Standard Bulletin - Weathering the Storm

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Introduction

This special issue of the Bulletin looks at the way in which the global financial meltdown of the last few months has affected the shipping market and how Members can weather the storm.

The world economic landscape has changed radically. Companies have seen their share values plummet, the banking system is in crisis, business confidence has been destroyed and the Chinese industrial miracle, which has been the engine of world economic growth for a number of years, has been stopped dead in its tracks.

Against this background, the shipping market faces unprecedented challenges:

- shipyards have seen their order books filled for years in advance despite a massive expansion in capacity, but all this has suddenly changed
- in the chartering market, because of the collapse in freight markets, insolvency and financial defaults have already occurred and more are feared
- shipowners are faced with an increased risk of wrongful repudiation, non-payment of hire and a potential liability for charterer's bad debts, particularly for port services and bunker suppliers.

This Bulletin provides:

- an idea of how the current market situation is affecting the club
- practical legal advice on a number of issues, so that Members can take steps to protect themselves from the consequences of cancelled contracts and business failures
- advice on what to do when putting ships into lay-up
- advice on steel cargo, which is one area where we expect claims to increase.

As with most things prevention is better than cure, and the articles which follow are designed to anticipate the most common problems which Members may face in the current market so that early and effective action can be taken.

Now is the time to read your contracts carefully and take advice on your rights and obligations. Wordings in new contracts should be carefully scrutinised and financial guarantees sought wherever possible. When things do go wrong advice is offered on the methods of attaching assets through the Rule B procedures in the US, freezing orders issued by the English Commercial Court, or bunker arrests.

The following articles can only provide a brief overview of some of the main issues facing the shipping industry today; all the contributors to this edition would like to point out that if Members need formal advice on an issue, they should contact the club or their lawyers who will be able to tailor their advice to the particular circumstances.

In This Issue

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The Club Perspective

Many of the problems highlighted by Brian Glover in his Introduction do not directly impact on P&I or even defence cover. In fact in many ways a downturn in the shipping market, with a decline in both commodity prices and shipping activity, results in fewer and smaller claims. That said, however, what is bad for shipowners must also be ultimately bad for the clubs that serve them. We also know that any violent adjustments in shipping activity, whether up or down, can result in an increase in certain types of claims. This has been seen in the past with crew injury claims from disgruntled ex-employees after they have been laid off. Depressed economic conditions also result in a greater incidence of cargo rejection as the need for raw materials such as steel declines; Chris Spencer discusses this further on page 16.

Many of the problems experienced by shipowners in the current market, however, have more relevance to defence cover and the club has already seen a marked increase in claims activity over the past few months; in November we opened twice as many files as usual. Defence cover is available for a range of disputes, mainly contractual in nature, which arise out of or in relation to the charterering or operation by the member of the entered ship. Commercial disputes per se are not covered if they do not relate to the operation of the ship, but the defence clubs will be heavily involved in chartererparty disputes for non-payment of hire, etc and under any new buildings cover which they provide. It is important to use defence support prudently since unnecessary litigation is both expensive and commercially counter-productive; the cover is discretionary being based on an assessment of the merits of the member's case and the cost benefits derived from ongoing support.

As well as the increase in the number of actual files opened, our defence specialists round the world have also been heavily involved in dealing with an increasing number of general contractual and commercial enquiries from Members. In addition to the 16 legally qualified claims handlers in the London office, each of the Club's overseas offices include qualified lawyers among the claims staff: Colin Snell leads a team of two in New York, Wendy Ng a team of three in Singapore, and Gillian Musgrave a team of three in Piraeus.

The club exists to serve its members, particularly in times of crisis or hardship. This involves close co-operation and the pooling of information. To help us achieve this we have, over recent months, been involved in a number of initiatives; on 14 November, we arranged for Bentleys, Stokes and Lowless to give a talk at International House on the forward freight market, while on 2 December the Club hosted a joint seminar for Members with Holman Fenwick Willan in Piraeus. The theme for the day was the impact of the current financial crisis on shipping contracts. November also saw the club involved with Reed Smith's Hamburg Shipping Law Seminar, and the Singapore Shipowners' Association Emergency Meeting.

The club was also represented at two bulk freight market meetings held in Naples (on 4 November - attended by Alistair Groom and David Roberts) and London (on 19 November – attended by David Roberts and John White-Thomson). On both occasions it was invaluable to hear – first hand – the concerns of Members and other shipowners, and to participate in the industry-wide attempts to find solutions to the current problems.

We are well aware, following the recent member and broker survey, of the importance attached to the claims' service and we are constantly striving to improve it. All the initiatives mentioned above, together with the on-going day-to-day contact we have with Members, help us at the club understand your concerns in greater depth, and enable us to offer a more pragmatic and commercial service.

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Pre-Contract Considerations and Enquiries

Given the inherent volatility of shipping generally, and the relative "mobility" of assets, it has always been the case that participants in the various shipping markets should consider carefully with whom, and on what terms, they contract. Most of what follows would spring to mind at any time, but it is of far greater moment in these troubled times.

Guarantees

The importance of effective guarantees cannot be overstated, and with the current turmoil, particularly in the chartering market, parties will be well advised to look for additional security. Guarantees are subject to their own formal rules. Although the guarantee can easily and briefly be contained within the underlying contract, a party should take care in observing the relevant formalities.

The key elements of an enforceable guarantee are that a party cannot bring any action upon a guarantee unless it "or some memorandum or note thereof" is:

- in writing, and
- signed by the party to be charged or its lawfully authorised agent.

One of the leading cases illustrates how English courts consider the issues that can arise (The "Maria D" [1991] 2 Lloyd's Rep 311).

Parties might not always have the opportunity to draft tailor-made guarantees. There is nothing wrong with this in principle – indeed in the "Maria D" there was a simple sentence that was sufficient. That said, one should perhaps adopt such a liberal and pragmatic approach with caution: the guarantee is a separate contract. Problems can arise in defining the proper law of the guarantee and the relevant forum for determining a dispute between the creditor and the guarantor. Ideally, these issues should be addressed, whether in a free-standing tailor-made guarantee or in any wording incorporated into the principal contract.

Similarly, guarantees are generally sensitive to agreed variation in performance of the underlying contract, and in a properly drafted guarantee, provision is usually made to the effect that any such variation or indulgence shall not be fatal to the creditor's rights against the guarantor.

The practical lessons are thus:

- guarantees must be in writing and signed (including printed names) by or clearly for the guarantor
- although a relatively informal guarantee can 'work', there is much to be said for a more sophisticated document
- variation in performance can jeopardise the security without adequate provision or, in any event, where there is a substantial change in performance (The "Kalma"[1999] 2 Lloyd's Rep 374).

Searches in Court Registries

Searches to establish whether any claims have been commenced against a party is relatively cheap and easy to do.

Under English law, there are a limited class of maritime liens (claims that follow the vessel on sale) and these do not include "necessaries"/supply claims. However, if a claim against the vessel affording a right to arrest has been issued, then it might still be served on the vessel notwithstanding its sale. A prospective buyer would be well advised to make searches in relevant jurisdictions if it has any concerns about the credit history of the seller.

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If a claim does follow the vessel on sale, the warranties contained within the standard MOA terms as to the vessel being free from liens and encumbrances will be of little value if the selling company's only asset is the subject of the sale.

In any event, both owners and charterers might glean very useful information from conducting such searches: an owner might be able to establish whether a charterer is, for example, being pursued by a number of creditors; similarly, a charterer might be able to establish whether the vessel it is chartering is going to run the risk of being arrested in the course of the charterparty service.

Such searches are available in many jurisdictions, including the Southern District of New York, where correspondent lawyers can provide details of Rule B orders (assuming they are not under seal) that have been filed against any particular entity.

Bunkers and Supplies

Under English law, the charterer does not have the authority to bind the owner to a contract for the supply of fuel under typical charterparty wordings. One of the difficulties is that these principles are not universally observed: even if a vessel is employed under an English law charterparty, it might well be the case that in another jurisdiction, which takes a different approach to the creditors' rights, the creditor might successfully arrest the vessel and assert its claims. To some extent, charterparty clausing can address this: typically, such clauses will include an undertaking by charterers that they will not procure supplies, necessaries or services (including port expenses and bunkers) on the credit of the owners (see for example clause 23 of the NYPE 1993 form).

This is only a partial solution. It should help to lay to rest any arguments about the authority of the charterer, but probably does not necessarily deal with the relationship between the creditor and the vessel and its owners. In order to achieve even greater protection against third-party creditor claims against the vessel, an owner might seek to try to endorse any supply contracts/documentation with a wording that makes it clear that the bunkers (and indeed other supplies) are solely for the account of the charterers. This method is not, to my knowledge, universally tested (and is unnecessary under English law), but it does bring the creditor into the loop and will thus make it harder for him to assert rights other than against the relevant contracting party.

Dispute Resolution Clauses

When problems emerge, fast resolution, including the securing of claims and perhaps the inspecting of property, is vital. There are a number of dispute resolution clauses in relatively common use (see for example the CEDR Mediation Clause) that interpose some form of attempt to settle or even formal mediation before arbitration is commenced. While such provisions probably do not delay the accrual of a formal cause of action (an absolute necessity for many security proceedings), they might delay a party that needs to show that it has commenced proceedings or can do so within a short period of time. A party should ask itself whether, certainly in the current climate, the delaying of a right formally to commence proceedings is in its interest; after all, it is always open to a party to try to resolve its disputes amicably, or invoke mediation of one form or another on an ad hoc basis.

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Cancellation and Frustration Of Charterparties

In recent months parties have been asking whether their charterparties, sale contracts, contracts of affreightment, etc. that have become loss-making or unprofitable can be cancelled. However, some parties are failing to distinguish between contractual cancellation and other events that may discharge them from their obligations.

Cancellation

An option to cancel in a charterparty is an express right to terminate in certain specified circumstances. This does not necessarily involve a breach of charter although, in practice, it often does; common express options to cancel are lack of readiness for delivery within the lay days, charterers' failure to pay hire in full and/or on time, or prolonged off-hire periods.

Express rights to cancel rarely, if ever, provide for cancellation solely on account of changed economic conditions. Present economic difficulties may well change the commercial viability of agreements, but that alone is unlikely to give a party to what has become a bad bargain a right to escape from it.

Such express rights to terminate can be contrasted with rights to terminate that may arise upon a repudiatory breach by one of the parties or upon the frustration of the charterparty. Both of these may overlap with cancellation, but all remain distinct and operate separately.

Parties should be careful to avoid mistakes with regard to cancellation since a wrongful cancellation, even if innocent, may constitute a repudiatory breach against the other party that could provide an easy escape for a party locked into an unprofitable charter.

Force Majeure and Frustration

Force majeure clauses are familiar terms in charters. They are generally detailed and may ultimately lead to a right of cancellation, subject to the wording of the clause. However, the usual forms of these clauses rarely go so far as to allow a cancellation, but operate as an exception to the charterparty that suspends obligations rather than bringing them to a permanent end.

Economic considerations alone are unlikely to fall within the force majeure exceptions to a charterparty. Whether or not the particular event is excepted from the charterparty is, however, a question of the construction of the particular clause in each instance.

The term "force majeure" is often used loosely to describe what is actually a claim that the contract is frustrated. If an unforeseen event, which is the fault of neither party, fundamentally changes the obligation(s) envisaged by the parties or makes the intended performance impossible, then frustration will bring the contract to an end.

A particular issue that arises in the present climate is whether sudden downturns in markets can allow parties to say this has made performance impossible or fundamentally different, and therefore that their contract is frustrated.

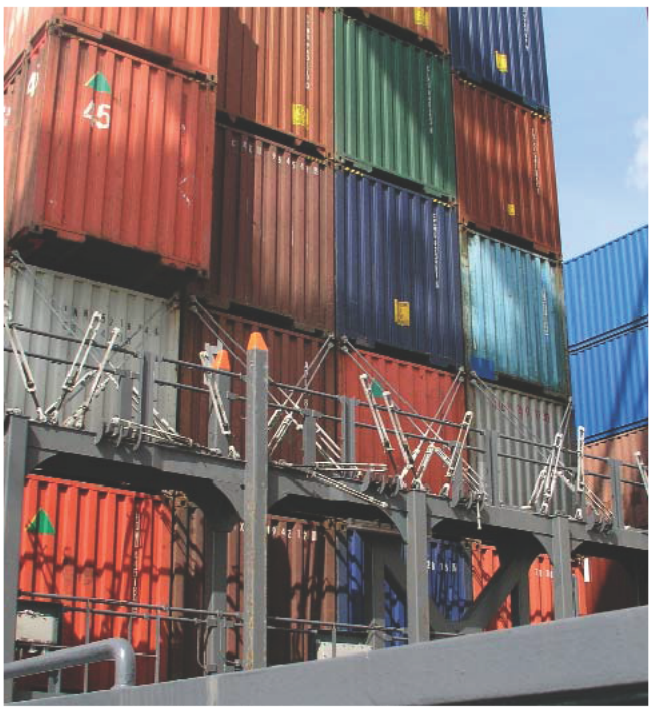
However, economic issues alone are unlikely to frustrate a contract. Unless the circumstances are quite extraordinary, an increased cost of performance does not frustrate a contract. The courts will rarely assist a party to escape a bad bargain purely on the basis that it is not, or is no longer, economic for him to perform his obligations.

On the other hand, in some circumstances, long delays to shipments or voyages (as may, for example, be encountered due to supply chain failures) may entitle a party to claim that the contract is frustrated. The assessment of what period of delay is sufficient to frustrate a contract is not an easy one as it is a mixed question of fact and of law. Each case needs to be considered on its merit. This may seem a harsh rule, but as expressed by Lord Denning:

"the fact that it has become more onerous or more expensive for one party than he thought is not sufficient to bring about a frustration. It must be more than merely more onerous or more expensive. It must be positively unjust to hold the parties bound" (The Eugenia [1964] 2 QB 226).

Conclusion

There are numerous situations that can lead to a charter coming to an end. However, despite the sudden global downturn, economic conditions alone are unlikely to provide a basis for contracting parties to escape from burdensome obligations.



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The Menace of Insolvency

Key Issues and Concerns when a Contractual Counter-party becomes Insolvent

What are the options?

Off-hire

Entry into administration by a disponent owner does not, of itself, give a charterer any immediate right to put the vessel off-hire under standard off-hire clauses. This is because the full working of the vessel and the ability of the disponent owner to comply with orders are not affected. It is not, in short, an off-hire event. On the contrary, the administrators of the disponent owner may wish to keep the charterparty alive, because the contract is with a presumably solvent company, namely the charterer who will, or should, continue to pay hire, absent an off-hire event occurring. This will be the case particularly if the yield on the contract is greater than that which it might get on the open market. The key point is whether, via the administrators, the insolvent company can continue to effect performance of its contractual obligations without an off-hire event occurring. Delay on the part of the administrators, with the result that the charterer's orders are similarly delayed in their execution, may however give rise to a damages claim.

Repudiation

The entry into administration might be said to be a repudiatory event that indicates that the disponent owner is unable to perform its obligations under the charterparty, thus entitling the charterer to terminate the contract. This is a significant step, and the charterer must be sure of his ground. The evidence needs to be clear so as to evince an intention, on the part of the disponent owner, not to perform. The mere fact of an administration, without more, is unlikely to be enough.

But what if the hire usually paid by the charterer to the disponent owner is at a lower rate than that which the disponent owner has to pay the head owner? The administrator may want out. Even if the administrator does not disclaim the contract, the charterer may ask how the contract is to be performed and receive no answer. There may also be a concurrent delay in obeying orders. In such circumstances, the charterer may well be justified in terminating the contract.

A clear and unequivocal refusal from the disponent owner's administrators to perform would entitle the charterer to accept the charterparty as terminated. However, this will only give the charterer a right to claim in the liquidation, with all the other hungry mouths, and will probably be of little economic value. There are only two choices for the charterer in these circumstances: either to seek to keep the charterparty alive, or accept termination and claim damages. The most practical solution would probably be to open a dialogue with the administrators to see if they will continue the charterparty. The premise should be that if the charterparty does continue, charter hire will continue to be paid. Furthermore, if the charterer has sublet the vessel at a profit, he may well want to keep the charterparty chain alive by dealing directly with the next disponent owner.

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Set-off

The position differs under English law depending on whether a right of set-off is claimed before or after the date of the insolvency order. After the disponent owner enters into insolvency, the operation of the Insolvency Act 1986 will provide the charterer, if disputing a claim to hire, with altogether broader rights where the right to hire accrued after the date of the order. Before the order, the ordinary rules concerning set-off apply for cross-claims that the charterer may have. Set-off of independent debts is less straightforward.

After an order has been made under the Insolvency Act, it would appear that any claim the disponent owner may have to be paid hire – such a claim being advanced through the administrator – will be only for his "net" claim. The calculation of the net claim will also take into account cross-claims arising under different contracts. So, if the disponent owner has a claim for hire for, say, US$50,000 and the charterer has a claim against the disponent owner for damages in the sum of US$25,000, under the same or another contract, then the net claim is US$25,000. Therefore, if the administrator decided to keep the disponent owner in a position where the charterparty with the charterer continued, future claims for hire may lead to set-offs by the charterer or by any other charterer, who also had other charterparties on other vessels with this disponent owner.

The position before an insolvency order is that of ordinary set-off. Thus, a cross-claim needs to be so closely connected that it would be unfair, inequitable, to allow the hire claim without taking the cross-claim into account. Set-off of independent debts is much more difficult, as very often a charterparty arbitration clause is not sufficiently wide to allow other claims to be introduced.

In a charterparty chain, can the head owner claim against the charterer, if as a consequence of a refusal by the charterer to pay hire, the disponent owner has terminated the charterparty?

Under English law, there is no authority to say a party who suffers loss in a chain can sue anyone other than his contractual counterparty. The position therefore needs to be looked at in the context of two potential claims in tort. There are two torts of potential relevance: inducing breach of contract and causing loss by unlawful means.

Inducing breach of contract:

The intention of the third party, the charterer in these circumstances, is key. He has to have induced the disponent owner to breach its contract with the head owner. In many cases, this will be extremely difficult to establish; especially so if the charterer is simply trying to get out of an uneconomic charterparty. It will not be enough to say that it was foreseeable; this act may cause the disponent owner to breach its charterparty with the head owner. To succeed in a claim, the head owner would have to show this was the charterer's intended or designed result.

Causing loss by unlawful means:

This also requires a narrow element of intentional harm, caused by "unlawful means" with an intention to damage a competitor. This too is difficult to prove, since however the charterer's conduct in breaching its contract with the disponent owner may be characterised, it will be a very difficult burden to show it was done with the intention of damaging the head owner. The prospects of tort claims of this nature being pursued successfully appear remote at present.

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Securing Maritime Claims: Rule B Attachments, Bunker Arrests and Freezing Injunctions

In the extraordinary current shipping market, a frequent priority, when a new claim arises or an old claim is revisited in the changed financial climate, is to seek security.

During, or shortly after, performance of a charterparty or a bill of lading contract, a number of alternatives may arise. An owner may be able to lien cargo, sub-freights or sub-hires, and a charterer may arrest the vessel after redelivery to secure its claim.

However, the purpose of this article is to focus on other, more general measures, not connected with a specific performing ship, namely Rule B attachments in New York, bunker arrests, and freezing orders in London, Hong Kong and Singapore.

Rule B Attachments

The US Maritime Attachment under Rule B (or "Rule B attachment") has become a major feature in recent months, although in fact, it has been available for several years.

The main advantages are that it can be obtained – even before the main proceedings have been started – to secure claims in a foreign jurisdiction such as London arbitration or before the English High Court, and that it can intercept and trap, in New York correspondent banks, electronic fund transfers (EFTs) in US dollars, either to or from the defendant.

Since so many payments in relation to maritime business are in US dollars, and such payments normally pass through New York, the attachment order can cast a very wide net.

Whilst EFTs are by far the most frequent targets, any personal property (tangible or intangible) can be attached if found within the jurisdiction of the court, so actual bank accounts, insurance proceeds, debts and credits may also be attached.

An important limitation is that the claim must be a "maritime" claim, such that it must derive from a contract that is wholly, or at least primarily, "maritime" in nature.

Charterparty and bills of lading claims are clearly not a problem. Contracts for the provision of services or supplies to a vessel or its crew will also tend to qualify, provided the services/supplies were directly or substantially related to navigation of the vessel or its participation in maritime commerce.

Perhaps surprisingly, claims under shipbuilding contracts will not (on the present law) qualify, although claims under a ship sale and purchase agreement (on a recent decision) may do so in certain limited circumstances.

Contracts for the sale of goods, such as GAFTA contracts, will generally not qualify, but may do where the particular facts of the claim relate closely to the carriage of the cargo on board a vessel, particularly where the claim stems from vessel-related liability.

Another important requirement is that the defendant must not be "found" within the Southern District of New York, where the application is made, or in a convenient adjacent jurisdiction for service of process. As we will see later, this has led a number of companies recently to set up a presence in New York Southern District, although the resulting protection will depend on the extent of the presence and the approach of the deciding judge, and this seems to be an area where the law may develop further.

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Paying Agents / Alter Egos

Where there is evidence that the defendant uses a third party to pay debts on its behalf, assets in the hands of that third party or payments to or from it may be attached, provided there is evidence of this as a recurrent practice.

Piercing of the corporate veil may also be allowed where an entity can be identified that is so closely related to the defendant as to act as its alter ego or controlling interest. Absent fraud – which is very difficult to prove – this is typically demonstrated by showing substantial domination and control by reference to, for example, a disregard of corporate formalities, low or inaccurate capitalisation, the intermingling of funds, and an overlap of ownership, officers, common office space, etc.

Circumventing Rule B Orders

There are various methods of potentially avoiding Rule B attachments.

Of these, the two most prevalent at present appear to be: (1) the establishing of a presence in New York Southern District and (2) the making of payments in other currencies.

The extent of the New York presence required is unclear. It is understood that many judges on the Southern District circuit will accept the simple registration of a branch as sufficient, but that a small handful will demand more than this, and a definitive Second Circuit (appeals court) ruling on the issue is apparently expected to come out next year.

Making payments in other currencies is clearly possible, but is not practical for major operators and not always easy to explain. It will also require the co-operation of counterparties, and will create exchange losses usually borne by the party requiring the change of currency.

It has also been said that it is possible to clear US dollar payments via banks in US cities other than New York, and that the use of particularly obscure correspondent banks in New York may also help avoid a Rule B. However, the writer has not yet seen any actual evidence of these methods being successfully used, and the correspondent banks used by the paying and receiving bank will not typically be a matter of choice.

Applications "under seal", multiple orders and counter-security

If there are fears of tipping a party off or disrupting ongoing negotiations (for example, whilst an escrow arrangement is being discussed), an application can be made "under seal" such that its existence is not made known and published on the internet shortly after the application is made (but often several days before it is dealt with), as will normally happen. Recently, a number of New York judges have attempted to discourage the use of sealed actions by requiring the plaintiff to "show cause" why the sealing order is necessary, a process that slows down the obtaining of the order. Seeking a sealing order is therefore probably best left to cases where there is no great urgency but initial secrecy is important.

In the current climate, it is often possible for several Rule B attachments to be served on the bank at which the payment is trapped, and for other parties to seek later to serve their orders. The issue then arises as to who will have priority. Where an attachment has been made and then, for example, a week later another party seeks to attach funds at the same bank, the first attachment will have priority (applying the principle "first in time, first in right"). However, it still makes sense to keep the second attachment in place since, if the original parties seek to settle the dispute with reference to the attached funds, the second attaching party will have at least some leverage.

The other common priority situation is where two parties serve the attachment order on the same bank on the same day. There is no precedent that directly addresses this scenario but, given the recurrence of this situation, a typical practice has developed whereby the attaching parties agree the funds can be apportioned pro rata by reference to the principal amounts of their respective claims.

Finally, it should be noted that, if a defendant has a counterclaim, he may be entitled to seek counter-security, and failure to provide it could result in the original attachment being thrown out. This is at the discretion of the judge, but the amount of the counter-security is not limited by the amount of the original claim.

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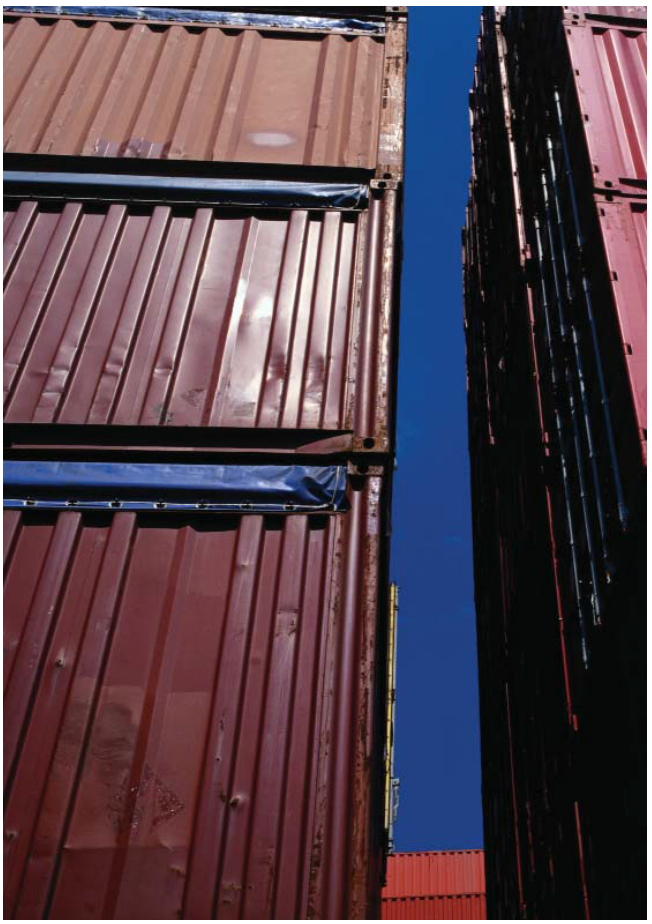

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Bunker Arrests

Typically suitable for lower than six-figure dollar claims, arrests or attachments of bunkers can be a useful tool: this is often threatened, sometimes obtained, and occasionally taken to the point of the bunkers being removed and stored ashore or in barges pending sale, at the port in question or elsewhere.

The risks and expenses associated with the removal of bunkers often dissuade parties from going down this route, and comprehensive local advice should always be obtained on the practicalities of storage and sale, and the risks of liability for detention of the vessel and wrongful arrest. One possible compromise strategy, subject always to local advice, is to seek the arrest order at the earliest possible opportunity, with a view to minimising the risk of any delay by prompt service of the order and not proceeding with the arrest if a solution cannot be found within a time frame that avoids significant delay to the vessel. Whilst this might have some costs consequences, those might be preferable to the long drawn-out delay and practical complications that might otherwise ensue.

There is also the initial problem of identifying bunkers owned by the defendant, which will involve finding instances where that party is the last time-charterer in a chain, and has ordered and paid for the bunkers itself. If the charterer has sub-time-chartered the vessel, even for a single trip, the difficulty lies in the fact that redelivery to it will typically be on dropping last outward sea pilot at the port in question, at which point an arrest will no longer be possible, and delivery into a new sub-time-charter may occur.

Information on bunker ownership, often accurate in itself, can sometimes be obtained via enquiry agents who have good connections with port agents and bunker suppliers, but it is usually hearsay in nature and rarely is positive documentary proof available. It is therefore often a question of putting best evidence forward to the local court and hoping it is accurate, which may then be tested by the court ordering the Master of the vessel to confirm who owns the bunkers on board. The approach varies considerably in different jurisdictions, and so good local advice is crucial.

One issue that may create a problem is the fact that many bunker suppliers provide bunkers on credit on terms whereby they retain title in the bunkers until payment. Typically, a time-charterer in financial difficulty may also be late in paying bunker suppliers, so in theory, this issue could be raised by the charterers to set an order aside.

Freezing Injunctions

Freezing injunctions (previously known as “Mareva injunctions”) originally developed in shipping cases, but are now an established feature of English law.

They restrain a defendant from disposing of assets or removing them from the jurisdiction or (in the case of a worldwide freezing injunction) from dissipating or disposing of them generally.

They may be granted not only in relation to a claim for a debt, but also in support of claims for damages for breach or repudiation of a contract or in tort. The defendant does not have to be domiciled, resident or present within the jurisdiction, and the injunction may be obtained ancillary to proceedings before a foreign court and at any stage, even before proceedings have been started or after judgment has been obtained. The availability of a freezing injunction where the main proceedings are, or will be, before a foreign court is discretionary in nature.

The initial application is invariably made without notice to the defendant, when the claimant has a duty of full and frank disclosure and will be required to give an unlimited cross-undertaking in damages in case the claim fails or the injunction turns out to be unjustified. That cross-undertaking may need to be “fortified” by provision of some form of security.

It must be stressed that a freezing injunction is a discretionary remedy and the key hurdle for the claimant is to convince the court that there is a real danger of the assets being removed from the jurisdiction or otherwise being dealt with or dissipated.

The resulting order does not operate to attach goods, money or other assets (without any ancillary order being made to that effect), rather it takes effect by everyone who has notice of the injunction or knowledge of it being obliged to do whatever he reasonably can to preserve the assets to which it relates, and anyone assisting in disposing of those assets or any part of them who has notice or knowledge of the injunction will be in contempt of court.

The hurdles are similar in Hong Kong, but there is a significant limitation in that the remedy is only available if substantive proceedings have been or will be commenced in Hong Kong. Therefore, where assets are located in Hong Kong but the main proceedings are elsewhere, the option of a worldwide freezing injunction in London may be considered instead.

The position in Singapore is not dissimilar to that in Hong Kong, in that there is serious doubt as to whether the Singapore Court has the power to grant such an injunction ancillary to foreign proceedings such as London arbitration.

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The End of the Shipbuilding Boom

The key problems currently confronting shipyards and shipowners arise to a large extent from the fact that it is now so much more difficult and expensive to arrange finance than it was before the onset of the "credit crunch". Matters have worsened in this respect over the last six months and the impact on shipbuilding has been striking. The Chinese government, which has overseen phenomenal growth in the capacity of its shipbuilding industry over the last five to 10 years, has acknowledged the problems. Only this month, it announced that investment in new shipyards would be halted, although one might legitimately ask whether this was an instance of the Chinese doing too little too late.

Slowdown in New Building Orders

Against this background, it was to be expected that there would be a sharp decline in recorded new building orders placed since the onset of the credit crunch last year.

The slowdown in orders for dry-bulk vessels will impact Chinese shipyards in particular. The order book at Chinese shipyards currently stands at around 200m dwt and almost two-thirds of this figure comprises bulk carriers. Larger yards in China, which have diversified into other ship types and boast fuller order books, may be better cushioned against the impact of the drop in dry-bulk orders. However, many smaller yards that are recent entrants to shipbuilding and rely on attracting such orders as their staple diet will be hit hard.

Newbuilding Cancellations and Delayed Deliveries

Not only has there been a marked slowdown in the placing of new orders in the year to date, there has also been a slew of cancellations and rumours of many more to come.

These widely reported developments may represent only the tip of an iceberg. In a controversial September 2008 report, Morgan Stanley predicted that newbuilding contracts to the value of US$20bn might be cancelled. Whilst the report was accused of overstating the problem, the huge increase in contract cancellations (which had been a rarity in the boom times of recent years) is undeniable. Certainly, the number of inquiries that we have received from owners regarding possible cancellation scenarios has substantially increased in recent months.

Even if shipbuilding contracts are not cancelled, there are likely to be significant delays to many projects either because of yards having difficulty completing projects or because of owners looking to defer delivery until freight/charter rates improve.

There are of course a variety of factors, several interrelated, which account for this.

Impact of the Credit Crunch

Many shipyards, even those with full order books, appear to be struggling to obtain the necessary financing to support construction and provide the refund guarantees required by owners. The yards' position is not helped by the fact that, following substantial increases in the costs of labour and raw materials, many of their existing contracts are now much less profitable than they were expected to be. In addition, many of those yards that embarked in recent years on overly ambitious expansion and redevelopment schemes now find that their cash flow is crippled as a result. Factors such as this make the yards an even less attractive lending proposition to the banks.

The problems raising finance are of course not limited to the shipyard side of the contract. Buyers are also experiencing increased difficulties obtaining finance for newbuilding programmes. Several banks would appear to have closed their books to new business. Projects that banks would have been all too willing to support 12-18 months ago now do not find favour. Ordering a vessel "on spec" for example (i.e. without the backing of significant charter commitments) is obviously a much higher-risk venture these days.

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Failure to Provide Refund Guarantees

Over the last six to 12 months, many owners have complained to us of significant delays in the production of refund guarantees by shipyards. In other cases, owners have been offered guarantees from institutions with credit ratings that are deemed unacceptable by their financiers. This is a problem that afflicts not only the much talked about greenfield shipyards in China but also many yards in countries with an established shipbuilding industry. Often the problems are sufficiently serious to call into question the ability of the shipyard to complete the newbuilding project in question. Many shipbuilding projects will be significantly delayed if not abandoned altogether.

At the risk of stating the obvious, the provision of a refund guarantee is an integral part of most shipbuilding projects. It secures the refund to the buyer of pre-delivery instalments paid to the builder in the event that the buyer subsequently terminates the contract. The precise effect of a delay in providing refund guarantees will vary, however, from contract to contract. Whether the buyer has a remedy at all depends on the contract terms. In some cases, the contract may not be effective or it may lapse automatically. In other cases, a right to terminate may arise and/or a right to claim damages may accrue in favour of the buyer. Specific advice is required to determine the buyers' rights and remedies, if any, under the contract or the law generally.

Plainly, it is in the buyer's interest to have inserted a fixed deadline for the provision of the refund guarantee. In addition, it is preferable to make provision for a single refund guarantee that will increase automatically when each instalment is paid, rather than to have a series of refund guarantees issued on an instalment-by-instalment basis. The latter structure can run into problems if refund guarantees are not readily procured for instalments that fall due in the later stages of the construction schedule. By this time, the buyer will already have incurred significant expense on the project.

Builder Insolvency

Delays in providing refund guarantees can be an early indicator that a yard is experiencing financial difficulties. It is important to ensure not only that shipbuilding contracts include appropriate provisions to deal with problems procuring refund guarantee(s), but also to define the circumstances in which the contract can be terminated and a demand made under the refund guarantee(s). Most shipbuilding contracts will include rights to terminate in the event of excessive delay in delivery and failure to meet minimum guaranteed performance characteristics. Owners will usually look to include additional rights to terminate for builder default. In some cases, yards have been prepared to agree that a buyer may terminate in the event of a material breach of contract by the shipyard that is not remedied within a fixed period of time. More commonly, the parties will agree that certain insolvency related events of default should be included. However, this remains a striking omission from the SAJ form, a leading industry standard form.

Where a builder default clause of this nature is included, buyers should ensure that it can be triggered not only by a formal resolution or order for the winding-up of the shipyard, but also by other events that are nevertheless reliable indicators that the shipyard is in financial difficulties. For example, buyers will often include express reference to events such as the appointment of a receiver, a suspension of payments, the cessation of business, the filing of an application for some form of creditor protection or rehabilitation procedure and/or special arrangements or compositions with creditors.

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Falling Freight Rates/Charter Rates

Even those owners who have secured finance for their newbuilding projects are reassessing plans in the light of concerns over falling freight rates and charter rates.

The collapse in freight rates and charter rates has been nothing short of spectacular. At the time of writing this article, the Baltic Dry Index is around 700 points, having crashed from a high of 11,800 as recently as May 2008. Freight rates for shipping iron ore from Brazil to China have fallen from around US$100 to US$10 per ton in a similar period. Meanwhile, there has been an even more dramatic collapse in the average time charter rate for a bulk carrier from approximately US$230,000 to just over US$4,000 (a fall of some 98%). The dire market conditions reflect in part a significant fall in demand for commodities as the global economic downturn takes grip. However, the lack of liquidity in the banking system and the willingness of the banks to finance trade are also playing their part. It is no coincidence that access to letters of credit, fundamental to the conduct of international trade, has become much more difficult.

Allied to concerns about the declining rates is the continuing debate about the risk of potential overcapacity in several sectors. As the huge wave of newbuilding orders over the last couple of years is gradually translated into newbuilding deliveries, the extent to which the doubters are justified will be realised. On current estimates, the world order book for dry-bulk vessels is equivalent to some 60% of the existing fleet, whilst in the case of container ships, the comparable figure is around 50%. The ability to absorb this new tonnage is clearly a matter of concern, particularly as it may come at a time when the economy remains depressed.

Whether they are having difficulties obtaining finance to fund the acquisition of their newbuildings or whether they are reappraising the costs of taking delivery against the likely earnings, many shipowners are investigating whether they can extricate themselves from commitments under shipbuilding contracts. In most cases, however, factors such as this will not entitle an owner to terminate a shipbuilding contract. Owners may therefore seek to defer taking delivery of their vessels instead, insisting upon the rectification of alleged technical defects and deficiencies prior to delivery in circumstances where they would previously have been willing to treat such matters as warranty items to be rectified post-delivery. An upsurge in deliverability disputes is therefore on the cards.

The boom years for shipbuilding are well and truly over. Owners are now placing fewer new orders, whilst existing contracts are at greater risk of being cancelled or being seriously delayed. The downturn will inevitably trigger its share of casualties. The scope for manoeuvre to deal with these changing times may in many cases be dictated by the terms of contracts that were entered into some time ago in a completely different economic climate. Determining the range of options available to you now will therefore be crucial. The relative advantages and disadvantages of each option will have to be weighed up carefully to ensure that the right judgement call is made, whilst resisting the temptation to opt for the immediate knee-jerk reaction. This is a process that will plainly require expertise and experience. Having a strong team in place will help you to steer a course through these troubled times.

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Ship Lay-Up

During this period of market change, there is the possibility that some members may be considering laying up ships until there is sign of an economic upturn.

By providing appropriate time and resources to the preparation for a lay-up period, significant risks are reduced when reactivating the ship. These include avoiding:

- Damage to plant and machinery
- Pollution risk from previous cargo or Marpol equipment
- Risk of injury to personnel
- Downtime and loss of hire

The extent of the precautions taken depends on the length of lay-up, the type of ship and the chosen lay-up location. For long term lay-up, Members may wish to involve professionals with proven expertise in managing laid-up tonnage, and in any event, they should consult with Class and hull insurers. Other authorities, including Flag State and the harbour jurisdiction where the lay-up is being considered, should also be consulted.

Prior to Lay-up

Well before a ship is laid up, the following must be carried out:

- Appointment of a 'lay-up' team consisting of experienced personnel
- Completion of a formal risk assessment
- Drawing up of a detailed plan with specific tasks and responsibilities

Lay-Up Team

This should include both technical and nautical experts. In addition to senior superintendents, the use of senior Masters and Chief Engineers is recommended, particularly those familiar with the actual ships being laid up.

Often in these situations, the crew are under the impression that they will be coming to the end of their contract and, as a result, will not be sufficiently motivated. Management needs to be alert to this issue.

Risk Assessment

The laying up of a vessel, even for a comparatively short time (months rather than years), still requires careful preparation. The risk assessment should consider:

- Legal implications - flag, certification, insurance, jurisdiction
- Safety of vessel - mooring arrangements, anchors
- Location - weather (wet, dry, humidity, storms, swell)
- Security - local and geopolitical
- Access to ship
- Availability of resources - repairs, customs, water, fuel
- Personnel/manning - who, how many crew required
- Inspection and maintenance - extent, who, what and when
- Contingency planning - what can go wrong and how to react to it. Long -term lay-up should include co-ordination with local authorities.

Planning the Lay-up

This should be carried out in advance so that the plan can be properly implemented. The technical requirements for a lengthy lay-up are considerable and beyond the scope of this article. An experienced team needs to have sailed on the vessel beforehand to carry out a thorough technical assessment of requirements, for example, to consider what should be done with the ship's spares. An inventory is useful so that, on reactivation, the ship can be properly resourced.

Climate is also a factor. Laying vessels up in winter climates does present additional problems such as freezing lines and electronic equipment. The latter may also require maintainance at the correct temperature.

Technical Assessment

Class should always be consulted before a ship is laid up. A ship laid up or out of commission is subject to specific requirements for the maintenance of Class. If the lay-up plan is not prepared in a manner approved by the Classification society, the likely suspension or withdrawal of Class may have an impact on the vessel's commercial approval after being reactivated, particularly in tanker trades. Maintenance of Class is also an insurance requirement, for both hull and P&I cover.

The following are technical matters to be considered.

Safety

- Power supply
- Fire protection systems - coverage, automatic alarms, testing
- Ventilation systems
- Watertight doors
- Cargo spaces - piping systems cleaned, vented, entered as applicable, testing
- Flammable materials, sludge, pumps, oil tanks
- Safety Equipment - listing and inspection
- Emergency power generators
- Ensuring contingency plans are available for water ingress, particularly into the engine room. This is often a problem encountered during a lay-up. Bilge alarms should be operating, pumps and crew should be ready to react should the occasion arise.

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Maintenance

- Lay-up maintenance schedules specified
- Lay-up work books / log maintained. Keeping good records is important when reactivating
- Underwater hull protected from corrosion (impressed current system operational or hull sacrificial anodes in good condition)
- Hull, deck, accommodation paint coatings evaluated
- Access and vents to internal spaces checked
- Internal spaces, cargo tanks, holds, voids, empty, should be clean and dry
- Ballast tanks should be empty, clean and dry, coatings evaluated
- Bilges should be clean and dry
- Chain lockers should be drained, cleaned, dry, coating is recommended
- Fuel oil tanks if empty should be drained, cleaned and gas freed fresh water tanks full or empty
- Cargo lines should be drained and free of liquid and tested
- Deck equipment, winches, windlass, etc. should be regularly greased and operated on a weekly basis

Machinery

The machinery space is usually kept above 0°C and humidity is kept to a minimum, within acceptable limits. The use of dehumidifiers is recommended.

The list of machinery items is extensive. Exposed parts should be greased, rotating machinery turned at regular intervals and lubricating systems operated. Record-keeping, drawing-up and implementation of the plan to ensure that machinery is kept in a good condition when reactivating takes careful planning. Special care and expert advice should be sought with the following machinery especially in respect to fuel and other fluids remaining in the systems during the lay-up period:

- Main engine, generators and other diesel engines – to ensure that all heavy fuel oil is flushed from the fuel system
- Turbines, turbo chargers
- Reduction gears
- Condensers and heat exchangers
- Air receivers and compressors, coolers
- Piping, shaft lines
- Electrical installations
- Steering gear
- Boilers
- Heaters
- Automation equipment, alarms and sensors.

Class and equipment manufacturers should also be consulted.

Surveys

At the beginning of the lay-up period, a laying-up survey should be carried out to confirm that safety measures, lay-up location and mooring arrangements are within a Class agreed programme.

Class will require an annual lay-up condition survey to be carried out. This confirms that the agreed lay-up maintenance programme is being followed. If successful, the class certificate will be endorsed or reissued.

Recommissioning

The plan (including a reactivation risk assessment) needs to be drawn up for recommissioning the vessel. This process, which may be occurring years after entering lay-up, with different personnel, will rely heavily on the lay-up records made initially and those maintained during the lay-up. The responsibility for reactivating the ship is solely the Member's and delivering the ship for Class survey requires considerable thought and resources.

Class has protocols for testing and surveying equipment, but not all equipment is covered by Class. Detailed reactivation plans need to be drawn up.

Dock and sea trials should be carried out, with Class in attendance, which will include verification of:

- Deck installations
- Main propulsion systems
- Electrical systems
- Auxiliaries
- Monitoring and alarm systems
- Anchoring systems
- Steering gear systems
- Main engine tests
- Cargo systems - including all valves
- Lifting systems
- Safety, life-saving appliances and fire fighting equipment.

The planning of the lay-up is important if reactivation is to proceed without major problems. There is considerable risk to the vessel, its crew and the environment when reactivating a vessel. Appropriate resources, including adequate time for familiarisation, testing and checking plant and equipment, must be allocated.

Club Rules

The club has specific requirements for Members' ships that are laid up for more than 90 days. These are currently set out in Rule 21.4 (which will be Rule 15.5 from 20 February 2009) and provide that prior to the ship resuming trading, at least seven days' notice in writing must be provided to the club. If notice is not given, any claim is only recoverable at the discretion of the Board.

On receipt of notice, the club may elect to survey the ship. If recommendations are made or repairs are required as a result of that survey, then no recovery from the club is permitted until those repairs or other actions have been carried out.

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Steel Cargo: Expected Increase in Claims

Present Market Background

Members should be aware that due to the recent downturn in the commodity price for steel, including finished steel, there is strong evidence to suggest that the number of steel cargo claims is going to increase as a result. The steel industry is cyclical in nature. When the economy is weak, buyers of steel tend to reject more cargo than usual, a phenomenon called "market rejection". With steel prices currently dropping between the time of purchase and of delivery, and the secondary scrap market also weak, there is a heightened risk of receivers rejecting cargo.

We have been advised by our correspondents in the Black Sea that they have seen specific examples of this recently. But it is by no means restricted to this area; it is affecting steel cargo worldwide. Turkey, Europe's third-largest producer of steel, has shown a particularly sharp drop in price and production levels of steel. The export price of Turkish steel peaked in July 2008. However, due to the global financial crisis and a rapid deterioration in demand, steel prices plummeted faster than expected. For example, several months ago, the price of steel coils was approximately US$1200 per ton CIF and the price has now almost halved to approximately US$670. In response to this drop in price, the leading Turkish steel producers have cut back on production in order to minimise their losses, and volumes are now at the lowest level since 2006. Scrap steel has also fallen to about US$200 per mt from a high of above US$500 per mt.

Some commentators are saying that steel prices are likely to continue to plunge during the coming months.

This will mean that receivers are going to be much more considered in whether to accept or reject steel cargo; they will be checking its condition more thoroughly and will be more inclined to reject a cargo if it is not in good condition.

Masters should be advised to be vigilant during the loading of steel cargo and to make sure that all pre-shipment damage is noted and recorded on the mate's receipts. The club requires that a pre-loading and loading inspection is carried out by a qualified surveyor on finished steel cargo. Please see the recent article by Eric Murdoch (the club's chief surveyor) regarding the need for pre-loading surveys in respect of finished steel, which was published in the December 2008 edition of the Standard Bulletin for further details.

Other Cargo – Record Keeping

In view of the present economic climate, it is not inconceivable that there will be a similar increase in the number of claims regarding other cargo, especially finished goods, e.g. cars, project cargo, high-value container cargo, wood pulp and timber. In fact, shippers and receivers are far more likely to reject any commodity cargo for the slightest damage in these prevailing markets.

Members should advise their Masters and their crew of the potential increase in claims and the need for extra care and vigilance. Masters should be instructed to prepare a Note of Protest regarding any cargo that is seen to be off-specification. Mates should keep careful records of the condition of loaded cargo, taking photographs and keeping a record when cargo is off-specification, soiled or slightly damaged. If in doubt, Members should contact their local P&I correspondent for advice.