunkers directly from physical suppliers, that would require owners to identify suppliers in each and every port where their vessels trade, and maintain relationships with those suppliers. Owners would also have to review each and every supplier's terms and conditions, many of which may be subject to the law of the local jurisdiction. In other words, trading directly with physical suppliers will saddle owners with precisely the administrative burden that intermediate traders such as OWB had sought to eliminate in the first place.

We are aware that BIMCO has suggested in a special circular dated 29 February 2016 that bunkers supply contracts should be amended to include wording that the UK Sale of Goods Act 1979 should apply to the contract. In light of the Supreme Court's decision in Res Cogitans, it seems to us that this wording would be inherently inconsistent with nature of the contract as held by the Court. It is therefore questionable whether this wording would have any effect at all.

In any event, it will be extremely interesting to see how the bunkering industry adapts to the challenges that have been thrown into the spotlight since OWB's collapse. We wonder, for example, whether the current crop of intermediate bunker traders might be replaced by a new crop of bunker brokers. Is it possible that the buy-low-sell-high bunker traders of today will instead become brokers or agents that take a percentage cut of each transaction they broker?

IMPACT ON ING / OWB'S CLAIMS

Last but most certainly not least, the Res Cogitans ruling has another implication for bunker transactions which is not nearly as hair-raising as the risk of double-payment, but nevertheless warrants serious consideration.

Purchasers of goods under English law sale of goods contracts have long since been afforded the protection of a number of implied terms pursuant to the English Sale of Goods Act 1979 ("**SOGA**"), including implied terms as to satisfactory quality, fitness for purpose, description etc. Sellers, on the hand, benefit from numerous implied terms relating to payment, sale of goods that are in the possession of other parties, etc. If it is true that bunker supply contracts such as the one featured in Res Cogitans are not sale of goods contracts, then that means SOGA would not apply, and the parties would lose the certainty and protection offered by SOGA.

Despite holding in Res Cogitans that the contract between OWB and PST was not a sale of goods contract, the Court nevertheless briefly commented that "the transaction… is closely analogous to a sale… the contract, although not one of sale, would contain similar implied terms as to description, quality, etc to those implied in any conventional sale". In other words, according to the Supreme Court, the contract between OWB and PST is almost – but not quite – a sale contract.

It is by no means clear which implied terms the Court is referring to, and to what extent they would apply to such a contract. Given that bunkers supplies are often made subject to the terms and conditions of the supplier, bunker suppliers whose terms are subject to English law may need to carefully reconsider the wording of their terms and conditions to take into account the fact that the implied terms imposed by SOGA may not be applicable.

Similarly, owners and charterers may need to scrutinise the terms of their English law bunker supply contracts in order to determine possible risks arising from the fact that the implied terms imposed by SOGA may no longer apply.

Disclaimer: Information contained in this article should not be applied to any particular set of facts without seeking legal advice.

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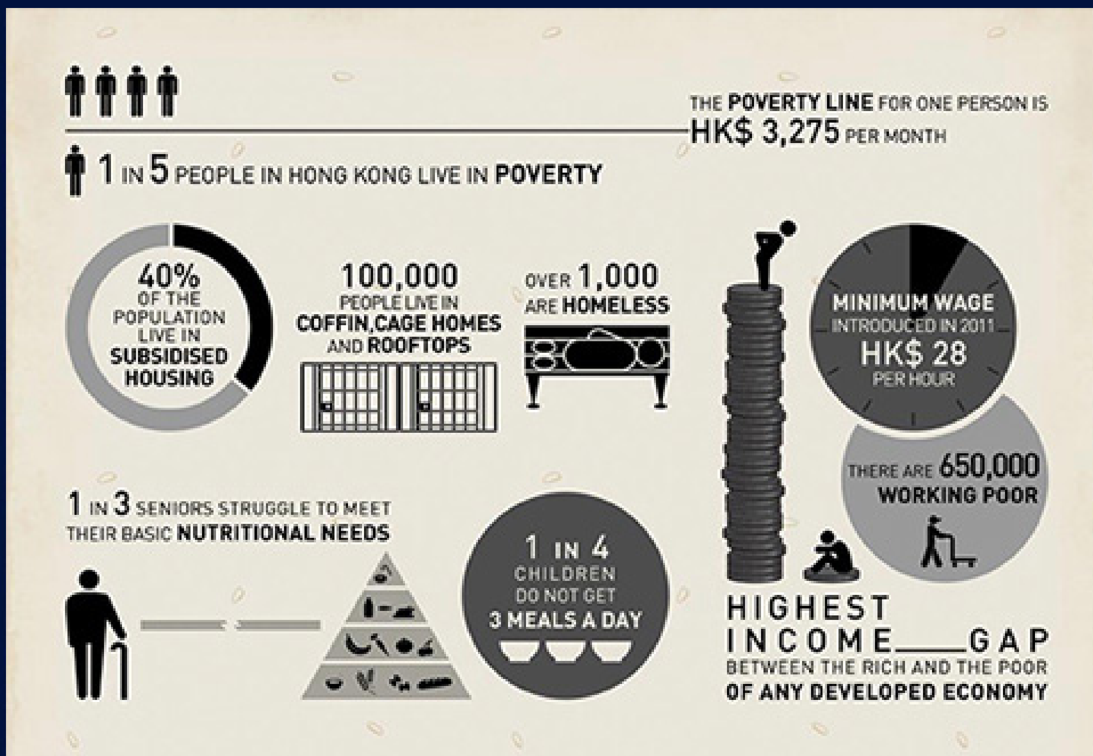
FEEDING HONG KONG SHIPPING FOOD DRIVE



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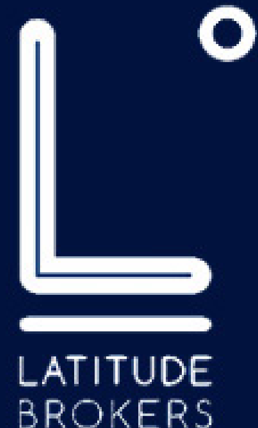

REPORTING SEASON - 2016 Q1 RESULTS

Reporting season is upon us again. The results have been mixed.
Here are some of the results and their reported outlooks for the coming year.

Bulkers:

- **Golden Ocean** reported a net loss of $68.24m this quarter, bettering the loss $75.34m it made in the previous quarter. The fleet is constantly growing, taking on four vessels (2 Capesize and 2 Newcastlemax vessels in January 2016). Operating revenues are up to $45.01m from $18.08m which can be explained by the number of ships taken on, despite being offset by industry record low rates. The first quarter of last year saw a huge amount of vessel impairment loss applied ($141m) whereas this year saw losses on interest expenses, impairment on securities and loss on derivatives making up the bulk of the balancing exercise. They look to postpone delivery of 2 of their 13 vessels on order this coming year. They also commented rates in 2016Q1 meant they were operating at a loss throughout but halfway through the second quarter, rates have improved on average to be in line with operational costs.

- **Diana Shipping** released figures suggesting a drop in revenue from $42.01m to $30.79m, a fall of 26.7%. In the same period, total operational expenses rose from $50.87m to $55.50m. The change in revenue was explained by the soft market, which saw the TCE drop from $10,545 to $6,196. Net Loss was reported at $31.39m, which built on the same loss of $10.76m of the same period a year prior.

- **Genco Shipping and Trading Ltd** revenue reduced 39.2% from $32.42m to $20.94m. This was attributed to the comparatively lower spot market rates achieved in the first quarter of this year, offset by the delivery of 2 Ultramax vessels. Total Operational Expenses decreased in the same time period from $108.18m to $67.90m driven by a lowering of compensation expenses and impairment of vessel assets. This resulted in a Net Loss of $54.58m, an improvement from the $79.12m loss recorded in the same period last year. There was a drop in the Time Charter Equivalent (TCE) from $4,977 to $2,629 due to the erosion of spot rates with the caveat that rates have improved for Genco at the end of March.

Last year reported 30.6m dwt of scrapped vessels. Bulk carrier ordering was down to 17.7m dwt from the 74.2m dwt per annum average over the past 10 years. The bulker owners above all commented they have a deliberate strategy to build up their fleets so that they will be in an advantageous position for future industry cycles. All have commented on small, but generally positive improvements in trade volumes and rates towards the end of March regarding various bulk trade. That being said, conference calls are still commenting on surviving the current market suggesting there is still a way to go before stabilizing to a new normal.

Containers:

- **Matson, Inc** announced a first quarter revenues of $454.2m, up from $398.2m from the same period last year. This came from their ocean transportation revenue streams, namely the inclusions of Alaska services and higher container volume and yield in Hawaii but offset by a slowdown in their Chinese trade. Operating expenses increased 19.9% from $353.3m to $419.6m. Matson made a net gain of $18.1m in the first quarter, down from $25m in the same quarter previous year.

- **Costamare Inc.** revenues remained consistent during the first quarter of both 2016 and 2015 just over $120m. In the same time period, a slight drop in operational expenses from $67.9m to $64.2m. Despite revenues and operation cost remaining much the same, net income is up 33.1%, from $26.3m to $35m. This improvement was driven by decreased outstanding loan amount and loan interest expenses year on year.

- **Seaspan Corporation** announced a Q1 comparative Revenue increase from $188.55m to $215.52m, an increase of 14.3%. This growth was attributed to expansion of the fleet and sizable contract revenue streams. Total Operations Expenses went up to $130.39m from $104.13m. Net Income this quarter was recorded at $7.13m down from 2015Q1 of $21.33m. This most came from an increase in their fair value of financial instruments from the forward LIBOR curve, and deferred financial fees which came from operating borrowings related to vessels delivered in 2015.

The container market looks to increase capacity by 4% this year and 7% next year on the back of TEU volume demand to increase by 2-4% in 2016 and 2-3% in 2017. Oversupply and its side effects are likely to continue. One such side effect being the reform of container alliances. At this moment, it is unclear how the alliances (both new and old) will operate but there will be a much better picture at the end of the year. One company commented on the new Panama Canal redefining the size of Panamax vessels up to approx. 14,000 TEU vessels and the improving efficiencies of scale from 5,000 TEU. China was the driver for many container companies' extraordinary results in Asia and they continue to hope for a cyclic recovery while none hazard a guess as to when this takes place.

Tankers:

- **Nordic American Tankers** reported the tanker market has been more or less the same over the last few quarters, which explains the consistency that is found in their accounts when comparing 2016Q1 and 2015Q1. Revenues rose to $76.73m, up from $69.56m. Operation costs rose to $76.73m, up 12.2% from $38.48m. Net gain this quarter improved 5.6% from $29.30m to $27.74m.

- **Gener8 Maritime Inc.** are following a "transformative year in 2015" almost doubling their Net Income from $30.92m to $60.86m from their Q1 results. This is despite the fact that revenues only increases by $2.64m. The improved net income came from total operating expenses dropping from $82.74m to $55.86m (including voyage expenses in the total operational expense calculation) which was driven by a $43.5m saving attributed to 88.4% decrease in the company's spot market days as a result of transitioning from spot market to Navig8 pools, decrease in oil prices and the sale of a vessel.

- **Navigator Holdings Ltd.** recorded revenue increases from $74.20m to $76.38m. This was principally due to increase in the number of vessel from 26.9 to 29.8 during respective quarters and an increase in average month charter rates from $29,561 per day to $29,180 per day. This was offset by a decrease in fleet utilization due to the softening market. Total Operation costs also rose from $42.29m to $49.08m in the same period with vessel operating expenses from an expanding fleet and an increase of DVOE $824, up to $8,164, making the bulk of the change. Net income at Navigator Holdings Ltd. dropped by 16% from $23.08m to $19.39m.

- **Ardmore Shipping Corporation** recorded a positive Net Income in the first quarter of $6.74m, up from $5.07m in 2015. This can be attributed to 47% increase in revenue, up to $43.54 from $29.62. This was driven by an average number of vessels operated increasing from 15.9 vessels to 24. As a result of the expansion, Total Operational Expense went up 41% from $22.93m to $32.36m. Ardmore of average traded within 0.1% of TCE in both 1Q's.

We have covered two subsections of Tanker owner, the crude carriers and the LPG/Chemical tankers. Tanker owners seemed to have done well across the board this quarter. Demand for crude is expected to grow 1.2 million barrels a day in 2016. OPEC production is at a 7 year high of 32.8 million barrels a day in April, which bodes well for those carrying the cargo. LPG saw a softening of the market this quarter which resulted from the "El Nino" year bringing warmer weather during the traditionally colder months coupled with low oil prices. This was seen as unexpected headwind rather than a stumbling block. Both sectors are positive and comment on difficulties in raising capital limiting the number of vessels entering the supply side.

The companies selected in this review were chosen because of the varying vessel sizes they operate, their expanding fleets and for their insight to their respective markets. All information is from their 2016 Q1 reports coupled with the transcript of conference calls found on SeekingAlpha.com

Pacific Basin

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YPSN PRC Networking Event
Thursday 6th May - The Apartments 3/F, Yongfu Road, Shanghai
Please see attachment for more details
RSVP at ypsn.prc@gmail.com